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SEC Regulatory Liability of Third-Party Fund Service Providers: A Hard Look Back and a Cautious Glimpse Forward—Part 1

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Part 1 of this article explores select administrative enforcement proceedings that the Securities and Exchange Commission (SEC) has brought against certain "third-party" service providers[1] to investment companies that are registered as such under the Investment Company Act of 1940 (1940 Act) (Registered Funds) or that are excepted from the definitions of "investment company" by virtue of their reliance on Section 3(c)(1) or Section 3(c)(7) of the 1940 Act (Private Funds, and with Registered Funds, Funds).[2] For years, the SEC has viewed certain types of securities market participants as "gatekeepers," and traditionally those gatekeepers have included broker-dealers, underwriters, public accounting firms and attorneys, which themselves are subject to SEC, self-regulatory and/or professional/ethical oversight. The SEC also has found that certain other market participants or related parties have caused or were a cause of a Fund's violations of the 1940 Act, such as Fund investment advisers and their personnel (including principals, executive officers and chief compliance officers), and Fund directors and officers (including executive officers and chief compliance officers).

However, these parties have their own, direct obligations to the Funds and their investors under the federal securities laws and applicable state law (for example, fiduciary duties owed pursuant to and specific obligations imposed by the Investment Advisers Act of 1940 (Advisers Act) and the 1940 Act; state fiduciary duties and similar obligations), and professional conduct laws and standards, which exceed the role and responsibilities of a mere third-party contractual service provider. Investment advisers, themselves subject to the Advisers Act, whether registered or not, are fiduciaries to their clients, and have additional duties under the 1940 Act. Independent directors of Registered Funds have specific fiduciary and other duties under the 1940 Act, and are expected to serve as "watchdogs" for the Registered Funds and their shareholders.

But the service providers that are the subject of this article are none of those, and have no similar obligations to the Funds to or for which they provide services, beyond those established by contract. Yet, as described below, third-party Fund service providers have been the subject of SEC administrative enforcement proceedings for decades. And at least in terms of recent history, it probably all started with a 2006 proceeding against a third-party Registered Fund administrator.

The Registered Fund Administrator and the Marketing Budgets (2006)[3]

This case was a stunner to many practitioners in the investment management industry due to, among other things, the substance of the violations as well as the extent of regulatory liability imposed on the third-party Registered Fund administrator. In a nutshell, the administrator and the investment advisers to open-end Registered Funds entered into arrangements where the administrator would rebate to the advisers a portion of its administration fee that the Funds paid to it under the Fund administration agreements, and the advisers used the rebate to pay for Fund distribution/marketing[4] as well as other expenses (including those that were unrelated to Fund marketing, such as check fraud losses, settlement for losses due to errors, golf country club dues for an officer of the adviser, and others) that the advisers would otherwise have paid for themselves. In return, the administrator expected the advisers to recommend or continue to recommend to the Fund's board that it serve as the Fund's administrator. The arrangements took various forms, written, oral, etc., but overall the administrator effectively agreed to dedicate a portion of its administration fee to market the Funds and pay for other expenses (that is, create a "marketing budget"). For all practical purposes, the advisers determined what expenses would be covered by the marketing budget, in the context of a marketing plan that was created either by the adviser alone or jointly with the administrator.

These side arrangements were not *fully* disclosed to the Funds' boards or disclosed to shareholders. What the boards did know was that the administrator spent a portion of its administration fee on Fund marketing. However, this was not included in the Funds' Rule 12b-1 plans and the board members did not discuss whether it should be. But regardless, what the boards did **not** know was that the administrator and the investment advisers had entered into side arrangements under which the adviser recommended to the board that the administrator serve (or continue to serve) as such. The SEC stated that the administrator failed to make these disclosures even after its former general counsel received legal advice that the administrator could be liable for aiding and abetting the advisers' violations of the 1940 Act unless the arrangements were disclosed to the Fund boards.

