

Are More Private Equity Enforcement Actions On the Horizon?

by Bettina Eckerle

The SEC has traditionally targeted private equity funds far less than hedge funds when it comes to enforcement. That may be about to change.

In recent remarks at the Private Equity International Conference in New York, Bruce Karpati, Chief, SEC Enforcement Division's Asset Management Unit, gave some clues as to what may lie ahead for [private equity](#), an industry in which many advisers are just now falling under the purview of the SEC. "As a result of these developments, it's not unreasonable to think that the number of cases involving private equity will increase," Karpati stated.

In the [speech](#), Karpati outlined the agency's top concerns about industry practices:

- **Marketing:** The SEC anticipates overly aggressive marketing due to current industry dynamics.
- **Valuations:** The main concern is the lack of transparency, particularly when it comes to the valuation of illiquid assets and the operation of portfolio companies. Karpati specifically called out as a problematic practice the writing up of assets during fund raising and a write-down soon after, stressing that interim valuations do in fact matter.
- **Conflicts of interest:** Karpati emphasized that much of the improper conduct relates to conflicts, which the SEC sees as an inherent risk, leading to misappropriation, cherry picking and other misconduct. Top concerns there include expense allocation between management company and funds; charging additional fees to portfolio companies when poorly defined by the partnership agreement; conflicts arising from managing different clients, investors and products under the same umbrella; and conflicts with a manager's other business which may be run in parallel with the adviser.

SEC is using a risk analytic initiative to identify high-risk areas through the use of data and quantitative methods, specifically targeting "Zombie" funds or "Zombie" managers.

A holistic approach where the compliance function and the CCO are plugged into a firm's overall risk management structure will go a long way towards mitigating these concerns. Please feel free to [tweet](#), e-mail or call me with comments or questions.

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