If you have any questions regarding the matters discussed in this memorandum, please contact the below attorneys or call your regular Skadden contact.

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

A Practical Guide to Interpreting the New SEC Private Fund Adviser Rules

On August 23, 2023, the Securities and Exchange Commission (the SEC) voted 3-2 to adopt a final set of rules and amendments under the Investment Advisers Act of 1940 (collectively, the Final Rules) that significantly expand the regulatory compliance requirements for private fund advisers (both registered and not registered), exempt reporting advisers, State-regulated advisers, advisers relying on the foreign private adviser exemption and all other registered advisers. This alert includes a reference guide that presents a detailed summary of the Final Rules, along with selected commentary derived from the SEC’s adopting release that provides interpretive background and guidance from the SEC that should be helpful to investment advisers and private fund investors as they determine how to properly read, apply and implement the requirements set forth in the Final Rules.

In response to the SEC’s approval of the Final Rules, the Alternative Investment Management Association and the Managed Funds Association, along with four other industry bodies, filed a lawsuit with the Fifth Circuit Court of Appeals in New Orleans challenging the adoption of the Final Rules, claiming that the SEC overstepped its legal authority. We will explore developments regarding this lawsuit (and any other legal actions that may be brought against the SEC in connection with the adoption of the Final Rules) in a subsequent alert.

Please read the guide on the following pages.

Contacts

John M. Caccia  
Partner / New York  
212.735.7826  
john.caccia@skadden.com

Heather Cruz  
Partner / New York  
212.735.2772  
heather.cruz@skadden.com

Greg Norman  
Partner / London  
44.20.7519.7192  
greg.p.norman@skadden.com

Anna Rips  
Partner / New York  
212.735.3237  
anna.rips@skadden.com

Anastasia T. Rockas  
Partner / New York  
212.735.2987  
anastasia.rockas@skadden.com

David A. Jain  
Counsel / New York  
212.735.2671  
david.jain@skadden.com
A Practical Guide to Interpreting the New SEC Private Fund Adviser Rules (including SEC commentary and guidance)
Table of Contents

Introduction .................................................................................................................................................. 1
Contacts ...................................................................................................................................................... 1
Summary of Applicability and Compliance Dates ....................................................................................... 2
Quarterly Statement Rule § 275.211(h)(1)-2 ............................................................................................. 3
  Fund Table ............................................................................................................................................... 3
  Portfolio Investment Table ....................................................................................................................... 4
  Calculations and Cross-References .......................................................................................................... 4
  Illiquid Funds vs. Liquid Funds .................................................................................................................. 4
  Performance ........................................................................................................................................... 5
  Consolidated Reporting ............................................................................................................................ 5
  Distribution of Quarterly Statements ....................................................................................................... 6
Private Fund Audit Rule § 275.206(4)-10 .................................................................................................... 8
  Financial Statement Audits ...................................................................................................................... 8
  Audit Requirements .................................................................................................................................. 9
  Advisers Not in a Control Relationship ................................................................................................... 9
  Books and Records ................................................................................................................................. 9
Adviser-Led Secondaries § 275.211(h)(2)-2 .............................................................................................. 10
  Scope of Adviser-Led Secondary Transaction .......................................................................................... 10
  Conducting an Adviser-Led Secondary Transaction .............................................................................. 10
  Books and Records ............................................................................................................................... 11
  Qualifying as an Adviser-Led Secondary Transaction ............................................................................ 11
Restricted Activities Rule § 275.211(h)(2)-1 ............................................................................................ 12
  Investigation Fees and Expenses .......................................................................................................... 12
  Regulatory and Compliance Fees and Expenses ..................................................................................... 13
  Reducing Adviser Clawback by Taxes ..................................................................................................... 13
  Allocation of Fees and Expenses Across Multiple Funds ...................................................................... 14
  Borrowings ........................................................................................................................................... 14
  Legacy Status ......................................................................................................................................... 15
  Procedures for Consent-Based Exceptions ............................................................................................. 15
Preferential Treatment § 275.211(h)(2)-3 .................................................................................................. 17
  Similar Pool of Assets ............................................................................................................................ 17
  Prohibited Activities ............................................................................................................................. 18
  Legacy Status ......................................................................................................................................... 18
  Disclosure Obligations ............................................................................................................................ 19
  Books and Records ............................................................................................................................... 20
Compliance Rule Amendments § 275.206(4)-7 ..................................................................................... 21
  Annual Review ....................................................................................................................................... 21
Defined Terms .......................................................................................................................................... 23
Introduction

On August 23, 2023, the Securities and Exchange Commission (the SEC) voted 3-2 to adopt a final set of rules and amendments under the Investment Advisers Act of 1940 (collectively, the Final Rules) that significantly expand the regulatory compliance requirements for private fund advisers (both registered and not registered), exempt reporting advisers, State-regulated advisers, advisers relying on the foreign private adviser exemption and all other registered advisers. The full text of the Final Rules was published in Release No. IA-6383 (the Adopting Release), Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews.

The materials set forth in this guide present a detailed summary of the Final Rules, along with selected commentary derived from the Adopting Release that provides further interpretive background and guidance from the SEC that should be helpful to investment advisers and private fund investors as they determine how to properly read, apply and implement the requirements set forth in the Final Rules. Note that any such commentary is presented in red italicized text to distinguish it from the more streamlined text of the Final Rules (appearing here in black); underlined words reflect our added emphasis; and any other words that appear in italics generally have the meanings ascribed by the SEC in the Final Rules (these terms are also set forth in the “Defined Terms” section of this guide).

Contacts

John M. Caccia
Partner / New York
212.735.7826
john.caccia@skadden.com

Heather Cruz
Partner / New York
212.735.2772
heather.cruz@skadden.com

Greg Norman
Partner / London
44.20.7519.7192
greg.p.norman@skadden.com

Anna Rips
Partner / New York
212.735.3237
anna.rips@skadden.com

Anastasia T. Rockas
Partner / New York
212.735.2987
anastasia.rockas@skadden.com

David A. Jain
Counsel / New York
212.735.2671
david.jain@skadden.com
## Summary of Applicability and Compliance Dates

### Applicability of SEC Private Fund Adviser Rules to Investment Advisers
(with corresponding compliance dates, all measured from the date of publication in the Federal Register)

