

EARLY IMPRESSIONS

Private Fund Adviser (PFA) Rules

October 2023

Foreword

Navigating the New Private Fund Adviser (PFA) Rules

In an ever-evolving regulatory landscape, changes to reporting requirements play a pivotal role in shaping the way the investment industry operates. The Securities and Exchange Commission's (SEC) issuance of new private fund adviser rules and amendments under the Investment Advisers Act 1940 marks a significant transformation in the regulation of private fund advisers. These rules are designed to address longstanding challenges and concerns in the private fund industry, aiming to safeguard the interests of investors while fostering greater transparency, governance, and fairness.

The private fund industry has experienced remarkable growth, with assets under management (AUM) reaching staggering figures. However, this growth has been coupled with inconsistencies in reporting practices and conflicts of interest. The new Private Fund Adviser Rules seek to address these issues and usher in a new era of accountability and transparency.

This comprehensive publication provides a detailed overview of the key aspects of the PFA Rules, offering valuable insights into their scope, implications, and compliance requirements. It covers seven major components of the rules, including the Quarterly Statements Rule, Audit Rule, Adviser-Led Secondaries Rule, Restricted Activities Rule, Preferential Treatment Rule, Annual Review Rule, and Recordkeeping Rule. Each of these rules is explained thoroughly, offering a roadmap for private fund advisers to navigate the regulatory transformation.

The compliance dates and transition periods outlined in the publication are crucial for private fund advisers to ensure a smooth transition to the new regulatory landscape. It is imperative for industry stakeholders to stay informed about these timelines and requirements to avoid potential pitfalls and legal challenges.

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering



Furthermore, the publication sheds light on the historical context of these rules, tracing their origins to the aftermath of the 2008 financial crisis and the Madoff Scandal. The Dodd-Frank Reforms and Consumer Protection Act of 2010 expanded the SEC's oversight role, ultimately leading to the formulation of these rules. The publication provides a comprehensive understanding of the rationale behind these regulations and their alignment with investor protection.

As the private fund industry continues to evolve, the adoption of these rules will have a profound impact on how private fund advisers conduct their operations. It is essential for professionals in the asset management sector to grasp the intricacies of these rules and adapt to the changing landscape.

In conclusion, the new Private Fund Adviser Rules are expected to significantly impact the investor reporting disclosures and audit requirements in private fund industry. This publication serves as a valuable reference guide for the stakeholders navigating these regulations, offering clarity and guidance on their implementation. As we move forward into this new regulatory era, understanding and compliance with these rules will be paramount in ensuring the transparency in the private fund industry.

We sincerely hope you find the enclosed publication informative. We will be happy to participate in any discussions required to provide clarifications on our views enclosed in the attached publication. We look forward to hearing from you.

Thank you.

For Uniquus India Private Ltd.

12 October 2023



Sandip Khetan
Co-Founder & Global
Head of Accounting &
Reporting Consulting

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering

Overview

The Securities and Exchange Commission issued new private fund advisers rules and amendments under the Investment Advisers Act of 1940 (“Advisers Act”) to enhance the regulation of private fund advisers. The new rules intend to enhance safeguard of investor interests arising from the following status quo and practices prevalent in the private fund industry –

01

The existing reporting practices are primarily driven by negotiations between fund advisers and investors rather than by regulations, leading to diverse and inconsistent reporting with varied degree of information available. Complex structures of private funds coupled with lack of standardized, consistent and detailed reporting (unless specifically negotiated) makes reporting less transparent for less experienced investors and sometimes even for sophisticated investors as well. In most cases, the investors are not able to negotiate terms in contractual agreements with fund advisers¹.

02

Current governance structure of private funds offers limited investor oversight on the private fund advisers. Most investors rely on side letters to secure required governance that are specific to them. This lack of governance also leads to preferential treatment of certain investors over others.

03

Existing regulations and governance structure are insufficient to provide investors against conflict-of-interest transactions between advisers and private funds such as adviser-led secondaries, compensation schemes and sales practices.

The new rules intend to address the risks arising from the aforesaid existing practices. Following are the final rules that primarily cover the aspects relating to private fund adviser reporting, governance and other activities.

1. As per ILPA SEC Survey 2022, there is a strong indication (65%) that LPs are not able to use their expertise and negotiating leverage to achieve favourable changes in common contractual terms, despite being sophisticated investors with access to “top-notch, expert legal counsel”.

