



# AIMA Private Fund Manager Training

Focus on SEC Priorities, Regulatory Trends and Compliance  
Practices for Private Funds and Advisers to Private Funds

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# Overview

- **Recent SEC Rule Proposals:**

Rule proposals would significantly impact both SEC registered and unregistered advisers

- Private Funds
- Form PF
- Cyber

- **SEC Focus on Advertising:**

New rules effective November 4, 2022

- **Recent SEC Guidance:**

Risk alerts focus the market as to the current requirements in examinations and enforcement

- Private Fund Advisers
- ESG Investing
- Fee Billing
- Principal Transaction and Cross Trades
- Digital-Asset Securities

- **Recent SEC Enforcement Actions:**

Managers should review their business and fund documentation to address any actions required

# Adviser Fiduciary Duty

- Failure to have an adequate compliance program is a violation of **Advisers Act Rule 206(4)-7**, which is independent of any securities law violation
  - SEC focuses on the content of your policies in light of recent guidance and actions, and whether you abide by those policies
- Registered advisers have **fiduciary duties of care and loyalty** to their clients
  - Must act in good faith
  - Full and fair disclosure of all material facts (ADV, PPM, marketing materials)
  - Reasonable care to avoid misleading clients
  - Place client's interests ahead of adviser's interests
- Adherence to anti-fraud provisions
  - Avoid conflicts of interest

# SEC Proposed Rules

# SEC Proposed Rule: Private Funds

The SEC proposed new rules and amendments under the Advisers Act which would significantly impact both SEC-registered private fund advisers and private fund advisers not SEC-registered (February 2022)

## Prohibitions Applicable to all Private Fund Advisers

- **Providing certain types of preferential treatment to investors**
  - All private fund advisers would be prohibited from providing preferential treatment to certain investors regarding redemptions/withdrawals or information about portfolio holdings or exposures. Private fund advisers must sufficiently disclose to investors the types of preferential treatment afforded to investors and potential investors within the private fund, including a description of any lower fee terms.
- **Charging fees for unperformed services**
  - All private fund advisers would be prohibited from charging a portfolio investment fees for monitoring, servicing, consulting or other services that the private fund adviser does not, or does not reasonably expect to, provide.

# SEC Proposed Rule: Private Funds (continued)

## Prohibitions Applicable to all Private Fund Advisers (continued)

- **Charging fees and expenses related to regulatory examinations and compliance**
  - All private fund advisers would be prohibited from charging a private fund the fees or expenses associated with any examination or investigation of the adviser or its affiliates by a governmental or regulatory authority, and/or, the regulatory and compliance fees and expenses of the private fund adviser.
- **Charging fees or allocating expenses on a Non-Pro Rata Basis**
  - All private fund advisers would be prohibited from directly or indirectly charging or allocating fees and expenses related to a portfolio investment or potential 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.
- **Reducing adviser clawbacks for taxes**
  - All private fund advisers would be prohibited from reducing the amount of any “clawback” by actual, potential or hypothetical taxes applicable to the adviser, its related persons, or their respective owners or interest holders.

# SEC Proposed Rule: Private Funds (continued)

## Prohibitions Applicable to all Private Fund Advisers (continued)

- **Limiting or eliminating liability or adviser misconduct**
  - All private fund advisers would be prohibited from, directly or indirectly, 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 a private fund.
- **Disclosures**
  - Disclosures to investors regarding the unique risks associated with digital assets
- **Pricing client portfolios**
  - Valuation methodologies used and disclosures related to valuation methodologies
- **Registration issues**
  - Compliance matters related to SEC registration

# SEC Proposed Rule: Private Funds (continued)

## Affirmative Obligations for SEC-Registered Private Fund Advisers

- **Distributions of quarterly statements**
  - SEC-registered private fund advisers would be required to distribute quarterly statements to private fund investors within 45 days after the end of each quarter.
- **Subjecting the private funds to mandatory audits**
  - SEC-registered private fund advisers would be required to obtain audited financial statements of the private funds they manage on an annual basis and upon the liquidation of a private fund.
- **Obligations related to adviser-led secondary transactions**
  - SEC-registered private fund advisers would be required to obtain a fairness opinion in connection with certain “adviser-led secondary transactions.”
- **Additional recordkeeping obligations and annual review**
  - SEC-registered private fund advisers would be required to retain books and records to the new obligations under the proposed rules and amendments.



