Private Equity to Get Public Scrutiny: New SEC Rules
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On August 23, 2023, the SEC enacted new rules for private fund advisors under the US Investment Advisers Act of 1940.*

The final rulemaking requires all SEC-registered private fund advisors to:

- Provide investors with quarterly statements detailing fees, expenses, compensation, and performance.
- Distribute annual audits for each managed private fund, using standards similar to the Custody Rule.
- Obtain and distribute fairness opinions for advisor-led secondary transactions, including summaries of relationships with opinion providers.

Additionally, the rules impose restrictions on activities by all private fund advisors, which include:

- Disclosing regulatory fees charged to the fund and not reducing advisor clawbacks based on certain taxes.
- Equitably allocating fees related to portfolio investments and providing advance written notice.
- Prohibiting fees associated with investigations unless disclosed and consented to by fund investors.
- Forbidding borrowing from private fund clients without investor consent.

The provisions spell out new or amended requirements for the following classes of advisors:

- Registered Private Fund Advisors
- All Private Fund Advisors
- All Registered Advisors
- Registered Real Estate Fund Advisors

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Lastly, the rules require that **all SEC-registered investment advisors**, including those that do not advise private funds, document their annual compliance policy reviews *in writing*. The SEC adopted staggered compliance dates for different portions of the final rules:

- For the Private Fund Audit Rule and the Quarterly Statement Rule: 18 months after the date of publication in the Federal Register.
- For the Advisor-Led Secondaries Rule, the Preferential Treatment Rule and the Restricted Activities Rule, the compliance dates are:
  - For advisors with $1.5 billion or more in private funds assets under management: 12 months after the date of publication in the Federal Register.
  - For advisors with less than $1.5 billion in private funds assets under management: 18 months after the date of publication in the Federal Register.
- Compliance with the amended Advisors Act Compliance Rule: 60 days after publication in the Federal Register.

**There are some critical insurance implications related to this new SEC rulemaking:**

- The rules do not permit an advisor to charge or allocate to the private fund certain investigation costs where there is a sanction for a violation of the Investment Advisors Act of 1940. It is therefore important that advisors have the broadest investigation and regulatory insurance coverage possible.
- Anytime there is increased regulatory oversight there is always a greater chance for regulatory investigations and subsequent follow-along litigation. Given this uncertainty and the unknowns of the scrutiny this new ruling will bring, including litigation and other costly proceedings, insurers may reassess the risk exposure that investment advisors are facing. It is important that advisors are well-positioned and differentiated in the insurance market and can demonstrate their adherence to these new rules.
- Insurers may look to increase premiums for the expected uptick in defense costs and add new restrictions such as sublimits or exclusions to certain provisions of the policy. The costs to comply with the new regulatory requirements may have an impact on fund performance. Advisors should ensure they have proper limits and retentions on their error and omissions coverage.

* A copy of the 660-page final rule release can be found here: [Final rule: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews](sec.gov)

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