WILLKIE FARR & GALLAGHER LLP

CLIENT ALERT

SEC Adopts Major Rule Changes for Private Fund Advisers

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On August 23, 2023, the Securities and Exchange Commission (the "SEC"), by a 3-2 vote, adopted new rules and amendments to existing rules (the "Final Rules") under the Investment Advisers Act of 1940 (the "Advisers Act") that substantially modify existing regulatory requirements and create significant new compliance obligations for investment advisers to private funds.[1] This Client Alert supplements our August 24th summary Client Alert and provides a comprehensive overview of the Final Rules.[2]

I. Executive Summary

Under the Final Rules, registered private fund advisers will be required to:

- Provide investors with quarterly statements reporting standardized private fund performance and detailing private fund fees and expenses, under new Rule 211(h)(1)-2 (the "Quarterly Statement Rule");

[1] *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Investment Advisers Act Release No. 6383 (Aug. 23, 2023) (the "Adopting Release"), available here.

[2] *See* SEC Adopts Major Rule Changes for Private Fund Advisers, Willkie Client Alert (Aug. 24, 2023), available here; *see* New SEC rules for Private Fund Advisers Impact GP-Led Secondary Transactions, Willkie Client Alert (Sept. 5, 2023) available here. *See* Appendix A for a chart summarizing the Final Rules.

- Obtain an annual audit for each private fund, under new Rule 206(4)-10 (the "Private Fund Audit Rule"); and

- Obtain a fairness opinion or valuation opinion for adviser-led secondary transactions, under new Rule 211(h)(2)-2 (the "Adviser-Led Secondaries Rule").[3]

All private fund advisers, whether or not registered with the SEC, will be prohibited from:

- Engaging in certain proscribed activities and practices without disclosure to (and in some cases, without consent of) investors, under new Rule 211(h)(2)-1 (the "Restricted Activities Rule"); and

- Providing certain types of preferential treatment that have a material, negative effect on other investors and other types of preferential treatment without disclosure to current and prospective investors, under new Rule 211(h)(2)-3 (the "Preferential Treatment Rule").[4]

While the Final Rules differ in important ways from the SEC's proposal, private fund advisers nonetheless will need to address substantial new requirements.[5]

Additionally, the SEC amended Rule 206(4)-7 under the Advisers Act (the "Compliance Rule") to require all SEC-registered investment advisers, including those that do not advise private funds, to document in writing the annual review of their compliance policies and procedures. The SEC also amended the recordkeeping requirements in Rule 204-2 under the Advisers Act to require advisers to retain books and records related to the Final Rules.

The Final Rules will be effective on November 13, 2023. Advisers must begin to comply with the amended Compliance Rule on November 13, 2023, while compliance with the other Final Rules will be required by either September 14, 2024 or March 14, 2025, depending on the adviser's assets under management.

The Final Rules will be subject to further review by the courts. On September 1, 2023, a coalition of private fund industry trade groups filed a challenge in the Fifth Circuit Court of Appeals seeking to invalidate the Final Rules as exceeding the agency's statutory authority and as arbitrary, capricious, and otherwise unlawful.[6] That challenge is unlikely to be resolved

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3 A "private fund" is an issuer that would be an "investment company" but for Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 (the "1940 Act"). Section 202(a)(29) of the Advisers Act.

4 The Final Rules include new defined terms set forth in new Rule 211(h)(1)-1.

5 Of particular note, the SEC did not adopt the proposed prohibitions on charging fees for unperformed services or seeking exculpation or indemnification for simple negligence. *See* Adopting Release at 25.

6 *See National Association of Private Fund Managers, et al. vs. Securities and Exchange Comm'n*, Petition for Review, (Sept. 1, 2023) Case: 23-60471, available here. Commissioners Uyeda and Peirce expressed similar concerns in their statements on the adoption of the Final Rules. *See* Mark T. Uyeda, *Statement on Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews* (Aug. 23, 2023), available here ("Thus, unable to regulate private funds directly under the Investment Company Act, the [SEC] relies on a tortured reading of Section 211(h)(2) of the Advisers Act, which was added by Section 913(g) of the Dodd-Frank Act, as authority for this rulemaking."). *See* Hester M. Peirce, *Uprooted: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews* (Aug. 23, 2023), available here ("These statutory provisions [the SEC argues support this rulemaking] are inadequate to support the rules we are adopting today.").

prior to the compliance date for the Final Rules, and it is also unlikely that the court will stay enforcement of the Final Rules pending resolution of the case. Given the uncertainty of any judicial outcome and the efforts necessary to be ready for the Final Rules, private fund advisers should expect that they will need to be ready to comply with the Final Rules by the relevant compliance date regardless of the ultimate outcome of the litigation.

II. Scope of the Final Rules

U.S.-based SEC-registered private fund advisers must comply with all of the Final Rules with respect to their private fund clients. The Restricted Activities and Preferential Treatment Rules also apply to all exempt reporting advisers, state-regulated advisers, advisers relying on the foreign private adviser exemption and advisers that are otherwise unregistered. All registered investment advisers, regardless of whether they advise private funds, must comply with the amended Compliance Rule.

Consistent with its historical position not to apply most of the substantive provisions of the Advisers Act with respect to non-U.S. clients of a non-U.S. adviser, the Final Rules will not apply to a non-U.S. adviser's non-U.S. private funds even if those funds have U.S. investors.[7] Nor will the Final Rules apply to family offices or other entities that are excluded from the definition of investment adviser. The Final Rules will apply to U.S. registered investment advisers, even where the adviser serves as an investment sub-adviser to a private fund that is advised by a non-U.S. investment adviser that is not subject to the Final Rules.[8]

The Final Rules exempt "securitized asset funds," which are defined as private funds whose primary purpose is to issue asset backed securities and whose investors are primarily debt holders. We expect that most Collateralized Loan Obligations (CLOs) will meet the definition of "securitized asset funds" and therefore will be exempt from the Final Rules with respect to their CLO clients. Because the Final Rules (other than the Compliance Rule) apply with respect to an adviser's private fund clients, advisers will need to determine which of their client relationships are within scope of the Final Rules, for example, determining whether a client account is a fund of one or a separately managed account.

III. Quarterly Statement Rule (Rule 211(h)(1)-2)

The Quarterly Statement Rule requires registered private fund advisers to prepare a quarterly statement that includes information regarding fees, expenses, and performance for any private fund that it advises, directly or indirectly, and distribute the quarterly statement to the private fund's investors, unless a quarterly statement that complies with the Rule is prepared and distributed by another person. Quarterly statements must comply with formatting and disclosure requirements but are permitted to provide additional information beyond what is required.[9] Nonetheless, the standardization and level of

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7 Adopting Release at 47–49.

8 *Id.* at 69 n.197.

9 *Id.* at 70. Although the required information in the quarterly statement is not intended to be an "advertisement" under Rule 206(4)-1 under the Advisers Act (the "Marketing Rule"), advisers nonetheless must consider whether any information in the statement would be subject to the Marketing Rule. *Id.*

specificity required by the Quarterly Statement Rule are likely to require most registered advisers to private funds to make substantial changes to the information they currently provide to investors. The requirement to provide quarterly statements cannot be waived by investor consent.[10]

A. Fee and Expense Table

The quarterly statement must include a table that discloses the following information, presented both before and after the application of any offsets, rebates, or waivers:

- A detailed accounting of all compensation, fees, and other amounts allocated or paid to the adviser or any of its related persons by the private fund during the reporting period;[11]
- A detailed accounting of all other fees and expenses allocated to or paid by the private fund during the reporting period; and
- The amount of any offsets or rebates carried forward during the reporting period to subsequent quarterly periods to reduce future payments or allocations to the adviser or its related persons.[12]

Adviser compensation and fund expenses must be presented both before and after the application of any offsets, rebates, or waivers as separate line items for each category of allocation, payment, fee or expense. To the extent that a fund expense also could be characterized as adviser compensation under the Rule (e.g., consulting, legal, or back office services), it must be disclosed as adviser compensation as opposed to a fund expense in the quarterly statement.[13]

Adviser compensation includes, but is not limited to, management, advisory, sub-advisory, or similar fees and payments and performance-based compensation.[14] However, amounts paid by an adviser out of the adviser's assets to a related person, such as sub-advisory fees paid from the adviser's account to an affiliated sub-adviser, are not required to be disclosed.[15] Fund expenses include, but are not limited to, organizational, accounting, legal, administration, audit, tax, due diligence, and travel fees and expenses.

A communication to a current investor is an "advertisement" when it offers new or additional investment advisory services with regard to securities. *See* Rule 206(4)-1.

10 Adopting Release at 70.

11 Both "related person" and "control" use the same definitions of these terms that appear in Form ADV and Form PF.

12 Advisers are not required to disclose the identity of the subset of investors that receive such offsets, rebates, or waivers. *See* Adopting Release at 87 n.257.

13 *Id.* at 86.

14 *Id.* at 78. "Performance-based compensation" means allocations, payments, or distributions of capital based on the private fund's (or any of its investments') capital gains, capital appreciation and/or other profit. It covers both cash and non-cash compensation, including, for example, allocations, payments, or distributions of performance-based compensation that are made in kind. *Id.* at 82–83.

15 *Id.* at 81.

