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SEC Warns PE Fund Managers On Fees and Valuations

May 15, 2014. In a recent speech to an industry group, the director of the SEC's Office of Compliance Inspections and Examinations advised private equity fund managers that as a result of common deficiencies uncovered through its recent examination efforts, the SEC is particularly sensitive to practices in the areas of undisclosed fees and inconsistent valuations.

The OCIE director, Andrew Bowden, told managers attending a symposium at Private Equity International earlier this month that the Office's examinations to date had revealed what it viewed as a frequent practice of managers charging fees to its investors that were not expressly disclosed to them, even if the fees were technically permitted by the agreements' typically broad language. Among the examples cited were:

- the engagement by the manager of consultants, or "operating partners" at the expense of the fund, who were on analysis little different from other manager employees who were compensated by the manager directly;
- charging the fund for back-office, compliance, legal and accounting expenses; and
- receipt of long-term monitoring fees, particularly those where substantial termination fees are payable upon disposition of a portfolio company.

Recent manager examinations also showed the improper use in practice of valuation methodologies that varied from the methods described either in the fund's operating agreement or disclosure documents. Among the deficiencies noted, Bowden said, were:

- cherry picking comparables;
- adding back undisclosed or unsupportable charges to EBITDA; and
- changing valuation methodologies from period to period.

909 Third Avenue, New York, NY 10022-4784 • p:212.735.8600 • f:212.735.8708 • www.morrisoncohen.com

The full text of Director Bowden's speech can be found at
http://www.sec.gov/News/Speech/Detail/Speech/1370541735361#.U3KcpXb_17Z

If you have any questions concerning the SEC's planned focus, please contact your Morrison Cohen attorneys.