WEIL PRIVATE FUNDS REGULATORY REVIEW

In recent years, the Securities and Exchange Commission (the "**SEC**" or "**Commission**") has proposed and adopted, and continues to propose and adopt, various rules and changes to the regulatory landscape of private funds and their advisers. This alert discusses two such changes whose recent (and perhaps underreported) adoptions have significant implications for private funds and their advisers: (i) the adoption of certain notification requirements to the SEC on Form PF, including for GP-led secondary transactions; and (ii) amendments to Rule 206(4)-7 under the Investment Advisers Act of 1940, as amended (the "**Advisers Act**", and such rule, the "**Compliance Rule**").[1] To assist our clients, this alert sets forth the requirements imposed by both sets of amendments and discusses the consequences of their adoption.

This alert additionally highlights a recent victory for the SEC in a litigation enforcement action brought by the Commission related to "Shadow Trading" (as defined below) and discusses such decision's implications on investment advisers.

Further, this alert provides a summary of the SEC's recent settlement of charges against (i) five investment advisers for violating certain requirements of Rule 206(4)-1 (the "**Marketing Rule**") under the Advisers Act, including, among other things, publicly advertising hypothetical performance on their websites without adopting and/or implementing related policies and procedures required under the Marketing Rule[2] and (ii) an investment adviser and its principal for breaches of their respective fiduciary duties to investors.[3]

Finally, we summarize (i) a risk alert which the SEC issued on April 17, 2024 detailing general observations by SEC staff related to compliance by investment advisers with the Marketing Rule[4] and (ii) a joint notice of proposed rulemaking issued by the SEC and the US Department of the Treasury's Financial Crimes Enforcement Network ("**FinCEN**") on May 13, 2024 that would apply customer identification program ("**CIP**") obligations to certain investment advisers.[5]

1 A previous alert discussing the Form PF Amendments can be found here.

2 A press release related to the settlements can be found here. Links to the full SEC Orders for the five charged advisers can be found here, here, here, here and here.

3 A press release related to the settlement can be found here. A link to the full SEC Order can be found here.

4 The Risk Alert can be found here.

5 The proposing release can be found here and a related fact sheet can be found here.

SEC NOTIFICATION REQUIREMENTS FOR GP-LED SECONDARIES AND OTHER MATERIAL EVENTS

On December 11, 2023, significant amendments to Form PF (the "**Form PF Amendments**") became effective. Form PF is the confidential reporting form completed by private fund advisers for use by the SEC and the Financial Stability Oversight Council.[6] The Form PF Amendments currently affect private fund advisers in two key ways:

- All private equity fund advisers[7] are required to file quarterly reports with the SEC within 60 days of each fiscal quarter end regarding any (i) GP- or adviser-led secondary transactions, (ii) general partner removals or (iii) investor elections to terminate a fund or its investment period that occurred during the previous fiscal quarter;[8] and
- Large hedge fund advisers[9] are required to file current reports as soon as practicable following, but no later than 72 hours from the occurrence of, one or more trigger events that may indicate significant stress at a fund.

SEC staff recently stated that it frequently reviews Form PFs as part of its routine pre-examination evaluation of private fund advisers for risk identification and scoping. For example, in its recently published "Annual Staff Report Relating to the Use of Form PF Data",[10] the SEC staff noted that analyses of Form PF facilitate the identification of potential compliance risks and assist in prioritizing the use of exam and enforcement resources. The report also noted that Commission staff may use Form PF data to identify private fund advisers whose activities involve areas of specific examination focus or that may present heightened compliance risks. The report highlighted that Commission staff has developed automated analyses and risk metrics that summarize and combine Form PF data with Form ADV data about an adviser's private funds and advisory business.

Private fund advisers may expect that the new current report requirements on Form PF will bring heightened scrutiny to activities that are the subject of current or periodic Form PF reporting, including GP-led secondary transactions.

