

Madison Capital Action Displays SEC's Emphasis On Process

By **Michael Longyear and Caleb Ellis** (April 1, 2026)

The U.S. Securities and Exchange Commission's Feb. 25 enforcement action against Madison Capital Funding LLC confirms a principle that investment advisers should internalize in an era of increased market dislocation: Fair value obligations do not recede in the face of volatility — they intensify.

From March through May 2020 — the earliest and most volatile phase of the COVID-19 pandemic — Madison Capital sold originated loans to affiliated funds at prices derived from a mechanical, preexisting formula. The SEC concluded that the firm failed to reassess whether those prices reflected fair value during that period of historic market disruption.

The result was a public enforcement action, a \$900,000 civil penalty, a censure and a cease-and-desist order — without any allegation of intentional fraud.

The case is not primarily about misstatements or fabricated prices. It is about process. More precisely, it reflects the SEC's view that when market conditions materially change, valuation methodologies must be reassessed in real time. This is especially so in principal transactions where the adviser sits on both sides of the trade.

For the white collar defense bar and investment advisers alike, the action illustrates how, in times of market stress, a firm's near-automated processes can be reframed as negligence under the Investment Advisers Act.

The Enforcement Action Against Madison Capital

Madison Capital Funding LLC is an Illinois-based registered investment adviser that had approximately \$3.7 billion in regulatory assets under management in May 2020 and is a wholly owned subsidiary of a large life insurance company.[1]

As a part of its lending business, Madison Capital originated senior loans in connection with leveraged buyouts and, after typically holding them for 30 to 60 days, sold portions of those loans to the pooled investment vehicles it advised.[2]

Madison Capital retained approximately 40-50% of each underlying loan, with the remaining portions allocated to the funds pursuant to the firm's own investment allocation policy.[3] These were principal transactions where the adviser, Madison Capital, was effectively on both sides of the trade.

Advisory agreements with the funds and investor disclosures represented that loans would be sold at "fair value" or "fair value as reasonably determined by Madison Capital," and expressly without third-party valuation.[4] Although the firm's valuation policy permitted discretionary market adjustments, in practice, it priced loans using a mechanical formula — "par value less the unamortized loan fee" — without conducting independent market analysis.[5]



Michael Longyear



Caleb Ellis

With the advent of the COVID-19 pandemic in March 2020, credit markets began to experience extreme volatility, with substantially widened credit spreads across fixed-income markets, reduced liquidity and downward price pressure on existing loan investments.[6]

Madison Capital acknowledged the disruption in a March 11, 2020, investor update, and, in response to the disruption, increased monitoring of portfolio companies and implemented a day-ahead credit check to confirm that loans being sold still carried a "B" rating or better under its internal system.[7] But what Madison Capital did not do was assess whether the market disruption had affected the fair market value of the loans being sold.

Between March and May 2020, Madison Capital executed 143 sales to the funds at par value less the unamortized loan fee — the preexisting formula the firm had in place.[8] Madison Capital certified to the review agent on each transaction that the price reflected fair market value based on current market conditions.[9]

On Feb. 25, 2026, the SEC issued an administrative order against Madison Capital, which set forth the terms of settlement.[10] In addition to voluntarily reimbursing the affiliated funds to which the loans were sold, the firm agreed to pay a \$900,000 civil penalty and accepted a censure and cease-and-desist order, without admitting or denying the findings.[11]

The SEC's Legal Theory: Process as Disclosure Enforcement

The SEC charged violations of Section 206(2) of the Advisers Act — which imposes a negligence standard — and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibit fraudulent, deceptive or misleading conduct toward fund investors.[12]

The order finds willful violations of both provisions — but that term carries a narrower meaning than it may suggest. Under the U.S. Court of Appeals for the District of Columbia Circuit's 2000 decision in *Wonsover v. SEC*[13] and the U.S. Court of Appeals for the Second Circuit's 1965 ruling in *Tager v. SEC*,[14] the applicable precedent cited in the order, willfulness for purposes of Advisers Act Section 203(e) sanctions requires only that the actor knew what they were doing, not that they were aware they were violating the securities laws.[15] It is not a finding of intent to defraud.

Rather than alleging that Madison Capital fabricated prices or committed scienter-based fraud under Section 206(1) of the Advisers Act, the commission proceeded under the theory that the firm promised to determine fair value and failed to perform the analysis necessary to make that determination once market conditions materially changed.

