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A Practical Guide to the SEC's Private Fund Adviser Rules: Commentary and Industry Insight

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Overview

As summarized previously in an Alston & Bird advisory, on August 23, 2023, the U.S. Securities and Exchange Commission ("SEC") voted 3–2 to adopt new rules and amendments to rules under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), affecting registered and unregistered advisers to private funds (the "Final Rules"). The full text of the Final Rules can be found here.

In Release No. IA-6383 (the "Adopting Release"), the SEC stated that the Final Rules "are designed specifically to address the following three factors for risks and harms that are common in an adviser's relationship with private funds and their investors: lack of transparency, conflicts of interest, and lack of effective governance mechanisms for client disclosure, consent, and oversight."

The SEC described its decision to adopt the Final Rules, which include significant new requirements for private fund advisers, as aimed at protecting the interest of "millions of Americans" who have "indirect exposure to private funds through the participation in public and private pension plans, endowments, foundations, and certain other retirement plans" and at curtailing certain practices, including those arising out of conflicts of interest, that "have the potential to lead to investor harm." The SEC also stated that the Final Rules are intended to be responsive to "the trend of rising interest in private fund investments by smaller investors with less bargaining power, such as the growth of new platforms to facilitate individual access to private investments with small investment sizes, or non-institutional investor groups pooling funds to invest in private funds, or other means by which small individual investors can access private investments."

This Alston & Bird Compliance Guide (this "Guide")[1] seeks to help industry participants navigate and comply with the Final Rules and is responsive to questions raised by our clients as they continue to prepare for compliance with the Final Rules. This Guide begins with two tables to orient readers: the first table lays out the applicability of each of the six rules based on adviser type and the compliance deadlines, and the second table notes the legacy status for the two applicable rules.

Each of the six Final Rules has a corresponding section in this Guide, including a detailed summary of each rule's requirements in table format. Commentary, derived from the SEC's adopting release, Alston & Bird's analysis, and centered on topics that our clients are focused on, can be found beneath each table. Text from the Adopting Release providing guidance is quoted from the rule text.

1 This Guide does not, and is not intended to, constitute legal advice, and the information provided herein is for general informational purposes only and may not represent the most up-to-date legal or other information available. All liability for actions taken or not taken based on the contents hereof is expressly disclaimed, and such content is provided "as is." The views expressed herein are those of the individual authors writing in their individual capacities only and not necessarily the view of Alston & Bird as a whole. Readers should contact their Alston & Bird relationship attorney to obtain advice on any particular legal matter.

Applicability and Compliance Dates

Table 1: Applicability of Private Fund Adviser Rules to Investment Advisers

Rule	SEC-Registered Adviser		Unregistered Adviser (Including ERAs, Foreign Private Advisers, State-Registered Advisers, and Advisers Exempt from State Registration)	
	Large Advisers (more than $1.5 billion AUM)	**Small Advisers** (less than $1.5 billion AUM)	**Large Advisers** (more than $1.5 billion AUM)	**Small Advisers** (less than $1.5 billion AUM)
Quarterly Statement	Applicable (March 14, 2025)	Applicable (March 14, 2025)	Not applicable	
Private Fund Audit	Applicable (March 14, 2025)	Applicable (March 14, 2025)	Not applicable	
Adviser-Led Secondaries	Applicable (September 14, 2024)	Applicable (March 14, 2025)	Not applicable	
Restricted Activities	Applicable to all Advisers (September 14, 2024)	Applicable to all Advisers (March 14, 2025)	Applicable to all Advisers (September 14, 2024)	Applicable to all Advisers (March 14, 2025)
Preferential Treatment	Applicable to all Advisers (September 14, 2024)	Applicable to all Advisers (March 14, 2025)	Applicable to all Advisers (September 14, 2024)	Applicable to all Advisers (March 14, 2025)
Compliance Rule Amendments	Applicable to all Registered Advisers (November 14, 2023)		Not Applicable	

Note: The SEC restated its position that most of the substantive provisions of the Advisers Act do not apply to non-U.S. clients (including non-U.S. private fund clients, regardless of whether they have U.S. investors) of an SEC-registered offshore adviser.

Further, the Final Rules do not apply to advisers to "securitized asset funds," which are defined as any private funds "whose primary purpose is to issue asset backed securities and whose investors are primarily debt holders." This definition corresponds to the definition of the term in Form PF and Form ADV.

Table 2: Legacy Status of Rules

Preferential Treatment	Legacy Status
Redemption Rights	Legacy
Information Rights	Legacy
Disclosure Obligations	No
Restricted Activities	**Legacy Status**
Regulatory, Compliance, and Examination Fees	No
Reducing Adviser Clawback[2] by Taxes	No
Non-Pro Rata Fees and Expense Allocations	No
Investigation Fees and Expenses	Legacy, unless investigation results in sanctions relating to violations of the Advisers Act

Private funds in existence prior to the compliance dates in Table 1 are allowed a limited legacy status privilege, as stated in Table 2. It is important for advisers to note the narrowness of the legacy treatment provided. Generally, if a fund has commenced operations and the contractual agreements governing the applicable fund (including side letters and borrowing agreements, if applicable) were entered into prior to the compliance date, the new rules will not apply to the extent that they would require an amendment to such governing documents. Within the meaning of the Final Rules, "commencement of operations" includes any bona fide activity directed toward operating a private fund, including investment, fundraising, or operational activity. Examples of such activity include the issuance of capital calls, the establishment of a fund-level subscription facility,[3] the occurrence of an initial closing, the conducting of due diligence on potential fund investments, and the making of a fund investment.

Importantly, as described further in the preferential treatment section of this Guide, disclosure requirements apply to *all* existing private funds regardless of their dates of inception.

