The SEC Releases New Private Fund Risk Alert and Proposed Changes to Form PF

By Joseph M. Mannon, Jeff VonDruska and Rachel Behar

February 9, 2022

On January 27, 2022, the Division of Examinations of the Securities and Exchange Commission (the Staff or SEC) issued a risk alert detailing key deficiencies observed during its examinations of investment advisers to private funds. This risk alert demonstrates increased focus from the Staff on common private and venture capital terms. Funds will want to review their disclosures in light of the risk alert. In particular, advisers should note the following takeaways:

- *Advisers' conduct should be consistent with its disclosures (whether in its Form ADV, advisory agreements or otherwise).* The Staff noted that certain advisers failed to follow certain practices set forth in its various fund disclosures with respect to the calculation of fund-level management fees charged after a commitment period. For example, some advisers used broad, vague terms in their fund agreements—such as "impaired," "permanently impaired," "written down" or "permanently written down"—but did not implement policies and procedures to ensure these terms were consistently applied. In addition, advisers did not accurately describe the reinvestment provisions utilized by funds, or omitted material information from such disclosures. All of the above instances may have caused advisers to collect excess or otherwise improperly calculate management fees.

- *Disclosures in marketing statements should not be false or misleading.* The Staff noted false or misleading marketing materials with respect to track records, performance calculations, predecessor performance and awards or firm characteristics.

- *Advisers must conduct a reasonable investigation into an investment to ensure that its advice is not based on materially inaccurate or incomplete information.* The Staff observed advisers that did not perform due diligence in accordance with their policies and procedures, or that did not have appropriate policies and procedures in place. In addition to due diligence on investments, some advisers failed to perform appropriate due diligence on key service providers, such as alternative data providers and placement agents.

- *Advisers should ensure that any limitations of its liability ("hedge clauses") in disclosure documents and client agreements are not misleading or in violation of the Investment Advisers Act of 1940.* This risk alert and a recent enforcement action highlight the SEC's crackdown on advisers that attempt to limit their liability and mislead clients. Advisers should review their agreements and disclosures and adopt appropriate policies and procedures if they do have hedge clauses.

On January 26, 2022, the SEC issued a proposed rule to amend Form PF. If finalized, these changes will result in more frequent and current reporting to the SEC.

- Large hedge fund advisers and private equity fund advisers would be required to file current reports within one business day of the occurrence of one or more "reporting events."
    - For large hedge fund advisers, a "reporting event" would include: losses of 20% or more; material changes in prime brokerage relationships; significant margin and counterparty default events; and changes in unencumbered cash, certain events impacting operations and events associated with withdrawals and redemptions.

    - For private equity fund advisers, a “reporting event” would include: the execution of adviser-led secondary transactions; implementation of limited partner or general partner clawbacks; removal of a general partner; termination of the investment period; and termination of the fund.

- The threshold for reporting as a large private equity adviser would be reduced from $2 billion to $1.5 billion in private equity assets under management.

- Large private equity advisers would be required to report additional information regarding fund strategies, use of leverage and portfolio company financings, controlled portfolio companies and their borrowings, fund investments in different levels of a portfolio company’s capital structure and portfolio company restructurings or recapitalizations.

- Large liquidity fund advisers would be required to report substantially the same information that money market funds would report on Form N-MFP (as amended by the SEC pursuant to its proposal).

If you have any questions regarding the topics discussed in this article, please contact **Joseph M. Mannon** at jmannon@vedderprice.com, **Jeff VonDruska** at jvondruska@vedderprice.com, **Rachel Behar** at rbehar@vedderprice.com or any Vedder Price attorney with whom you have worked.

vedderprice.com