

SEC Adopts Final Private Fund Adviser Rules

On August 23, 2023, the Securities and Exchange Commission (SEC) voted three to two (Commissioners Peirce and Uyeda dissenting) to adopt new and amended rules (Final Rules) under the Investment Advisers Act of 1940 (Advisers Act) requiring advisers to private funds (Private Fund Advisers) to provide additional disclosures to investors in such funds, restrict certain types of preferential treatment to investors, and impose new requirements related to fund audits, books and records, and adviser-led secondary transactions.

According to the SEC's adopting press release, "The new rules and amendments are designed to protect private fund investors by increasing transparency, competition, and efficiency in the private funds market." The Final Rules represent a significant expansion of the SEC's regulation of Private Fund Advisers and will considerably alter how Private Fund Advisers and investors in private funds structure their relationships.

Summary of the Final Rules

The Final Rules cover five broad categories that:

- Require registered Private Fund Advisers to provide investors with quarterly statements including information about fund performance, fees, and expenses;
 - Require registered Private Fund Advisers to obtain an annual audit of each advised fund conducted by an independent public accountant subject to regular inspection by the Public Company Accounting Oversight Board;
 - Require registered Private Fund Advisers, in connection with an adviser-led secondary transaction, to obtain and distribute to investors a fairness opinion or a valuation opinion and a written summary of certain material relationships between the adviser and the opinion provider;
 - Restrict all Private Fund Advisers (whether registered or not) from engaging in certain activities and practices described by the SEC as "contrary to the public interest and the protection of investors" including recouping some expenses and borrowing arrangements with funds; and
 - Impose additional requirements on Private Fund Advisers that provide preferential terms to one or more investors through side letters or otherwise, as well as outright prohibit certain preferential terms.
- As described below, the quarterly statement, private fund audit, and adviser-led secondaries rules apply only to SEC-registered Private Fund Advisers (Private Fund RIAs), while the restricted activities and preferential treatment rules apply to all Private Fund Advisers regardless of registration status.

Private Fund Adviser Rules Applicable to Private Fund RIAs

Quarterly Statements

The Final Rules require Private Fund RIAs to distribute quarterly statements to private fund investors that include:

- A fund table with a detailed accounting of all compensation, fees, and amounts paid or allocated to the adviser and related persons, all fees and expenses paid by the fund to any other persons, and any fee offsets or rebates applicable to the advisers and related persons during the reporting period.
- A portfolio investment table that includes a detailed accounting of all compensation paid or allocated by a private fund's portfolio investments to the adviser.



Christopher J. Bellini

**Chair, Private
Equity**
**Co-
Chair, Capital
Markets &
Securities**

cbellini@cozen.com
Phone: (612) 260-9029
Fax: (612) 260-9080



Ingrid Welch

**Member &
General Counsel**

iwelch@cozen.com
Phone: (215) 665-4616
Fax: (215) 665-2013

Related Practice Areas

- Business
- Capital Markets & Securities
- Corporate

- Expense calculation disclosures, including the methodology used by the adviser to calculate fund fees and expenses, with cross-references to the relevant provisions in the fund's offering documents that contain the calculation methodology.
- Standardized performance information, the form and content of which will vary depending on whether the fund is liquid or illiquid.

Private Fund Audits

The Final Rules require Private Fund RIAs to undergo a financial statement audit and deliver audited financial statements to private fund investors consistent with the audit exception in Rule 206(4)-2 under the Advisers Act (the Custody Rule). The Custody Rule requires financial statements to be audited by independent auditors who are registered and inspected by the Public Company Accounting Oversight Board.

Adviser-Led Secondaries

The Final Rules prohibit adviser-led secondary transactions¹ by a Private Fund RIA unless, prior to the date that the fund investors are required to respond to a written request by the adviser or related person to participate in the transaction, the Private Fund RIA distributes to investors (i) an opinion obtained from an independent opinion provider that the price being offered is fair or stating the value, or range of values, of the assets to be sold in connection with the transaction; and (ii) a summary of any material business relationships the Private Fund RIA (or its related persons) has with the independent opinion provider.

