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New Tariffs, Old Issues: Post-Liberation Day Advisers Act Considerations for Private Fund Managers

Article By:

Nathan Schuur

Robert H. Sutton

Markets remain exceptionally volatile following the announcement of the U.S. “Liberation Day” tariffs and retaliatory measures from other countries. While the ultimate path of policy remains uncertain, recent developments are likely to exert continued pressure on valuations and liquidity across private fund portfolios (even if certain policies are paused or rolled back). Historically, in the wake of major market events, the U.S. Securities and Exchange Commission (SEC) has closely examined fund sponsors’ compliance with applicable laws and regulations and adherence to guidance in core SEC focus areas, including valuations, investor disclosures, investor liquidity and borrowing activities, as sponsors navigate unusual circumstances. These are long-standing areas of regulatory concern, and the SEC has repeatedly emphasized (including during the first Trump administration)[1] the importance of maintaining robust compliance controls during periods of market stress. Given the heightened likelihood of SEC focus, sponsors should remain vigilant, ensuring that decision-making processes are well-documented and demonstrably aligned with the best interests of investors, with special attention paid to these perennial areas of focus. In particularly sensitive cases, it may be helpful to confer with legal counsel in deciding the best path forward.

Valuation Practices

The tariff announcements and recent market volatility complicate the valuation of portfolio assets, particularly in proximity to the quarter-end valuation date for Q1 2025. Sponsors, especially those with illiquid or difficult-to-value assets, should ensure that their valuation methodologies are consistently applied, appropriately calibrated to current conditions and clearly documented. Deviations from prior valuation practices may be justifiable, but should be carefully assessed for consistency with fund documentation and potential conflicts of interest. Where changes are made, sponsors should clearly document the changes, explain how they serve the interests of investors and confirm that the changes are not inconsistent with the fund’s governing documents. Sponsors should also expect scrutiny of any such changes in their next SEC exam.[2] Private fund valuation practices have also drawn commentary from other global financial regulators in recent years, such as the U.K. Financial Conduct Authority.[3] Sponsors regulated by those regulators should take those concerns into account as well.

Portfolio Impacts and Alignment with Investor Disclosures and Governing Documents

The recently imposed 10% universal tariff on imports, coupled with higher tariffs affecting numerous countries, has caused many sponsors to reassess risk exposure and adjust portfolio strategy, particularly for funds, portfolio companies or other portfolio investments that are sensitive to cross-border trade flows. Sponsors should consider whether any pivots in a fund's investment focus, portfolio composition or investment structures are consistent with prior investor disclosures, including offering documents, marketing materials and investor communications. The fund's governing documents (e.g., the partnership agreement) should also be reviewed to ensure that any material changes are consistent with any applicable contractual limitations. If any gaps are identified, sponsors should consider whether to take any additional actions (such as providing an update to existing investors, updating marketing materials for prospective investors and/or seeking any necessary amendments to the fund's partnership agreement) as well as the timing for any such actions.

Liquidity Management

For hedge funds and other funds that provide investors with periodic redemption rights, increased market volatility may create liquidity constraints. Determining the appropriate response greatly depends on the facts of the particular situation, but the response should take into account the SEC's longstanding focus on liquidity issues, particularly its focus on preferential liquidity terms that create conflicts of interest. The now-voided private fund adviser rules contained an express prohibition on providing preferential liquidity terms in ways that could harm other investors. Though the rules were struck down last year, they were based on fiduciary principles long applied by the SEC staff in this context (including during the first Trump administration),[4] and since the rules were vacated the SEC has continued to pursue these cases using its general antifraud authority. Sponsors of funds that permit redemptions should bear these fiduciary principles in mind when managing redemption requests.

Borrowing Considerations

Current market conditions may present cash-flow challenges to a sponsor's private funds, or to the sponsor-controlled portfolio companies or vehicles in which those funds invest, as fund sponsors seek to manage liquidity and operational challenges. This in turn may drive a need for increased borrowing by these funds, portfolio companies or other vehicles. These extensions of credit can provided a much-needed lifeline, although sponsors should ensure that any such borrowing does not contradict the fund's governing documents or disclosures to investors.[5] Given potential regulatory scrutiny (as well as potential investor scrutiny), sponsors should maintain records demonstrating adherence to established borrowing limits, purposes and approval processes outlined in governing documents, and should ensure consistency with investor disclosures.

Choosing the Best Path Forward

Sponsors navigating this evolving landscape must weigh their options carefully; particularly in sensitive cases, appropriately calibrating the legal risk can be a challenging task. While decision-making within sponsor firms often involves complex trade-offs between competing legal and commercial needs, the SEC has historically taken the position that fiduciary and disclosure obligations are heightened — not diminished — during periods of market stress.

[1] See, e.g., SEC Office of Compliance Inspections and Examinations, "Risk Alert: Select COVID-19 Compliance Risks and Considerations for Broker-Dealers and Investment Advisers" (Aug. 12, 2020), and "Risk Alert: Observations from Examinations of Investment Advisers Managing Private Funds" (June 23, 2020).

[2] Valuations are a key component of nearly every SEC exam. Because overvaluing an asset may increase the management fee due to a fund sponsor (in the case of hedge funds and other liquid strategies with NAV-based fee structures) and/or may boost the investment performance used in investor marketing (in the case of most strategies whether liquid or illiquid), overvaluations frequently result in enforcement action as well because the SEC is able to point to direct investor harm or clear likelihood of investors being misled. But overconservative valuations are not a panacea, and even *undervaluing*a fund's assets has resulted in enforcement action. Valuation has remained an important topic for the SEC regardless of which political party is in power.

[3] The UK FCA recently published the findings of a multi-firm review of valuation processes for private market assets and recommendations for creation of a robust valuation framework. UK Sponsors should review the findings closely as they may represent the FCA's expectations going forward. Non-UK sponsors may also wish to take the findings into account as peer regulators at the SEC and on the European continent may be influenced by the FCA's findings.

[4] See "Risk Alert: Observations from Examinations of Investment Advisers Managing Private Funds" (June 23, 2020) (highlighting, among other things, preferential liquidity rights as a risk area).

[5] Fund sponsors relying on the "venture capital fund" adviser exemption from SEC registration (under Investment Advisers Act Sec. 203(l) and Rule 203(l)-1) should also bear in mind that the exemption contains a leverage limitation that caps each fund's total permitted leverage at no more than 15% of the fund's aggregate capital contributions and uncalled committed capital. Fund sponsors seeking to retain this exemption should therefore avoid causing any fund to exceed this threshold.

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