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# THE SEC'S NEW PROPOSED RULES FOR PRIVATE FUND ADVISERS

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# Overview of Proposed Updates

- **Proposed Amendment to Form PF**

- *Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers*, Release No. IA-5950 (Jan. 26, 2022).

- **Proposed New and Amended Advisers Act Rules for Private Fund Advisers**

- *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA-5955 (Feb. 9, 2022)



# **SEC Proposes to Amend Form PF to Enhance Systemic Risk Monitoring**

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# Key Takeaways

1

## Form PF Current Reporting

Potentially transforms Form PF into a current reporting form for *large hedge fund advisers* and *advisers to private equity funds*

2

## Reporting Threshold for Section 4 of Form PF

The reporting threshold applicable to large private equity advisers would be reduced from \$2 billion to \$1.5 billion in private equity fund AUM, thereby expanding applicability of Section 4 of Form PF

3

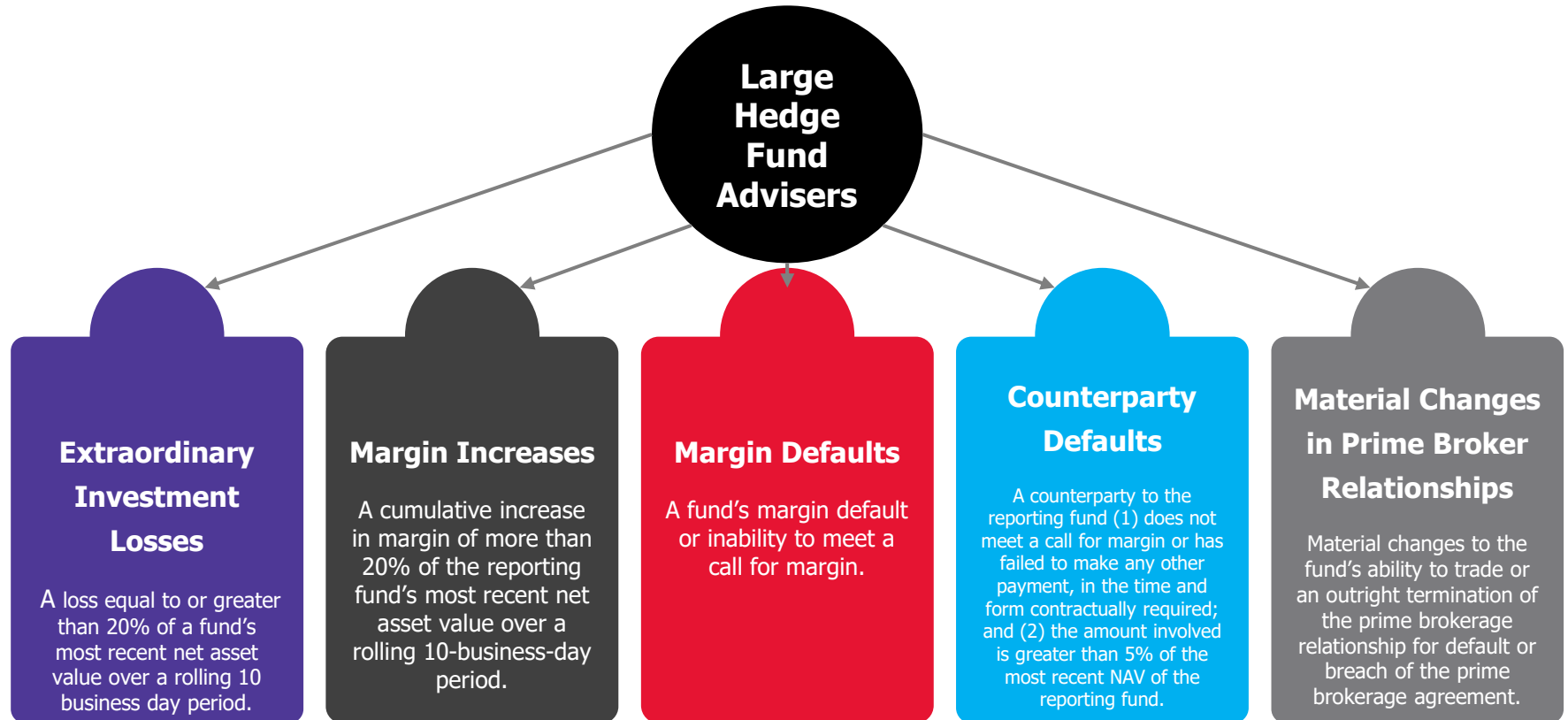
## Form N-MFP

The proposed rules include a new large liquidity fund adviser reporting requirement, essentially requiring such advisers to report the same information that money market funds report on Form N-MFP

