New Study Backs Up SEC's Focus on Valuation

by Bettina Eckerle

The SEC has targeted valuation as a serious compliance concern for private equity funds. It was not only listed in the SEC's 2013 enforcement priorities, but also discussed by agency leaders at a New York City Bar program on SEC enforcement.

And, according to a recent study, it may be for good reason. Researchers at Oxford University found that funds tend to inflate their performance data when trying to seek new capital.

The study, which examined 761 funds that received investments from the California Public Employees' Retirement System (CalPERS), found that funds generally value their portfolios conservatively. However, the trend disappeared during fundraising.

As noted by the researchers, "We find that valuations of remaining portfolio companies, and therefore reported returns, are inflated during fundraising, with a gradual reversal once the follow-on fund has been closed. This finding is clearly relevant to recent regulatory concerns about conflicts of interest facing private equity fund managers… It is hard to rationalize the pattern we observe except as a positive bias in valuation during fundraising."

The study appears to bolster the SEC's claims that industry competition may pressure some firms to exaggerate their performance in order to stay afloat. Please e-mail or tweet me any questions or comments.

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