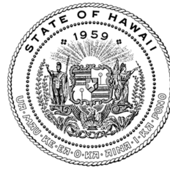
DAVID Y. IGE
GOVERNOR



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STATE OF HAWAII
HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
201 MERCHANT STREET, SUITE 1700
HONOLULU, HAWAII 96813
Oahu (808) 586-7390
Toll Free 1(800) 295-0089
www.eutf.hawaii.gov

TESTIMONY BY DEREK MIZUNO
ADMINISTRATOR, HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND
DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON LABOR & TOURISM
ON HOUSE BILL NO. 2104

February 8, 2022
8:30 a.m.
Via Videoconference

RELATING TO THE HAWAII EMPLOYER-UNION HEALTH BENEFITS TRUST FUND INVESTMENTS

Chair Onishi, Vice Chair Sayama, and Members of the Committee:

The Hawaii Employer-Union Health Benefits Trust Fund (EUTF) Board of Trustees strongly supports this bill. The EUTF Board believes that this change provides the EUTF with the best opportunity to maximize returns without prudent levels of risk and aligns with the employees' retirement system of the State of Hawaii.

The intent of this bill is to help preserve EUTF's ability to generate strong investment returns. In order to address the State and counties' unfunded liabilities ($10.5 billion and $8.1 billion in the aggregate and for the State, respectively at July 1, 2021 with funded ratios of 33.6% and 30.0%, respectively), through investment returns instead of increasing contributions, the EUTF must compete with global institutional investors for the opportunity to invest in high quality, high-yield private alternative investments. Such investments require significant amount of time and money to identify and analyze and access to them is becoming increasingly more competitive. The alternative investment fund information is proprietary and confidential. If the EUTF is required to disclose such confidential information, some high-

performing alternative investment funds may likely not allow EUTF investment in their fund for concerns that their commercial and trade secrets will be disclosed to the public. If the EUTF had to settle for median performing funds instead of top quartile funds (median difference of 7.4% over a 20-year period), it could result in over $50 million of lost annual investment income. This issue will put the generation of strong performance and the paydown of EUTF's unfunded liabilities at risk.

Thank you for the opportunity to testify.

OFFICE OF INFORMATION PRACTICES

STATE OF HAWAII
NO. 1 CAPITOL DISTRICT BUILDING
250 SOUTH HOTEL STREET, SUITE 107
HONOLULU, HAWAII 96813
TELEPHONE: 808-586-1400 FAX: 808-586-1412
EMAIL: oip@hawaii.gov

To: House Committee on Labor & Tourism

From: Cheryl Kakazu Park, Director

Date: February 8, 2022, 9:30 a.m.
State Capitol, Conference Room 312 and Via Videoconference

Re: Testimony on H.B. No. 2104
Relating to the Hawaii Employer-Union Health Benefits Trust Fund Investments

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Thank you for the opportunity to submit testimony on this bill, which would allow the Hawaii Employer-Union Health Benefits Trust Fund (EUTF) to withhold specified types of alternative investment fund information from public disclosure under chapter 92F, HRS, the Uniform Information Practices Act (UIPA). The Office of Information Practices (OIP) takes no position on this bill, but offers comments.

This bill would allow EUTF to withhold from public disclosure the same type of alternative investment fund information that the Employees' Retirement System (ERS) is already allowed to withhold under Act 71 of 2021. OIP did not object to the exemption to disclosure for the specified alternative investment fund information for ERS, and does not object to allowing EUTF to withhold the same information, because OIP believes the listed categories of records relating to alternative investments that would be statutorily exempted by this bill are reasonably limited and specific and are consistent with the UIPA's generally applicable exceptions to disclosure. The records to be protected would likely fall

under the UIPA's frustration exception to disclosure in any case, so this bill would not restrict public access to records that have historically been public under the UIPA. OIP further recognizes that having a specific statutory exemption will give confidence to alternative investments that EUTF will not be required to publicly release their confidential information.

Thank you for considering OIP's testimony.

LATE *Testimony submitted late may not be considered by the Committee for decision making purposes.