2 **Adviser clawback** means any obligation of the adviser, its related persons, or their respective owners or interest holders to restore or otherwise return performance-based compensation to the private fund pursuant to the private fund's governing agreements.

3 **Fund-level subscription facility** means any subscription facilities, subscription line financing, capital call facilities, capital commitment facilities, bridge lines, or other indebtedness incurred by the private fund that is secured by the unfunded capital commitments of the private fund's investors.

I. Quarterly Statement Rule – § 275.211(h)(1)-2 (Registered Advisers to Private Funds)

Registered investment advisers to private funds must prepare a quarterly statement for each private fund they advise that includes a fund table, a portfolio investment[4] table, and performance information. These quarterly statements must be distributed[5] to all investors in the underlying private fund in accordance with the timing requirements set forth below. "Reporting period" refers to the quarterly reporting period covered by a quarterly statement. Additionally, advisers must consolidate reporting for "similar pools of assets"[6] and provide all consolidated information to investors to the extent it would provide more meaningful information and would not be misleading.

Quarterly Statements Requirements for Liquid Funds and Illiquid Funds		
	Liquid Funds A private fund that is not an illiquid fund.	**Illiquid Funds** A private fund that is not required to redeem interests upon an investor's request and has limited opportunities, if any, for investors to withdraw before termination of the fund.
Fund Table **Note:** Advisers must keep a written record of accurate and current documentation substantiating the determination that a private fund client is a liquid fund or an illiquid fund under the classifications described above.	In an organized, table format, advisers must disclose a detailed accounting of— ■ **All compensation, fees, and other amounts** allocated or paid to the adviser or any of its related persons[7] by the private fund during the reporting period. • **Separate line items reflecting the total dollar amount** for each category, including, but not limited to, (i) management, (ii) advisory, and (iii) sub-advisory fees, and (iv) performance-based compensation.	Same as liquid funds.

4 **Portfolio investment** means any entity or issuer in which the private fund has invested directly or indirectly, including through holding companies, subsidiaries, acquisition vehicles, SPVs, and other vehicles through which an investment is made or otherwise held by the fund. However, such definition would generally exclude potential *portfolio* investments. Hence, a broken deal fee from an unconsummated portfolio investment would generally not constitute portfolio investment compensation. However, if the fund bears a broken deal expense, the expense must be disclosed as a fund fee or expense.

5 **Distribute** means send or sent to all of the private fund's investors unless the context otherwise requires; provided that, if an investor is a pooled investment vehicle that is controlling, controlled by, or under common control with the adviser or its related persons, the adviser must look through that pool (and any pools in a control relationship with the adviser or its related persons) in order to distribute to investors in those pools.

6 **Similar pool of assets** means a pooled investment vehicle (other than an investment company registered under the Investment Company Act of 1940, as amended, a company that elects to be regulated as such, or a securitized asset fund) with substantially similar investment policies, objectives, or strategies to those of the private fund managed by the investment adviser or its related persons.

7 **Related person** has the meaning ascribed to it in Form ADV.

I. Quarterly Statement Rule – § 275.211(h)(1)-2 (Registered Advisers to Private Funds)

Quarterly Statements Requirements for Liquid Funds and Illiquid Funds		
	Liquid Funds A private fund that is not an illiquid fund.	**Illiquid Funds** A private fund that is not required to redeem interests upon an investor's request and has limited opportunities, if any, for investors to withdraw before termination of the fund.
Fund Table **Note:** Advisers must keep a written record of accurate and current documentation substantiating the determination that a private fund client is a liquid fund or an illiquid fund under the classifications described above.	■ **All fees and expenses** paid by or allocated to the private fund during the reporting period. • **Separate line items reflecting the total dollar amount** for each category, including, but not limited to, organizational, accounting, legal, administration, audit, tax, due diligence, and travel fees and expenses. ■ **Any offsets or rebates carried forward** during the reporting period to subsequent reporting periods to reduce future payments or allocations to the adviser or its related persons. The adviser must present the dollar amount of each category of adviser compensation or fund expense **before** and **after** any such reductions for the reporting period.	Same as liquid funds.

I. Quarterly Statement Rule – § 275.211(h)(1)-2 (Registered Advisers to Private Funds)

Quarterly Statements Requirements for Liquid Funds and Illiquid Funds		
	Liquid Funds A private fund that is not an illiquid fund.	**Illiquid Funds** A private fund that is not required to redeem interests upon an investor's request and has limited opportunities, if any, for investors to withdraw before termination of the fund.
Portfolio Investment Table	In an organized, table format, advisers must disclose a detailed accounting of— ■ All portfolio investment compensation allocated or paid by each covered portfolio investment[8] to the adviser or its related persons (including any affiliated sub-advisers) during the reporting period (both before and after the application of any offsets, rebates, or waivers). ■ **Separate line items reflecting the total dollar amount** must be included for each category of allocation of payment, including origination, management, consulting, monitoring, servicing, transaction, administrative, advisory, closing, disposition, directors, trustees, or similar fees or payments by the portfolio investment to the adviser or any of its related persons. ■ The table must list the private fund's ownership percentage of each covered portfolio investment (but not reflect the percentage of ownership attributable to any other person's interest therein) that paid or allocated compensation to the adviser or its related persons during the reporting period. ■ The table must disclose the identity of each covered portfolio investment to the extent necessary for an investor to understand the nature of the potential or actual conflicts associated with such payments.	Same as liquid funds.

8 **Covered portfolio investment** means a portfolio investment that allocated or paid the adviser or its related persons portfolio investment compensation during the reporting period.

