OPTIMA

Regulatory Alert

SEC Charges Madison Capital Funding, LLC, a formerly Registered Investment Adviser, with Improper Principal Transactions and Valuations

Despite a decreasing number of enforcement actions being announced by the Securities and Exchange Commission ("SEC"), the Division of Examinations (the "Division") and Division of Enforcement are pursing core violations of the Investment Advisers Act of 1940 ("Advisers Act").

In the case outlined below, Madison Capital Funding LLC ("Madison"), wilfully violated Section 206(2) of the Advisers Act by engaging in practices that operated as a fraud or deceit on its clients, and violated Section 206(4) and Rule 206(4)-8 by making material misstatements or omissions to fund investors about the valuation and fairness of loan sales.

FACTS

On February 25, 2026, the SEC settled with Madison, a formerly registered investment adviser,[1] over charges stemming from Madison's **"season and sell" transactions**[2] with funds whose assets it managed (the "Funds"). Madison originated senior loans for private equity sponsors and sold portions of those loans to the Funds, typically after holding them for 30 to 60 days.

The Funds' advisory agreements and disclosures to investors stated that Madison would sell the loans to the Funds at "fair value" or "fair market value" after an independent review agent provided consent to the sales on behalf of the Funds. Madison valued and sold the recently originated loans to the Funds at par less the unamortized loan fee. However, according to the SEC, **during the COVID pandemic, Madison improperly continued to price and sell the loans at par value less the unamortized loan fee, failing to determine the effect of the significant market disruption resulting from the COVID pandemic on the fair market value of the loans.**

The SEC found that Madison's loan sales to the Funds were principal transactions under Adviser Act Section 206(3) which requires an adviser acting as principal in a transaction with a client to disclose in writing before the completion of such transaction the capacity in which the adviser is acting, and to obtain the client's consent for each sale. To comply with Section 206(3), each Fund contracted with a third-party agent to serve as an independent review party (the "Review Agent"). **The Review Agent was responsible for reviewing the proposed transactions and providing consent to the sales on behalf of the Funds.**

[1] Madison withdrew its registration with the SEC on March 31, 2022.

[2] "Season and sell loans" are typically held for a short duration on the adviser's books for several reasons, including to comply with tax regulations for offshore investors, or because the borrower did not have enough liquidity at the time to purchase the loans.

Madison sent the Review Agent a consent form with information about each loan. Madison certified that: the purchase was (1) being conducted on an arm's length basis in accordance with Madison's management agreement; and (2) based on current market conditions. **The SEC found that Madison knew the Review Agent relied on Madison's certification that the sale was made at fair market value and was not responsible for making its own determination of fair market value.**

In March 2020, the coronavirus pandemic began and there was a disruption in U.S. fixed income markets that lasted for months. The SEC found that **Madison failed to determine the effect of the market disruption on the fair market value of the loans at the time of purchase by the Funds.**

The SEC found that Madison's conduct resulted in a violation of Advisers Act Section 206(2) (the anti-fraud provision) and Sections 206(4) and 206(8) which together make it unlawful for any investment adviser to a pooled investment vehicle to engage in fraudulent activity. In accepting Madison's offer of settlement, the SEC considered remedial acts promptly undertaken by Madison in response to a Division of Examinations (the "Division") deficiency letter regarding the above facts. **Madison voluntarily reimbursed the Funds $5,010,855, plus $203,820 in interest, as compensation for the sale of loans to the Funds. Madison also voluntarily made certain enhancements to its disclosures and policies regarding its loan transfer practices. The SEC also acknowledged that, aside from one loan, the loans sold to the Funds during the relevant period either continue to perform or were fully repaid by the borrowers. Despite Madison's best efforts to remediate, the SEC brought enforcement action against Madison, which agreed to a civil monetary penalty of $900,000, a censure and a cease and desist order.**

OPTIMA PARTNERS INSIGHTS

This action underscores that:

- The SEC will pursue enforcement actions even in cases where the adviser has compensated investors to remediate a finding in a Division examination.
- This case continues the trend of deficiencies identified during routine Division examinations involving allegations of fraud, investor harm, and violations of the Advisers Act, leading to enforcement investigations.
- Even if an adviser has established and disclosed a valuation methodology, and follows that methodology consistently, the SEC will challenge the valuation methodology if it finds that it was inappropriate based on prevailing market conditions. Valuation of assets is generally correlated with the calculation of the adviser's fees.
- An independent review agent is responsible for understanding and verifying information under review. In addition, advisers cannot withhold information or mislead an independent party's review of information.
- Advisers must review compliance policies and procedures, client agreements and disclosures to investors to confirm adherence to the Advisers Act requirements.

If you have questions or would like to discuss, please contact your Optima relationship Partner or info@optima-partners.com .