Securities Enforcement Alert

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SEC Settlement with Private Fund Sponsor Highlights Ongoing Scrutiny of Private Funds and "Fair Market Value" Pricing of Principal Trades

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On February 25, 2026, the SEC settled[1] an enforcement action with an investment adviser ("Adviser") in connection with its valuation practices. The SEC found that during the initial COVID-19 market disruption (March 2020–May 2020), the Adviser sold loans to private funds it advised in principal transactions at par value (less unamortized loan fees) without reasonably determining whether those prices reflected fair market value under then-declining market conditions. The SEC found these practices were contrary to statements to investors and not in the funds' best interests, resulting in violations of Sections 206(2) and 206(4) of the Investment Advisers Act of 1940 and Rule 206(4)-8 thereunder, and a $900,000 civil penalty. The resolution took into account that the Adviser reimbursed the funds approximately $5.2 million in connection with a 2021 SEC examination and voluntarily enhanced its disclosures and policies regarding loan transfer practices following an SEC examination.

Background

According to the SEC Order, the Adviser originated senior loans (using funds from its parent company) to support leveraged buyouts of lower-middle-market companies, and then typically sold portions of those loans to private funds it advised after holding them for a seasoning period of 30–60 days. The funds' private placement memoranda and governing advisory agreements stated that the Adviser would sell loans to the funds at terms no less favorable than a comparable arm's length transaction and "fair market value" determined by the Adviser. The Adviser's written valuation policy considered "fair market value" to be the loan's purchase price less unamortized loan fees/discount, subject to market adjustments in the Adviser's sole discretion.

The Adviser maintained an internal credit rating system for both originating and selling loans, and only sold loans to its private funds that obtained a certain quality-related rating. The day before a sale, the Adviser would ask its credit team whether there were any downgrades or proposed downgrades of the loans scheduled to be sold. To address Section 206(3) principal transaction requirements, each fund engaged an independent, third-party review agent to provide consent to the trades on the funds' behalf, although these agents did not conduct their own assessment of "fair market value." The SEC noted that the Adviser knew the funds' agent relied on its certification of "fair market value" in consenting to transactions.

[1] SEC Order, File No. 3-22599

The SEC found that in March 2020, credit spreads widened and liquidity in less liquid fixed-income markets declined. The Adviser anticipated these widening spreads and reduced deal volume in the near term, which it communicated to investors. The Adviser implemented enhanced monitoring and a day-ahead internal credit check to confirm loans were not downgraded—but did not perform other analyses to determine whether the market disruption affected the fair market value of the loans sold. The SEC identified 143 sales from March 2020 to May 2020 at par less unamortized loan fees, without market adjustments, and found that the Adviser represented to the review agent that the price reflected fair market value "based on current market conditions," even though it had not reasonably determined the effect of the disruption on fair value at the time of the sales.

The SEC found that the above conduct violated Advisers Act Section 206(2) and Section 206(4), and Rule 206(4)-8 thereunder. The Order acknowledged that during the SEC examination, the Adviser reimbursed the funds approximately $5.01 million, plus over $200K in interest, and it enhanced its disclosures and policies regarding its loan transfer practices. Even so, the SEC imposed the $900,000 penalty.

Analysis and Takeaways

- **Private funds remain an SEC focus.** Notwithstanding the SEC's announced focus on retail investors, the staff continues to focus on private funds through examinations and enforcement actions. As we have said several times, including on the Asset Management Corner podcast, we continue to see Exams and Enforcement staff scrutinizing private fund practices in complex areas like valuation and the calculation of post-commitment management fees.
- **Valuation is key.** In our experience, valuation cases are extremely challenging and fact intensive for SEC staff to examine and investigate. Staff from both Exams and Enforcement frequently enlist the help of in-house valuation experts. This enforcement action is not a simple fact pattern and shows the staff's resolve and the Commission's willingness to continue bringing negligence-based, non-scienter fraud cases against private fund advisers in the right circumstances. Advisers should be attentive to whether their valuation practices align with their stated policies and investor disclosures.
- **Principal transactions are a priority.** The order underscores the SEC's skepticism of transactions where an adviser (or affiliate) is effectively on both sides of the trade. While this action related to a season-and-sell fact pattern, the SEC will scrutinize other principal transactions, including circumstances where sponsors warehouse investments on behalf of private funds. Whether it is a principal trade, a cross trade, or another form of conflict-driven transfer, the SEC's emphasis is consistent: advisers must have robust governance, documentation, and pricing discipline that match disclosures, and cannot treat third-party consents as a substitute for actually determining fairness.
- **Season-and-sell transactions garner heightened scrutiny.** The SEC noted here that the Adviser's transactions were typically held on its books for thirty to sixty days before sale for several reasons. These included addressing the tax requirements of offshore investors, or because the funds did not have enough liquidity at the time to purchase the loans. The period between origination and sale creates a risk that the changing market conditions will affect the value of the loan by the time of sale, and policies to confirm valuation should be in place where this type of risk exists.
- **Remediation helps; does not eliminate penalty risk.** One of the notable aspects of this settlement is the Adviser reimbursed the funds after an examination deficiency letter and enhanced its policies, yet still received a $900,000 penalty. This outcome reinforces that remediation during examination is often treated as a mitigating factor, not a safe harbor in all instances.
- **Long tail of Enforcement.** This action concerns conduct from March 2020 to May 2020, nearly six years ago. The case illustrates that examinations and investigations spun out of significant market events like COVID-19 can result in enforcement actions years later. The SEC brought several valuation cases coming out of the COVID-19 pandemic and attendant market disruption, including the largest mismarking case ever charged by the SEC in the *Infinity Q* matter, and those cases may be at an end given statute of limitations. Poor valuation practices tend to be revealed after market dislocations.

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