TPG Pays $12.8 Million to Settle Allegations that it Misled Investors

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TPG Capital Advisors, LLC ("TPG") will pay $12.8 million to settle allegations that it misled prospective private equity fund investors, according to a settlement with the Securities and Exchange Commission dated December 21, 2017.[1] According to the SEC, TPG misled prospective investors by failing to adequately inform them of TPG's practice of accelerating monitoring fees payable by portfolio companies. TPG neither admitted to nor denied the SEC's findings.

TPG is a Fort Worth-based investment adviser whose private equity platform has more than $50 billion in regulatory assets under management. The SEC alleged that TPG misled investors in three TPG-advised private equity funds organized between 2006 and 2008.

The SEC settlement indicates that TPG typically enters into monitoring agreements with the portfolio companies into which the TPG-advised private equity funds have invested. The monitoring agreements require each portfolio company to pay TPG an annual fee in exchange for TPG providing consulting and advisory services to the portfolio company. The monitoring fees that TPG receives from portfolio companies are in addition to the management fees that TPG receives from the private equity funds that it advises. TPG uses a portion of the monitoring fees paid by portfolio companies to offset the annual management fees payable by TPG's private equity funds.

TPG's monitoring agreements with portfolio companies commonly provided for up to ten years of monitoring services and fees, according to the settlement. Some monitoring agreements also permitted TPG to accelerate the payment of future monitoring fees when certain events occurred, such as a portfolio company's private sale or initial public offering. Between 2013 and 2015, TPG terminated certain portfolio company monitoring agreements and accelerated the payment of future monitoring fees under those agreements.

Although TPG informed prospective investors of its practice of entering into monitoring agreements and collecting monitoring fees, it failed to inform them that it had the ability to accelerate the payment of future monitoring fees when it terminated those monitoring agreements. TPG eventually disclosed its ability to collect accelerated monitoring fees in 2013, more than four years after investors had committed capital to the TPG-advised private funds.

Requiring lump sum payments of accelerated monitoring fees presented a conflict of interest for TPG because the payments allowed TPG to benefit at the expense of investors in three of its funds. The payments provided TPG with significant economic benefits but harmed investors by reducing the portfolio companies' available cash and potentially reducing their value in advance of a public offering or sale transaction. Because of this undisclosed conflict of interest, TPG could not effectively consent to this practice on behalf of the funds it advised.

TPG's "negligent" failure to disclose and obtain appropriate consent for its practice of accelerating management fees was a breach of its fiduciary duty to the funds in violation of Section 206(2) of the Investment Advisers Act of 1940 (the "Advisers Act"), and also violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

Section 206(2) of the Advisers Act makes it "unlawful for any investment adviser … to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder make it unlawful for any investment adviser to a pooled investment vehicle to "[m]ake any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle" or "engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle."

The settlement requires TPG to disgorge $9.5 million and pay a $3 million civil penalty. However, the consequences to TPG could have been worse. The SEC noted that, in determining to accept TPG's settlement offer, it considered TPG's level of cooperation with the SEC's investigation. The SEC stated that, "Throughout the staff's investigation, TPG voluntarily and promptly provided documents and information to the staff. TPG met with the staff on multiple occasions and provided detailed factual summaries of relevant information. TPG was extremely prompt and responsive in addressing staff inquiries."

The SEC's settlement with TPG should serve as a reminder to investment advisers to review their disclosure policies and practices, but it does not expand the types of activities that could subject an adviser to enforcement actions. The SEC previously sanctioned Apollo Global Management and three private equity fund advisers within The Blackstone Group for similar practices.[2]

For more information, please contact a member of our Private Investment Funds and Advisers Practice.

Footnotes.

1. Read the full settlement order.

2. The Apollo and Blackstone enforcement actions may be viewed here and here.