California Private Funds Managing Public Retirement Plans Face New Disclosures

Reporting and disclosure requirements for managers of "alternative investment vehicles" ("***AIV***") in California just became more complex with Governor Jerry Brown's signing of a new amendment to California law, specifically aimed at transparency for fees and expenses associated with investment by State and Local pension and retirement plans. The new provision, AB 2833, provides that managers of AIVs (those who manage private equity funds, venture capital funds, hedge funds, and absolute return funds) are now required to deliver a slew of additional disclosures to Trustees of public pension and retirement plans ("***Public Plans***"), which include plans offered to civil servants and university educators. Further, the law puts the onus on Public Plan Trustees to relay the information obtained to Public Plan participants at an annual meeting, and to obtain assurances from the AIV managers that the manager will in fact deliver such required disclosures, which are:

- Fees and expenses paid by the Public Plan directly to the AIV, including to the general partner, manager, or related parties;[1]
- The pro rata share of fees and expenses attributable to the Public Plan that are not included above, which may be calculated by the Public plan trustee, but would then remove the responsibility from the fund manager;
- The pro rata share attributable to the Public Plan of carried interest distributed to the AIV manager and/or related party;
- The pro rata share attributable to the Public Plan of aggregate fees and expenses by all of the portfolio companies held by the AIV to the manager or related party; and
- To make available upon request information required to be disclosed under the California Public Records Act, including the dollar amount of the cash contributions made by Public Plan.[2]

Additionally, the AIV manager must further make available the gross and net rate of return since inception of the AIV, which the Trustee will utilize to compile his or her required annual report outlining such information for each AIV in which the Public Plan invests (although, this obligation on the AIV manager can be negated if the Trustee decides to calculate this information on his or her own). While the strict requirement for disclosure of the above information only applies to AIVs and Public Trustees who contract on or after January 1, 2017, those Public Plan Trustees who have already contracted with a California AIV prior to January 2017 will be required to make "reasonable efforts" to obtain all of the above outlined information.[3]

While the law is well intentioned to provide transparency and supplementary information to Public Plan participants, like police officers and teachers, the law itself creates many more questions than it answers. First, the drafters used imprecise terminology, such as when they require a tabulation of the carried interest being distributed to an AIV manager, but neglect to account for carried interest which may be clawed back. Further, while the goal of the law was to bring to light the fees associated with millions of public dollars invested annually, the drafters imperfectly created a responsibility on Public Plan Trustees to utilize "best efforts" for existing contracts with AIV managers, however what exactly will these efforts entail? Can the Trustee request the information and if he doesn't get it the responsibility is off of his hands? Does the responsibility transfer to the manager to compile the data? Who will be responsible for the costs of compiling the

information? Further, there has been no enactment of an enforcement arm to this law; that is to say, what happens if the AIV manager or the Public Plan Trustee fails to live up to the responsibilities promulgated under this law?[4]

Additionally, many managers may turn their backs on California Public Plans due to the increased costs of compiling the data, not to mention the additional time and effort attributable to these new requirements. With reduced options available to Public Plan Trustees, they may have to settle for an AIV that may not be as appealing as one that refuses to take them on. Nonetheless, this may be a moot point, as it will be hard for AIV managers to pass up on providing services to the massive California public pension market. Nevertheless, with increased reporting requirements, the costs have to be accounted for by someone, which may be passed along to investors – thereby creating a new fee problem when trying to plug the hole on an old one.

With all of the uncertainties still surrounding this law, many legislatures across the country are considering enacting similar regulations. Both Illinois and Rhode Island are currently considering analogous legislation, while Alabama, Kentucky, and New Jersey have considered, but not yet passed, similar enhanced reporting and disclosure requirements.[5] Further, the Institutional Limited Partners Association has released a fee reporting template to promote more uniform reporting practices,[6] however, with the passage of this new California law, and the potential laws springing up across the country, a patchwork system of laws, as opposed to one uniform scheme, seems to be the new framework in this field.

[1] Adding confusion to the law, the term "related party" is defined very broadly, providing potential loopholes from fee disclosure. "Related Party" is defined as: (1) any current or former employee, manager, or partner of any related entity that is involved in the investment activities or accounting and valuation functions of the relevant entity or any of their respective family members; (2) any operational partner, senior advisor, or other consultant or employee whose primary activity for a relevant entity is to provide operational or back office support to any portfolio company of any alternative investment vehicle, account or fund managed by a related party; (3) any entity where at least 10% of the ownership is held directly or indirectly by a related party or operational person; and (4) any consulting, legal or other service provider regularly engaged by portfolio companies of an alternative investment vehicle, account or fund managed by a related person that also provides advice or services to any related person or relevant entity.

[2] https://leginfo.legislature.ca.gov/faces/billCompareClient.xhtml?bill_id=201520160AB2833

[3] http://www.klgates.com/new-california-law-mandating-disclosure-of-certain-fees-and-expenses-09-20-2016/

[4] http://www.jdsupra.com/legalnews/ab2833-new-california-law-opens-lid-on-77588/

[5] http://www.klgates.com/new-california-law-mandating-disclosure-of-certain-fees-and-expenses-09-20-2016/

[6] https://ilpa.org/best-practices/reporting-best-practices/reporting-template/