

SEC Adopts Private Fund Adviser Reforms

Posted in Alert on September 15, 2023

On August 23, 2023, the Securities and Exchange Commission (the “SEC”) adopted new rules and rule amendments (collectively, the “Rules”) under the Investment Advisers Act of 1940, as amended (the “Investment Advisers Act”) that will have a significant impact on the way advisers to private funds operate, including exempt reporting advisers and advisers not registered with the SEC. The dates by which advisers must come into compliance with the Rules (the “Compliance Date”) are indicated below.

I. All Private Fund Advisers (Including Exempt Reporting Advisers and Unregistered Advisers)

All private fund advisers must comply with the following rules:

1. **Restricted Activities Rule** – Private fund advisers are prohibited from:
 - Charging or allocating to a private fund any fees or expenses associated with an investigation of the adviser or related persons, or fees or expenses related to an investigation of the adviser or related persons that results or has resulted in a court or governmental authority imposing a sanction for a violation of the Investment Advisers Act without disclosure and consent from fund investors;
 - Charging or allocating to the private fund regulatory, examination, or compliance fees or expenses of the adviser or related persons, unless such fees and expenses are disclosed to investors within 45 days after the end of the applicable quarter;
 - Reducing the amount of an adviser clawback by actual, potential or hypothetical taxes applicable to the adviser, its related persons or their respective owners unless the adviser discloses the pre-tax and post-tax amount of the clawback to investors within 45 days after the end of the applicable quarter;
 - Charging or allocating fees or expenses related to a portfolio investment also held by other funds or clients of the adviser or related persons on a non-pro rata basis, unless the allocation approach is fair and equitable and the adviser distributes advance written notice of the non-pro rata charge and a description of how the allocation approach is fair and equitable under the circumstances; and
 - Borrowing or receiving an extension of credit from a private fund client without describing material terms to, and obtaining advance written consent from, fund investors unrelated to the adviser.
2. **Preferential Treatment Rule** – Private fund advisers are prohibited from providing preferential treatment to investors regarding:
 - Preferential redemption rights granted to an investor in the private fund or a similar pool of assets on terms the adviser should expect to have a material negative effect on other investors unless those rights are required by applicable law or are offered to all other investors in the applicable private fund and any related fund with substantially similar investment policies, objectives or strategies (“similar pool of assets”);
 - Preferential information about portfolio holdings or exposures of the private fund or a similar pool of assets, if the private fund adviser should expect the information to have a material, negative effect on other investors in that private fund or a similar pool of assets, unless such information is provided to all investors in the private fund and any similar pool of assets; and
 - Any other preferential treatment to an investor in the fund, unless material terms are disclosed in writing in advance to each prospective investor prior to a commitment to invest. The Rules also require subsequent disclosure of such terms to current investors in the fund.
3. **Legacy Status** – The Rules provide legacy status for the prohibitions included in the Preferential Treatment Rule and the aspects of the Restricted Activities Rule that require investor consent. The legacy status will apply to agreements that were entered into prior to the compliance date of the applicable Rules if its application would require the parties to amend the agreements.

However, legacy status does not permit private fund advisers to charge for fees or expenses related to an investigation that results or has resulted in a court or governmental authority imposing a sanction for a violation of the Investment Advisers Act. Additionally, legacy status applies only to the prohibitions of the Preferential Treatment Rule – it does not apply to the disclosure portions of the Preferential Treatment Rule. As such, preferential treatment information in side letters that existed before the compliance date must be disclosed to other investors, even if they invest in the fund after the compliance date.

Compliance Date: Smaller private fund advisers, meaning those with less than \$1.5 billion in assets under management (“Smaller Private Fund Advisers”), will have until March 14, 2025 to comply with the above Rules. Larger private fund advisers, those with \$1.5 billion or more in assets under management (“Larger Private Fund Advisers”), will have until September 14, 2024 to comply.

II. SEC Registered Private Fund Advisers

SEC registered private fund advisers must comply with the following rules:

1. Quarterly Statement Rule – Registered private fund advisers must prepare and distribute quarterly statements to investors containing detailed information including, but not limited to: fees and expenses paid by the private fund, the cost of investment in the fund, certain adviser compensation, and fund-level performance criteria used and assumptions made in calculating performance.

Compliance Date: March 14, 2025.

2. Private Fund Audit Rule – Registered private fund advisers must cause each private fund they advise to undergo a financial statement audit that meets the standards of the audit provision in the Investment Advisers Act rule 206(4)-(2) (the “Custody Rule”).

Compliance Date: March 14, 2025.

3. Adviser-Led Secondaries Rule – Registered private fund advisers must obtain a fairness opinion or a valuation opinion when offering existing private fund investors the choice between selling their interests in a private fund and converting or exchanging their interests in the private fund for interests in another investment vehicle advised by the adviser or any related person. Additionally, the adviser must distribute to the private fund’s investors a summary of any material business relationships the adviser or a related party has, or has had within the prior two years, with the independent opinion provider.

Compliance Date: Smaller private fund advisers will have until March 14, 2025 to comply with the above Rule. Larger private fund advisers will have until September 14, 2024 to comply.

4. Books and Records Rule Amendments – Registered private fund advisers must document and retain, in writing, their annual audits, quarterly statements, fairness or valuation opinions, notices under the Preferential Treatment Rule (discussed above), and all documents under the Restricted Activities Rule (discussed above).

III. All Registered Advisers

Annual Written Review – All SEC registered investment advisers, regardless of whether they provide investment advice to private funds, must annually review and document, in writing, the adequacy of their compliance policies and procedures and the effectiveness of their implementation.

Compliance Date: November 13, 2023. This means that when the SEC registered adviser commences its annual review within the 12 months after the compliance date, the review must be documented in writing.

IV. Legal Challenges

On September 1, 2023, a lawsuit was filed with the federal Court of Appeals in the Fifth Circuit challenging the validity and enforceability of the Rules. The lawsuit was filed in the form of a joint Petition for Review (the “Petition”) by six trade associations: (1) National Association of Private Fund Managers, (2) Alternative Investment Management Association, (3) American Investment Council, (4) Loan Syndications and Trading Association, (5) Managed Funds Association, and (6) National Venture Capital Association.

The Petition asserts that the Rules are in violation of the Administrative Procedure Act and exceed the SEC’s statutory authority. Though the filing of the Petition does not automatically delay the compliance date of the Rules, a delay may be requested or granted.

V. Conclusion

The Rules enhance compliance burdens of both registered and unregistered advisers. Advisers should begin preparing to come into compliance with the Rules well in advance of the applicable compliance dates.

We Can Help

For questions, please contact [Scott McGinness](#), [Frank Williams](#), [Livia Campos](#) or another member of our [Securities](#) Practice Group.