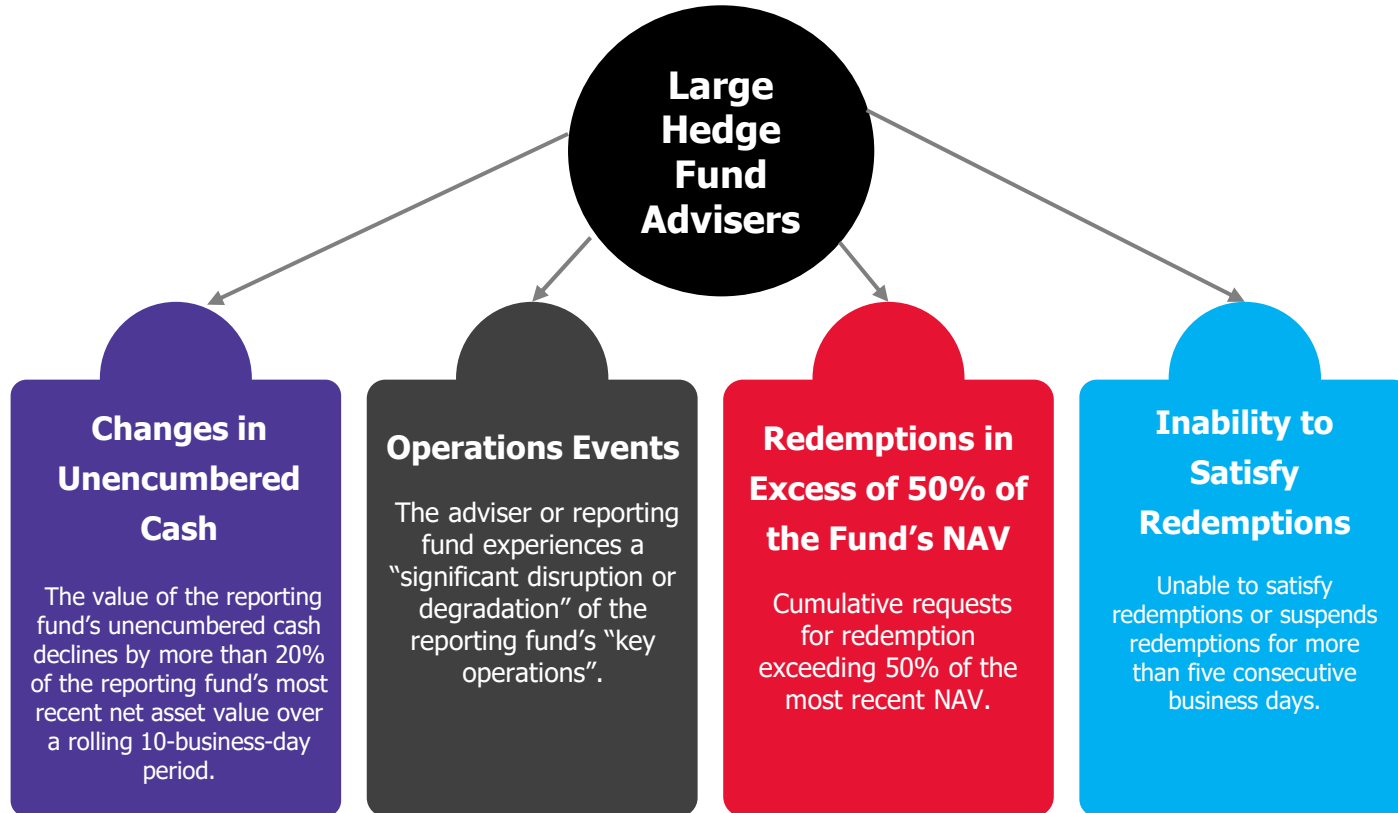
# Form PF Current Reporting Proposal

- Form PF currently requires large hedge fund advisers to file quarterly and private equity advisers (and other private fund advisers) to file annually
  - The existing requirements remain the same
- The SEC has proposed current reporting **due within one business day** of triggering event
  - 9 triggering events for large hedge fund advisers
  - 3 triggering events for advisers to private equity funds

