Davis Polk

Private Equity Regulatory Update - March 2022

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In this issue, we discuss, among other things, recent SEC proposals to enhance private fund investor protections and a recent enforcement action involving a private equity fund adviser.

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Rules and regulations

SEC proposes new rules and amendments to enhance private fund investor protections

Summary

In a February 9, 2022 release, (the Proposing Release), the Securities and Exchange Commission (SEC) proposed new rules and amendments under the Investment Advisers Act of 1940 (the Advisers Act) (the Proposal). The Proposal is designed to enhance the regulation of private fund advisers, increase investors' visibility into certain adviser practices, and address adviser practices that can potentially lead to investor harm. In addition to amending the books and records and compliance rules under the Advisers Act to facilitate the proposed amendments, the Proposal would require that registered private fund advisers:

– Provide investors with quarterly statements, intended to increase transparency regarding the full cost of investing in private funds and the performance of such funds;

- Obtain a financial statement audit by an independent public accountant for each private fund at least annually and upon liquidation, and “promptly” distribute such audited financial statements to investors; and
- Obtain and distribute to investors a fairness opinion from an independent opinion provider in connection with certain adviser-led secondary transactions where such adviser (x) offers fund investors the option to sell their interests in the private fund or (y) to exchange them for new interests in another vehicle advised by the adviser.

The Proposal would also prohibit private fund advisers, including unregistered advisers, from:

- Providing (x) preferential terms to certain investors regarding redemptions or information about portfolio holdings or exposures (e.g. through side letters) or (y) any other preferential term that the adviser does not disclose in writing to current and prospective investors; and
- Engaging in certain activities and practices that are “contrary to the public interest and the protection of investors”, which include (A) charging certain fees and expenses, including fees for unperformed services and fees associated with an examination or investigation of the adviser, (B) reducing the amount of any adviser clawback by the amount of certain taxes, (C) seeking reimbursement, indemnification, exculpation or limitation of liability by the private fund or its investors for certain bases of liability, and (D) borrowing fund assets or receiving an extension of credit from private fund clients.

According to the Proposing Release, the Proposal responds to SEC concerns that advisers are not providing investors with clear, comparable information regarding certain fees and expenses, preferred terms and fund performance calculation methodologies. It is aimed at minimizing what the Proposing Release describes as “an information imbalance between advisers and private fund investors…[which] serves only the adviser’s interest and leaves many investors without the tools they need to effectively protect their interests, whether through negotiations or otherwise.” By doing so, the Proposal addresses the SEC’s broader policy goals of limiting conflicts of interest between advisers and private funds, increasing transparency and helping investors make informed investment decisions.

The SEC has requested public comments on the proposal, to be received by the SEC on or before April 11, 2022.

Key takeaways

The proposals contained in the Proposing Release are discussed in greater detail below. Some key takeaways of the Proposal include:

- Rules requiring *registered private fund advisers* to (i) obtain and “promptly” distribute to investors annual, audited financial statements prepared by independent public accountants; (ii) obtain and disclose to investors a fairness opinion from an independent opinion provider in connection with certain adviser-led secondary transactions; and (iii) provide investors with quarterly statements that disclose detail on fund fees, expenses, and performance.
- Rules prohibiting *all advisers of private funds* from (i) charging certain fees and expenses to private funds or their portfolio investments; (ii) seeking reimbursement, indemnification, exculpation or limitation of liability for certain activities; (iii) reducing the amount of any adviser clawback by the amount of certain taxes; (iv) borrowing fund assets or receiving an extension of credit from private fund clients; and (v) giving preferential terms to certain investors.
- An amendment of the books and records rule under the Advisers Act, requiring advisers to retain records related to the proposed rules.
- An amendment of the compliance rule under the Advisers Act such that all SEC-registered investment advisers would be required to document their annual review in *writing*. The SEC did not prescribe any elements regarding what must be a part of the written review and intends for advisers to have flexibility with respect to how they satisfy this requirement.

If the Proposal is adopted, it would have a significant impact on the disclosure and compliance obligations of private fund advisers.

