GIBSON DUNN

A Guide to Understanding the New Private Funds Rules

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On August 23, 2023, the U.S. Securities and Exchange Commission (the "***SEC***") by a 3-2 vote adopted final rules (the "***Final Rules***") under the Investment Advisers Act of 1940, as amended (the "***Advisers Act***"), which modify certain aspects of the rules initially proposed on February 9, 2022 (the "***Proposed Rules***") and adopt others largely as proposed. The Final Rules reflect the SEC's asserted goal of bringing "transparency" to the inner workings of private funds and their sponsors by restricting or requiring extensive disclosure of preferential treatment granted in side letters, as well as imposing numerous additional reporting and other compliance requirements.[1] While several of the Final Rules require further clarification, and industry practice will undoubtedly evolve as the Final Rules are further analyzed and, to the extent possible, implemented, the following table sets forth ***a high-level overview of key requirements and restrictions reflected in the Final Rules***. Following the table is a ***Q&A*** addressing some of the most frequently asked questions sponsors and other industry participants have asked us. These materials are a general, initial summary and do not assess the legality of the Final Rules, which remain subject to potential challenge.

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Private Funds Rules - Overview of Key Requirements and Restrictions

Requirement or Restriction	High-Level Observations	Compliance Date[2] / Grandfathering of existing funds[3]
Preferential Treatment Rule (Disclosure Requirements): An adviser may not admit an investor into a fund unless it has provided *advance disclosure of material economic terms* granted preferentially to other investors, and must disclose *all* other preferential treatment "as soon as reasonably practicable" after the end of the fundraising period (for illiquid funds) or the investor's investment (for liquid funds) and at least annually thereafter (if new preferential terms are granted since the last notice).	As set forth below, this requirement fundamentally changes the rules of the game with respect to a fund's typical MFN process and requires advance disclosure of material economic terms, including to those investors who are not entitled to elect them, and to those who would not typically see them (e.g., smaller investors who do not have side letters).Because the disclosure requirements apply to existing funds, older funds will need to disclose preferential treatment previously granted but not yet disclosed.	Compliance Date: 12 months (Larger Advisers) 18 months (Smaller Advisers) Existing funds grandfathered? No.
Quarterly Statement Rule: Registered advisers must issue quarterly statements detailing information regarding fund-level performance; the costs of investing in the fund, including itemized fund fees and expenses; the impact of any offsets or fee waivers; and an itemized accounting of all amounts paid to the adviser or its related persons by each portfolio company.	As set forth below, the requirement to show performance metrics for illiquid funds, both with and without the impact of fund-level subscription facilities, and to spell out clearly all fund-level and portfolio company-level special fees and expenses (e.g., monitoring fees) and *provide a cross-reference to the section of the private fund's organizational and offering documents setting forth the applicable calculation methodology* with respect to each is extremely burdensome and could provide another basis	Compliance Date: 18 months (Larger and Smaller Advisers) Existing funds grandfathered? No