The SEC declined to allow advisers to: (1) exclude expenses of a *de minimis* amount, (2) label expenses as miscellaneous, or (3) group fund expenses into "broad categories that obfuscate the nature and/or extent of the fees and expenses."[16] Consequently, private fund advisers will need to compile and report expense information with the precision required by the Quarterly Statement Rule.

The "reporting period" is the private fund's fiscal quarter covered by the quarterly statement or, for the initial quarterly statement of a newly formed private fund, the period covering the private fund's first two full fiscal quarters of operating results. To the extent a newly formed private fund begins generating operating results on a day other than the first day of a fiscal quarter (e.g., February 1st), the adviser should include the partial quarter and the immediately succeeding two full fiscal quarters in the newly formed private fund's initial quarterly statement.[17]

B. Portfolio Investment Table

The quarterly statement must include a separate table that discloses, for each "covered portfolio investment," a detailed accounting of all "portfolio investment compensation" allocated or paid to the adviser or any of its related persons by the covered portfolio investment during the reporting period. Portfolio investment compensation must be presented both before and after the application of any offsets, rebates, or waivers as separate line items for each category of allocation or payment reflecting the total dollar amount.

- A "portfolio investment" includes any entity or issuer in which the private fund has invested directly or indirectly and is intended to capture any entity or issuer in which the private fund holds an investment, including through holding companies, subsidiaries, acquisition vehicles, special purpose vehicles, and other vehicles through which investments are made or otherwise held by the private fund.[18]
- A "covered portfolio investment" is a portfolio investment that allocated or paid the adviser or its related persons portfolio investment compensation during the reporting period.
- "Portfolio investment compensation" is any compensation, fees, and other amounts allocated or paid to the investment adviser or any of its related persons by the portfolio investment attributable to the private fund's interest in such portfolio investment, including, but not limited to, origination, management, consulting, monitoring, servicing, transaction, administrative, advisory, closing, disposition, directors, trustees or similar fees or payments.

More than one entity or issuer may meet the definition of portfolio investment for any single investment made by a private fund—for example, if a private fund invests directly in a holding company that owns two subsidiaries, this definition

[16] *Id.* at 78 n.230.

[17] *Id.* For example, if a fund begins generating operating results on Feb. 1, the reporting period for the initial quarterly statement would cover the period beginning on Feb. 1 and ending on Sept. 30.

[18] Adopting Release at 90.

captures all three entities.[19] On the other hand, fund transactions negotiated with counterparties (e.g., derivatives) generally would not be deemed a portfolio investment.[20] Likewise, portfolio investment compensation generally would not include compensation, such as a broken deal fee, from only a potential portfolio investment.[21] However, to the extent that a fund bears a broken deal expense, the Quarterly Statement Rule will require its disclosure as a fund fee or expense.

If an adviser or its related person does not receive investment-level compensation under the definition of covered portfolio investment in a reporting period, the adviser would not have to list any information regarding portfolio investments since they do not fall within the covered portfolio investment definition.[22] Advisers nonetheless will need to identify and consider portfolio investment payments and allocations to determine whether they must provide the disclosures in the portfolio investment tables.

The identity of each covered portfolio investment generally should be disclosed to the extent necessary for an investor to understand the nature of the potential or actual conflicts associated with such payments.[23] To the extent the identity of any covered portfolio investment is not necessary for an investor to understand the nature of the conflict, consistent code names may be used (e.g., “portfolio investment A”).[24]

The amount of portfolio investment compensation disclosed should reflect only the amount attributable to a private fund’s interest in a covered portfolio investment and not any portion attributable to any other person’s interest in the covered portfolio investment.[25] In addition, distributions representing profit or return of capital to the fund in respect of the fund’s ownership or other interest in a portfolio investment (e.g., dividends) are not required to be disclosed.[26]

C. Disclosure of Calculation Methodology and Cross-References to Organizational and Offering Documents

The quarterly statement must include prominent disclosure about how expenses, payments, allocations, rebates, waivers, and offsets are calculated. This disclosure generally will require advisers to describe, among other things:

[19] *Id.*
[20] *Id.* at 90 n.269.
[21] *Id.* at 90–91 n.271.
[22] *Id.* at 95.
[23] *Id.* at 99.
[24] *Id.*
[25] *Id.* at 93–94. It is not clear how portfolio investment compensation attribution should be calculated with respect to certain types of covered portfolio investments (such as debt instruments) or in circumstances where a private fund’s interest in a covered portfolio company fluctuates over the relevant reporting period.
[26] Adopting Release at 96.

- The structure of, and the method used to determine, any performance-based compensation set forth in the quarterly statement (such as the distribution waterfall, if applicable); and

- The criteria on which each type of compensation is based (e.g., whether such compensation is fixed, based on performance over a certain period, or based on the value of the fund's assets).[27]

To meet the prominence standard, disclosures must be readily noticeable and included within the quarterly statement.[28] Thus, an adviser may not provide these disclosures only in a separate document, website hyperlink or QR code, or other separate disclosure.

The quarterly statement also must include cross-references to the relevant sections of the private fund's organizational and offering documents that set forth the applicable calculation methodology.[29] As a result, private fund advisers will need to devote special attention to ensuring that the expense allocation methodology used for the quarterly statement is consistent with the methodology set out in the applicable organizational and offering documents. We anticipate that the cross-referencing requirements will allow for close scrutiny of expense allocation practices by the SEC and fund investors.

D. Performance Disclosure

The quarterly statement must include standardized fund performance information based on the type of fund being reported (i.e., liquid vs. illiquid funds). Advisers must determine whether a private fund is an illiquid fund or a liquid fund no later than the time the adviser sends the initial quarterly statement. The Quarterly Statement Rule does not require the adviser to revisit the determination periodically, but the SEC indicated that advisers generally should consider whether they are providing accurate information to investors and whether they need to revisit the liquid/illiquid determination based on changes in the fund.[30]

- "Illiquid funds" are private funds that are not required to redeem interests upon an investor's request and have limited opportunities, if any, for investors to withdraw before termination of the fund.[31]

- "Liquid funds" are private funds that are not illiquid funds.[32]

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[27] *Id.* at 101.

[28] *Id.* at 142.

[29] *Id.* at 101.

[30] *Id.* at 110 n.322.

[31] *Id.* at 110. Generally, if a private fund does not allow voluntary redemptions/withdrawals, it is an illiquid fund. *Id.* at 112. Under this definition, certain nominally open-end funds, such as a hedge fund with highly irregular or sparse redemption opportunities, may be considered illiquid.

[32] Generally, if a private fund allows voluntary redemptions/withdrawals, then it is a liquid fund. Most traditional hedge funds are likely liquid funds. *Id.* at 112, 121.

1. **Liquid Fund Performance**

Performance of liquid funds must present with equal prominence:

- Annual net total returns for each fiscal year over the past 10 fiscal years or since the fund's inception (whichever is shorter);
- Average annual net total returns over the 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 covered by the quarterly statement.

The SEC declined to adopt a definition of "net total returns," acknowledging that the liquid fund category captures a set of private funds that are highly diverse and in some cases target niche assets for which the calculation of net total returns is based on specialized industry norms and practices.[33]

2. **Illiquid Fund Performance**

Performance of illiquid funds must present, with equal prominence, since the fund's inception:

- Gross IRR and gross MOIC for the illiquid fund;
- Net IRR and net MOIC for the illiquid fund; and
- 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.

"Gross IRR" and "gross MOIC" are defined as an internal rate of return or a multiple of invested capital, respectively, that is calculated gross of all fees, expenses, and performance-based compensation borne by the private fund.[34] "Net IRR" and "net MOIC" must be net of all fees, expenses, and performance-based compensation borne by the private fund.

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[33] *See* Adopting Release at 118–19.

[34] Rule 211(h)(1)-1. "Internal rate of return" is defined as the discount rate that causes the net present value of all cash flows throughout the life of the fund to be equal to zero. When calculating a fund's internal rate of return, an adviser will need to take into account the specific date a cash flow occurred (or is deemed to occur). *Id.* "Multiple of 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. *Id.*

Reflecting the SEC's view that "levered" performance figures have the potential to mislead investors, performance of illiquid funds must be computed with and without the impact of fund-level subscription facilities.[35] Advisers generally should treat any distributions that they recall for additional investments (often referred to as "recycling") as additional contributions for purposes of calculating illiquid fund performance metrics.[36] In addition, advisers will have discretion in determining whether an investment has been realized for purposes of the Quarterly Statement Rule based on the specific facts and circumstances (e.g., a dividend recapitalization where the fund recoups most or all of its entire investment), provided that the methodology used is properly documented.[37] To the extent quarter-end numbers are not available at the time of distribution of the quarterly statement, an adviser is required to include performance measures through the most recent practicable date, which the SEC indicated generally would be through the end of the quarter immediately preceding the quarter covered by the quarterly statement.[38]

3. **Statement of Contributions and Distributions**

Performance of illiquid funds must be accompanied by a statement of contributions and distributions that presents:

- All capital inflows the private fund has received from investors and all capital outflows the private fund has distributed to investors since the private fund's inception, with the value and date of each inflow and outflow; and
- The net asset value of the private fund as of the end of the reporting period.

