Proskauer

End of (Fund) Life Issues

The Capital Commitment on **May 22, 2025**

Amid a challenging environment for exits, especially in the wake of the recent market volatility, private fund managers continue to pursue alternative strategies, such as term extensions and liquidity solutions, to ride out the liquidity downturn. While these measures are designed to protect the value of the funds' investments and are frequently requested by limited partners, they raise potential regulatory concerns that have been the subject of SEC scrutiny in the past. As noted by a senior staff member of the Division of Examinations in March, the SEC continues to conduct exams with a focus on the bread-and-butter issues like fees, conflicts and related disclosures. Therefore, as funds approach maturity, it is worth reviewing the areas that have received the greatest regulatory attention.

Post-Commitment Fee Calculations and Asset Valuations

In each of the past three years, the SEC's exam priorities have included the calculation of post-commitment period management fees. After the commitment period, as a fund moves from making investments to managing them and selling when the time is right, the management fee calculation often shifts from being based on committed capital to invested capital (sometimes adjusted for full or partial dispositions, as well as write-offs of investments). Determining the appropriate management fee base and performing the correct fee calculations can be operationally challenging, and directly affects what investors pay the adviser. As a result, SEC exams and enforcement actions have focused on whether the adviser potentially overcharged clients by failing to adhere to the disclosed fee calculation methodology. The resolution of this issue often turns on the proper interpretation of the relevant language of the management fee provision in the limited partnership agreement ("LPA"). Partial dispositions, impairments and valuation issues can complicate the calculation even further. Moreover, the SEC staff has a natural inclination to interpret the language of fee provisions against the adviser in favor of reduced fees irrespective of the original intent of the adviser and the investors.

When the fee base shifts at the end of the commitment period, it is especially important to carefully review the LPA language and management fee calculation methodology. Because the operative LPA language generally will have been drafted many years before (at the outset of the fund) and may differ slightly from newer vintage funds, it is often advisable to consult with fund counsel to ensure that the adviser understands any nuances in the methodology from the start and performs the fee calculations correctly. Likewise, ensuring that the firm's valuation policies are being followed (especially for those investments experiencing difficulties) is important because the timing of any write-down in valuation can impact the fee base for the management fee calculation. It is also important to be mindful of whether the valuation policy has been revised over time since the fund was launched, potentially introducing inadvertently diverging standards between the language of the adviser's policies and the language of the LPA. We expect the SEC will continue to examine and investigate in this area, particularly where the calculation results in excess fees to the adviser.

Adviser-Led Secondaries

The volume of adviser-led secondary transactions has continued to grow as advisers seek to accommodate investor needs for liquidity. For many years, these transactions have been the subject of concern for SEC staff given what the staff sees as inherent conflicts and perceived lack of transparency. It also has been a perennial topic on the SEC's list of exam priorities. Although the SEC rule that would have imposed specific requirements on adviser-led secondaries was struck down by the Fifth Circuit, the SEC's concerns regarding the conduct underlying the proposed rule are likely to continue under existing fiduciary/disclosure concepts.

To mitigate the associated risks, advisers should be attentive to asset valuations, new vehicle terms and the completeness of disclosures. Additional attention should be placed on the consent process to ensure that limited partners have complete information and adequate time to provide fully informed consent. Advisers should bear in mind the SEC's historic concerns and adopt deliberate processes and disclosures.

Fund Level Leverage

Net asset value (“NAV”) financing continues to emerge as a potential solution for a number of issues as funds enter their harvest periods. At an industry conference last May, a senior staff member from the Division of Examinations noted that the Private Funds Unit was at the beginning of the learning process regarding NAV loans and how such loans fit within the fund documents and related disclosures. The 2025 Exam priorities included, as a new topic, the use of debt and fund-level lines of credit, along with disclosures of potential conflicts of interests and related risks. Many institutional investors are also focused on similar concerns, which may be a source of similar scrutiny during pre-investment and ongoing operational due diligence. Given the evolving market, private fund advisers should strive to stay ahead of the curve and structure fund level financing transactions in a manner that is consistent with the fund documents with fiduciary concerns in mind.

Custody Rule Compliance

Another issue confronting advisers managing private funds nearing or at the end of their terms is complying with the Custody Rule (Rule 206(4)-2 under the Investment Advisers Act). The rule’s asset-verification procedures – whether by annual audit or surprise custody inspection – remain applicable as long as the fund holds any securities or cash.

For funds in the end-of-life phase, these requirements can be cost-prohibitive and often feel poorly tailored to the actual risk level. Funds at this stage may be unable to call capital to cover the related costs due to limited remaining undrawn commitments, or to contractual limitations on calling capital altogether. Sponsors may seek to lower costs by arranging a surprise custody inspection rather than a full audit, but such an approach still imposes costs and logistical difficulties, and the technical requirements are generally viewed as unworkable for many private funds (for example, due to the requirement that quarterly statements list every transaction in the fund’s accounts). These financial and operational burdens are compounded by the non-waivable nature of the Custody Rule’s requirements, even with explicit investor consent – a principle that SEC staff routinely reiterate during examinations, rejecting investor waivers as a basis for non-compliance.

Even in the new regulatory environment, the SEC will continue to focus on the bread-and-butter issues that have been top-of-mind for SEC staffers who specialize in private funds. Advisers managing funds through maturity should keep these issues in mind.

Read more of our Top Ten Regulatory and Litigation Risks for Private Funds in 2025.

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