	for the SEC staff to review performance calculations and fee and expense allocations during exams. We also expect the timing deadlines for the quarter- and year-end statements to present significant operational challenges for sponsors.	
Private Fund Audit Rule: Registered advisers must obtain an annual audit for each private fund that meets the requirements of the audit provision in the Advisers Act custody rule (Rule 206(4)-2), and will no longer be able to opt out of the requirement using surprise examinations.	Many private fund sponsors are already providing audited financial statements in compliance with the custody rule. Sponsors who opt out of this requirement in favor of surprise examinations will be affected. We note that the SEC has re-opened its comment period with respect to its proposal regarding safeguarding client assets to allow commenters to assess its interplay with the Private Fund Audit Rule.	Compliance Date: 18 months (Larger and Smaller Advisers) Existing funds grandfathered? No
Adviser-Led Secondaries Rule: Registered advisers must obtain and distribute an independent fairness opinion or valuation opinion in connection with an adviser-led secondary transaction, and disclose material business relationships the adviser has had in the last two years with the opinion provider.	We believe that a U.S. market norm has likely developed in recent years where many sponsors are already providing fairness opinions or valuation opinions as a best practice in GP-led secondaries. This requirement will, however, increase expenses for transactions that have not historically relied on such opinions (such as where a third-party bid establishes the price), and ultimately such expenses will be passed onto investors.	Compliance Date: 12 months (Larger Advisers) 18 months (Smaller Advisers Existing funds grandfathered? No
Books and Records Rule Amendments: Requirement to maintain certain books and records demonstrating compliance with the Final Rules.	We believe that the books and records amendments generally clarify that sponsors must maintain specific records of compliance with the new rules. We anticipate the SEC staff will focus on this requirement in considering possible deficiencies related to the new rules as part of routine exams.	Compliance Date: Based on the compliance date of the underlying rule for which records are required Existing funds grandfathered? No
Restricted Activities Rule (Investigation Costs): An adviser may not allocate to the private fund any fees or expenses associated with an investigation of the adviser without disclosing as much and receiving consent from a majority in interest of fund investors (excluding the adviser and its related persons), and is prohibited from charging the fund for fees and expenses for an investigation that results or has resulted in a sanction for a violation of the Advisers Act or the rules thereunder.	We believe this rule will adversely affect and burden sponsors.[4] Sponsors will no longer be able to allocate costs of an investigation to a fund unless a majority in interest of unaffiliated investors consent. The adopting release makes clear that the SEC intends that sponsors seek separate consents for each investigation, which would suggest that the practice of describing such costs with generality in the fund's governing document would not be sufficient. Even if sponsors obtain consent to allocate costs related to an investigation to a fund, they will not be able to do so if the investigation results in sanctions for violations of the Advisers Act.	Compliance Date: 12 months (Larger Advisers) 18 months (Smaller Advisers Existing funds grandfathered? Yes, if disclosed.[5]
Restricted Activities Rule (Regulatory/Compliance Costs): Advisers may not charge or allocate to the private fund regulatory, examination, or compliance fees or expenses unless they are disclosed to investors within 45 days after the	The adopting release makes clear that the SEC continues to view advisers charging to the fund "manager-level" expenses that it feels should more appropriately be borne by the adviser as "contrary to the public interest and the protection of investors." As is currently the case, an adviser that allocates its regulatory,	Compliance Date: 12 months (Larger Advisers) 18 months (Smaller Advisers Existing funds grandfathered?

