Investment Adviser Agrees to Pay $5 Million for Compliance Deficiencies in Valuing Client Assets

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On June 4, 2019, the Securities and Exchange Commission ("SEC") announced that Deer Park Road Management Company, LP ("Deer Park"), a prominent private fund manager in the mortgage-backed securities space and registered investment adviser, agreed to pay a $5 million penalty to settle charges of willful violation of Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder by failing to adopt and carry out written policies and procedures reasonably designed to prevent violations of the federal securities laws in connection with inaccurate valuations. Scott Burg, Deer Park's Chief Investment Officer, also personally agreed to pay a $250,000 penalty to settle the matter. In addition to paying a fine, both Deer Park and Mr. Burg agreed to cease and desist from additional compliance violations. A copy of the SEC order is available here.

According to the SEC, from at least October 2012 through December 2015, Deer Park's valuation policies were not reasonably designed for its business practices, and the firm did not have policies and procedures to address the potential conflicts of interest resulting from the role of traders valuing securities that they managed. The SEC also alleged that the firm did not sufficiently secure its traders from providing erroneous information to a pricing vendor and then using the prices the firm received to value bonds in its flagship fund. Further, the order found that Deer Park failed to implement its existing policies.

Overseeing valuation was a committee that lacked expertise in bond valuation, and Mr. Burg, who approved valuations that evidenced a failure to apply Deer Park's policy. The SEC indicated that Mr. Burg authorized valuations noted by traders in valuation spreadsheets as being undervalued and with explanations to mark up gradually rather than to market, in violation of the accounting principles required by Deer Park's policies.

Valuation of client assets is a key area for investment advisers as improper valuation can lead to, among other things, incorrect payment of withdrawal proceeds, inaccurate calculation of fees and imprecise performance reporting. Given the SEC's increased focus on valuation practices, investment advisers should regularly review their valuation policies and procedures to confirm that they are tailored to their specific businesses and regularly test to ensure that such policies and procedures are being properly implemented.

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