# SEC Proposed Rule: Form PF

The SEC published new amendments to enhance private fund reporting on Form PF which focus on the following major changes (February 2022)

## Large Hedge Fund Advisers – Provide Notification of:

- Extraordinary investment losses
- Significant margin and default events
- Material change in relationship with prime broker
- Changes in unencumbered cash
- Operation events
- Withdrawals and redemptions
- Unable to satisfy redemptions or suspension of redemptions

## Large Private Equity Advisers

- Threshold changed from \$2 billion to \$1.5 billion in AUM
- Additional information required

## All Advisers of Private Equity Funds – Required to Report:

- Adviser-led secondary transactions
- General partner or limited partner clawback
- Removal of a general partner, termination of the investment period or termination of a fund

## Large Liquidity Fund Advisers

- Reporting changes

# SEC Proposed Rule: Cybersecurity

The SEC published new proposed rules to require registered investment advisers and funds to adopt and implement Cybersecurity policies and procedures, require investment advisers to report significant Cybersecurity incidents, amend registration forms related to the disclosure of significant Cybersecurity risks and incidents, and require new recordkeeping requirements (February 2022)

“Cybersecurity incident” is defined as: “an unauthorized occurrence on or conducted through [an adviser’s or a fund’s] information systems that jeopardizes the confidentiality, integrity, or availability of [an adviser’s or a fund’s] information systems or any [adviser or fund] information residing therein”

# SEC Proposed Rule: Cybersecurity (continued)

## Cybersecurity Risk Management Policies and Procedures

- Risk Assessment
- User Security and Access
- Information Protection
- Threat and Vulnerability Management
- Cybersecurity Incident Response and Recovery
- Annual Review and Required Written Reports
- Fund Board Oversight
- Recordkeeping

## Reporting of Significant Cybersecurity Incidents to the SEC

- Proposed Rule 204-6
- Form ADV-C

## Disclosure of Cybersecurity Risks and Incidents

- Cybersecurity Risks and Incidents Disclosure
- Requirement to Deliver Certain Interim Brochure Amendments to Existing Clients
- Proposed Amendments to Fund Registration Statements

# SEC Rule

# SEC Rule: Advertising Rule

The SEC adopted Rule 206(4)-1, the “Advertising Rule” which requires investment advisers to make several changes to their existing compliance and reporting programs (December 2020)

Transition period-18 months (effective November 4, 2022)

## Definition of “Advertisement”

- **The Advertising Rule definition of an advertisement includes two prongs:**
  - Any direct or indirect communication an investment adviser makes that either (1) offers the adviser’s investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the adviser (“private fund investors”) or (2) offers new investment advisory services with regard to securities to current clients or private fund investors.
  - Compensated testimonials and endorsements, including a similar scope of activity as traditional solicitations under the current Solicitation Rule.

# SEC Rule: Advertising Rule (continued)

## General Prohibitions of Certain Marketing Practices

### Testimonials and Endorsements

- Exemptions
  - Affiliated Personnel
  - De minimis compensation
  - Registered Broker-Dealers
  - Covered Persons

## Third-Party Ratings

### Performance Advertising

- Net Performance Requirement
- Prescribed Time Periods
- Statements About SEC Approval
- Related Performance
- Extracted Performance
- Hypothetical Performance
- Predecessor Performance

# SEC Rule: Advertising Rule (continued)

## Amendments to Form ADV

## Amendments to Recordkeeping Requirements

## Existing Staff No-Action Letters

- The SEC Division of Investment Management no-action letters related to the Advertising Rule and the Solicitation Rule have been withdrawn as the positions either are incorporated into the final Marketing Rule or will no longer apply (Mayer Brown Letter withdrawn)

# SEC Risk Alerts



# SEC Risk Alert: Private Fund Advisers

The SEC released a Risk Alert relating to certain compliance issues observed during examinations of registered investment advisers that manage private funds (January 2022)