I. Quarterly Statement Rule – § 275.211(h)(1)-2 (Registered Advisers to Private Funds)

Quarterly Statements Requirements for Liquid Funds and Illiquid Funds		
	Liquid Funds A private fund that is not an illiquid fund.	**Illiquid Funds** A private fund that is not required to redeem interests upon an investor's request and has limited opportunities, if any, for investors to withdraw before termination of the fund.
Performance Information	Must disclose with equal prominence performance information— ■ Based on the **net total return** on an annual basis for each fiscal year for the 10 fiscal years prior to the quarterly statement or since the fund's inception (whichever is shorter). ■ Based on average annual net total returns over one-, five-, and 10-fiscal-year periods; and ■ The **cumulative net total return** for the **current fiscal year** as of the end of the most recent fiscal quarter.	Must disclose the following performance measures with equal prominence in each quarterly statement, **shown since inception** of the illiquid fund and **computed with and without the impact of any fund-level subscription facilities**— ■ **Gross IRR**[9] [10] and **gross MOIC**[11] [12] for the illiquid fund. ■ **Net IRR**[13] and **net MOIC**[14] for the illiquid fund. ■ **Gross IRR** and **gross MOIC** for the **realized and unrealized portions** of the illiquid fund's portfolio, with the realized and unrealized performance shown separately.

9 **IRR** or internal rate of return, means the discount rate that causes the net present value of all cash flows throughout the life of the fund to be equal to zero.

10 **Gross IRR** means an internal rate of return that is calculated gross of all fees, expenses, and performance-based compensation borne by the private fund.

11 **MOIC** or multiple on invested capital, means, as of the end of the applicable fiscal quarter, (1) the sum of: (i) the unrealized value of the illiquid fund; and (ii) the value of all distributions made by the illiquid fund; (2) divided by the total capital contributed to the illiquid fund by its investors.

12 **Gross MOIC** means a multiple of invested capital that is calculated gross of all fees, expenses, and performance-based compensation borne by the private fund.

13 **Net IRR** means an internal rate of return that is calculated net of all fees, expenses, and performance-based compensation borne by the private fund.

14 **Net MOIC** means multiple of invested capital that is calculated net of all fees, expenses, and performance-based compensation borne by the private fund.

I. Quarterly Statement Rule – § 275.211(h)(1)-2 (Registered Advisers to Private Funds)

Quarterly Statements Requirements for Liquid Funds and Illiquid Funds		
	Liquid Funds A private fund that is not an illiquid fund.	**Illiquid Funds** A private fund that is not required to redeem interests upon an investor's request and has limited opportunities, if any, for investors to withdraw before termination of the fund.
Statement of Contributions and Distributions	Not applicable.	Must provide a statement of **contributions and distributions with respect to illiquid funds.** This is a document that presents: ■ All capital inflows (including date and value) received from investors since inception, ■ All capital outflows (including date and value) distributed to investors since inception, and ■ NAV as of the end of the applicable reporting period.

Sub-advisory fees allocated or paid to a related person of the adviser solely by the adviser (and not by the private fund) are not required to be disclosed as a separate item of adviser compensation. However, compensation to an unaffiliated sub-adviser is required to be separately disclosed as a fund fee and expense, to the extent such compensation is allocated to or paid by the fund.

In the SEC's view, a fund of funds adviser should be in a position to determine whether an entity paying the adviser, or a related person, is a portfolio investment of the fund of funds under the Final Rules. For example, the fund of funds adviser can request information from the payor regarding whether certain underlying funds hold an investment in the payor. The fund of funds adviser can also request a list of investments from the underlying funds to determine whether any of those underlying portfolio investments have a business relationship with the adviser or its related persons. However, the SEC also recognizes that despite their best efforts, certain fund of funds advisers may lack information or may not be given information about underlying entities, and depending on a private fund's underlying investment structure, a fund of funds adviser may have to rely on good faith belief to determine which entity or entities constitute a portfolio investment under the Final Rules. An adviser may consider documenting this determination, as well as its initial and ongoing diligence efforts to determine whether a portfolio investment has compensated the adviser or its related persons, in its records.

To the extent the identity of any covered portfolio investment is not necessary for an investor to understand the nature of the conflict, advisers may use consistent code names (e.g., "portfolio investment A").

I. Quarterly Statement Rule – § 275.211(h)(1)-2 (Registered Advisers to Private Funds)

An adviser's and its related persons' interests in the private fund generally should be excluded when calculating performance for a quarterly statement to prevent the performance from being misleading (e.g., where a general partner's interest in a private fund does not pay management fees or bear carried interest).

If a fund expense could also be characterized as adviser compensation, it must be disclosed as adviser compensation rather than as a fund expense. This is intended to capture amounts paid to related persons for providing services that a third party could have provided. Advisers should also note that the SEC made no exception for nonmaterial expenses. Advisers are not permitted to exclude de minimis expenses, group smaller expenses together into broader categories, or identify expenses simply as "miscellaneous."

With regard to the fund table, the SEC noted that offsets, rebates, and waivers applicable to certain, but not all, investors through one or more separate arrangements (for example, side letters) are required to be reflected and described prominently in the fund-wide numbers presented in the quarterly statement. Advisers are not required to disclose the identity of the subset of investors that receive such offsets, rebates, or waivers. Therefore, if an investor is entitled to a management fee waiver pursuant to its side letter, this would need to be reflected in the quarterly reporting numbers. Advisers should note the difference between this requirement and the performance calculation requirements of the New Marketing Rule (Rule 206(4)-1 of the Advisers Act) (which, for example, required the highest possible applicable fee to be used in calculations to show a fund's average net returns). Notably, while information in the quarterly statement would generally not be considered to be an "advertisement" under the New Marketing Rule, any quarterly statement to a current investor that offers new or additional investment advisory services with regard to securities would be an advertisement thereunder. Likewise, any quarterly statement furnished to a prospective investor would also likely constitute an advertisement. Accordingly, there may be situations in which the Quarterly Statement Rule requirements and the New Marketing Rule requirements would both apply.