<table>
<thead>
<tr>
<th></th>
<th>Registered</th>
<th>Not Registered (including exempt reporting advisers, State-regulated advisers and advisers relying on the foreign private adviser exemption)</th>
<th>All Registered Advisers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Less than $1.5 billion AUM in private fund assets</td>
<td>At least $1.5 billion AUM in private fund assets</td>
<td>Less than $1.5 billion AUM in private fund assets</td>
</tr>
<tr>
<td>Quarterly Statement Rule</td>
<td>Yes (18 months)</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Private Fund Audit Rule</td>
<td>Yes (18 months)</td>
<td>Yes (12 months)</td>
<td>N/A</td>
</tr>
<tr>
<td>Adviser-Led Secondaries Rule</td>
<td>Yes (18 months)</td>
<td>Yes (12 months)</td>
<td>Yes (18 months)</td>
</tr>
<tr>
<td>Restricted Activities Rule</td>
<td>Yes (18 months)</td>
<td>Yes (12 months)</td>
<td>Yes (18 months)</td>
</tr>
<tr>
<td>Preferential Treatment Rule</td>
<td>Yes (18 months)</td>
<td>Yes (12 months)</td>
<td>Yes (18 months)</td>
</tr>
<tr>
<td>Compliance Rule Amendments</td>
<td>Yes (60 days)</td>
<td>Yes (60 days)</td>
<td>Yes (60 days)</td>
</tr>
</tbody>
</table>

1 The SEC differentiates between larger private fund advisers and smaller private fund advisers based on “private fund assets under management,” calculated as of the last day of an adviser’s most recently completed fiscal year. An adviser’s private fund assets under management are the portion of such adviser’s regulatory assets under management (calculated in accordance with Part 1A, Instruction 5.b of Form ADV) that are attributable to the private funds that it advises.

2 Exclusion does not apply to the Compliance Rule Amendments.

3 Assets under management.

4 The SEC agreed to provide legacy status for (i) the prohibitions aspect of the Preferential Treatment Rule (which prohibits advisers from providing certain preferential redemption rights and information about portfolio holdings) and (ii) the aspects of the Restricted Activities Rule that require investor consent (which restrict an adviser from borrowing from a private fund and from charging for certain investigation fees and expenses). This legacy status only applies to a private fund (i) whose governing agreement was entered into prior to the applicable compliance date (if the rule would require the parties to the agreement otherwise amend it), and (ii) that commenced operations (including any bona fide activity directed toward operating a private fund, including investment, fundraising or operational activity) as of the applicable compliance date.
Quarterly Statement Rule
§ 275.211(h)(1)-2

- Covered Advisers:
  - Registered private fund advisers (excludes securitized asset funds)
- Compliance Period:
  - 18 months for all covered advisers

Fund Table

An adviser must prepare a quarterly statement for each private fund that it advises that includes a fund table (presented both before and after the application of any offsets, rebates or waivers) containing:

- A detailed accounting of:
  - All compensation, fees and other amounts (which includes reimbursement of expenses) allocated or paid to the adviser (or any of its related persons) by the fund during the reporting period, including:
    ▪ separate line items for each category of allocation or payment reflecting the total dollar amount, including but not limited to:
      - management, advisory, subadvisory or similar fees or payments; and
      - performance-based compensation.
    ▪ These line-item tallies do not allow for (i) the exclusion of de minimis expenses, (ii) the general grouping of smaller expenses into broad categories or (iii) the labeling of expenses as miscellaneous.
    ▪ The reporting requires disclosure of any adviser compensation allocated or paid to the adviser (or any of its related persons), including a related person that is a subadviser to the private fund, to the extent that the compensation to such related person is allocated or paid by the fund; accordingly, subadvisory fees allocated or paid to a related person solely by the fund’s adviser (and not by the fund) do not need to be disclosed as a separate item of adviser compensation.
  - All fees and expenses allocated to or paid by the private fund during the reporting period, including:
    ▪ separate line items for each category of fee or expense reflecting the total dollar amount, including but not limited to:
      - organizational, accounting, legal, administration, audit, tax, due diligence and travel fees and 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 any of its related persons).
Portfolio Investment Table

An adviser must prepare a quarterly statement for each private fund that it advises that includes a portfolio investment table (presented both before and after the application of any offsets, rebates or waivers) containing:

- A detailed account of all portfolio investment compensation allocated or paid to the adviser (or any of its related persons) by each covered portfolio investment during the reporting period including:
  - separate line items for each category of allocation or payment; and
  - dollar amounts.

- An adviser is not required to include distributions representing profit or return of capital to the fund, in each case, in respect of the fund’s ownership or other interest in a portfolio investment (e.g., dividends).

- The SEC noted that, despite the best efforts of certain fund-of-funds advisers, these advisers may lack information or may not be given information in respect of underlying entities, and, depending on a private fund’s underlying investment structure, a fund-of-funds adviser may have to rely on good faith belief to determine which entity or entities constitute a portfolio investment under this rule. An adviser may consider documenting this determination, as well as its initial and ongoing diligence efforts to determine whether a portfolio investment has compensated the adviser (or its related persons), in its records.

Calculations and Cross-References

Quarterly statements must include prominent disclosure regarding the manner in which all expenses, payments, allocations, rebates, waivers and offsets are calculated, including cross-references to the relevant sections of the private fund’s organizational and offering documents that set forth the calculation methodology.

Illiquid Funds vs. Liquid Funds

- An illiquid fund is a private fund that:
  - is not required to redeem interests upon an investor’s request; and
  - has limited opportunities, if any, for investors to withdraw before termination of the fund.

- A liquid fund is a private fund that is not an illiquid fund.

Books and Records

An adviser must make and keep true, accurate and current documentation substantiating the adviser’s determination that a private fund client is a liquid fund or an illiquid fund pursuant to the classifications described above.
Performance

Standardized fund performance information should be displayed in each quarterly statement with equal prominence, including:

- **For liquid funds:**
  - Annual net total returns for each fiscal year on an annual basis over the past 10 fiscal years or since the fund’s inception, whichever period is shorter.
  - Average net total returns over the 1-, 5-, and 10-fiscal-year time periods and on a quarterly basis for the current year.
  - The cumulative net total return for the current fiscal year at the end of the most recent fiscal quarter covered by the quarterly statement.

- **For illiquid funds:**
  - Gross IRR and gross MOIC for the illiquid fund.
  - Net IRR and net MOIC for the illiquid fund.
  - Gross IRR and gross MOIC for the realized and unrealized portions of the illiquid fund’s portfolio, with the realized and unrealized performance shown separately.
  - Performance information should be:
    - shown since the fund’s inception through the end of the quarter covered by the statement; and
    - computed with and without the impact of any fund-level subscription facilities.

- **A statement of contributions and distributions,** which should include:
  - all capital inflows (with the value and date) the private fund has received from investors since the private fund’s inception;
  - all capital outflows (with the value and date) the private fund has distributed to investors since the private fund’s inception; and
  - the net asset value of the private fund as of the end of the applicable reporting period.
  - Advisers should consider including in the statement of contributions and distributions any fees and expenses related to a subscription facility.
  - The adviser’s (and its affiliates’) interests should be excluded when calculating performance because such interests are typically non-fee-paying.