Background

The Proposing Release describes the growing influence of private funds and their advisers, noting that there are now 5,037 registered private fund advisers holding over $18 trillion in private fund assets under management. It outlines the view of SEC Staff that many advisers have conflicted affiliate relationships with the private funds that they manage and withhold from investors important details regarding private fund investments, including certain preferential term arrangements, performance calculation methodologies and the magnitude and scope of management fees, performance-based compensation, fund expenses and other ongoing fee streams (e.g. consulting fees, monitoring fees, servicing fees, transaction fees and director's fees). According to the Proposing Release, despite the SEC's examination and enforcement efforts since Dodd-Frank established a federal regulatory regime for private funds and their advisers, this "information imbalance" between private fund advisers and investors has persisted, prompting the proposed reforms. The Proposing Release adds that conflicts of interest are widespread in the private fund context. In the SEC's view, advisers are often able to influence or control portfolio companies without adequate oversight from fund-level governance mechanisms. For example, limited partner advisory committees (LPACs) or boards of directors may lack the necessary independence, authority or accountability to oversee and consent to these conflicts or other harmful practices. To the extent investors are afforded governance or similar rights, potential conflicts may arise between them when advisers grant preferential terms to certain investors (e.g. seed investors, strategic investors, those with large commitments, and employees, friends and family) that are not attainable for smaller institutional or individual investors.

In light of these regulatory challenges, as further described below, the SEC is proposing a series of rules and amendments under the Advisers Act designed to increase visibility into certain practices that may lead to investor harm and prohibit adviser activity that it believes is contrary to the public interest and the protection of investors.

Proposed rules and amendments under the Advisers Act

Quarterly statements

Under the proposed rule, an investment adviser that is registered or required to be registered with the SEC would need to (i) prepare a quarterly statement that includes certain information regarding fees, expenses and performance, on a consolidated basis for substantially similar pools of assets, for any private fund that it advises and (ii) circulate the statement to all investors within 45 days after each calendar quarter end (or, for newly formed private funds, after its second full calendar quarter of generating operating results). The SEC notes in the Proposing Release that it has observed "problematic compensation schemes and sales practices" in recent examinations of private fund advisers, including expenses charged to private funds contrary to their fund documents and shared expenses improperly allocated between private fund clients and advisers' accounts (e.g. broken-deal, due diligence and consultant expenses). Intended to improve the quality of information disclosed to investors in private fund, quarterly financial statements prepared under the Proposal would need to cover:

- Fees and expenses: Advisers would need to disclose the following information in a table format:
  - A detailed accounting of all compensation, fees, and other amounts allocated or paid to the adviser or any of its related persons by the private fund during the reporting period, with separate line items for each category of allocation or payment reflecting the total dollar amount (e.g. management, advisory, sub-advisory, or similar fees or payments, and performance-based compensation).
    - The proposed rule would define "related persons" as including: (i) all officers, partners or directors (or any person performing similar functions) of the adviser; (ii) all persons directly or indirectly controlling or controlled by the adviser; (iii) all current employees (other than employees performing only clerical, administrative, support or similar functions) of the adviser; and (iv) any person under "common control" with the adviser. This definition is designed to capture the multiple affiliated but separate legal entities through which many advisers provide advisory services to, and receive compensation from, private fund clients.
    - The proposed rule would define "control" as the power, directly or indirectly, to direct the management of policies of a person, whether through ownership of securities, by contract, or otherwise.
  - A detailed accounting of all fund fees and expenses paid by the private fund during the reporting period, other than those disclosed as adviser compensation, with separate line items for each category of fee or expense reflecting the total dollar amount (e.g. organizational, accounting, legal, administration, audit, tax, due diligence, and travel expenses).
    - For example, if a private fund paid insurance premiums, administrator expenses and audit fees during the reporting period, a general reference to "fund expenses" on the quarterly statement would not be sufficient. An adviser would need to list each specific category of expenses as a separate line item (e.g. insurance premiums, administrative expenses and audit fees) and the corresponding dollar amount.
    - If a fund expense could also be characterized as adviser compensation under the proposed rule, the proposed rule would require advisers to disclose such payment or allocation as adviser compensation and not as a fund expense in the quarterly statement.