# Current Reporting Triggering Events

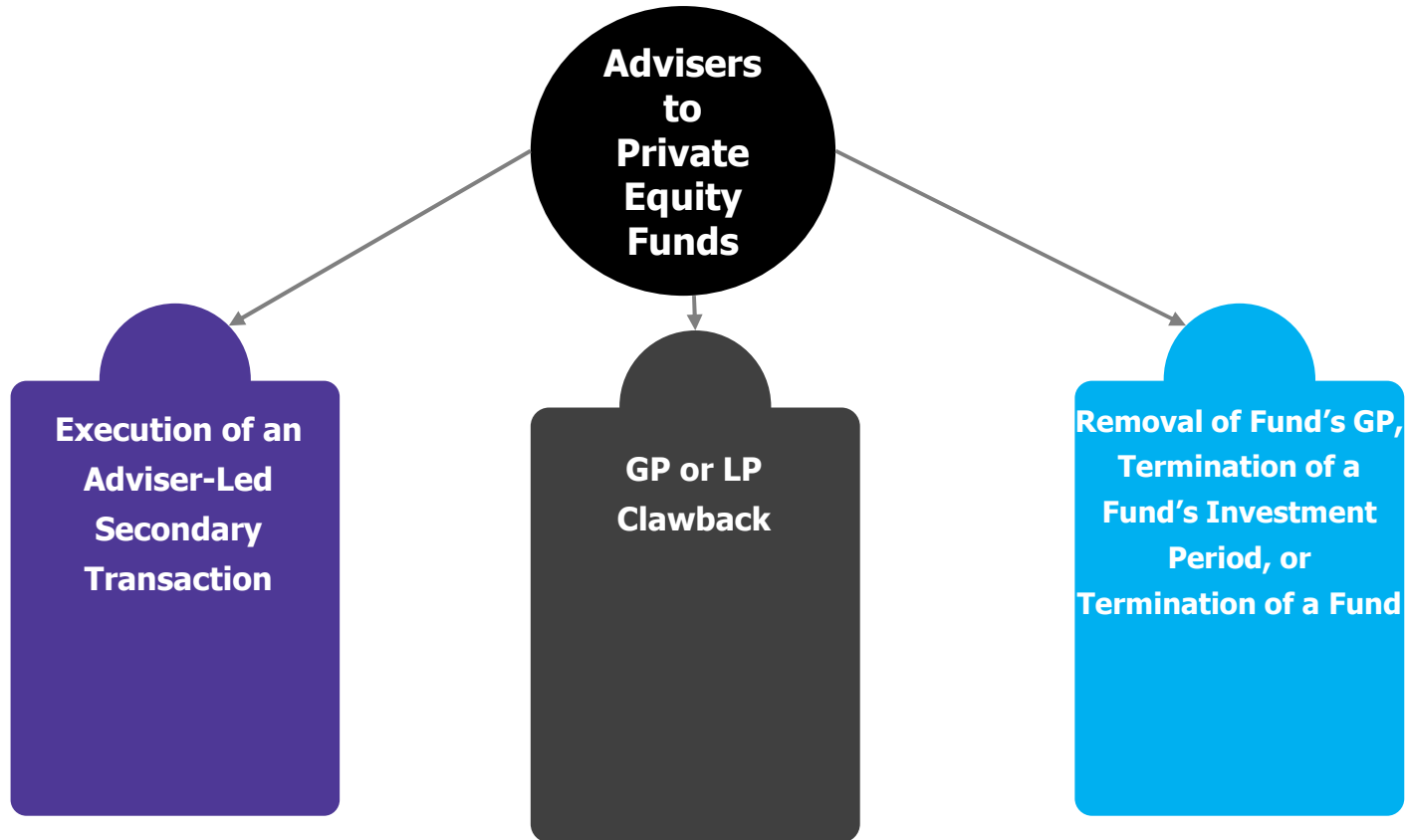


# Current Reporting Triggering Events





# Current Reporting Triggering Events





# **Investor Reporting and Investment Adviser Documentation Proposal**

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# Overview

- **Proposed changes applicable to registered investment advisers:**
  - Quarterly investor reporting requirements
  - Private fund annual audit requirement
  - Fairness opinion requirement for adviser-led secondaries transactions
  - Annual review of compliance program
- **Proposed changes applicable to all advisers:**
  - Proposed prohibition on certain activities
  - Proposed reforms to side letters and “preferential treatment” of certain investors
- **The SEC has posed questions for comment asking whether other parts of the proposed rules should also apply to exempt reporting advisers**

# Proposed Quarterly Reporting Requirement

- Private fund advisers are not currently subject to investor reporting requirements under the Investment Advisers Act
- The proposed rules would require a registered private fund adviser to prepare a quarterly statement for each private fund that it advises (directly or indirectly) that has at least two full calendar quarters of operating results
- Must be distributed to investors within 45 days of the calendar quarter end

# Proposed Quarterly Reporting Requirement

- Quarterly Reports Would Include (with prominent disclosure):
  1. Fund table
  2. Portfolio investment table
  3. Performance data depending on whether the fund is a liquid or illiquid fund
  4. Consolidated reporting to cover substantially similar pools of assets, if meaningful
- No relief has been proposed for registered CPOs that distribute quarterly reports to investors

# Proposed Private Fund Audit Rule

- Requires registered private fund advisers to obtain an audited financial statement for each private fund annually and upon liquidation
