

CFA Institute

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First Steps in Preparing for the SEC Private Fund Adviser Quarterly Statement Rule

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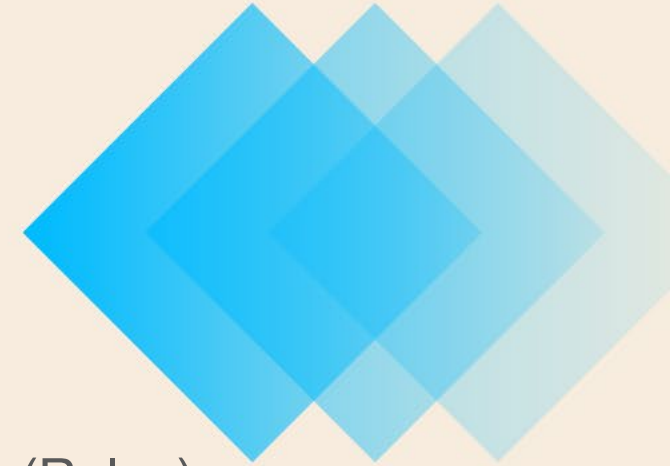
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Background: SEC Private Fund Adviser Rules



- In August 2023, the SEC adopted a new set of private fund adviser rules (Rules)
- The Rules aim to reduce conflicts of interest and protect private fund investors through a variety of disclosure and practice requirements
- The Rules materially increase the compliance burden for private fund advisers
- The Rules represent a dramatic shift in the relationship between investors and advisers
- The compliance dates for the Rules are September 2024 and March 2025, depending on the specific Rule and the size of the adviser

Overview of the Rules

- Rules applicable to all private fund advisers
 - Preferential Treatment Rule
 - Restricted Activities Rule
- Rules applicable to all SEC registered private fund advisers
 - **Quarterly Statement Rule**
 - Private Fund Audit Rule
 - Adviser-Led Secondary Rule
- Rules applicable to all SEC registered investment advisers
 - Compliance Rule Amendment



Legal Challenges to Rules



- On 1 September 2023, a lawsuit was filed by private fund industry associations with the federal Court of Appeals in the Fifth Circuit challenging the validity and enforceability of the Rules
- On 5 February 2024, the court heard oral arguments from the SEC and industry groups representing private investment fund sponsors
- Historically the Fifth Circuit has been hostile to government regulation
- Based on the judges' questions during oral arguments many believe the court may be preparing to overturn at least some portion of the Rules

Implementation and Compliance Timelines

Rule	Large Advisers (\$1.5 billion or more in private fund assets)	Small Advisers (less than \$1.5 billion in private fund assets)
<i>Rules Applicable to All Private Fund Advisers:</i>		
Preferential Treatment Rule	September 16, 2024	March 14, 2025
Restricted Activities Rule		
<i>Rules Applicable to All SEC Registered Investment Advisers to Private Funds:</i>		
<u>Quarterly Statement Rule</u>	March 14, 2025	
Private Fund Audit Rule		
Adviser-Led Secondaries Rule	September 16, 2024	March 14, 2025
<i>Rules Applicable to All SEC Registered Investment Advisers:</i>		
Compliance Rule Amendments	November 13, 2023	



Quarterly Statement Rule: Overview

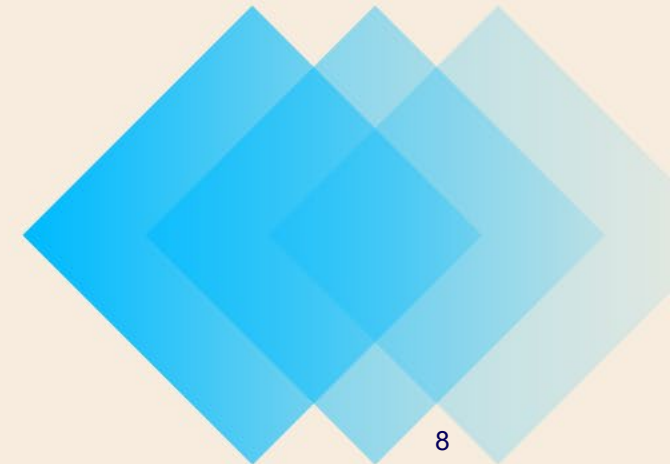


The Quarterly Statement Rule requires advisers to provide investors with quarterly information about private fund adviser compensation, fund fees and expenses, and performance:

