

SEC Risk Alert Cites Frequent Advisory Fee and Expense Compliance Issues

In recent years, the SEC's Office of Compliance Inspections and Examinations ("OCIE") has been focused on private fund managers' fee and expense practices when examining registered advisers. This was also highlighted in OCIE's [Exam Priorities for 2018](#), which lists fee and expense calculations, as well as related investor disclosures, as among OCIE's top priorities.¹ On April 12, OCIE issued a [Risk Alert](#) detailing the most frequent advisory fee² and expense compliance issues identified in examinations of registered advisers completed during the past two years, including:

- management fee charges based on (1) incorrectly valued assets in clients' accounts, including, for example, using a different valuation method and/or process than that which was specified in advisory and governing agreements (e.g., valuing an illiquid asset at initial cost instead of fair market value) or (2) a methodology different from that authorized in advisory and governing agreements (e.g., not applying a step-down from commitment-based to invested capital-based management fees at the end of the investment period);
- charging fees for an entire billing cycle without pro-rating to reflect that advisory services commenced or were terminated mid-billing cycle or billing a client with improper frequency, in each case in contravention of what was disclosed in advisory and governing agreements;
- applying an incorrect fee rate, including, for example, charging performance fees (e.g., carried interest) to investors who were not "qualified clients" under the Advisers Act;³
- omitting credits or rebates and applying discounts to advisory fees incorrectly (e.g., offsets to management fees such as for transaction or monitoring services);
- disclosure issues involving advisory fees, including, for example, Form ADV disclosures that were inconsistent with actual practices and the failure to disclose certain fees paid to a manager in addition to advisory fees; and
- misallocating manager expenses, including the allocation of manager expenses (e.g., regulatory filing fees, certain travel expenses, etc.) to a client or fund in contravention of advisory and governing agreements or other disclosures.

In light of the SEC's ongoing focus on fee and expense matters, private fund managers should continue to review their fee and expense practices in light of their Advisers Act obligations.

- 1 See February 8, 2018, *KirklandPEN*, “[SEC Announces 2018 Examination Priorities](#).”
- 2 Managers should be aware that the deficiencies highlighted in the Risk Alert may apply to both management fee and carried interest practices.
- 3 A “qualified client” is a client or investor with a net worth (exclusive of primary residence) of at least \$2.1 million or \$1.0 million or more in assets under management with the manager. Certain grandfathering rules also may apply to advisory agreements entered into prior to a manager’s registration.

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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