Consolidated Reporting

Advisers must consolidate reporting for similar pools of assets to the extent that doing so would provide more meaningful information to the private fund’s investors and would not be misleading. For more information regarding what constitutes a “similar pool of assets,” see below under “Preferential Treatment — Similar Pool of Assets.”
Distribution of Quarterly Statements

Each quarterly statement must be prepared and distributed to investors in accordance with the following:

- **Format and Content**
  - The statement must use clear, concise, plain English.
  - The statement must present information in a format that facilitates review from one quarterly statement to the next.
  - The recorded performance information must include:
    - the date as of which such performance information is current through; and
    - prominent disclosure of the criteria used and assumptions made in calculating such performance information.

- **Timing**
  - **If the fund is not a fund of funds**, advisers must distribute the statement:
    - within 45 days of the end of each of the first three fiscal quarters of each fiscal year; and
    - within 90 days of the end of each fiscal year.
  - **If the fund is a fund of funds**, advisers must distribute the statement:
    - within 75 days of the end of each of the first three fiscal quarters of each fiscal year; and
    - within 120 days of the end of each fiscal year.
  - **For newly formed funds**:
    - Quarterly statements must be prepared and distributed beginning with the quarter following the fund’s second full fiscal quarter of generating operating results.
    - An adviser must determine whether it will classify each private fund that it advises as liquid or illiquid by the time it sends the initial quarterly statement to investors.

- **Books and Records**
  - An adviser must make and keep true, accurate and current:
    - a copy of each quarterly statement distributed pursuant to the rules described above, along with a record of each addressee and the corresponding date(s) sent; and
    - all records evidencing the calculation method for all expenses, payments, allocations, rebates, offsets, waivers and performance listed on any statement delivered in accordance with the rules described above.

- The SEC noted that it would take the position that, if an adviser is unable to deliver the quarterly statement in the time frame required under this rule due to reasonably unforeseeable circumstances, this would not provide a basis for enforcement action as long as the adviser reasonably believed that the quarterly statement would be distributed by the applicable deadline and the adviser delivers the quarterly statement as promptly as practicable.

- An adviser generally will satisfy the requirement to “distribute” the quarterly statements when the statements are sent to all investors in the private fund.
• If an adviser distributes a quarterly statement electronically through a data room, this distribution, like other electronic deliveries, should be executed in accordance with the SEC’s guidance regarding electronic delivery. Accordingly, if an adviser places quarterly statements in a data room without any notice to investors, advisers would not meet the distribution requirement under the rule. However, if the adviser notifies investors when the quarterly statements are uploaded to the data room within the applicable time period under the rule for preparation and delivery of the quarterly statement and ensures that investors have access to the quarterly statement included therein, the adviser would generally satisfy the distribution requirement.

• Advisers to private equity funds and other illiquid funds that provide prospective investors with access to a virtual data room for the fund (containing the fund’s offering documents (including categories of fees and expenses that may be charged), the adviser’s brochure and other ancillary items, such as case studies) meet the contractual and other needs of investors for updated information by updating the documents in the data room.
Private Fund Audit Rule

§ 275.206(4)-10

- Covered Advisers:
  - Registered private fund advisers (excludes securitized asset funds)
- Compliance Period:
  - 18 months for all covered advisers

Financial Statement Audits

An adviser shall cause each private fund that it advises, directly or indirectly, to undergo a financial statement audit that meets the requirements set forth in paragraphs (b)(4)(i) through (b)(4)(iii) of 17 CFR 275.206(4)-2 of the Advisers Act (the Custody Rule). Specifically, in respect of each such private fund, an adviser must ensure that each private fund undergoes an audit in accordance with the following:

- **Annual Audits**
  - At least annually, the adviser must distribute such private fund’s audited financial statements (audited financial statements consist of the applicable financial statements, related schedules, accompanying footnotes and the audit report) prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) of such private fund within 120 days of the end of its fiscal year.

- **Audit Upon Liquidation**
  - Upon liquidation, the adviser must distribute such private fund’s audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) of such private fund promptly after the completion of the related audit.

- **Delivery of Audited Financial Statements**
  - Audited financial statements must be delivered in accordance with the requirements set forth in paragraph (c) of the Custody Rule (which notes that the delivery requirements set forth above will not be satisfied if financial statements are sent solely to limited partners (or members or other beneficial owners) that themselves are (i) limited partnerships (or limited liability companies or another type of pooled investment vehicle) and (ii) an adviser’s related persons).
  - In circumstances where an investor is itself a limited partnership, limited liability company or another type of pooled vehicle that is a related person of the adviser, it is necessary to look through each such pool (and any pools in a control relationship with the adviser (or its related persons), such as in a master-feeder fund structure) in order to satisfy the delivery requirements to investors in such pools. Outside of a control relationship, such as if the private fund investor is an unaffiliated fund of funds, this same concern is not present, and looking through the structure is not necessary to make meaningful delivery; distributing the audited financial statements to the adviser to, or other designated party of, the unaffiliated fund of funds will be sufficient.
  - These delivery and timing requirements are set forth in the Custody Rule.
  - The mandatory private fund adviser audit rule effectively eliminates the surprise examination option under the Custody Rule for private fund advisers.
The SEC noted that it would take the position that, if an adviser is unable to deliver audited financial statements in the timeframe required above due to reasonably unforeseeable circumstances, this would not provide a basis for enforcement action as long as the adviser reasonably believed that the audited financial statements would be distributed by the deadline and the adviser delivers the financial statements as promptly as practicable.

Audit Requirements

- Each audit must be conducted by an independent public accountant that is:
  - registered with the Public Company Accounting Oversight Board (PCAOB); and
  - subject to regular inspection as of the commencement of the professional engagement period (and as of each calendar year-end) by the PCAOB in accordance with its rules.

  These requirements are set forth in the Custody Rule.

- An “audit” of an entity (such as a private fund) that is not an issuer as defined in section 2(a)(7) of the Sarbanes-Oxley Act of 2002 must be an audit performed in accordance with either (i) U.S. Generally Accepted Auditing Standards or (ii) the standards of the PCAOB.

Advisers Not in a Control Relationship

- For a private fund that an adviser does not control (and that the adviser is neither controlled by nor under common control with), to the extent such private fund does not otherwise undergo an audit as described above, in order for the adviser to provide investment advice, directly or indirectly, to such private fund, the adviser must:
  - take all reasonable steps (which will depend on facts and circumstances) to cause such private fund to undergo a financial statement audit that meets the Custody Rule’s requirements, set forth in paragraph (b)(4) thereof, subjecting “limited partnerships … to an annual audit” (which are described above under “Financial Statement Audits”); and
  - cause audited financial statements to be delivered in accordance with the requirements set forth in paragraph (c) of the Custody Rule (which are described above under “Financial Statement Audits — Delivery of Audited Financial Statements.”)

