



# SEC issues rules

## Enhanced regulation of private fund advisers

August 28, 2023



### SEC final rules enhance regulation of private fund advisers by increasing transparency and restricting certain practices.

#### Source and applicability

- SEC Release No. [IA-6383](#), Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews
- Private fund advisers, regardless of whether registered, or required to be registered, under the Investment Advisers Act of 1940 (the Advisers Act)

#### Fast facts, impacts, actions

The SEC has released its final rules for private fund advisers, after considering comments. There are five key sets of rules within the SEC release. All of these rules apply to registered private fund advisers, and some also apply to unregistered private fund advisers.

Applying only to registered private fund advisers	
<b>Quarterly Statement Rule</b> requiring details of performance, fees and expenses in quarterly statements for each private fund advised.	<b>Audit Rule</b> requiring an annual audit of each private fund advised, meeting the requirements of the audit provision under the <b>Custody Rule</b> .
<b>Adviser-Led Secondaries Rule</b> requiring a fairness or valuation opinion from an independent opinion provider in connection with an adviser-led secondary transaction.	
Applying to all private fund advisers	
<b>Restricted Activities Rule</b> prohibiting certain activities unless the adviser provides specified disclosure, and prohibiting other activities unless consent is also obtained from a private fund's investors.	<b>Preferential Treatment Rule</b> prohibiting certain types of preferential treatment to a fund investor that would have a material, negative effect on other investors, and prohibiting other types of preferential treatment unless the adviser satisfies certain disclosure obligations.

The final rules also amend the books and records requirements in Rule 204-2 of the Advisers Act.

## Background

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 increased the Commission's oversight responsibility for private fund advisers. Among other things, the Dodd-Frank Act amended the Advisers Act generally to require private fund advisers to register with the Commission and to require the Commission to establish reporting and recordkeeping requirements for advisers for investor protection.

The final rules reflect the SEC's belief that, despite existing regulation, advisers frequently do not provide investors with sufficiently detailed information about private fund investments, the costs of investing in private funds, how performance is calculated, the existence of preferential terms granted to certain investors, and conflicts of interest that are not apparent to investors.

## Quarterly Statement Rule

### Fees and expenses

Registered private fund advisers must prepare and distribute to existing investors quarterly statements for each private fund they directly or indirectly advise. Statements must include fund-level detail of fees and expenses, portfolio investment-level detail of compensation paid by the portfolio investment to the adviser (and its affiliates), and performance measures. Statements must be distributed to private fund investors within 45 days after the end of each quarter and 90 days after year-end (75 and 120 days respectively, for fund of funds). Consolidated reporting for substantially similar pools of assets is required if more meaningful and not misleading to investors.

Quarterly reporting of fees and expenses must include prominent disclosure of the manner in which the fund calculates expenses, payments, allocations, rebates, waivers and offsets. This disclosure also must cross-reference each expense to the relevant sections of the organizational and offering documents that explain the calculation methodologies.

Further, relevant fund-level information and portfolio investment-level information for each covered portfolio investment must be disclosed in table format. Covered portfolio investment means a portfolio investment that allocated or paid the investment adviser or its related persons portfolio investment compensation during the reporting period.

	Fund table	Portfolio investment table
<b>Required tabular disclosures for each quarterly statement</b>	<ul style="list-style-type: none"><li>Detailed accounting of all compensation, fees and other amounts paid to the adviser and paid or allocated to the adviser's related persons (presented before and after the effect of any offsets, rebates or waivers)</li><li>Detailed accounting of all other fees and expenses paid by or allocated to the private fund (fund expenses), presented before and after the effect of any offsets, rebates or waivers</li><li>Amounts of offsets or rebates carried forward to subsequent periods to reduce future adviser compensation</li></ul>	<ul style="list-style-type: none"><li>Detailed accounting of portfolio investment compensation allocated or paid to the adviser, or the adviser's related persons, by each covered portfolio investment, including a separate line item for each category of allocation, presented before and after application of offsets, rebates or waivers</li></ul>

## Fund performance

The types of fund performance disclosures are based on whether the private fund is considered a liquid or illiquid fund as defined in the final rules. The reporting should include the date through which performance information is current and prominent disclosure of criteria and assumptions used to calculate performance. The quarterly statement itself should be clear, concise and in plain English using a format that facilitates review from one quarterly statement to the next.