end of the fiscal quarter in which such charges occur.	compliance and examination costs to a fund should ensure that this practice is clearly permitted under the fund's governing documents. However, even with such authority, the level of granular disclosure regarding such costs that the Final Rule seemingly requires could have a chilling effect on the practice (where applicable) and discourage investment in compliance.	Disclosure requirement generally applies
Restricted Activities Rule **(After-tax Clawback):** Advisers may not reduce the amount of a GP clawback by amounts due for certain taxes unless the pre-tax and post-tax amounts of the clawback are disclosed to investors within 45 days after the end of the fiscal quarter in which the clawback occurs.	Advisers who wish to reduce their GP clawback amount by their actual or hypothetical taxes (the latter being a common practice permitted by most fund governing documents) will need to provide investors with notice of having done so and disclosure of specific dollar amounts.	<u>Compliance Date</u>: 12 months (Larger Advisers) 18 months (Smaller Advisers <u>Existing funds grandfathered?</u> Yes, with disclosure
Restricted Activities Rule (Non-*pro rata* investment-level allocations): Advisers may not charge or allocate fees or expenses related to a portfolio investment on a non-*pro rata* basis when multiple funds and other clients are invested, unless the allocation is "fair and equitable" *and* the adviser distributes advance notice describing the charge and justifying its fairness and equitability.	We believe that this requirement will put additional pressure on advisers to determine, at the outset of a fundraise, whether certain costs, such as those related to AIVs or feeder funds set up to accommodate particular investors' unique tax or regulatory profiles, will be allocated across the fund or instead allocated exclusively to such investors. Increased disclosure will likely lead to more allocation of these costs across the fund. This rule also places additional pressure on the practice of disproportionately allocating broken deal expenses to the fund as opposed to investors who were proposed to have invested alongside the fund, which is a longstanding focus of the SEC.	<u>Compliance Date</u>: 12 months (Larger Advisers) 18 months (Smaller Advisers <u>Existing funds grandfathered?</u> Disclosure requirement generally applies
Restricted Activities Rule **(Borrowing from the fund):** Advisers may not borrow or receive an extension of credit from a private fund without disclosure to and consent from fund investors.	This rule does not apply to the more typical practice of sponsors lending money to the fund. In light of the clarification that disclosure and consent are required, a minority of sponsors may seek to include the ability to borrow from the fund on certain pre-defined terms in the fund's governing documents.	<u>Compliance Date</u>: 12 months (Larger Advisers) 18 months (Smaller Advisers <u>Existing funds grandfathered?</u> Yes.[6]
Preferential Treatment Rule (Redemption Rights): An adviser may not offer preferential treatment to investors regarding their ability to redeem if the adviser reasonably expects such terms to have a material, negative effect on other investors, unless such ability is required by law or offered to all other investors in the fund without qualification.	State pension funds and sovereign wealth funds, in particular, often negotiate special redemption rights. Sponsors are being placed in the difficult position of determining whether such rights have a material, negative effect on other investors, when they are not driven by laws, rules or regulations applicable to the investor. The SEC has provided little guidance to assist in this determination, which must be examined on a case-by-case basis.	<u>Compliance Date</u>: 12 months (Larger Advisers) 18 months (Smaller Advisers <u>Existing funds grandfathered?</u> Yes.[7]
Preferential Treatment Rule (Portfolio Holdings Information): An adviser may not provide preferential information about portfolio	Attention should be given to information required by bespoke reporting templates to determine whether this provision applies.	<u>Compliance Date</u>: 12 months (Larger Advisers)

holdings or exposures if the adviser reasonably expects that providing the information would have a material, negative effect on other investors, unless such preferential information is offered to all investors.		18 months (Smaller Advisers Existing funds grandfathered? Yes.[8]
Compliance Rule Amendment: All registered advisers (including those without private fund clients) must document in writing the required annual review of their compliance policies and procedures.	We believe this codifies an informal position that the SEC examinations staff has already imposed on advisers.	Compliance Date: 60 days after publication of the Final Rules in the Federal Register Existing funds grandfathered? N/A

Frequently Asked Questions:

The following ***Q&A*** sets forth our answers to questions to frequently asked questions:

Question: Which of the Final Rules apply to various types of sponsors?

Registered investment advisers to private funds are subject to all of the rules and restrictions set forth in the table above.

Exempt reporting advisers and other unregistered advisers are not affected by the Quarterly Statement Rule, the Private Fund Audit Rule, the Adviser-Led Secondaries Rule or the Compliance Rule Amendment.

Offshore advisers whose principal place of business is outside the U.S., whether registered or unregistered, are technically subject to the Final Rules, but the SEC has indicated that it will not extend the requirements of these rules to the adviser's activities with respect to their offshore private fund clients, even if the offshore funds have U.S. investors.

The Final Rule states that Quarterly Statement Rule, Private Fund Audit Rule, Adviser-Led Secondaries Rule, Restricted Activities Rule and Preferential Treatment Rules do not apply to investment advisers with respect to **securitized asset funds** they advise; **real estate funds relying on Section 3(c)(5)(C),** and **other collective investment vehicles that are not "private funds"[9]** are also outside the technical scope of those rules.

Real estate fund managers that are not registered with the SEC (or filing reports as an exempt reporting adviser) on the basis that they are not advising on "securities" are not subject to the Advisers Act or the Final Rules.

