

THE SEC'S NEW RULES FOR PRIVATE FUND ADVISERS: FIRST IMPRESSIONS

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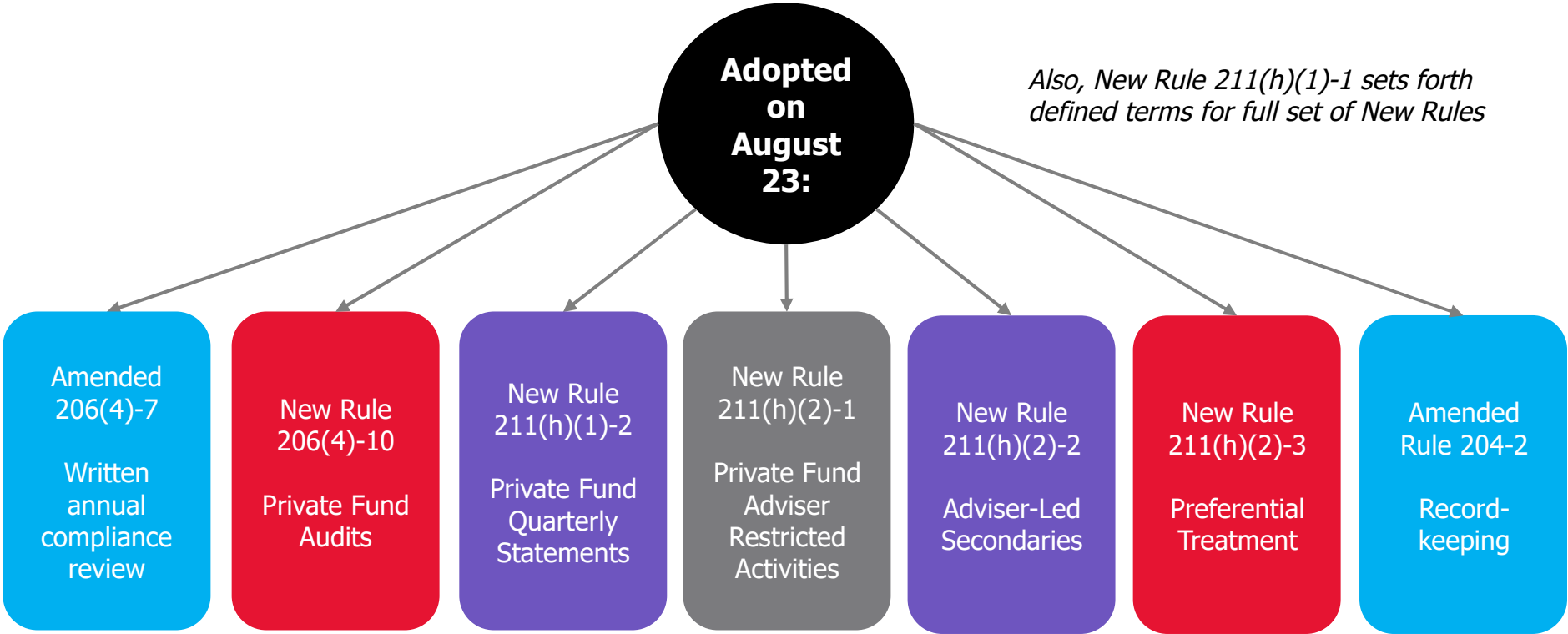


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The New Rules and Amendments, at a Glance:



Securitized asset funds (i.e., CLOs and other ABS funds) are excluded from New Rules

Written Annual Review of Compliance Program

Rule 206(4)-7

Who

SEC-Registered Advisers (or Advisers Required to be Registered)

When

60 days after publication in Federal Register

What

- Rule 206(4)-7(b) has always required advisers to annually review adequacy of their compliance policies and effectiveness of their implementation
- As amended, Rule 206(4)-7 will now require such review to be documented in writing
- In Adopting Release, SEC indicated expectation that written annual compliance program reviews would be able to be produced to Staff within several hours and in less than 24 hours in normal course
- SEC also noted in Adopting Release that it considers written compliance program reviews to not be protected by attorney-client privilege or work product doctrine

Private Fund Audits

Rule 206(4)-10

Who

SEC-Registered Advisers (or Advisers Required to be Registered)

When

18 months after publication in Federal Register

What

- Adviser must cause each private fund that it advises, directly or indirectly, to undergo financial statement audit (if fund not otherwise audited)
- Audit requirements cross-reference Custody Rule (e.g., independent public accountant overseen by PCAOB)
- Adviser shall cause audited financials to be delivered
- For third-party advisers (i.e., where private fund is not controlled by or under common control with adviser), adviser is prohibited from providing advice to fund if adviser has not taken all reasonable steps to cause fund to be audited