With regard to the portfolio investment table, advisers should note that they need not include distributions representing profit or return of capital due to the fund's interest in a portfolio investment. Consistent with the overarching theme of the other rules, here, the SEC is focused on creating visibility into activities that may indicate conflicts of interest, (e.g., the payment of fees to the adviser or its affiliate among the various entities in a given fund structure at the expense of the fund's investors).

Regarding subscription facility-related disclosures, the SEC's goal in requiring advisers to display levered and un-levered returns (i.e., "before and after the use of subscription facilities") is to prevent investors from being misled. These temporary substitutes for investor capital (which include subscription facilities, subscription line financing, capital call facilities, capital commitment facilities, bridge lines, or other indebtedness incurred by the private fund that is secured by the unfunded capital commitments of the investors) permit the fund to delay the calling for contributions from investors, which can increase performance metrics artificially. The SEC stated that they generally interpret the phrase "computed without the impact of fund-level subscription facilities" to require advisers to exclude fees and expenses associated with the facility, such as the interest expense, when calculating net performance figures and preparing the statement of contributions and distributions.

I. Quarterly Statement Rule – § 275.211(h)(1)-2 (Registered Advisers to Private Funds)

More on Similar Pools of Assets:

- Consolidated Reporting. Advisers must consolidate reporting for similar pools of assets to the extent it would provide more meaningful information to investors and would not be misleading. Advisers generally should disclose the basis of any consolidated reporting in the quarterly statement, including, e.g., if the statement includes multiple entities and, if so, which entities and the methods used to calculate the amounts on the statement allocated from each entity. Advisers generally should also disclose any important assumptions associated with consolidated reporting that affect performance reporting as part of the quarterly statement. An example might include how unequal tax expenses are factored into consolidated performance reporting where one fund has greater tax expenses than the other funds in a consolidated fund structure.

- Principles-Based Analysis to Determine "Similar Pool of Assets." Determining whether a vehicle constitutes a similar pool of assets to a given fund requires a "principles-based" analysis, and generally would include a parallel fund or a feeder fund investing in the same assets, or any other vehicle with a substantially similar investment policy, objective, *or* strategy. For example, a feeder fund acting as a conduit to an affiliated master fund generally would be required to provide feeder fund investors with a single quarterly statement covering the applicable feeder fund and the feeder fund's proportionate share of the master fund on a consolidated basis. Notably, in the New Marketing Rule, the term "related portfolio" is defined to mean "a portfolio with substantially similar investment policies, objectives, *and* strategies" (emphasis added). Under the Final Rules, the scope of "similar pool of assets" is broader because the term includes a pooled investment vehicle with "substantially similar investment policies, objectives, *or* strategies" (emphasis added). The SEC emphasized that it removed the word "substantially" from the defined term to signal the broader scope under the Final Rules. The breadth of this concept is designed to capture the most commonly used fund structures and prevent advisers from structuring around the prohibitions on preferential treatment (more on preferential treatment below). For example, an adviser's healthcare-focused private fund may be considered a "similar pool of assets" to the adviser's technology-focused private fund under the definition.

- Co-Investment Vehicles. Generally, since co-investment vehicles operate in a similar manner as other pooled investment vehicles that invest alongside an adviser's main fund (i.e., they typically enter and exit investment(s) at substantially the same time and on substantially the same terms as the adviser's main fund does), co-investment vehicles are likely to constitute similar pools of assets, subject to each situation's facts and circumstances analysis.

- SMAs and Funds of One. Separately managed accounts are not included in the definition of similar pool of assets. A case-by-case analysis would apply to funds of one because the SEC stated that there are "circumstances in which a fund of one or single investor fund can be a pooled investment vehicle and therefore can fall within the definition of 'similar pool of assets.'"

- Different Target Returns or Sector Focus. However, in general, a pool of assets with a materially different target return or sector focus is likely not to have sufficiently similar investment policies, objectives, or strategies to those of the fund in question and thus would not constitute a similar pool of assets.

I. Quarterly Statement Rule – § 275.211(h)(1)-2
(Registered Advisers to Private Funds)

Distribution to Investors		
Format	**Timing**	**Records**
Quarterly statement must: ■ **Provide cross-references** to the relevant sections of the private fund's organizational and offering documents **that set forth the calculation methodology**. ■ Use clear, concise, plain English. ■ Facilitate the review of one quarterly statement to the next (by way of consistent formatting). ■ List fees and expenses as separate line items, by total dollar amount, per specific category. ■ Include the date the performance information is current through. ■ Include prominent disclosure of (1) the criteria used and (2) the assumptions made in calculating performance information.	**If the private fund is newly formed**, then quarterly statements must be distributed beginning with the quarter following the second full fiscal quarter of generating operating results. **If the private fund is not a fund of funds**, then a quarterly statement must be distributed within— ■ 45 days after the end of each of the first three fiscal quarters of each fiscal year, and ■ 90 days after the end of each fiscal year. **If the private fund is a fund of funds**, then a quarterly statement must be distributed— ■ Within 75 days after the first three fiscal quarter ends, and ■ 120 days after the end of the fiscal year. ■ No additional time is permitted for a private fund that is a fund of funds of funds. **If the private fund is wound up and dissolves**, then the final quarterly statement covers the fiscal quarter in which the fund is wound up and dissolves.	Advisers must maintain accurate and current: ■ Copies of each quarterly statement distributed. ■ A record of each addressee and corresponding dates of distribution. ■ Records evidencing the calculation method for all expenses, payments, allocations, rebates, offsets, waivers, and performance listed on any statement delivered pursuant to the quarterly statement rule.

