Simpson Thacher

Regulatory and Enforcement Alert

SEC Charges Private Equity Adviser for Management Fee Offset Practices Inconsistent With Governing Documents

August 22, 2025

On August 15, 2025, the SEC announced settled charges against a registered investment adviser to private equity funds (the "Adviser") for breaches of fiduciary duty arising from the adviser's fund management fee calculation and management fee offset practices. The Order alleges that the Adviser's actions resulted in charging its funds over $500,000 in excess management fees. The Adviser was censured and ordered to pay a civil penalty of $175,000, as well as disgorgement and prejudgment interest, through a Fair Fund.

This action marks the first settlement under SEC Chairman Paul Atkins' leadership charging a private equity adviser for management fee-related issues under a negligence-based theory (*i.e.*, not alleging fraud).

Background

Central to this action were the Adviser's management fee offset practices. In general, management fee offsets reduce the management fee paid by limited partners to a fund based on certain fees that the fund's adviser or general partner receives from the fund's portfolio companies (among other types of fee offsets). For example, an adviser or general partner may receive transaction fees, advisory fees, monitoring fees, or other similar fees related to services it provides to portfolio companies. Fund limited partnership agreements ("LPAs") often require a private fund adviser to credit back to the funds all or a portion of such portfolio company fees received by reducing or offsetting the management fees the fund owes to the adviser. Management fee offsets are a perennial focus area for the SEC, are relatively straightforward for the SEC Staff to test, and have been included in recent annual examination priorities.[1]

In the instant case, the Adviser's funds' LPAs permitted the Adviser to receive transaction fees, advisory fees, and monitoring fees, among other fees, from portfolio companies ("Transaction Fees"). However, the Adviser's funds' LPAs required the Adviser to credit back to each fund a portion of such Transaction Fees (with limited exclusions from the offset) to reduce or offset the management fees the fund owed to the Adviser. The Order found that the Adviser breached its fiduciary duty to nine of its funds by engaging in two management fee offset calculation practices related to its receipt of Transaction Fees. First, the Order alleged that the Adviser failed to adequately disclose its offset practices regarding the receipt of interest on deferred Transaction Fees and the resulting

[1] *See* 2025 Examination priorities, https://www.sec.gov/files/2025-exam-priorities.pdf; 2024 Examination Priorities, https://www.sec.gov/files/2024-exam-priorities.pdf.

conflicts of interest. Second, the Order alleged that the Adviser improperly duplicated Transaction Fee reductions when calculating certain management fee offsets. Both allegations are discussed in further detail below.

RECEIPT OF INTEREST ON DEFERRED TRANSACTION FEES

The Adviser entered into management services agreements with many of its funds' portfolio companies, pursuant to which portfolio companies paid Transaction Fees to the Adviser for certain services. The agreements typically allowed the payment of Transaction Fees by portfolio companies to be deferred if either (i) the Adviser, in its sole discretion, elected to defer payment or (ii) the portfolio company's loan covenants required deferral. The management services agreements also allowed the Adviser to charge interest on deferred Transaction Fees at an annual rate of 8 percent. The Adviser elected to defer Transaction Fees on multiple occasions. In situations where the Adviser ultimately received deferred Transaction Fees and associated interest payments from portfolio companies, the Adviser included the Transaction Fees, but not the interest payments, in each relevant fund's management fee offsets.

The SEC found that the Adviser's ability to collect interest on deferred Transaction Fees and the resulting conflict of interest were not adequately disclosed in the funds' LPAs. Additionally, the SEC indicated that, while the LPA authorized certain types of exclusions from the management fee offset, interest on deferred Transaction Fees was not clearly excluded from the offset. Accordingly, the SEC found that the Adviser collected $423,065 in interest on deferred Transaction Fees that should have increased the relevant funds' management fee offsets, and thus reduced the management fee, under their respective LPAs.

IMPROPER DUPLICATION OF TRANSACTION FEE REDUCTIONS

When more than one fund invested in the same portfolio company, the Adviser's funds' LPAs governed the allocation of Transaction Fees among the funds for purposes of calculating each fund's respective management fee offset. Pursuant to the Adviser's funds' LPAs, each fund's management fee offset calculation would first be based on *all* Transaction Fees received by the Adviser from the portfolio company and would then be reduced to account for each funds' equity ownership in the portfolio company. The Order indicated that for at least one portfolio company, when the Adviser calculated its funds' management fee offsets, the Adviser first allocated a portion of the Transaction Fees based on the pro rata share of the total capital invested by the funds—instead of first allocating *all* Transaction Fees received by the Adviser—and then reduced the management fee offset to account for each fund's equity ownership in the portfolio company.

The Order alleged that the Adviser's practice amounted to improper double counting that led to the lowering of each fund's management fee offset, and thus increased management fees in a manner that was inconsistent with the Adviser's funds' LPAs. As a result of this conduct, the Order found that the Adviser received $78,976 in excess management fees. The Order also found that the Adviser did not disclose its allocation practice or the resulting conflicts of interest.

Violations and Remedies

The Adviser agreed to settle to an Order finding violations of Section 206(2) of the Advisers Act, which prohibits investment advisers from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client. The Adviser was censured and ordered to pay through a Fair Fund disgorgement and prejudgment interest of $502,041 and $6,835, respectively, as well as a civil penalty of $175,000.

Takeaways

- The Atkins-led SEC is likely to continue to bring enforcement actions against private fund advisers for management fee and expense issues, even when fund limited partners are all sophisticated parties. Registrants should also be prepared for examination scrutiny on the topics of fees (including but not limited to the application of fee offsets) and expenses.
- The SEC did not include charges under the Compliance Rule (Rule 206(4)-7 of the Advisers Act) or the Pooled Investment Vehicle Rule (Rule 206(4)-8 of the Advisers Act).[2]
- The SEC ordered distribution through a Fair Fund. In many similar cases, advisers reimburse outside of an ordered SEC process to avoid perceived drawbacks from Fair Funds including administrative overhead, prolonged engagement with and oversight by the SEC Staff, and additional expenses.

Conclusion

This Order serves as a first look at a negligence-based private equity management fee action settled under an Atkins-led Commission, highlighting that despite speculation by some, the SEC will not cease bringing such actions. Advisers should remain vigilant in ensuring that all fee calculations are in strict compliance with fund LPAs and that current policies accurately effectuate such LPA provisions. Advisers can consider testing the application of offsets under their LPAs (and proactively remediating any issues if identified) as one straightforward way to prepare for examination.

[2] Certain prior SEC orders related to management fee offsets have included charges under Rule 206(4)-8. *See, e.g.*, Advisers Act Rel. No. 6146 (Sept. 23, 2022) (ordering a civil penalty in the amount of $325,000) and Advisers Act Rel. No. 4951 (June 29, 2018) (ordering a civil penalty in the amount of $200,000).

For further information regarding this Alert, please contact one of the following authors:

WASHINGTON, D.C.

Adam S. Aderton
+1-202-636-5549
adam.aderton@stblaw.com

Meaghan A. Kelly
+1-202-636-5542
mkelly@stblaw.com

NEW YORK CITY

Anna C. Goodnight
+1 212-455-2307
anna.goodnight@stblaw.com