



SEC Adopts Private Fund Rules

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Introduction

On August 23, 2023, the SEC adopted a series of five new regulations and two amendments to existing rules, effective on November 13, 2023, with staggered compliance dates.

Rule	Applicability	Compliance Dates
Quarterly Statements Rule	All SEC-registered private fund advisers	March 14, 2025
Private Fund Audit Rule	All SEC-registered private fund advisers	March 14, 2025
Adviser-Led Secondaries Rule	All SEC-registered private fund advisers	Large Private Fund Advisers (advisers to private funds with \$1.5 billion or more in private fund assets under management): September 14, 2024 Smaller Private Fund Advisers (advisers to private funds with less than \$1.5 billion in private fund assets under management): March 14, 2025
Restricted Activities Rule	All private fund advisers (including state-registered advisers, exempt reporting advisers, and all others that are not registered with the SEC or with the states). Legacy status protects private funds in existence prior to the compliance date from restrictions on charging for certain investigation fees and expenses.	Large Private Fund Advisers: September 14, 2024 Smaller Private Fund Advisers: March 14, 2025
Preferential Treatment Rule	All private fund advisers (including state-registered advisers, exempt reporting advisers, and all others that are not registered with the SEC or with the states). Legacy status protects agreements entered into prior to the compliance date against the prohibitions on preferential redemption and information rights	Large Private Fund Advisers: September 14, 2024 Smaller Private Fund Advisers: March 14, 2025
Books and Records Rule Amendments	All SEC-registered private fund advisers.	November 13, 2023
Compliance Rule Amendments	All SEC-registered investment advisers.	November 13, 2023

Restricted Activities Rule

The Restricted Activities Rule generally restricts private fund advisers from engaging in five “restricted activities”, unless they satisfy certain disclosure and, in some cases, consent requirements.

- **Only permitted with written disclosure to investors**
 - The non-pro rata allocation of portfolio investment fees and expenses (the non-pro rata charge or allocation must also be fair and equitable)
 - Reducing the amount of adviser clawbacks by actual, potential or hypothetical taxes
 - Charging of (i) regulatory or compliance fees or expenses of the adviser or its related persons and (ii) charging fees or expenses associated with an examination of the adviser or its related persons
- **Only permitted with prior disclosure to investors and consent from at least a majority in the interest of investors**
 - Charging a private fund any fees or expenses related to an investigation of the adviser or its related persons by any governmental or regulatory authority (the examination must also not result in sanctions for violations of the Advisers Act)
 - Borrowing from private fund clients

Preferential Treatment Rule

Prohibited Preferential Treatment

Applicability – Exempt Reporting Advisers

- **Redemption Rights:** Cannot grant an investor in private fund (or similar pool of assets) preferential redemption rights that the adviser reasonably expects to have a material, negative effect on other investors in the private fund (or similar pool of assets) *unless*:
 - the adviser offers preferential redemption rights to all existing and future investors or
 - is required by applicable law, rule, regulation or order or certain governmental authorities
- **Information Rights:** Cannot provide portfolio or investment exposure information of a private fund (or similar pool of assets) if the adviser reasonably expects providing such would have a material, negative effect on other investors in the private fund (or similar pool of assets), unless:
 - such information is offered to all other existing investors in the fund (or similar pool of assets) at substantially the same time

Preferential Treatment Rule

Prohibited Preferential Treatment

- “Material, Negative Effect”
 - Facts and circumstances, so managers must make determinations. Chilling effect?
 - For information rights, ability to redeem is an important factor (no blanket exception for closed-end funds, but...)
- “Similar Pool of Assets” - pooled investment vehicle with substantially similar investment policies, objectives, or strategies to those of the private fund
 - What is captured? Broad, but no SMAs.
 - Interpretive questions abound. Cited examples are not necessarily intuitive.

Preferential Treatment Rule

Disclosure of Preferential Treatment

- Before Investment – Written notice to prospective investors of material economic terms provided to other investors in the same fund
 - “Material economic terms” not defined; “most important that would significantly impact bargaining position”
 - What is? Cost of investing, liquidity rights, fee breaks, co-investment rights.
 - What is not? Excuse rights.
 - Manager interpretation. Overinclusive?
 - How will managers comply? Concerns over closing process, burden and cost.
 - Chilling effect?
 - Increased costs?
- After Investment – Written notice of all other preferential rights
 - Liquid funds: as soon as reasonably practicable after the investment.
 - Illiquid funds: as soon as reasonably practicable after the final closing.