Though not required by the Quarterly Statement Rule, the SEC suggested that advisers consider whether to provide other details that investors would find relevant in the statement of contributions and distributions, such as information about how each contribution and distribution was used, the dates of drawdowns from fund-level subscription facilities, and any fees and expenses related to a subscription facility.[39]

4. **Disclosure of Performance Calculation Methodology**

The quarterly statement must include the following additional details relating to performance information:

- The date through which the performance information is current; and

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35 *See* OCIE National Examination Program Risk Alert: Observations from Examinations of Investment Advisers Managing Private Funds (June 23, 2020) ("EXAMS Private Funds Risk Alert 2020"), available here (describing how EXAMS observed "advisers that . . . did not disclose material information about the material impact of leverage on fund performance").

36 *See* Adopting Release at 123 n.356.

37 *Id.* at 137–38. The SEC declined to require certain metrics, such as RVPI ("residual value to paid-in capital") and DPI ("distributions to paid-in capital") ratios, that are required in advertisements with unrealized investments under FINRA guidance. This may have implications for future regulatory guidance related to adviser marketing materials. *Id.* at 139–40.

38 *Id.* at 124.

39 *Id.* at 141.

- Prominent disclosure of the criteria used and assumptions made in calculating the performance.

Disclosure of criteria and assumptions may include whether dividends are reinvested, whether a fee rate is assumed (e.g., a blended rate or weighted average that would factor in any discounts), or whether a different method for calculating net performance has been used.[40]

E. Preparation and Distribution of Quarterly Statements

Quarterly statements must be distributed to investors:

- Within 45 days (75 days for a fund of funds) after the end of each of the first three fiscal quarters of each fiscal year of the private fund; and

- Within 90 days (120 for a fund of funds) after the end of each fiscal year of the private fund.

Advisers will not be required to issue a reconciled fourth quarterly statement in the event that information in the quarterly statement is updated or corrected as a result of the final audit.[41] Newly formed funds must begin reporting after completing two full fiscal quarters of operating results.

For purposes of the Final Rules, "distribute, distributes, or distributed" means send or sent to all of the private fund's investors, unless the context otherwise requires.[42] Distribution may occur by electronic means in accordance with the SEC's guidance regarding electronic delivery.[43] In circumstances where an investor is itself a pooled vehicle that is controlling, controlled by, or under common control with (i.e., is in a "control relationship" 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, such as in a master-feeder fund structure), to send the quarterly statements to investors in those pools.

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40 *Id.* at 114, 141.

41 *Id.* at 145 n.428.

42 *See* Rule 211(h)(1)-1 (defining "distribute"). This term "distribute" also appears in the Adviser-Led Secondaries Rule, the Restricted Activities Rule, and the Preferential Treatment Rule. *See* Rule 211(h)(1)-2(b), Rule 211(h)(2)-1(c) and Rule 211(h)(2)-3(c).

43 An adviser may satisfy the distribution requirement if the adviser notifies investors when quarterly statements are uploaded to the data room within the applicable time period and ensures that investors have access to the quarterly statement included therein. In circumstances where an adviser is obligated to rely on a third party, such as a trustee, to deliver quarterly statements to investors, an adviser should use every reasonable effort to effect such delivery in compliance with the Quarterly Statement Rule. See *Investment Adviser Marketing*, Investment Advisers Act Release No. IA-5653 (Dec. 22, 2021) ("Marketing Release"), at n.346, available here. If any distribution is made electronically for purposes of these rules, it should be done in accordance with the SEC's guidance regarding electronic delivery. See Use of Electronic Media by Broker Dealers, Transfer Agents, and Investment Advisers for Delivery of Information; Additional Examples Under the Securities Act of 1933, Securities Exchange Act of 1934, and Investment Company Act of 1940, Release No. 34-37182 (May 9, 1996), 61 Fed. Reg. 24644 (May 15, 1996) ("Use of Electronic Media Release"), available here; *see also* Commission Interpretation: Use of Electronic Media, Release No. 34-42728 (Apr. 28, 2020), 65 Fed. Reg. 25843 (May 4, 2000), available here.

The distribution deadline for quarterly statements does not align with the requirement in Rule 206(4)-2 under the Advisers Act (the "Custody Rule") to deliver audited financial statements within 120 days, which the SEC believed would be too great of a delay for quarterly statements.[44] Advisers to funds (including funds of funds) that do not currently receive information from their underlying investments in a sufficiently timely manner to comply with the Quarterly Statement Rule will need to consider contractual or other types of arrangements with their underlying investments to attain this information in a timely manner.[45]

F. Consolidating Reporting for Certain Fund Structures

Private fund advisers must consolidate reporting for "similar pools of assets" (e.g., master-feeder structures) to the extent doing so provides more meaningful information to the private fund's investors and is not misleading. In recognition of the complexity of private fund structures, the Quarterly Statement Rule takes a principles-based approach with respect to whether private fund advisers must consolidate reporting for a specific fund structure.[46] The SEC acknowledged that this may lead to some degree of difference across different segments of the private fund industry.

A "similar pool of assets" is defined as a pooled investment vehicle (other than a registered fund or securitized asset fund) with substantially similar investment policies, objectives, or strategies to those of the private fund managed by the adviser or its related persons. Whether a pool of assets managed by the adviser is "similar" to the private fund requires a facts and circumstances analysis.[47] A pool of assets with a materially different target return or sector focus, for example, would likely not have substantially similar investment policies, objectives, or strategies to those of the subject private fund, depending on the facts and circumstances.[48]

The types of asset pools that are in scope would include a variety of pools, regardless of whether they are private funds. For example, the definition will capture: (1) limited liability companies, partnerships, and other organizational structures, regardless of the number of investors; (2) feeders to the same master fund; (3) parallel fund structures and alternative investment vehicles; (4) co-investment vehicles; (5) pooled vehicles with different base currencies; and (6) pooled vehicles with embedded leverage.

Depending on the facts and circumstances, the definition will likely capture vehicles outside of what industry participants may typically think of as pools of assets with substantially similar investment policies, objectives, or strategies.[49] For example, the Adopting Release states that an adviser's healthcare-focused private fund may be considered a "similar pool

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[44] *See* Adopting Release at 145.
[45] *Id.* at 149.
[46] *Id.* at 151.
[47] *See id.* at 283.
[48] *See id.*
[49] *See id.* at 282.

of assets" to the adviser's technology-focused private fund under the definition.[50] In addition, while separately managed accounts are not in scope, the SEC indicated that depending on the facts and circumstances, 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."[51] The definition also may capture proprietary vehicles offered to employees and their related persons.[52] As noted above, private fund advisers will need to assess carefully which of their pools of assets fall within the definition.

Advisers generally should disclose the basis of any consolidated reporting in the quarterly statement, including for statements that cover multiple entities, the identity of the entities and the methods used to calculate the amounts on the statement allocated from each entity.[53] Advisers generally also should disclose any important assumptions associated with consolidated reporting that affect performance reporting as part of the quarterly statement, such as 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.

G. Format and Content Requirements for Quarterly Statements

The Quarterly Statement Rule requires the use of clear, concise, plain English descriptions in quarterly statements. The Rule also requires advisers to present information in the quarterly statement in a format that facilitates review from one quarterly statement to the next. The SEC indicated that an adviser generally should use consistent formats for fund quarterly statements to facilitate comparison over time.[54] In addition, any non-required information included in a quarterly statement must be as short as practicable, not more prominent than the required information, and not obscure or impede an investor's understanding of the mandatory information.[55]

IV. Private Fund Audit Rule (Rule 206(4)-10)

The Private Fund Audit Rule requires registered private fund advisers to cause each private fund that they advise, directly or indirectly, to:

- Undergo a financial statement audit that meets the requirements of the audit provision in the Custody Rule; and

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[50] *Id.* However, an adviser may conclude that even if its healthcare-focused private fund is a "similar pool of assets" to its technology-focused private fund, consolidating the reporting for such funds would not provide more meaningful information to the private fund's investors or would otherwise be misleading.

[51] *Id.* We anticipate that an adviser's historical practice will be an important factor in making this determination.

[52] Adopting Release at 283.

[53] *Id.* at 151 n.440.

[54] *Id.* at 154–55. The format and content requirements apply to all aspects of a quarterly statement, including the requirements to disclose the manner in which expenses, payments, allocations, rebates, waivers, and offsets are calculated and to cross-reference sections of the private fund's organizational and offering documents. To satisfy the requirement for "clear" disclosures, the SEC indicated that advisers generally should use a font size and type that are legible, and margins and paper size (if applicable) that are reasonable.

[55] *Id.*

- Deliver the audited financial statements to investors in accordance with the Custody Rule, if the private fund does not otherwise undergo such an audit.[56]

The following requirements in the Custody Rule will be imposed under the Private Fund Audit Rule:

- The audit must be performed by an independent public accountant that meets the standards of independence in Rule 2-01(b) and (c) of Regulation S-X that is registered with, and subject to regular inspection as of the commencement of the professional engagement period, and as of each calendar year-end, by, the Public Company Accounting Oversight Board in accordance with its rules;
- The audit must meet the definition of audit in Rule 1-02(d) of Regulation S-X;
- Audited financial statements must be prepared in accordance with generally accepted accounting principles; and
- The private fund's audited financial statements must be delivered to investors in the private fund annually within 120 days of the private fund's fiscal year-end and promptly upon liquidation.

The SEC acknowledged that the Private Fund Audit Rule effectively eliminates the surprise examination option under the Custody Rule for private fund advisers.[57] Thus, all private funds, including those already in existence, will need to undergo an audit after the compliance date, and funds that previously complied with the Custody Rule by undergoing a surprise examination may bear greater expenses to comply with the Private Fund Audit Rule.