The Commission generally does not consider the required information in the quarterly statement to be an ‘advertisement’ under the Marketing Rule (**Rule 206(4)-1**). However, an adviser that includes other performance metrics in addition to the required information should assess whether such information complies with the Marketing Rule.

	Liquid funds	Illiquid funds*
<b>Performance measures</b>	<ul style="list-style-type: none"> <li>Annual net total returns for the 10 fiscal years prior to the quarterly statement or since the fund’s inception (whichever is shorter)</li> <li>Average annual net total returns over the 1, 5, and 10-fiscal-year periods</li> <li>Cumulative net total return for current fiscal year as of the end of the most recent fiscal quarter</li> </ul>	<ul style="list-style-type: none"> <li>Gross and net Internal Rate of Return (IRR) from inception through end of quarter</li> <li>Gross and net Multiple of Invested Capital (MOIC) from inception through end of quarter</li> <li>Gross IRR and MOIC for realized and unrealized portions of the fund’s portfolio, with realized and unrealized performance shown separately</li> <li>Statement of contributions and distributions</li> </ul>

\*Computed with and without the impact of fund-level subscription facilities. Gross performance measures exclude fees, expenses and performance-based compensation borne by private fund. If quarter-end numbers are not available at the time of distribution, include performance measures through the most recent practicable date.

## Audit Rule

A registered investment adviser must ensure a private fund undergoes a financial statement audit that meets the requirements of the audit provision in the Custody Rule (**Rule 206(4)-2(b)(4)**) at least annually and on liquidation. This requirement applies whether the adviser provides investment advice directly or indirectly to the fund. The audit must be performed in accordance with US GAAS by an independent public accountant that meets the SEC independence requirements and is registered with and subject to regular inspection by the PCAOB.



Under the Custody Rule, surprise examination requirements may be satisfied by obtaining financial statement audits of pooled investment vehicles. Unlike the Custody Rule, there is no alternative means of satisfying the private fund audit requirement in these final rules.

Delivery of the financial statements will require look-through to individual investors when the private fund investor is a pooled investment vehicle also controlled by the adviser. If the adviser does not control the private fund (and is not controlled by or under common control with the fund), the adviser should take all


reasonable steps to cause the private fund to undergo an audit. The Commission notes in the rule release that ‘all reasonable steps’ depends on facts and circumstances and that advisers are in the best position to evaluate their control relationship over private fund clients and should be in a position to determine the appropriate steps to comply with this standard.

### Written agreement and Commission notification

The final rules do not adopt the proposal’s written agreement or independent public accountant notification requirements; however, the Commission recently proposed amendments to the Custody Rule (Safeguarding Advisory Client Assets) considering similar requirements. Relatedly, the Commission reopened its comment period for the Safeguarding Advisory Client Assets proposal initially released in February 2023 ([Release No. IA-6240](#)). See KPMG Defining Issues, [SEC proposal amends the Custody Rule](#), and [comment letter](#) on the proposed amendments to the Custody Rule for further information.

### Adviser-Led Secondaries Rule

In recent years, advisers have become increasingly active in the secondary market and the number and deal value of ‘adviser-led’ transactions has increased to become a meaningful portion of the secondary market, particularly for closed-end private funds. The Commission believes requiring the adviser to obtain a fairness or valuation opinion from an independent opinion provider for adviser-led secondary transactions provides an important check against an adviser’s conflicts of interest in structuring and leading transactions from which it may stand to profit at the expense of private fund investors.



