

SEC Settles Cases Alleging Compliance Failures at Private Equity Firms

On March 11, the SEC announced two matters of significant importance to the private equity industry and to private fund sponsors generally. Together, these cases demonstrate the SEC's continued focus on the private equity industry, in particular the role of compliance in preventing and detecting possible violations of the securities laws. These cases also reflect the SEC's interest in monitoring the fundraising activities, valuation practices, and disclosures to investors of private fund sponsors. Although these two matters involved private equity firms, the issues they raised are applicable to a broad range of private fund sponsors, including fund-of-fund and hedge fund managers.

Oppenheimer

In the first case, the SEC filed an order instituting settled administrative proceedings against Oppenheimer Asset Management Inc. and Oppenheimer Alternative Investment Management, LLC ("Oppenheimer") for allegedly misleading investors about the valuation policies and performance of its Oppenheimer Global Resource Private Equity Fund I LP ("OGR"). OGR was a fund-of-funds, with an investment strategy that involved investment in other private equity funds. OGR's marketing materials and quarterly reports stated that the Fund's asset values were "based on the underlying managers' estimated values."

According to the SEC, however, Oppenheimer shifted its valuation methodology with respect to one of the private equity funds in OGR's portfolio, causing it to be valued at a significant markup to the underlying manager's estimated value. That investment, Cartesian Investors-A, LLC ("Cartesian"), was invested solely in a holding company set up by the Romanian government to compensate citizens whose property was seized by the Communist regime. Rather than using Cartesian's own valuation methodology, Oppenheimer valued Cartesian at par—the price at which the Romanian government issued shares. This alleged overvaluation of Cartesian resulted in OGR's internal rate of return increasing from 3.8 to 38.3 percent for the quarter ended June 30, 2009. The SEC also alleged that Oppenheimer falsely represented to potential investors that Cartesian had been subject to evaluations by independent valuation firms and auditors.

Oppenheimer's written policies required the compliance department to review and approve marketing materials and quarterly reports. However, after Oppenheimer's compliance department approved the OGR "pitch book" that incorporated Cartesian's own estimated value, OGR's portfolio manager directed his team to revise the pitch book to reflect Cartesian's par value instead. Thereafter, the pitch book and related quarterly reports were not resubmitted for compliance department review, as required by Oppenheimer's policies. As a result, the SEC concluded that Oppenheimer's policies "were not reasonably designed to ensure that valuations were determined in a manner consistent with written representations to investors."

The SEC stated that "[t]his action against Oppenheimer for misleadingly writing up the value of illiquid investments is clear warning that the SEC will not tolerate lax disclosure practices in the marketing of private equity funds." Emphasizing Oppenheimer's alleged compliance breakdown, the SEC cautioned that "firms must implement policies and procedures to ensure that investors receive performance data derived from the disclosed valuation methodology."

Without admitting or denying the findings, Oppenheimer agreed to pay a penalty of over \$600,000 and return over \$2 million to those who invested in OGR during the period in which the alleged misrepresentations were made. Oppenheimer also agreed to retain an independent consultant to review its valuation policies and procedures.

Ranieri

In another matter announced this week, the SEC filed orders instituting settled administrative and cease-and-desist proceedings against a private equity firm, a former firm executive, and an unregistered “finder” for the finder’s solicitation of more than \$500 million in capital commitments without registering as a broker-dealer under the federal securities laws. Each of the defendants agreed to settle the charges without admitting or denying the SEC’s allegations.

The defendants in these cases were the private equity firm Ranieri Partners (“Ranieri”), a former Ranieri executive, and an individual “finder” who solicited capital contributions from several institutional investors for two private investment funds managed by Ranieri. Pursuant to a consulting agreement, Ranieri engaged the finder to make initial introductions between potential investors and Ranieri, for which the finder would be paid a fee equal to 1% of all capital commitments he facilitated. The contract specified that the finder was not permitted to provide private placement memoranda directly to potential investors, or to contact investors directly to discuss the merits of the Ranieri funds. The finder was paid \$2.4 million under the agreement.

The SEC contended that, notwithstanding the contractual limitations on the finder’s role, he performed activities that went beyond that of a mere finder. The SEC alleged that Ranieri and its former executive failed to oversee the finder’s activities, and knew or should have known that he was violating the terms of the contract. According to the SEC, not only did “Ranieri Partners fail[] to limit [his] access to key documents,” but “Ranieri Partners also received [his] requests for expense reimbursements, which reflected [his] extensive contact with potential investors.” Despite the fact that Ranieri knew or should have known that the finder was engaging in prohibited activities, however, Ranieri allegedly took no further steps to monitor or limit his contact with investors. This case is particularly notable because the SEC sanctioned not only the finder for his failure to register as a broker-dealer, but also Ranieri and the former Ranieri executive for their failure to supervise the finder’s activities.

Ranieri Partners agreed to pay a penalty of \$375,000. The former Ranieri executive agreed to pay a penalty of \$75,000 and a nine-month suspension from acting in a supervisory capacity at an investment adviser or broker-dealer. The individual finder agreed to be barred from the securities industry. The SEC ordered disgorgement of approximately \$2.4 million, but payment was waived based upon the finder’s statement of financial condition.

If you have any questions or would like to learn more about the issues raised by these cases, please contact your usual Ropes & Gray advisor.

For the SEC’s press release in the Oppenheimer matter, please click [here](#).

For the SEC’s press release in the Ranieri matter, please click [here](#).