The SEC clarified that an adviser's inability to deliver audited financial statements within the required time frame due to reasonably unforeseeable circumstances would not provide a basis for enforcement action so long as the adviser reasonably believed that the audited financial statements would be distributed by the deadline and the adviser delivers the financial statements as promptly as practicable.[58]

When the adviser does not control the private fund and is neither controlled by nor under common control with the fund, the adviser must take "all reasonable steps" to cause the private fund to comply with the Rule if the private fund does not otherwise undergo an audit. The SEC recognized that what would constitute "all reasonable steps" depends on the facts and circumstances.[59] The SEC also indicated that an adviser has the option to treat a special purpose vehicle ("SPV") either as a separate client (and comply with the Rule's delivery requirements) or as assets of the private funds managed by the

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[56] See Rule 206(4)-10(a). Defined terms in the Private Fund Audit Rule have the same meaning as in the Custody Rule. See Rule 206(4)-10(c). The Private Fund Audit Rule does not use the defined term "distribute" used in the other Final Rules.

[57] Adopting Release at 163.

[58] *Id.* at 176–77.

[59] *Id.* at 182.

adviser indirectly through the SPV (and within the scope of the audits of such funds).[60] This determination should be consistent with the adviser's treatment of SPVs under the Custody Rule.[61]

V. Adviser-Led Secondaries Rule (Rule 211(h)(2)-2)

The Adviser-Led Secondaries Rule requires registered private fund advisers conducting an adviser-led secondary transaction to satisfy the following requirements in respect of the transaction:

- The adviser must obtain a fairness opinion or a valuation opinion from an independent opinion provider and distribute the opinion to the selling fund investors;[62] and
- The adviser must prepare and distribute to the selling fund investors a written summary of any material business relationships the adviser or any of its related persons has, or has had with the independent opinion provider within the two-year period immediately prior to the issuance of the fairness opinion or valuation opinion.[63]

The requirements applicable to an advisory-led secondary transaction must be satisfied prior to the due date for when selling fund investors must return the election form in respect of the relevant transaction.[64]

"Adviser-led secondary transaction" is defined as any transaction initiated by the investment adviser or any of its related persons that offers private fund investors the choice between:

- Selling all or a portion of their interests in the private fund; and
- Converting or exchanging all or a portion of their interests in the private fund for interests in another vehicle advised by the adviser or any of its related persons.

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60 *Id.* at 170–71; *see also* See Custody of Funds or Securities of Clients by Investment Advisers, SEC Investment Advisers Act Release No. IA-2968 (Dec. 30, 2009), 75 Fed. Reg. 1455 (Jan. 11, 2010), ("2009 Custody Rule Release"), at 1466 ("To comply with the rule, as amended, the investment adviser could either treat the SPV as a separate client, in which case the adviser will have custody of the SPV's assets, or treat the SPV's assets as assets of the pooled investment vehicles of which it has custody indirectly."), available here.

61 *See* Adopting Release at 160-61.

62 "Fairness opinion" means a written opinion stating that the price being offered to the private fund for any assets being sold as part of an adviser-led secondary transaction is fair. "Valuation opinion" means a written opinion stating the value (as a single amount or a range) of any assets being sold as part of an adviser-led secondary transaction. "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. *See* Rule 211(h)(1)-1.

63 Though requiring a facts and circumstances analysis, the SEC indicated that audit, consulting, capital raising, investment banking, and other similar services typically would be material business relationships. Adopting Release at 199.

64 "Election form" means a written solicitation distributed by, or on behalf of, the adviser or any related person requesting private fund investors to make a binding election to participate in an adviser-led secondary transaction. *See* Rule 211(h)(1)-1 (defining "Election form").

Single asset transactions, strip sale transactions, and full fund restructurings generally would be adviser-led secondary transactions subject to the Rule (assuming they otherwise meet the definition in the Rule).[65] However, tender offers are not captured by the definition if investors are not required to either sell or convert/exchange (e.g., if an investor is allowed to retain its interest in the same fund with respect to the asset subject to the transaction on the same terms).[66]

Whether an adviser or its related person initiates a secondary transaction turns on a facts and circumstances analysis.[67] In the SEC's view, a transaction would be initiated by the 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. Conversely, a transaction would not be 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.

VI. Restricted Activities Rule (Rule 211(h)(2)-1)

The Restricted Activities Rule prohibits all private fund advisers (whether registered or unregistered) from engaging, directly or indirectly, in the following activities, unless they satisfy certain disclosure and, in some cases, consent requirements:

- Charging or allocating to a private fund fees or expenses associated with an investigation of the adviser or its related persons by any governmental or regulatory authority without disclosure to and consent from fund investors (but in no case for 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 thereunder);

- Charging or allocating to a private fund any regulatory, examination or compliance fees or expenses of the adviser or its related persons without disclosure to fund investors;

- Reducing the amount of an 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 discloses the pre-tax and post-tax amount of the clawback to investors;

- Charging or allocating fees or expenses related to a portfolio investment (or potential portfolio investment) on a non-pro rata basis when multiple clients of the adviser or its related persons (other than a securitized asset fund) have invested (or propose to invest) in the same portfolio investment, unless the allocation approach is fair and equitable and the adviser distributes advance written notice of the non-pro rata charge and a description of how the allocation approach is fair and equitable under the circumstances; and

65 *See* Adopting Release at 189.
66 *Id.* at 192.
67 *Id.* at 190.

- Borrowing or receiving a loan or an extension of credit from a private fund client without disclosure to and consent from fund investors.

The SEC did not adopt the proposed prohibitions on charging fees for unperformed services or an adviser seeking exculpation or indemnification for simple negligence.[68] The SEC noted, however, that charging a client fees for unperformed services (including indirectly by charging fees to a portfolio investment held by the fund) where the adviser does not, or does not reasonably expect to, provide such services is inconsistent with an adviser's fiduciary duty.[69] Advisers may charge fees for services in advance, but if those services are not performed, the adviser must return those fees.[70]

With respect to exculpation and indemnification, the SEC provided interpretive guidance on hedge clauses in advisory agreements.[71] In the SEC's view, a reimbursement, indemnification, or exculpation of an adviser for breaching its fiduciary duty (which may involve conduct that is negligent) would operate effectively as a waiver of the fiduciary duty and would be invalid under the Advisers Act.[72]

Other proposed requirements that were not adopted nonetheless may become applicable to private fund advisers if other SEC rulemaking proposals are adopted. For example, the Safeguarding Rule proposal includes a requirement that is similar to the auditor notice requirement that was proposed but not adopted in the Final Rules.[73]

A. Investigation Expenses

The Restricted Activities Rule prohibits a private fund adviser from charging or allocating to a 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:

68 *Id.* at 248.

69 *Id.* at 250.

70 *Id.* at 253. If "an adviser expects to provide monitoring services to a portfolio investment, the adviser is not prohibited from charging for those services." *Id.* However, "to the extent that the adviser ultimately does not provide the services, the adviser would need to refund any prepaid amounts attributable to unperformed services." *Id.*

71 *See id.* at 256–57. *See also Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Advisers Act Release No. IA-5248 (June 5, 2019), 84 Fed. Reg. 33669 (July 12, 2019) ("2019 IA Fiduciary Duty Interpretation"), available here and here; See also *In the Matter of Comprehensive Capital Management, Inc.*, Investment Advisers Act Release No. 5943 (Jan. 11, 2022) (settled action) (alleging adviser included in its investment advisory agreement liability disclaimer language (i.e., a hedge clause), which could lead a client to believe incorrectly that the client had waived a non-waivable cause of action against the adviser provided by State or Federal law. Most, if not all, of the adviser's clients were retail investors, but the Order does not appear to cover institutional investors).

72 *See* Adopting Release at 257.

73 *See id.* at 180–81; *see* proposed rule 223-1(b)(2) (requiring the auditor to notify the SEC regarding any discrepancies detected during the course of performing its procedures). *See also SEC Proposes Amendments to Investment Adviser Custody Requirements*, Willkie Client Alert (March 6, 2023), available here. The SEC recently reopened the comment period for the Safeguarding Rule proposal. *See Safeguarding Advisory Client Assets; Reopening of Comment Period*, Advisers Act Release No. IA-6384 (Aug. 23, 2023), 88 Fed. Reg. 59818 (Aug. 30, 2023), available here.

- Requests the consent of each investor of the private fund to such charge or allocation; and
- Obtains written consent from at least a majority in interest of the private fund's investors that are not related persons of the adviser.[74]

The terms "investigation" and "governmental or regulatory authority" are not defined in the Final Rules but presumably include investigations of any kind by federal, state, local or non-U.S. government agencies, law enforcement or self-regulatory organizations (e.g., FINRA). The SEC recognized that governmental or regulatory bodies may not formally notify an adviser that it is under investigation.[75] Thus, whether an adviser is under investigation would be determined based on the information available.

When requesting consent, advisers generally should list each category of fee or expense as a separate line item, rather than grouping fund expenses into broad categories, and describe how each such fee or expense is related to the relevant investigation.[76] Moreover, consent must be obtained for each specific investigation.[77] The Adopting Release does not explicitly address an adviser's ability to rely on negative consent or how to treat nonresponsive investors.