ANNUAL WRITTEN REVIEW RULE

On August 23, 2023, the SEC adopted new rules under the Advisers Act that significantly increased the regulation of private fund advisers (both registered and unregistered) (the "**Private Fund Adviser Rules**").[11] One of the lesser reported new requirements is already effective and requires **all advisers** registered with the SEC ("**RIAs**"), regardless of whether they advise private funds[12] or not, to document the annual review of their compliance policies and procedures ("**Annual Review**") **in writing** (the "**Written Review Rule**").

Under the Compliance Rule, RIAs are required to (i) adopt and implement written policies and procedures that are reasonably designed to prevent, detect and correct violations of the Advisers Act and (ii) review such policies and procedures at least annually for their adequacy and effectiveness. Specifically, Annual Reviews must consider any compliance matters that arose during the previous year, any changes in the RIA's or its affiliates' businesses and any changes in the Advisers Act or other applicable regulations that may necessitate revisions to the RIA's compliance policies and procedures.

Prior to the Private Fund Adviser Rules' adoption, the Compliance Rule did not expressly require RIAs to document their Annual Reviews in writing. The Commission stated that this new written requirement "**focuses attention on the importance of the annual compliance review process.**" Additionally, the SEC stated that it believes requiring written Annual Reviews will (i) help advisers better assess compliance matters and regulatory developments that arose during the previous year as well as changes in an RIA's or its affiliates' businesses and (ii) serve as a resource for the RIA's clients and investors to assess whether the adviser applies a structured framework and rigor to its compliance program.

Unlike other requirements under the Private Fund Adviser Rules, the Written Review Rule is **currently effective** (as of November 13, 2023) and will impact private fund advisers' upcoming Annual Reviews. Written Annual Reviews are meant to be made available to the SEC promptly upon request. Accordingly, private fund advisers should carefully consider the Written Review Rule's requirements and prepare for potential questions from SEC staff regarding Annual Reviews during examinations, especially in light

---

6 The full text of the Form PF Amendments' adopting release can be found here and a related fact sheet can be found here. Exempt reporting advisers ("**ERAs**") are not required to file Form PF as a result of the Form PF Amendments.

7 A private equity fund adviser is any adviser having at least $150 million in regulatory assets under management attributable to private equity funds.

8 Such reporting is not required for any quarters where such events did not occur.

9 A large hedge fund adviser is any adviser having at least $1.5 billion in regulatory assets under management attributable to hedge funds as of the end of any month in the prior fiscal quarter.

10 The SEC's full report can be found here.

11 The Private Fund Adviser Rules' adopting release can be found here. A related fact sheet and press release can be found here and here, respectively. A previous alert discussing the final rules can be found here.

12 A "private fund" is an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act of 1940, as amended, but for Section 3(c)(1) or 3(c)(7) of that Act.

of the SEC's heightened focus on private fund advisers. Additionally, RIAs should ensure Annual Reviews provide a comprehensive assessment of all compliance obligations, including those required under recently adopted rules (e.g., the Marketing Rule).

INSIDER TRADING DECISION

On April 5, 2024, a Federal jury found a biotech executive (the "**Defendant**") guilty of insider trading in connection with a litigation enforcement action brought by the SEC.[13] The Defendant, who served as the former head of business development for a publicly traded pharmaceutical company, Medivation, traded in the stock of Medivation's close competitor shortly after learning highly confidential information pertaining to Medivation's imminent acquisition by another large pharmaceutical company at a significant premium to its then-current share price.

The SEC's complaint[14] notes that the Defendant (i) learned of Medivation's acquisition through his employment, and (ii) knew or was reckless in not knowing that such information was (a) material and nonpublic and (b) material not only to Medivation but also to Medivation's competitor, the stock of which the Defendant traded in subsequent to learning of Medivation's acquisition. The SEC's complaint further notes that the Defendant's actions violated the duty of trust and confidence, including a duty to refrain from using Medivation's proprietary information for personal gain, owed by the Defendant to Medivation.

For this conduct, the Defendant was charged with, and found liable for, violations of Section 10(b) of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**") and Exchange Act Rule 10b-5.