  - The amount of any offsets or rebates carried forward during the reporting period to subsequent quarterly periods to reduce future payments or allocations to the adviser or its related persons.

- Portfolio investment-level disclosure: Advisers would need to disclose the following information in a table format:

  - A detailed accounting of all portfolio investment compensation allocated or paid by each "covered portfolio investment" during the reporting period, with separate line items for each category of allocation of payment reflecting the total dollar amount, including origination, management, consulting, monitoring, servicing, transaction, administrative, advisory, closing, disposition, directors, trustees or similar fees or payments by the covered portfolio investment to the investment adviser or any of its related persons.

    - The proposed rule would define "portfolio investment" as any entity or issuer in which the private fund has invested directly or indirectly, which would capture any entity or issuer in which the private fund holds an investment (e.g. through holding companies, subsidiaries, acquisition vehicles and special purpose vehicles).

    - Advisers would only be required to disclose information regarding "covered portfolio investments", which the Proposing Release defines as "portfolio investments that allocated or paid the investment adviser or its related persons portfolio investment compensation during the reporting period."

  - The private fund's ownership percentage of each such "covered portfolio investment" as of the end of the reporting period.

- Calculations and cross references to organizational and offering documents: Advisers would need to provide prominent disclosure regarding the manner in which expenses, payments, allocations, rebates, waivers, and offsets are calculated, as well as cross-references to the relevant sections of the private fund's organizational and offering documents that set forth the calculation methodology.

  - The proposed rule would require advisers to describe, for example, the structure of, and the method used to determine, any performance-based compensation set forth in the statement (e.g. the distribution waterfall, if applicable) and the criteria on which each type of compensation is based (e.g. whether compensation is fixed, performance-based or based on the value of the fund's assets).

- Performance disclosure: Advisers would need to include standardized performance in each quarterly statement provided to fund investors. The adviser would need to display the different categories of required performance information with equal prominence and include within the quarterly statement prominent disclosures of the criteria used and assumptions made in calculating the fund's performance. The SEC has proposed a different approach for liquid and illiquid funds:

Illiquid funds

- An adviser to an illiquid fund would need to show performance based on (i) the gross internal rate of return and gross multiple of invested capital for the illiquid fund, (ii) net internal rate of return and net multiple of invested capital for the illiquid fund and (iii) gross internal rate of return and gross multiple of invested capital for the realized and unrealized portions (shown separately) of the illiquid fund's portfolio, in each case since such illiquid fund's inception and computed without the impact of any fund-level subscription facilities (as defined below).

  - The proposed rule would define an "illiquid fund" as a private fund that: (i) has a limited life; (ii) does not continuously raise capital; (iii) is not required to redeem interests upon an investor's request; (iv) has a predominant operating strategy the return of the proceeds from disposition of investments to investors; (v) has limited opportunities, if any for investors to withdraw before termination of the fund; and (vi) does not routinely acquire (directly or indirectly) as part of its investment strategy market-traded securities and derivative instruments. This would include many private equity, real estate and venture capital funds that are closed-ended and do not offer periodic redemption options, other than in exceptional circumstances.

  - The proposed rule would define "fund-level subscription facilities" as any subscription facilities, subscription line financing, capital call facilities, capital commitment facilities, bridge lines or other indebtedness incurred by the private fund that is secured by the unfunded capital commitments of the private fund's investors. As it applies to the proposed rule, the phrase "computed without the impact of fund-level subscription facilities" would require advisers to calculate performance measures as if the private fund called capital, as opposed to drawing on fund-level subscription facilities, and to exclude fees and expenses associated with the subscription facility, such as the interest expense, when calculating net performance figures and preparing the statement of contribution and distributions outlined below.

    - The SEC expressed its view that subscription facilities have the potential to increase performance metrics artificially.