The consent-based exception is not available in the event that an investigation results or has resulted in a court or governmental authority imposing a sanction for a violation of the Advisers Act or the rules thereunder.[78] The SEC explained that an adviser that charges a private fund client for fees and expenses associated with an investigation in accordance with the consent requirement nevertheless would be obligated to refund the private fund for these fees and expenses if the adviser is later sanctioned for violations of the Advisers Act or the rules thereunder.[79]

B. Regulatory, Compliance and Examination Expenses

The Restricted Activities Rule prohibits a private fund adviser from charging or allocating to a private fund any regulatory or compliance fees or expenses, or fees or expenses associated with an examination, of the adviser or its related persons, unless the adviser distributes a written notice to the private fund's investors within 45 days after the end of the fiscal quarter in which the charge occurs. The written notice should include a detailed accounting of each category of fees and expenses

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74 The requirement to seek and obtain consent from non-related person investors will not apply with respect to a private fund whose investors are solely related persons of the fund's adviser, such as an internal fund whose investors are limited to the adviser's employees. *See* Adopting Release at 206 n.622.

75 *Id.* at 235.

76 *Id.* at 234 n.703.

77 *Id.* at 236.

78 Settlements and judgments against advisers typically include at least one violation of the Advisers Act or the rules thereunder. The consent-based exception would still be available for violations of other federal securities laws or other laws.

79 *See* Adopting Release at 238–39.

that lists each specific category of fee or expense as a separate line item and the dollar amount thereof, rather than grouping such fees and expenses into broad categories such as "compliance expenses."[80]

The 45-day timeline generally matches the timeline required for advisers to distribute quarterly statements under the Quarterly Statement Rule, but will not provide advisers with the benefit of the extension afforded in the fourth quarter of the year or to funds of funds by that Rule. Registered private fund advisers may, but are not required to, provide such disclosure in a statement delivered to investors under the Quarterly Statement Rule.[81]

C. Reduction of Adviser Clawbacks for Taxes

The Restricted Activities Rule prohibits a private fund adviser from reducing the amount of an "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 the private fund's investors within 45 days after the end of the fiscal quarter in which the adviser clawback occurs. An "adviser clawback" for purposes of the Rule 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.

The written notice must set forth the aggregate dollar amounts of the adviser clawback *before* and *after* any reduction. These aggregate dollar amounts should reflect the gross amount of excess compensation received by the adviser (or its related persons) that is being clawed back.[82]

In lieu of, or in addition to, providing a standalone clawback notice, registered private fund advisers may, but are not required to, provide clawback disclosure in a statement delivered to investors under the Quarterly Statement Rule to the extent that the statement is delivered within the 45-day deadline.[83]Non-Pro Rata Allocations

The Restricted Activities Rule prohibits a private fund adviser from charging or allocating fees or expenses related to a portfolio investment (or potential portfolio investment) on a non-pro rata basis when multiple private funds and other clients advised by the adviser or its related persons (other than a securitized asset fund) 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

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80 *Id.* at 209 n.630.
81 *Id.* at 209 n.631.
82 *Id.* at 220.
83 *Id.* at 220–21.

- The adviser distributes a written notice to each investor prior to charging or allocating such fees or expenses to a private fund client.

The SEC declined to define the term "pro rata." The SEC observed that advisers typically implement pro rata allocations based on ownership percentages but acknowledged that there may be multiple methods to determine pro rata allocations.[84] Accordingly, private fund advisers will face delicate matters of judgment when seeking to determine whether an allocation is on a non-pro rata basis (e.g., if broken-deal expenses are not allocated to co-investors).

Determining whether a charge or allocation is fair and equitable will depend on factors relevant for the specific expense. Such factors may include, for example, (1) whether the expense relates to a specific type of security that one private fund client holds, (2) whether the expense relates to a bespoke structuring arrangement for one private fund client to participate in the portfolio investment, or (3) whether one private fund client may receive a greater benefit from the expense relative to other private fund clients.[85] The SEC recognized that fair and equitable treatment may not always mean clients must be treated identically.[86]

The written notice must set forth the non-pro rata charge or allocation and a description of how it is fair and equitable under the circumstances. The SEC indicated that advisers should consider addressing factors relevant to reaching a determination that the charge or allocation is fair and equitable, such as the adviser's allocation approach.[87] The SEC did not prescribe how far in advance an adviser must provide the written notice, but indicated that the notice should "enable investors to discuss the non-pro rata allocation with the adviser before being charged."[88]

The Restricted Activities Rule does not prohibit an adviser from paying a fund's pro rata portion of any fee or expense with its own capital.[89] The Rule also does not prohibit an adviser from diluting a fund's interest in the portfolio investment in a manner that is fair and equitable to the extent that the fund lacks the resources to pay for its share if such dilution is otherwise permitted by applicable law and the fund's governing documents.[90]

D. Borrowing from a Private Fund

The Restricted Activities Rule prohibits a private fund adviser from borrowing money, securities, or other private fund assets, or receiving a loan or an extension of credit, from a private fund client, unless the adviser:

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84 *Id.* at 228–29.
85 *Id.* at 228.
86 Adopting Release at 228.
87 *Id.* at 228–29.
88 *Id.* at 230.
89 *See id.* at 223–24 n.671.
90 *Id.*

- Distributes to each investor a written description of the material terms of, and requests each investor to consent to, such borrowing, loan, or extension of credit; and
- Obtains written consent from at least a majority in interest of the private fund's investors that are not related persons of the adviser.

Advisers must describe the material terms of a borrowing to investors, but the Restricted Activities Rule does not enumerate specific terms of the borrowing that must be disclosed. Though ultimately a facts and circumstances determination, material terms of a borrowing generally will include, as applicable: (1) the amount of money to be borrowed, (2) the interest rate, and (3) the repayment schedule.[91] The SEC indicated that advisers may consider providing additional information, including, to the extent relevant, updated post-borrowing disclosure to reflect increases, decreases, or other changes in the borrowing.[92] It is possible, however, that the specificity called for in this disclosure may pose challenges to advisers seeking to provide sufficient advance notice and consent.

The SEC clarified that ordinary course tax advances and management fee offsets would not be viewed as restricted borrowings subject to the Restricted Activities Rule.[93] In addition, the Rule will not apply to borrowings from a third party on the fund's behalf or to the adviser's borrowings from individual investors outside of the fund, such as a bank that is invested in the fund.[94] Private fund advisers will need to consider carefully whether other types of arrangements, such as funding a sponsor's commitment in exchange for waiving future management fees, would be considered a restricted borrowing.

VII. Preferential Treatment Rule (Rule 211(h)(2)-3)

The Preferential Treatment Rule prohibits all private fund advisers (whether registered or unregistered) from providing certain types of preferential treatment to one or more investors (including seed investors, strategic investors, those with large commitments, and employees, friends, and family) that would have a material, negative effect on other investors and permits other types of preferential treatment so long as disclosure is provided to current and prospective investors.

A. Prohibited Forms of Preferential Treatment

The Preferential Treatment Rule prohibits private fund advisers from engaging, directly or indirectly, in the following activities, unless an exception applies:

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91 *See id.* at 244.

92 *See id.* at 244 n.736.

93 Adopting Release at 246. However, a tax advance structured to contemplate amounts that will be repaid to the fund, as opposed to amounts that only reduce an adviser's future income, generally would be subject to the Rule. *Id.* at 247.

94 *See id.* at 244.

- Granting an investor in a private fund (or 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 a similar pool of assets); or

- Providing information regarding the portfolio holdings or exposures of a private fund (or a similar pool of assets) to any investor in the private fund if the adviser 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).

The Preferential Treatment Rule applies to preferential treatment provided through various means, including written side letters and a fund's governing documents.[95] The Preferential Treatment Rule also applies even if the preferential treatment is provided indirectly, such as by an adviser's related persons.[96].

The SEC explained that the "reasonably expects" standard imposes an objective standard that takes into account what the adviser reasonably expected at the time based on the facts and circumstances at the time the adviser granted or provided the preferential treatment.[97] For example, an adviser could form a reasonable expectation that certain redemption terms would have a material, negative effect on other fund investors if a majority of the portfolio investments were not likely to be liquid.[98] However, the SEC indicated that it generally does not view preferential information rights provided to one or more investors in an illiquid private fund as having a material, negative effect on other investors.[99]

The ability to redeem is an important part of determining whether providing information would have a material, negative effect on other investors and thus whether an adviser triggers the preferential information prohibition.[100] However, there may be cases where preferential information may be reasonably expected to have a material, negative effect on other investors in the fund even when the preferred investor does not have the ability to redeem its interest in the fund, and so whether preferential information violates the Preferential Treatment Rule requires a facts and circumstances analysis.[101] Employees of a private fund adviser that are also investors in the private fund, for example, often have preferential

[95] *See id.* at 266–67. The Preferential Treatment Rule applies to all types of communications: formal and informal as well as written, visual, and oral. *See id.* at 279 n.850.

[96] *See id.* at 266–67. For example, the Rule applies when the adviser's related person is the general partner (or similar control person) and is a party (and/or caused the private fund to be a party, directly or indirectly) to a side letter or other arrangement with an investor, even if the adviser itself (or any related person of the adviser) is not a party to the side letter or other arrangement. *Id.*

[97] Adopting Release at 268–69.

[98] *Id.* at 269. The Adopting Release does not identify the extent to which an adviser may take into account certain terms and authorities under the fund documents to mitigate the negative impact of preferential redemption rights, such as the ability to suspend redemptions, to create side pockets, or to grant a special one-time redemption right to other investors if a preferential redemption right is ever exercised.

