

## 2017 Review: Developments for SEC-Registered Private Fund Managers

### PENpoints

*Last year saw a substantial increase in SEC investment adviser examinations, and the SEC Chairman anticipates an additional, though smaller, increase in 2018.*

The year 2017 witnessed sweeping changes to U.S. Securities and Exchange Commission (“SEC”) leadership and a number of notable regulatory developments affecting private fund managers, which are discussed below.

#### Changes in SEC Leadership

In addition to new SEC Chairman, Jay Clayton, the Senate confirmed two new SEC Commissioners (Robert Jackson and Hester Pierce) in December 2017, giving the SEC a full slate of commissioners for the first time in over two years. Additionally, several new key division directors were named in 2017, including the Director of the Division of Investment Management, Director of the Office of Compliance Inspections and Examinations, and Co-Directors of the Division of Enforcement. We expect to see further regulatory developments in 2018 as the SEC’s new leadership team continues to advance its agenda.

#### Supreme Court Limits SEC Disgorgement Remedy to Five Years

In June 2017, the Supreme Court ruled that a five-year statute of limitations applies to disgorgement remedies that may be imposed by the SEC. Under this ruling, the SEC can no longer require persons, including private fund managers, to disgorge so-called “ill-gotten gains,” such as unauthorized fees or expenses, received outside the five-year limitations period. As a result, the SEC may be less motivated to pursue cases where the alleged misconduct comes to the Staff’s attention close in time to the end of the statute of limitations period and where both disgorgement and penalties would be based primarily on conduct outside of that period. However, this

court decision may also result in earlier referrals to SEC Enforcement, an increased focus on bringing cases quickly, and continued demands from the SEC that parties under investigation suspend the running of the five-year limitations period via tolling agreements.<sup>1</sup>

#### SEC Continues to Pursue Enforcement Actions against Private Fund Managers

Despite a stated shift in SEC focus and resources to the protection of retail investors, we expect that private equity and other private fund managers will continue to receive significant attention from the SEC. In 2017, the SEC’s Division of Enforcement continued to bring the following types of enforcement actions against private fund managers:

- *Allocation of Broken-Deal Expenses; Accelerated Monitoring Fees.* In line with high-profile cases brought over the past few years involving the allocation of broken-deal expenses<sup>2</sup> and accelerated monitoring fees,<sup>3</sup> the SEC continued to focus on these topics in 2017. For example, the SEC settled charges against (1) a private equity manager for charging broken-deal expenses solely to its private equity fund instead of allocating a portion of such expenses to manager-affiliated co-investment vehicles,<sup>4</sup> and (2) another private equity manager over its receipt of accelerated portfolio company moni-

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1 See June 6, 2017 *KirklandAIM*, “[Supreme Court Limits SEC Disgorgement Remedy to Five Years](#).” See also the Court’s unanimous [decision](#).

2 See SEC [Consent Order](#) and [Press Release](#).

3 See October 13, 2015 *KirklandPEN*, “[Private Fund Manager Settles SEC Enforcement Case for Accelerated Monitoring Fees and Service Provider Discounts](#).” See also August 24, 2016 *KirklandAIM*, “[Private Equity Manager Settles SEC Proceeding over Accelerated Monitoring Fees and Other Practices](#).”

4 See September 26, 2017 *KirklandPEN*, “[SEC Settles with PE Fund Manager over Broken-Deal Expenses](#)” and SEC [Consent Order](#).

toring fees upon exit (i.e., sales and IPOs), where the manager failed to disclose this practice prior to LP commitment to the fund.<sup>5</sup>

- *Use of Affiliated Service Providers.* In January 2017, the SEC settled charges with a private equity manager over failure to disclose relationships between certain manager principals and a third-party IT service provider used by portfolio companies, even though neither the manager nor the principals profited from the relationship.<sup>6</sup>
- *Allocation of Expenses between Managers and Funds.* Consistent with the past several years, the SEC continued to focus on whether expenses are properly chargeable to private funds or their managers, including, among other issues, the allocation of manager regulatory and overhead expenses to private funds.<sup>7</sup>
- *Unpaid General Partner Capital Contributions.* In 2017, the SEC settled separate cases against two private equity managers over the alleged failure of their affiliated general partners to make timely capital contributions to their private funds as required under each fund's governing documents.<sup>8</sup>
- *Political Contributions.* In January 2017, the SEC settled charges with 10 investment advisers over pay-to-play rule violations, including cases involving private fund managers and exempt reporting advisers. Some of the matters involved modest contributions that were returned to the donor.<sup>9</sup> Application of the rule's fee forfeiture provisions also resulted in an investment adviser filing an SEC exemptive application seeking a fee forfeiture waiver for a \$2,700 contribution which resulted in \$37 million in forfeited fees.<sup>10</sup>
- *Whistleblowers.* In January 2017, the SEC settled charges with an investment adviser over the advis-

er's use of separation agreements in which exiting employees were required to waive their ability to obtain whistleblower awards.<sup>11</sup>