Eric W. Gill, Financial Secretary-Treasurer   Gemma G. Weinstein, President   Godfrey Maeshiro, Senior Vice President

February 7, 2022

Committee on Labor and Tourism
Representative Richard Onishi, Chair
Senator Jackson Sayama, Vice Chair

Testimony in opposition to HB 2104

Chair Onishi, Vice Chair Sayama and Members of the Committee:

UNITE HERE Local 5 is **opposed to HB 2104.** The EUTF fund is working people's money. Beneficiaries have struggled long and hard to ensure that they and their families can have access to quality medical care. EUTF is funded through public money, for the public benefit. Working people deserve to be able to see what their money is being invested in, whether those investments are suitable to their needs and concerns, and whether those investments are sound. This is not a pot of money for private equity firms to play around with.

Investment in private equity firms in particular need to be closely studied and monitored by the public. On January 27, 2022, the SEC issued a Risk Alert about private equity investment. It is attached here. This is not the first risk alert the SEC has issued regarding private equity investments, nor is such concern limited to the SEC. In addition to the risk alert, the passages below are illustrative. While not all PE firms have engaged in the misdeeds listed below, the prevalence of these issues by some PE firms makes transparency/ public disclosure critical.

A 2016 report by the Center for Economic and Policy Research states:

> Private equity general partners (GPs) have misallocated PE firm expenses and inappropriately charged them to investors; have failed to share income from portfolio company monitoring fees with their investors, as stipulated; have waived their fiduciary responsibility to pension funds and other LPs; have manipulated the value of companies in their fund's portfolio; and have collected transaction fees from portfolio companies without registering as broker-dealers as required by law. In some cases, these activities violate the specific terms and conditions of the Limited Partnership Agreements (LPAs) between GPs and their limited partner investors(LPs), while in others vague and misleading wording allows PE firms to take advantage of their asymmetric position of power vis-à-vis investors and the lack of transparency in their activities. In addition, some of these practices violate the U.S. tax code. Monitoring fees are a tax deductible expense for the portfolio companies owned by PE funds and greatly reduce the taxes these companies pay. In many cases, however, no monitoring services are actually provided and the payments are actually dividends, which are taxable, that are paid to the private equity firm.[i]

Further on, the report elaborates on fiduciary responsibility:

> Some Limited Partnership Agreements specifically state that private equity firms may waive their fiduciary responsibility towards their limited partners. This means that the general partner may make decisions that increase the fund's profits (and the GP's share of those profits —so-called carried interest) even if those decisions negatively affect the LP investors. This waiver has serious implications for investors, such as pension funds and insurance companies, which have fiduciary responsibilities to their members and clients. These entities violate their own fiduciary responsibilities if

> they sign agreements that allow the PE firm to put its interests above those of its members and clients.[ii]

Concerns about private equity have not disappeared since 2016. In fact, on June 23, 2020, the SEC Office of Compliance Inspections and Examinations ("OCIE") issued a risk alert about several common practices in private equity. In the report's introduction, the OCIE notes:

> Many of the deficiencies discussed below may have caused investors in private funds ("investors") to pay more in fees and expenses than they should have or resulted in investors not being informed of relevant conflicts of interest concerning the private fund adviser and the fund.[iii]

Here are a few excerpts of the OCIE's report:

> "The [OCIE] staff observed private fund advisers that preferentially allocated limited investment opportunities to new clients, higher fee-paying clients, or proprietary accounts or proprietary-controlled clients, **thereby depriving certain investors of limited investment opportunities without adequate disclosure.**"[iv] [emphasis added]

> "The staff observed private fund advisers that allocated securities at different prices or in apparently inequitable amounts among clients (1) without providing adequate disclosure about the allocation process or (2) in a manner inconsistent with the allocation process disclosed to investors, **thereby causing certain investors to pay more for investments or not to receive their equitable allocation of such investments.**" [v] [emphasis added]

> "Advisers charged private fund clients for expenses that were not permitted by the relevant fund operating agreements, such as adviser-related expenses like salaries of adviser personnel, compliance, regulatory filings, and office expenses, **thereby causing investors to overpay expenses.**" [vi]

> "Advisers failed to comply with contractual limits on certain expenses that could be charged to investors, such as legal fees or placement agent fees, **thereby causing investors to overpay expenses.**" [vii]

> "**Advisers failed to follow their own travel and entertainment expense policies, potentially resulting in investors overpaying for such expenses.**" [viii]