  - The proposed rule would define "internal rate of return" as the discount rate that causes the net present value of all cash flows throughout the life of the private fund to be equal to zero. Cash flows would be represented by capital contributions and fund distributions, and the unrealized value of the fund would be represented by a fund distribution.
  - The proposed rule would define "multiple of invested capital" as (i) the sum of: (A) the unrealized value of the illiquid fund; and (B) the value of all distributions made by the illiquid fund; (ii) divided by the total capital contributed to the illiquid fund by its investors. This is intended to provide investors with a measure of the fund's aggregate value relative to the capital invested as of the end of the applicable reporting period.

- An adviser to an illiquid fund would also need to provide investors with a statement of contributions and distributions for the illiquid fund, which would present (without the impact of any fund-level subscription facilities):
  - (i) All capital inflows the private fund has received from investors and all capital outflows the private fund has distributed to investors since the private fund's inception, with the value and date of each inflow and outflow; and
  - (ii) The net asset value of the private fund as of the end of the reporting period covered by the quarterly statement.

Liquid funds

- An adviser to a liquid fund would need to show performance: (i) first, based on net total return on an annual basis since the fund's inception; (ii) second, based on its average annual net returns over the one-, five- and ten-calendar year periods; and (iii) third, based on the fund's cumulative net total return for the current calendar year as of the end of the most recent calendar quarter covered by the quarterly statement.
  - The proposed rule would define a "liquid fund" as any private fund that is not an illiquid fund (e.g. hedge funds that allow periodic investor redemptions).

Mandatory private fund adviser audits

The proposed audit rule would require registered advisers to private funds (including sub-advisers) to cause the private funds to undergo an audit by an independent public accountant at least annually and upon liquidation. In the Proposing Release, the SEC stated that audits would test assertions associated with the investment portfolio and provide a check against adviser misrepresentations of performance, fees and other information about the fund. Under the proposed rule:

- The audit must be performed by an independent public accountant that meets the standards of independence in rule 2-01(b) and (c) of Regulation S-X that is registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the Public Company Accounting Oversight Board (PCAOB) in accordance with its rules;
- The audit must meet the audit definition in rule 1-02(d) of Regulation S-X, the professional engagement period of which shall begin and end as indicated in Regulation S-X rule 2-01(f)(5);
- Audited financial statements must be prepared in accordance with U.S. Generally Accepted Accounting Principles (U.S. GAAP) or, in the case of financial statements of private funds organized under non-U.S. law or that have a general partner or other manager with a principal place of business outside the United States, must contain information substantially similar to statements prepared in accordance with U.S. GAAP and material differences with U.S. GAAP must be reconciled;
- "Promptly" after completion of the audit, the private fund's audited financial statements, which include any reconciliation to U.S. GAAP prepared for a foreign private fund, must be distributed to all investors; and
  - The SEC did not provide a specific definition of "promptly" for these purposes.

- The auditor must electronically notify the SEC's Division of Examinations (i) promptly upon issuing an audit report to the private fund that contains a modified opinion and (ii) within four business days of resignation or dismissal from, or other termination of, the engagement, or upon removing itself or being removed from consideration for being reappointed.

Adviser-led secondaries

Intended to prevent conflicts of interest between the adviser and private fund investors, the Proposal would require registered private fund advisers to obtain a written fairness opinion from an independent opinion provider in connection with certain adviser-led secondary transactions. Advisers would also need to prepare a summary of any material business relationships the adviser or any of its related persons has, or has had within the past two years, with the independent opinion provider. Whether a business relationship would be "material" would depend on the facts and circumstances. Prior to the closing of the transaction, the adviser would need to distribute the fairness opinion and summary to all investors in the private fund.

- The proposed rule would define "adviser-led secondaries" as transactions initiated by the investment adviser or any of its related persons that offer the private fund's investors the choice to: (i) sell all or a portion of their interests in the private fund; or (ii) convert or exchange all or a portion of their interests in the private fund for interests in another vehicle advised by the adviser or any of its related persons. Whether a transaction is "initiated by the adviser" would depend on the facts and circumstances, but the SEC notes that a transaction would generally qualify as such if the adviser commences a process, or causes one or more other persons to commence a process, that is designed to offer private fund investors the option to obtain liquidity for their private fund interests.
  - According to the Proposing Release, the SEC would not view a transaction as being initiated by an adviser if the adviser, at the unsolicited request of an investor, assists in a secondary sale of such investor's interest in a fund.
- The proposed rule would define an "independent opinion provider" as one that (i) provides fairness opinions in the ordinary course of its business and (ii) is not a related person of the adviser.

