



# Summary of SEC Rule Amendments under the Investment Advisers Act of 1940

## Introduction

On August 23, 2023, the U.S. Securities and Exchange Commission (SEC) issued a series of new rules and amendments (the Final Rules) under the Investment Advisers Act of 1940 (Advisers Act) that represent a substantial departure from the existing regulatory landscape of the investment advisory industry. The SEC's objective in issuing these Final Rules is to enhance the efficiency and fairness of the private fund market by fostering transparency, mitigating conflicts of interest, and bolstering accountability to safeguard the interests of private fund investors.

Below is an overview of the key points of these rule amendments, focusing on their implications for advisers' reporting requirements, disclosures, and activities.

## Summary of Rule Amendments Applicable to All Private Fund Advisers

### *Restricted Activities Rule (Rule 211(h)(1)-1)*

The Restricted Activities Rule restricts all private fund advisers from engaging in certain activities. For the specific activities detailed below, the fund manager must disclose the activity to investors or obtain prior consent from investors. Investor consent is needed by a majority in interest of investors that are not considered related persons of the adviser. The following activities are restricted:

#### *Activities Requiring Investor Consent*

- Borrowing money or other assets, or receiving a loan or line of credit, from another private fund client unless the activity is disclosed and the adviser receives consent from the fund's investors.
- Allocating fees or expenses related to an investigation of the adviser (or any of its related persons) by any regulatory or governmental entity to the private fund without the adviser disclosing the activity and receiving consent from the fund's investors.

#### *Activities Requiring Disclosure to Investors*

- Allocating any regulatory examination or compliance fees or expenses incurred by the adviser to the private fund without disclosure to the fund's investors.
- Adjusting the adviser's clawback amount by taxes incurred, unless disclosed to the fund's investors on both a pre-tax and post-tax basis.
- Allocating expenses associated with a portfolio company investment on a non-pro rata basis to multiple private funds managed by the same adviser that all invested in such portfolio company, unless the allocation methodology is fair and equitable and written disclosure detailing as such is made to the fund's investors prior to the allocation of expenses occurring.

Additionally, the Final Rules include a requirement for SEC registered investment advisers (RIAs) to maintain documentation of their compliance with the disclosure and consent requirements of the Restricted Activities Rule.

The Restricted Activities Rule has an effective compliance date of 12 months after the date of publication in the Federal Register for advisers with less than \$1.5 billion in private fund assets and 18 months after the date of publication in the Federal Register for advisers with greater than \$1.5 billion in private fund assets.



### ***Preferential Treatment Rule (Rule 211(h)(2)-3)***

The Preferential Treatment Rule aims to address conflicts of interest in the allocation of investment opportunities and concerns that private fund advisers do not provide investors with sufficient detail regarding preferential terms granted to other investors. Specifically, all private fund advisers are prohibited from:

- Providing preferential terms to certain investors regarding redemption rights, unless such redemption rights are required by applicable laws or regulations, or if such redemption rights are offered to all other investors without qualification.
- Providing information regarding portfolio holdings unless the adviser also offers such information to all other investors at substantially the same time.

Additionally, all private fund advisers must disclose to all investors the following types of preferential treatment:

- Before a prospective investor's investment in the private fund, written notice of specific information regarding any preferential treatment related to any material economic terms that the adviser or its related persons provide to other investors in the same private fund.
- Written disclosure of any preferential treatment the adviser or its related persons has provided to other investors.

The Preferential Treatment Rule has an effective compliance date of 12 months after the date of publication in the Federal Register for advisers with less than \$1.5 billion in private fund assets and 18 months after the date of publication in the Federal Register for advisers with greater than \$1.5 billion in private fund assets.

## **Summary of Rule Amendments Applicable to RIAs Only**

### ***Quarterly Statement Rule (Rule 211(h)(1)-2)***

The Quarterly Statement Rule requires quarterly statements containing certain fund-level reporting to be prepared and distributed to the investors of private funds advised by RIAs, as summarized below:

- The quarterly statements must be distributed 45 days after the fund's first three fiscal quarter-ends and 90 days after fiscal year-end.
- The quarterly statements must include tables showing compensation from the fund or the fund's portfolio investments to the adviser or its related persons, with line items for each type of compensation.
- The quarterly statements must include detail of the fees and expenses incurred by the fund, such as legal fees, due diligence fees, and tax/audit fees.
- For closed-ended or illiquid funds, the quarterly statements must include realized and unrealized net IRR and MOIC calculations from inception, on both a gross and net basis.

The Quarterly Statement Rule has an effective compliance date of 18 months after the date of publication in the Federal Register for all RIAs.



### ***Private Fund Audit Rule (Rule 206(4)-10)***

The Private Fund Audit Rule requires audited annual financial statements to be issued within 120 days of fiscal year-end for private funds advised by an RIA, with longer periods applicable to certain fund-of-funds entities.

The Private Fund Audit Rule has an effective compliance date of 18 months after the date of publication in the Federal Register for all RIAs.

### ***Adviser-Led Secondaries Rule (Rule 211(h)(2)-2)***

The Adviser-Led Secondaries Rule results in additional scrutiny over all adviser-led private fund secondary transactions. The adviser must obtain and disclose to investors a fairness or valuation opinion from an independent third party in advance of the secondary transaction. Additionally, the adviser must disclose in writing a summary of any material business relationships the adviser or its related persons has or has had with the opinion provider within the two-year period prior to the issuance of the applicable opinion.

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The Adviser-Led Secondaries Rule has an effective compliance date of 12 months after the date of publication in the Federal Register for advisers with less than \$1.5 billion in private fund assets and 18 months after the date of publication in the Federal Register for advisers with greater than \$1.5 billion in private fund assets.

### ***Compliance Rule (Rule 206(4)-7(b))***

The SEC amended the Compliance Rule to require all RIAs to document in writing their annual compliance review.

This rule amendment has the earliest effective compliance date, which is 60 days after the date of publication in the Federal Register for all RIAs.

## **Conclusion**

The Final Rules place a substantial burden on private fund advisers in terms of compliance and introduce significant limitations on established practices of both registered and unregistered advisers. Consequently, advisers should proactively establish a compliance plan well ahead of the relevant compliance deadlines. These deadlines vary depending on the specific rule, an adviser's registration status, and, in certain instances, the total assets under management attributed to the adviser's private funds.

SteelBridge is a boutique advisory services firm with expertise in private capital and is available as a partner to advisers as they navigate a new world of complex and time-consuming compliance requirements in the investment advisory industry. To learn more, please contact us at 646.737.7960 x1001 or visit our website at [www.steelbridgeconsulting.com](http://www.steelbridgeconsulting.com).