## Conduct Inconsistent with Disclosures

- **Failure to obtain required informed consent from Limited Partner Advisory Committees, Advisory Boards, or Advisory Committees**
  - Failures to follow practices described in various agreements, documents, and disclosures
- **Failure to follow practices described in fund disclosures regarding the calculation of Post-Commitment Period fund-level management fees**
  - Failures to reduce the cost basis of investments when calculating management fees or using undefined terms with no policies and procedures reasonably designed to apply terms consistently
- **Failure to comply with LPA liquidation and fund extension terms**
  - Extending the terms of private equity funds without obtaining the required approvals or without complying with the relevant liquidation provisions

# SEC Risk Alert: Private Fund Advisers (continued)

- **Failure to invest in accordance with fund disclosures regarding investment strategy**
  - Instances of implementing an investment strategy that diverges materially from fund disclosures
- **Failures relating to recycling practices**
  - Failures to accurately describe the “recycling” practices utilized by the funds or material information from such disclosures omitted
- **Failure to follow fund disclosures regarding adviser personnel**
  - Private fund advisers not adhering to “key person” provisions set forth in the governing agreements of the funds

# SEC Risk Alert: Private Fund Advisers (continued)

## Disclosures Regarding Performance and Marketing (Advisers Act Rule 206(4)-8 and 204-2(a)(16))

- **Misleading material information about a track record**
  - Private fund advisers providing inaccurate or misleading disclosures about their track record
- **Inaccurate performance calculations**
  - Private fund advisers using inaccurate data when creating track records
- **Portability**
  - Failures to adequately support or omit material information about predecessor performance
- **Misleading statements regarding awards or other claims**
  - Private fund advisers making misleading statements regarding awards they received and failing to disclose the criteria for obtaining them

# SEC Risk Alert: Private Fund Advisers (continued)

## Due Diligence

- **Lack of reasonable investigation into underlying investments or funds**
  - Private fund advisers have failed to perform reasonable investigations of investments
  - Private fund advisors have failed to perform adequate due diligence on important service providers
- **Inadequate policies and procedures regarding investment due diligence**
  - Private fund advisers did not appear to maintain reasonably designed policies and procedures regarding due diligence of investments

## Hedge Clauses

- Provisions or statements have been misleading and violate the anti-fraud provisions of the Advisers Act
- Private fund advisers included potentially misleading hedge clauses in documents

# SEC Risk Alert: Investment Advisers' Fee Calculations

The SEC released a Risk Alert relating to certain fee calculation deficiencies found during investment adviser examinations (November 2021)

- **The SEC found the following deficiencies:**
  - Charging fees inaccurately
  - Failing to refund prepaid fees on terminated accounts
  - Providing false, misleading or otherwise omitting disclosures relating to fee practices
  - Missing or otherwise maintaining incomplete policies and procedures
  - Issuing inaccurate financial statements

# SEC Risk Alert: Investment Advisers' Fee Calculations (continued)

- The SEC notes the following examples of policies and practices that investment advisers should consider in order to mitigate deficiencies:
  - Adopt and implement written policies and procedures addressing advisory fee billing processes and validating fee calculations
  - Centralize the fee billing process and validate that the fees charged to clients are consistent with compliance procedures, advisory contracts, and disclosures
  - Ensure resources and tools established for reviewing fee calculations are utilized
  - Properly record all advisory expenses and fees assessed to and received from clients

# SEC Risk Alert: Principal Transactions & Cross Trades

The SEC released a Risk Alert highlighting observations from an examination initiative of registered investment advisers that engaged in cross trades, principal transactions (or both) involving fixed income securities (July 2021)

The SEC found that nearly two-thirds of the examined advisers were deficient in the following areas.

## Compliance Programs

- Were inconsistent with the advisers' practices
- Lacked certain considerations or guidance necessary to properly implement and were not effectively tested

# SEC Risk Alert: Principal Transactions & Cross Trades (continued)

## Conflicts of Interest

- Conflicts of interest associated with cross trades that were not identified and/or mitigated, disclosed, or otherwise addressed by the advisers' compliance programs

## Written Disclosures

- Omitted relevant information concerning cross trading activities in their Form ADVs
- Had no disclosures in their Form ADV Part 2As regarding the conflicts of interest associated with executing such trades
- Did not include disclosures in their Form ADV Part 2As, advisory agreements, and separate written communications to clients