At the heart of this proceeding is the administration agreements themselves, which the SEC pointed out required the administrator to, among other things, prepare the Funds' prospectuses and statements of additional information, compliance reports, and shareholder reports, and compile written materials, including reports, agreements, and fee comparisons, for the boards to use at their meetings. In other words, from the SEC's perspective, the administrator could have included or attempted to include disclosures about the side arrangements in these various documents, but apparently it did not do so.

The SEC found that the administrator willfully aided and abetted and caused the investment advisers' violations of Sections 206(1) and 206(2) of the Advisers Act and of Section 34(b) of the 1940 Act, and the Funds' violations of 1940 Act Section 12(b) and Rule 12b-1, and ordered the administrator to, among other things, pay disgorgement of over $11M and a civil penalty of $10M.

Notably, the SEC brought this action against the third-party Fund administrator, even though the administrator had no separate duty to the Funds, their shareholders or other stakeholders other than the obligations imposed by the administration agreement, and even though the investment advisers to the Funds, which do owe significant duties to the Funds, were at the core of the conduct at issue, and the trustees, which also owe significant duties to the Funds, were aware of the marketing budget. Thus, a third-party Fund service provider need not be the sole cause of the violative conduct in order to have regulatory liability—this is a comparative not contributory liability. And this brings us to the next case, fast forwarding from 2006 to 2013.

The "Turnkey" Fund Platform Administrator and Boilerplate Disclosures (2013)[5]

To set the stage, the Registered Fund administrator in this case operated, in conjunction with its affiliates, a "turnkey" open-end series trust platform.[6] The SEC found that the administrator and its compliance services affiliate (notably referenced as gatekeepers),[7] along with the trustees, were a cause of the Funds' disclosure, reporting, recordkeeping, and compliance violations:

- *Shareholder Report Disclosures*—Under the administration agreement, the administrator was responsible for preparing the Funds' shareholder reports, including those portions of the reports that included a discussion of the trustees' Section 15(c) evaluation process as required by Form N-1A. However, a number of reports included boilerplate language concerning the material factors and conclusions which formed the basis for the trustees' approval or renewal of the advisory contracts, and in some instances the disclosures that were materially untrue or misleading. The SEC found that the administrator caused these violations of Section 30(e) by failing to ensure "as the responsible party" that the shareholder reports contained the discussion required by Form N-1A. [8]

- *Compliance Manual Process*—Under the compliance services agreement, the affiliated service provider was responsible for administering the Funds' compliance programs in conformity with the requirements of Rule 38a-1. However, the service provider did not follow the process outlined in the compliance manuals for Fund board approval of the investment advisers' compliance policies and procedures.

The SEC ordered the administrator and the compliance services provider to, among other things, each pay a civil penalty of $50,000. Notably, the SEC found that the trustees also caused or were a cause of the Funds' violations related to the shareholder reports and the compliance manual process (but were not subject to any civil monetary penalties). Further, the SEC repeatedly noted the involvement of outside legal counsel in the preparation, review and approval of shareholder reports and board minutes (which were used to prepare the relevant disclosures in the reports and also reflected boilerplate or otherwise materially untrue or misleading disclosures). This reflects, again, comparative responsibility, even where the other parties involved had specific legal and regulatory duties and obligations, which brings us to the next SEC proceeding, just two years later.

The Auditor, the Trustee and the Registered Fund Administrator (2015)[9]

