

# SEC adopts rules impacting private funds and advisers

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## At a glance

*The SEC adopted sweeping reforms of regulations over investment advisers and the private funds they advise aimed at investor protection. The new rules are expected to have a significant impact on private fund disclosures, reporting, fees and expenses, and operations.*

## What happened?

On August 23, the SEC adopted new [rules](#) aimed at enhancing private fund investor protection. Certain key requirements remained in the final rules from the 2022 proposal, including the annual audit requirement for each private fund, preparation and distribution of detailed fund-level information in quarterly statements, fairness opinions for adviser-led secondaries, and books and records amendments. The final rules, however, reflect several changes from the proposal, including elimination of certain auditor notification requirements and the proposed prohibition of indemnification clauses, exclusion of securitized asset funds, allowance of certain legacy terms in existing fund agreements, and inclusion of staggered compliance dates.

The SEC adopted the following new regulations and requirements.

- **Private fund adviser audits:** Registered private fund advisers will be required to obtain annual and liquidation audits for each private fund they advise that meets the requirements of the audit provisions in the Advisers Act Custody Rule (Rule 206(4)-2)). Further, the auditor will need to meet the standards of independence in Rule 2-01(b) and 2-01(c) of Regulation S-X with respect to the audits, and be registered with and subject to regular inspection by the PCAOB.
- **Private fund quarterly statements:** Private fund advisers that are registered or required to be registered will be required to prepare and provide investors with statements on fund performance, costs of investing in the fund, fees and expenses paid by the fund, and certain compensation and other amounts paid to the adviser.

For a fund of funds, the statement must be distributed to investors within 75 days of each fiscal quarter end and 120 days of each fiscal year end. If not a fund of funds, the statement must be distributed to investors within 45 days of each fiscal quarter and 90 days of each fiscal year end.

Specifically, the statement will need to include the following:

- **Fund fee and expense table:** all compensation, fees, and other amounts allocated or paid to the adviser or its related persons from the fund; all other fees and expenses allocated to or paid by the fund; and any offsets and rebates carried forward to reduce future payments or allocations to the adviser or its related persons
- **Portfolio investment table:** all portfolio investment compensation allocated or paid to the adviser or its related persons by each covered portfolio investment during the period with separate line items for each allocation or payment category
- **Calculations and cross-references:** prominent disclosure of how all expenses, payments, allocations, rebates, waivers, and offsets are calculated, with cross references to the organizational and offering documents
- **Performance information:** For liquid funds, disclose annual net total returns since inception or for each fiscal year over the past 10 years, whichever is shorter; average annual net total returns for one, five, and ten year periods; and cumulative net total return for the current fiscal year as of the end of the most recent fiscal quarter covered by the statement. For illiquid funds, disclose the gross and net internal rate of return (IRR) and multiple of invested capital (MOIC), along with gross IRR and MOIC separated by realized and

unrealized performance since the inception of the fund computed with and without the impact of any fund-level subscription facilities; and a statement of contributions and distributions.

If more meaningful and not misleading, advisers must consolidate this reporting to cover similar pools of assets.

- **Adviser-led secondaries:** Registered private fund advisers will be required to obtain and distribute to investors an independent fairness or valuation opinion on the fairness of the interests offered to the private fund for any interests being sold as part of certain adviser-led secondary transactions, along with a written summary of any material business relationships between the adviser and the opinion provider.
- **Private fund adviser restricted activities:** Advisers will be prohibited from certain activities, including:
  - Charging or allocating fees and expenses associated with an investigation of the adviser or its related persons by any governmental or regulatory authority without disclosure and consent from fund investors
  - Charging or allocating regulatory, examination, or compliance fees or expenses of the adviser, unless disclosed
  - Charging or allocating fees and expenses related to a portfolio investment on a non-pro rata basis, unless the allocation approach is fair and equitable and the adviser distributes advance written notice of the approach and a description of how it is fair and equitable
  - Reducing the amount of any adviser clawback for certain taxes, unless the adviser discloses the aggregate clawback before and after taxes to investors
- **Preferential treatment:** All private fund advisers may not provide preferential treatment concerning (1) certain redemptions that it expects to have a material, negative effect on other investors, unless the ability to redeem is required by law or the adviser offers the preferential redemption rights to all other investors, and (2) certain portfolio information about portfolio holdings or exposures that it expects to have a material, negative effect on other investors, unless offered to all investors.

An adviser may not provide preferential treatment unless certain terms are disclosed in advance of an investor's investment in the private fund and all preferential terms are disclosed at least annually to all investors.
- **Amended compliance rule written annual review of compliance program:** All investment advisers, including those that do not advise private funds, will need to document their annual review of the adequacy of the policies and procedures established and the effectiveness of their implementation.

## What's next?

For the private fund audit rule and the quarterly statement rule, registrants should begin preparation for compliance with the new requirements, which become effective 18 months from publication in the Federal Register. For the adviser-led secondaries rule, the restricted activities rule and the preferential treatment rule, registrants will have staggered compliance dates between 12 and 18 months depending on size. For the amended Advisers Act compliance rule, compliance will be required 60 days after publication in the Federal Register.

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