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Smaller GPs to feel the pinch as SEC overhauls private fund rules

Increased costs may hurt smaller managers, forcing consolidation and reduced competition

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Start-up and smaller GPs could be disproportionately impacted by new SEC rules designed to provide greater transparency to investors in private funds.

Private fund advisers will now have to provide investors with quarterly statements detailing fund performance, fees, and expenses, an annual audit for each fund, and a fairness and valuation opinion when engaging in a secondary transaction.

GPs will also not be able to offer preferential terms to investors with respect to redemptions, unless required by law, or if it offers redemption rights to all other investors without qualification.

However, the SEC did not go ahead with a proposal that would have banned side letters outright.

Industry bodies are concerned that the cost and re-allocation of resources for compliance efforts will hurt smaller managers if they don't have the ability or the capital to do so, which would lead to consolidation and reduced competition.

"We have expressed serious concerns that the unnecessary proposal would reduce competition, limit choices for investors, and reduce returns for retirees across America," said Drew Maloney, president and CEO of the American Investment Council.

The Managed Funds Association, which represents the wider alternative asset management industry echoed the sentiment, saying it won't rule out potential litigation against the SEC.

"MFA continues to have concerns that the final rule will increase costs, undermine competition, and reduce investment opportunities for pensions, foundations, and endowments," said CEO Bryan Corbett.

"MFA will assess the final rule and work with our members to determine the appropriate next steps to protect the interests of alternative asset managers and their investors, including potential litigation."

The SEC voted 3-2 to pass the rules, with Republican commissioners Hester Peirce and Mark Uyeda voting against.

Speaking during the vote, Peirce said that the rule would harm private markets “in the name of fostering competition while squelching it.”

“Large incumbent advisors will figure out how to comply, but newer smaller advisors will struggle to enter the industry and compete with incumbents,” she said.

“The general suspicion cast on advisors trying to attract assets will deter small and new advisers from gaining traction.”

SEC Chair Gary Gensler maintained that the regulation at its core will benefit investors.

“By enhancing advisers’ transparency and integrity, we will help promote greater competition and thereby efficiency,” he said.

“Consistent with our mission and Congressional mandate, we advance today’s rules on behalf of all investors — big or small, institutional or retail, sophisticated or not.”

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