[99] *See id.* at 281.The SEC declined to provide a blanket exemption for all closed-end funds. *Id.* at 281–82.

[100] *Id.*

[101] *Id.* at 261–62.

information rights about portfolio holdings by virtue of their responsibilities to the fund, which will require the adviser to determine whether these information rights have a material, negative effect on other investors.[102]

The term "similar pool of assets" is broad in scope and designed to prevent advisers from structuring around the prohibitions on preferential treatment.[103] The term could include structures such as custom feeder funds created for favored investors and parallel funds created solely for investors with preferential terms.[104]

1. **Exceptions to Preferential Redemption Prohibition**

There are two exceptions to the prohibition of preferential redemption rights that are available when:

- The ability to redeem is required by applicable law, rule, regulation, or order of any relevant foreign or U.S. government, state, or political subdivision to which the investor, the private fund, or any similar pool of assets is subject;[105] or
- The adviser has offered the same redemption ability to all existing investors and will continue to offer the same redemption ability to all future investors in the private fund or similar pool of assets.

The first exception is intended to prevent the exclusion of certain investors from funds or to cause an investor to violate other applicable laws.[106] For example, under this exception, a pension plan subject to 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. Preferential redemption rights under this exception, however, still must be disclosed pursuant to the disclosure requirement in the Preferential Treatment Rule.

To qualify for the second exception, an adviser must have offered the same redemption ability to all other existing investors and must continue to offer such redemption ability to all future investors without qualification (e.g., no minimum commitment size, affiliation requirements, or other limitations).[107] Accordingly, an adviser seeking to rely on the exception may not restrict a share class with different liquidity options than, but otherwise subject to the same terms as, another share class of the same fund only to friends and family investors if the adviser reasonably expects such liquidity rights to have a material, negative effect on other investors. An adviser also may not rely on the exception if preferential redemption terms for one

[102] The Adopting Release does not indicate whether an adviser's policies and procedures that seek to mitigate conflicts of interest with respect to preferential information rights about portfolio holdings would sufficiently mitigate material, negative effects such that those rights would not impose a material, negative effect on other investors.

[103] *Id.* at 283–84.

[104] *Id.* at 284.

[105] The Restricted Activities Rule uses different terminology ("governmental or regulatory authority") in the restriction on allocating investigation expenses.

[106] *See* Adopting Release at 273. The SEC declined to provide a similar exception for redemptions pursuant to more informal arrangements, such as an investor's policies or resolutions. *Id.* at 274.

[107] *Id.* at 275.

share class (but not other share classes) are conditioned on accepting uncapped liability when the adviser has reason to believe that certain investors (e.g., government entities) cannot agree to uncapped liability.

2. Exception to the Preferential Transparency Prohibition

There is an exception to the prohibition of preferential transparency available when the adviser offers the same information to all other existing investors in the private fund and any similar pool of assets at the same time or substantially the same time. There is no exception from this prohibition for preferential information that an investor must obtain as a requirement of state or other law.[108] However, as noted above, the SEC clarified in the adopting release that it does not regard the provision of preferential information in a closed-end fund as having an adverse effect on investors.[109]

B. Other Forms of Preferential Treatment

The Preferential Treatment Rule prohibits private fund advisers, directly or indirectly, from providing any preferential treatment to any investor, unless the adviser:

- Provides a written notice to each prospective investor in a private fund that provides 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, prior to the prospective investor's investment in the private fund; and

- Distributes written disclosure to current investors meeting the following requirements:

  - For an illiquid fund, written disclosure of all preferential treatment the adviser or its related persons has provided to other investors in the same private fund, as soon as reasonably practicable following the end of the private fund's fundraising period;

  - For a liquid fund, written disclosure of all preferential treatment the adviser or its related persons has provided to other investors in the same private fund, as soon as reasonably practicable following the investor's investment in the private fund; and

  - For all private funds on at least an annual basis, 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 private fund since the last written notice provided in accordance with this section, if any.

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[108] *Id.* at 280–81.
[109] *Id.* at 281.

1. **Disclosure Requirements**

Disclosure to current investors must include all preferential treatment (or any preferential treatment provided to an investor since the last notice), while disclosure to prospective investors must only describe preferential treatment related to material economic terms.[110] Though the phrase "material economic terms" is not defined, it generally would include those terms that a prospective investor would find most important and that would significantly impact its bargaining position (e.g., the cost of investing, liquidity rights, fee breaks, and co-investment rights).[111] The SEC indicated that co-investment rights generally would qualify as a material economic term, including when such rights have materially different fee and expense terms from those of the main fund (e.g., no fees or no obligation to bear broken-deal expenses) or are offered to provide an investor with additional exposure to a particular investment or investment type.[112] Conversely, "excuse rights" (i.e., the right to refrain from participating in a specific investment the private fund plans to make) might not be a material economic term that must be disclosed to prospective investors, under specific facts and circumstances.[113]

The disclosure requirements apply to all forms of preferential treatment, including preferential treatment granted in accordance with one of the exceptions to the prohibitions on preferential redemption and transparency rights.[114] Moreover, the disclosure requirements are not limited to an investor's initial investment in a fund.[115] For example, if an existing investor increases its investment in a fund, the adviser is required to disclose all preferential treatment to such investor following such additional investment in accordance with the timelines set forth in the Rule. However, the SEC clarified that the disclosure requirements would apply only to terms actually provided and not to preferential terms merely offered to investors.[116]

Compliance with the disclosure requirements will require advisers to describe specifically the preferential treatment to convey its relevance.[117] In this regard, the SEC indicated that mere disclosure of the fact that other investors are paying lower fees would not be specific enough. The SEC clarified that an adviser may comply with the disclosure requirements by providing copies of side letters (with identifying information regarding the other investors redacted).[118] Alternatively, an adviser may provide a written summary of the preferential terms provided to other investors in the same private fund, provided the summary specifically describes the preferential treatment.

110 *Id.* at 294. This includes preferential information provided to any transferees during such period. *Id.*
111 *See* Adopting Release at 288–89.
112 *Id.* at 290 n.882.
113 *Id.* at 291 n.887.
114 *Id.* at 290.
115 *Id.* at 290 n.885.
116 *Id.* at 290. *See also* Rule 211(h)(2)-3(b) (referring to the preferential treatment "the adviser or its related persons *provide* . . ." (emphasis added)).
117 *Id.* at 293.
118 *Id.* Advisers are not required to disclose the names or even types of investors provided preferential terms to comply with the disclosure requirements. *See id.* at 293 n.891.

2. Delivery of Disclosures

The timing of the delivery requirements under the Preferential Treatment Rule differs depending on whether the recipient is a prospective or current investor in the private fund.

- For a prospective investor, the notice needs to be provided, in writing, prior to the investor's investment in the fund.
- For a current investor, the adviser must distribute the notice as soon as reasonably practicable after the end of the fund's fundraising period (for illiquid funds) or as soon as reasonably practicable following the investor's investment in the fund (for liquid funds).
- For a current investor, the adviser also must distribute an annual notice if any preferential treatment is provided to an investor since the last notice.

The SEC did not prescribe the method of delivery (e.g., electronic, data room, via mail) for the written notices or a specific time frame for their delivery.[119] Whether a written notice to a current investor is furnished "as soon as reasonably practicable" will depend on the facts and circumstances.[120] While this standard imposes no specific time limit, the SEC indicated that it would generally be appropriate for advisers to distribute these notices within four weeks.[121] These disclosure requirements may require sponsors of closed-end funds to send out MFN election materials sooner than they have done historically.

The SEC clarified that a private fund that does not admit new investors or provide new terms to existing investors does not need to deliver an annual notice.[122] However, an adviser that enters into a side letter after the closing date of the fund must disclose any preferential terms in the side letter to investors that are locked into the fund. If an investor is a pooled investment vehicle that is in a control relationship with the adviser, the adviser must look through that pool in order to send the notice to investors in those pools.[123]

VIII. Written Documentation of Annual Review of Compliance Program

The SEC amended the Compliance Rule to require all SEC-registered investment advisers, including those that do not advise private funds, to document in writing the annual review of their compliance policies and procedures required by the

119 Adopting Release at 296.

120 *Id.* at 295.

121 *Id.*

122 *Id.* at 294 n.893. However, an adviser that enters into a side letter after the closing date of the fund must disclose any preferential terms in the side letter to investors that are locked into the fund. *Id.*

123 *Id.* at 294.

Rule. The SEC noted that the amendments should not significantly increase costs for advisers since most advisers already document this review in writing.[124]

The amended Compliance Rule does not enumerate specific elements that advisers must include in the written documentation of their annual review.[125] The SEC indicated that the written documentation requirement is intended to be flexible to allow advisers to continue to use the review procedures they have developed and found most effective. The amendments also do not prescribe a specific format of the written documentation, instead, allowing an adviser to determine what would be appropriate.[126] For example, advisers may choose to document the annual review: (1) in a lengthy written report with supporting documentation; (2) quarterly documentation, aggregated at year end; (3) a presentation to the board or another governing body, such as a limited partner advisory committee; (4) a short memorandum summarizing the findings; and (5) informal documentation, such as a compilation of notes throughout the year.