Adviser-led secondary transactions are transactions initiated by the adviser, or its related persons, that offer private fund investors the choice to sell all or a portion of their interests in the private fund, or to convert or exchange all or a portion of such interests for interests in another vehicle advised by the adviser, or its related persons.

The final rules require the adviser to prepare and distribute to private fund investors a summary of material business relationships the adviser or any of its related persons has, or has had within the past two years, with the independent opinion provider. Whether a business relationship is material requires a facts and circumstances analysis; however, according to the Commission, audit, consulting, capital raising, investment banking and other similar services would typically meet this standard.

### Restricted Activities Rule

The final rules restrict all private fund advisers from engaging in certain sales practices, conflicts of interest and compensation schemes that are contrary to the public interest and the protection of investors unless appropriate disclosure is made, and in certain cases, consent is obtained. The rules specifically call out the following activities.

Restricted advisor activity	Notice to investors required*	Investor consent required
Charging fees or expenses associated with an investigation of the adviser (or related persons)	Yes	Yes
Charging regulatory or compliance fees or expenses associated with an examination of the adviser	Yes	No
Reducing the amount of an adviser clawback by actual, potential or hypothetical taxes applicable to adviser	Yes	No

Restricted advisor activity	Notice to investors required*	Investor consent required
Charging fees or expenses related to a portfolio investment on a non-pro rata basis when multiple funds/clients are invested in the same portfolio investment	Yes	No
Borrowing money, securities or other private fund assets, or receiving a loan or extension of credit from a private fund	Yes	Yes


\* The detail and form of the notice requirements are defined in the final rules.

## Preferential Treatment Rule

The final rules specifically prohibit certain activities related to preferential terms being provided to only certain investors regarding redemption or information about portfolio holdings or exposures. The following are exceptions to these prohibitions.

- For redemptions (1) if the redemption is required by law, rule, regulation or order of certain governmental authorities, and (2) if the adviser has offered the same redemption ability to all future investors in the private fund or similar pool of assets.
- For portfolio holdings or exposures information, when the adviser offers such information to all other existing investors at substantially the same time.

Other preferential treatment is prohibited unless the adviser provides written disclosures to prospective and current investors in the fund regarding all preferential treatment the adviser or its related persons are providing to other investors in the fund. The timing and nature of these delivery requirements depend on whether the recipient is an existing or prospective investor.



The Commission recognizes that advisers provide various types of preferential treatment, some of which do not have a material, negative effect on other fund investors. In this case, disclosure is considered appropriate because it would allow investors to make their own assessment.

## Miscellaneous

### Legacy status

The final rules provide legacy status under the prohibitions aspect of the Preferential Treatment Rule and aspects of the Restricted Activities Rule. Advisers will not be required to amend governing agreements for private funds that commenced operations as of the new rules' compliance date. However, such legacy status does not permit advisers to charge private funds for fees or expenses related to an investigation that results or has resulted in sanctions for a violation of the Advisers Act.

## Written documentation of all advisers' annual reviews of compliance programs

The final rules amend the Advisers Act Compliance Rule to require all SEC registered advisers to document the annual review of their compliance policies and procedures in writing.

## Securitized asset funds (SAFs)

The final Quarterly Statement, Restricted Activities, Adviser-Led Secondaries, Preferential Treatment, and Audit Rules do not apply to investment advisers with respect to any private fund whose primary purpose is to issue asset backed securities and whose investors are primarily debt holders (Securitized Asset Funds).

## Compliance dates

The final rules will be effective following posting to the Federal Register using the following compliance guidelines.

	Larger private fund advisers (> \$1.5B)	Smaller private fund advisers
Audit Rule and Quarterly Statement Rule	18 months	18 months
Adviser-Led Secondaries, Preferential Treatment, and Restricted Activities Rules	12 months	18 months
Amended Advisers Act Compliance Rule	60 days	60 days

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