- *Sharing of Confidential Information by Employee.* In December 2017, the SEC settled charges with a private fund manager in connection with an employee sharing confidential information with his spouse, who owned and operated a different private fund manager that invested its fund using a substantially similar strategy. In the consent order, the SEC noted that while the manager had taken certain remedial measures upon becoming aware of the information sharing, such actions were not "sufficient" to prevent the employee from continuing to share such information in violation of the manager's compliance policies and procedures.<sup>12</sup>
- *Insider Trading.* The SEC continued its longstanding focus on pursuing insider trading actions, including cases against private fund managers for the failure to establish, maintain and enforce policies and procedures to prevent insider trading. In August 2017, the SEC settled charges against a private fund manager over an analyst making investment recommendations based on information received from a third-party research firm where the manager failed to adequately oversee the flow of potential material non-public information between the analyst and the research firm.<sup>13</sup>

### Continued Uptick in SEC Examinations

The number of investment adviser examinations increased by more than 40% during the SEC's fiscal year ended September 30, 2017, and Chairman Clayton has indicated that he anticipates an additional 5% increase in 2018. While more than 50% of the SEC's 2018 budget request was devoted to examination and enforce-

5 See SEC [Consent Order](#).

6 See SEC [Consent Order](#).

7 See August 2, 2017 *KirklandAIM*, "[SEC Settles with Affiliated Advisers and their Principal over Registration and Other Practices](#)" and SEC [Consent Order](#).

8 See SEC [Consent Order](#) and SEC [Consent Order](#).

9 See SEC [Press Release](#).

10 See [Exemptive Application](#) and [Amended Exemptive Application](#).

11 See SEC [Consent Order](#) and [Press Release](#).

12 See December 11, 2017 *KirklandPEN*, "[Private Fund Manager Settles with SEC for Alleged Compliance Failures Involving Employee Sharing Confidential Information with Spouse](#)." See also SEC [Consent Order](#).

13 See SEC [Consent Order](#) and [Press Release](#).

ment programs, it remains to be seen whether the SEC's stated focus on the protection of retail investors will result in any shift of examination or enforcement resources away from private fund managers.

### Other Notable Developments

- *Cybersecurity.* As expected, the SEC continued to focus on cybersecurity in 2017 and we expect such focus to continue in 2018 and beyond.<sup>14</sup>
- *Advertising Rule.* The SEC also remained focused on compliance with the Advertising Rule<sup>15</sup> and, in September 2017, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a risk alert detailing frequent Advertising Rule compliance issues identified in examinations of registered advisers, such as misleading or "cherry picked" performance results, use of misleading third-party rankings or awards, and use of prohibited advisory client testimonials.<sup>16</sup>
- *Revised Form ADV.* A revised Form ADV went into effect for all filings made after October 1, 2017, so all 2018 annual amendment filings will be on the revised Form ADV.
- *Update to SEC Regulatory Agenda.* On December 15, 2017, the SEC published the fall update to its regulatory agenda, which identifies the fiduciary rule as a short-term priority and amending the definition of "accredited investor" under Regulation D as a long-term priority. It also removes from the SEC rulemaking agenda proposed third-party investment adviser examinations and the proposed requirement for investment advisers to adopt formal business continuity plans.<sup>17</sup>
- *Cryptocurrencies.* As has been widely reported, the SEC has significantly increased its attention on cryptocurrencies and "initial coin offerings" in recent months<sup>18</sup> and we expect that this focus will continue.

<sup>14</sup> See March 13, 2017 *KirklandPEN*, "[Recent Cyber-Attacks Against PE Firms and Portfolio Companies.](#)" See also May 18, 2017 *KirklandAIM*, "[SEC's OCIE Issues Cybersecurity Alert.](#)"

<sup>15</sup> Advisers Act Rule 206(4)-1.

<sup>16</sup> See September 18, 2017 *KirklandAIM*, "[SEC Risk Alert Cites Frequent Advertising Rule Compliance Issues.](#)" See also OCIE's [Risk Alert](#).

<sup>17</sup> See SEC's [short-term](#) and [long-term](#) agendas.

<sup>18</sup> See December 11, 2017 "[Statement on Cryptocurrencies and Initial Coin Offerings](#)" from SEC Chairman Jay Clayton. See also December 14, 2017 *Kirkland Alert*, "[SEC Chairman Issues Statement on Cryptocurrencies and Initial Coin Offerings](#)" and August 3, 2017 *KirklandAIM*, "[Regulators Claiming Jurisdiction over Virtual Currencies.](#)"

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## PENnotes

**45th Annual Securities Regulation Institute  
Coronado, CA, January 22-24, 2018**

Hosted by Northwestern Law, the 43rd Annual Securities Regulation Institute will take place in Coronado, California. One of the most visible and highly regarded securities and corporate law conferences in the country, the Securities Regulation Institute reaches prominent attorneys from both firm and in-house practices. Kirkland partner Scott Falk is on the planning committee and will be a panel member for the Mergers & Acquisitions session. Click [here](#) for more information or to register.

