

SEC PRIVATE FUND ADVISERS; DOCUMENTATION OF REGISTERED INVESTMENT ADVISER COMPLIANCE

On August 23, 2023, the SEC adopted six new rules, six exclusively targeting Private Fund Advisers, *regardless of registration status*, as well as a new general rule applicable to *all Registered Investment Advisers* (together, the “Private Fund Adviser Rules”).

These rules were originally proposed in February, 2022, and are aimed at addressing perceived opacity and conflict of interests in the Private Fund space. This includes any fund utilizing one of two commonly utilized exceptions within the Investment Company Act of 1940 (3(c)1 and 3(c)7). This includes all LP’s, LLC’s, Statutory Business Trusts (DE or NH), and Private Group Trusts, regardless of size or implementation (i.e. traditional long-only, hedge, or private capital funds).

KEY ASPECTS OF THE RULES

- **Quarterly Statement Rule** - requiring a new granular fund level disclosure detailing required information around performance, fees, and expenses.
- **Audit Rule** - requiring all funds to have an annual audit
- **Adviser-Led Secondaries Rule** - requiring a fairness or valuation opinion for any Adviser-led secondary transactions
- **Restricted Activities Rule** - prohibiting certain practices, without granular substantive disclosures to all investors, and in some cases, only with investor consent

Timetable

Effective date is 60 days from publication in the Federal Register (likely early November 2023)

Compliance date will vary by rule

- **Audit & quarterly Statement Rules:** 18 months post effective date (roughly, May 2025)
- **Adviser-Led Secondaries, Preferential Treatment, and Restricted Activities Rules:** 12 months post effective date if Adviser manages >1.5 Billion in Private Funds (roughly November 2024), or 18 months post effective date if <1.5 Billion (roughly, May 2025)
- **Amended Adviser Act Compliance Rule:** 60 days from publication in the Federal Register (roughly early November 2023)

SEC PRIVATE FUND ADVISER RULES

- **Preferential Treatment Rule** - prohibiting certain treatment where there is a material negative effect on excluded investors, with additional prohibitions around preferential treatment without disclosure to existing and prospective investors.
- **Adviser Act Compliance Rule** - requiring all registered Advisers to document in writing the annual review of their compliance policies and procedures.

RATIONALE FOR RULES

- Every-day investors have indirect exposure to these funds through retirement plans, endowments, and foundations.
- The actions of some examined Advisers have revealed practices that are deemed to imply conflicts and to lack transparency, and therefore are contrary to the public interest and require protection of these end-stakeholders.

CHANGES FOR ALL REGISTERED PRIVATE FUND ADVISERS

QUARTERLY STATEMENT RULE

All Private Fund Advisers will need to distribute quarterly a disclosure of fund-level information with some required formatting

- Statement requirements include
 - A fund table listing all compensation paid to the Adviser/related persons, fund fees and expenses, and any fee offsets or rebates
 - A portfolio investment table listing all compensation paid by the fund's investments to the Adviser
 - Expense disclosures, including methodologies used to calculate fees and expenses, with cross references to the relevant provisions in the fund's offering documents which contain the methodologies "standard" performance information

PRIVATE FUND AUDIT RULE

- Adviser will engage in a financial statement audit that meets the provisions in the Advisers Act (the Custody Rule, as it now stands under Rule 206(4)-2)

ADVISER-LED SECONDARIES RULE

- Advisers will need to secure a fairness or valuation opinion when offering existing investors the option between selling their interests and converting or exchanging their interests into another vehicle advised by the Adviser (or any related person).

SEC PRIVATE FUND ADVISER RULES

- Advisers will have to prepare and distribute a summary of any material business relationships the Adviser has, or has had within 2 years, with the opinion provider.

BOOKS AND RECORDS RULE CHANGES

- Changes to Rule 204-2, under the Advisers Act (Recordkeeping Rule) to require Private Fund Advisers to maintain certain documents relating to the final rules

CHANGES FOR ALL PRIVATE FUND ADVISERS

RESTRICTED ACTIVITIES RULE

- Charging to the fund fees or expenses associated with an investigation of the Adviser without disclosure and consent from fund investors, and full prohibition against passing through fees or expenses related to investigations resulting in governmental imposition or sanction for a violation of the Advisers Act (or its rules).
- Charging regulatory, exam, or compliance fees or expenses of the Adviser, without full disclosure
- Reducing clawbacks for certain taxes, without pre and post-tax disclosure of the clawback
- Charging portfolio investment expenses on a non-pro rata basis, unless approach is equitable with advance written notice describing non-pro rata approach and a description of how the allocation is fair
- Borrowing or securing credit from the fund without disclosure to and consent from investors.

PREFERENTIAL TREATMENT RULE

- Prohibition against Advisers providing preferred terms to investors regarding
 - Certain redemptions (unless required in law or offered to all other investors)
 - Disclosure of information on a preferred basis surrounding holdings or exposures (unless offered to all other investors)
- Prohibition against any other preferential treatment, without disclosing certain terms of the treatment in advance of an investor's subscription, with all terms disclosed after the investment.

LEGACY STATUS

- Private funds operating prior to the compliance date are not required to comply with the restrictions above requiring investor consent.

SEC PRIVATE FUND ADVISER RULES

- Agreements executed with investors *prior to the applicable compliance date*¹, are exempt from the prohibitions against preferential treatment and restrictions on side letters.

CHANGES FOR ALL REGISTERED ADVISERS

COMPLIANCE RULE AMENDMENTS

- Update to Rule 206(4)-7 (Compliance Rule) requiring all Advisers (including those that do not manage private funds) to document their annual reviews of their compliance policies and procedures in writing

KEY TAKEAWAYS

- This is the largest set of rule-making impacting the private fund space in over a decade
- Advisers will need to review their disclosures and practices today to see where changes will be required.
- All Advisers will need to review the Compliance Rule amendments to see if / where there may be impact to them.
- Some smaller Advisers may deem the impact and associated compliance burden costs to be insurmountable

NORTHERN TRUST SUPPORT FOR NEW REQUIREMENTS

The Service Strategy and Enablement team has been actively monitoring this regulation. We will continue to digest the significant amount of detail in this comprehensive set of rules to understand where Northern Trust, as a fund administrator, can support Private Fund Adviser clients.

For further reference, please see the SEC's [rule](#) and [Commissioner statements](#).

Contact Us

To learn more, contact your Northern Trust relationship manager, or visit northerntrust.com.

¹ See timetable section on page 1 for applicable dates.

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