The amendments preserve the flexibility for advisers to seek the guidance of service providers or outside counsel during their annual review.[127] In instances where an adviser hires external service providers or outside counsel to participate in the annual review, the adviser may take steps to defray any potential costs.[128] For example, advisers may choose to have their employees document a summary of results as explained to them by service providers or outside counsel, rather than request that the service provider or outside counsel produce a written summary. The SEC noted, however, that attempts to improperly shield from, or unnecessarily delay production of, any record—whether through improper claims of attorney-client privilege, the work-product doctrine, or other similar protections over required records based on reliance on attorneys working for the adviser in-house or the engagement of law firms and other service providers (e.g., compliance consultants) through law firms—would not be consistent with the obligation to produce required records to the SEC or its staff promptly (within 24 hours) upon request.[129]

IX. Legacy Status

The SEC provided exemptions from certain provisions of the Restricted Activities Rule and the Preferential Treatment Rule with respect to certain funds that have commenced operations before the compliance date ("legacy status"). Legacy status is available with respect to the restricted activities in the Restricted Activities Rule that require investor consent—i.e., allocating investigation expenses[130] and borrowing from a private fund—and the prohibitions in the Preferential Treatment Rule relating to preferential redemptions and transparency. Legacy status does not apply to the investor consent

[124] *Id.* at 300.
[125] *Id.* at 302.
[126] Adopting Release at 303.
[127] *Id.* at 301.
[128] *Id.* at 300.
[129] *Id.* at 303 n.924, 304.
[130] *See* Rule 211(h)(2)-2(b). However, legacy status does not permit advisers to charge for 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 thereunder. *Id.*

requirements of the Restricted Activities Rule for: (i) charging regulatory expenses, (ii) reducing adviser clawbacks for taxes or (iii) charging fees on a non-pro rata basis.[131] Legacy status does not apply to the disclosure requirements of the Preferential Treatment Rule.[132] Legacy status also does not apply to the Quarterly Statement Rule, the Adviser-Led Secondaries Rule, the Annual Audit Rule, or the Compliance Rule.

Legacy status applies only to contractual agreements that:

- Govern the fund (e.g., the private fund's operating or organizational agreements, subscription agreements, and side letters), or govern a borrowing, loan, or extension of credit entered into by the fund (e.g., promissory notes and credit agreements);
- Were entered into prior to the compliance date; and
- Would need to be amended because of the applicable Rule.[133]

Only agreements with respect to private funds that have commenced operations as of the compliance date are eligible for legacy status.[134] The commencement of operations includes any bona fide activity directed towards operating a private fund, including investment, fundraising, or operational activity. Examples of activity that could indicate a private fund has commenced operations include issuing capital calls, setting up a subscription facility for the fund, holding an initial fund closing and conducting due diligence on potential fund investments, or making an investment on behalf of the fund.

Amendments sufficient for legacy status include, for example, changing or removing redemption terms for one or more investors where such terms are specified in the governing agreement.[135] Removing terms from a side letter that granted an investor redemption rights or periodic reporting about the fund's holdings or exposures also would be an amendment sufficient for legacy status.

Because legacy status does not apply to the disclosure portions of the Preferential Treatment Rule, any terms in side letters entered into before the compliance date providing for preferential treatment must be disclosed to investors that invest in the fund following the compliance date.[136] Advisers are not required to disclose the identity of the specific investor that received a preferential term and can choose to anonymize that information.

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131 *See* Rule 211(h)(2)-1(b). *See* Adopting Release at 312.
132 *See* Rule 211(h)(2)-3(d). *See* Adopting Release at 313–14.
133 Adopting Release at 314–15.
134 *Id.* at 312–13.
135 *Id.* at 314–15.
136 *Id.* at 313.

An adviser may not seek to do indirectly what it is prohibited from doing directly by, for example, adding parties to a side letter after the compliance date.[137] However, new investors to an existing fund may be admitted without jeopardizing the availability of legacy status to the extent the applicable terms are set forth in the fund's limited partnership (or similar) agreement and applicable to all investors.

X. Recordkeeping

The SEC amended the recordkeeping requirements in Rule 204-2 under the Advisers Act to require registered investment advisers to retain books and records related to the Final Rules.

- Quarterly Statement Rule. Advisers must make and keep (1) a copy of any quarterly statement distributed to fund investors pursuant to the Rule; (2) a record of each addressee and the date the statement was sent; (3) records evidencing the calculation method for all expenses, payments, allocations, rebates, waivers, and performance listed on any quarterly statement; and (4) documentation substantiating the adviser's determination that a private fund client is a liquid fund or an illiquid fund.

- Private Fund Audit Rule. Advisers must make and keep (1) a copy of any audited financial statements; (2) a record of each addressee and the corresponding date(s) sent; and (3) a record documenting steps taken to cause a private fund client with which it is not in a control relationship to undergo a financial statement audit that complies with the Rule.

- Adviser-Led Secondaries Rule. Advisers must make and keep (1) a copy of any fairness opinion or valuation opinion and material business relationship summary distributed to investors; and (2) a record of each addressee and the date(s) the opinion and summary were sent.

- Restricted Activities Rule. Advisers must make and keep (1) a copy of any notification, consent or other document distributed or received pursuant to the Restricted Activities Rule; and (2) a record of each addressee and the corresponding date(s) sent for each such document distributed by the adviser.

- Preferential Treatment Rule. Advisers must make and keep (1) any notice required by the Rule; and (2) a record of each addressee and the corresponding date(s) sent.

- Compliance Rule. Pursuant to existing recordkeeping requirements, advisers must make and keep any records documenting an adviser's annual review of its compliance policies and procedures, which will include the written review required by the amended Compliance Rule.

[137] *Id.* at 315.

XI. Effective Date and Compliance Period

The Final Rules will become effective on November 13, 2023. Compliance with the amended Compliance Rule will be required of all registered investment advisers on this date. The compliance dates for the Final Rules will differ for larger private fund advisers (with $1.5 billion or more in private fund regulatory assets under management, calculated as of the last day of the adviser's most recently completed fiscal year) and smaller private fund advisers (with less than $1.5 billion in private fund regulatory assets under management), as shown in the following table.[138]

<table>
<tr><th>Private Fund Adviser Rules</th><th>Large Private Fund Advisers
($1.5 billion or more in private fund assets)</th><th>Smaller Private Fund Advisers
(Less than $1.5 billion in private fund assets)</th></tr>
<tr><td>Private Fund Audit Rule
Rule 206(4)-10</td><td rowspan="2">March 14, 2025</td><td rowspan="5">March 14, 2025</td></tr>
<tr><td>Quarterly Statement Rule
Rule 211(h)(1)-2</td></tr>
<tr><td>Restricted Activities Rule
Rule 211(h)(2)-1</td><td rowspan="3">September 14, 2024</td></tr>
<tr><td>Adviser-Led Secondaries Rule
Rule 211(h)(2)-2</td></tr>
<tr><td>Preferential Treatment Rule
Rule 211(h)(2)-3</td></tr>
<tr><td>The Compliance Rule
Rule 206(4)-7</td><td colspan="2">November 13, 2023
(for all registered investment advisers)</td></tr>
</table>

XII. Conclusion

The Final Rules mark the beginning of a significantly altered compliance regime for private fund advisers. They require significant disclosure of many business elements of private fund advisers' management practices, and require relatively quick turnarounds for detailed quarterly statement summaries of fund performance and expenses. As the SEC continues to impose more oversight of the private funds market, this development will likely lead to new legal questions regarding the resolution of terms, the otherwise unspecified style of producing disclosures, and the best ways for private fund advisers to balance their business practices and disclosure responsibilities, to both disclose appropriately and to preserve the confidentiality of their key relationships with investors via side letters and other agreements or practices.

[138] Unlike the proposed transition period and most recently adopted SEC rules that have transition periods, the transition period for the Final Rules begins on the publication date, not the effective date.

Appendix A: Summary Of The Final Rules

Quarterly Statement Rule **Rule 211(h)(1)-2**	**Applicable Private Fund Advisers**	**Legacy Treatment**	**Compliance Date**
For all funds in existence for at least two full fiscal quarters, an investment adviser must prepare and distribute quarterly statements for any private fund that it advises. Timing of Distribution: • 45 days after the end of the first, second and third fiscal quarters and 90 days after fiscal year end; 75 and 120 days, respectively, for fund of funds, unless such a quarterly statement is prepared and distributed by another person. Fund Table: • A detailed accounting of all compensation, fees, and other amounts allocated or paid to the investment adviser or any of its related persons by the private fund during the reporting period, with separate line items for each category of allocation or payment reflecting the total dollar amount, including, but not limited to, management, advisory, sub-advisory, or similar fees or payments, and performance-based compensation. • A detailed accounting of all fees and expenses allocated to or paid by the private fund during the reporting period with separate line items for each category of fee or expense reflecting the total dollar amount, including, but not limited to, organizational, accounting, legal, administration, audit, tax, due diligence, and travel fees and expenses. • The amount of any offsets or rebates carried forward during the reporting period to subsequent periods to reduce future payments or allocations to the adviser or its related persons. • Information must be presented both before and after the application of any offsets, rebates, or waivers. Portfolio Investment Table: • The quarterly statement must include a separate table for the private fund's covered portfolio investments that discloses, at a minimum, the following information for each covered portfolio investment: • A detailed accounting of all portfolio investment compensation allocated or paid to the investment adviser or any of its related persons by the covered portfolio investment during the reporting period, with separate line items for each category of allocation or payment reflecting the total dollar amount, presented both before and after the application of any offsets, rebates, or waivers. Performance: • Upon sending the initial quarterly statement, the adviser must determine that the private fund is either an *illiquid* fund or a *liquid* fund. • The quarterly statement must present the following with equal prominence: • For "liquid funds": ○ Annual net total returns for each fiscal year over the past 10 fiscal years or since inception, whichever time period is shorter;	SEC-registered advisers only	N/A	March 14, 2025