- A. Quarterly statements rule**
- B. Audit rule**
- C. Adviser-led secondaries rule**
- D. Restricted activities rule**
- E. Preferential treatment rule**
- F. Annual review rule**
- G. Recordkeeping rule**

The final rules have been published in the Federal Register on September 14, 2023, with a transition period ranging from 12 to 18 months from the publishing date in the register. The rules have received mixed reactions from the stakeholders. Investor bodies such as ILPA² have welcomed this step by SEC whereas industry bodies like AIMA³, MFA⁴, NAPFM⁵ and others have filed a lawsuit challenging SEC's authority to make such rules and thereby their enforceability.

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering

Background

In the aftermath of 2008 financial crisis and Madoff Scandal⁶, US congress expanded SEC's oversight role on private fund advisers through Dodd-Frank Reforms and Consumer Protection Act 2010. In 2022, the private fund advisers' assets under management (AUM) stood at \$26.6 trillion⁷. While private funds primarily serve as direct investment channels for institutional investors and high net worth individuals, smaller investors are indirectly exposed to private funds through their participation in pension and retirement plans that make direct investment in such private funds.

By virtue of the oversight powers vested under Dodd-Frank Act, SEC examined various private fund advisers and noted primary investor protection risk as lack of transparency & governance mechanism and conflict of interest. In light of the mammoth size of the industry and opacity in reporting and governance, SEC issued the new Private Fund Adviser Rules, with investor protection at its core.

2. Institutional Limited Partners Association

3. Alternative Investment Management Association

4. Managed Funds Association

5. National Association of Private Fund Managers

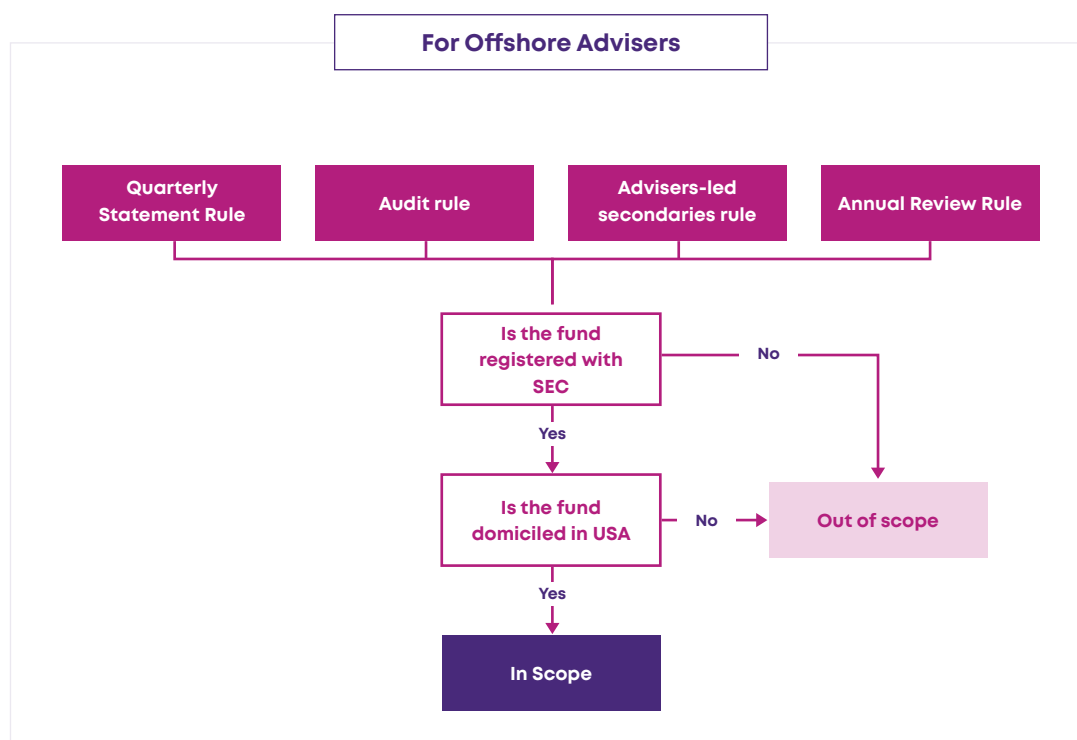
6. Madoff scandal was a \$64 billion fraud perpetuated by Bernie Madoff (former Nasdaq chairman) through his wealth management firm, discovered in late 2008.