> "*Valuation.* The staff observed private fund advisers that did not value client assets in accordance with their valuation processes or in accordance with disclosures to clients (such as that the assets would be valued in accordance with GAAP). In some cases, the staff observed that this failure to value a private fund's holdings in accordance with the disclosed valuation process **led to overcharging management fees and carried interest** because such fees were based on inappropriately overvalued holdings." [ix]

Nor is this report the first time the OCIE has discussed issues within private equity. In a speech by then-director of the OCIE Andrew Bowden on May 6, 2014, he discussed the results of examinations the OCIE had been conducting on private equity advisers. Among other things, he stated:

> By far, the most common observation our examiners have made when examining private equity firms has to do with the adviser's collection of fees and allocation of expenses. When we have examined how fees and expenses are handled by advisers to private equity funds, we have identified what we believe are **violations of law or material weaknesses in controls over 50% of the time**.[x]

And

> So … when we think about the private equity business model as a whole, without regard to any specific registrant, we see **unique and inherent temptations and risks** that arise from the ability to control portfolio companies, **which are not generally mitigated, and may be exacerbated, by broadly worded disclosures and poor transparency.**[xi]

Beyond these issues related to the treatment of investors are issues about what private equity funds are invested in and how the funds make profits. For example, a November 2020 report issued by the Institute for Policy Studies discusses twelve examples of companies and billionaires whose wealth increased during the pandemic, including five private equity firms:

> In recent years, private equity firms and their billionaire backers have moved into sectors of the economy such as health care, grocery provision, and pet supply. **With their singular focus on aggressive cost cutting and profit extraction, these private firms are not oriented toward protecting their essential workers during a pandemic.** Among the "Delinquent Dozen" are several private equity firms that own or have large ownership stakes in multiple companies with essential workers. They could use their significant power and wealth to direct corporate managers to protect essential workers, but they have fallen short.[xii]

The people deserve the right to information about private equity investments. Please reject HB 2104.

Thank you.

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[i] "Fees, Fees and More Fees:How Private Equity Abuses Its Limited Partners and U.S. Taxpayers," Center for Economic and Policy Research, May 2016, pg. 1. https://cepr.net/images/stories/reports/private-equity-fees-2016-05.pdf

[ii] "Fees, Fees and More Fees:How Private Equity Abuses Its Limited Partners and U.S. Taxpayers," Center for Economic and Policy Research, May 2016, pg. 3. https://cepr.net/images/stories/reports/private-equity-fees-2016-05.pdf

[iii] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 1. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[iv] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 2. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[v] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 2. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[vi] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 5. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[vii] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 5. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[viii] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 5. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[ix] Risk Alert, SEC Office of Compliance Inspections and Examinations, June 23, 2020, pg. 5. https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf

[x] "Spreading Sunshine in Private Equity," speech by Andrew J. Bowden, Director, Office of Compliance Inspections and Examinations, at the Private Equity International (PEI), Private Fund Compliance Forum, May 6, 2014. https://www.sec.gov/news/speech/2014--spch05062014ab.html

[xi] "Spreading Sunshine in Private Equity," speech by Andrew J. Bowden, Director, Office of Compliance Inspections and Examinations, at the Private Equity International (PEI), Private Fund Compliance Forum, May 6, 2014. https://www.sec.gov/news/speech/2014--spch05062014ab.html

[xii] "Billionaire Wealth vs. Community Health: Protecting Essential Workers from Pandemic Profiteers," by the Institute for Policy Studies, Bargaining for the Common Good and United for Respect, November 2020, pg. 5.