- The rule applies to SEC registered private fund advisers (but not Exempt Reporting Advisers that are not registered with the SEC)
- The rule applies to both *existing* and *future* private funds
- “Private funds” – funds relying on **3(c)(1) or 3(c)(7)** of the Investment Company Act (exception for securitized asset funds)
- Funds will be required to provide both fund-level and portfolio-level information, as well as performance information and disclosures
- The rule provides formatting requirements to make it easier for investors to compare funds
- Statements can provide additional information beyond minimum requirements but must adhere to formatting and disclosure requirements

Quarterly Statement Rule: Components

- Preparation and Distribution of Quarterly Statements
- Fee and Expense Disclosure
- Performance Disclosure
- Consolidated Reporting for Certain Fund Structures
- Format and Content Requirements
- Recordkeeping



Preparation and Distribution of Quarterly Statements

Type of Fund	First Three Fiscal Quarters End	Fiscal Year End
Not a Fund of Funds	Within 45 Days	Within 90 Days
Fund of Funds	Within 75 Days	Within 120 Days

- Statements required once the fund has two full fiscal quarters of operating results
- Contractual arrangements with underlying investments may be beneficial to facilitate on-time reporting

Initial Quarterly Statement Reporting Dates

	Regular funds		Funds of funds	
	45 Days (Q1-Q3)	90 Days (Year-End)	75 Days (Q1-Q3)	120 Days (Year-End)
Fiscal quarters ending November 30, 2024	N/A	N/A	N/A	3/30/25 (Sunday)
Fiscal quarters ending December 31, 2024	N/A	3/31/25	3/16/25 (Sunday)	4/30/25
Fiscal quarters ending January 31, 2025	3/17/25	5/1/25	4/16/25	5/31/25
Fiscal quarters ending February 28, 2025	4/14/25	5/29/25	5/14/25	6/28/25
Fiscal quarters ending March 31, 2025	5/15/25	6/29/25 (Sunday)	6/14/25	7/29/25

Fee and Expense Disclosure

Private Fund-Level Disclosure

- Adviser Compensation
- Fund Expenses
- Offsets, Rebates and Waivers
- Carry Forward

Portfolio Investment-Level Disclosure

- Covered Portfolio Investment
- Portfolio Investment Compensation

Covered Portfolio Investments are portfolio investments that allocated or paid the investment adviser or its related persons portfolio investment compensation during the reporting period.

Private Fund-Level Disclosure

Adviser

Compensation –

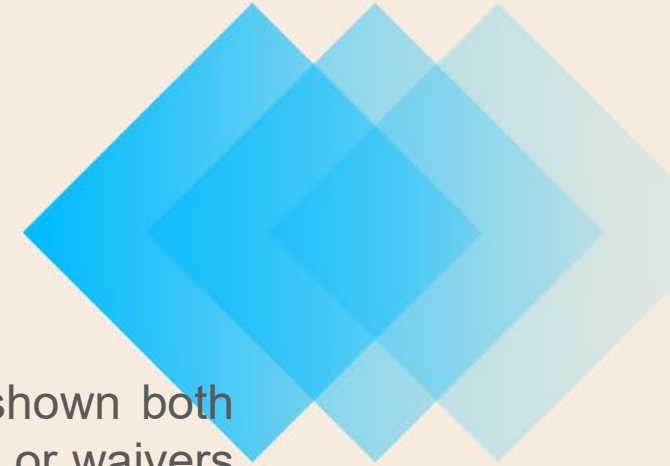
A detailed accounting of all compensation paid or allocated to the adviser and its related persons (includes management fee, incentive fee, and other compensation)

Fund Expenses –

A detailed and itemized accounting of all fees and expenses allocated to or paid by the private fund during the reporting period, with separate line items for each category reflecting the total dollar amount

- The above requirements do not align with US GAAP requirements
- Level of granularity – No miscellaneous or *de minimus* line items allowed

Private Fund-Level Disclosure (Continued)



Offsets, Rebates and Waivers –

Adviser compensation and fund expenses must be shown both before and after the application of any offsets, rebates or waivers as a separate line item

