

## Practice Update

# The SEC's Newly Adopted Rules and Rule Amendments for Private Fund Advisers

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*UPDATE: This Practice Update was revised on September 18, 2023, to reflect the new compliance dates in light of the publication of the new rules in the Federal Register on September 14, 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 Advisers Act) to enhance the regulation of private fund advisers. Notably, the SEC issued a split decision, voting 3 – 2 along party lines to approve the Rules.

The Rules impose several new requirements on investment advisers that provide investment advice to “private funds,” which are investment funds that rely on the Section 3(c)(1) or 3(c)(7) registration exemptions in the Investment Company Act of 1940. The Rules, absent the Compliance Rule Amendments (described below), do not cover investment advisers that provide investment advice to registered funds and other investment funds that rely on other registration exemptions, such as the real estate Section 3(c)(5)(C) exemption. The following provides a high-level summary of the regulatory implications and compliance dates related to the Rules.

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## 1. For SEC Registered Private Fund Advisers

The Rules impose several new requirements on SEC registered private fund advisers, including each of the following:

- *Quarterly Statement Rule.* An SEC registered private fund adviser must provide the investors in a private fund it manages with quarterly statements. These statements must contain certain standardized information, including fund-level information regarding performance, the cost of investing in the fund, fees and expenses paid by the fund, and compensation and other amounts paid to the adviser.
- *Private Fund Audit Rule.* An SEC registered private fund adviser must obtain an annual audit of the financial statements of any private fund that it manages. The financial statement audit must comply with Rule 206(4)-2 of the Advisers Act (the Custody Rule). These audits are intended to provide an important check on the adviser's valuation of private fund assets and protect fund investors against the misappropriation of fund assets.
- *Adviser-Led Secondaries Rule.* An SEC registered private fund adviser must obtain a fairness opinion or a valuation opinion when offering existing fund investors the option to sell their interests in a private fund or to convert or exchange such interests for interests in another vehicle managed by the adviser or its related persons. The rule further requires the adviser to prepare and furnish private fund investors with a summary of any material business relationships the adviser has, or has had within the past two years, with the independent opinion provider. This opinion is intended to provide a check against the adviser's conflicts of interest in structuring and leading such transactions.
- *Books and Records Rule Amendments.* In order to enhance the SEC's ability to assess the adviser's adherence to the Rules, the reforms include amendments to the books and records rule under the Advisers Act. Specifically, an SEC registered

private fund adviser will be required to document its annual audits in writing; retain a copy of any quarterly statements distributed to fund investors; retain a copy of any adviser-led secondaries fairness or valuation opinion and summary of material business relationships; retain copies of all written notices sent to investors under the Preferential Treatment Rule (discussed below); and retain copies of all notifications, consent forms, and other documents distributed to private fund investors pursuant to the Restricted Activities Rule (discussed below).

## 2. For All Private Fund Advisers

Additionally, all private fund advisers (whether or not they are SEC registered) must comply with the following Rules:

- *Restricted Activities Rule.* All private fund advisers are prohibited from engaging in the following activities:
  - charging or allocating to a private fund it manages (A) fees or expenses associated with an investigation of the adviser without disclosure and consent from fund investors, or (B) 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 Advisers Act or the rules promulgated thereunder;
  - charging or allocating to the private fund regulatory, examination, or compliance fees or expenses of the adviser, unless such fees and expenses are disclosed to investors;
  - reducing the amount of an adviser clawback by the amount of certain taxes, unless the adviser discloses the pre-tax and post-tax amount of the clawback to investors;
  - charging or allocating fees or 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 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 disclosing the same to, and obtaining consent from, fund investors.
- *Preferential Treatment Rule.* All private fund advisers are prohibited from providing preferential terms in side letters or otherwise to investors regarding:
  - preferential redemption rights, unless such preferential redemption rights are required by applicable law or are offered to all other investors without qualification;
  - certain preferential information about portfolio holdings and/or exposures, unless such preferential information is provided to all investors; and
  - any other preferential terms to an investor, unless such preferential terms are disclosed to all other investors prior to the investor committing to an investment in the fund and following the investor investing in the fund.
- *Legacy Status or Grandfathering.* Importantly, the SEC has provided “legacy status” related to certain provisions of the Restricted Activities Rule and the Preferential Treatment Rule that require investor consent. Accordingly, private fund advisers will not be required to amend written agreements that were entered into prior to the compliance date for these Rules.

### 3. For All SEC Registered Investment Advisers

*Compliance Rule Amendments.* Certain of the Rules apply to all SEC-registered investment advisers, including those that do not advise private funds.

Specifically, all SEC-registered investment advisers are required to maintain written records of their annual reviews of compliance policies and procedures.

#### 4. Compliance Dates

The compliance dates for the Rules will be staggered as follows:

- *Private Fund Audit Rule and Quarterly Statement Rule.* The compliance date will be 18 months from September 14, 2023 (date of publication in the *Federal Register*). This means that the compliance date is March 14, 2025.
- *Adviser-Led Secondaries Rule, Preferential Treatment Rule, and Restricted Activities Rule.* For advisers with \$1.5 billion or more in private fund assets under management, the compliance date will be 12 months from September 14, 2023 (date of publication in the *Federal Register*). This means that the compliance date is September 14, 2024.

For advisers managing less than \$1.5 billion in private fund assets, the compliance date will be 18 months from September 14, 2023 (the date of publication in the *Federal Register*). This means that the compliance date is March 14, 2025.

- *Compliance Rule Amendments.* The compliance date will be 60 days from September 14, 2023 (date of publication in the *Federal Register*). This means that the compliance date is November 13, 2023.

#### 5. Conclusion

Advisers should begin preparing to ensure their compliance with the Rules well ahead of the above compliance dates. We will continue to monitor progress regarding the Rules and will follow up with a separate Practice Update once the Rules are published.

For additional information on how these proposals might affect your firm or practice, please contact Paul Foley, Chair, John Faust, Kiki Scarff, Michael Fulks, or Brittany Puckett, each of Akerman's Investment Management Practice.

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