Private Fund Quarterly Statements

Rule 211(h)(1)-2

Who

SEC-Registered Advisers (or Advisers Required to be Registered)

When

18 months after publication in Federal Register

What

- Private fund advisers will be required to deliver quarterly account statements to investors within 45 days of quarter end (90 days for quarter that is FYE)
 - Fund of funds: 75 days and 120 days
- Statements must include:
 - Fund Table: extensive, line-by-line calculations of fees and expenses
 - Portfolio Investment Table: fees and compensation paid or allocated to adviser and related persons by portfolio investments
 - Calculation methodology must be disclosed, with citations to relevant sections in fund governing documents

Private Fund Quarterly Statements (cont.)

Rule 211(h)(1)-2

Who

SEC-Registered Advisers (or Advisers Required to be Registered)

When

18 months after publication in Federal Register

What

- Performance:
 - Liquid (open-end) funds must show annual net total returns, average annual net total returns for 1-, 5- and 10-years, and cumulative net total returns for current FY and most recent quarter
 - Illiquid (closed-end) funds must show:
 - Gross and Net IRR and MOIC, with and without fund-level subscription facilities
 - Gross IRR and Gross MOIC for realized and unrealized portions of portfolio separately
- Consolidated reporting is permitted
- Format and content standards will provide SEC staff with tool to apply subjectively on exams
- In change from proposal, SEC dropped requirement to show adviser's ownership percentage of portfolio investments

Adviser-Led Secondaries

Rule 211(h)(2)-2

Who

SEC-Registered Advisers (or Advisers Required to be Registered)

When

12 months after publication in Federal Register for advisers with \$1.5 billion of private fund assets; otherwise, 18 months

What

- As defined in Rule 211(h)(1)-1, adviser-led secondary is any transaction initiated by adviser or its related persons that offers private fund investors choice to (1) sell their interests, or (2) convert or exchange their interests for interests in another vehicle advised by adviser or its related person
- Adviser conducting adviser-led secondary transaction must, prior to due date on secondary deal's election form:
 - Obtain, and distribute to investors, fairness opinion or valuation opinion from independent opinion provider, and
 - Prepare, and distribute to investors, written summary of any material business relationships over past two years between independent opinion provider and adviser and its related persons

Restricted Activities

Rule 211(h)(2)-1

Who

Any Private Fund Adviser

When

12 months after publication in Federal Register for advisers with \$1.5 billion of private fund assets; otherwise, 18 months

What

- In change from proposal, SEC did not adopt following prohibitions:
 - Monitoring, servicing, consulting and other fees for services not reasonably expected to be provided;
 - Reimbursement, indemnification, exculpation or limitation of liability provisions (including simple negligence)
- Cannot charge regulatory investigation expenses without written notice and consent from at least majority of unrelated investors
 - Such expenses can never be charged – including with respect to current funds – where sanction imposed
 - Funds existing prior to compliance date are carved out if they would have to amend their governing documents
- Cannot charge regulatory, compliance or examination fees without detailed written notice (including dollar amounts) distributed within 45 days of quarter end

Restricted Activities (cont.)

Rule 211(h)(2)-1

Who

Any Private Fund Adviser

When

12 months after publication in Federal Register for advisers with \$1.5 billion of private fund assets; otherwise, 18 months

What

- Cannot reduce clawbacks for certain tax payments by adviser and its owners without written notice of aggregate amounts within 45 days of clawback
- Cannot charge or allocate fees relating to portfolio investment other than pro-rata, unless (i) fair and equitable under circumstances, and (ii) advance notice to investors, including description of fairness and equity
- Cannot borrow assets or receive loans from private funds without written notice and consent from at least majority of unrelated investors
 - Funds existing prior to compliance date are carved out if they would have to amend their governing documents / contracts

Preferential Treatment

Rule 211(h)(2)-3

Who

Any Private Fund Adviser

When

12 months after publication in Federal Register for advisers with \$1.5 billion of private fund assets; otherwise, 18 months

What

- No preferentially liquidity for investors if it would have material, negative effect on other investors
 - Investors that require special liquidity by law are exempt
 - May have preferentially liquidity arrangements if offered to all existing and future investors
- No disclosure of investment holdings or exposures to certain investors if it would have material, negative effect on other investors
 - May offer to all existing investors at same, or substantially same, time
- For these two items, Funds existing prior to compliance date are carved out if they would have to amend their governing documents / contracts
- Application to “similar pools of assets” could be complex

Preferential Treatment (cont.)