The SEC brought this enforcement proceeding against a third-party Registered Fund administrator, the Funds' auditor, and a Fund trustee and audit committee member. The core issue here was that the trustee and *an affiliate* of the auditor had a consulting arrangement, which impaired the auditor's independence.[10] For the administrator's part in this, it had contractually agreed to assist the Funds in discharging their responsibilities under 1940 Act Rule 38a-1.[11] Characterizing the Funds' audit committee charters as part of those compliance policies and procedures, the SEC stated that each charter required the Fund's audit committee to, among other things, evaluate the independence of the auditors in accordance with the SEC rules and regulations. It was the SEC's view that the Funds did not adopt sufficient additional written policies and procedures reasonably designed to prevent auditor independence violations. The trustee and officer questionnaires that the administrator circulated were primarily directed at evaluating whether the trustees were "independent" (as was commonplace), although they also were designed to identify conflicts of interest that could bear on auditor independence. For example, the questionnaires asked about the principal occupation(s) and other positions held. At some point during the relevant period, the questionnaires also asked about any "direct or material indirect business relationship" with the Funds' auditor. The trustee did not disclose his consulting arrangement with the auditor's affiliate in any response to the questionnaires or otherwise.

But, as the SEC noted, the questionnaires did not *expressly* ask about business relationships with the auditor's *affiliates*, and no other Fund policy or procedure addressed this. The SEC also stated its view that the Funds did not provide sufficient training to assist the trustees in the discharge of their responsibilities regarding auditor independence. In addition, the auditor's audit engagement letters with each Fund provided that the administrator, serving as "management" to each fund, was responsible for "assist[ing] [the auditor] in maintaining independence." Moreover, the SEC stated, the administrator drafted, for approval and implementation by each Fund's board, Rule 38a-1 compliance policies and procedures. The SEC's view was that, as drafted by the administrator and approved by the boards, the Funds' written policies and procedures governing auditor independence and, more generally, the selection, retention, and engagement of auditors, were inadequate, and thus violated Rule 38a-1. The SEC thought that the administrator should have known this.

The SEC found that the administrator caused each Fund to violate Rule 38a-1 and ordered the administrator to, among other things, pay a $45,000 civil penalty. But the SEC also found that the auditor engaged in improper professional conduct under the SEC's Rules of Practice, and violated Regulation S-X, and that the auditor and the trustee caused the Funds to violate 1940 Act Sections 20(a) and 30(a) and Rule 20a-1 thereunder. The auditor was ordered to, among other things, pay disgorgement and interest of over $600,000 and a $500,000 civil money penalty. The trustee was required to pay disgorgement and interest of over $35,000 and a $25,000 civil money penalty. Again, comparative, not contributory liability, even when the other parties involved in the matter have specific legal, regulatory, and/or professional/ethical duties and obligations to the Fund.

The Private Fund Administrator That Did Not Follow Up on Red Flags (2016)[12]

The following year the SEC brought an administrative proceeding against a Private Fund administrator, referring to the administrator as a "gatekeeper." According to the SEC, the administrator "ignored or missed red flags including undisclosed brokerage and bank accounts, related party transactions, inter-series and inter-fund transfers in violation of fund offering documents, and undisclosed margin or credit agreements." Despite the red flags, the administrator did not correct previously issued accounting reports and capital statements that it had prepared for the Funds' investment adviser and continued to provide to the adviser reports and statements that were materially false.[13] The administrator served as such for only one year, pursuant to written agreement that, consistent with prior proceedings, the SEC specifically referenced in the settlement.

Before summarizing the issues and red flags in this case, a number of details set the stage. The Private Funds' investment adviser misappropriated Fund assets and used Fund assets for unauthorized investments. In addition, the administrator replaced the Funds' prior administrator, which had been delinquent in its Fund accounting and had not prepared the Funds' quarterly accounting records for the last year and a half. The administrator was supposed to recreate and set up the Funds' accounting dating back to the Funds' inception, bring the Funds' accounting records up to date, prepare monthly and annual financial statements of the Funds, liaise with the Funds' auditor in preparing annual financial statements, and assist in reviewing notes to the annual financial statements. Not an ideal scenario to say the least, but things just got worse from there.

The Accounting System Set Up

The first problem was that the administrator did not set up the Fund accounting system correctly to reflect the Funds' series structure, which contemplated that each series within each Fund generally would invest in one investment, and further, as set out in the Funds' governing documents, that each series was a sub-partnership such that the assets and liabilities of each series could not be commingled with any other series. But the accounting system that the administrator established for the Funds did not allocate Fund assets and liabilities to specific series. This, coupled with the fact that the adviser maintained only one bank account for each Fund, resulted in the capital account statements that the administrator generated for Fund investors not accurately reflecting the series structure.