# SEC Risk Alert: ESG Investing

The SEC released a Risk Alert highlighting observations from recent examinations of firms offering investment products and financial services that incorporate environmental, social, and governance (“ESG”) factors (April 2021)

## Areas of Focus for Examinations Addressing ESG Investing

- **Portfolio Management**
  - Policies, procedures, and practices related to ESG, including due diligence and proxy-voting policies
- **Performance Advertising and Marketing**
  - Regulatory filings, websites, client presentations, and other client /investor-facing documents such as marketing materials
- **Compliance programs**
  - Written policies and procedures, including implementation and oversight

# SEC Risk Alert: ESG Investing (continued)

## Observed Deficiencies and Weaknesses in Internal Firm Controls

- Portfolio-management practices that were inconsistent with disclosures about ESG approaches
- Controls that were inadequate to implement and monitor the ESG-related directives
- Inconsistencies between public ESG-related proxy-voting claims and internal proxy-voting policies and practices
- Unsubstantiated or otherwise potentially misleading claims regarding ESG investing and approaches
- Inadequate controls to ensure that ESG-related disclosures and marketing are consistent with a firm's practices
- Compliance programs that did not adequately address the relevant ESG issues
- Less effective compliance programs due to compliance personnel with limited knowledge of relevant ESG-related investment analyses or oversight over ESG-related disclosures and marketing decisions

# SEC Risk Alert: ESG Investing (continued)

## Observed Effective Practices

- Providing clear, precise disclosures that are tailored to the firms' specific approaches to ESG investing and align with the firms' actual practices
- Crafting policies and procedures to address ESG investing and cover key aspects of the firms' ESG practices
- Integrating compliance personnel into the firms' ESG-related processes and ensuring that compliance personnel are knowledgeable about the firms' ESG approaches and practices, which assists those personnel in review of ESG-related marketing materials and other client/investor facing documents

# SEC Risk Alert: Digital-Asset Securities

The SEC released a Risk Alert highlighting its continued focus on digital assets (April 2021)

**For Investment Advisers Managing Digital Asset Securities, the SEC Identified Six Areas of Risk**

## **Portfolio Management**

- Whether digital assets managed on behalf of clients are classified as securities

## **Books and Records**

- Whether advisers are making and keeping accurate books and records

## **Custody**

- Custody of digital assets, compliance with the Custody Rule, and issues including unauthorized transactions and safekeeping of digital assets

## **Disclosures**

- Disclosures to investors regarding the unique risks associated with digital assets including issues related to the technical, legal, market, and operational risks

## **Pricing Client Portfolios**

- Valuation methodologies used and disclosures related to valuation methodologies, advisory calculations, and the impact that the firm's valuation practices have on the fees charged

## **Registration Issues**

- Compliance matters related to SEC registration

# SEC Cases

# SEC Cases

- **SEC Imposes Monetary Penalty and Issues Cease-and-Desist Order in Connection with Private Equity Fund Adviser Fee and Expose Disclosure Failures (Global Infrastructure Management LLC)**
  - On December 20, 2021, the SEC issued an order in which it charged that an investment adviser failed to properly offset management fees and for making misleading statements about the fees and expenses it charged and to adopt and implement compliance policies and procedures
  - The SEC found that the adviser provided inconsistent statements about how it would calculate management fees
  - The SEC imposed a civil money penalty of \$4.5 million against the investment adviser and issued a cease-and-desist order
  - The settlement highlights the importance of having compliance procedures that are followed and the SEC's continued focus on fees

# SEC Cases (continued)

- **SEC Charges Registered Investment Adviser with Alleged Hedge Fund Clauses (Comprehensive Capital Management, Inc.)**
  - On January 11, 2022, the SEC charged a registered investment adviser with failure to divulge conflicts of interest
  - The SEC alleged that the investment adviser inserted a hedge clause and violated Section 206(2) of the Advisers Act
  - The investment adviser consented to a cease-and-desist order and a censure. It further agreed to a disgorgement of its fee of approximately \$75,000 plus a penalty of \$300,000
- **SEC Charges 12 Financial Firms for Failure to Meet Form CRS Obligations (February 15, 2022)**
  - Required to be delivered to retail clients

# Speakers

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