Appendix A: Summary Of The Final Rules

○ Average annual net total returns over a 1, 5 and 10 fiscal-year period; and ○ Cumulative net total return for the current fiscal year as of the end of the most recent fiscal quarter covered by the quarterly statement. For “illiquid funds”: ○ Gross IRR and gross MOIC; ○ Net IRR and net MOIC; ○ 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; and a ○ Statement of contributions and distributions for the illiquid fund. ○ All of these performance measures must be shown since the inception of the illiquid fund through the end of the quarter covered by the quarterly statement (or, to the extent quarter-end numbers are not available at the time the adviser distributes the quarterly statement, through the most recent practicable date) and computed with and without the impact of any fund-level subscription facilities. Calculations and Cross-References: • The quarterly statement must include prominent disclosure regarding the manner in which all expenses, payments, allocations, rebates, waivers, and offsets are calculated and include cross references to the sections of the private fund’s organizational and offering documents that set forth the applicable calculation methodology. Other Matters: • The quarterly statement must include the date as of which the performance information is current through and prominent disclosure of the criteria used and assumptions made in calculating the performance. Consolidated Reporting: • To the extent doing so would provide more meaningful information to the private fund’s investors and would not be misleading, the adviser must consolidate the reporting required above to cover similar pools of assets. Formatting and Content: • The quarterly statement must use clear, concise, plain English and be presented in a format that facilitates review from one quarterly statement to the next.			

Appendix A: Summary Of The Final Rules

<table>
<tr><th>Restricted Activities Rule
Rule 211(h)(2)-1</th><th>Applicable Private Fund Advisers</th><th>Legacy Treatment</th><th>Compliance Date</th></tr>
<tr><td>An investment adviser to a private fund (other than a securitized asset fund) may not, directly or indirectly, do the following with respect to the private fund, or any investor in that private fund:

• 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 investment adviser requests each investor of the private fund to consent to, and obtains written consent from at least a majority in interest of the private fund’s investors that are not related persons of the adviser for, such charge or allocation; provided, however, that the investment adviser may not charge or allocate to the private fund 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 Investment Advisers Act of 1940 or the rules promulgated thereunder.

• Charge or allocate to the private fund any regulatory or compliance fees or expenses, or fees or expenses associated with an examination, of the adviser or its related persons, unless the investment adviser distributes a written notice 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.

• Reduce the amount of an adviser clawback by actual, potential, or hypothetical taxes applicable to the adviser, its related persons, or their respective owners or interest holders, unless the investment adviser distributes a written notice to the investors of such private fund client that sets forth the aggregate dollar amounts of the adviser clawback before and after any reduction for actual, potential, or hypothetical taxes within 45 days after the end of the fiscal quarter in which the adviser clawback occurs.

• Charge or allocate fees or expenses related to a portfolio investment (or potential portfolio investment) on a non-pro rata basis when multiple private funds and other clients advised by the adviser or its related persons (other than a securitized asset fund) have invested (or propose to invest) in the same portfolio investment, unless (i) the non-pro rata charge or allocation is fair and equitable under the circumstances and (ii) prior to charging or allocating such fees or expenses to a private fund client, the investment adviser distributes to each investor of the private fund a written notice of the non-pro rata charge or allocation and a description of how it is fair and equitable under the circumstances.

• Borrow money, securities, or other private fund assets, or receive a loan or an extension of credit, from a private fund client, unless the adviser: (i) distributes to each investor a written description of the material terms of, and requests each investor to consent to, such borrowing, loan, or extension of credit; and (ii) obtains written consent from at least a majority in interest of the private fund’s investors that are not related persons of the adviser.</td><td>All private fund advisers</td><td>Legacy treatment applies to the restricted activities of (i) charging or allocation of fees/expenses associated with an investigation and (ii) borrowing from a private fund client.</td><td>September 14, 2024 for larger private fund advisers (with $1.5 billion or more in private fund regulatory assets under management, calculated as of the last day of the adviser’s most recently completed fiscal year);

March 14, 2025 for smaller private fund advisers (with less than $1.5 billion in private fund regulatory assets under management).</td></tr>
</table>

Appendix A: Summary Of The Final Rules

<table>
<tr><th>Adviser-Led Secondaries Rule
Rule 211(h)(2)-2</th><th>Applicable Private Fund Advisers</th><th>Legacy Treatment</th><th>Compliance Date</th></tr>
<tr><td>In connection with any adviser-led secondary transaction, an adviser must:

Obtain and distribute to the investors in the fund either (i) a fairness opinion or (ii) a valuation opinion from an independent opinion provider; and
Prepare and distribute to the investors a written summary of any material business relationships the adviser or its related persons has had within the 2-year period prior to issuance of the opinion with the independent opinion provider.
In each case, these documents must be distributed prior to the date of the election form in respect of the adviser-led secondary transaction.
</td><td>SEC-registered advisers only</td><td>N/A</td><td>September 14, 2024 for larger private fund advisers;

March 14, 2025 for smaller private fund advisers.</td></tr>
<tr><th>Preferential Treatment Rule
Rule 211(h)(2)-3</th><th>Applicable Private Fund Advisers</th><th>Legacy Treatment</th><th>Compliance Date</th></tr>
<tr><td>An investment adviser to a private fund (other than a securitized asset fund) may not, directly or indirectly, do the following with respect to the private fund, or any investor in that private fund:

Grant an investor in the private fund or 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, except:

If such ability to redeem is required by the applicable laws, rules, regulations, or orders of any relevant foreign or U.S. Government, State, or political subdivision to which the investor, the private fund, or any similar pool of assets is subject; or
If the investment adviser has offered the same redemption ability to all other existing investors, and will continue to offer such redemption ability to all future investors, in the private fund and any similar pool of assets;

Provide information regarding the portfolio holdings or exposures of the private fund, or of a similar pool of assets, to any investor in the private fund if the adviser reasonably expects that providing the information would have a material, negative effect on other investors in that private fund or in a similar pool of assets, except if the investment adviser offers such information to all other existing investors in the private fund and any similar pool of assets at the same time or substantially the same time.

An investment adviser to a private fund (other than a securitized asset fund) may not, directly or indirectly, provide any preferential treatment to any investor in the private fund unless the adviser provides written notices as follows:

Advance written notice for prospective investors in a private fund. The investment adviser shall provide to each prospective investor in the private fund, prior to the investor’s investment in the private fund, a written notice that provides 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.
</td><td>All private fund advisers</td><td>Legacy treatment applies to the preferential treatment prohibitions on (1) granting preferential redemption rights and (2) preferential portfolio holdings or exposures.</td><td>September 14, 2024 for larger private fund advisers;

March 14, 2025 for smaller private fund advisers.</td></tr>
</table>

Appendix A: Summary Of The Final Rules

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<tr><td>

Written notice for current investors in a private fund. The investment adviser shall distribute to current investors:

For an illiquid fund, as soon as reasonably practicable following the end of the private fund’s fundraising period, written disclosure of all preferential treatment the adviser or its related persons have provided to other investors in the same private fund;
For a liquid fund, as soon as reasonably practicable following the investor’s investment in the private fund, written disclosure of all preferential treatment the adviser or its related persons have provided to other investors in the same private fund; and
On at least an annual basis, 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 private fund since the last written notice provided in accordance with this section, if any.

</td><td></td><td></td><td></td></tr>
<tr><th>Annual Audit Rule
Rule 206(4)-10</th><th>Applicable Private Fund Advisers</th><th>Legacy Treatment</th><th>Compliance Date</th></tr>
<tr><td>An adviser must cause the private funds it advises directly or indirectly to:

Undergo an annual, independent financial statement audit as defined under Regulation S-X that meets the requirements under the Custody Rule; and
Cause audited financial statements to be delivered to a related person under the Custody Rule, if the private fund does not otherwise undergo such an audit.

For a private fund that the adviser does not control and is neither controlled by nor under common control with, if the adviser fails to take all reasonable steps to cause the private fund to (i) undergo a financial statement audit meeting the requirements under the Custody Rule and to (ii) cause those financial statements to be delivered to a related person under the Custody Rule, if the private fund does not otherwise undergo such an audit, the adviser is prohibited from providing investment advice, directly or indirectly, to the private fund.

Notably, changes to the Custody Rule, including but not limited to those in the Safekeeping Rule proposal, could be incorporated by reference into the Annual Audit Rule.</td><td>SEC-registered advisers only</td><td>N/A</td><td>March 14, 2025</td></tr>
<tr><th>Compliance Rule
Rule 206(4)-7</th><th>Applicable Advisers</th><th>Legacy Treatment</th><th>Compliance Date</th></tr>
<tr><td>An adviser must review and document in writing, no less than annually, the adequacy of its policies and procedures and the effectiveness of their implementation.</td><td>All SEC-registered advisers</td><td>N/A</td><td>November 13, 2023</td></tr>
</table>

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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