- If a private fund that is a client of an adviser is already undergoing an audit, a noncontrolling adviser does not have to take reasonable steps to cause such private fund client to undergo an audit.

Books and Records

For each of an adviser’s private fund clients, an adviser must make and keep true, accurate and current:

- a copy of any audited financial statements prepared and distributed pursuant to the audit requirements set forth above, along with a record of each addressee and the corresponding date(s) sent; or

- a record documenting the steps taken by the adviser to cause a private fund client that the adviser does not control, is not controlled by, and with which the adviser is not under common control, to undergo a financial statement audit.
Adviser-Led Secondaries
§ 275.211(h)(2)-2

- Covered Advisers:
  - Registered private fund advisers (excludes securitized asset funds)
- Compliance Period:
  - 12 months for advisers with at least $1.5 billion in assets under management
  - 18 months for advisers with less than $1.5 billion in assets under management

Scope of Adviser-Led Secondary Transaction

- The provisions apply to any transaction initiated by an adviser (or any of its related persons) that offers investors the choice between:
  - selling all or a portion of their interests; and
  - converting or exchanging all or a portion of their interests for interests in another vehicle advised by the adviser (or any of its related persons).
- A transaction would generally be considered to be initiated by an adviser if the adviser commences a process (or causes one or more other persons to commence a process) that is designed to offer private fund investors the option to obtain liquidity for their private fund interests; however, whether the adviser (or any of its related persons) initiates a secondary transaction requires an analysis of facts and circumstances.
- A transaction would generally not be viewed as having been initiated by an adviser if the adviser, at the unsolicited request of an investor, assists in the secondary sale of such investor’s fund interest.

Conducting an Adviser-Led Secondary Transaction

- An adviser conducting an adviser-led secondary transaction with respect to each private fund that it advises must, prior to the applicable due date of the election form in respect of such adviser-led secondary transaction:
  - obtain and distribute to the fund’s investors a fairness opinion (stating that the price being offered to the private fund for the assets being sold is fair) or valuation opinion (stating the value (as a single amount or a range) of the assets being sold) from an independent opinion provider; and
  - prepare and distribute to the fund’s investors a written summary of any material business relationships (whether a business relationship is material requires a facts-and-circumstances analysis; and audit, consulting, capital raising, investment banking and other similar services would typically meet this standard) that the adviser (or its related persons) has (or has had within the two-year period immediately prior to the issuance of the fairness opinion or valuation opinion) with the applicable independent opinion provider.
- Advisers and investors will have the ability to negotiate whether a fairness opinion or a valuation opinion is more appropriate.
Books and Records

In connection with any adviser-led secondary transaction, an adviser must make and keep a true, accurate and current copy of any (i) fairness opinion or valuation opinion provided to a fund’s investors and (ii) a summary of material business relationships, with a record of each addressee and the corresponding date(s) sent.

Qualifying as an Adviser-Led Secondary Transaction

- Adviser-led secondary transactions generally include secondary transactions where a fund is selling one or more assets to another vehicle managed by the adviser if investors have the option between obtaining liquidity and rolling all or a portion of their interests into the other vehicle.

- Examples include (i) single asset transactions (such as the fund selling a single asset to a new vehicle managed by the adviser), (ii) strip sale transactions (such as the fund selling a portion of multiple assets to a new vehicle managed by the adviser) and (iii) full fund restructurings (such as the fund selling all of its assets to a new vehicle managed by the adviser).

- Rebalancing between parallel funds and seasonal and sell transactions between parallel funds generally will not be covered by the “adviser-led secondary transaction” definition because the adviser is not offering investors the choice between selling and converting/exchanging their interests in the private fund.

- With regard to tender offers, generally, if an investor is allowed to retain its interest in the same fund with respect to the asset subject to the transaction on the same terms (i.e., the investor is not required to either sell or convert/exchange), as many tender offers permit investors to do, then the transaction would not qualify as an adviser-led secondary transaction.
Restricted Activities Rule
§ 275.211(h)(2)-1

- Covered Advisers:
  - Registered private fund advisers (excludes securitized asset funds)
  - Nonregistered private fund advisers (includes exempt reporting advisers, State-regulated advisers and advisers relying on the foreign private adviser exemption)

- Compliance Period:
  - 12 months for advisers with at least $1.5 billion in assets under management
  - 18 months for advisers with less than $1.5 billion in assets under management

Investigation Fees and Expenses
Requires “before-the-fact” disclosure and investor consent

- An adviser may not, directly or indirectly, with respect to each private fund that it advises (or any investor in such private fund):
  - charge or allocate to the fund fees or expenses associated with an investigation of the adviser (or any of its related persons) by any governmental or regulatory authority, unless the adviser:
    - requests each investor of the fund to consent to such charge or allocation; and
    - obtains written consent from at least a majority in interest of the fund’s investors that are not related persons of the adviser;
  - provided, however, that the adviser may not charge or allocate to the fund 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.

- The SEC recognizes that governmental or regulatory bodies may not formally notify an adviser that it is under investigation; in such a circumstance, whether an adviser is under investigation will be determined based on the information available.

- An adviser may charge a fund for fees and expenses associated with an investigation by the SEC of the adviser (or its related persons) for a potential violation of Section 206 of the Advisers Act or the rules thereunder, provided those fees and expenses are consented to by investors pursuant to this rule. However, if the investigation results in a court or governmental authority imposing a sanction on the adviser for a violation of the Advisers Act or the rules promulgated thereunder, then the adviser must refund the fees and expenses associated with the investigation, such as lawyers’ fees, to the fund.
Regulatory and Compliance Fees and Expenses

Requires “after-the-fact” disclosure

- An adviser may not, directly or indirectly, with respect to each private fund that it advises (or any investor in such private fund):
  - charge or allocate to the fund any regulatory or compliance fees or expenses (or fees or expenses associated with an examination) of the adviser (or any of its related persons) unless:
    ▪ the adviser distributes a written notice of any such fees or expenses (and the dollar amount thereof) to the investors of such fund within 45 days after the end of the fiscal quarter in which the charge occurs.

- Regulatory, compliance and examination fees and expenses are customary costs of doing business that enable advisers to operate and attract clients as well as investors. For example, advisers may incur filing and other fees associated with SEC filings, such as Form ADV and Form PF, as well as certain state filings; advisers may also pay fees and expenses for a compliance consultant to help them with mock or real examinations.