**24th Annual Harvard Business School Venture  
Capital Private Equity Conference  
Boston, MA, January 27, 2018**

Kirkland is a sponsor of the 24th Annual Harvard Business School Venture Capital and Private Equity Conference, which will address a range of today's most relevant topics. Kirkland partner Erica Berthou will moderate the Fundraising & Limited Partners panel, partner Christian Atwood will moderate the State of PE panel, and partner Steven Serajeddini will moderate the Distressed panel. Click [here](#) for more details or to register.

**PLI Drafting and Negotiating Corporate  
Agreements 2018  
Chicago, IL, January 31, 2018**

This PLI seminar will teach the basics of drafting and negotiating corporate agreements — from how the provisions of an agreement fit together, to the fundamental drafting and negotiating principles common to all corporate agreements. Kirkland partner Keith Crow will be a panelist. Click [here](#) for more information or to register.

**17th Annual Beecken Petty O'Keefe & Company  
Private Equity Conference  
Chicago, IL, February 23, 2018**

Kirkland is a sponsor of this annual event, which brings together financiers, students and entrepreneurs to network and share insights into the dynamics of investing in a constantly changing economy. This year's conference is themed "Remaining Nimble and Achieving Returns While Facing Uncertainty and Volatility." Click [here](#) for more information.

**25th Annual Columbia Business School Private  
Equity Conference  
New York, NY, February 23, 2018**

Kirkland will sponsor the 25th annual Columbia Business School Private Equity Conference. The event will focus on the emerging challenges and opportunities facing the private equity and venture capital industries in the coming year. Kirkland partner Srinivas Kaushik will moderate the Leveraged Buyout panel, and partners Stephanie Berdik and David Nemecek will give a lunchtime presentation on "Cracking the Credit Code: Trends in Private Debt." Click [here](#) for more information or to register.

**13th Annual Stern Private Equity Conference  
New York, NY, March 2, 2018**

Kirkland will sponsor New York University's Stern School of Business' 13th Annual Stern Private Equity Conference. The conference will provide a forum for industry leaders to discuss the opportunities and risks of today's private equity and venture capital environment, including how tepid global growth, regulatory dynamics, political pressure and financial market conditions are posing challenges to fundraising, deal financing and operations. Click [here](#) for more information or to register.

**Wharton Private Equity & Venture Capital  
Conference  
New York, NY, March 16, 2018**

The Wharton School's Private Equity and Venture Capital Conference will showcase several keynote speeches and panel discussions on the state of the private equity and venture capital industries. Kirkland partner Robert Blaustein will moderate the Funds panel, and partner Stephen Hessler will moderate the Distressed Opportunities panel. Click [here](#) for more information or to register.

**2018 Kellogg Private Equity and Venture  
Capital Conference  
Chicago, IL, April 25, 2018**

Kirkland is a sponsor of this annual student-led conference, which brings industry professionals, alumni, students and Kellogg faculty together for a day of discussion on the current state of the industry and its most pressing issues. More information to follow.

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Kirkland & Ellis' nearly 500 private equity attorneys handle leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and fund formations on behalf of more than 400 private equity firms and hedge funds around the world.

Kirkland has been widely recognized for its preeminent private equity practice. The Firm was named "Private Equity Group of the Year" in each of the last seven years by *Law360* and was commended as being the most active private equity law firm of the last decade in *The PitchBook Decade Report*. U.S. News Media Group and Best Lawyers have ranked Kirkland as a Tier 1 law firm for Leveraged Buyouts and Private Equity Law for seven consecutive years and as a top-tier firm for Private Funds/Hedge Funds Law since 2012. The Firm was recognized as the #1 law firm for private equity in the 2018 Vault 100 rankings, and, in 2016, Private Equity International named the Firm "Law Firm of the Year in North America: Fund Formation" for the third year in a row.

In 2012-2017, Chambers and Partners ranked Kirkland as a Tier 1 law firm for Investment Funds in the United States, United Kingdom, Asia-Pacific and globally. The Firm was ranked as the #1 law firm for both Global and U.S. Buyouts by deal volume in Mergermarket's *League Tables of Legal Advisors to Global M&A for Full Year 2011-2016*, and has consistently received top rankings among law firms in Private Equity by The Legal 500, the Practical Law Company and IFLR, among others.

*The Lawyer* magazine has recognized Kirkland as one of its "Transatlantic Elite," having noted that the Firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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