January 27, 2022

Observations from Examinations of Private Fund Advisers

I. Introduction

On June 23, 2020, the Division of Examinations ("EXAMS") published a Risk Alert (the "2020 Private Fund Adviser Risk Alert") providing an overview of compliance issues observed by EXAMS staff* in examinations of registered investment advisers that manage private funds ("private fund advisers").[1] In light of the significant role of private fund advisers in the financial markets, we are publishing this risk alert detailing additional observations: (A) failure to act consistently with disclosures; (B) use of misleading disclosures regarding performance and marketing; (C) due diligence failures relating to investments or service providers; and (D) use of potentially misleading "hedge clauses."[2]

More than 5,000 SEC-registered investment advisers, approximately 35% of all SEC-registered advisers, manage approximately $18 trillion in private fund assets.[3] In the past five years alone, we have observed substantial growth in reported private fund assets, which have increased by 70% in that period. These assets are deployed through a variety of investment strategies employed by hedge funds, private equity funds, and real estate-related funds, among others. The size and complexity of advisers vary widely from, for example, an adviser with a private fund limited to investors made up of friends and family, to an adviser with a worldwide footprint managing multiple private funds with hundreds of billions of dollars in assets. This Risk Alert is intended to assist private fund advisers in reviewing and enhancing their compliance programs, and also to provide investors with information concerning private fund adviser deficiencies.

II. Legal Background

An investment adviser's fiduciary duty under the Investment Advisers Act of 1940 ("Advisers

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[*] This Risk Alert represents the views of the staff of EXAMS. This Risk Alert is not a rule, regulation, or statement of the Securities and Exchange Commission (the "SEC" or the "Commission"). The Commission has neither approved nor disapproved the content of this Risk Alert. This Risk Alert, like all staff statements, has no legal force or effect: it does not alter or amend applicable law, and it creates no new or additional obligations for any person. This document was prepared by EXAMS staff and is not legal advice.

[1] EXAMS Risk Alert, Observations from Examinations of Investment Advisers Managing Private Funds (June 23, 2020) (the "2020 Private Fund Adviser Risk Alert").

[2] The observations in this Risk Alert and the 2020 Private Fund Adviser Risk Alert were drawn from over 5 years of examinations of private fund advisers. This Risk Alert, the 2020 Private Fund Adviser Risk Alert, and The Five Most Frequent Compliance Topics (Feb. 17, 2017) (for all advisers) reflect observations of the EXAMS staff regarding private fund advisers and are intended to assist private fund adviser compliance staff.

[3] Form ADV data current as of November 30, 2021.

Act") comprises a duty of care and a duty of loyalty.[4] This means the adviser must, at all times, serve the best interest of its client and not subordinate its client's interest to its own. In other words, the investment adviser cannot place its own interests ahead of the interests of its client. This combination of care and loyalty obligations requires the investment adviser to act in the "best interest" of its client at all times. Although investment advisers owe their clients a fiduciary duty under the Advisers Act, that fiduciary duty must be viewed in the context of the agreed-upon scope of the relationship between the adviser and the client.[5]

In addition, Advisers Act Rule 206(4)-8 prohibits investment advisers to pooled investment vehicles from: (1) making any untrue statement of a material fact or omitting to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle; or (2) otherwise engaging in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.

Advisers Act Rule 206(4)-7 (the "Compliance Rule") requires registered investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and the rules that the Commission has adopted under the Advisers Act by the adviser or any of its supervised persons. In developing its policies and procedures, an adviser should identify matters that create risk exposure for the adviser and its clients in light of the firm's particular operations and then design compliance policies and procedures that address those risks. The Compliance Rule also requires advisers to review, no less frequently than annually, the adequacy of the policies and procedures established and the effectiveness of their implementation.

III. Private Fund Adviser Deficiencies[6]

A. Conduct Inconsistent with Disclosures

EXAMS staff has observed the following failures to act consistently with material disclosures to clients or investors:

- *Failure to obtain informed consent from Limited Partner Advisory Committees, Advisory Boards or Advisory Committees (collectively "LPACs") required under fund disclosures.* EXAMS staff observed private fund advisers that did not follow practices described in their limited partnership agreements ("LPAs"), operating agreements, private placement memoranda, due-diligence questionnaires, side letters or other disclosures ("fund disclosures") regarding the use of LPACs. For example, staff observed private fund advisers that failed to bring conflicts to their LPACs for review and consent, in

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4 *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Advisers Act Release No. 5248 (June 5, 2019) ("Fiduciary Interpretation").

5 *See* Fiduciary Interpretation.