Rule 211(h)(2)-3

Who

Any Private Fund Adviser

When

12 months after publication in Federal Register for advisers with \$1.5 billion of private fund assets; otherwise, 18 months

What

- No other preferential treatment to investors, unless:
 - Advance, specific written notice to all prospective investors, prior to time of their investment
 - Written disclosure to current liquid fund investors as soon as reasonably practicable after investment of all preferential treatment provided
 - Written disclosure to current illiquid fund investors as soon as reasonably practicable after end of fundraising period
 - Updates of any additional preferential treatment provided at least annually
 - No carve-outs for existing funds

Record-keeping

Rule 204-2

Who

SEC-Registered Advisers (or Advisers Required to be Registered)

When

12-18 months, as applicable

What

- Advisers will be required to maintain records of:
 - Quarterly account statements, addressees and dates sent
 - All records evidencing calculation method and expenses, payments, allocations, rebates, offsets, waivers and performance
 - Audited financial statements, addressees and dates sent
 - Steps taken to cause an uncontrolled private fund to undergo financial audit
 - Documentation substantiating determination of fund as liquid or illiquid
 - Fairness opinions, valuation opinions and material business relationship summaries, addressees and dates sent
 - Notices, consents and other documents for restricted activities and preferential treatment

Compliance Dates (After Federal Register Publication)

**Adopted
on
August
23:**

Also, New Rule 211(h)(1)-1 sets forth defined terms for full set of New Rules

Amended
Rule 206(4)-7

Written
annual
compliance
review

60 days

New Rule
206(4)-10

Private Fund
Audits

18
months

New Rule
211(h)(1)-2

Private Fund
Quarterly
Statements

18
months

New Rule
211(h)(2)-1

Private Fund
Adviser
Restricted
Activities

12-18
months

New Rule
211(h)(2)-2

Adviser-Led
Secondaries

12-18
months

New Rule
211(h)(2)-3

Preferential
Treatment

12-18
months

Amended
Rule 204-2

Record-
keeping

12-18
months

Planning for Next Steps

Please join us for the follow-up webinar,
**“The SEC’s New Rules for Private
Fund Advisers: Practical Next Steps”**
on **Tuesday, September 19, 12:00 PM ET**

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Christine Lombardo advises investment managers and broker-dealers on financial regulatory matters. She concentrates her practice on securities regulation for a broad range of financial firms including retail asset managers, private fund managers, family offices, broker-dealers, other professional traders, and high-net-worth individuals. Christine also counsels legal, compliance, and business personnel on the structure, operation, and distribution of advisory programs, including digital advisory offerings, and investment products, including hedge funds, private equity funds, venture capital funds, real estate funds, and other alternative investment products. Christine also counsels financial firms through examinations by industry regulators, as well as on enforcement related matters. She also serves as a co-leader of the firm's financial technology (fintech) industry team. Before joining Morgan Lewis, she was an associate at an international law firm in New York and worked for the Division of Enforcement at FINRA.

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The deputy leader of Morgan Lewis's global investment management practice, Courtney Nowell advises global institutional investor clients on the terms of their inbound and outbound investments, including into private equity and other co-mingled open-ended and closed-ended investment funds. She has over 20 years' experience drafting and negotiating the terms of investment agreements and side letters for clients investing into leveraged buyout, venture capital, distressed debt, special opportunity, real estate, hedge, energy, infrastructure, and credit funds. She also represents investors in opportunity and sidecar funds, co-investment funds and with the drafting and negotiating of funds of one and other bespoke strategic private investment partnerships.

Courtney's clients include sovereign wealth funds and major public and private pension funds, as well as foundations, endowments and family offices.

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John J. "Jack" O'Brien counsels registered and private funds and fund managers in connection with organizational, offering, transactional, and compliance matters. He regularly works with a variety of different fund structures, including open-end and closed-end funds, exchange-traded funds, and hedge funds. He also counsels investment adviser and broker-dealer clients on various matters, particularly with respect to registration and disclosure, marketing regulations, pay-to-play issues, and transactions in exchange-traded funds.

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Christine Ayako Schleppegrell counsels asset managers on legal, regulatory, and compliance matters, focusing on advisers to private funds (private equity, hedge, venture capital, infrastructure, real estate, credit) and separately managed accounts. She spent several years in private practice and more recently at the US Securities and Exchange Commission (SEC), including in leadership roles in the Division of Investment Management. While at the SEC, Christine led the Private Funds Branch during a time of landmark rulemaking impacting private fund advisers—she draws on this experience to advise on current and pending regulations and to guide clients through enforcement and examination proceedings.

