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Kirkland AIM

SEC Proposes Sweeping Rule Changes for Private Fund Advisers (Part 1 of 2)

10 February 2022

On February 9, 2022, the SEC voted (3-1)¹ to propose significant new rules under the Investment Advisers Act of 1940 (the “Advisers Act”) to increase the regulation of investment advisers, including private fund advisers (the “Proposed Rules”). The Proposed Rules, which were issued in two separate releases, address:

- [SEC-registered and unregistered private fund advisers](#) (the “Private Fund Adviser Proposal”); and
- [cybersecurity risk management for SEC-registered advisers](#) (the “Cybersecurity Proposal”).

The Proposed Rules represent the most significant proposed rulemaking applicable to private fund advisers by the SEC under Chairman Gensler, and follow on the heels of [a risk alert regarding private fund adviser deficiencies](#) and [proposed amendments to Form PF](#). This alert provides an executive summary of the new Proposed Rules, and will be followed by a separate alert providing more details regarding the Proposed Rules based on the more extensive proposing releases that the SEC issued on February 9, 2022.

If adopted, the Private Fund Adviser Proposal² would:

- Require SEC-registered private fund advisers to provide investors with quarterly statements detailing information about private fund performance, fees, and expenses;
- Require SEC-registered private fund advisers to obtain an annual audit for each private fund and cause the private fund’s auditor to notify the SEC upon certain events (i.e., modification of the auditor’s opinion regarding fund financial statements and termination of the auditor’s engagement);

- Require SEC-registered private fund advisers, in connection with an adviser-led secondary transaction, to distribute to investors a fairness opinion and a written summary of certain material business relationships between the opinion provider and the adviser and its related persons;
- Prohibit all private fund advisers, *including those that are not registered with the SEC*, from engaging in certain activities and practices that the SEC views as contrary to the public interest and the protection of investors, including:
 - Charging certain fees and expenses to a private fund or its portfolio investments, such as fees for unperformed services (e.g., accelerated monitoring fees) and expenses associated with an SEC examination or investigation of the adviser;
 - Seeking reimbursement, indemnification, exculpation, or limitation of its liability for an adviser's breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to a private fund;
 - Reducing the amount of an adviser's clawback by the amount of certain taxes;
 - Charging fees or expenses related to a portfolio investment on a non-pro rata basis when multiple private funds and other clients advised by the adviser or its related persons have invested (or propose to invest) in the same portfolio investment; and
 - Borrowing or receiving an extension of credit from a private fund client.
- Prohibit all private fund advisers, *including those that are not registered with the SEC*, from providing certain types of preferential treatment that have a material negative effect on other investors (e.g., side letters providing investor redemption rights or enhanced portfolio information rights), while also prohibiting all other types of preferential treatment unless disclosed to current and prospective investors; and
- Require all SEC-registered advisers (including those that do not advise private funds) to document the annual review of their compliance policies and procedures in writing.

If adopted, the Cybersecurity Rule Proposal³ would:

- Require SEC-registered advisers and funds to adopt and implement written policies and procedures that are reasonably designed to address cybersecurity risks;
- Require SEC-registered advisers to confidentially report significant cybersecurity incidents to the SEC through new a Form ADV-C;
- Enhance SEC-registered adviser and fund disclosures to investors related to cybersecurity risks and incidents.⁴

A public comment period will remain open for both Proposed Rules for 60 days following the publication of the proposing releases on the SEC’s website on February 9, 2022 (i.e., April 11, 2022) or 30 days following publication of the proposing releases in the Federal Register, whichever is longer. Publication in the Federal Register often occurs well after the SEC announces proposed rules on its website; however, the public comment period is still relatively short given the extensive nature of the Rule Proposals.

Please contact the Kirkland regulatory attorneys with whom you regularly work if you have questions regarding these proposals.

1. Commissioner Peirce, appointed by President Trump, issued a [dissenting statement](#) regarding the Private Fund Adviser Proposal discussed below. [↔](#)

2. The SEC fact sheet summarizing the Private Fund Adviser Proposal is available through [this link](#). [↔](#)

3. The SEC fact sheet summarizing the Cybersecurity Proposal is available through [this link](#). [↔](#)

4. Both Proposed Rules also include amendments to the books and records rule under the Advisers Act that would require advisers to retain records to facilitate the SEC’s ability to assess an adviser’s compliance with such rules. [↔](#)

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Suggested Reading

- 18 February 2022 Kirkland AIM SEC Proposes Sweeping Rule Changes for Private Fund Advisers (Part 2 of 2)
- 04 February 2022 Kirkland AIM SEC Risk Alert Details Additional Private Fund Adviser Examination Deficiencies
- 31 January 2022 Kirkland AIM SEC Proposes Significant Amendments to Private Fund Manager Reporting on Form PF

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