# New Developments in U.S. Private Fund Adviser Regulation FAQ[1]

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**October 31, 2023**

Below are some Frequently Asked Questions (FAQs) about U.S. regulation of private fund advisers and recent changes to applicable regulation that may affect non-U.S. advisers that manage private funds with U.S. investors.

## 1. What are the new SEC rules? When were they published and what is their purpose?

On August 23, 2023, the U.S. Securities and Exchange Commission (SEC) adopted new rules and amendments under the Investment Advisers Act of 1940 (Advisers Act) that are designed to increase regulation of private fund advisers by addressing information disparities, conflicts of interest, and certain other practices that the SEC believes may be harmful to private fund investors.

## 2. My firm advises only private funds with U.S. investors. The funds are not organized or incorporated in the U.S. What are my firm's registration and/or filing requirements in the U.S.?[2]

Under the Advisers Act, any person who provides investment advice for compensation, including advice to private funds, generally must register or notice file with the SEC and/or one or more individual states. This applies to non-U.S. advisers who allow U.S. persons to invest in their funds, even if the funds are not "U.S. persons." Note that if an adviser manages private funds, the fund (not the investors in the fund) is the client of the adviser. Regulation S under the U.S. Securities Act of 1933 provides that a fund is a "U.S. person" if it is organized or incorporated under the laws of the United States.

Generally, non-U.S. private fund advisers may be required to comply with one of three levels of regulation:

1. **Foreign private advisers**

   This very limited exemption applies to a non-U.S. adviser that i) has no office or place of business in the U.S., ii) advises fewer than 15 U.S. clients (in this case, including private funds and investors in those funds), iii) has less than $25 million in assets under management (AUM), and iv) does not hold itself out to the public in the U.S. as an investment adviser.

   An adviser that satisfies these criteria is exempt from having to register or to notice file in the U.S.

2. **Advisers only to private funds or only to venture capital funds ("exempt reporting advisers" or "ERAs")**

   *Exemption for Advisers Only to Private Funds*

   - Available to advisers that advise only private funds and that have less than $150 million in assets under management *in the U.S.* (i.e., assets managed from a location outside the U.S. are not included).

   - An adviser with its principal office and place of business outside the U.S. may rely on the exemption, provided that:

     1. all clients that are U.S. persons are private funds (even if some or all non-U.S. clients are not); and

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[1] This is not a complete summary of the requirements applicable to private fund advisers with U.S. clients and investors or of the new rules applicable to private fund advisers. Please contact U.S. regulatory counsel before making any decisions based on the information in this FAQ.

[2] Firms that advise U.S. clients other than private funds may be subject to different requirements.

2. assets managed at a "place of business" in the U.S. are limited to $150 million in private fund assets (aggregating all funds managed by the adviser).

- Assets managed on behalf of non-U.S. funds and other clients may be excluded from the calculation of assets under management, as can assets managed outside the U.S. for funds that have U.S. investors.

For example, consider an adviser i) with its principal office and place of business in Israel ii) that only advises a private fund organized in the Cayman Islands that has $200 million in AUM attributable to U.S. investors, and iii) has no place of business in the U.S. That adviser would not be required to register in the

U.S. because a) it has no U.S. clients (the fund is not a U.S. person because it was organized outside the U.S.), even though the fund has U.S. investors, and b) it manages no assets from the U.S. This is so even though the adviser has more than $150 million in AUM.

On the other hand, if the adviser managed the same fund from the U.S., it would be required to register in the U.S.

- Some non-U.S. advisers (namely, those without a U.S. place of business) may therefore be able to rely on this exemption indefinitely.

*Exemption for Advisers Only to Venture Capital Funds*

- Available to advisers that advise only venture capital funds, which is a private fund that:

1. represents to investors that the fund pursues a venture capital strategy;

2. does not provide investors with redemption rights (except in extraordinary circumstances);

3. does not borrow more than 15 percent of the fund's assets, where any borrowings are for a period not longer than 120 days; and

4. holds no more than 20 percent of its assets in investments that are not "qualifying investments" (excluding cash and short-term holdings).

