



KIRKLAND & ELLIS LLP

# SEC Rule Proposals Impacting Private Fund Adviser Regulation

**SEC Small Business Capital Formation Advisory Committee**

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## Background and Overview of Rule

- ▶ In February 2022, the SEC proposed significant new rules under the Advisers Act to increase the regulation of private fund advisers
- ▶ If adopted in proposed form, the rules would **entail significant compliance challenges** and considerably shift the overall regulatory landscape for private fund advisers
- ▶ The proposed rules represent a **departure from the emphasis on disclosure of adviser practices** – the rules, as proposed, would result in the rare imposition of substantive requirements and prohibitions on existing and future private fund advisory contracts (e.g., LPAs)
- ▶ Certain aspects of the rules could **apply retroactively** – arguments for “grandfathering” for certain or all of the proposals were raised in comment letters
- ▶ Proposed rules could impose **significant increased costs** (including for fund investors) – arguments regarding the cost / benefit analysis with respect to certain aspects of the proposed rules were raised in comment letters
- ▶ As proposed, a ban on certain activities would **apply even to those not registered with the SEC** (including exempt reporting advisers (e.g., venture capital firms relying on an exemption from registration) and other non-registered advisers (e.g., foreign private advisers)) – this is a significant expansion of the SEC’s current regulatory reach

# Private Fund Adviser Proposal Requirements

## ▶ **Applicable to SEC Registered Advisers**

- **Annual Audit.** Require SEC-registered private fund advisers to obtain an annual audit for each private fund, and distribute the audited financial statements to investors “promptly” after the audit’s completion.
  - ▶ Advisers would also be required to cause the private fund’s auditor to notify the SEC upon certain events (i.e., modification of the auditor’s opinion regarding fund financial statements and termination of the auditor’s engagement).
- **Adviser-Led Secondary Transactions.** Require SEC-registered private fund advisers, in connection with an adviser-led secondary transaction, to distribute to investors a fairness opinion and a written summary of certain material business relationships between the opinion provider and the adviser and its related persons.
- **Written Annual Compliance Review.** Require all SEC-registered advisers (including those that do not advise private funds) to document the annual review of their compliance policies and procedures in writing.
- **Quarterly Statements.** Require SEC-registered private fund advisers to provide investors with quarterly statements for each private fund they advise that has at least two full calendar quarters of operating results, and which details information about private fund performance, fees, and expenses, including the following:
  - ▶ Detailed accounting of all fees and expenses paid by the private fund during the quarterly reporting period.
  - ▶ Disclosure of compensation or other amounts paid by the private fund’s portfolio investments to the adviser or any of its related persons.
  - ▶ Disclosure of standardized information regarding the private fund’s performance, contingent on whether the fund is a liquid or illiquid (e.g., private equity) fund.

## Private Fund Adviser Proposal (*cont'd*)

- ▶ **Applicable to ALL private fund advisers (unregistered and exempt reporting advisers)**
  - **Prohibited Practices.** Prohibit all private fund advisers, including those that are not registered with the SEC, from engaging in certain activities and practices that the SEC views as contrary to the public interest and the protection of investors, including:
    - ▶ Charging certain fees and expenses to a private fund or its portfolio investments, such as fees for unperformed services (e.g., accelerated monitoring fees) and expenses associated with an SEC examination or investigation of the adviser;
    - ▶ Seeking reimbursement, indemnification, exculpation, or limitation of its liability for an adviser's breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to a private fund;
    - ▶ Reducing the amount of an adviser's clawback by the amount of certain taxes;
    - ▶ Charging fees or expenses related to a portfolio investment on a non-pro rata basis when multiple private funds and other clients advised by the adviser or its related persons have invested (or propose to invest) in the same portfolio investment; and
    - ▶ Borrowing or receiving an extension of credit from a private fund client.
  - **Preferential Treatment Prohibitions and Disclosures.** Prohibit all private fund advisers, including those that are not registered with the SEC, from providing certain types of preferential treatment that have a material negative effect on other investors (e.g., side letters providing investor redemption rights or enhanced portfolio information rights), while also prohibiting all other types of preferential treatment unless disclosed to current and prospective investors; and

# International Reach

