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Allocation of Expenses

Best Practices for Expense Allocation and Fee Practices: High-Risk Allocation Practices, Inadequate Disclosures and Remedying Improper Allocations

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By Rorie A. Norton, *Hedge Fund Law Report*

There were no specific regulations – and minimal SEC guidance – for fund managers to reference prior to 2015 when allocating expenses between themselves and their funds. To fill this void and protect investors, the SEC announced in 2015, and again in 2016, that private fund fee and expense practices would be a priority of its Office of Compliance Inspections and Examinations. A flurry of enforcement actions followed, targeting practices often viewed as "market" by advisers to private equity funds at the time. Fund managers must study those actions to ensure they do not commit the same violations highlighted by the SEC.

This three-part series illuminates best practices for fund managers to avoid expense allocation violations. The first article outlines trends in the types of expense allocations most aggressively scrutinized by the SEC. The second article examines the flaws in disclosures to investors and the gaps in policies and procedures of managers that frequently result in expense allocation violations. The third article describes best practices fund managers should adopt to prevent violations, as well as remedial actions to take upon discovering the improper allocation of an expense.

See "ACA 2017 Fund Manager Compliance Survey Details Variety in Expense Allocation Practices and Business Continuity Measures (Part Two of Two)" (Jun. 8, 2017); and "SEC Enforcement Director Highlights Increased Focus on Undisclosed Private Equity Fees and Expenses" (May 19, 2016).

To read the first article in this series, click here.

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