

Breakdown of final Private Fund Adviser Rules

The US SEC published its initial proposal for amendments and additional rules for the [Private Fund Adviser Rule in February 2022](#). Following a year of dialogue with industry representatives, including AIMA, the final proposal was published on 23 August 2023.

A breakdown of the key changes to the rules is outlined below.

Covered under	Current rule	Final rule	Consequence
Restricted Activities Rule	Private fund agreements typically indemnify the adviser for negligence, a standard arrangement that, by reducing the adviser’s risk, encourages the adoption of the more complex investment strategies investors are looking for.	The Adopting Release withdraws the proposed change to impose a prohibition on indemnification in the case of negligence (which would have lowered the typical liability standard from gross negligence to simple negligence), but it includes a strongly worded warning about how the staff will view indemnification clauses	This adjustment means the liability standard for matters not impacting the Federal fiduciary obligations of the adviser has not changed. However, the addition of an investor consent element to the restriction on charging fees or expenses related to an investigation of the adviser or any of its related persons (which is effectively an indemnification), paired with the absolute ban on charging or allocating fees or expenses related to an investigation that results in a sanction for violating the Advisers Act or the rules thereunder, may operate in practice in a manner similar to an outright ban on indemnification at least as regards to investigative expenses.
Restricted Activities Rule (2)	Investors and private fund managers are free to negotiate what fee structure they find mutually agreeable.	The Adopting Release revises the proposed outright prohibition of this practice, and charging fees to the funds will now continue to be allowed as “Restricted Activities” if the activity is disclosed and, in some instances, consented to by investors as well.	Full pass-through fee structures, which are often preferred by investors, will be permitted to survive if advisers provide the required disclosures. However, obtaining investor affirmative consent for anything is often a challenging process, regardless of what the topic is. For the restricted activities that require investor consent (investigations and borrowing from a fund), the requirement for consent could, in practice, operate similar to a ban.
Restricted Activities Rule (3)	Private fund agreements	Managers will be prohibited	See Restricted Activities Rule (2)

	<p>allow advisers to charge fees or share expenses, which properly incentivize the advisor to invest in compliance.</p>	<p>outright from charging fees or expenses related to an investigation that results or has resulted in a court or governmental authority imposing a sanction for a violation of the Advisers Act or the rules promulgated thereunder. Disclosure and consent are irrelevant.</p>	
<p>Preferential Treatment Rule / Side Letter Rights Rule</p>	<p>Investors and private fund managers can negotiate an allocation of capital under any mutually agreeable terms, including bespoke transparency, redemption rights and fees.</p>	<p>The Adopting Release permits certain forms of preferential redemption rights and the sharing of information on the fund's portfolio holdings/exposures (which the proposed rule would have prohibited outright) if the requirements of one of the limited exceptions are satisfied.</p> <p>An adviser can only grant an investor in the fund or in a <i>"similar pool of assets"</i> the ability to redeem on terms that the adviser reasonably expects to have a material, negative effect on other investors in that private fund or in a <i>"similar pool of assets"</i> only if: (i) required by the applicable laws, rules,</p>	<p>Having to offer the same right to everyone and leave that offer open to existing and prospective investors effectively nullifies any preference, which will negatively affect the ability to offer different redemption rights to seed investors. This may also limit the ability to have share classes with different redemption rights for any reason.</p> <p>A <i>"similar pool of assets"</i> is any pool of assets that has substantially similar investment policies, objectives, or strategies to those of the fund managed by the investment adviser or its related persons. The disjunctive "or" will encompass a wide range of fund types not traditionally thought of as similar. The Adopting Release gives the example that <i>"an adviser's healthcare-focused private fund may be considered a 'similar pool of assets' to the adviser's technology-focused private fund under the definition"</i>.</p> <p>This expansive definition of <i>"similar pool of assets"</i> will impact vastly more funds and pools of assets than simply the ones that are classic parallel pools. This definition could ultimately affect the redemption</p>

		<p>regulations, or orders of any relevant foreign or US government, state, or political subdivision to which the investor, the fund, or any <i>"similar pool of assets"</i> is subject; or (ii) the same right is offered (and open continuously) to all existing and prospective investors in that fund and any <i>"similar pool of assets"</i> without any qualifications.</p>	<p>rights across the adviser's entire product offering. Moreover, providing the required disclosure to investors in similar pools of assets could widen the universe of investors to whom the adviser is seen to be marketing that fund.</p>
<p>Grandfathering</p>	<p>Private fund managers and investors can continue with their existing contractual arrangements indefinitely and unrestricted.</p>	<p>The proposed rule did not offer grandfathering, so the SEC's decision to offer 'legacy status' (i.e., grandfathering) is welcome, although the coverage may be incomplete and lead to some disparate outcomes.</p>	<p>Legacy status is not available for any portion of the restricted activities or preferential treatments that require disclosure. Therefore, the non-disclosure/confidentiality provisions of all agreements will need to be re-assessed and potentially amended to the extent they are inconsistent with the disclosure obligations.</p> <p>With respect to the restricted activities that require investor consent (investigations and borrowing from a fund) and the preferential treatments restrictions regarding redemption rights and portfolio holdings/exposures disclosures, the legacy status is limited by, among other things, the requirement that the agreement <i>"would require the parties to amend such governing agreements"</i>. If that is not the case, the legacy status will not apply. As a result, existing arrangements will have to be carefully assessed in light of this limitation.</p>