Published on *The National Law Review* https://natlawreview.com

Increased Regulatory Scrutiny of Private Funds

Article By:

Robert E Plaze

Michael R. Suppappola

Anthony M. Drenzek

President Biden has signaled a shift to a more assertive SEC Enforcement program with the nomination, and expected confirmation, of Gary Gensler as the next Chair of the SEC. Mr. Gensler previously served as the Chairman of the CFTC from 2009 to 2014, where he established a reputation as a forceful regulator. This reputation suggests that we should expect a significant increase in enforcement actions against private fund managers.

Under former Chairman Clayton, private fund advisers benefited indirectly from the SEC's focus on "Main Street" investors. More of the SEC's limited resources were devoted to addressing retail fraud, leaving fewer resources available to focus on private funds. As former Enforcement Director Stephanie Avakian explained recently, the SEC relied more heavily on exams by OCIE (recently renamed the "Division of Examinations") – through deficiency notices and remediation, rather than enforcement actions – to address perceived private fund compliance violations. Whether the SEC returns to the more assertive "broken windows" approach to regulation under prior administrations remains to be seen.

In any event, the SEC's approach will almost certainly change under the new administration. We expect that Chairman Gensler will place a far greater emphasis on policing "Wall Street," which today has grown to encompass private funds. As a result, we expect more enforcement actions involving the types of conduct identified in the OCIE Private Funds Risk Alert from this past June: conflicts of interest; fees and expenses; MNPI; advisers' codes of ethics; and related policies and procedures.

We also believe that a number of recent market developments are ripe for increased regulatory scrutiny. Within the past few years, we have seen substantial market innovation and growth in several sectors including SPACs, ETFs (including more exotic forms of ETFs, like leveraged-ETFs), private equity generally, and private credit specifically. At the same time, digital assets have proliferated and attracted extraordinary amounts of capital; the value of Bitcoin alone has reached several all-time highs in 2021. Finally, the market has experienced significant volatility, first with the pandemic, and more recently with stocks like GameStop and AMC Theaters fueled by social media. Regulators and market intermediaries like Robinhood have struggled to respond to some of these new challenges. Any one of these market developments standing alone would likely garner increased attention from regulators. Collectively, they virtually ensure a more robust regulatory enforcement regime.

National Law Review, Volume XI, Number 83