I. Quarterly Statement Rule – § 275.211(h)(1)-2 (Registered Advisers to Private Funds)

If a newly formed private fund begins generating results on a day other than the first day of a fiscal quarter, the adviser should include the partial quarter and the immediately succeeding fiscal quarters in the newly formed private fund's initial quarterly statement. For example, if a fund begins generating operating results on February 1, the reporting period for the initial quarterly statement would cover the period beginning on February 1 and ending on September 30.

Distribution via data room access is permitted if the adviser notifies investors when the quarterly statements are uploaded to the data room within the applicable time period and ensures that investors have access thereto. If some but not all of the information required to be delivered in the quarterly statement is included in a quarterly statement furnished by another person, the adviser generally would need to prepare and furnish separately the required information not included.

The SEC stated that failure to deliver a quarterly statement in the required timeframe would not be a basis for an enforcement action so long as the adviser reasonably believed that the quarterly statement would be distributed by the required deadline and the adviser thereafter delivers the quarterly statement as promptly as practicable. The rule is intended to preclude advisers from using layers of pooled investment vehicles in a control relationship with the adviser to avoid meaningful application of the distribution requirement. Therefore, when an investor is itself a pooled investment vehicle that is controlling, controlled by, or under common control with the adviser or its related persons, the adviser must look through such pool and send the quarterly statements to the investors in such pool.

Because the quarterly statements must cross-reference the applicable governing document provisions that permit the charging or allocating of certain fees and expenses to the fund, advisers should review the relevant provisions of their governing documents for purposes of referencing the fee and expense disclosures in the quarterly statements. In the governing documents of funds that will launch after the new rules begin to apply, advisers should consider making "evergreen" references to complying with "applicable laws, rules, and regulatory requirements," as opposed to hard-wiring specific content and timing requirements into the documents, which will allow for flexibility to adapt to any changes to the rules.

II. Mandatory Private Fund Audit Rule – § 275.206(4)-10 (Registered Advisers to Private Funds)

Registered investment advisers to private funds must cause each private fund they advise, directly or indirectly, to undergo an annual financial audit that meets the requirements set forth in paragraphs (b)(4)(i) through (b)(4)(iii) of 17 CFR 275.206(4)-2 of the Advisers Act (the "Custody Rule").

Annual Audits of Private Funds		
Requirements	**Timing and Delivery**	**Records**
The private fund adviser audit— ■ Must be performed by an **independent public accountant** that is registered with the PCAOB. ■ Must meet the definition of audit in 17 CFR 210.1-02(d) (rule 1-02(d) of Regulation S-X) ■ Must be prepared in accordance with U.S. GAAP.[15]	The adviser must deliver a private fund's audit to investors in the private fund— ■ **At least annually** within 120 days of the end of a private fund's fiscal year. ■ **Promptly upon liquidation** of the private fund. Audited financial statements must be delivered in accordance with paragraph (c) of the Custody Rule.	For each of an adviser's private fund clients, the adviser must maintain— ■ A copy of all audited financial statements prepared and distributed. ■ A record of each addressee and corresponding dates of distribution. ■ A record of steps taken by the adviser to cause a private fund client with which it is not in a control relationship with to undergo a financial statement audit.

Where an investor in a private fund is itself a pooled vehicle that is a related person of the adviser, the adviser must look through that pool (and any pools in a control relationship with the adviser or its related persons, such as in a master-feeder fund structure) to furnish the audited financial statements to the investors in those pools.

Further, for a fund that the adviser does not control (i.e., is neither controlled by nor under common control with the adviser), to the extent such fund does not otherwise undergo an audit compliant with this rule, for the adviser to provide investment advice, directly or indirectly, to such private fund, the adviser must take all reasonable steps to cause: (1) the fund to undergo a compliant audit; and (2) audited financial statements to be delivered under this rule. For example, a sub-adviser to an unaffiliated fund could document the sub-adviser's efforts to satisfy this requirement by including (or seeking to include) the audit requirement in its sub-advisory agreement.

15 The SEC has stated that certain financial statements must either be prepared in accordance with U.S. GAAP or prepared in accordance with some other comprehensive body of accounting standards if the information is substantially similar to financial statements prepared in accordance with U.S. GAAP and contain a footnote reconciling any material differences.

II. Mandatory Private Fund Audit Rule – § 275.206(4)-10 (Registered Advisers to Private Funds)

An adviser may either treat an SPV as a separate client, in which case the adviser will be advising the SPV directly, or treat the SPV's assets as assets of the pooled investment vehicle that it is advising indirectly through the SPV. If the adviser treats the SPV as a separate client, the adviser must comply with the audited financial statement distribution requirement. If the adviser treats the SPV's assets as assets of the pooled investment vehicle's assets, the SPV's assets will be required to be considered within the scope of the pooled investment vehicle's financial statement audit.

In the rare instance that an adviser is unable to distribute the private fund's audited financial statements within the required timeframe because of reasonably unforeseeable circumstances (e.g., due to the COVID-19 pandemic), the SEC would take the position that such a delay would not provide a basis for enforcement action so long as the adviser reasonably believed the audited financial statements would be distributed by the applicable deadline and the adviser thereafter delivers the financial statements as promptly as practicable.

