

## CLIENT ALERT

### Hedge Fund Advisor Heavily Sanctioned for Failure to Follow Conflict of Interest Rules

Sep.26.2013

A recent SEC settlement<sup>1</sup> reminds investment advisers of the need for robust compliance procedures, to be followed by everyone, in the critically important area of conflicts of interest.

Last week, on September 18, the SEC sanctioned the chief operating officer (COO) of the registered adviser to a hedge fund, barring him from the industry for 18 months and requiring him to pay over \$3 million in disgorged profits, interest, and certain costs.

According to the SEC, the COO served as manager of the fund's illiquid asset portfolio and also, together with his friend, separately owned a partnership that held illiquid securities. The COO arranged for the fund to purchase those securities for over \$7 million but did not inform the fund's trustee or the adviser's chief compliance officer that he would receive a portion (\$2.7 million) of the sales proceeds, nor did he obtain the fund trustee's consent to enter into a conflict transaction. This violated the Advisers Act, which provides that an investment adviser, acting as principal for its own account, may not knowingly sell any security to or purchase any security from a client (in this case, the fund) without disclosing to such client in writing before the completion of the transaction the capacity in which he is acting and obtaining the client's prior, written, revocable consent.

Conflicts arise all the time in the investment advisory business. Recognize them, disclose them, and obtain proper consent. Ensure you have an A+ compliance program in place that you follow, setting the proper tone at the top. Review and train personnel to be aware of conflicts (actual and potential, material, and otherwise) and to inform the CCO and the general counsel about any transaction that may pose conflict issues before that transaction is effected.

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<sup>1</sup> In re Shadron L. Stastney, Advisers Act Rel. No. 3671 (Sept. 18, 2013).

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For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.