Private Fund Adviser Rules Applicable to all Private Fund Advisers

Restricted Activities

Under the Final Rules, Private Fund Advisers are restricted from engaging in the following practices:

- Charging or allocating to a private fund expenses associated with an investigation of the Private Fund Adviser (or its related persons) by regulatory authorities, absent written consent by fund investors. However, regardless of any consent, a Private Fund Adviser may not charge or allocate fees and expenses stemming from an investigation that results or has resulted in sanctions for violations of the Advisers Act or the rules thereunder.
- Charging or allocating to a private fund any regulatory, compliance, or examination expenses of the Private Fund Adviser (or its related persons) by regulatory authorities, unless such expenses are disclosed in a written notice to investors within 45 days of the end of the fiscal quarter in which the expenses were incurred.
- Reducing the amount of an adviser's (or a related person's) clawback by actual, potential or hypothetical taxes, unless the Private Fund Adviser discloses in a written notice the aggregate dollar amounts of the adviser clawback, both before and after any such reduction, within 45 days of the end of the fiscal quarter in which the clawback occurs.
- Charging or allocating fees and expenses related to a private fund portfolio investment held by multiple funds on a non-pro rata basis, unless the charge or allocation is fair and equitable under the circumstances and the Private Fund Adviser first distributes a written notice describing the allocation and how it is fair and equitable under the circumstances.
- Borrowing money, securities, or other private fund assets, or receiving a loan or extension of credit from a private fund, unless the Private Fund Adviser distributes a written description of the material terms of the proposed borrowing to the fund's investors and obtains written investor consent. The SEC noted in the adopting press release that this prohibition will not prohibit a Private Fund Adviser from borrowing directly from individual investors outside of the fund.

Preferential Treatment and Restrictions on Side Letters

The Final Rules prohibit Private Fund Advisers from providing preferential redemption rights or information regarding portfolio holdings or exposures to an investor (or an investor in a similar pool of assets) if the preferential treatment would reasonably be expected to have a material,

negative effect on other investors. The Final Rules provide limited exceptions where the redemption rights are required by law or where the redemption or information rights are offered to all existing and future investors in the private fund (and any similar pool of assets).

All forms of preferential treatment are subject to requirements for written disclosure to investors, including:

- Advance written notice to prospective investors of any preferential material economic terms provided to other investors;
- Written notice to current investors of any other type of preferential treatment; and
- Annual notice of any preferential treatment provided in the period since the prior written notice.

Recordkeeping

To ensure compliance with the Final Rules, the SEC adopted amendments to the Adviser Act's books and records rule requiring registered investment advisers to retain records related to the Final Rules, including records relating to quarterly statements, audited financial statements, adviser-led secondaries, and notices of preferential treatment.

Compliance Dates

The Final Rules will be effective 60 days after publication in the Federal Register (Effective Date). The Final Rules have the following compliance dates:

- The compliance date for the Private Fund Audit Rule and the Quarterly Statement Rule is 18 months after the Effective Date;
- The compliance date for the Adviser-Led Secondaries Rule, the Preferential Treatment Rule, and the Restricted Activities Rule is 12 months after the Effective Date for advisers with at least \$1.5 billion private fund assets under management and 18 months after the Effective Date for advisers under the \$1.5 billion threshold; and
- The compliance date for the amended Advisers Act compliance rule is 60 days after the Effective Date.

¹ Generally, an adviser-led secondary transaction is any transaction initiated by the investment adviser or any of its related persons that offers private fund investors the choice between: (1) selling all or a portion of their interests in the private fund; and (2) converting or exchanging all or a portion of their interests in the private fund for interests in another vehicle advised by the adviser or any of its related persons.
