CLIENT ALERTS & INSIGHTS

SEC Adopts New Rules For Private Fund Advisers

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On August 23, 2023, the Securities and Exchange Commission ("SEC") formally adopted new rules and amendments (collectively, the "Final Rule") under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), that impose new requirements on investment advisers to hedge funds, private equity funds and certain other private funds, including in some cases, regardless of whether the adviser is registered with the SEC. The Final Rule represents an expansion of the SEC's regulation of private fund advisers and will impact how private fund advisers and private fund investors structure their relationships going forward. The Final Rule imposes new requirements and regulations with respect to the following:

- Restricted Activities: The Final Rule modifies the proposed prohibited activity rule that would apply to all private fund advisers **(whether registered with the SEC or unregistered)** to include exceptions to prohibitions of certain activities if certain disclosure and, in some cases, investor consent, is provided. Specifically, subject to compliance with applicable requirements of the Final Rule, advisers are not expressly prohibited from:
  - charging or allocating to the private fund fees or expenses associated with an investigation of the adviser or its related persons by any governmental or regulatory authority; however, regardless of any disclosure or consent, an adviser may not charge or allocate fees and expenses related to an investigation that results or has resulted in a court or governmental authority imposing a sanction for violating the Advisers Act;
  - charging or allocating to the private fund any regulatory or compliance fees or expenses, or fees or expenses associated with an examination, of the adviser or its related persons;
  - reducing the amount of an adviser clawback by actual, potential, or hypothetical taxes applicable to the adviser, its related persons, or their respective owners or interest holders;
  - charging or allocating fees and expenses related to a portfolio investment (or potential portfolio investment) on a non-pro rata basis when multiple private funds and other clients advised by the adviser or its related persons have invested (or propose to invest) in the same portfolio investment, where such non-pro rata allocation is fair and equitable; and
  - borrowing money, securities, or other private fund assets, or receiving a loan or an extension of credit, from a private fund client.

- Preferential Treatment: The Final Rule prohibits all private fund advisers **(whether registered with the SEC or unregistered)** from engaging in certain types of preferential treatment of investors (through the execution of side letter agreements or otherwise) that have a material negative effect on other investors unless the following exceptions are met:
  - providing certain preferential redemptions from the fund, unless the ability to redeem is required by applicable law or the adviser offers the preferential redemption rights to all other investors;
  - providing certain preferential information about portfolio holdings or exposures, unless such preferential treatment is offered to all investors; and
  - providing preferential treatment, unless material economic terms (versus all investment terms in the proposal) are disclosed in advance of the investor's investment in the private fund and all terms are disclosed after the investor's investment.

The compliance date for the Restricted Activities and Preferential Treatment provisions of the Final Rule is (i) 12 months after publication in the Federal Register for advisers with at least $1.5 billion of private fund assets under management ("AUM") and (ii) 18 months after publication in the Federal Register for advisers with less than $1.5 billion of AUM.

- Quarterly Statements, Private Fund Audits and Adviser-Led Secondary Transactions: The Final Rule requires private fund advisers registered with the SEC to:
  - prepare and distribute quarterly statements disclosing information on fund performance, fees and expenses, as well as certain compensation or other amounts paid to the adviser;
  - obtain an annual audit by an independent public accountant for each private fund they manage that complies with the audit provision in the current Advisers Act custody rule; and [1]
  - distribute to investors a fairness opinion or, in a change from the proposal, a valuation opinion in connection with adviser-led secondary transactions and disclose certain material relationships between the adviser and the opinion provider.

The compliance date for the Quarterly Statements and Private Fund Audit provisions of the Final Rule is 18 months after publication in the Federal Register. The compliance date for the Adviser-Led Secondary Transactions provisions of the Final Rule is (i) 12 months after publication in the Federal Register for advisers with at least $1.5 billion of AUM and (ii) 18 months after publication in the Federal Register for advisers with less than $1.5 billion of AUM.

- Advisers Act Compliance: The Final Rule amends the compliance rule under the Advisers Act to require all SEC-registered advisers to provide written documentation of their annual review of compliance policies and procedures.

The compliance date for the Advisers Act Compliance provision of the Final Rule is 60 days after publication in the Federal Register.

The Final Rule affords legacy status for compliance by advisers with the prohibitions aspect of the preferential treatment rule and the aspects of the restricted activities rule that require consent, which apply only to private funds that have commenced as of, and governing agreements that were entered into prior to, the compliance date if those agreements would need to be amended.

The Final Rule amends the books and records rule under the Advisers Act to require advisers who are registered or required to be registered with the SEC to retain books and records related to the provision of quarterly statements, private fund audits, adviser-led secondary transactions and preferential treatment of investors.

The SEC did not adopt the proposed prohibition on the adviser seeking reimbursement, indemnification, exculpation or limitation of liability for the adviser's breach of fiduciary duty, willful malfeasance, bad faith, negligence, or recklessness in providing services to the private fund, and did not adopt the proposed prohibition on charging fees for unperformed services.

If you have any questions regarding the above, please contact a member of **Benesch's Corporate and Securities Practice Group**.

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[1] This rule is subject to the outstanding safeguarding proposal, the comment period for which was re-opened by the SEC in connection with the formal adoption of the Final Rule.