This decision emphasizes the SEC's focus on the risk of individuals to leverage material nonpublic information ("**MNPI**") regarding one company to inform trading in another related company sharing the same industry or sector ("**Shadow Trading**") and serves as a template for similar, future litigation and examination by the Commission. In response to this decision, advisers should carefully review the requirements of Section 204A of the Adviser Act (requiring that advisers maintain and enforce written policies reasonably designed to prevent the misuse of MNPI by the adviser or any person associated with it) and consider whether enhancements to the adviser's compliance program and/or nondisclosure agreements or similar contracts are appropriate in light of this decision. Such considerations may include:

- Reviewing the specific risks Shadow Trading poses to the adviser and whether such risks are adequately addressed by the adviser's current insider trading and MNPI policies and procedures;
- Assessing whether the implementation of trading restrictions, surveillance or pre-clearance measures concerning companies sharing the same industry or sector as the adviser's portfolio investments are necessary; and
- Requiring additional training and attestations from employees related to insider trading and the handling of MNPI.

MARKETING RULE VIOLATIONS SETTLEMENTS

On April 12, 2024, the SEC announced that it had settled charges against five investment advisers for publicly advertising hypothetical performance on their websites without adopting and/or implementing policies and procedures reasonably designed to ensure that such performance was relevant to the likely financial situation and investment objectives of the advertisements' intended audiences, as required under the Marketing Rule.

One of the advisers was additionally charged with violations of other regulatory requirements, including (i) making false and misleading statements about its performance (a) in advertisements and (b) to a client, (ii) failing to present net performance information alongside gross performance, (iii) being unable to substantiate performance claims upon demand by the Commission, (iv) failing to enter into written agreements with persons giving compensated endorsements and (v) failing to maintain copies of (a) advertisements that appeared on its website and (b) books and records demonstrating the calculation of performance in its advertisements.

As part of their settlements, each of the advisers agreed to pay civil penalties ranging from $20,000 to $100,000.

These settlements are the second wave of cases brought by the SEC as part of its ongoing Marketing Rule sweep of investment advisers and underscore the Commission's continuing, intense focus on advisers' Marketing Rule compliance, including, particularly, requirements under the Rule concerning hypothetical performance.[15] In response to these settlements, advisers should carefully review their websites and other marketing materials for uses of hypothetical performance, and where such performance exists, ensure related, Marketing Rule-compliant policies and procedures have been adopted and/or implemented or otherwise remove such performance entirely.

---

13 A statement from the SEC regarding the verdict can be found here.

14 A copy of the SEC's original complaint, filed on August 17, 2021, can be found here.

15 A previous alert discussing the SEC's first wave of Marketing Rule cases the can be found here.

SEC RISK ALERT DETAILING OBSERVATIONS REGARDING MARKETING RULE COMPLIANCE

On April 17, 2024, the SEC's Division of Examinations issued a Risk Alert to provide information regarding investment advisers' compliance with the Marketing Rule.

Among its observations detailed in the Alert, the SEC staff noted that certain advisers adopted policies and procedures that were not "reasonably designed or implemented" to address compliance with the Marketing Rule. Such policies and procedures include, among others, those that consist "only of general descriptions and expectations" related to the Marketing Rule, and those that do not address applicable marketing channels utilized by the adviser (e.g., social media) or that are not otherwise tailored to address an adviser's specified advertisements.

The SEC staff also observed deficiencies related to the books and records maintenance and preservation requirements related to the Marketing Rule, such as where advisers did not maintain questionnaires or surveys that they completed in the preparation of third-party ratings, information posted to social media or documentation to support performance included in advertisements. The Commission also found that some advisers inaccurately reported on Form ADV that their advertisements did not include performance results, hypothetical performance or third-party ratings, even though their websites or social media posts touted that the firm was ranked in certain third-party ratings.