- Must distribute to investors “promptly” after the audit’s completion
- The fund’s auditor would be required to notify the SEC upon the auditor’s termination or issuance of a modified opinion

# Proposed Prohibition on Certain Activities

- Applicable to all advisers to private funds, regardless of registration status
- Proposed rule prohibits private fund advisers from, directly or indirectly, engaging in certain sales practices, conflicts of interest, and compensation arrangements
- Each of these prohibitions presents a change to existing market standard practices
- Current approach to regulation generally permits these activities provided that the adviser discloses the activities to investors prior to its subscription

# Proposed Prohibition on Certain Activities

- The proposal prohibits **all private fund advisers** from:
  - Seeking reimbursement, indemnification, exculpation, or limitation of its liability by the private fund or its investors for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to the private fund
  - Charging the following fees and expenses to a private fund or portfolio investment:
    - Accelerated monitoring fees
    - Fees or expenses associated with an examination or investigation of the adviser or its related persons by governmental or regulatory authorities
    - Regulatory or compliance expenses or fees of the adviser or its related persons
    - Fees and expenses related to a portfolio investment on a non-pro-rata basis when multiple private funds and other clients advised by the adviser or its related persons have invested (or propose to invest) in the same portfolio investment
  - Borrowing money, securities, or other fund assets, or receiving an extension of credit, from a private fund client
  - Reducing the amount of any adviser clawback by the amount of certain taxes