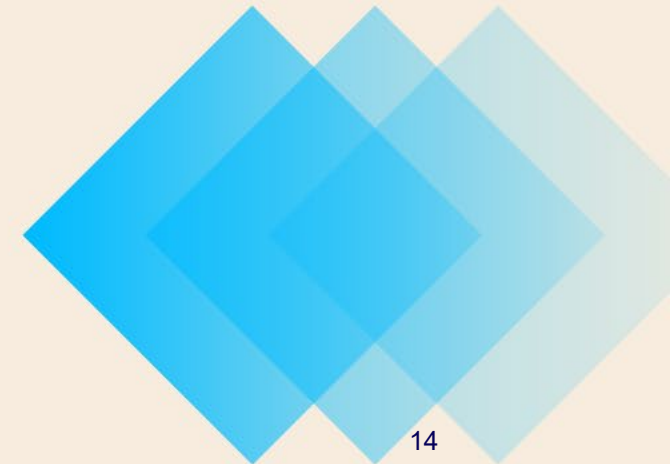
Carry Forward –

The amount of any offsets or rebates carried forward during the reporting period to subsequent periods to reduce future payments or allocations to the adviser or its related persons

Portfolio Investment-Level Disclosure

Portfolio Investment Compensation –

- Requires a separate table for the private fund's covered portfolio investments that contains a detailed accounting of all compensation allocated or paid by portfolio investments to the adviser or any of its related persons during the reporting period
- Must include separate line items for each category reflecting the total dollar amount, both before and after the application of any offsets, rebates and waivers
- Includes monitoring fees



Expense Calculations and Cross-References

- Calculation Methodology
- Source

It will be important to review PPMs, LPAs and other fund documents to confirm the adequacy of disclosure and amendments may be needed before first statement is distributed.

“The quarterly statement must include prominent disclosure regarding the manner in which all expenses, payments, allocations, rebates, waivers, and offsets are calculated and include cross references to the sections of the private fund’s organizational and offering documents that set forth the applicable calculation methodology”

Performance Disclosure

Liquid vs. Illiquid –

An adviser is required to determine whether the private fund is a liquid fund or an illiquid fund by the time it sends the initial quarterly statement

- **An illiquid fund is 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**
- **A fund that is not an illiquid fund is a liquid fund**
- **Periodic liquidity (even if infrequent) is generally a characteristic of a liquid fund**



Performance Disclosure – Liquid Funds



Annual Net Total Returns

- For each year over the past 10 years or since inception, whichever time period is shorter

Average Annual Net Total Returns

- Average annual net total returns over the one-, five-, and 10-fiscal-year periods (as applicable)

Cumulative Net Total Return

- For the current fiscal year as of the end of the most recent fiscal quarter covered by the quarterly statement

Performance Disclosure – Illiquid Funds

Illiquid fund quarterly statements are required to have the following performance measures, shown since inception of the fund through the end of the relevant quarter and computed with and without the impact of any fund-level subscription facilities:

Gross internal rate of return (IRR) and gross multiple on invested capital (MOIC);

Net IRR and net MOIC;

Gross IRR and gross MOIC for the realized and unrealized portions of the illiquid fund's portfolio, with the realized and unrealized portions shown separately; and

A statement of contributions and distributions that presents: (1) all capital inflows the private fund has received from investors and all capital outflows the private fund has distributed to investors, with the value and date of each inflow and outflow; and (2) the net asset value of the private fund as of the end of the reporting period covered by the quarterly statement.

Issues:

Interaction with the Marketing Rule

Unavailable information from portfolio investments and third parties

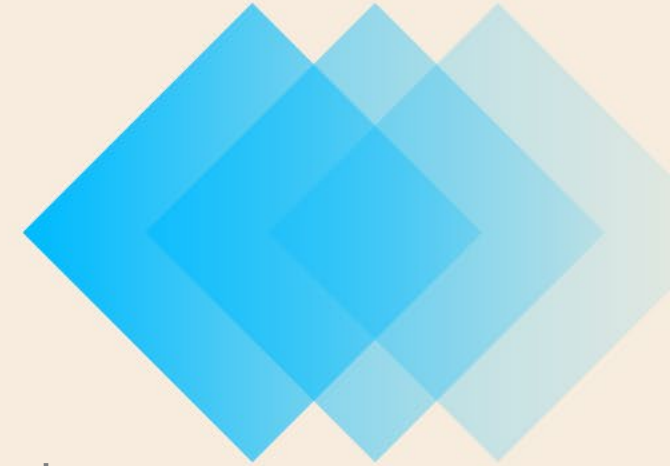
Investment-by-investment “impact of any fund-level subscription facilities”