Question: What do sponsors have to disclose before and after admitting investors, and how will the current MFN process change?

Sponsors will now have to disclose (i) fee and carry breaks or other material economic arrangements preferentially granted to other investors *ahead* of admitting new investors into their private funds, and (ii) *all* preferential treatment as soon as reasonably practicable after the final closing of a closed end fund or the admission of the new investor in an open-end fund, and at least annually thereafter if preferential terms are provided that were not previously disclosed. This disclosure requirement applies to existing funds, even if they have held a final closing prior to the compliance date.

In a statement released concurrently with the release of the Final Rule, Commissioner Caroline A. Crenshaw stated that "collective action problems appear to prevent coordination among investors to bargain for uniform baseline terms."[10] The SEC's decision to require disclosure of material economic terms ahead of admitting investors to the fund and disclosure of all preferential treatment post-final closing takes aim at that purported collective action problem.

Notably, the SEC seemingly narrowed its original proposal by opting to require advance written disclosure of “any preferential treatment related to *any material economic terms*,” as opposed to advance disclosure of *all* preferential treatment, as originally proposed.[11] Notwithstanding that concession, *all* preferential treatment (notably, without the materiality qualifier) must invariably be disclosed as soon “as reasonably practicable” following the end of the private fund’s fundraising period (for illiquid funds) or the investor’s investment in the private fund (for liquid funds).[12]

The SEC notes that “as soon as reasonably practicable” will be a facts and circumstances analysis, but suggests that it believes that “it would generally be appropriate for advisers to distribute the notices within four weeks.”[13] We find this proposed timeline ambitious and, in the absence of a hard deadline, would predict that many sponsors will continue take additional time to complete their MFN process. The “as soon as reasonably practicable” requirement would, however, cut against conducting an MFN process an excessive number of months after the final closing, as sometimes happens at present.

Material economic terms that require prior disclosure include, without limitation, “the cost of investing, liquidity rights, fee breaks, and co-investment rights.”[14] The SEC cited excuse rights as an example of non-economic preferential terms which must be disclosed post-closing. **Providing a summary of preferential treatment provisions with sufficient specificity to convey its relevance will satisfy this requirement, as will providing the actual provisions granted, and in each case this may be done on an anonymized basis.**[15]

In our experience, most investors in private funds with commitments in excess of a certain threshold negotiate side letters with sponsors that contain a “most favored nations” (“***MFN***”) clause entitling them to view all or part of the side letters granted to other investors and, most frequently, to opt into those more favorable terms negotiated by other investors who make commitments that are equal to or lesser than their capital commitment (and are not otherwise inapplicable to them). This process (the “***MFN Process***”) typically happens after the fund’s final closing in the closed-end fund context. **Accordingly, the Final Rules essentially require sponsors to conduct a portion of their MFN Process in piecemeal fashion, with part of the process conducted prior to the final closing and the rest conducted post final closing, and to do so with respect to each investor *regardless of whether such investor negotiated a side letter with an MFN clause or is entitled to elect any of the disclosed provisions.* This will curtail the common practice of only showing other investors’ side letter provisions to those investors with MFN provisions and of only showing investors those provisions which they are eligible to elect.** Due to the ongoing disclosure requirements, those sponsors of closed-end funds which already held their final closings and ran a more limited MFN process will now be required to disclose any preferential treatment granted to other investors, regardless of size, that had not been previously disclosed. There is no requirement to offer the election of such provisions to the investors who receive the disclosure.

While, as a technical matter, only *disclosure* of the key terms is required (and not an opportunity to elect such terms), the natural consequence of disclosure is that investors may ask sponsors at the time they are informed of key terms (regardless of whether they have a side letter with an MFN provision) to be granted the same terms as other similarly situated investors.