Here's the rub—the SEC thought that this made it possible for the adviser to misappropriate Fund assets and use Fund assets for unauthorized investments.

The Margin Loans and Accounts

The second problem related to undisclosed margin loans and brokerage accounts, which were discovered through the Fund audit process when, in responding to the auditor's request, a broker identified two previously undisclosed brokerage accounts, one in the name of a Fund and the other in the name of the Fund's general partner. The account had a negative balance of over $4M due to margin borrowing.[14] When the auditor asked the administrator about the accounts, the administrator responded that it did not know about them and would need to ask the adviser. So, the administrator asked the adviser's Fund operations director, who responded that she was also unaware of the accounts and would need to ask the adviser's principal.

After that, well, nothing happened. No follow up, no further mention of the account. The administrator did not adjust its past or future net asset value (NAV) calculations or reports, capital account statements, or financial statements (even though it knew that 85 percent of the relevant Fund series' value had been margined), all of which were based on an account balance of just under $5M when the balance, offset by the margin loan, was actually less than $650,000. As for the auditors, they issued unqualified opinions on the relevant Fund's financial statements, which did not include the margin loan balance or disclose its existence.

And as it turns out, the adviser used the margin loan proceeds to purchase a personal residence and to cover up losses from misappropriating assets from another Fund.

But there is more to come.

The Line of Credit

The third problem related to a line of credit. Two Funds invested significant amounts of their total assets in an unrelated loan fund (for one Fund, the loan fund investment was its sole holding). The adviser provided the administrator with capital account statements from the loan fund's adviser showing the balances for the two Funds. However, these recent statements and subsequent statements had a major difference from the prior months' statements—the title of each statement clearly indicated that the Funds' interests in the loan fund had been "pledged" by the adviser.

But the administrator did not reflect in its Fund accounting records that the adviser had pledged these interests, and did not discuss the matter with the adviser. Another rub—the SEC believed that had the administrator done so, it would have found that one of the Funds had previously entered into a bank line of credit agreement that was collateralized by the Funds' investment in the loan fund and further would have found out that the adviser borrowed almost $4M against the line of credit and used the proceeds for investments that were not recorded in the books and records of any Funds. This means that the administrator did not account for the loan balance in the Funds' NAVs or in capital account statements.

Interestingly, the SEC stated that it was the administrator's "duty to accurately keep the accounts and records" for the Fund, but the excerpts of the administration agreement in the release state that the administrator was responsible for "keeping the accounts and records of the Fund."[15]

But there is more.

The Prohibited Inter-Series and Inter-Fund Commingling Transactions

The Funds engaged in a series of related transactions in violation of their governing documents. It began with one Fund selling an investment in one of its series (Selling Fund and Selling Series), resulting in the deposit in the Fund's bank account of $6.6M in sales proceeds, and after that:

- The principal of the adviser used about $1M of the sales proceeds to invest in a pharmaceutical company, but neither the adviser nor the administrator allocated the investment to any Fund investors much less the relevant series' investors. The principal also transferred $400,000 of the proceeds to the adviser for certain expenses in violation of the Fund's governing documents. The administrator recorded this amount on the Fund's records as a receivable due from the adviser.[16]
- Then the adviser (appropriately) distributed about $5M of the proceeds to the Selling Series' investors, leaving less than $400,000 in the Fund's bank account. However, the adviser still needed to distribute the remaining $1.6M of the sales proceeds to those investors. So the adviser raised $2.1M in capital from a different set of investors for another series of the Selling Fund (New Series), and distributed $1.6M of it to Selling Series investors.
- A few months later, the adviser borrowed $1.6M against an investment in another Fund, transferred the proceeds into the Selling Fund's account, and then used that cash to purchase an investment on behalf of the New Series.

