

MEMO# 34036

February 16, 2022

SEC Proposes Private Fund Regulatory Reforms

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TO: ICI Members SUBJECTS: Compliance

Disclosure

Financial Stability

Fixed Income Securities

Investment Advisers

Money Market Funds

Recordkeeping RE: SEC Proposes Private Fund Regulatory Reforms

On February 9, the Securities and Exchange Commission voted to propose new rules and amendments under the Investment Advisers Act of 1940 with respect to private fund advisers. The proposal passed by a vote of three-to-one. The proposal's goals are to improve private fund adviser regulation and to provide more transparency, competition, and efficiency in the private fund market.

In general, the proposal would:

- Require registered investment advisers to prepare a quarterly statement that includes information regarding fees, expenses, and performance for any private fund that the adviser oversees. This statement would be distributed to the private fund's investors within 45 days of the end of each calendar quarter.[\[1\]](#) Under proposed amendments to the Advisers Act Books and Records Rule, advisers would be required to maintain copies of each quarterly statement and retain evidence of delivery to each investor.

The SEC proposes this requirement so that private fund investors could compare fund fees and expenses to statements made in the fund's governing documents. The proposal would not require private funds to give individualized reports of each investor's fees, expenses, and performance.

- Require private fund advisers to obtain an annual audit, by an independent public accountant, of the financial statements of the private funds they manage.[\[2\]](#) The audit would need to be prepared in accordance with generally accepted accounting principles (GAAP), performed in accordance with generally accepted auditing principles (GAAS), and in compliance with Regulation S-X. The proposal notes that the

proposed audit rule is based on the Advisers Act Custody Rule, but compliance with either rule would not automatically satisfy the other.[3]

- Prohibit an adviser from completing an adviser-led secondary transaction with respect to any private fund, unless the adviser distributes to investors a fairness opinion from an independent opinion provider and a summary of any material business relationships the adviser or its related persons have had with the independent opinion provider, prior to the closing of the transaction.[4] The proposal also includes recordkeeping requirements in connection with adviser-led secondaries.
- Prohibit private fund advisers from charging certain fees such as accelerated monitoring fees or fees associated with regulatory compliance, reducing the amount of adviser clawback by the amount of certain taxes, attempting to limit liability in any way for breach of fiduciary duty, bad faith, negligence or recklessness, or borrowing from fund clients.
- Prohibit advisers, regardless of registration status with the Commission, from giving preferential terms to certain clients regarding redemption or providing portfolio holdings or exposures information.[5] Other kinds of preferential treatment would be disclosed to current and prospective investors. The proposal indicates that whether a term is "preferential" would depend on facts and circumstances. The proposal notes that the primary concern in this area are preferential terms that have a material, negative impact on other investors in the private fund or investors in a substantially similar pool of assets.

The full proposal is available at <https://www.sec.gov/rules/proposed/2022/ia-5955.pdf>; the SEC Fact Sheet is available at <https://www.sec.gov/files/ia-5955-fact-sheet.pdf>; and the press release is available at https://www.sec.gov/news/press-release/2022-19?utm_medium=email&utm_source=govdelivery.

The public comment period will remain open for 30 days after publication in the Federal Register or April 11, 2022 (which is 60 days after issuance), whichever is later.

SEC Chair Gary Gensler and Commissioners Peirce, Lee, and Crenshaw delivered statements on the proposal.

- Chair Gensler gave his support for the proposal, noting that private funds exist not only for the benefit of wealthy individuals, but also "teachers, firefighters, municipal workers, students, and professors" for whom pension plans and government endowments invest. Chair Gensler believes the private fund space would benefit from more "efficiency, competition, and transparency." The Chair's full statement is available at <https://www.sec.gov/news/statement/gensler-statement-private-fund-advisers-proposal-020922>.
- Commissioner Peirce stated that the proposal represents a "sea change" for private funds. Commissioner Peirce voted against the proposal, believing that the proposal assumes that sophisticated investors such as institutions and high net worth individuals are not adequately equipped to obtain information about their investment. Commissioner Peirce called the proposed changes a "meaningful recasting of the SEC's mission." Commissioner Peirce's full statement is available at <https://www.sec.gov/news/statement/peirce-statement-proposed-private-fund-advisers-020922>.
- Commissioner Lee supported the proposal by noting the increasing exposure of retail investors in the private fund space. The Commissioner stated that the practical effect

of this proposal is to bring "efficiency and fairness to this market, through transparency, addressing conflicts and creating accountability." Commissioner Lee's full statement is available at

<https://www.sec.gov/news/statement/lee-private-fund-20220209>.

- Commissioner Crenshaw also supported the proposal. She pointed out that private funds serve many kinds of clients and private fund advisers have the same fiduciary duty to each client. Her statement pointed out the work of the SEC Office of Examinations in evaluating private funds, which revealed "concerning examples of private fund advisers' conflicts of interest, inconsistent disclosures, and improper allocations of fees and expenses." Commissioner Crenshaw's full statement is available at <https://www.sec.gov/news/statement/crenshaw-private-fund-20220209>.

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endnotes

[1] Proposed Advisers Act Rule 211(h)(1)-2.

[2] Proposed Advisers Act Rule 206(4)-10. The proposed rule would apply to all investment advisers registered, or required to be registered, with the Commission.

[3] See Advisers Act Rule 206(4)-2(b)(4).

[4] Proposed Advisers Act Rule 211(h)(2)-2. The proposed rule would not apply to advisers that are not required to register as investment advisers with the Commission, such as state-registered advisers and exempt reporting advisers.

[5] Proposed Advisers Act Rule 211(h)(2)-3(a)(1) and (2).