Prohibited activities

This proposal would prohibit private fund advisers from engaging in certain sales practices, conflicts of interest and compensation schemes that are "contrary to the public interest and the protection of investors". The Proposing Release states the SEC's belief that these activities may result in fraud and investor harm by incentivizing advisers to place their interests ahead of their clients'.

Regardless of whether such activities are permitted by the private fund's governing documents, disclosed to investors by the adviser or consented to by private fund investors, the proposed rule would prohibit all private fund advisers (including exempt advisers) from:

1. Charging certain fees and expenses to a portfolio investment, including monitoring fees or certain other fees, in respect of any services the investment adviser does not, or does not reasonably expect to, provide to the portfolio investment. The SEC intends to prevent private fund advisers from being "unjustly enriched"; that is, from charging portfolio companies certain fees through monitoring or management services agreements containing acceleration clauses, which require the portfolio company to pay the adviser these unpaid fees upon the occurrence of certain triggering events, even though the adviser will never provide the contracted-for services. Advisers, the Proposing Release explains, receive the benefit of the accelerated fees, which reduce the portfolio investment's available cash, without incurring the costs associated with performing the contracted-for services. The proposed rule would not prohibit an adviser from receiving payments in advance for services that it reasonably expects to provide to the portfolio investment in the future;

2. Charging a private fund for (i) fees or expenses associated with an examination or investigation of the adviser or its related persons by governmental or regulatory authorities or (ii) regulatory or compliance expenses or fees of the adviser or its related persons, even where such fees and expenses are otherwise disclosed. This would include, for example, the adviser's SEC registration fees and the fees and expenses related to preparing and filing all items and schedules in its Form ADV;

3. Charging certain 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;

4. Reducing the amount of any adviser clawback by the amount of actual, potential or hypothetical taxes applicable to the adviser, its related persons, or their respective owners or interest holders. The Proposing Release notes that the interest of investors to receive their share of fund profits justifies any burden on the adviser or its owners to amend tax returns from prior years or use loss carryforwards for future tax years;

- The proposed rule would define "adviser clawback" as any obligation of the adviser, its related persons, or their respective owners or interest holders to restore or otherwise return performance-based compensation to the private fund pursuant to the private fund's governing agreements. It would define "performance-based compensation" as any "allocations, payments or distributions of capital based on the private fund's (or its portfolio investments') capital gains and/or capital appreciation."

5. Seeking reimbursement, indemnification, exculpation, or limitation of its liability by the private fund or its investors, directly or indirectly, for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to the private fund; and

6. Borrowing money, securities, or other fund assets, or receiving an extension of credit, from a private fund client.

Preferential treatment / side letters

Private fund advisers would not be permitted to provide preferential terms to certain investors regarding redemptions or information about portfolio holdings or exposures (e.g. through side letters); this provision would also apply with respect to investors in a "substantially similar pool of assets". Private fund advisers would also be prohibited from providing other preferential terms unless the adviser disclosed such terms in writing to current and prospective investors. Whether any terms are "preferential" would depend on the facts and circumstances. However, the proposed rules would be tailored to address:

- Prohibited preferential redemptions: Private fund advisers and their related persons would be prohibited from granting an investor in the private fund or in a substantially similar pool of assets the ability to redeem its interest on terms that the adviser reasonably expects to have a material, negative effect on other investors in that private fund or in a substantially similar pool of assets (e.g. certain preferential redemption rights and liquidity terms for parallel vehicles).
- Prohibited preferential transparency: Private fund advisers and their related persons would be prohibited from providing information regarding the portfolio holdings or exposures of the private fund or of a substantially similar pool of assets to any investor if the adviser reasonably expects that providing the information would have a material, negative effect on other investors in that private fund or in a substantially similar pool of assets.
- Substantially similar pool of assets: The proposed rule would define the term "substantially similar pool of assets" as a pooled investment (other than an investment company registered under the Investment Company Act of 1940 or a company that elects to be regulated as such) with substantially similar investment policies, objectives or strategies to those of the private fund managed by the adviser or its related persons. Whether a pool of assets managed by the adviser is "substantially similar" to the private fund would be determined based on individual facts and circumstances. According to the Proposing Release, the types of asset pools captured by this term would include limited liability companies, partnerships and other organizational structures, regardless of number of investors; feeders to the same master fund; and parallel fund structures and alternative investment vehicles. The Proposing Release notes, for example, that a pool of assets with a materially different target return or sector focus would likely not have substantially similar investment policies, objectives or strategies as the subject private fund, depending on the facts and circumstances.
- Other preferential treatment: Private fund advisers and their related persons would be prohibited from providing other preferential terms (e.g. certain excuse rights) unless the adviser provides certain written disclosures to prospective and current investors. The Proposing Release noted that the adviser would need to describe specifically the preferential treatment to convey its relevance. For example, where an adviser gives certain investors preferential fee terms, it would need to disclose to other investors the applicable rate -not merely that certain investors pay a lower fee. An adviser could comply with the proposed disclosure requirements by providing copies of side letters (redacting identifying information) or a written summary of the preferential terms specifically describing the preferential treatment. For a prospective investor, the notice would need to be provided, in writing, prior to the investor's investment. For an existing investor, the adviser would need to distribute the written notice annually to all private fund investors if any preferential treatment has been provided to an investor since the last notice.

Books and records

The proposal would amend rule 204-2 (the books and records rule) under the Advisers Act to require advisers to retain records related to the proposed rules. The proposed rule would require private fund advisers to:

- Retain a copy of any quarterly statement distributed to fund investors pursuant to the proposed quarterly statement rule, as well as a record of each addressee, the date(s) the statement was sent, address(es), and delivery method(s).
- Retain all records evidencing the calculation method for all expenses, payments, allocations, rebates, offsets, waivers and performance listed on any quarterly statement delivered pursuant to the proposed quarterly statement rule.
- Retain documentation substantiating the adviser's determination that the private fund it manages is a liquid fund or an illiquid fund pursuant to the proposed quarterly statement rule.

- Retain a copy of any audited financial statements, along with a record of each addressee and the corresponding date(s) sent, address(es) and delivery method(s) for each such addressee. The adviser would also be required to keep a record documenting steps taken by the adviser to cause a private fund client with which it is not in a control relationship to undergo a financial statement audit that would comply with the mandatory audit rule.
- Retain copies of the fairness opinion and material business relationship summary distributed to investors, as well as a record of each addressee, the date(s) sent, address(es), and delivery method(s).
- Retain all written notices sent to current and prospective investors in a private fund pursuant to the proposed preferential treatment rule. In addition, advisers would need to retain copies of a record of each addressee and the corresponding dates sent, addresses and delivery method for each addressee.

Transition period

The SEC proposed a one-year transition period from the date of publication of any final rule in the Federal Register to provide time for advisers to prepare for compliance with the new and amended rules.

SEC outlines new cybersecurity disclosure mandates

On March 9, the SEC proposed cybersecurity disclosure mandates for public companies designed to provide “consistent, comparable, and decision-useful” information to investors. For purposes of the proposal, public companies include issuers that are business development companies as defined in section 2(a)(48) of the Investment Company Act of 1940 (Investment Company Act), but not registered investment companies. The proposal would require disclosures regarding cybersecurity risk management and material cybersecurity incidents in filings on Forms 8-K, 6-K, 10-Q, 10-K and 20-F, and is likely to spur additional compliance costs and enforcement risks as the SEC steps up its policing of public company cybersecurity management and reporting. The proposal is open for public comment through May 9. For further information, please see Davis Polk’s client update on this topic.

Industry update

Remarks at the IAA Investment Adviser Compliance Conference

On March 3, 2022, the Director of the Division of Investment Management, William Birdthistle addressed the IAA Investment Adviser Compliance Conference to share his thoughts about “the tests posed by modern markets for the millions of Americans who face the task of navigating them.”

