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New California Law Requires Increased Private Fund Fee And Expense Disclosure.

Recent state legislative developments in California will require disclosure of certain information by private investment fund managers, primarily in the area of fees and expenses incurred by state and local pension and retirement plans.

On September 14, 2016, the Governor of California approved a bill adding Section 7514.7 to the California Government Code, which imposes significant new disclosure requirements for private funds with investments by California state and local public pension and/or retirement systems, including the University of California's retirement plan (Public Plan Investors).

Section 7514.7 will apply to Public Plan Investors investing in private investment funds (defined to include private equity funds, venture capital funds, hedge funds and absolute return funds) on and after January 1, 2017. The Public Plan Investor will be required to obtain assurances that the fund will make specified disclosures regarding fees, expenses, carried interest and portfolio company fees, in addition to other specified information. Section 7514.7 also will require the Public Plan Investor to disclose such information, as well as the gross and net rates of return of the fund since inception, at least once annually at a meeting open to the public.

Specifically, every Public Plan Investor will require each private investment fund in which it invests to make each of the following disclosures to the Public Plan Investor at least annually:

(i) The fees and expenses that the Public Plan Investor pays directly to the private investment fund, the fund manager (including the general partner) or related parties¹.

(ii) The Public Plan Investor's pro rata share of fees and expenses not included above that are paid from the private investment fund to the fund manager or related parties. The Public Plan Investor may independently calculate this information based on information contractually required to be provided by the private investment fund to the Public Plan Investor. If the Public Plan Investor independently calculates this information, then the private investment fund will not be required to provide the information identified in this item (ii).

(iii) The Public Plan Investor's pro rata share of carried interest distributed by the private investment fund to the fund manager or related parties.

(iv) The Public Plan Investor's pro rata share of aggregate fees and expenses paid by all of the portfolio companies held by the private investment fund to the fund manager or related parties.

(v) The following information that under the California Public Records Act is required to be disclosed upon request:

- The name, address, and vintage year of the private investment fund;
- The dollar amount of the commitment made to the private investment fund by the Public Plan Investor;

- The dollar amount of cash contributions made by the Public Plan Investor to the private investment fund since inception;
- The dollar amount, on a fiscal year-end basis, of cash distributions received by the Public Plan Investor from the private investment fund;
- The dollar amount, on a fiscal year-end basis, of cash distributions received by the Public Plan Investor plus remaining value of assets attributable to the Public Plan Investor's investment in the private investment fund;
- The net internal rate of return of the private investment fund since inception;
- The investment multiple of the private investment fund since inception;
- The dollar amount of the total management fees and costs paid on an annual fiscal year-end basis by the Public Plan Investor to the private investment fund; and
- The dollar amount of cash profit received by the Public Plan Investor from the private investment fund on a fiscal year-end basis.

Additional disclosure requirements may also be required by specific Public Plan Investors themselves. Section 7514.7 will apply to new contracts entered into on and after January 1, 2017, and for existing contracts for which a new capital commitment is made on or after January 1, 2017. Section 7514.7 also will require Public Plan Investors to undertake reasonable efforts to obtain the above-mentioned information with respect to contracts in place prior to January 1, 2017.

Similar legislation may be introduced in other states, including legislation currently pending in Illinois, seeking to require increased transparency around public investments in private investment funds. These efforts may include a private investment fund being required to provide a report to a state or local pension or retirement plan investor using a template developed by the Institutional Limited Partners Association, which to date has been endorsed by a significant number of state and local pension and retirement systems.

While these requirements may only apply to contracts entered into (or investments made) after a certain future date, they also may require pension or retirement plan investors to use "best efforts" (or a similar standard) to obtain this information in connection with existing private fund investments. Accordingly, sponsors of private investment funds should be vigilant for potential disclosure requirements that could apply in connection with investments secured from state and local retirement and pension plans and consult with counsel versed in these areas to ensure that provisions in fund governance documents do comply with statutory requirements.

Footnote

1. The definition of a related party includes (i) any current or former employee, manager, or partner of any entity owned 10% or more by related persons (as defined in Section 7514.7) that is involved in the investment activities or accounting and valuation functions of the general partner, investment adviser or separate carried interest vehicle (each a "relevant entity"), and (ii) 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 private investment fund or account managed by a related person.

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