III. Adviser-Led Secondaries Rule – § 275.211(h)(2)-2 (Registered Advisers to Private Funds)

Registered advisers to private funds must obtain a fairness opinion or valuation opinion in connection with any *adviser-led secondary transaction*. A transaction would be considered "initiated" by an adviser if the adviser commences a process, or causes one or more other persons to commence a process, that is designed to offer private fund investors the option to obtain liquidity for their private fund interests. However, a transaction would not be considered initiated by the adviser if the adviser, at the unsolicited request of the investor, assists in the secondary sale of such investor's fund interest.

Examples of such transactions include single asset transactions, strip sale transactions, and full fund restructurings. Rebalancing between parallel funds and "season and sell" transactions between parallel funds generally will not be considered "adviser-led secondary transactions" because the adviser is not offering investors the choice between selling and converting/exchanging their interests in the private fund. Likewise, tender offers will not be captured by the definition if an investor is not faced with the decision between selling all or a portion of its interest and converting/exchanging all or a portion of its interest.

Adviser-Led Secondaries Rule		
Applicability	**Conducting Transaction**	**Records**
The adviser-led secondaries rule applies to any transaction— ■ **Initiated** by an adviser or its related persons that offers investors the option between: • **Selling** all or a portion of their fund interests, OR • **Converting or exchanging** all or a portion of their fund interests for new interests in another vehicle advised by the adviser or any of its related persons.	An adviser conducting an adviser-led secondary transaction with regard to each private fund that it advises must, prior to the due date of the **election form** of the adviser-led secondary transaction— ■ Obtain from an **independent opinion provider**[16] a (1) **fairness opinion** *or* (2) **valuation opinion.** ■ Distribute the applicable opinion to the fund's investors. ■ Prepare a written summary of **any material business relationships** that the adviser has with the applicable independent opinion provider and distribute the summary to fund investors.	For each adviser-led secondary transaction, an adviser must retain a copy of— ■ Any fairness opinion or valuation opinion distributed to a fund's investors. ■ Any material business relationship summary. ■ A record of each addressee and corresponding dates of distribution.

In response to commenters, the SEC specifically stated that it is not necessary to expand past current market practice and explicitly allow investors to rely on an opinion. Accordingly, it follows that requiring a non-reliance letter or click-through for investors to access an opinion remains permissible under the new rules.

16 **Independent opinion provider** means a person that (1) provides fairness opinions or valuation opinions in the ordinary course of its business, and (2) is not a related person of the adviser.

IV. Restricted Activities Rule – § 275.211(h)(2)-1 (All Private Fund Advisers)

The restricted activities rule requires that all investment advisers to private funds (registered advisers, unregistered advisers, and advisers who are exempt or restricted from registering) either refrain from engaging in five certain activities; or (1) disclose such activities to the investors in the private funds they advise and, in some cases, (2) obtain investor consent.

Restricted Activities Rule			
Disclosure or Consent	**Activity**	**Restrictions**	**Requirements**
Disclosure-Based	**Regulatory and Compliance Fees and Expenses** (*Subsequent Disclosure*)	Advisers are prohibited from charging their private fund clients (or any investor in such private funds) for (1) regulatory or compliance fees and expenses of the adviser or its related persons; and (2) fees and expenses associated with an examination of the adviser or its related persons by any governmental or regulatory authority, **Unless →**	▪ The adviser distributes a written notice of any such fees or expenses, and the dollar amount thereof, to the investors of such fund, ▪ within 45 days after the end of the fiscal quarter in which the charge occurs.
	Reducing Adviser Clawback by Taxes (*Subsequent Disclosure*)	Advisers are prohibited from reducing the amount of any adviser clawback by actual, potential, or hypothetical taxes applicable to the adviser, its related persons, or their respective owners or interest holders, **Unless →**	▪ The adviser distributes a written notice to investors that sets forth the **pre-tax** and **post-tax** aggregate dollar amounts of the adviser clawback, ▪ within 45 days after the end of the fiscal quarter in which the adviser clawback occurs.
	Certain Non-Pro Rata Fee and Expense Allocations (*Prior Disclosure*)	Advisers may not, directly or indirectly, charge or allocate 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* (this may encompass SMAs) advised by the adviser or its related persons have invested (or propose to invest) in the same portfolio investment, **Unless →**	▪ The **non-pro-rata charge** or allocation is **fair and equitable** under the circumstances, and ▪ **prior to such charge or allocation**, the adviser distributes to each investor of the private fund a written notice of the non-prorata charge or allocation and a description of how it is **fair and equitable** under the circumstances.

IV. Restricted Activities Rule – § 275.211(h)(2)-1
(All Private Fund Advisers)

Restricted Activities Rule			
Disclosure or Consent	**Activity**	**Restrictions**	**Requirements**
Consent Based *(Prior)*	**Investigation Fees and Expenses**	Advisers may not, directly or indirectly, charge or allocate to the private fund fees or expenses associated with an investigation of the adviser or its related persons by any governmental or regulatory authority, **Unless →**	▪ The adviser requests consent from all investors of the private fund, and ▪ obtains **written consent** from **at least a majority in interest** of investors who are not related persons of the adviser. ▪ **Outright Prohibition: Regardless of disclosure or consent**, advisers **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 or rules thereunder. Accordingly, if such fees and expenses were charged to the fund prior to a determination of a sanction or violation, they must be refunded.
	Borrowings	Advisers are prohibited from borrowing money, securities, or other private fund assets, or receiving a loan or extension of credit, from a private fund client, **Unless →**	▪ Adviser distributes to each investor a written description of the material terms of such borrowing, loan, or extension of credit, and ▪ Requests and obtains **written consent** from **at least a majority in interest** of investors who are not related persons of the adviser.