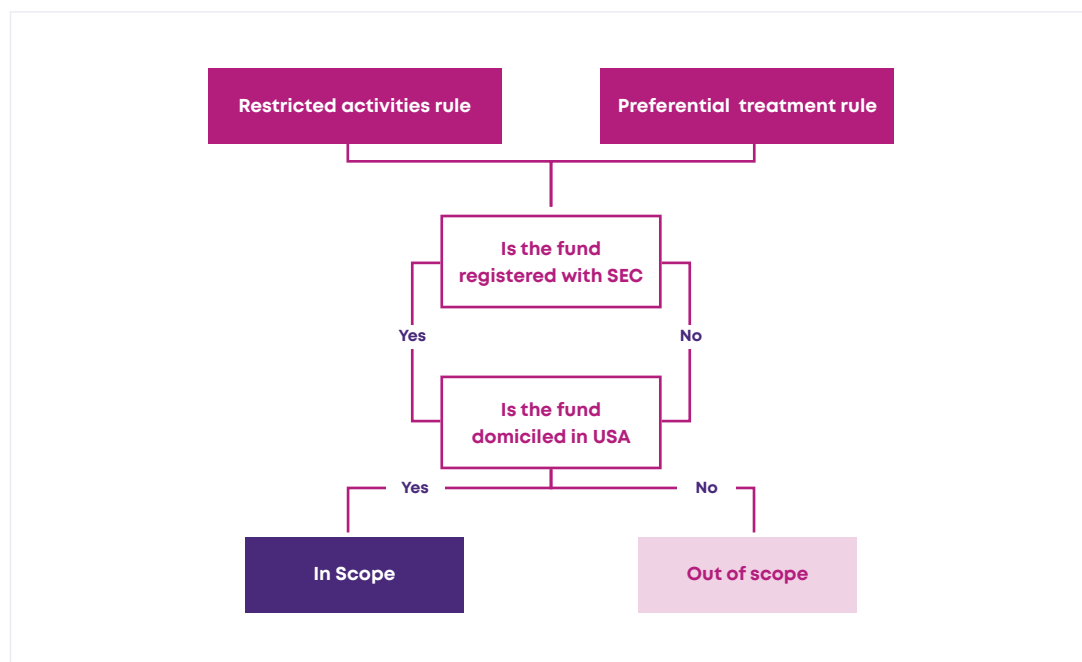
7. Source – Final PFA rules

Scope of PFA Rules

Final Rules	In Scope
Quarterly statements rule	All SEC-registered private fund advisers
Audit rule	
Adviser-led secondaries rule	
Restricted activities rule	All advisers to private funds, regardless of registration
Preferential treatment rule	
Annual review rule	All SEC-registered advisers <i>(including non-private fund advisers)</i>
Record keeping rule	As applicable above rule

Quarterly statement rule, Audit rule and Adviser-led secondaries rule **are not applicable to non-US private funds of registered-offshore advisers**, this is in line with SEC's historical approach of not applying substantive provisions of Advisers Act with respect to these funds/advisers. Further, the restricted activities rule and preferential treatment rule are not applicable to unregistered offshore advisers for their non-US funds. Below flowcharts summarize, the applicability of rules to offshore advisers:





With respect to the advisers to securitized asset funds (referred as “SAF Advisers”, by SEC), any of the final rules do not apply except for the annual review rule. The exemption from these rules is limited to the securitized asset funds managed by such advisers and not for the private funds.

Key Rules

A. Quarterly Statements Rule

The rule requires registered private fund advisers to distribute a quarterly statement to private fund investors and establishes a base-line level disclosure requirement. The statement must disclose fund-level information regarding performance, the cost of investing in the private fund, fees and expenses paid by the private fund, as well as certain compensation and other amounts paid to the adviser.

i. Fees and Expense Disclosure

The rule requires an investment adviser that is registered or required to be registered with the SEC to prepare and distribute quarterly statements for any private fund that it advises with certain information regarding the fund’s fees (such as advisory or sub-advisor fees and other similar fees) and expenses (such as organizational, legal, administration, accounting, travel, taxes, etc.) and any

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering

compensation paid or allocated to the adviser or its related persons⁸ by the fund, as well as any compensation paid or allocated by the fund's underlying portfolio investments.