Preferential Treatment Rule

Disclosure of Preferential Treatment

- When must disclosure be delivered?
- What is captured? Side letters, seed deals, strategic arrangements, informal arrangements, etc.
- How will disclosure be delivered?
 - Redacted side letters; detailed summary.
 - Updated MFN process. Disclosure goes to all, not just those who can elect.
- Annual Disclosure
 - How applicable to closed-end funds? Final Closing, but Transfers...
 - Applicable to existing funds at compliance date?

Adviser-Led Secondaries Rule

- What is a secondary?
 - Give a fund investor a choice between selling all or an apportion of their interest or converting/rolling in another vehicle advised by the adviser or its related persons.
- What is the rule?
 - Registered advisers must obtain and distribute an independent fairness opinion or valuation opinion in connection with an adviser-led secondary transaction.
 - Need to disclose material business relationships the adviser has had in the last two years with the opinion provider.
 - Need to share with investors before elections are due.

Adviser-Led Secondaries Rule

Other rules implicated:

- Preferential Treatment Rule
 - Will create further disclosures of lead investors rights
- Non-Pro Rata Allocation of Expenses
 - Permitted if fair and equitable
 - Need to provide notice and describe how it is fair and equitable
 - We will see more disclosure in consents

Quarterly Statements Rule

The Quarterly Statements Rule requires SEC-registered private fund advisers to prepare a quarterly statement for each private fund that it advises (directly or indirectly).

- The quarterly statements must include:
 - A “fund table” with private fund-level disclosures of fees and expenses;
 - A “portfolio investment table” with investment-level disclosures of fees and expenses;
 - Prominent disclosure as to the manner of calculation, including cross-references to applicable sections of a private fund’s governing documents; and
 - Detailed performance measures of the private fund for the relevant reporting period.
- **Timing**
 - Quarterly statements must be prepared and distributed to private fund investors within 45 days after the first three fiscal quarter ends of each fiscal year and 90 days after the end of each fiscal year.
 - Advisers to funds of funds must prepare and distribute quarterly statements within 75 days after the first three fiscal quarter ends of each year and 120 days after the fiscal year end.

Private Fund Audit Rule

Requires advisers to obtain and distribute an annual financial statement audit, meeting the requirements of the audit provisions set forth in the Custody Rule (Rule 206(4)-2 of the Advisers Act), for the private funds they advise, directly or indirectly.

- The Audit Rule also requires:
 - An audit to be performed by an independent public accountant registered with, and subject to the oversight of, the PCAOB;
 - The audit to meet the definition of audit found in 17 CFR 210.1-02(d) (rule 1-02(d) of Regulation S-X);
 - Audited financial statements to be prepared in accordance with US GAAP; and
 - The audit is to be delivered to private fund investors annually within 120 days of the private fund's fiscal year-end and promptly upon liquidation.

Enforcement Perspective

- **Enforcement Will Continue to Focus on:**

- Lack of transparency
- Failure to disclose conflicts of interest
- Lack of governance

- **Key Takeaways:**

- Now Enforcement has two angles:
 - compliance with the pre-new rules expectations and duties; **and**
 - compliance with the new rules.
- And where the new rules do not prescribe additional requirements, baseline fiduciary obligations and SEC expectations persist.

For example . . .

Enforcement Perspective

- **Restricted Activities Rule:**

- Even though Advisers are not flatly prohibited from engaging in certain enumerated activities, the SEC included a critical reminder in a footnote in the adopting release:
 - The applicability of disclosure and consent obligations under law, rule, regulation or otherwise has **not** changed.
 - Advisers are obligated to act in a fund's best interests (duty of care).
 - Advisers are obligated to make full and fair disclosure of all conflicts and material facts that **might** incline an investment adviser – consciously or unconsciously – to render advice that is not disinterested (duty of loyalty).

- **Practical Tips:**

- Augment policies and procedures to incorporate new rules, **but also** continue to implement and oversee the policies and procedures that ensure that fiduciary duties are being discharged completely, and
- Continue to train on and monitor compliance with historically important Advisers Act principles: do **not** forget the old for the new.

Questions?

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Thank you