These cash flows were reflected on bank statements provided to the administrator, but the administrator did not account for them in a manner that reflected the true transfer of economic interests. Moreover, the administrator's records for the Selling Fund credited the adviser with equity ownership in the New Series, but there was no payment from the adviser for its investment in the New Series (in fact, there was no subscription agreement or other documentation for the adviser's investment). So, the administrator increased the "due from the adviser" receivable balance and then later improperly recorded this balance as "repaid" when the adviser transferred the $1.6M from one Fund to the Selling Fund (see third bullet above). The SEC believed that this further enabled the adviser to hide its misappropriation.

The SEC found that the administrator was a cause of the adviser's violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8, and ordered the administrator to, among other things, pay approximately $106,000 in disgorgement and interest, and a civil money penalty of $75,000. But the SEC was not done with this administrator, which brings us to the next proceeding, the Release for which was published on the same day as this one.

Same Administrator, Different Private Funds (2016)[17]

Although the same Private Fund administrator was the subject of this administrative proceeding, the conduct related to a different Private Fund family.[18] For the adviser's part, it made undisclosed withdrawals of more than $1M directly from the Funds. As for the administrator, it accounted for the withdrawals as receivables on the Funds' records (that is, as an asset) without evidence that the adviser was able or willing to repay the receivables, and also provided monthly statements to Fund investors that did not state the existence and amounts of the withdrawals and that overstated the value of the investors' holdings. By the time the administrator disclosed to investors the existence of the withdrawals, which was almost two years after it began serving as such, Fund investors had suffered significant losses.

But let's start at the beginning, which is what the SEC did by highlighting that at the time the administrator began serving as such, it performed no due diligence on the background of the adviser's principal, which "could" have revealed, among other things, the principal's prior felony fraud convictions. Also, at the start of the administration agreement (which, consistent with prior proceedings, the SEC specifically referenced), the administrator learned that the adviser's principal was withdrawing money from the Fund that was in existence at the time (the second Fund was formed a few months later), and questioned the principal about the withdrawals. The principal responded that he was making the withdrawals to cover start-up expenses and represented to the administrator that he would repay the withdrawn amounts as the Fund grew.[19] Based on the principal's representation, the administrator recorded the withdrawals as a Fund receivable (that is, as an asset), similar to the conduct described in the above proceeding. The administrator did not disclose in monthly account statements to Fund investors that the receivable was due from the adviser.

The principal did not repay the Fund as promised, and in fact withdrew even more from the Fund, and started withdrawing money from the second Fund once it was organized. Around the same time, the prior administrator (Prior Administrator) contacted this administrator with warnings about investor complaints and lack of communication from the adviser. A few months later, the administrator told the principal that the Fund offering materials needed to disclose the withdrawals. The principal said that he would, and would obtain each investor's signature on the revised disclosures.

Two months later, the administrator received another warning from the Prior Administrator, and at this time, the administrator asked the principal about the disclosures and investor signatures, and asked him to establish a payment plan. The administrator also conducted a background check on the principal, discovering the prior fraud conviction. At that point, the administrator's global compliance office became involved, and, although it asked some questions, it left the decision as to whether to continue the relationship up to management in the United States. The administrator decided to continue.

All the while, the administrator accounted for the withdrawals the same way, and continued to send monthly statements to investors that did not disclose the withdrawals or that the receivables were due from the adviser.

About five months later, the administrator determined that the principal would not be able to repay the receivables. It also learned, at that time, the principal had not provided the administrator with investors' signature pages showing that they had received any revised disclosures.

But again, nothing changed. The administrator continued to provide administration services in the same manner, and continued reporting in monthly statements to investors NAVs that were not accurate due to the receivables.

