

# SEC Proposes Standard of Conduct Interpretation and Enhanced Regulation for Investment Advisers; Private Fund Manager Penalized for Failing to Disclose Conflicts of Interest

## SEC Proposals

On April 18, 2018, the Securities and Exchange Commission (“SEC”) proposed a long-anticipated package of rulemakings and interpretations aimed at establishing a broker-dealer standard of conduct and clarifying investor confusion about differences in a customer relationship with a broker-dealer and investment adviser. While the majority of these proposals apply to broker-dealers and advisers to retail investors,<sup>1</sup> the following aspects of the proposed interpretations and regulations could apply to all registered investment advisers, including private fund managers.

### *Enhanced Investment Adviser Regulation*

The proposal included a request for comment regarding whether the SEC should propose the following requirements for investment advisers:

- licensing and continuing education requirements for adviser personnel,
- delivery of account statements to clients, including information about fees and expenses, and
- additional financial responsibility requirements in areas such as a net capital requirements, fidelity bonds or other requirements to protect investor assets.

### *Standard of Conduct Interpretation for Investment Advisers*

The SEC also proposed an interpretation of the standard of conduct for investment advisers intended to codify and reaffirm (and, in some cases, clarify) the fiduciary duty that investment advisers owe to their clients under the Investment Adviser’s Act, in order to provide greater transparency to investors regarding these obligations. The proposal highlights certain aspects of an investment adviser’s fiduciary duty — specifically:

- **Duty of Care:** includes the duty to provide advice that is in the client's best interest, the duty to seek best execution of public securities transactions and the duty to act and to provide advice and monitoring over the course of the relationship, and
- **Duty of Loyalty:** requires the investment adviser to put a client's interests ahead of its own and avoid unfairly favoring one client over another, make full and fair disclosure of material facts and seek to avoid, and otherwise make full and fair disclosure of, material conflicts of interests with its clients.

The SEC is seeking public comment on each of these proposals.

## **SEC Penalizes Private Fund Manager for Failing to Disclose Conflicts of Interest**

On April 24, 2018, the SEC entered into a [settlement](#) with a private fund manager for the manager's alleged failure to disclose conflicts of interest between with its fund clients and investors related to a service agreement between the manager and a group purchasing organization (the "GPO"). The GPO aggregated portfolio company spending to obtain volume discounts, and in turn the manager received a portion of fees that vendors paid to the GPO in connection with these purchases.<sup>2</sup> The SEC alleged that the manager breached its fiduciary duty to its private equity fund clients by failing to disclose the conflict of interest and being unable to effectively consent to the agreement with the GPO on behalf of its private equity fund clients, in violation of the Advisers Act.

In addition to a \$90,000 fine, the manager agreed to pay approximately \$620,000 of disgorgement and \$66,000 of prejudgment interest to the SEC.

The consent order continues the SEC enforcement and examination focus on undisclosed benefits accruing to the manager from its relationship to a private fund and its portfolio companies and notes that such conflicts could be approved by a fund's advisory board if authorized in the fund's organizational documents.

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<sup>1</sup> These are described in our April 27, 2018, [Kirkland Alert](#).

<sup>2</sup> The relevant agreements provided that the payment was for services rendered to the GPO by a private fund manager employee.

If you have any questions about the matters addressed in this *Kirkland AIM*, please contact the following Kirkland attorneys or your regular Kirkland contact.

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