To illustrate the refunding of investigation fees and expenses, an adviser may charge a private fund client for fees and expenses associated with an investigation by the SEC of the adviser or its related persons for a potential violation of Section 206 of the Advisers Act or the rules thereunder, provided those fees and expenses are consented to by investors. However, if the investigation results in a court or governmental authority imposing a sanction on the adviser for a violation of the Act or the rules promulgated thereunder, then the adviser must refund the fund for the fees and expenses associated with the investigation, such as lawyer's fees.

IV. Restricted Activities Rule – § 275.211(h)(2)-1 (All Private Fund Advisers)

Tax distributions made to an adviser or its related persons would not be considered a type of restricted borrowing because they are tax payments allocated to the private fund's adviser or such related persons that are attributable to and made against their unrealized income (or other similarly allocated amounts) in respect of the private fund's profits. Consequently, they are not structured to include the repayment of advanced amounts to the fund, but rather only the reduction of the future income to be received by the adviser or its related persons. However, if a tax advance is structured to contemplate amounts that will be repaid to the fund, as opposed to amounts that only reduce an adviser's future income, it would generally be a restricted borrowing, subject to the consent requirement. Similarly, management fee offsets are not borrowings because they do not involve the adviser or its related persons taking fund assets and promising to repay such assets at a later date.

Notably, the SEC has taken the position that since limited partner advisory committees, advisory boards, or boards of directors do not have a fiduciary obligation to the private fund investors, the consent-based exceptions require that the consent is sought and obtained specifically from fund investors.

When determining whether a non-pro-rata allocation is "fair and equitable" under the applicable circumstances, an adviser may consider the following examples provided by the SEC that the Commission believed may be "fair and equitable":

- Expenses relate to a specific type of security held by a private fund client.
- Expenses are associated with setting up a bespoke investment structure for an investor.
- A private fund client is expected to receive a greater benefit from the expense compared with other clients.

Advisers may generally include disclosures related to the restricted activities rule in their quarterly reports.

V. Preferential Treatment Rule – § 275.211(h)(2)-3 (All Private Fund Advisers)

Under the preferential treatment rule, private fund advisers will be prohibited from providing preferential treatment to certain investors in private funds managed or advised by the adviser, including preferential terms regarding redemption or information about portfolio holdings or exposures, unless disclosed and, in some cases, offered to existing and prospective investors. This prohibition also includes indirect preferential treatment by the adviser through its related persons. Preferential terms are provided through side letters or otherwise.

Subject to certain conditions, private fund advisers may rely on "legacy status" to exempt them from the below prohibitions regarding preferential redemption rights and preferential portfolio holdings information rights. These conditions are as follows: (1) if a private fund has commenced operations before or as of the applicable compliance date (as seen in Table 1); and (2) the contractual agreements governing the private fund are entered in writing prior to the applicable compliance date. Under this legacy status exemption, private fund advisers must still disclose such preferential treatment to all current and prospective investors. Under the preferential treatment rule, all preferential treatment—regardless of the applicable exceptions or legacy status—must be disclosed.

Preferential Treatment Rule		
Type of Preferential Treatment	**Prohibitions**	**Exceptions**
Preferential Redemption Rights	Private fund advisers are prohibited from granting an investor in a private fund (or an investor in a similar pool of assets) the ability to redeem its interest on terms that the adviser reasonably expects to have a **material, negative effect** on other investors in that private fund or in a similar pool of assets.	Preferential redemptions are permissible under two exceptions— ■ Redemptions that are required by applicable law, rule, regulation, or order of certain governmental authorities (importantly, this does *not* include informal arrangements or internal policies),[17] or ■ If the adviser has offered (and will continue to offer) the same redemption ability to all existing (and future) investors in the private fund or similar pool of assets *without qualification* (that is, terms may *not* be dependent on commitment size, affiliation, etc.).

17 For example, under this exception, a pension plan under state or local law may be required to redeem its interest under certain circumstances, such as a violation by the adviser of state pay-to-play, anti-boycott, or similar laws. However, advisers that use this exception will still be subject to the disclosure obligations (e.g., for a pension plan that receives preferential redemption rights under this exception, an adviser will need to disclose this preferential treatment).

V. Preferential Treatment Rule – § 275.211(h)(2)-3 (All Private Fund Advisers)

Preferential Treatment Rule		
Type of Preferential Treatment	**Prohibitions**	**Exceptions**
Preferential Portfolio Holdings Information	Private fund advisers may not provide information regarding the portfolio holdings or exposures of a private fund (or of a similar pool of assets) to any investor in the fund if the adviser reasonably expects that providing such information would have a **material, negative effect** on the other investors in such fund (or the investors in a similar pool of assets).	Preferential information rights are permitted if— ■ The adviser offers such information to all other existing investors in such fund and in such similar pool of assets **at the same time** (or substantially the same time). • Note that the SEC has stated that preferential information rights provided to one or more investors in an illiquid fund will generally *not* be viewed as having a material, negative effect on other investors because of the relative inability to act on such information in an illiquid fund.
All Other Preferential Treatment	All other preferential treatment is prohibited if not adequately disclosed.	All other preferential treatment is permitted if— ■ The adviser provides written disclosures to prospective and current investors in a private fund regarding preferential treatment the adviser or its related persons are providing to other investors in the same fund[18] **in accordance with the timing and notice requirements set forth in the table below**.

With regard to preferential information rights, an adviser could provide, to one current investor, ESG data related to a specific portfolio company that the private equity fund holds only if the adviser offers that same information to all other investors in the private equity fund and any similar pools of assets. To qualify for the exception, the adviser must offer to provide the information to other investors at the same time or substantially the same time.