(a) Private Fund-Level Disclosure

The quarterly statement rule will require private fund advisers to disclose the following information to investors in a tabular format:

- 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 ("*adviser compensation*") **during the reporting period**;
- 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 paragraph (1) above ("*fund expenses*"); and [*Organizational, accounting, legal, administration, audit, tax, due diligence, and travel expenses*]
- 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.

(b) Portfolio Investment-Level Disclosure

The quarterly statement rule requires 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 table.

(c) Calculations and Cross-References to Organizational and Offering Documents

This disclosure will generally require advisers to describe, among other things, the structure of, and the method used to determine, any performance-based compensation set forth in the quarterly statement (such as the distribution waterfall, if applicable) and the criteria on which each type of compensation is based (e.g., whether such compensation is fixed, based on performance over a certain period, or based on the value of the fund's assets).

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering

8. *related persons*" to include: (i) all officers, partners, or directors (or any person performing similar functions) of the adviser; (ii) all persons directly or indirectly controlling or controlled by the adviser; (iii) all current employees (other than employees performing only clerical, administrative, support or similar functions) of the adviser; and (iv) any person under common control with the advisers

ii. Performance Disclosures

In addition to providing information regarding fees and expenses, the rule requires advisers to include standardized fund performance information in each quarterly statement provided to fund investors.

Liquid Funds

To show performance based on net total return on an annual basis for the 10 fiscal years prior to the quarterly statement or since the fund's inception, over one-, five-, and 10-fiscal year periods, and on a cumulative basis for the current fiscal year as of the end of the most recent fiscal quarter.

Illiquid Funds

To show performance based on internal rates of return and multiples of invested capital since inception and to present a statement of contributions and distributions.

iii. Preparation and Distribution of Quarterly Statements

- For Funds other than Fund of Funds (FoF) – 45 days for the first three quarters and 90 days for the fiscal year end
- For FoF – 75 days for the first three quarters and 120 days for the fiscal year end

Navigating Regulatory Transformation: Quarterly statement rule would involve changes in various operational aspects in terms of systems, technology, skills and scalability. We recommend advisers and administrators to review and implement the following system, technology and skill upgrades:

- i. Review existing quarterly reporting template and incorporate changes as per new disclosures,
- ii. Systems enhancements to ensure accurate and timely data collection for various funds and portfolio companies with respect to fees and compensation paid to advisers. Additional efforts will be required by investment advisers dealing with FoF for data collections, validations and reporting for identification of covered portfolio companies.
- iii. Automating data collection followed by fee disclosures and calculations for performance disclosures.
- iv. Training the financial reporting team to understand the new reporting requirements. Preparation and review of internal proforma statements for a few reporting cycles could be beneficial before going live.

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering

B. Audit Rule

The rule requires registered private fund advisers to cause the private funds they advise to undergo a financial statement audit that meets the requirements of the audit provision in the Advisers Act custody rule (rule 206(4)-2)). The implication of this rule is that the adviser using surprise exam option (under Custody Rules) instead of annual audits, will now be required to undergo annual audits. If an adviser treats a Special Purpose Vehicle (SPV) as a separate client, this rule requires the audit of SPV as well. These audits will provide an important check on the adviser's valuation of private fund assets and protect private fund investors against the misappropriation of fund assets. The funds are required to be audited (at least annually and upon liquidation) under US GAAS and the audited financial statements are required to be distributed within **120 days of the end of the reporting period**.

In the case of fund of funds, this timeline is extended to 180 days, recognizing the practical challenges faced by such advisers, as the timely completion of their audits depends on the audit schedules of underlying funds.

Navigating Regulatory Transformation: Audit Rule would require advisers to undertake additional efforts and readiness steps to ensure compliance. We recommend advisers to perform an audit readiness assessment and look-out for the key audit considerations:

- i. Setting up process for review of investment valuation to ensure (a) accurate adjustments to fair value (including calibration and backtesting), corporate actions, capital activity, (b) cut-off procedures near the reporting date. Further, documenting valuation memos with covering key aspects including valuation assumptions or comparable valuations consideration is crucial. Any gaps in the valuation process can lead to audit delays and additional costs.
- ii. Setting up review mechanism for complex calculations such as (a) realized and unrealized gain calculations, (b) carried interest or performance calculations,
- iii. Documenting internal controls and processes related to investment process, valuation & pricing, asset custody, accounting policies.
- iv. Setting up and maintaining effective data management systems to facilitate the audit process.
- v. Hiring staff or experienced consultants for assistance before and during the annual audit process for timely closure of audits.
- vi. Designing US GAAP compliant Policy Manual and financial statement templates
- vii. Conducting a pre-audit review by management or consultants to identify and address potential issues before the actual audit could also be beneficial.