# Side Letters and the Prohibition of Preferential Treatment

- Applicable to **all** private fund advisers
- Advisers would be prohibited from providing preferential terms to certain investors regarding redemption or portfolio holdings or exposures information
- Other preferential treatment may only be provided to investors if the adviser provides written disclosures of such preferential treatment to prospective and current investors
  - SEC noted that terms that are considered “preferential” depend on the facts and circumstances
- Proposed rules could significantly impact side letter practice

# Proposal for Adviser-Led Secondaries

- A registered private fund adviser would be required to provide investors with
  - A fairness opinion from an independent opinion provider; and
  - A summary of any material business relationships the adviser or any of its related persons has, or has had within the past two years, with the independent opinion provider.
- The proposed definition of “adviser-led secondary transaction” is:
  - Any transaction initiated by the investment adviser or any of its related persons that offers private fund investors the choice to (1) sell all or a portion of their interests in the private fund; or (2) convert or exchange all or a portion of their interests in the private fund for interests in another vehicle advised by the adviser or any of its related persons

# Proposal for Adviser-Led Secondaries

- The SEC is expressing an interest in reporting adviser-led secondary transactions
  - Inclusion of an adviser-led secondaries transaction as a triggering event under the Form PF amendments
  - The proposed fairness opinion requirement
- Possibly an indication of increased SEC scrutiny and regulation of these transactions

# Annual Review of Compliance Program

- Under the proposed rules, registered investment advisers would be subject to a requirement to document, in writing, the annual review of their compliance policies and procedures
- Such documentation would allow SEC staff to determine whether the adviser has complied with the SEC's compliance rule

# What's Next?

- **Form PF Proposal Comment Period**
  - 30 days from publication in the Federal Register
- **Investor Reporting and Documentation Proposal Comment Period**
  - The longer of 30 days from publication in the Federal Register or April 11
- **OTHER RULE PROPOSALS**
  - Beneficial Ownership Reporting
  - Cybersecurity



# Attorney Biographies

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Christine Lombardo advises investment managers and broker-dealers on financial regulatory matters. She concentrates her practice on securities regulation for a broad range of financial firms including retail asset managers, private fund managers, family offices, broker-dealers, other professional traders, and high-net-worth individuals. Christine also counsels legal, compliance, and business personnel on the structure, operation, and distribution of advisory programs, including digital advisory offerings, and investment products, including hedge funds, private equity funds, venture capital funds, real estate funds, and other alternative investment products. She is admitted in New York only, and her practice is supervised by PA Bar members.

Christine also counsels financial firms through examinations by industry regulators, as well as on enforcement related matters. Before joining Morgan Lewis, she worked for the Division of Enforcement at FINRA.

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The co-leader of Morgan Lewis's global private funds practice, Courtney Nowell advises global institutional investor clients on the terms of their inbound and outbound investments, including into private equity and other co-mingled open-ended and closed-ended investment funds. She has over 20 years' experience drafting and negotiating the terms of investment agreements and side letters for clients investing into leveraged buyout, venture capital, distressed debt, special opportunity, real estate, hedge, energy, infrastructure, and credit funds. She also represents investors in opportunity and sidecar funds, co-investment funds and with the drafting and negotiating of funds of one and other bespoke strategic private investment partnerships.

Courtney's clients include sovereign wealth funds and major public and private pension funds, as well as foundations, endowments and family offices.

Before joining Morgan Lewis, Courtney was a partner at another global law firm and a member of its global board. She also worked at a national accounting and professional services firm where she advised on tax rulings and tax legislative developments.

Courtney is a former member of the board of directors of a foundation that supports a legal fellowship program that awards fellowships to law students who demonstrate a commitment to public service and public policy.



