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What Exempt Reporting Advisers need to know about the Private Funds Adviser Rule

SEC Private Fund Adviser Compliance Requirements

Overview of the Private Fund Adviser Rules

On August 23, the SEC voted to adopt final amendments to the Investment Advisers Act of 1940 that subject private fund advisers to a number of new requirements. The Rules also include an amendment to existing Rule 206(4)-7 under the Advisers Act that will require all registered investment advisers to document the results of their required annual compliance reviews in writing.

While the final Private Fund Adviser Rules might not seem to be quite the burden as originally proposed, they still represent a seismic shift for the private fund industry, and many believe that the rules may have negative effects on managers of and investors in private funds.

There's a lot to unpack with the new rule and this piece will take us through the biggest challenges that will face Exempt Reporting Advisers.

The final Private Fund Adviser Rules are divided into six distinct parts:

1. Written Annual Compliance Review
2. Quarterly Statement Rule
3. Mandatory Annual Audit
4. Adviser-led Secondaries Rule
5. Restricted Activities Rule
6. Preferential Treatment Rule

The adopting release and SEC fact sheet can be found here.

Exempt Reporting Adviser ("ERAs") who advise private funds are subject to only the **Preferential Treatment** and **Restricted Activities Rules**.

Restricted Activities Rule

All private fund advisers will be **prohibited outright from charging 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. Disclosure and consent are irrelevant.

All private fund advisers also will be prohibited, unless either (i) **disclosed to** or (ii) **disclosed to and consented to by investors**, as applicable, from the following:

- Charging or allocating to the private fund fees or expenses with an **investigation of the adviser by any governmental or regulatory authority**, unless the adviser requests **each investor of the private fund consents** to such charge or allocation and **obtains written consent from at least a majority in interest** of the private fund's investors, and provided the fees and expenses do not meet those outright prohibited (as above);
- Charging or allocating to the private fund **regulatory, examination, or compliance fees or expenses of the adviser**, unless distributes a written notice **(i.e., disclosure)** of any such fees or expenses , and the dollar amount thereof, to the investors of such private fund client in writing within 45 days after the end of the fiscal quarter in which the charge occurs;
- Reducing the amount of an **adviser clawback** by the amount of certain taxes, unless the adviser **discloses** to investors within 45 days after the end of the fiscal quarter in which the adviser clawback occurs the pre-tax and post-tax amount of the clawback;
- 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 (i.e., **ex ante disclosure**) 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 ex ante disclosure to, and consent from, fund investors.

Preferential Treatment rule

All private fund advisers are prohibited from providing preferential terms to investors regarding redemptions from the fund if the adviser reasonably expects such terms would have a material, negative effect on other investors in the private fund or in a similar pool of assets, unless:

- the investor's **ability to redeem is required by laws, rules, regulations or orders by certain governmental authorities** to which the investor, the private fund or similar pool of assets is subject or
- the adviser has **offered the same redemption ability to all existing investor**s and will continue to offer the same redemption ability to all future investors in the private fund or similar pool of assets.

All private fund advisers are prohibited from providing information on the private fund's portfolio holdings/ exposures if the advisers reasonably expects that providing the information would have a material, negative effect on other investors in that private fund or a similar pool of assets, **unless such preferential information is offered to all other existing investors in the private or any similar pool of assets at the same time or substantially the same time.**

The new rule requires the private fund adviser to provide to any prospective investor in the private fund, prior to the investor's investment in the private fund, a written notice regarding specific information that pertains to **preferential treatment related to any material economic terms** that the adviser provides to other investors in the same private fund.

The requirement to provide current investors comprehensive, **annual disclosure of all preferential treatment** provided by the adviser or its related persons since the last annual notice.

The requirement to distribute to current investors a written **notice of all preferential treatment** the adviser or its related persons has provided to other investors in:

- a liquid fund **as soon as reasonably practicable following the investor's investment in the private fund**; or
- an illiquid fund **as soon as reasonably practicable following the end of the fund's fundraising period.**

Effective and compliance dates

The New Rules will take effect 60 days after publication in the Federal Register (Effective Date) which was September 14, 2023; however, the SEC's interpretations regarding how an adviser's fiduciary duty applies to its private fund clients (as discussed in the Restricted Activities Rule section above) are effective immediately.

Compliance with the amendments to the Compliance Rule is required on the Effective Date - November 13, 2023.

Compliance with the (1.) Restricted Activities Rule, (2.) Preferential Treatment Rule and (3.) Adviser-Led Secondaries Rule will be required within 12 months of the Effective Date for advisers with $1.5 billion or more in private fund assets under management (September 14, 2024) and within 18 months of the Effective Date for advisers with less than $1.5 billion in private fund assets under management (March 14, 2025)

Compliance with the (4.) Quarterly Statement Rule and (5.) Audit Rule will be required within 18 months after the Effective Date (March 14, 2025)

SEC Registration Status of Adviser	Domicile of the Adviser?	Domicile of Private Fund	Do the new Private Funds Adviser Rules Apply?	Compliance period
Exempt Reporting Adviser ("ERA")	U.S. Adviser	U.S.	Yes. Preferential Treatment and Restricted Activities Rules	18 months. March 14, 2025 (for small advisers under $1.5bn)
Exempt Reporting Adviser ("ERA")	U.S. Adviser	Offshore Fund	Yes. Preferential Treatment and Restricted Activities Rules	18 months. March 14, 2025 (for small advisers under $1.5bn)
Exempt Reporting Adviser ("ERA")	Offshore Adviser	U.S.	Yes. Preferential Treatment and Restricted Activities Rules	18 months. March 14, 2025 (for small advisers under $1.5bn)
Exempt Reporting Adviser ("ERA")	Offshore Adviser	Offshore Fund	No	N/A

How can Waystone Compliance Solutions help?

Our team of US compliance professionals are experts at managing SEC regulatory compliance programs, providing clear insight into how to meet the challenges of this complex rule.

If you would like more information on this topic or have any questions, please reach out to our US Compliance Solutions team today.