It was not until approximately seven months later that the administrator first sent monthly investor account statements that disclosed that a significant portion of investors' account values was comprised of a receivable from an affiliate. By this time, the total amount withdrawn by the principal was over $1M, which was nearly 54 percent of the first Fund and more than 26 percent of the second. After this disclosure, many Fund investors sought to redeem their Fund interests. The administrator also pushed the principal to implement a repayment plan, threatening to resign if he did not. Approximately three months later, the principal terminated the administration agreement and the relationship ended.

All told, the administrator served as such for just shy of two years, and had known about the withdrawals from the beginning. According to the SEC, the administrator knew or should have known that the principal was unwilling or unable to repay the receivables and further that the monthly account statements it sent to Fund investors were materially misleading.

Again, the SEC found that the administrator was a cause of the adviser's violations of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, and ordered the administrator to, among other things, pay approximately $97,000 in disgorgement and interest, and a civil money penalty of $75,000. Together, these two proceedings signal that the SEC expects Fund administrators to be not only "gatekeepers" but also watchdogs (similar to independent directors of Registered Funds), even where the person that they are watching owes fiduciary and other duties to the Funds under applicable laws and that fiduciary's conduct is fraudulent. The SEC did not limit this view to Private Fund administrators, as demonstrated by an SEC proceeding just two years later involving a Registered Fund administrator. But first, we pivot to an enforcement proceeding involving a Registered Fund bank custodian, which was settled just a few months later in December 2016.

The Registered Fund Custodian Bank and the FX Trades[20]

For about three years, this Registered Fund custodian bank provided its Registered Fund custody clients with records of foreign currency exchange (FX) trades that the SEC believed omitted material information and were misleading in light of the circumstances in which they were made. The bank represented to certain custody clients: that it provided "best execution" on FX trades; that its priority was to obtain the best possible prices on FX trades; that it guaranteed the most competitive rates available on FX trades; that it priced FX trades at prevailing interbank or market rates; and that its FX rates were based on the size of the trade, the bank's inventory of the currency, prevailing market conditions, market rates, and/or the bank's risk management assessment.

But these representations did not accurately describe the bank's FX trades in that: the bank priced most trades executed in the United States near the end of each trading day, regardless of when trade orders were received; the bank applied a predetermined, uniform markup to current interbank market rates to price FX trades, limited only by the high/low interbank rates of the day (which meant that the bank often executed FX trades with custody clients at or near the highest and lowest rates in the interbank market between the time the market opened in the morning in the United States and the time that the bank priced the transactions (hereinafter the US trading day).

As a result, the SEC found that the bank in fact: did not provide "best execution" on these FX trades; did not undertake to obtain the best possible prices for custody clients; did not guarantee the most competitive rates available; did not price the FX trades at prevailing interbank or market rates; and did not base its FX rates on the size of the trade, its currency inventory, prevailing market conditions, market rates and/or risk management assessment. The bank realized substantial revenues from these trades; during the relevant three-year period, the bank obtained at least $75M in profits.

Pursuant to the agreements with its Registered Fund custody clients, the bank provided those clients with, among other things, detailed and itemized daily records of all transactions (including detailed and itemized records of receipts and disbursements of cash and other debits and credits in the Funds' accounts), as well as periodic transaction reports. Consistent with prior proceedings, the SEC specifically references the contractual requirements, which in this case obligated the bank to prepare and maintain these and other 1940 Act-required books and records in accordance with the requirements of the 1940 Act and related rules.

Given the bank's misstatements about how it priced FX trades, the SEC stated records were materially misleading because they omitted information that would have revealed that the bank had not executed the trades in the manner described.

The SEC found that the bank had *itself violated* 1940 Act Section 34(b) and caused the Funds' violations of Section 31(a) and Rule 31a-1(b) thereunder. The SEC ordered the bank to, among other things, pay disgorgement and interest of over $90M and a civil money penalty of $75M. This is another example that the contractual language does indeed matter.

In Part 2 of this article, we will return to Fund administrators, in a proceeding two years after this one, but we will revisit Fund custodians just one year after that. Stay tuned.