We expect that these disclosure requirements will present a substantial logistical challenge and may affect previously negotiated commercial arrangements. The SEC has not prescribed a method of delivery for electronic notices, so sponsors will be able to choose whether to do so in the private placement memorandum (the “***PPM***”), as a standalone disclosure document in an electronic data room, via email or otherwise. PPM supplements may be a natural place to make this disclosure, since private funds typically accept investors across multiple closings over the course of a fundraising and already provide supplements to PPMs, although virtual data rooms may also be an attractive alternative delivery method.

Sponsors will face the issue of how to handle their *first* closing and how to handle disclosure of terms that are being negotiated *concurrently* in the final hours before a later closing. In a typical fund closing, multiple side letters are negotiated concurrently with investors in the days leading up to the closing date. Time will tell where the industry lands on this point, but **one potential reading of the Final Rules suggests that a sponsor concerned about managing these closing dynamics could take the position that any preferential terms granted *as of the same date and at a given closing* can be deemed not to have been granted prior to the capital commitments made by any other investor in that closing, and therefore may be disclosed later**. It remains to be seen, however, whether this approach is consistent with the intent of the Final Rules and whether, alternatively, the Final Rules would effectively obligate sponsors to communicate *two* dates to their prospective investors for their closings: one being the "drop dead" date when all side letter terms need to be agreed to, and the second being a later date when commitments will be accepted and the closing will occur. This approach would give the fund, and legal counsel, time to disclose any additional material economic terms to all investors and make any last-minute updates to their side letters in response to any requests to opt into those terms that they are eligible for. In any event, **we expect that the Preferential Treatment Rule's disclosure requirement, assuming it can be practically implemented, will increase organizational expense costs for sponsors**. Many sponsors agree to organizational expense caps with their investors, and some are able to negotiate that the MFN Process falls *outside* of those caps. If at least a portion of the MFN Process, which can be lengthy and expensive, must take place ahead of closing investors, then sponsors are likely to seek increases to their organizational expense caps to accommodate these added costs. The Final Rules will also allow smaller investors, including those that did not themselves negotiate a "most favored nations" clause (or even have a side letter), to view the provisions negotiated by larger investors. This may result in more protracted negotiations with investors who are making capital commitments at sizes which, in the view of sponsors, do not typically entitle them to a side letter arrangement, or to propose in the fund's PPM fee breakpoints and other means of giving preference based on size, timing and other pre-determined criteria instead of doing so through the side letter process.

Question: How will sponsors' quarterly and annual reports be affected?

Under the Final Rules, registered investment advisers are required to prepare quarterly statements for each of their private funds that include (A) a table with a *detailed accounting* of all fees, compensation and other amounts paid to the adviser or any of its related persons by the fund as well as all other fees and expenses paid by the fund during the relevant reporting period, (B) a table with a detailed accounting of all fees and compensation paid to the adviser or any of its related persons by the fund's covered portfolio investments and (C) performance measures of the fund for the relevant reporting period.[16] Advisers must comply with the quarterly statement requirement for a new fund once it has had two full fiscal quarters of operating results. The Final Rule goes into granular detail about what information needs to be clearly and prominently disclosed in the quarterly statements, including the methodologies used and assumptions relied upon in the quarterly statement, as further described below.

(A) Quarterly Statement: Fund-Level Fee, Compensation and Expense Disclosure

The Quarterly Statement Rule requires registered investment advisers to disclose on a quarterly basis (1) 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, including, but not limited to, management, advisory, sub-advisory, or similar fees or payments, and performance-based compensation (e.g., carried interest), (2) a detailed accounting of all fees and expenses allocated to or paid by the private fund during the reporting period other than those listed in (1), including, but not limited to, organizational, accounting, legal, administration, audit, tax, due diligence, and travel fees and expenses, and (3) 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.

