

Increased disclosure for private equity and hedge fund managers ahead?

Private market insights

Takeaways of the new proposed disclosure requirements

On February 9, 2022, the Securities and Exchange Commission (SEC) voted 3-1 to pass a [proposal](#) that would increase the disclosure requirements for private equity and hedge fund managers. After a two-month public comment period, the SEC will hold a vote on the final version of the new requirements. These new requirements arise from numerous deficiencies that the SEC has identified from its examinations of private equity and hedge fund managers over the past several years. The deficiencies led the SEC to issue multiple "Risk Alerts" with the most recent one released to the public on January 27, 2022. In that publication, the SEC specifies the deficiencies – identified by its examiners – related to conduct inconsistent with disclosures as:

- Failure to obtain informed consent from Limited Partner Advisory Committees, Advisory Boards or Advisory Committees (collectively "LPACs") required under fund disclosures.
- Failure to follow practices described in fund disclosures regarding the calculation of Post-Commitment Period fund-level management fees.
- Failure to comply with Limited Partner Agreement (LPA) liquidation and fund extension terms.
- Failure to invest in accordance with fund disclosures regarding investment strategy.
- Failures relating to recycling practices.
- Failure to follow fund disclosures regarding adviser personnel.

Additionally, the SEC identified areas of focus for performance and marketing as:

- Misleading material information about a track record.
- Inaccurate performance calculations.
- Portability – failure to support adequately, or omissions of material information about, predecessor performance.
- Misleading statements regarding awards or other claims.

Finally, the SEC identified issues associated with fund managers' due diligence as:

- Lack of a reasonable investigation into underlying investments or funds.
- Inadequate policies and procedures regarding investment due diligence.

In addition to the deficiencies noted above, the SEC detailed a number of proposed new rules and amendments pertaining to:

- Quarterly disclosure of performance.
- Fees.
- Expenses.
- Audit requirements.
- Expense and reimbursement prohibitions.
- Requirements related to cyber-security.
- Documented reviews of compliance requirements.
- Limitations on side letters that create differentiated treatment around key terms.

In general, we view the proposed rules favorably, some more so than others. As this is still a work in progress we will refrain from expressing a definitive opinion until the proposals are finalized.

Private equity or hedge fund managers engaging in any of the behaviors listed above would and should certainly be of significant concern to investors. The information released to date from the SEC does not provide context as to how prevalent these observed negative behaviors are within their respective industries. In terms of the conduct inconsistent with disclosures, at Mercer we actively monitor a significant number of funds and we also serve on a meaningful number of LPACs in support of our clients' interests. As a matter of practice and experience, Mercer does not share the same deficiency concerns highlighted broadly across both the private equity and hedge fund industry. If we were to identify any of the described behaviors during our due diligence process prior to investment, we would discontinue our recommendation process. Witnessing those behaviors from a fund in an existing client portfolio would result in us strenuously objecting and immediately bringing the issue to the respective client's attention. As to the performance and marketing as well as fund managers' due diligence concerns, in our evaluation of fund managers, we perform extensive due diligence including reconciling calculations, independently calculating performance metrics and seeking to validate a fund's due diligence processes. While we apply these in-depth processes, Mercer would welcome improved transparency and disclosure in the name of investor interests.

As mentioned above, the information on the funds engaging in the inappropriate behaviors was minimal, which makes it difficult to draw firm conclusions. However, our experience suggests that the identified risks and concerns are more prevalent with weaker firms and with those that are less institutional in nature. Moreover, maintaining a good reputation is critical for both private equity and hedge fund managers, and any material misrepresentations can significantly jeopardize the ability to raise additional capital. In discussing the proposed requirements with some of our fund managers, several made the point that they were already Registered Investment Advisors (RIAs) and had successfully completed SEC audits and, as a result, were already in compliance with almost all of the proposed requirements. They also observed that funds that were not already RIAs might require more effort to achieve compliance. Mercer will continue to monitor the developments of these issues and will generate additional communications to our clients as warranted. As always, please let us know if we can provide any additional information for your specific portfolio circumstances.



William T. Charlton, Jr., Ph.D., CFA
Global Head of Private Markets Data Analytics and Research

Important notices

References to Mercer shall be construed to include Mercer LLC and/or its associated companies.

© 2022 Mercer LLC. All rights reserved.

This contains confidential and proprietary information of Mercer and is intended for the exclusive use of the parties to whom it was provided by Mercer.

This content may not be modified, sold or otherwise provided, in whole or in part, to any other person or entity without Mercer's prior written permission. Mercer does not provide tax or legal advice. You should contact your tax advisor, accountant and/or attorney before making any decisions with tax or legal implications.

This does not constitute an offer to purchase or sell any securities.

The findings, ratings and/or opinions expressed herein are the intellectual property of Mercer and are subject to change without notice. They are not intended to convey any guarantees as to the future performance of the investment products, asset classes or capital markets discussed.

For Mercer's conflict of interest disclosures, contact your Mercer representative or see <http://www.mercer.com/conflictsofinterest>.

This does not contain investment advice relating to your particular circumstances. No investment decision should be made based on this information without first obtaining appropriate professional advice and considering your circumstances. Mercer provides recommendations based on the particular client's circumstances, investment objectives and needs. As such, investment results will vary and actual results may differ materially.

Information contained herein may have been obtained from a range of third party sources. While the information is believed to be reliable, Mercer has not sought to verify it independently. As such, Mercer makes no representations or warranties as to the accuracy of the information presented and takes no responsibility or liability (including for indirect, consequential, or incidental damages) for any error, omission or inaccuracy in the data supplied by any third party.

Not all services mentioned are available in all jurisdictions. Please contact your Mercer representative for more information.

Certain regulated services in Europe are provided by Mercer Global Investments Europe Limited and Mercer Limited.

Mercer Global Investments Europe Limited and Mercer Limited are regulated by the Central Bank of Ireland under the European Union (Markets in Financial Instruments) Regulation 2017, as an investment firm. Registered officer: Charlotte House, Charlemont Street, Dublin 2, Ireland. Registered in Ireland No. 416688. Mercer Limited is authorized and regulated by the Financial Conduct Authority. Registered in England and Wales No. 984275. Registered Office: 1 Tower Place West, Tower Place, London EC3R 5BU.

Investment management services for Canadian investors are provided by Mercer Global Investments Canada Limited. Investment consulting services for Canadian investors are provided by Mercer (Canada) Limited.

Investment management and advisory services for U.S. clients are provided by Mercer Investments LLC (Mercer Investments). Mercer Investments LLC is registered to do business as "Mercer Investment Advisers LLC" in the following states: Arizona, California, Florida, Illinois, Kentucky, New Jersey, North Carolina, Oklahoma, Pennsylvania, Texas, and West Virginia; as "Mercer Investments LLC (Delaware)" in Georgia; as "Mercer Investments LLC of Delaware" in Louisiana; and "Mercer Investments LLC, a limited liability company of Delaware" in Oregon. Mercer Investments LLC is a federally registered investment adviser under the Investment Advisers Act of 1940, as amended. Registration as an investment adviser does not imply a certain level of skill or training. The oral and written communications of an adviser provide you with information about which you determine to hire or retain an adviser. Mercer Investments' Form ADV Part 2A & 2B can be obtained by written request directed to: Compliance Department, Mercer Investments 99 High Street, Boston, MA 02110.

March 2022