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Jedd H. Wider focuses on global private investment funds and managed accounts, particularly global hedge, private equity, secondary, and venture capital funds. As co-leader of the global private funds practice, he represents leading financial institutions, fund managers, and institutional investors in their roles as fund sponsors, placement agents, and investment entities. He assists clients through all stages of product development and capital raising as well as customized arrangements, seed and lead investor arrangements, and joint ventures. He specializes in all aspects of secondary transactions, and complex financial structurings. Jedd concentrates on all aspects of bespoke fund products and arrangements including funds of one and managed accounts and regularly advises clients on all aspects of regulatory compliance.

Members of the international media often seek out Jedd for his views on the hedge fund and private equity fund industries and capital markets. His analysis can be found in US and international publications, including *The Wall Street Journal*, *The Economist*, and *The Financial Times*, as well as on television networks such as Bloomberg and CNN.

Jedd lectures and serves as a panelist on private investment fund topics for trade programs and organizations around the world. He has delivered speeches and presentations to numerous private fund conferences such as the Hedge Fund Institutional Forum, Dow Jones Private Equity Analyst Limited Partners Summit, Endowments & Foundations Roundtable, Association of Life Insurance Counsel, National Association of Public Pension Fund Attorneys (NAPPA), West Legalworks, InfoVest21 Hedge Fund Conference, the Annual Euromoney Summit of European Hedge Funds in London, Capital Roundtable Fund Conferences, the Annual International Conference on Private Investment Funds in London, the Wharton Private Equity and Venture Capital Conference, the On Point Investors and Hedge Fund Risk Summit, and the Lazard Capital Markets Hedge Fund Conference.

Jedd is listed in *The US Legal 500*, *Chambers Global: The World's Leading Lawyers*, and *Chambers USA: America's Leading Lawyers for Business*. He serves as an editorial board member of *The Journal of Investment Compliance* and as an editor of the *Morgan Lewis Hedge Fund Deskbook: Legal and Practical Guide for a New Era* published by Thomson Reuters/West. He regularly publishes articles on current hedge fund and private equity fund topics. He co-chairs the Annual Morgan Lewis Advanced Topics in Hedge Fund Practices Conference and chairs Morgan Lewis's Hedge Fund University Web Series.

Jedd clerked for Judge Nicholas Politan of the US District Court for the District of New Jersey and for US Attorney Rudolph Giuliani of the Southern District of New York. He is conversant in French.<sup>25</sup>

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Joseph D. Zargari focuses on the private investment fund industry, including the structuring, formation, governance, and regulation of and investment in US and non-US hedge funds, private equity funds, venture capital funds, managed accounts, and other products. In addition, Joe has a significant practice representing buyers, sellers, and general partners in secondary transactions (including portfolio sales of fund interests and GP-led transactions). He also provides legal, regulatory, and transactional advice for investment managers and institutional investors. Joe is the practice group leader for the New York office investment management practice.

Actively engaged in all aspects of the private funds practice, Joe's experience covers all types of private investment funds, including hedge funds, private equity funds, venture capital funds, secondary funds, real estate funds, credit funds, infrastructure funds, energy funds, funds of funds, hybrid funds, and funds of one. He counsels sponsors through all stages of product development and capital raising, including management company and fund formation, placement agent agreements, seed and lead investor arrangements, regulatory and compliance issues, and investment activities (including direct investments and co-investments). He also advises funds of funds, pension plans, endowments, family offices, and other institutions in connection with their investments in private funds.

In addition, Joe regularly represents clients engaged in secondary transactions (including traditional purchases and sales of fund interests, fund recapitalizations and restructurings, tender offers, and structured, stapled, and synthetic secondary deals) and is a frequent speaker on the subject. He advises secondary funds, institutional investors, pension plans, endowments, family offices, and other institutions in their capacities as buyers and sellers of private fund interests on the secondary market and has counseled clients in many leading secondary transactions.