The SEC emphasizes in several places throughout its commentary to the Final Rules that there should be separate line items for each category of compensation, fee or expense and that the exclusion of *de minimis* expenses, the grouping of smaller expenses into broad categories or the labeling of any expenses as miscellaneous is prohibited, which will require significant effort on the part of advisers. Additionally, they advise that to the extent a certain expense could be categorized as either adviser compensation or a fund expense, the Final Rule requires that such payment or allocation be categorized as adviser compensation. For example, if an adviser or its related persons provide consulting, legal or back-office services to a private fund as a permitted expense under the private fund's governing documents, such amounts should be categorized as compensation as opposed to an expense. This highlights the technicalities that the Final Rule imposes upon advisers and the potential pitfalls that may arise in compliance.

The SEC also noted in its commentary that the definitions of "related person" and "control" adopted under the Final Rules are consistent with the definitions used on Form ADV and Form PF, which registered investment advisers are familiar with.

This set of disclosure must be done before and after the application of any offsets, rebates or waivers to fees or compensation received by the adviser, including, but not limited to, any fees an adviser or its related person receives for management services provided to a fund's portfolio company.

(B) Quarterly Statement: Portfolio Investment-Level Fee and Compensation Disclosure

Similar to the above, the Quarterly Statement Rule requires registered investment advisers to disclose a detailed accounting of all portfolio investment compensation allocated or paid by each ***covered portfolio investment*** during the reporting period in a single, separate table from the disclosure table noted above.

The definition of a portfolio investment is broad and is intended to cover any entity through which a private fund holds an investment, including through holding vehicles, subsidiaries, acquisition vehicles, special purpose vehicles or the like. In its commentary to the Final Rules, the SEC recognizes that this may impose challenges specifically for funds of funds, as it may be difficult to determine portfolio investment compensation arrangements at the underlying fund level.

This prong of the Final Rule also similarly requires a detailed line-by-line itemization of all portfolio investment compensation. Additionally, the SEC also notes in its commentary to the Final Rules that advisers are required to list the portfolio investment compensation allocated or paid with respect to each covered portfolio investment both before and after the application of any offsets, rebates or waivers. However, it is not clear how this is intended to apply at this level, as such offsets are taken into account at the fund level, not the portfolio company level.

"Portfolio investment compensation" includes any compensation, fees, and other amounts allocated or paid to the adviser or any of its related persons by the portfolio investment attributable to the private fund's interest in the portfolio investment, including, but not limited to, origination, management, consulting, monitoring, servicing, transaction, administrative, advisory, closing, disposition, directors, trustees or similar fees or payments. Notably, this requirement could cause some sponsors to consider transitioning in-house or affiliated operating groups to unaffiliated entities (e.g., owned by the operating advisors themselves).

(C) Quarterly Statement: Performance Disclosure

Under the Final Rule, registered investment advisers are required to provide standardized fund performance information in each quarterly statement. The performance metrics shown will depend on whether a private fund is classified as a liquid fund or an illiquid fund. An "illiquid fund" is defined as a private fund that does not have investor redemption mechanisms and that has limited opportunities for investor withdrawal other than in exceptional circumstances. A "liquid fund" is defined as a private fund that is not an illiquid fund.

(1) *Liquid Funds*

For liquid funds, registered investment advisers are required to show performance based on (A) annual net total return for each fiscal year for the 10 fiscal years prior to the quarterly statement or since inception (whichever is shorter), (B) average annual net total returns over one-, five-, and 10-fiscal year periods, and (C) cumulative net total return for the current fiscal year as of the end of the most recent fiscal quarter. It is anticipated that estimations may need to be made for liquid funds that have been operating for lengthy periods of time that did not keep adequate records of the earlier years.