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering

C. Adviser-Led Secondaries Rule

A transaction that provides fund investors with the choice of either selling all or a portion of their interests in a private fund or converting/exchanging them for new interests in another vehicle managed by the adviser or any of its affiliated entities is referred to as an 'adviser-led secondary transaction'.

The reforms require a registered private fund adviser to obtain a fairness opinion or a valuation opinion in an adviser-led secondary transaction from an independent opinion provider. The rule also requires the adviser to prepare and distribute to the private fund's investors a summary of any material business relationships the adviser has, or has had within the prior two years, with the independent opinion provider. The fairness or valuation opinion along with the summary of material business relationship are required to be distributed to private investors before **to the due date of the election form** (i.e., before due date of the final election made by the investors) of the transaction.

This requirement is aimed to contain an adviser's conflicts of interest in structuring and leading such transactions.

D. Restricted Activities Rule

The Final Rule restricts the private fund advisers from engaging in the following activities, unless they satisfy certain disclosure and, in some cases, consent requirements:

I. Restricted Activities		Exceptions
i	Charging or allocating to the private fund fees or expenses associated with an investigation of the adviser or its related persons by any governmental or regulatory authority;	Disclosure based: Permitted, if the adviser distributes a written notice to investors on quarterly basis.
ii	Charging the private fund for any regulatory, examination, or compliance fees or expenses of the adviser or its related persons;	Consent based: Permitted if the adviser seeks consent from all investors of a private fund and obtains written consent from at least a majority interests of fund investors that not related to the adviser.
iii	Reducing the amount of any adviser clawback by actual, potential, or hypothetical taxes applicable to the adviser, its related persons, or their respective owners or interest holders;	Disclosure based: Permitted if the adviser distributes a written notice disclosing aggregate clawback amount before and after any tax reduction, within 45 days of the quarter in which the clawback occurs.

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering

I.	Restricted Activities	Exceptions
iv	Borrowing money, securities, or other private fund assets, or receiving a loan or extension of credit, from a private fund client	Consent based: Permitted if the adviser distributes a written notice describing material terms of the borrowings to the investors of the fund, seeks consent for borrowing and obtains written consent from at least a majority interests of fund investors that are not related to the adviser.
v	Charging or allocating fees and expenses related to a portfolio investment on a non-pro rata basis when more than one private fund or other client advised by the adviser or its related persons have invested in the same portfolio company;	Disclosure based: Permitted if the adviser distributes a written notice to each investor disclosing the non-pro rata charge and a description of how it is fair and equitable under the circumstances.

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering

E. Preferential Treatment Rule

This rule prohibits all private fund advisers⁹, whether registered with the Commission or not, from:

01

Granting an investor in a private fund the ability to redeem its interest on terms that the adviser reasonably expects to have a material, negative effect on other investors in that private fund

02

Providing information regarding portfolio holdings or exposures of a private fund or of a substantially similar pool of assets to any investor if the adviser reasonably expects that providing the information would have a material, negative effect on other investors in that private fund or in a substantially similar pool of assets.

The rule offers certain exceptions to the above treatment. The advisers are required to provide to current investors comprehensive, annual disclosure of all preferential treatment provided by the adviser or its related persons since the last annual notice.

⁹ Read the grandfathering provisions under section - [Transition Period, Compliance Date and Grandfathering](#)

F. Annual Review Rule

The new rule amends the Advisers Act compliance rule¹⁰ to require all SEC-registered advisers to document the annual review of their compliance policies and procedures in writing. The rule does not dictate a specific format for the written documentation. The SEC has emphasized that advisers have the flexibility to choose a documentation style that aligns best with their business operations and to implement review procedures that they have found to be the most effective.

The SEC has also provided guidance regarding the timing of these reviews in relation to the Compliance Date. If an adviser initiates its annual review within the following 12 months after the compliance date, they are required to maintain written documentation of this review.