SEC Marketing Rule FAQ

- On February 6, 2024, the SEC staff from the Division of IM published a **new** FAQ on the calculation of gross and net performance
- The FAQ states that for advisers to private funds it would violate the Marketing Rule to present **Gross IRR *without*** the impact of the applicable borrowing compared only to **Net IRR** that is calculated ***with*** the impact of the borrowing
- In addition, the FAQ notes an adviser would violate the general prohibitions of the Marketing Rule if Net IRR were presented including the impact of fund-level subscription facilities, without including either:
 - (i) Net IRR without the impact of such facilities; or
 - (ii) appropriate disclosures describing the impact of such facilities on the net performance shown.
- Practically, this aligns the Marketing Rule with the Quarterly Statement Rule and the presentation of four IRRs:
 - **Net IRR *with*** the subscription facility and **Gross IRR *with*** the subscription facility
 - **Net IRR *without*** the subscription facility and **Gross IRR *without*** the subscription facility



Performance Disclosure – Performance Calculation Information



Calculation Method

- Include prominent disclosure of the criteria used and assumptions made in calculating the performance

Up to Date

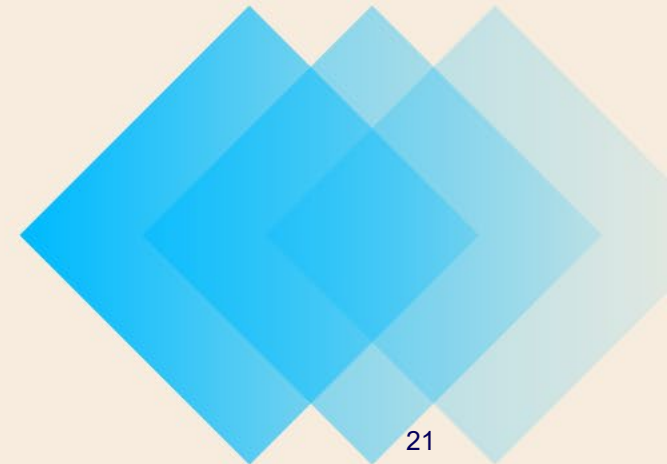
- Include the date as of which the performance information is current through

Templates

- A number of industry organizations/service providers are preparing templates

Issues for Sub-Advisers

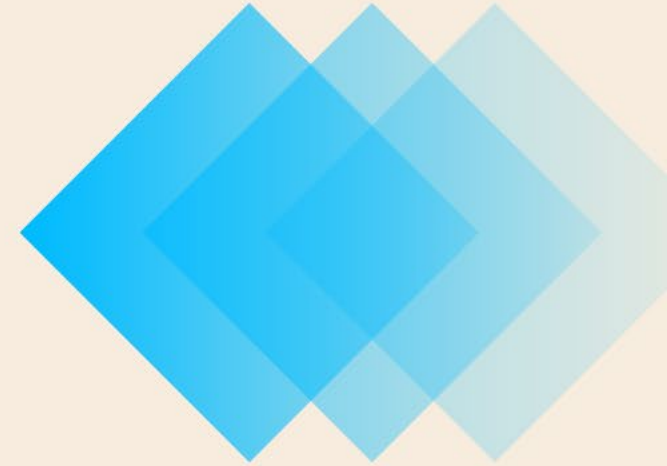
- Required to produce reports even if the principal adviser is not subject to the rule
- Disclosure of sub-advisory fees not required where it is paid by the fund's adviser (and not by the fund)



Consolidated Reporting for Certain Fund Structures

- Principles-based approach to consolidated reporting for similar pools of assets if:
 - Meaningful to investors; and
 - Not misleading
- Examples of fund structures include master-feeder structures, parallel funds and other co-investment/side-car vehicles
- Advisers generally should take into account any input received from investors on approaches to consolidation that they view as most meaningful

Format and Content Requirements



Clear, concise,
plain English

Easy to review,
generally
consistent
between quarters

Tabular format
with cross-
references to
fund documents

Recordkeeping



A copy of any quarterly statement distributed to fund investors pursuant to the quarterly statement rule, as well as a record of each addressee and the date(s) the statement was sent



All records evidencing the calculation method for all expenses, payments, allocations, rebates, offsets, waivers, and performance



Books and records substantiating the adviser's determination that a private fund client is a liquid fund or an illiquid fund



Record retention time period is consistent with other Advisers Act requirements.