- The 45-day timeline for providing written notice of any regulatory and compliance fees and expenses generally coincides with the timeline required for advisers to distribute quarterly statements under the quarterly statement rule (except for quarterly statements distributed at fiscal year-end or quarterly statements prepared for a fund of funds). This structure will allow advisers that are subject to the quarterly statement rule to generally include disclosures related to the restricted activities rule in their quarterly reports, subject to those exceptions.

- As the SEC did not flatly prohibit advisers from passing on compliance, regulatory and examination expenses, the SEC did not describe which fees and expenses are related to an adviser’s activities or a fund’s activities.

- Advisers and investors may negotiate whether certain compliance, regulatory or examination fees and expenses are charged to a fund; provided that the disclosure of such fees and expenses satisfies the requirements of this rule.

Reducing Adviser Clawback by Taxes

Requires “after-the-fact” disclosure

- An adviser may not, directly or indirectly, with respect to each private fund that it advises (or any investor in such private fund):
  - reduce the amount of an adviser clawback by actual, potential or hypothetical taxes applicable to (i) the adviser, (ii) its related persons or (iii) their respective owners or interest holders, unless:
    ▪ the adviser distributes a written notice to the investors of such fund that sets forth the aggregate dollar amounts of the adviser clawback before and after any reduction for actual, potential or hypothetical taxes within 45 days after the end of the fiscal quarter in which the adviser clawback occurs.

- Aggregate dollar amounts should reflect the gross amount of excess compensation received by the adviser (or its related persons) that is being clawed back. The aggregate dollar amount of the clawback before the application of any tax reductions must not be reduced by taxes paid, or deemed paid, by the recipients or other persons on their behalf, whereas the aggregate dollar amount of the clawback after the application of any tax reduction needs to be so reduced.
Allocation of Fees and Expenses Across Multiple Funds
Requires “before-the-fact” disclosure

- An adviser may not, directly or indirectly, with respect to each private fund that it advises (or any investor in such private fund):
  - charge or allocate fees or expenses related to a portfolio investment (or potential 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, unless:
    ▪ the non-pro rata charge or allocation is fair and equitable under the circumstances; and
    ▪ prior to charging or allocating such fees or expenses to a fund, the adviser distributes to each investor of the fund a written notice of the non-pro rata charge or allocation and a description of how it is fair and equitable under the circumstances.

- Whether an allocation is fair and equitable will depend on factors relevant for the specific expense; for example, (i) whether the expense relates to a specific type of security that one private fund client holds, (ii) whether the expense relates to a bespoke structuring arrangement for one private fund client to participate in the portfolio investment and (iii) if one private fund client may receive a greater benefit from the expense relative to other private fund clients, such as the potential benefit of certain insurance policies.

- In any notice that is provided to investors, advisers should consider addressing relevant factors, which might include the adviser’s allocation approach and the reason(s) why the adviser believes that its non-pro rata allocation approach is fair and equitable under the circumstances.

- Because there may be multiple methods to determine pro rata allocations, the SEC has declined to define “pro rata.”

Borrowings
Requires “before-the-fact” disclosure and investor consent

- An adviser may not, directly or indirectly, with respect to each private fund that it advises (or any investor in such private fund):
  - borrow money, securities or other private fund assets, or receive a loan or an extension of credit, from a private fund client, unless the adviser:
    ▪ distributes to each investor a written description of the material terms of (and requests each investor to consent to) such borrowing, loan or extension of credit; and
    ▪ obtains written consent from at least a majority in interest of the fund’s investors that are not related persons of the adviser.

- This rule does not enumerate specific terms of the borrowing that an adviser must disclose in connection with its consent request; rather, the rule requires advisers to disclose the prospective borrowing and the material terms related thereto (this could include, for example, the amount of money to be borrowed, the interest rate and the repayment schedule, depending on the facts and circumstances).

- These restrictions will not apply to (i) borrowings from a third party on the fund’s behalf or (ii) the adviser’s borrowings from individual investors outside of the fund, such as a bank that is invested in the fund; instead the restriction focuses on the types of borrowings that, based on the SEC’s
experience, present the greatest opportunities for an adviser to abuse its control over a client’s assets (namely, when an adviser borrows its client’s assets, directly or indirectly, for its own use).

- The SEC would not interpret this rule to apply to tax advances as a type of restricted borrowing because they are tax payments that are attributable to and made against the unrealized income (or other amounts) allocated in respect of the fund; as such, tax advances are not structured to include the repayment of advanced amounts to the fund, but rather only the reduction of the future income to be received by the adviser. However, to the extent that a tax advance is structured to contemplate amounts that will be repaid to the fund, as opposed to amounts that only reduce an adviser’s future income, the advance would generally be a restricted borrowing under final rule, subject to the rule’s consent requirement.

- The SEC considers a management fee offset to be a calculation methodology that reduces the amount a fund pays the adviser and its affiliates in the future. Management fee offsets are not borrowings subject to this rule because they do not involve the adviser (or its affiliates) taking fund assets and promising to repay such assets at a later date.

### Legacy Status

- The restrictions relating to Investigation Fees and Expenses and Borrowing (each, as described above) do not apply to a private fund to the extent that:
  - such fund has commenced operations as of the applicable compliance date (which includes any bona fide activity directed toward operating the fund, including investment, fundraising or operational activities; for example, (i) issuing capital calls, (ii) setting up a subscription facility for the fund, (iii) holding an initial fund closing, (iv) conducting due diligence on potential fund investments or (v) making an investment on behalf of the fund); and
  - the contractual agreements governing such fund (which include, but are not limited to, the fund’s operating or organizational agreements (e.g., limited partnership agreement, limited liability company agreement, articles of association or bylaws), subscription agreements, and side letters) and, in the case of any activities described above under the restrictions on borrowing, the contractual agreements governing the borrowing, loan or extension of credit entered into by such fund (which include, but are not limited to, the contractual agreements governing such fund as described above, if applicable, as well as promissory notes and credit agreements), are entered into in writing prior to the applicable compliance date to the extent the prohibitions described above would otherwise require amendments to such governing agreements; provided that, the foregoing shall not permit an adviser to such a fund to charge or allocate to such fund any 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.

- The SEC interprets the legacy status provision for the borrowing restriction to apply to existing borrowings from a private fund that has commenced operations as of the applicable compliance date and that were entered into in writing prior to such compliance date. Thus, an adviser would not be required to seek consent for such existing borrowings for purposes of complying with this new rule.