6 This Risk Alert does not address all deficiencies among private fund advisers. In addition to the 2020 Private Fund Adviser Risk Alert, EXAMS also published, for example, a risk alert on February 7, 2017, The Five Most Frequent Compliance Topics Identified in OCIE Examinations of Investment Advisers, which identifies deficiencies across all types of investment advisers.

contravention of fund disclosures. EXAMS staff also observed private fund advisers that did not obtain consent for certain conflicted transactions from the LPAC until after the transaction had occurred or obtained approval after providing the LPAC with incomplete information in contravention of fund disclosures.

- *Failure to follow practices described in fund disclosures regarding the calculation of Post-Commitment Period fund-level management fees.* EXAMS staff observed private fund advisers that did not follow practices described in fund disclosures regarding the calculation of the fund-level management fee during a private fund's Post-Commitment Period.[7] EXAMS staff observed that such failures resulted in investors paying more in management fees than they were required to pay under the terms of the fund disclosures. For example, private fund advisers did not reduce the cost basis of an investment when calculating their management fee after selling, writing off, writing down or otherwise disposing of a portion of an investment. Other private fund advisers used broad, undefined terms in the LPA, such as "impaired," "permanently impaired," "written down," or "permanently written down," but did not implement policies and procedures reasonably designed to apply these terms consistently when calculating management fees, potentially resulting in inaccurate management fees being charged.

- *Failure to comply with LPA liquidation and fund extension terms.* EXAMS staff observed advisers that extended the terms of private equity funds without obtaining the required approvals or without complying with the liquidation provisions described in the funds' LPAs, which, among other things, resulted in potentially inappropriate management fees being charged to investors.

- *Failure to invest in accordance with fund disclosures regarding investment strategy.* EXAMS staff observed private fund advisers that did not comply with investment limitations in fund disclosures. For example, the staff observed private fund advisers that implemented an investment strategy that diverged materially from fund disclosures. EXAMS staff also observed advisers that caused funds to exceed leverage limitations detailed in fund disclosures.

- *Failures relating to recycling practices.* "Recycling" refers to contractual provisions that allow a fund to add realized investment proceeds back to the capital commitments of investors. EXAMS staff observed private fund advisers that did not accurately describe the "recycling" practices utilized by their funds or omitted material information from such disclosures. In some instances, this failure may have caused private fund advisers to collect excess management fees.

- *Failure to follow fund disclosures regarding adviser personnel.* EXAMS staff observed advisers that did not adhere to the LPA "key person" process after the departure of

[7] Advisers to private equity funds typically assess a management fee based on a percentage of limited partner capital commitments during the period of time the fund deploys capital ("Commitment Period"). The basis of the amount used to calculate this fee, however, is generally reduced to "invested capital," less dispositions, write downs and write offs after the Commitment Period ("Post-Commitment Period"). These arrangements vary in accordance with contractual provisions.

several adviser principals or did not provide accurate information to investors reflecting the status of key previously-employed portfolio managers.

B. Disclosures Regarding Performance and Marketing

EXAMS staff has observed private fund advisers providing to investors or prospective investors misleading track records or other marketing statements that appear to violate Rule 206(4)-8.[8] In addition, Advisers Act Rule 204-2(a)(16) requires advisers to maintain all accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of any performance or rate of return of any or all managed accounts or securities recommendations. EXAMS staff has also observed failures by private fund advisers to maintain these required records.

- *Misleading material information about a track record.* EXAMS staff observed private fund advisers that provided inaccurate or misleading disclosures about their track record, including how benchmarks were used or how the portfolio for the track record was constructed. For example, the staff observed advisers that only marketed a favorable or cherry-picked track record of one fund or a subset of funds or did not disclose material information about the material impact of leverage on fund performance. In addition, the staff observed private fund advisers that utilized stale performance information in presentations to potential investors or track records that did not accurately reflect fees and expenses.

- *Inaccurate performance calculations.* EXAMS staff observed private fund advisers that presented inaccurate performance calculations to investors. For example, the staff observed private fund advisers that used inaccurate underlying data (*e.g.,* data from incorrect time periods, mischaracterization of return of capital distributions as dividends from portfolio companies, and/or projected rather than actual performance used in performance calculations) when creating track records, thereby leading to inaccurate and potentially misleading disclosures regarding performance.