(2) *Illiquid Funds*

For illiquid funds, registered investment advisers of illiquid funds are required to (i) show performance based on internal rates of return and multiples of invested capital (both gross and net metrics shown with equal prominence) (A) since inception and (B) for the realized and unrealized portions of the illiquid fund's portfolio, with the realized and unrealized performance shown separately and (ii) present a statement of contributions and distributions. The Final Rule defines the terms "internal rate of return" and "multiple of invested capital", on both a gross and net basis, and provides color on what is expected to be included in the statement of contributions and distributions.[17] **This illustrates the granular and prescriptive nature of the Final Rule, which will require concerted effort on behalf of fund sponsors to ensure compliance.**

Advisers are required to consider the impact of fund-level subscription facilities on returns and disclose such performance information for illiquid funds on ***both*** a levered and an unlevered basis. In its commentary to the Final Rules, the SEC is repeatedly focused on standardizing information across private funds as much as possible, and as such has provided no room for exclusions to this rule, such as possibly exempting advisers from providing unlevered returns on short-term subscription facilities or excluding subscription line fees and expenses from the calculation of net performance figures.

The SEC notes in its commentary to the Final Rules that to the extent that certain funds rely on information from portfolio investments to generate the required performance data and such information is not available prior to the distribution of the quarterly statement, an adviser would be expected to use the performance measures "through the most recent practicable date", which is likely the end of the immediately preceding quarter.

An additional prong to the quarterly statement rule is to include **clear and prominent disclosure of the methodologies and assumptions made in calculating performance information.** This includes, but is not limited to, whether dividends were reinvested in a liquid fund, or whether any fee rates or fee discounts were assumed in the calculation of net performance measures.

This Final Rule also requires the quarterly statement to include ***cross-references*** to the sections of the private fund's organizational and offering documents that set forth the applicable calculation methodology for all expenses, payments, allocations, rebates, waivers, and offsets. This will likely result in significant changes to how private placement memoranda and the operating agreements of private funds are drafted going forward. Furthermore, to the extent that the allocation and methodology provisions in existing operating agreements are not adequately detailed, this requirement under the Final Rule may prompt future LPA amendments that require limited partner consent.

This consequence of the Final Rules is in tension with the legacy status (i.e. grandfathering) that the Final Rules afford governing agreements entered into prior to the date that the Final Rules take effect. The cross-reference requirement of the Quarterly Statement Rule may effectively eliminate the protections provided by the legacy status concept if sponsors will be required to amend their governing agreements to include sufficient allocation and methodology provisions according to the SEC's new standards. Notwithstanding the fact that many sponsors may already disclose some of the information required under the Quarterly Statement Rule to their investors, it is anticipated that compliance with the Quarterly Statement Rule will result in significant increased cost to advisers and funds, especially at the outset in establishing compliant quarterly statement templates and disclosures.

Such disclosures must be included in the quarterly statement itself as opposed to in a separate document. The SEC noted that while advisers are not required to provide all supporting calculations in quarterly statements, such information should be made available to investors upon request.

With regards to timing, the Final Rule mandates that registered investment advisers must distribute the quarterly statements to the private fund's investors within 45 days after the end of the first three fiscal quarters of each fiscal year and within 90 days after the end of each fiscal year, and in the case of fund of funds, within 75 days after the end of the first three fiscal quarters of each fiscal year and within 120 days after the end of each fiscal year.

Question: Which of the Proposed Rules were not adopted or were modified by the Final Rules?

While the Final Rules will require sponsors to provide investors with significantly more "transparency" regarding preferential economic arrangements granted in side letters (notably, with respect to material economic terms, *before* closing new investors into their funds) and fees received by the adviser and related persons, as well as providing new rules on quarterly statements, fund audits, adviser-led secondaries, books and records, annual compliance reviews and certain restricted activities, and some of the "disclose and consent" requirements may operate in practical effect as prohibitions on the relevant conduct, it is worth noting that **the Final Rules do *not* specifically adopt the following items which had been set forth in the Proposed Rules.**

In particular, the Final Rules do not:

(i) require all preferential rights granted by side letter to be disclosed prior to investment (only material economic terms must be disclosed *prior*, the rest must be disclosed later);

(ii) eliminate sponsors' ability to be indemnified, or limit liability, for simple negligence (preserving the "gross negligence" standard for indemnification);

(iii) prohibit clawbacks of carried interest net of taxes (as noted above, this was replaced by a disclosure requirement);

(iv) expressly prohibit allocating portfolio investment fees and expenses to funds on a non-pro rata basis, subject to disclosure requirements; or

(v) prohibit borrowing from a fund (which may done with disclosure and consent).

