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Proposed Reforms to Private Fund Adviser Regulation

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On February 9, 2022, the US Securities and Exchange Commission (the “SEC”) proposed changes to the rules governing advisers to private funds. If adopted, the rules would constitute a sweeping change to the regulatory framework for private fund¹ advisers. The proposed amendments to the Investment Advisers Act of 1940 would (i) require registered investment advisers to provide private fund investors with greater transparency and consistent information regarding fees and fund performance and (ii) prohibit all private fund advisers, whether registered or exempt, from engaging in certain practices that the SEC believes are contrary to the public interest.

Summary of Proposed Changes

Registered private fund advisers (and those required to register) would be required to:

- Deliver to investors, within 45 days after the end of each quarter, a standardized report disclosing:
 - the fees and expenses incurred, allocated, or paid at both the fund and portfolio investment levels (along with any rebates, waivers, or offsets);
 - the fund's direct or indirect ownership percentage of each covered portfolio investment; and
 - the fund's investment performance (with liquid funds reporting performance based on net total return over specified periods and illiquid funds reporting performance based on the internal rate of return and a multiple of invested capital).
- Obtain from an independent public accountant, annually and at liquidation, an audit of the financial statements of each private fund advised by it, prepared in accordance with US generally accepted accounting principles, and deliver the audited financial statements to each of the private fund's investors.
- Enter into an agreement with its independent public accountant that requires the accountant to notify the SEC (i) promptly after issuing an audit report that contains a modified opinion and (ii) within four business days after resignation, removal, or other termination of the accountant's engagement.
- Obtain an independent, fairness opinion in connection with any “adviser-led secondary transaction” (i.e., a transaction in fund interests initiated by the investment adviser where fund investors

have the option to sell all or a portion of their interests in the private fund or convert or exchange all or a portion of their interest in the private fund for interests in another vehicle advised by the adviser). The adviser must deliver to the investors participating in such transaction both a fairness opinion and a summary of any material business relationships the adviser has, or had, with the independent opinion provider.

- Prepare and retain a written report documenting the annual review of the registered adviser's compliance policies and procedures.

All private fund advisers would be prohibited from:

- Providing preferential treatment to one or more investors with respect to (i) redemption or other liquidity rights or (ii) access to information regarding portfolio investments and exposures.
- Providing any other preferential treatment to any investor in a private fund unless the adviser provides written disclosures to prospective investors, and annually to current investors, regarding all preferential treatment the adviser or its related persons are providing to other investors in the same fund.
- Charging or allocating certain fees and expenses, including: (i) fees for unperformed services, including accelerating the payment of portfolio monitoring or similar servicing fees; (ii) allocating to a fund the costs associated with a government examination or investigation of the adviser; (iii) allocating to a fund advisor-level regulatory or compliance expenses or fees; or (iv) allocating fees and expenses related to a portfolio investment held by multiple funds and co-investment vehicles on a non-pro rata basis.
- Reducing the amount of any adviser clawback by the amount of certain taxes.
- Seeking reimbursement, indemnification, exculpation, or limitation of its liability by the private fund or its investors for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness.
- Borrowing money, securities, or other fund assets, or receiving an extension of credit, from a private fund client.

Transition Period

If adopted, the SEC is proposing a one-year transition period from the effective date.

Public Comment

The SEC is requesting comments to the proposed rulemaking, and market participants will have until the later of 30 days after the proposal is published in the Federal Register, or until April 11, 2022, to submit comments on the proposal to the SEC.

¹Private funds are funds relying on the exemptions from investment company registration requirements contained in Sections 3(c)(1) or 3(c)(7)

of the Investment Company Act of 1940.

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