- *Portability - failure to support adequately, or omissions of material information about, predecessor performance.* EXAMS staff observed private fund advisers that did not maintain books and records supporting predecessor performance at other advisers as required under Advisers Act Rule 204-2(a)(16). In addition, the staff observed private fund advisers that appeared to have omitted material facts about predecessor performance. For example, the staff observed private fund advisers that marketed incomplete prior track records or advertised performance that persons at the adviser were not primarily responsible for achieving at the prior adviser.

- *Misleading statements regarding awards or other claims.* EXAMS staff observed private fund advisers that made misleading statements regarding awards they received or characteristics of their firm. For example, the staff observed private fund advisers that

[8] The Commission adopted significant revisions to Advisers Act Rule 206(4)-1 that address the marketing of private funds. The rule, which advisers must comply with by November 4, 2022, provides additional specificity regarding misleading marketing materials. In addition to Rule 206(4)-1 and Rule 206(4)-8, the anti-fraud provisions of the federal securities laws, *e.g.,* Section 206 of the Advisers Act, Section 17(a) of the Securities Act of 1933, and Section 10(b) of the Securities Exchange Act of 1934, may apply to this activity.

marketed awards received, but failed to make full and fair disclosures about the awards, such as the criteria for obtaining them, the amount of any fee paid by the adviser to receive them, and any amounts paid to the grantor of the awards for the adviser's right to promote its receipt of the awards. The staff also observed advisers that incorrectly claimed their investments were "supported" or "overseen" by the SEC or the United States government.

C. Due Diligence

As a fiduciary, an investment adviser must have a reasonable belief that the advice it provides is in the best interest of the client based on the client's objectives. A reasonable belief that investment advice is in the best interest of a client also requires that an adviser conduct a reasonable investigation into the investment that is sufficient to ensure that the adviser is not basing its advice on materially inaccurate or incomplete information.[9]

EXAMS staff observed potential failures to conduct a reasonable investigation into an investment, to follow the due diligence process described to clients or investors, and to adopt and implement reasonably designed due diligence policies and procedures pursuant to the Compliance Rule:

- *Lack of a reasonable investigation into underlying investments or funds.* EXAMS staff observed advisers that did not perform reasonable investigations of investments in accordance with their policies and procedures, including the compliance and internal controls of the underlying investments or private funds in which they invested. In addition, the staff observed advisers that failed to perform adequate due diligence on important service providers, such as alternative data providers and placement agents.

- *Inadequate policies and procedures regarding investment due diligence.* EXAMS staff observed private fund advisers that did not appear to maintain reasonably designed policies and procedures regarding due diligence of investments. For example, the staff observed private fund advisers that outlined a due diligence process in fund disclosures, but did not maintain policies and procedures related to due diligence that were tailored to their advisory businesses.

D. Hedge Clauses

Whether a clause in an agreement, or a statement in disclosure documents provided to clients and investors, that purports to limit an adviser's liability (a "hedge clause") is misleading and would violate Sections 206(1) and 206(2) of the Advisers Act depends on all of the surrounding facts and circumstances.[10] EXAMS staff observed private fund advisers that included potentially misleading hedge clauses in documents that purported to waive or limit the Advisers Act fiduciary duty except for certain exceptions, such as a non-appealable judicial finding of gross negligence, willful misconduct, or fraud. Such clauses could be inconsistent with Sections 206 and 215(a) of the Advisers Act.

[9] *See* Fiduciary Interpretation.

[10] *See* Fiduciary Interpretation.

IV. Conclusion

Examinations of private fund advisers have resulted in a range of actions, including deficiency letters and, where appropriate, referrals to the Division of Enforcement. In response to these observations, many of the advisers modified their practices to address the issues identified by EXAMS staff. The Division encourages private fund advisers to review their practices, and written policies and procedures, including implementation of those policies and procedures, to address the issues identified in this Risk Alert.

This Risk Alert is intended to highlight for firms risks and issues that EXAMS staff has identified. In addition, this Risk Alert describes risks that firms may consider to (i) assess their supervisory, compliance, and/or other risk management systems related to these risks, and (ii) make any changes, as may be appropriate, to address or strengthen such systems. Other risks besides those described in this Risk Alert may be appropriate to consider, and some issues discussed in this Risk Alert may not be relevant to a particular firm's business. The adequacy of supervisory, compliance and other risk management systems can be determined only with reference to the profile of each specific firm and other facts and circumstances.