Blogs
August 25, 2016
Asset Management ADVocate

More Sanctions from Private Equity Fees: W.L. Ross

Shortly after my post on the SEC's recent settlement with Apollo Global Management went up, the SEC released a settlement with another private equity fund manager: W.L. Ross & Co. LLC ("WLR"). Like the Apollo case, the SEC sanctioned WLR for failing to fully disclose how it was collecting its fees. But WLR paid a lower penalty than Apollo, perhaps due to its greater perceived cooperation with the SEC.

Failure to Disclose Allocation Methodology

Like the case against Apollo, the WLR enforcement case involved a variety of fees that were being charged to portfolio companies, treated in the aggregate as "transaction fees" by the SEC. WLR committed to charge back 50% of these transaction fees to reduce its investment advisory fees. All of this was disclosed by WLR. What WLR did not disclose was how it would "allocate Transaction Fees when multiple WLR funds and co-investors are invested in a portfolio company." The method it chose was to allocate "based upon the WLR funds' relative ownership percentages of the portfolio company." This had the effect of allocating transaction fees to co-owners of the portfolio companies that were not WLR funds, which reduced the amount of transaction fees subject to the charge back. Over a ten-year period, this reduced WLR's charge back by $10.4 million as compared to a method that would allocate the full amount of the transaction fees to the WLR funds on a pro rata basis. According to the settlement:

> WL Ross did not disclose to the WLR Funds, the Funds' Advisory Boards, or the Funds' limited partners its chosen practice of allocating Transaction Fees based upon the WLR Funds' relative ownership percentages of the portfolio company. As a result, the WLR Funds, their boards, and limited partners may not have been aware that the WLR Funds did not receive that portion of the Transaction Fees allocable to co-investors' ownership percentages of the portfolio companies, or that WL Ross retained for itself that portion of the Transaction Fees instead.

More Remediation, Less Sanctions

This came to light in an SEC examination in 2014, and WLR undertook to:

- restate the allocation formula so that it was pro rata for all of its clients;
- reallocate charges retroactively to 2001 using the new formula and voluntarily pay back over $10 million in restitution;
- hire a new Chief Compliance Officer; and
- engage a third-party compliance firm to review its compliance policies and procedures.

The SEC wrote a lengthy paragraph noting its over-the-top cooperation. As a result, the SEC censured WLR but assessed a relatively small $2.3 million in civil money penalties. Like Apollo, WLR was able to avoid an injunctive proceeding, but unlike Apollo it did not have to pay a substantially larger civil money penalty nor did it have to pay for setting up and administering a restitution fund. Since they were issued only one day apart, it is hard not to compare and contrast the two orders and reach the conclusion that WLR's decision to resolve its problems on its own initiative earned it a relatively better deal, all things considered.

Explore more in

Investment Management
Blog series

Asset Management ADVocate

The Asset Management ADVocate provides unique analysis and insight into legal developments affecting asset managers in the United States. Subscribe ?

View the blog