Christine’s practice focuses on the interpretation and application of federal securities laws, primarily the Advisers Act, Investment Company Act, Exchange Act, and Securities Act. She serves as a resource for SEC-registered advisers, exempt reporting advisers, and unregistered advisers, ranging from global asset managers with diverse product offerings to startup advisers launching their first funds. Christine provides strategic advice on fund and adviser structuring and deal-related regulatory issues that arise in connection with corporate purchases and mergers and acquisitions. She also specializes in counseling on marketing rule compliance and performance advertising as well as extraterritorial matters, including participating affiliate arrangements.

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Stephen C. Tirrell's practice focuses on advising private investment funds (U.S. and non-US) and investment advisers in relation to all aspects of their businesses. Steve assists clients in the structure and organization of hedge funds, hybrid funds and private equity funds, including equity, arbitrage, distressed, global macro, funds of funds, first-loss funds, real estate funds, infrastructure funds and others. Steve counsels clients on seed capital arrangements, compensation arrangements among partners and employees, complex fund restructurings, co-investments and compliance with the Investment Advisers Act of 1940 and other relevant U.S. securities laws.

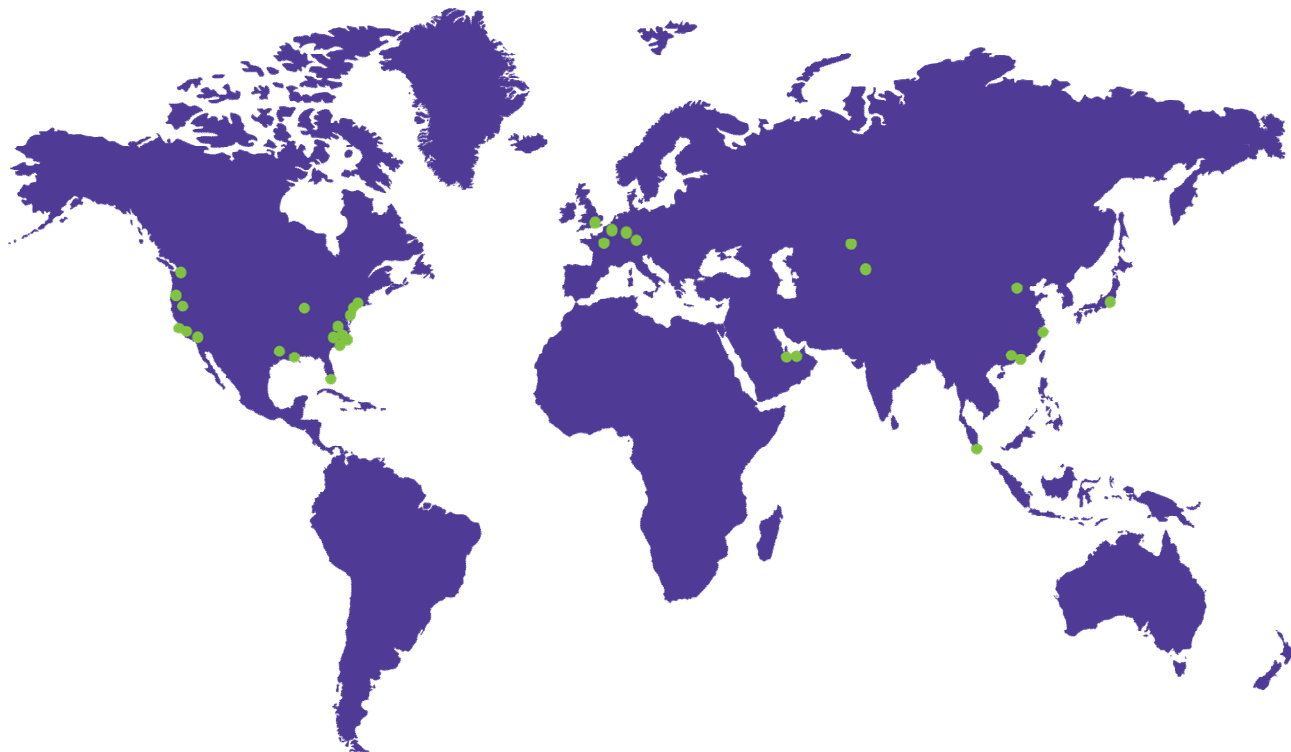
In addition to his private fund practice, Steve represents and advises a variety of entities, including banks, broker-dealers, CDOs, and hedge funds, with respect to issues involving joint venture arrangements, derivatives products and new product development.

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