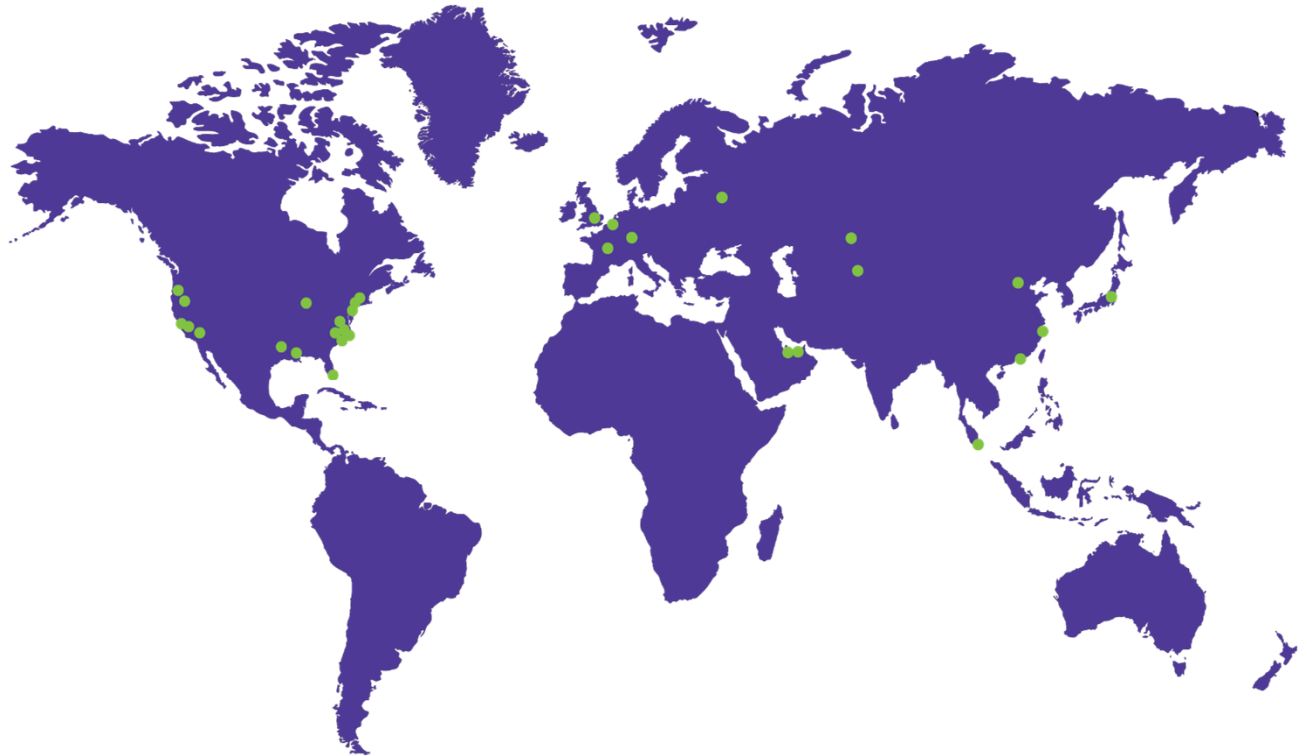
Joe has presented at a number of industry conferences on investment management-related matters, including at conferences sponsored by the Managed Funds Association and the National Association of Public Pension Attorneys, as well as at conferences sponsored by Morgan Lewis in New York, London, Chicago, Boston, and Dallas. Joe has also authored, and been interviewed for, articles on fund formation, investment management, and secondary transaction matters in various publications, including *Private Equity Law Report*, *PEI's Secondaries Investor* publication, *Hedge Fund Legal & Compliance Digest*, HedgeFund Intelligence's *Absolute Return* magazine, and the *Morgan Lewis Hedge Fund Deskbook*.

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