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SEC Chairman Gensler Seeking to Bring “More Sunshine and Competition” to Private Funds; Division of Examinations Issues Observations on Fee Calculations

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SEC Chairman Gensler Seeking to Bring “More Sunshine and Competition” to Private Funds

In a [recent speech](#) to the Institutional Limited Partners Association, SEC Chairman Gary Gensler expressed his desire to “bring more sunshine and competition to the private funds space.” Citing the growth of the private fund industry, and what he regards as systemic importance to the economy, he identified three policy principles through which he intends the SEC to view private funds during his tenure: (1) efficiency, competition and transparency; (2) market integrity; and (3) resiliency.

Efficiency, Competition and Transparency

- *Fees & Expenses:* Citing to estimates that fees and expenses cost private fund investors around \$250 billion yearly, Chairman Gensler related that he has asked the SEC Staff to look for ways to increase transparency into private fund fee arrangements. Beyond management fees and performance-based compensation, he referenced an interest in “other fees” borne by private fund investors and portfolio companies, including “consulting fees, advisory fees, monitoring fees, servicing fees, transaction fees, director’s fees and others.”
- *Side Letters:* Although he acknowledged that some side letters are benign, such as side letters relating to tax reporting, Chairman Gensler took issue with side letters that have preferred liquidity terms or differing disclosures for different groups of

investors. Chairman Gensler has asked the SEC Staff to consider how to level the playing field among investors and to strengthen transparency, as well as whether certain side letter provisions should be prohibited.

- *Performance Metrics:* Chairman Gensler noted his belief that basic facts about private fund performance are not as readily available as those about mutual funds. He has asked the SEC Staff to provide recommendations on how to enhance transparency of performance metrics.

Market Integrity

- *Fiduciary Duties and Conflicts of Interest:* Referencing similar concerns as raised by the SEC in a [2019 Commission Interpretation](#) (previously addressed in this [KirklandPEN](#)) Chairman Gensler expressed concern that some sponsors request that their limited partners waive fiduciary duties imposed by state laws (e.g., Delaware), and emphasized that Advisers Act federal fiduciary duties may not be waived. He has asked the SEC Staff for ways to better mitigate the effects of conflicts of interest between general partners, affiliates and investors, and although Chairman Gensler did not reference specific prohibitions on conflicts or practices, he described that the Staff could consider them.

Resiliency

- *Form PF:* Chairman Gensler expressed an intention to update Form PF to increase reporting and disclosure, specifically considering whether more granular or timelier information would be useful in times of market dysfunction. He described a process through which the SEC is working in conjunction with the CFTC, members of the Financial Stability Oversight Council, the Department of the Treasury and the Federal Reserve on potential rulemakings.

Each of Chairman Gensler's underlying principles shares a similar theme of increased regulation and transparency for private fund sponsors. As such, the speech is an important forecast of the SEC's private fund initiatives and priorities during his tenure.

Division of Examinations Issues Observations on Fee Calculations

On November 10, 2021, the SEC's Division of Examinations issued a [Risk Alert](#) setting forth notable compliance issues relating to registered investment advisers' fee calculations. Although generally focused on retail investment advisory relationships,

the Risk Alert highlights a number of useful topics for private fund sponsors, including accuracy of fee calculations, adequacy of fee disclosures and accuracy of financial statements. These observations follow on trends raised in the SEC's [2018 Risk Alert](#) describing advisory fee and expense compliance issues more generally, and private fund sponsor compliance personnel will benefit from reviewing both Risk Alerts, together with their accounting personnel as needed, to consider shoring up their practices in these areas.

Please contact the Kirkland regulatory attorneys with whom you regularly work if you have questions regarding any of the information above.

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Suggested Reading

- 19 April 2021 Kirkland AIM Risk Alert: SEC's Examination Division Issues ESG Risk Alert for Investment Advisers
- 19 April 2021 Kirkland AIM SEC's Examination Division Issues Priorities for 2021
- 29 January 2021 Kirkland AIM 2021 Private Fund Manager U.S. SEC/CFTC Filing Deadlines

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