This framing is significant. The case amounts to disclosure enforcement: If an adviser represents that it will determine fair value, that representation becomes an ongoing procedural obligation. When market conditions shift in a way that could materially affect asset values, maintaining status quo operating procedures may constitute negligence — even absent intent to deceive.

It did not ultimately matter that Madison Capital took some responsive steps — e.g., enhanced monitoring, daily credit rating checks — or that all but one of the loans in question continued to perform or were fully paid off by borrowers.[16] Instead, the commission drew the line at Madison Capital's failure to conduct a legitimate fair value reassessment.

Principal Transactions, Consent Requirements and Heightened Conflict Risk

Principal transactions present inherent conflicts because an adviser's economic interests may differ from those of its clients. Federal regulations deal with this by requiring advisers to disclose the capacity in which they are acting and obtain client consent before completing each principal transaction.[17]

Madison Capital followed this framework: Each fund contracted with a third-party agent to serve as an independent review party, responsible for reviewing proposed transactions and providing consent to the sales on behalf of the funds.

Still, the SEC's order points to a weakness that investment advisers and defense counsel alike should note. The funds' review agent was, by the terms of the advisory agreements with the funds, "not responsible" for making an independent determination of fair market value; that job rested solely with Madison Capital.[18]

In situations like this — where the investment adviser's transaction conduct and the factual basis for that conduct are both subject to SEC scrutiny — a formal consent mechanism may satisfy the technical requirements of the Advisers Act without providing full substantive protection. Indeed, the commission did consider Madison Capital's formal compliance with the consent process as a mitigating factor.

In practice, this means that valuation discipline is more than an accounting function; it actually mitigates the conflict inherent to a principal transaction. Treating the fair market valuation process mechanically during a period of pronounced market dislocation would cause this conflict mitigation protection to weaken at the moments when it is needed most.

The Madison Capital action signals that the SEC views valuation reassessment during these periods as central to fulfilling fiduciary duties in affiliated transactions — and that formal compliance with consent procedures does not equate to a substantive fair market value analysis.

Implications for White Collar Defense Counsel

For defense counsel, the case illustrates several practical considerations.

First, documentation of the asset valuation process is critical. Counsel should quickly determine whether an investment adviser's contemporaneous materials reflect an active reassessment of market conditions or rely on preexisting methodologies.

If the Madison Capital resolution is any indication, regulators will not look at whether the formula was defensible prior to market dislocation, but whether anyone stopped to consider whether it remained defensible after the events unfolded. In Madison Capital's case, the firm could only point to enhanced monitoring and daily credit checks — not a revised fair value analysis. This gap framed the enforcement narrative.

Second, the structure and independence of review agents or valuation committees warrant scrutiny. Where review bodies are contractually relieved of the obligation to make independent determinations and instead rely on adviser-supplied certifications, the commission will look past the structural arrangement to its practical effect. Counsel should evaluate whether the consent and review mechanisms are designed to catch valuation failures or merely ratify them.

Third, the willfulness finding and the absence of scienter or individual liability charges against Madison Capital illustrate the commission's willingness to resolve valuation-process cases under a negligence theory at the entity level. That reality should inform Wells advocacy and settlement negotiations.

An argument that no one intended to harm investors addresses a charge that was not brought. Framing should instead focus on the reasonableness of the process at the time, any other remedial steps taken during the disruption and a firm's voluntary remediation after the fact.

Notably, as to the last point, the SEC's order expressly credits Madison Capital's remedial efforts. In May 2021, following a commission staff examination deficiency letter, the firm voluntarily reimbursed the funds \$5,010,854.90, plus \$203,819.69 in interest, and enhanced its disclosures and policies regarding loan transfer practices.[19]

The commission's willingness to credit that remediation — and to resolve the matter at the entity level without charging individuals — suggests that quick, voluntary reimbursement and policy remediation can be material factors in negotiating a resolution.

Fourth, counsel should be mindful of collateral consequences. A valuation-related enforcement finding does not stay within the four corners of the SEC order. Investor disputes and redemption demands can follow quickly, particularly where investors can compare what they paid against third-party pricing data available at the time.