18 Note that this portion of the rule does not apply to similar pools of assets.

V. Preferential Treatment Rule – § 275.211(h)(2)-3
(All Private Fund Advisers)

<table>
<tr><th colspan="3">Notice of Preferential Treatment</th></tr>
<tr><th>Investor Type</th><th>Illiquid Funds</th><th>Liquid Funds</th></tr>
<tr><td>Prospective Investors</td><td>Prior to its investment in a fund, each prospective investor must be given a written notice that provides specific information regarding any preferential treatment related to any material economic terms[19] that the adviser (or its related persons) provides to other investors in the same fund.</td><td>Same notice requirement for prospective investors as illiquid funds.</td></tr>
<tr><td rowspan="2">Existing Investors</td><td>As soon as reasonably practicable following the end of a fund's fundraising period, the adviser must provide written disclosure of all preferential treatment the adviser (or its related persons) has provided to other investors in the same fund.</td><td>As soon as reasonably practicable following the closing of an investor's investment in a fund, the adviser must provide written disclosure of all preferential treatment the adviser (or its related persons) has provided to other investors in the same fund.</td></tr>
<tr><td colspan="2">Liquid and Illiquid Funds: In addition to the requirements set forth above, on at least an annual basis, the adviser must provide a written notice that provides specific information regarding any preferential treatment provided by the adviser (or its related persons) to other investors in the same fund since the last written notice was provided.</td></tr>
<tr><td colspan="3">In response to commenter concerns that requiring the disclosure of all preferential treatment prior to a prospective investor's investment would slow down the closing process, the SEC allowed advisers to wait until after an investor has closed to disclose the remaining preferential terms (i.e., those that are not material economic terms—for example, excuse rights provided to certain investors but not others.)</td></tr>
</table>

These disclosure requirements are not limited to an investor's initial investment in a fund. For example, if an existing investor increases its fund commitment, the adviser must disclose all preferential treatment to such investor following the increase, and if an investor transfers to another investor (whether new or existing) and preferential terms are granted, the preferential treatment rules would similarly apply.

19 **Material economic terms** include, but are not limited to, the cost of investing, liquidity rights, fee breaks, and co-investment rights. Co-investment rights will generally qualify as a material economic term to the extent they include materially different fee and expense terms from those of the main fund (e.g., no fees or no obligation to bear broken deal expenses). Even if co-investment rights do not include different fee and expense terms, and for example, are offered to provide an investor with additional exposure to a particular investment or investment type, investors often negotiate for those rights and give up other terms in the bargaining process in order to secure access to co-investment opportunities. As a result, co-investment terms generally will be material given their impact on an investor's bargaining position.

V. Preferential Treatment Rule – § 275.211(h)(2)-3 (All Private Fund Advisers)

A private fund adviser should maintain all written communications it received, and copies of all written communications it sent, relating to any notice required under the preferential treatment rule, as well as a record of each addressee and the corresponding dates sent.

There are some significant details and nuances that advisers and their investor relations teams must bear in mind with regard to the preferential treatment rules. Some significant aspects are as follows:

- As stated above, there is no exemption from the disclosure requirement of the preferential treatment rules. Therefore, beginning on the applicable compliance date, all private fund advisers subject to the new rules will need to begin making the required disclosures and notices of all preferential treatment with respect to all existing funds, irrespective of where a fund stands in its lifecycle. For example, a fund late in its harvest period that is no longer accepting new investors would still have to disclose the preferential treatment given to existing investors, even if the recipients of such information would be virtually unable to act upon it. Following this initial disclosure, if no additional preferential treatment is conferred, there would be no requirement to provide an annual update.
- This rule applies to all preferential treatment provided, even if not through a side letter.
- In terms of specifically *how* to comply with these disclosure requirements, the SEC suggested:
    - Providing copies of side letters (which may be accomplished through a data room) with identifying information regarding the other investors redacted.
    - Providing a written summary of the preferential terms provided to other investors in the same fund, provided the summary specifically describes the preferential treatment.
- There is no requirement to disclose the names or even types of investors receiving preferential terms. However, advisers must specifically describe the preferential treatment to convey its relevance. Simply disclosing that other investors are paying lower fees is not sufficient. For example, if an investor gets lower fees because of its higher capital contribution, the adviser must describe the lower fee terms, including the applicable rates (or ranges of rates if multiple investors pay such lower fees). Note that this may also serve the purpose of justifying the differences.
- Advisers should evaluate the language in the most favored nation (MFN) provisions included in the governing documents (including limited partnership agreements and side letters) to determine whether they need to be updated to account for distributing information to all investors, not just those with MFN rights.

VI. Compliance Rule Amendments – § 275.206(4)-7

The Final Rules amend the Advisers Act's Compliance Rule to require **all registered investment advisers** (whether they advise private funds or not) to conduct and document in writing an annual review of their compliance policies and procedures to determine the adequacy and effectiveness of their compliance programs.

Unlike the other five Final Rules, the amendment to document the annual compliance review took effect on **November 13, 2023**. The SEC stated that the burden of documenting such a review should be minimally burdensome because "most advisers are already documenting their annual review in writing," and because the SEC "did not prescribe a specific format for the written documentation," allowing for flexibility in this process.

Written Documentation Requirements	Practical Considerations
■ Requirement for all investment advisers to conduct an **annual review** by **written documentation** of their compliance policies and procedures. ■ The review should evaluate the adequacy of the adviser's policies and procedures and the effectiveness of the implementation of such policies and procedures. ■ The review does not have a prescribed form, with the SEC offering flexibility as to format and content.	■ If an adviser completed a review of its policies and procedures in accordance with Rule 206(4)-7 for a review year *prior to the compliance date*, the documentation requirement will not apply.

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