



New SEC rules may increase reporting hurdles for CLOs

by Michelle D'souza

CLOs could be caught by sweeping new rules on disclosure by private funds proposed by the SEC in February.

Among the changes are the introduction of quarterly reporting requirements, independent fairness opinions for GP-led transactions, private fund audits, six new prohibited activities, new requirements around potential preferential treatment and an annual review.

Lindsay Trapp, partner at Dechert, warns that some of the proposed changes won't only affect US fully registered investment advisors.

"It isn't just a case that you can ignore this if you're a manager relying on an exempt reporting adviser, private fund advisor or even state level advisory regulation, which may include advisors based in Europe that are not fully registered," she says.

"You have to pay attention to these. The additional requirements have aspects around sales, etc. and some of these will have a bigger bite than they used to for such managers."



Some rules will affect managers relying on the exemptions

Lindsay Trapp
Partner
Dechert

Not every CLO is a private fund — but CLOs that are registered as 3(c)(1) or 3(c)(7) funds are private and are subject to these rules, says Mike Sherman, partner at Dechert.

"A CLO is seldom audited in accordance with GAAP [generally accepted accounting principles]. If this goes through, every CLO that must rely on 3(c)(1) or 3(c)(7) will be subject to a GAAP audit," he explains.

Sherman also argues the audit will be tricky to apply for funds holding assets that are difficult or impossible to value under GAAP without there being an exception.

For credit funds in general, the rule surrounding advisor-led secondaries could also be an unwanted obstacle.

"Getting third-party opinions in relation to GP-led transactions will be a departure from the industry standard and may not be of additional benefit to investors, given advisers are already required to comply with cross-trades (including agency and principal transactions) rules under the Advisers Act," says Trapp.

Transparency around side letters may also pose a problem for managers. "A manager may make an exception for a large investor, but may not intend to make that same exception for anyone else. Once they've disclosed they've granted X or Y terms, it's going to be harder to push back and say we're not going to do that," adds Sherman.