Director Birdthistle discussed fracture and chaos in today’s financial industries, noting examples of fracture such as the disintegration of large pension plans, and the splintering of financial services tasks to distinct service providers, rather than being provided by the investment adviser. He noted that “if these service providers are not registered with the SEC, then their performance of critical responsibilities for advisers may constitute an unwelcome disintegration of important protections that could result in harm to investors.”

Director Birdthistle shifted to note that laws and regulations may be effective to ensure that “a coherent and orderly market endures for American investors” given the presence of fracture and chaos in the market. He noted recent rule proposals intended to decrease information gaps and enhance investor protections by, for example, prohibiting certain practices by private fund advisers, and requiring investment advisers and registered funds to adopt cybersecurity polices. He noted in particular his interest in bringing order to the “new frontier” of crypto assets and expanding use of digital technology: “For investment advisers, I am cognizant of questions about how providing advice regarding crypto assets impacts compliance with the [Advisers] Act, particularly aspects of the custody rule.”

Director Birdthistle concluded by noting the long-lasting ramification of our choices and decisions, stating that “decency and humanity have very long memories. And that the contingency of our investments today can ensure harmony and order in our country for many years to come.”

Litigation

SEC settles administrative charges with former Abraaj Head of Global Fundraising

On March 2, 2022, the SEC issued an order (Bourgeois Order or the Order) instituting and settling cease-and-desist proceedings against Mark Bourgeois (Bourgeois), who previously served as a managing partner and head of global fundraising for the Abraaj Group.

Prior to July 2018, Bourgeois served as a managing partner of the Abraaj Group, and was responsible globally for fundraising and investor relations. He also served as CEO of Abraaj's United States subsidiary, and as a member of Abraaj's "Management Executive Committee." The SEC alleges that in 2017, Bourgeois began leading an effort to raise funds for a new $6 billion global emerging markets private equity fund, and that Bourgeois's bonus compensation was directly tied to success in raising commitments for the fund. By the fall of 2017, the fund had secured approximately $3 billion in investor commitments; Bourgeois was allegedly paid a "nearly $2 million bonus" in January 2018 for his efforts. Bourgeois allegedly continued leading fundraising efforts through the first quarter of 2018.

According to the Bourgeois Order, potential investors in the fund were offered an inflated performance track record for Abraaj's existing funds. More specifically, from 2017 through the beginning of 2018, investment personnel allegedly stated that certain write-downs were needed for a number of portfolio companies in other Abraaj-managed funds. Those write-downs were not made, allegedly inflating those funds' performance. The SEC alleges that while Bourgeois was not responsible for determining whether the write-downs would be made, he was aware of the suggested write-downs and recommended that the write-downs not be applied (or be delayed) to avoid negative impact on fundraising efforts.

In February and March 2018, after allegations of fraud and mismanagement at Abraaj were publicized, one of Abraaj's largest United States investors allegedly asked Bourgeois that Abraaj release investors from their commitments in the funds. Bourgeois urged Arif Naqvi, Abraaj's founder, largest owner, and "control person" to acquiesce to these requests, and by early March 2018 Abraaj released investors from their commitments.

On account of the conduct described above, the SEC alleges that Bourgeois violated Section 17(a)(2) of the Securities Act, and aided and abetted Abraaj's violations of Sections 17(a)(1) and (3) of the Securities Act, Section 206(4) of the Advisers Act, and Rule 206(4)-(8) thereunder.

The Bourgeois Order notes that the SEC considered Bourgeois' cooperation with the SEC's investigation in determining to reach the resolution described in the Order, and declined to impose a civil money penalty on account of his cooperation. Bourgeois agreed to cooperate with the Commission in any other investigations or proceedings relating to Abraaj, including the SEC's suit against Abraaj and Naqvi pending in the U.S. District Court for the Southern District of New York, and to be barred from the securities industry subject to a right to reapply after three years. Bourgeois also agreed to pay approximately $2 million in disgorgement, which will be deemed satisfied by Bourgeois forfeiting the same amount to "another government agency."