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The Trend of Increasing Disclosure Obligations for Private Funds Continues in 2022

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Last month, the SEC proposed new rules under the Advisers Act that, if implemented, would be the most significant enhancement of disclosure obligations for private fund managers since the Dodd-Frank Act. Citing investor protection and transparency concerns for limited partners as investors, these proposals signal the Commission's intent to add additional tools to the fund manager enforcement and examination toolbox.

SEC Chairman Gary Gensler publicly signaled a new direction for the SEC's regulation of private funds last year. Previously, regulators had taken a more hands-off approach to private fund regulation in light of participants' considerable commercial sophistication, reasoning that those parties are capable of protecting their own economic interests. Chairman Gensler indicated a departure from that view, observing that limited partners are often retirement plans and non-profit or university endowments, behind which "are teachers, firefighters, municipal workers, students, and professors." Spotlighting the SEC's responsibility to "protect[] investors," "facilitate[e] capital formation," and "maintain[] fair, orderly, and efficient markets" in the private fund space, Chairman Gensler proceeded to highlight several specific areas where he would instruct SEC staff to consider tightening regulation, such as increasing transparency around fees and expenses, evaluating hedge clauses, and limiting use of side letters.

This year has seen Chairman Gensler's agenda put into action. The SEC's proposed Advisers Act reforms would increase disclosure obligations for private funds. In particular, they would require additional disclosure by private fund managers on topics including quarterly statements, annual audits, and adviser-led secondary transactions. The proposed rules would also prohibit certain existing practices (such as accelerated monitoring fees, and certain exculpatory and indemnification provisions), and would require additional disclosure as to certain alleged "preferential treatment" of certain fund investors.

The Commission is also actively advancing its agenda through additional rulemaking and guidance:

- On January 26, the Commission voted to propose amendments to Form PF that would, among other things, lower the reporting threshold for large private equity advisers from $2 billion to $1.5 billion, and would require rapid reporting—within one business day—of certain events that the Commission believes indicate significant financial stress at a fund. The Commission's press release touted these amendments as "bolster[ing] the Commission's regulatory oversight of private fund advisors and its investor protection efforts in light of the growth of the private fund industry."
- On January 27, the Division of Examinations issued a risk alert providing observations from examinations of private fund advisers, which included various examples of deficiencies for conduct inconsistent with prior material disclosures, and insufficient fund disclosures regarding performance, marketing, and hedge clauses.
- On February 10, the Commission proposed significant amendments to Section 13 reporting obligations, which would significantly shorten the filing deadlines for initial and amended Schedules 13D and 13G, as well as provide additional guidance on those filing obligations.

There are also signs of a more rigorous enforcement regime relating to fund manager disclosures. On January 11, the Commission entered into a settlement order with a wealth management firm for disclosure violations. Among the order's fact findings, the SEC highlighted the firm's use of a hedge clause, containing relatively standard language disclaiming certain causes of action against the adviser, along with its statement that "nothing in this Agreement shall serve to waive or limit any rights Client may have under [federal or state] laws." The Commission found that this hedge clause violated Section 206(2) of the Advisers Act, which protects prospective clients from fraudulent or misleading practices. The order noted that the hedge clause "could lead a client to believe incorrectly that the client had waived a non-waivable cause of action against the adviser provided by state or federal law." The order also highlighted the firm's lack of procedures "to assess a client's sophistication in the law or to explain the meaning" of the hedge clause, concluding that "there was no evidence this non-waiver disclosure would be comprehended by retail clients." Although hedge clauses were just one specific area of concern emphasized in Chairman Gensler's November 2021 speech, the SEC may be willing to increase regulatory scrutiny over private funds through more aggressive enforcement actions.

Private fund managers and participants should continue to monitor the SEC's rulemaking and enforcement efforts, and assess their internal policies and procedures against the new benchmarks the SEC provides—benchmarks that are poised to become more rigorous as Chairman Gensler continues to push a more expansive vision of private fund regulation.

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