   "Qualifying assets" include, generally, equity purchased directly from private operating companies.

- Available to non-U.S. advisers *but even their non-U.S. clients must be venture capital funds.*

*Regulatory Requirements for ERAs*

ERAs must annually make a "notice filing" with the SEC that sets out basic information about the adviser, the funds it advises, AUM, and other basic information.

ERAs are also subject to the anti-fraud provisions of the Advisers Act, which include, among other things, the following:

- broad regulation of fraud: requires full and meaningful disclosure; prohibits false and misleading statements in advertising; requires mitigation of conflicts of interest; and imposes many other requirements consistent with an adviser's fiduciary duties to its clients;
- prohibitions on principal transactions without disclosure and consent;
- "pay-to-play" regulation that prohibits certain political contributions; and
- certain of the new private fund adviser rules, as described below.

**3. Fully registered investment advisers (RIAs)**

Private fund advisers (including non-U.S. private fund advisers) who cannot rely on the above exemptions must fully register with the SEC.

This involves more substantial reporting and disclosure requirements and more significant substantive regulation, including, among others:

- mandatory audits or surprise exams of all client assets, which must be held with a qualified custodian (i.e., a bank);
- restrictions on when an adviser can charge performance-based compensation;
- more significant marketing restrictions, including those related to performance; and
- many other requirements.

  Most non-U.S. private fund advisers do not fully register because they can rely on the private fund adviser exemption or on the venture capital fund adviser exemption.

## 3. If I am subject to U.S. law as a private fund adviser, will the SEC's new rules apply to my firm?

As discussed above in Question 1, U.S. laws apply to non-U.S. investment advisers to varying degrees. If you are subject to registration or notice requirements in the U.S., then the new rules apply to you with respect to your U.S. private funds.

## 4. What are the main components of the new rules?

The new rules impose requirements on SEC-registered private fund advisers as well as, in certain cases, on advisers not registered with the SEC.

Registered private fund advisers are required to:

- conduct annual audits of their advised private funds;
- prepare and distribute quarterly statements to private fund investors;
- obtain a fairness or valuation opinion in connection with adviser-led secondaries; and
- document their annual compliance reviews in writing.

Both registered and unregistered investment advisers (including exempt reporting advisers and foreign private advisers) are restricted or prohibited from engaging in certain activities as set out in responses to Questions 5 and 6 below.

## 5. What do the new provisions related to preferential treatment of certain investors entail?

The new "preferential treatment" rule prohibits all private fund advisers, including exempt reporting advisers and foreign private advisers, from doing the following:

- providing preferential terms regarding redemptions or portfolio holdings information only to certain investors; and
- providing any other preferential terms unless disclosed to prospective investors (prior to investing) and to current investors (after the fundraising period for "*illiquid*" funds and after investment for "*liquid*" funds) and then annually thereafter.

*Illiquid funds*. Illiquid funds are defined as those that are not required to redeem interests upon an investor's request and have limited opportunities for investors to withdraw prior to a fund's termination. This is typical for most private funds.

*Liquid funds*. Liquid funds are defined as those that are not illiquid.



## 6. What other activities are now restricted under the new provisions?

The new "restricted activities" rule restricts all private fund advisers, including exempt reporting advisers and foreign private advisers, from doing the following:

1. Charging the following fees and expenses to a private fund:

    - Those associated with an investigation by any governmental or regulatory authority, unless a majority-in-interest of the private fund's investors consent in writing. Importantly, fees and expenses for investigations that result in a sanction for violating the Advisers Act cannot be charged to the fund at all, even with investor consent.

    - Regulatory or compliance fees or fees and expenses associated with an examination, unless the adviser discloses the dollar amount of such fees and expenses to investors within 45 days after the end of the fiscal quarter in which the charge occurs.