The order's creation of a fair fund for the \$900,000 penalty further signals the SEC's intent to return funds to harmed investors, which may itself attract investor attention and, potentially, derivative litigation. In fact, recent developments suggest that investors, banks and other financial entities are paying increased attention to the valuation of loans and other assets owned by private credit lenders.[20]

There are other potential consequences. Directors and officers insurance coverage may be contested if the carrier characterizes the conduct as a knowing valuation failure. External auditors may reexamine prior-period financial statements. Counsel engaged at the investigation stage should be plotting these downstream risks contemporaneously with the regulatory defense, not after resolution.

Compliance and Risk Management Takeaways for Advisers

For investment advisers — particularly those engaged in private credit and direct lending — the message is plain: Market disruption events should trigger affirmative valuation review, not business-as-usual periods to be managed through.

Advisers should consider the following.

First, valuation policies should expressly require reassessment when material market events occur. The policy should identify trigger events — e.g., sustained credit spread widening or central bank emergency interventions — and specify a process for documenting the reassessment in real time. The Madison Capital order illustrates that a policy that permits discretionary market adjustments, but does not require their consideration during a dislocation, provides limited regulatory protection.

Second, representations regarding fair value should be treated as enforceable legal

commitments with procedural teeth, not aspirational language. The commission read the advisory agreement language at issue here — "fair value as reasonably determined by Madison Capital" — as imposing an affirmative ongoing obligation to actually perform that determination. Advisers should be sure they can deliver what their fund documents promise.

Third, advisers should define what they view as a sufficient reassessment process. While the Madison Capital order does not prescribe a standard or guidance, reasonable practices may include a review of observable secondary market prices and dealer quotes, consultation of third-party pricing services or index-level data, and an assessment of whether existing valuation methodologies adequately account for material market events.

Last, proactive remediation remains a key factor in achieving a resolution with regulators. The voluntary reimbursement in this case — over \$5.2 million returned to the funds — illustrates that remediation is the mechanism by which advisers can limit investor harm and demonstrate good faith to enforcement staff. Advisers that identify a potential valuation failure should consider prompt remediation and document that decision-making process.

Conclusion

The Madison Capital case is a reminder that fiduciary obligations are under even greater scrutiny during periods of market disruption. In the SEC's view, failing to revisit pricing assumptions during dislocation can amount to negligence.

For advisers engaged in principal transactions, disciplined valuation reassessment during periods of market volatility is central to regulatory compliance. And for defense counsel, the Madison Capital case is a useful template for how the SEC will frame these matters — process failure dressed as disclosure violation — and for the collateral exposure that may follow.

The firm's voluntary reimbursement and policy remediation, and the commission's apparent credit for those steps, also stand as a practical road map for how to obtain a favorable resolution when a valuation failure is identified.

Michael D. Longyear is a partner at Lankler Siffert & Wohl LLP. He previously served as an assistant U.S. attorney, chief of the Violent and Organized Crime Unit, and co-chief of the Narcotics Unit in the U.S. Attorney's Office for the Southern District of New York's Criminal Division.

Caleb Ellis is an associate at Lankler Siffert & Wohl.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of their employer, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] In the Matter of Madison Capital Funding LLC, Investment Advisers Act of 1940 Release No. 6948, Admin. Proc. File No. 3-22599, at ¶ 2 (S.E.C. Feb. 25, 2026), <https://www.sec.gov/files/litigation/admin/2026/ia-6948.pdf>.

[2] Id. ¶¶ 3–7.

[3] Id. ¶ 4.

[4] Id. ¶ 10.

[5] Id. ¶¶ 11-12.

[6] Id. ¶ 13.

[7] Id. ¶¶ 14-15.

[8] Id. ¶ 16.

[9] Id.

[10] Id.

[11] Id. ¶ 19.

[12] Id. ¶¶ 17-18.

[13] *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000).

[14] *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965).

[15] In the Matter of Madison Capital Funding LLC, Investment Advisers Act Release No. 6948, at ¶ 17 n.1.

[16] Id. ¶ 16.

[17] 17 C.F.R. § 275.206(3)-2.

[18] In the Matter of Madison Capital Funding LLC, Investment Advisers Act Release No. 6948, at ¶ 12.

[19] Id. ¶ 19.

[20] See Private Credit Crisis Rattles Investors as Blue Owl Capital Faces Turmoil, N.Y. Times (Mar. 3, 2026), <https://www.nytimes.com/2026/03/03/business/private-credit-crisis-blue-owl-capital.html>.