Further, the Final Rules also do not provide the specific prohibition against charging accelerated monitoring fees that was noted in the Proposed Rules; although members of the SEC staff clarified during the open meeting held on the Final Rules on August 23, 2023 (the "***Open Meeting***") that they did not feel specific language on accelerated monitoring fees was necessary because they believe such fees are *already prohibited* under applicable guidance. The Final Rules also do not *expressly* prohibit charging an adviser's regulatory, compliance, examination and certain investigation costs to the fund (except, in some cases, with consent and disclosure and excluding those investigations that result from a violation of the Advisers Act). Our view, however, is that the SEC's consistent messaging on the impropriety of such charges, combined with burdensome disclosure requirements, could function as a de-facto prohibition of such charges.

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[1] Resources:

- Link to the Final Rule and the Adopting Release (Release No. IA-6383; File No. S7-03-22 , RIN 3235-AN07, 17 CFR Part 275, Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews: Final Rule)

- Link to the SEC's Fact Sheet concerning Final Rules

[2] For purposes of the compliance date, the SEC recognized that smaller advisers will require more time to implement certain rules and provided size-based deadlines for implementation, which will be staggered starting from the publication of the Final Rule in the Federal Register. "***Larger Advisers***" means advisers with assets under management attributable to private funds ("***Private Funds AUM***") of $1.5 billion or more. "***Smaller Advisers***" means advisers with Private Funds AUM of less than $1.5 billion.

[3] The Final Rules grandfather in certain existing arrangements if the private fund has "commenced operations" and has made contractual arrangements related to the provision that were entered into prior to the compliance date, and if the Final Rules would require amending such agreements.

[4] Note that the term "investigation" does not appear to include examinations of the adviser, which are addressed in the row immediately below.

[5] Except that costs associated with investigations resulting in Advisers Act sanctions may not be allocated to new or existing funds even with disclosure and consent.

[6] For loan agreements entered into prior to the compliance date if compliance would require an amendment to such agreements

[7] With respect to contractual obligations entered into prior to the compliance date.

[8] With respect to contractual obligations entered into prior to the compliance date.

[9] Issuers that would be investment companies but for the exclusions contained in Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940.

[10] "Statement Regarding Private Fund Adviser Rulemaking", Aug. 23, 2023, Commissioner Caroline A. Crenshaw (https://www.sec.gov/news/statement/crenshaw-statement-private-fund-advisers-082323?utm_medium=email&utm_source=govdelivery)

[11] Release, page 292.

[12] Release, page 294.

[13] Release, page 299.

[14] *Id.*

[15] Id at 297.

[16] 17 C.F.R. § 275.211(h)(1)-2(b)-(c).

[17] *See* 17 C.F.R. § 275.211(h)(1)-1. "Multiple of invested capital" means (i) the sum of: (A) the unrealized value of the illiquid fund; and (B) the value of distributions made by the illiquid fund; (ii) divided by the total capital contributed to the illiquid fund by its investors. "Internal rate of return" means the discount rate that causes the net present value of all cash flows throughout the life of the private fund to be equal to zero. Gross metrics are calculated gross of all fees, expenses and performance-based compensation borne by the private fund, whereas net metrics are calculated net of all fees, expenses and performance-based compensation borne by the private fund.

Gibson Dunn's lawyers are available to assist with any questions you may have regarding the issues and considerations discussed above, and we will continue to monitor developments in the coming months. Please contact the Gibson Dunn lawyer with whom you usually work in the firm's Investment Funds practice group, or any of the individuals listed below:

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Related Capabilities

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