Practical Next Steps

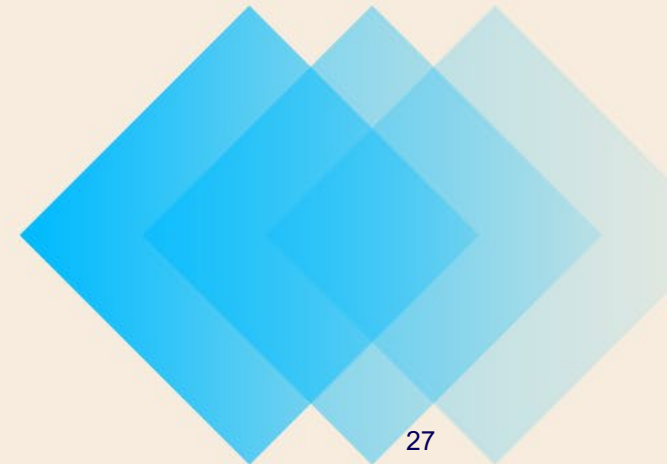
- **Threshold Issues:**
 - Classify funds as liquid or illiquid
 - Classify each fund as a “regular” fund or a fund of funds
- **Internal Policy Creation/Internal Processes**
 - Form a working group – compliance, finance, operations, marketing, investor relations
 - Determine who will be responsible for which aspects of the reports
 - Establish processes for keeping data
 - Determine calculation methodology
 - Develop policies, procedures and training

Practical Next Steps (Continued)

- Third Party Engagement:
 - Engage fund administrator to facilitate reporting
 - Engage with portfolio investments and other counterparties
- Fund Level
 - Review PPMs, LPAs and other fund documents and flag sections describing how expenses, payments, allocations, rebates, waivers and offsets are calculated
 - Amend fund documents as necessary

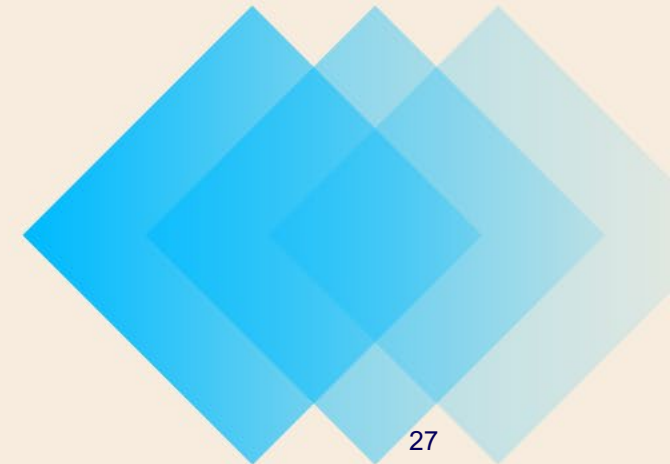
Resources – K&L Gates

- Sign up for K&L Gates Content [Stay Informed | K&L Gates \(emailcc.com\)](https://www.klgates.com/stay-informed)
- Consult the [K&L Gates Private Fund Adviser Rules Guide to Compliance](#)
- K&L Gates speakers
 - [TJ Bright | People | K&L Gates \(klgates.com\)](#)
 - [Pamela A. Grossetti | People | K&L Gates \(klgates.com\)](#)



Resources – CFA Institute

- Subscribe to the [GIPS Standards Newsletter](#)
- GIPS Standards website www.gipsstandards.org
 - SEC Private Fund Adviser Rules webpage
 - SEC Marketing Rule webpage
 - SEC Marketing Rule [Survey](#)
- CFA Institute speakers
 - Krista Harvey krista.harvey@cfainstitute.org
 - Karyn Vincent karyn.Vincent@cfainstitute.org
- CFA Institute Annual GIPS Standards Conference
 - San Diego, CA
 - September 17-18, 2024
- GIPS Standards Help Desk gips@cfainstitute.org



Thank You