### Procedures for Consent-Based Exceptions

- Each consent-based exception (Investigation Fees and Expense; Borrowings) will require an adviser to seek consent for the restricted activity from all the fund’s investors and obtain consent from at least a majority in interest of investors that are not related persons of the adviser.
• A fund’s governing documents may establish that a higher threshold of investor consent is necessary for the adviser to engage in these restricted activities and may generally prescribe the manner and process by which the applicable threshold of investor consent is obtained.

• In light of the limitations posed by fund governance bodies (such as limited partner advisory committees (LPACs), advisory boards or boards of directors, which do not generally have a fiduciary obligation to the private fund investors) the consent-based exceptions discussed above will require that the relevant consent be sought and obtained specifically from fund investors.
Preferential Treatment

§ 275.211(h)(2)-3

- Covered Advisers:
  - Registered private fund advisers (excludes securitized asset funds)
  - Nonregistered private fund advisers (includes exempt reporting advisers, State-regulated advisers and advisers relying on the foreign private adviser exemption)

- Compliance Period:
  - 12 months for advisers with at least $1.5 billion in assets under management
  - 18 months for advisers with less than $1.5 billion in assets under management

Similar Pool of Assets

In respect of an investment adviser and any private fund that it manages, a “similar pool of assets” is any pooled investment vehicle (other than an investment company registered under the Investment Company Act of 1940, a company that elects to be regulated as such, or a securitized asset fund) that (i) is also managed by the adviser (or any of its related persons) and (ii) has substantially similar investment policies, objectives or strategies to those of such private fund.

- Whether a pool of assets managed by the adviser is “similar” to a private fund requires an analysis of the facts and circumstances. When practitioners are determining what constitutes a “similar pool of assets” in respect of a private fund (for example, a parallel feeder fund investing in the same master fund as the subject fund, or any other investment vehicle with a substantially similar investment policy, objective or strategy), a pool of assets with a materially different target return or sector focus, for example, would, depending on the facts and circumstances, likely not have substantially similar investment policies, objectives or strategies to those of such private fund and thus not constitute a “similar pool of assets.”

- The definition of “similar pool of assets” is designed to cover most commonly used private fund structures (or similar arrangements) and prevent advisers from structuring around the prohibitions on preferential treatment. For example, in a master-feeder structure, where an adviser may create custom feeder funds for favored investors, the broad definition of “similar pool of assets” is meant to preclude such adviser from providing preferential treatment to investors in these custom feeder funds to the detriment of investors in standard commingled feeder funds within the master-feeder structure.

- The term includes various types of asset pools, regardless of whether they are private funds. For example, the term would include limited liability companies, partnerships and other organizational structures, regardless of the number of investors; feeders to the same master fund; and parallel fund structures and alternative investment vehicles. It would also include pooled vehicles with different base currencies and pooled vehicles with embedded leverage to the extent such pooled vehicles have substantially similar investment policies, objectives or strategies as those of the subject private fund. In addition, an adviser is required to consider whether its proprietary vehicles meet the definition of “similar pool of assets.”

- Separately managed accounts are not generally included in the definition of “similar pool of assets.” There are, however, certain circumstances in which a fund of one or single-investor fund can be a pooled investment vehicle and therefore can fall within the definition of “similar pool of assets.” The SEC recognizes that there are circumstances in which it may be appropriate for an adviser to treat a single-investor fund as a private fund; for example, a fund that seeks to raise capital from multiple investors but has only a single, initial investor for a period of time could be a private fund, as could a fund in which all but one of the investors have redeemed their interests.
Since co-investment vehicles, such as parallel funds, operate in a similar manner as do other pooled investment vehicles that invest alongside the adviser’s main fund (because the parallel funds typically enter and exit the applicable investment(s) at substantially the same time and on substantially the same terms as the adviser’s main fund does), providing investors in co-investment vehicles with preferential information presents the same risks and circumvention concerns as arises with other pooled investment vehicles captured by the definition of “similar pool of assets.” As a result, advisers should not treat co-investment vehicles differently.

Prohibited Activities

An investment adviser to a private fund may not, directly or indirectly, do the following with respect to such private fund (or any investor in such fund):

- **Redemptions**: The adviser may not grant an investor in the same fund (or an investor in any similar pool of assets) the ability to redeem on terms that the adviser reasonably expects to have a material, negative effect on the other investors in such fund (or the investors in such similar pool of assets), except:
  - if such ability to redeem is required by the applicable laws, rules, regulations or orders of any relevant foreign or U.S. government, state or political subdivision to which such investor, fund or such similar pool of assets is subject (but not including informal arrangements, such as policies and resolutions); or
  - if the adviser has offered (and will continue to offer) the same redemption ability to all other existing and future investors in such fund and in such similar pool of assets (which must be applied without qualification, i.e., redemption terms may not be related to (i) commitment size, (ii) affiliation requirements or (iii) other limitations).

- **Portfolio holdings information**: The adviser may not provide information regarding the portfolio holdings or exposures of such fund (or of a similar pool of assets) to any investor in such fund if the adviser reasonably expects that providing such information would have a material, negative effect on the other investors in such fund (or the investors in a similar pool of assets), unless the adviser offers such information to all other existing investors in such fund and in such similar pool of assets at the same (or substantially the same) time.
  - Preferential information rights provided to one or more investors in an illiquid private fund will generally not be viewed as having a material, negative effect on other investors.

Legacy Status

- The prohibitions described above do not apply to a private fund to the extent that:
  - such fund has commenced operations as of the applicable compliance date (which includes any bona fide activity directed toward operating the fund, including investment, fundraising or operational activities; for example, (i) issuing capital calls, (ii) setting up a subscription facility for the fund, (iii) holding an initial fund closing, (iv) conducting due diligence on potential fund investments or (v) making an investment on behalf of the fund); and
  - the contractual agreements governing such fund (which include, but are not limited to, the fund’s operating or organizational agreements (e.g., limited partnership agreement, limited liability company agreement, articles of association or bylaws), subscription agreements, and side letters) are entered into in writing prior to the applicable compliance date to the extent the prohibitions described above would otherwise require amendments (such as changing or removing redemption terms for one or more investors where such terms are specified in the governing agreement, or removing terms from a
Preferential Treatment

side letter that granted an investor redemption rights or periodic reporting about the fund’s holdings or exposures) to such governing agreements.

- The legacy provisions apply only with respect to an adviser’s existing agreements with parties as of the applicable compliance date. An adviser may not add parties to a side letter after the compliance date in order to do indirectly what it is prohibited from doing directly; however, an adviser who admits new investors to an existing fund would not be viewed as having violated the above legacy provision to the extent the applicable terms are set forth in the fund’s limited partnership (or similar) agreement and applicable to all investors.

