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AFFECTING THE SECURITIES AND FUTURES INDUSTRIES

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## SEC FOCUS ON PRIVATE EQUITY: IT'S BACK!

*In recent years, through the operation of specialized units, the SEC has intensified its enforcement focus on private equity firms. The authors discuss this development, focusing on cases involving valuation, misallocation of fees and expenses, conflicts of interest, and “broken windows” enforcement. They close with the lessons to be drawn from the cases.*

By Richard D. Marshall and Mark D. Goldstein \*

As of March 30, 2012, the Securities and Exchange Commission revoked the exemption from registration for investment advisers with 15 or fewer clients. This forced private equity fund managers, who had previously not been required to register with the SEC, to register as investment advisers. In 2018, thousands of private fund managers, managing almost 14,000 private equity funds, were registered with the SEC.<sup>1</sup>

Faced with this newly created obligation to regulate private equity funds and their managers, the SEC created specialized units in both the Office of Compliance

Inspections and Examinations (“OCIE”)<sup>2</sup> and the Division of Enforcement (“Enforcement”)<sup>3</sup> devoted to the private equity industry. After an initial learning period, this led to a significant increase in the number of private equity enforcement actions.<sup>4</sup>

After Chairman Clayton became chairman of the SEC, he refocused the SEC’s enforcement efforts on protecting retail investors, which led to a decline in the

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<sup>1</sup> “In 2019, 4,520 advisers reported advising 37,873 private funds with a total gross asset value of \$14.9 trillion; in 2018 there were 4,654 advisers advising 36,095 private funds, with \$13.3 trillion gross asset value. While the percentage of hedge funds and private equity funds was exactly equal three years ago, their popularity as a pool of choice has diverged, with private equity funds now making up nearly 40% (39.9) of privately offered funds and hedge funds representing about 30% (30.3) in the private fund space.” Evolution, Revolution 2019, available at [https://higherlogicdownload.s3.amazonaws.com/INVESTMENTADVISER/aa03843e-7981-46b2-aa49-c572f2ddb7e8/UploadedImages/publications/Evolution\\_Revolution\\_2019\\_FINAL.pdf](https://higherlogicdownload.s3.amazonaws.com/INVESTMENTADVISER/aa03843e-7981-46b2-aa49-c572f2ddb7e8/UploadedImages/publications/Evolution_Revolution_2019_FINAL.pdf).

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<sup>2</sup> Marc Wyatt, Private Equity: A Look Back and a Glimpse Ahead, May 13, 2015, available at <https://www.sec.gov/news/speech/private-equity-look-back-and-glimpse-ahead.html>.

<sup>3</sup> Bruce Karpati, Private Equity Enforcement Concerns, Jan. 23, 2013, available at <https://www.sec.gov/news/speech/2013-spch012313bkhtm> (“The Division has been bringing more private equity cases, as well as hedge fund and registered fund cases with private equity-like issues.”).

<sup>4</sup> *SEC Taking Hard Look at Private Equity*, Los Angeles Daily Journal, June 2, 2016, available at <https://www.paulhastings.com/docs/default-source/PDFs/sec-taking-hard-look-at-private-equity.pdf> (“In recent months, through public statements by commissioners and other senior officials and enforcement actions, the Securities and Exchange Commission has demonstrated its intensifying enforcement focus on private equity firms.”).

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\* RICHARD D. MARSHALL is a Partner in the New York office of Katten and MARK D. GOLDSTEIN is Special Counsel in the New York office of the firm. Their e-mail addresses are [richard.marshall@katten.com](mailto:richard.marshall@katten.com) and [mark.goldstein@katten.com](mailto:mark.goldstein@katten.com).

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