Furthermore, the SEC clarified that if an adviser's review year partially overlaps with the Compliance Date, and they have already assessed the sufficiency of their policies and procedures in accordance with the compliance rule (Rule 206(4)-7) for that period preceding the Compliance Date, the new documentation requirement will not retroactively apply to that prior period.

G. Recordkeeping Rule

The new rule requires the private fund advisers to retain books and records related to the quarterly statements rule, the audit rule, the adviser-led secondaries rule, the restricted activities rule, and the preferential treatment rule. It states that the following documents should be maintained and retained for each rule:

Final Rule	Documentation
Quarterly statements rule	- Copies of any distributed quarterly statement - Record of each addressee and dates of statement distribution - Records substantiating calculation methods for expenses, payments, allocations, rebates, offsets, waivers, and performance listed on quarterly statements, - Books and records supporting determination of private fund client as liquid or illiquid fund
Audit rule	- Copy of audited financial statements - Record of each addressee and corresponding sending dates

¹⁰. Adviser Act rule 206(4)-7

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering

Final Rule	Documentation
	Record of steps taken to ensure financial statement audit for private fund clients which it is not in a control relationship
Adviser-led secondaries rule	- Copy of fairness or valuation opinion and summary of material business relationship distributed to investors - Record of each addressee and dates of opinion and summary distribution
Restricted activities rule	- Copy of notifications, consents, or other documents distributed to or received from private fund investors - Record of each addressee and corresponding sending dates for each document distributed by the adviser
Preferential treatment rule	- Copies of all written notices sent to current and prospective private fund investors - Record of each addressee and corresponding sending dates

Transition Period, Compliance Date and Grandfathering

Rule	Compliance Date
Audit rule and Quarterly Statements Rule	March 14, 2025 (18 months from the Publish Date in Federal Register)
Adviser-led secondaries rule, preferential treatment rule, and the restricted activities rule	<i>For Large Private Fund Advisers¹¹ – September 14, 2024</i> <i>For Smaller Private Fund Advisers¹² – March 14, 2025</i>
Annual review rule	November 13, 2023 (60 days from the Publish Date in Federal Register)

¹¹. Advisers with \$1.5 billion or more in private funds under assets under management

¹². Advisers with less than \$1.5 billion in private funds under assets under management

Certain sections of the final rules do not apply to existing funds and their contractual arrangements i.e., such funds and contracts can grandfather the old practices and contracts. The grandfathering provisions pertain to two specific aspects: (i) the preferential treatment rule that restricts certain redemption and information rights, and (ii) restricted activities rule related to investor consent for adviser borrowing from a fund and charging investigation fees and expenses to a fund.

A grandfathered section of the rules does not affect private fund governing agreements if (i) the fund had commenced operations¹³ on compliance date, (ii) the governing agreements were executed prior to the compliance date, and (iii) the section of the rules, if applied and not grandfathered, would necessitate amendments to these governing agreements. For the purposes of the grandfathered provisions, private fund governing agreements encompass the fund's operating or organizational agreements (e.g., LPAs), subscription agreements, and side letters.

1. Foreword

2. Overview

3. Background

4. Scope of PFA Rules

5. Key Rules

6. Transition Period, Compliance Date and Grandfathering

¹³. Additionally, a fund is considered to have commenced operations if it has engaged in genuine investment, fundraising, or operational activities.

A TEAM THAT YOU CAN TRUST TO DELIVER



Sandip Khetan

Co-Founder and Global Head of ARC
sandip.khetan@uniquus.com



Avinash Ramkumar

Partner, ARC - USA
avinash@uniquus.com



Huy M. Tran

Partner, ARC - USA
huytran@uniquus.com



Nirav Patel

Partner, ARC - India
niravp@uniquus.com



Sagar Lakhani

Partner, ARC - India
sagarlakhani@uniquus.com



Sharad Chaudhry

Partner, ARC - India
schaudhry@uniquus.com



Venkateswaran Narayanan

Partner, ARC - India
vn@uniquus.com



Ankur Vyas

Managing Director, ARC - USA
ankurvyas@uniquus.com



Vishwa Deep Mishra

Associate Director, ARC - India
vishwamishra@uniquus.com

To know more about us, please visit www.uniquus.com