Disclosure Obligations

An investment adviser to a private fund may not, directly or indirectly, provide any preferential treatment to any investor in a private fund unless the adviser provides written notice in accordance with the following:

- **Notice to prospective investors, which applies to both illiquid and liquid funds.**
  - Prior to its investment in a fund, each prospective investor must be given a written notice that provides specific information regarding any preferential treatment related to any material economic terms that the adviser (or its related persons) provides to other investors in the same fund.
  - “Material economic terms” include (i) cost of investing, (ii) liquidity rights, (iii) fee breaks and (iv) co-investment rights. Co-investment rights generally qualify to the extent they include materially different fee and expense terms from those of the main fund (e.g., no fees or no obligation to bear broken-deal expenses). Even without different fee and expense terms, co-investment terms generally will be material given their impact on an investor’s bargaining position.

- **Notice to existing investors.**
  - **Illiquid Funds**
    - As soon as reasonably practicable following the end of a fund’s fundraising period, the adviser must provide written disclosure of all preferential treatment the adviser (or its related persons) has provided to other investors in the same fund.
  - **Liquid Funds**
    - As soon as reasonably practicable following an investor’s investment in a fund, the adviser must provide written disclosure of all preferential treatment the adviser (or its related persons) has provided to other investors in the same fund.
  - **All Funds**
    - On at least an annual basis, the adviser must provide a written notice that provides specific information regarding any preferential treatment provided by the adviser (or its related persons) to other investors in the same fund since the last written notice was provided. (This includes preferential information provided to any transferees during such period; if an investor is a pooled investment vehicle that is in a control relationship with the adviser, the adviser must look through that pool in order to send the notice to investors in such pool.)
    - As a practical matter, a private fund that does not admit new investors or provide new terms to existing investors does not need to deliver an annual notice; however, an adviser that enters into a side letter after the closing date of the fund...
must disclose any preferential terms in the side letter to investors that have previously been admitted into the fund.

- Whether a written notice is furnished “as soon as reasonably practicable” will depend on the facts and circumstances. While this standard imposes no specific time limit, the SEC noted that it would generally be appropriate for advisers to distribute the notices within four weeks.

- The disclosure requirements described above are not limited to an investor’s initial investment in a fund. For example, if an existing investor increases its investment in a fund, an adviser is required to disclose all preferential treatment to such investor following such additional investment.

- An adviser could comply with these disclosure requirements by providing copies of side letters (with identifying information regarding the other investors redacted). Alternatively, an adviser could provide a written summary of the preferential terms provided to other investors in the same private fund, provided the summary specifically describes the preferential treatment.

- Advisers are not required to disclose the names or even types of investors provided preferential terms as part of this disclosure requirement.

- An adviser must specifically describe the preferential treatment to convey its relevance. Mere disclosure of the fact that other investors are paying lower fees is not specific enough. For example, if an adviser provides an investor with lower fee terms in exchange for a significantly higher capital contribution than paid by others, an adviser must describe the lower fee terms, including the applicable rate (or range of rates if multiple investors pay such lower fees), in order to provide the required specific information.

- This rule applies to preferential treatment provided through various means, including written side letters; it also applies even if the preferential treatment is provided indirectly, such as by an adviser’s related persons, because granting of preferential treatment also has the potential to harm the fund and its investors when performed indirectly. For example, the rule applies when an adviser’s related person is the general partner (or similar control person) and is a party (and/or caused the private fund to be a party, directly or indirectly) to a side letter or other arrangement with an investor, even if the adviser itself (or any related person of the adviser) is not a party to the side letter or other arrangement. The rule will still apply under those circumstances because it prohibits an adviser from providing preferential treatment directly or indirectly.

Books and Records

An adviser shall make and keep true and accurate originals of all written communications it received, and copies of all written communications it sent, relating to any notice required pursuant to § 275.211(h)(2)-3 (Preferential Treatment), as well as a record of each addressee and the corresponding date(s) sent.

- Regardless of whether an investor actually receives any preferential treatment, the SEC noted that the foregoing recordkeeping obligation is necessary to help ensure that advisers comply with the preferential treatment rule. Accordingly, advisers are required to retain copies of all written notices sent to current and prospective investors in a private fund (regardless of whether they are admitted to the fund) pursuant to above requirements.
Compliance Rule Amendments

§ 275.206(4)-7

- **Covered Advisers:**
  - Registered private fund advisers (excludes securitized asset funds)
  - Nonregistered private fund advisers (includes exempt reporting advisers, State-regulated advisers and advisers relying on the foreign private adviser exemption)
  - Registered fund advisers to nonprivate funds

- **Compliance Period:**
  - 60 days for all covered advisers

**Annual Review**

- All advisers (whether or not they advise private funds) must review and document in writing, on at least an annual basis:
  - the adequacy of the policies and procedures established pursuant to 17 CFR § 275.206(4)-7 of the Advisers Act (Compliance and Procedures and Practices), which require advisers to adopt and implement written policies and procedures reasonably designed to prevent an adviser and its supervised persons from violating the Advisers Act and the rules that the SEC has adopted under the Advisers Act; and
  - the effectiveness of their implementation.

This amendment modifies the current Compliance and Procedures and Practices set forth in the Advisers Act by expanding the annual review of policies and procedures to also include written documentation of such review.

The required written documentation of the annual review is meant to be made available to the SEC and the SEC staff and therefore advisers should promptly produce it upon request. This documentation is not subject to attorney-client privilege, the work-product doctrine or other similar protections.

The annual review should consider any compliance matters that arose during the previous year, any changes in the business activities of the adviser or its affiliates, and any changes in the Advisers Act or applicable regulations that might suggest a need to revise the policies and procedures.

At a minimum, the SEC would expect an adviser’s policies and procedures to address (if relevant to the adviser): (i) the adviser’s policies and procedures formulated pursuant to 17 CFR § 275.206(4)–7(a) (requiring the adoption and implementation of written policies and procedures reasonably designed to prevent violation of the Advisers Act and the rules that the SEC has adopted under the Advisers Act) and (ii) any records documenting the adviser’s annual review of those policies and procedures conducted pursuant to 17 CFR § 275.206(4)–7(b) (requiring that an adviser review, no less frequently than annually, the adequacy of the policies and procedures established pursuant to 17 CFR § 275.206(4)–7(b) and the effectiveness of their implementation).

The rule does not enumerate specific elements that advisers must include in the written documentation of their annual review. The written documentation requirement is intended to be flexible to allow advisers to continue to use the review procedures they have developed and found most effective. For example, some advisers may review the adequacy of their compliance policies and procedures (or a subset of those compliance policies and procedures) and the
effectiveness of their implementation on a quarterly basis; in such a case, written documentation of the annual review could comprise written quarterly reports.

