

OCIE Turns Up Heat on Private Fund Adviser Compliance

September 03, 2020

On June 23, the SEC's Office of Compliance Inspections and Examinations issued a risk alert providing an overview of certain compliance deficiencies observed in examinations of registered investment advisers managing private equity funds or hedge funds ("private funds"). The risk alert is relevant not only to private fund advisers but also to investors in, and distributors of, private funds and private placement variable products that offer private funds as investment options.

Further, many of the same issues flagged by the risk alert will also be relevant to decisions whether to take advantage of new flexibility just announced by the Department of Labor, as discussed in ["DOL Warms Up to Private Equity in 401\(k\) Plans."](#)

Conflicts of Interest

The deficiencies noted in the risk alert that relate to conflicts include nonexistent or inadequate disclosure about:

- Conflicts related to allocations of investments among clients.
- Multiple clients investing in the same portfolio company at different levels of a capital structure.
- Financial relationships between investors or clients and the private fund adviser.
- Preferential liquidity rights included in private fund advisers' side letters with select investors.
- Private fund advisers' interests in recommended investments.
- Conflicts related to co-investments or failure to follow the disclosed co-investment allocation process.
- Private fund advisers' relationship with service providers.
- Conflicts related to private fund restructurings.

- Conflicts related to purchases and sales between clients (i.e., “cross-transactions”).

Fees and Expenses Borne (Directly or Indirectly) by Private Fund Investors

The risk alert notes deficiencies such as:

- Inaccurate allocation of fees and expenses.
- Inadequate disclosure regarding the role and compensation of individuals who may provide services to the private fund or portfolio companies but are not adviser personnel.
- Failure to value the fund’s assets in accordance with established valuation processes or in accordance with disclosures to investors.
- Disclosure and other issues related to the adviser’s receipt of monitoring fees, board fees, or deal fees from a private fund’s portfolio companies.

Material Non-Public Information and Codes of Ethics

The risk alert also identified:

- Inadequate policies and procedures to address the risks posed by employees who could have access to material non-public information through their interactions with (1) insiders of publicly traded companies; (2) outside consultants; or (3) value-added investors in a private fund (such as corporate executives or financial professionals).
- Failures to address the risks posed by employees (1) who could obtain material non-public information through their ability to access office space or systems of the adviser or its affiliates; or (2) who periodically have access to material non-public information about issuers of public securities, for example, through private investment in public securities.
- Failures to enforce private fund advisers’ codes of ethics provisions (1) imposing investment trading restrictions on securities placed on the adviser’s “restricted list”; (2) governing employees’ receipt of gifts and entertainment from third parties; and (3) requiring certain personnel with access to material non-public information to request preclearance for certain investment transactions.

In various contexts, the SEC staff has previously expressed concern about many of the same types of private fund adviser compliance deficiencies that are cited in the OCIE’s risk alert. Accordingly, the SEC staff has given ample warning of its views, and it would be prudent for firms to give them careful consideration.

Related Practices

[Financial Services Regulatory](#)

Related Industries

[Life, Annuity, and Retirement Solutions](#)

[Securities & Investment Companies](#)

©2024 Carlton Fields, P.A. Carlton Fields practices law in California through Carlton Fields, LLP. Carlton Fields publications should not be construed as legal advice on any specific facts or circumstances. The contents are intended for general information and educational purposes only, and should not be relied on as if it were advice about a particular fact situation. The distribution of this publication is not intended to create, and receipt of it does not constitute, an attorney-client relationship with Carlton Fields. This publication may not be quoted or referred to in any other publication or proceeding without the prior written consent of the firm, to be given or withheld at our discretion. To request reprint permission for any of our publications, please use our [Contact Us](#) form via the link below. The views set forth herein are the personal views of the author and do not necessarily reflect those of the firm. This site may contain hypertext links to information created and maintained by other entities. Carlton Fields does not control or guarantee the accuracy or completeness of this outside information, nor is the inclusion of a link to be intended as an endorsement of those outside sites.