

Allocating Fees and Expenses: The SEC Is Paying Close Attention

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In May 2014, the Director of the Office of Compliance Inspections and Examinations (“OCIE”) at the Securities and Exchange Commission (“SEC”) gave a speech to the Private Fund Compliance Forum to “share some insights we have learned from the examinations of private equity advisers.” The examinations referred to were part of OCIE’s “presence exam initiative” that began approximately two years earlier as a result of the Dodd-Frank Act, and involved inspections and exams of more than 150 private equity advisers. The OCIE Director offered a number of observations from the examiners, but “by far, the most common observation” concerned the allocation of fees and expenses by advisers. Specifically, the OCIE Director noted that examiners had found “violations of law or material weaknesses in controls *over 50% of the time*.” The SEC staff saw improper fee and expense allocation as no accident, but rather as an attempt by private equity advisers to make up for tighter margins and industry consolidation that put downward pressures on percentage-based management fees.

The 2014 OCIE Director’s speech signaled an increased focus by the SEC on issues related to fees and expenses and related conflicts of interest, which is ongoing and evolving. Subsequent comments by SEC officials, as well as a number of enforcement actions, demonstrate that the SEC continues to refine its approach as it becomes more familiar with the industry. Set out below is an overview and analysis of the current enforcement landscape and some general recommendations on how to manage the risk of increased scrutiny.

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