    - Non-pro rata charges or allocations of fees and expenses related to a portfolio investment where multiple private funds and other clients advised by the adviser have invested in the same portfolio investment, unless the allocation is fair and equitable and the adviser discloses the non-pro rata charge or allocation to investors prior to the charge or allocation.

2. Reducing the amount of any clawback by the amount of taxes applicable to the adviser, unless the adviser discloses the amount of the reduction within 45 days after the end of the fiscal quarter in which the clawback occurs.

3. Borrowing money, securities, or other private fund assets, or receiving a loan from a private fund client, unless the adviser discloses the terms to investors and a majority of investors consent to the arrangement in writing.

## 7. Do the new rules apply with respect to existing funds or only with respect to funds formed in the future?

The new rules apply to all funds whether currently existing or to be formed at some time in the future. As noted below, however, there are certain exceptions for current funds if a fund's offering documents would need to be amended solely in order to comply with certain aspects of the new rules.

There are two general exceptions for existing funds:

1. Existing funds can charge a private fund for certain investigation expenses (unless the investigation results in a sanction for violating the Advisers Act) and may borrow from a private fund, in either case without investor consent, if a fund's offering documents would need to be amended to comply with the restricted activities rule.

2. Existing funds also may engage in preferential information sharing and preferential redemptions, in either case without complying with the various requirements under the preferential treatment rule, if a fund's offering documents would need to be amended to comply with the preferential treatment rule.

## 8. What are the compliance dates for the new rules?

The compliance date for the audit and quarterly statement requirements is March 14, 2025.

The compliance dates for the adviser-led secondaries, restricted activities, and preferential treatment rules vary, depending on adviser AUM:

- September 14, 2024, for advisers with $1.5 billion or more in AUM

- March 14, 2025, for advisers with less than $1.5 billion in AUM

## 9. Does Israel have similar rules or regulations?

Israel does not have regulatory requirements that are similar to the above-described U.S. rules. In general, the Israeli Securities Authority (ISA) regulates Israeli advisors under the Law for Governance of Investment Advice, Investment Marketing and Portfolio Management 5755-1995 (the "Advisors Law"). However, the Advisors Law would typically not apply to Israeli private funds since their investors are comprised of non-Israeli investors and investors who are accredited investors. In addition, the Israeli law for Joint Investment in Trust 1754-1994 typically does not apply to such private funds since they have less than 50 investors. Therefore, in general the operation of private funds is not regulated by the ISA. The private funds do not register with the ISA and the managers of the funds are not required to obtain a license from the ISA.

## 10. How would the new rules affect Israeli fund managers?

As set forth above, the new rules would directly apply to Israeli fund managers who are subject to regulation by the SEC due to their investor base (U.S. clients) or other applicable nexus to the U.S.

In addition, even for Israeli fund managers who are not directly subject to the new rules, it is expected that the new rules will have an impact on their operations and fund raising.

It is likely that the new rules will constitute best practices and U.S. investors in Israeli based funds will expect Israeli fund managers to comply with the new rules as governance and transparency measures and provide U.S. investors in such funds the same level of governance they would have in U.S. domiciled funds.

It is particularly worthwhile to note that many Israeli private funds have many side letters with investors and often provide such investors preferential terms with respect to carried interest (discounted rate of carry or providing a hurdle threshold before the general partner is entitled to carried interest). In addition, such side letters often provide other rights such as co-investment rights, additional information rights and more. Such side letters are typically not disclosed to limited partners (who invest less than the limited partner receiving the side letter). It remains to be seen if the new rules will change the above practice.

## 11. Whom can I contact for more information about U.S. regulatory requirements that may affect my firm?

Please contact Ayal Shenhav at ayal.shenhav@goldfarb.com, Amy Caiazza at acaiazza@wsgr.com, or Marc Foster at marc.foster@wsgr.com with any questions regarding U.S. private fund adviser regulation.

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