In addition, the SEC staff also noted that it observed advertisements that contained untrue statements of material fact or omissions of material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading. Examples include:

- Statements representing erroneous adviser personnel qualifications (e.g., education, experience, professional designations);
- References to certain investment mandates (such as ESG mandates) where the adviser used no such mandate;
- Statements that an adviser was different from others because it acted in the "best interest of clients" without disclosing that all investment advisers have a fiduciary duty to act in their clients' best interest;
- Statements that an adviser was "seen on" national media, implying appearances in national news media without disclosing that the "appearances" were compensated advertisements, or advertisements containing images of celebrities in a manner that erroneously implied the celebrities endorsed the firms;
- Advertisements containing net performance calculated using a lower fee than was offered to the intended audience of the advertisement;
- Advertisements containing third-party ratings (1) implying the adviser was the sole top recipient of an award when the award went to multiple recipients (or where the adviser was not the top recipient) or (2) indicating that the adviser was highly rated without disclosing that the methodology for such rating was based primarily on factors that were not related to the quality of investment advice, such as assets under management, number of clients or that adviser personnel nominated fellow employees for such award; and
- Statements containing performance information that did not also include disclosures to provide context to the presentations, such as performance during time periods when most investors would have experienced the advertised performance returns because of general market performance.

The SEC staff also highlighted advertisements that included statements about the potential benefits of the advisers' services that did not appear to provide fair and balanced treatment of any material risks or material limitations associated with the potential benefits, including social media posts that highlighted performance information without also disclosing the materials risks and limitations. In a similar vein, the Commission also observed advertisements that included only the most profitable investments, or otherwise specifically excluded certain investments, without providing sufficient context to evaluate the rationale for selection, and generally that advisers did not establish policies and procedures to ensure references to specific investment advice are shown in a fair and balanced manner.

In light of the above observations, advisers should review their policies and procedures related to the Marketing Rule and make modifications as appropriate.

SEC AND FINCEN ISSUE JOINT ADVISER CUSTOMER IDENTIFICATION PROGRAM PROPOSAL

On May 13, 2024, the SEC and FinCEN issued a joint notice of proposed rulemaking to apply CIP obligations to certain investment advisers (the "**Proposal**"). If adopted, the Proposal would require RIAs and ERAs to, among other things, implement a CIP that includes procedures for: (i) verifying the identity of each customer to the extent reasonable and practicable; and (ii) maintaining records of the information used to verify a customer's identity, including name, address and other identifying information. Under the Proposal, private fund advisers would be required to "collect the identifying information of the private fund and, in some cases, individuals with authority or control over such private fund, *but not that of those invested in such fund* [emphasis added]."

FIDUCIARY DUTY VIOLATIONS ENFORCEMENT ACTION

On May 14, 2024, the SEC announced that it had settled charges against an investment adviser and its principal ("**Principal**") for breaches of their respective fiduciary duties to the adviser's clients, including both separately managed accounts and a private fund.

Specifically, the adviser and Principal failed to disclose a conflict of interest to clients and fund investors related to payments that a third-party film production finance company made to Principal. The adviser and Principal then later materially misled their clients and investors regarding the nature of these payments and the associated conflicts of interest they posed.

Additionally, the SEC's order notes that the adviser and Principal satisfied a redemption request from one fund investor but did not satisfy several redemption requests submitted at the same time by other fund investors who were advisory clients of the adviser. By preferencing one investor's redemption request over other client redemption requests, the SEC believed that the adviser and Principal violated their fiduciary duties to the other clients.

The SEC's order cited the adviser's and Principal's actions as violations of the antifraud provisions of Sections 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. As part of their settlements, the adviser agreed to pay a civil penalty of $200,000, and Principal agreed to pay disgorgement of $531,787, prejudgment interest of $95,924 and a civil penalty of $150,000, totaling $777,711.

This settlement underscores the SEC's continuing, intense focus on advisers' adherence to duties of care and loyalty owed to clients, both issues which were featured on the Commission's 2024 list of examination priorities. In response to this settlement, advisers should carefully review all compensation that both they and their principals receive for potential conflicts of interest and ensure the details of such compensation and any related conflicts are adequately disclosed to investors

KEY TAKEAWAYS

Form PF Amendments

1. As a result of the Form PF Amendments, private equity fund advisers and hedge fund advisers are required to submit additional reporting regarding certain trigger events within shorter time periods.
2. The SEC utilizes Form PF for purposes of informing its pre-examination assessments of private fund advisers.
3. Private equity fund advisers and hedge fund advisers should ensure compliance with all reporting requirements under Form PF (including the Form PF Amendments) and be prepared for heightened scrutiny in areas that are the focus of new Form PF reporting, including GP-led secondary transactions.