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NOTES

1 For purposes of this article, the term "third-party" means that the service provider was not an "investment adviser" to the Fund (as that term is defined in the Investment Advisers Act of 1940 (Advisers Act) or the Investment Company Act of 1940 (1940 Act) or otherwise an "affiliated person" of the investment adviser (as that term is defined in the 1940 Act).

2 Specifically, the types of service providers on which this article focuses are primarily third-party administrators and custodians. This article excludes from discussion proceedings (or portions thereof) against investment advisers (including advisers that provide pricing services to or on behalf of other advisers or Funds) and their affiliates, public accounting firms/auditors, officers (including compliance officers) and directors/officers of investment advisers and Funds, broker-dealers, underwriters and other distribution participants, and accountants, auditors and attorneys. This article also focuses on administrative proceedings as opposed to court actions (whether brought by private plaintiffs or the SEC). Lastly, this article does not encompass administrative proceedings brought against Fund service providers for violating a law to which they were directly subject, *see*, *for example*, Securities Exchange Act of 1934 Release No. 98153 (Aug. 17, 2023).

3 1940 Act Release No. 27500 (Sept. 26, 2006). The summaries of these administrative proceedings in this article are based on the facts and circumstances set out in the related SEC release.

4 Under the 1940 Act, open-end Registered Funds cannot use their own assets to pay for distribution activities except pursuant to a written plan adopted and implemented in accordance with 1940 Act Rule 12b-1, which requires, among other things, that the Fund's board of directors approve the plan. Further, for context, the 1940 Act prohibits persons from doing indirectly what they are prohibited from doing directly.

5 1940 Act Release No. 30502 (May 2, 2013).

6 For those not familiar, these types of Fund platforms usually have different series that are managed mostly by different investment advisers and sub-advisers that are unaffiliated with each other, but the creator/sponsor of the platform (through various affiliates) provides, among others, administrative and chief compliance officer/compliance services, and arranges for a common board of directors/trustees. Turnkey platform sponsors certainly have a closer relationship to the Funds than most third-party Fund service providers, but the SEC's focus appeared to be on the obligations of these service providers under their written agreements with the Funds.

7 *See https://www.sec.gov/news/press-release/2013-2013-78htm*.

8 Under the administration agreement, the administrator also was responsible for ensuring that the Funds maintained and preserved all documents and other written information that the trustees considered in approving the Funds' investment advisory contracts in accordance with 1940 Act Rule 31a-2, but the SEC cited several instances of recordkeeping violations.

9 1940 Act Release No. 31703 (July 1, 2015).

10 Similar to the 2006 proceeding, this proceeding was a bit of a stunner to the industry, as the Registered Funds' processes and procedures at issue in this case were fairly commonplace.

11 This rule, among other things, required each such Fund, with the approval of its board, to "adopt and implement written policies and procedures reasonably designed to prevent violation of the Federal Securities Laws" by the Fund.

12 Advisers Act Release No. 4428 (June 16, 2016).

13 The reports and statements were used by the adviser to communicate financial positions and performance to Fund investors and were provided to the Funds' independent auditor.

14 The other account did not have a balance.

15 The agreement also charged the administrator with the responsibility of "preparing the monthly and annual financial statements of the Fund in conformity with United States generally accepted accounting principles," which may have had a closer nexus to the issue than the recordkeeping obligation under the agreement.

16 Relatedly, recently adopted Advisers Act Rule 211(h)(2)-1 imposes Private Fund investor disclosure and consent requirements for adviser borrowings.

17 Advisers Act Release No. 4429 (June 16, 2016).

18 The conduct at issue here occurred *after* the conduct at issue in the above proceeding, reflecting a possible pattern that may have been concerning to the SEC.

19 In fact, a few months after learning of the withdrawals, the administrator received a letter from the principal in which he promised to repay the amounts owed in the next three months, with 7 percent interest.

20 1940 Act Release No. 32390 (Dec. 12, 2016).From the Editor