- The SEC noted that it understands that some advisers may choose to document the annual review of their written policies and procedures in: (i) a lengthy written report with supporting documentation; (ii) quarterly documentation, aggregated at year-end; (iii) a presentation to the board or another governing body, such as a limited partner advisory committee; (iv) a short memorandum summarizing the findings; and/or (v) informal documentation, such as a compilation of notes throughout the year. This rule does not prescribe a specific format of the written documentation, instead, allowing an adviser to determine what would be appropriate.

- Nothing in this rule prohibits advisers from seeking the guidance of service providers or outside counsel during their annual reviews. Although this rule will now require that the adviser document the annual review in writing, the rule still provides advisers the flexibility to determine the scope of that review, including when, if at all, and how to communicate with service providers or outside counsel.
Defined Terms

Adviser clawback means any obligation of the adviser, its related persons, or their respective owners or interest holders to restore or otherwise return performance-based compensation to the private fund pursuant to the private fund’s governing agreements.

Adviser-led secondary transaction means any transaction initiated by the investment adviser or any of its related persons that offers private fund investors the choice between:

i. selling all or a portion of their interests in the private fund; and

ii. converting or exchanging all or a portion of their interests in the private fund for interests in another vehicle advised by the adviser or any of its related persons.

Committed capital means any commitment pursuant to which a person is obligated to acquire an interest in, or make capital contributions to, the private fund.

Control means the power, directly or indirectly, to direct the management or policies of a person, whether through ownership of securities, by contract or otherwise. For the purposes of this definition, control includes the following scenarios:

i. Each of an investment adviser’s officers, partners or directors exercising executive responsibility (or persons having similar status or functions) is presumed to control the investment adviser.

ii. A person is presumed to control a corporation if the person:

(a) directly or indirectly has the right to vote 25% or more of a class of the corporation’s voting securities; or

(b) has the power to sell or direct the sale of 25% or more of a class of the corporation’s voting securities.

iii. A person is presumed to control a partnership if the person has the right to receive upon dissolution, or has contributed, 25% or more of the capital of the partnership.

iv. A person is presumed to control a limited liability company if the person:

(a) directly or indirectly has the right to vote 25% or more of a class of the interests of the limited liability company;

(b) has the right to receive upon dissolution, or has contributed, 25% or more of the capital of the limited liability company; or

(c) is an elected manager of the limited liability company.

v. A person is presumed to control a trust if the person is a trustee or managing agent of the trust.

Covered portfolio investment means a portfolio investment that allocated or paid the investment adviser or its related persons’ portfolio investment compensation during the reporting period.
Distribute, distributes or distributed means to send or have sent to all of the private fund's investors, unless the context otherwise requires; provided that, if an investor is a pooled investment vehicle that is controlling, controlled by, or under common control with (a “control relationship”) the adviser or its related persons, the adviser must look through that pool (and any pools in a control relationship with the adviser or its related persons) in order to send to investors in those pools.

Election form means a written solicitation distributed by, or on behalf of, the adviser or any related person requesting private fund investors to make a binding election to participate in an adviser-led secondary transaction.

Fairness opinion means a written opinion stating that the price being offered to the private fund for any assets being sold as part of an adviser-led secondary transaction is fair.

Fund-level subscription facilities means any subscription facilities, subscription line financing, capital call facilities, capital commitment facilities, bridge lines or other indebtedness incurred by the private fund that is secured by the unfunded capital commitments of the private fund’s investors.

Gross IRR means an internal rate of return that is calculated gross of all fees, expenses and performance-based compensation borne by the private fund.

Gross MOIC means a multiple of invested capital that is calculated gross of all fees, expenses and performance-based compensation borne by the private fund.

Illiquid fund means a private fund that:

i. is not required to redeem interests upon an investor’s request; and

ii. has limited opportunities, if any, for investors to withdraw before termination of the fund.

Independent opinion provider means a person that:

i. provides fairness opinions or valuation opinions in the ordinary course of its business; and

ii. is not a related person of the adviser.

Internal rate of return means the discount rate that causes the net present value of all cash flows throughout the life of the fund to be equal to zero.

Liquid fund means a private fund that is not an illiquid fund.

Multiple of invested capital means, as of the end of the applicable fiscal quarter:

i. The sum of:

   (a) the unrealized value of the illiquid fund; and
   (b) the value of all distributions made by the illiquid fund;

ii. divided by the total capital contributed to the illiquid fund by its investors.

Net IRR means an internal rate of return that is calculated net of all fees, expenses and performance-based compensation borne by the private fund.
**Defined Terms**

**Net MOIC** means a *multiple of invested capital* that is calculated net of all fees, expenses and *performance-based compensation* borne by the private fund.

**Performance-based compensation** means allocations, payments or distributions of capital based on the private fund’s (or any of its investments’) capital gains, capital appreciation and/or other profit.

**Portfolio investment** means any entity or issuer in which the private fund has directly or indirectly invested.

**Portfolio investment compensation** means any compensation, fees and other amounts allocated or paid to the investment adviser or any of its *related persons* by the *portfolio investment* attributable to the private fund’s interest in such *portfolio investment*, including, but not limited to, origination, management, consulting, monitoring, servicing, transaction, administrative, advisory, closing, disposition, directors, trustees or similar fees or payments.

**Related person** means:

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 adviser.

**Reporting period** means the private fund’s fiscal quarter covered by the quarterly statement or, for the initial quarterly statement of a newly formed private fund, the period covering the private fund’s first two full fiscal quarters of operating results.

**Securitized asset fund** means any private fund whose primary purpose is to issue asset-backed securities and whose investors are primarily debt-holders.

**Similar pool of assets** means a pooled investment vehicle (other than an investment company registered under the Investment Company Act of 1940, a company that elects to be regulated as such, or a *securitized asset fund*) with substantially similar investment policies, objectives or strategies to those of the private fund managed by the investment adviser or its *related persons*.

**Statement of contributions and distributions** means a document that presents:

i. all capital inflows the private fund has received from investors and all capital outflows the private fund has *distributed* to investors since the private fund’s inception, with the value and date of each inflow and outflow; and

ii. the net asset value of the private fund as of the end of the *reporting period*.

**Unfunded capital commitments** means *committed capital* that has not yet been contributed to the private fund by investors.

**Valuation opinion** means a written opinion stating the value (as a single amount or a range) of any assets being sold as part of an *adviser-led secondary transaction*.
This guide is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This guide is considered advertising under applicable state laws.

This guide is not intended to be comprehensive or to provide financial, investment, legal, tax or other professional advice or services. This guide is not a substitute for such professional advice or services, and it should not be acted on or relied upon, or used as a basis for any investment or other decision or action that may affect you or your business. Before making any such decision you should consult a suitably qualified professional adviser.