SEWARD & KISSEL LLP

# THE PRIVATE FUNDS BULLET REPORT

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## Business Planning, Structural, Legal, Regulatory & Compliance Developments

- In a December 18, 2012 speech before the Regulatory Compliance Association, Bruce Karpati, Chief of the SEC Enforcement Division's Asset Management Unit, highlighted two distinct initiatives designed to identify fraud in the alternative investments space: the Private Equity Initiative and the Aberrational Performance Inquiry. The focus of the Private Equity Initiative will be managers of "zombie" funds that delay the liquidation of their holdings in order to maintain income derived from such assets, as well as private equity managers who misrepresent the value of their holdings. The Aberrational Performance Inquiry will seek to identify and refer for examination or inspection hedge fund managers with suspicious or improbable performance returns by analyzing performance data gathered from thousands of hedge fund advisers.

- On March 11, 2013, the SEC announced the settlement of charges against a New York-based private equity firm, one of its former senior executives, and a placement agent for securities law violations committed in soliciting more than $500 million in commitments. The SEC found that the placement agent, who was entitled to receive transaction-based compensation calculated as a percentage on capital committed by investors introduced by the placement agent, acted as an unregistered broker dealer in soliciting investors for the private funds. The investment adviser and its former executive were found to have aided and abetted the violation and agreed to pay $375,000 and $75,000 in penalties, respectively. The SEC also suspended the former executive from acting in a supervisory capacity for nine months, while the placement agent was barred permanently from the securities industry.

- On March 11, 2013, the SEC accepted a settlement offer of $2.8 million from an investment adviser to a fund of private equity funds for distributing marketing materials to investors that included misleading information with respect to valuation methodologies in violation of the Securities Act of 1933 and the Investment Advisers Act of 1940. Although the marketing materials disseminated by the adviser included statements that valuations were "based on underlying managers' estimated values," the materials included marked-up valuations that were calculated using a different methodology. The SEC noted that as a result the internal rate of return in the marketing materials increased from approximately 3.8% to 38.3% for certain quarters. The SEC found that the marketing materials were materially misleading and that the investment adviser's written compliance policies were not reasonably designed to ensure valuations provided to investors were presented in a manner consistent with representations made regarding those valuations.

- On March 4, 2013, the SEC's Office of Compliance Inspections and Examinations ("OCIE") issued a National Examination Risk Alert that discusses common deficiencies and compliance failures by investment advisers in complying with Rule 206(4)-2 of the Investment Advisers Act of 1940 (the "Custody Rule"). OCIE observed, among other tings, that advisers did not always recognize they had custody over client assets, conducted "surprise examinations" that lacked the element of surprise, for example, by conducting the exams on the same date every year, or failed to comply with all applicable requirements in conducting independent audits of private funds relying on an exemption from the annual surprise exam requirement. OCIE noted that compliance deficiencies have resulted in actions ranging from immediate remediation to enforcement referrals and subsequent litigation.

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