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Kirkland AIM

## SEC Settles with Private Fund Manager and its Principals Over Alleged Misuse of Fund Assets

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On May 6, 2019, the SEC entered into a [consent order](#) (“Order”) with a private equity fund manager and certain of its principals alleging, in part, that the manager misused the assets of one of its private funds to the advantage of the manager and certain of its principals.<sup>1</sup> According to the Order:

- The manager retroactively implemented management fee waiver provisions without properly applying an offset provision in the fund’s limited partnership agreement, resulting in the manager receiving an additional \$1.4 million in management fees.<sup>2</sup>
- The manager improperly borrowed over \$3 million from the fund on an interest-free basis to fund its advisory operations without authorization.
- The manager caused the fund to overpay approximately \$600,000 in organizational expenses by (i) causing the fund to pay certain estimated expenses before such expenses were actually incurred and (ii) misclassifying certain expenses as organizational expenses and charging them to the fund (e.g., placement fees, despite the fact that the fund’s limited partnership agreement expressly excluded them from organizational expenses).
- The manager’s CEO did not adequately supervise the CFO/CCO, who completed and documented the loan, accounted for fees and expenses and participated in the analyses and discussions that resulted in the allegedly problematic transactions noted above.

The SEC entered into a settlement order against the manager and the CFO/CCO, ordering them to cease and desist from committing or causing further violations and requiring each of them to pay civil monetary penalties of \$100,000 and \$15,000, respectively.<sup>3</sup> Further, the SEC required the CEO to pay a civil monetary penalty of \$25,000.

Recent SEC exams maintain a heightened focus on private fund manager fee and expense practices. Accordingly, managers should assess their internal fee and expense policies to ensure that such policies are consistent with the Advisers Act and the manager's actual practices and governing documents. In addition, managers should review their practices to ensure their personnel are appropriately supervised in performing functions of interest to the SEC.

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1. The SEC further alleged that the manager violated (i) the Custody Rule for failing to issue audited financial statements for the fund until more than 120 days after the fiscal years ended 2013, 2014 and 2015 (which was, in part, the result of a delay in retaining a new auditor and the prior auditor withdrawing its reports for prior periods); and (ii) Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder for failing to adopt and implement written policies and procedures reasonably designed to prevent violations of the kind described herein.↵

2. In addition, the SEC found that the retroactive nature of the manager's action was not expressly authorized by the fund's limited partnership agreement.↵

3. In deciding to accept the manager's settlement offer, the SEC noted that it considered certain remedial efforts undertaken by the manager, including repaying the management fee offset and reimbursing the expenses to the fund in full with interest.↵

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- [Investment Funds](#)
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## Suggested Reading

- [07 January 2019 Kirkland AIM 2019 Private Fund Manager Compliance Update: U.S. SEC/CFTC Filing Deadlines and SEC Examination Priorities](#)
- [20 December 2018 Kirkland AIM OCIE Risk Alert Relating to Electronic Messaging](#)
- [18 December 2018 Kirkland AIM Two SEC Settlements Involving Private Equity Operations Groups, In-House Charges and Service Provider Conflicts](#)

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