Written Review Rule

1. The Written Review Rule may bring new, sustained focus by the SEC on advisers' Annual Reviews.
2. In light of the SEC's heightened focus on the private fund industry, RIAs should carefully consider their obligations under, and ensure all of their compliance policies and procedures are regularly reviewed and maintained in compliance with, the Compliance Rule.
3. The incorporation of recently adopted rules (e.g., the Marketing Rule) into Annual Reviews is critical.
4. The Written Review Rule is currently effective (as of November 13, 2023) and will impact RIAs' upcoming Annual Reviews.

Insider Trading Decision

1. A pharmaceutical executive was convicted of insider trading charges brought by the SEC in connection with the executive's misappropriation of MNPI regarding his own company's acquisition to inform trading in a competitor firm.
2. The conviction emphasizes the SEC's focus on Shadow Trading and highlights the potential for similar, future litigation and examination by the Commission.
3. In light of the SEC's focus on Shadow Trading, investment advisers should carefully review their current MNPI and insider trading policies and procedures and assess whether enhancements related to Shadow Trading are appropriate.

Marketing Rule Violations Settlements

1. The SEC settled charges with five investment advisers for Marketing Rule violations in connection with such advisers' advertising hypothetical performance on their websites without adopting and implementing related policies and procedures as required under the Rule.
2. The settlements are the second set of cases in the SEC's ongoing Marketing Rule sweep and reflect the Commission's continued, intense focus on advisers' Marketing Rule compliance.

3. In response to these settlements, advisers should carefully review their websites and other marketing materials for uses of hypothetical performance, and where such performance exists, ensure related, Marketing Rule-compliant policies and procedures have been adopted and/or implemented or that such performance is removed entirely.

SEC Risk Alert

1. The SEC issued a Risk Alert on April 17, 2024 to provide information regarding investment advisers' compliance with the Marketing Rule.
2. The SEC staff has observed various deficiencies related to the Marketing Rule, including that advisers did not have policies and procedures reasonably designed or implemented to address Marketing Rule compliance, that advisers were not retaining certain books and records related to advertisements required to be retained, that advisers were reporting inaccurate information about their advertisements on Form ADV, that advisers were making untrue statements of material fact or material omissions in their advertisements (including related to performance), and that advisers were not presenting a fair and balanced treatment of material risks and limitations or investment advice in a fair and balanced manner.
3. In light of this Risk Alert, advisers should reflect upon their own practices, policies and procedures and effectuate any appropriate modifications to promote compliance with the Marketing Rule.

Fiduciary Duty Violations Enforcement Action

1. The SEC settled charges against an investment adviser and its Principal for breaches of their fiduciary duties to the adviser's clients in connection with their (i) failure to disclose a conflict of interest to investors regarding payments made by a third-party film production finance company to Principal, (ii) misleading clients and investors regarding the nature of these payments and associated conflicts of interest and (iii) granting certain investor redemption requests but not others submitted at the same time.
2. The settlement underscores the SEC's continuing focus on issues related to advisers' duty of care and duty of loyalty obligations, both issues which were featured on the Commission's 2024 list of examination priorities.
3. In response to this settlement, advisers should carefully review all compensation that both they and their principals receive for potential conflicts of interest and ensure the details of such compensation and any related conflicts are adequately disclosed to investors.

Weil's Private Funds Group is available to help.
Please reach out to:

Christopher Mulligan
Partner
christopher.mulligan@weil.com
+1 202 682 7007

Christopher Scully
Partner
christopher.scully@weil.com
+1 202 682 7119

David Wohl
Partner
david.wohl@weil.com
+1 212 310 8933

John Bradshaw
Associate
john.bradshaw@weil.com
+1 212 310 8535

Stephen Filocoma
Associate
stephen.filocoma@weil.com
+1 212 310 8639