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VIA EMAIL

To Our Investment Adviser Clients and Other Friends:

Re: SEC Adopts New Rules for Private Fund Advisers

On August 23, 2023, the Securities Exchange Commission (the "SEC") adopted significant new rules for private fund advisers (the "Rules") under the Investment Advisers Act of 1940 (the "Advisers Act"). Some of the Rules apply to all investment advisers to private funds, including exempt reporting advisers and state-registered advisers ("Investment Advisers"), while others only apply to SEC-registered investment advisers ("Registered Advisers"). Further, the Rules, with the exception of the Compliance Rule Amendment (as described below), do not apply with respect to securitized asset funds or other funds that do not rely on section 3(c)(1) or 3(c)(7) of the Investment Company Act, such as real estate funds that rely on Investment Company Act section 3(c)(5).

These changes mark a significant shift in SEC regulation of private funds. A number of trade associations have joined in a lawsuit against the SEC alleging that the Rules exceed the SEC's authority under the Advisers Act and other laws, but there is no certainty that this litigation will succeed, and if it does, to what extent. Therefore, Investment Advisers should begin to prepare for each applicable "Compliance Date," which includes November 13, 2023 for the Compliance Rule Amendment and either September 14, 2024 or March 14, 2025 for the other Rules, depending on the specific rule and the Investment Adviser's assets under management, as detailed further in "Compliance Deadlines" below.

Legacy Status. The Rules permit "Legacy Status" for some practices that would otherwise be prohibited following the Compliance Date. Where permitted, Legacy Status applies to private fund governing documents (e.g., agreements of limited partnership, subscription agreements and side letters) that were entered into before the Compliance Date if the Rules would otherwise require amending the governing documents. Investors may still be admitted to an existing fund following the Compliance Date with the terms offered before the Compliance Date to the extent the applicable terms are included in the fund's governing documents and offered to all investors. However, an Investment Adviser cannot add parties to an existing side letter after the Compliance Date to engage indirectly in prohibited activity. Furthermore, the private fund must have commenced operations prior to the Compliance Date to permit Legacy Status.

RULES AFFECTING ALL INVESTMENT ADVISERS TO PRIVATE FUNDS

Preferential Treatment Rule - Rule 211(h)(2)-3. The Preferential Treatment Rule references both practices that are prohibited outright and practices that are permissible with appropriate notice or consent.

Prohibited Preferential Treatment: This rule prohibits Investment Advisers from providing (i) preferential redemption terms to an investor in a private fund or in a similar pool of assets (such as a parallel or feeder fund) that can be reasonably expected to have a material, negative effect on other investors in that fund or in a similar pool of assets, and (ii) information about portfolio holdings or exposures of a private fund or of a similar pool of assets if the Investment Adviser reasonably expects that providing such information would have a material, negative effect on other investors in that fund or in a similar pool of assets. Investment Advisers may still offer preferential redemption rights that have a material, negative effect on other investors if the investor with preferential rights is required to redeem due to applicable law that the investor must comply with, or if the same redemption rights are offered to all existing and future investors of that fund and any similar pool of assets without qualifications. Investment Advisers may offer information rights that would otherwise be prohibited by the Preferential Treatment Rule if this information is offered to all other existing investors in the fund at the same time.

The Preferential Treatment Rule will substantially impact hedge fund managers, as hedge fund governing documents typically allow its manager to waive certain redemption restrictions in its discretion and managers frequently offer more favorable transparency rights and in some cases better redemption terms for different classes of investors based on certain qualifications (e.g., investment level or affiliation with the manager). Following the Compliance Date, hedge fund managers must consider the Preferential Treatment Rule to ensure they do not allow a redemption or structure a particular class with redemption or transparency rights that are reasonably likely to have a material, negative effect on other investors. Investors are not required to have identical redemption or transparency rights, but the Investment Adviser must offer the same rights to all existing and future investors without qualification, such as minimum commitment size or affiliation with the Investment Adviser. Legacy Status is permitted under this prohibited portion of the Preferential Treatment Rule, largely because the SEC acknowledges how disruptive and costly renegotiating governing agreements would be.

Permissible Preferential Treatment, with Disclosure: For all other preferential rights, the Rules impose a disclosure obligation, with advance disclosure required if such information relates to "material economic terms."

Prior to a prospective investor's admission to a fund, the Investment Adviser must provide the prospective investor with written notice of any material economic terms that are actually provided to other fund investors. The Rules list co-investment rights, the cost of investing, liquidity rights and fee breaks as examples of "material economic terms." The SEC staff have stated that excuse rights or other investment carveouts (such as prohibitions on tobacco investments) are not considered "material economic terms." Material economic terms that are negotiated in side letters will need to be disclosed prior to each investor's admission, unlike current practice for many closed-end funds, which disclose side letter rights pursuant to a "most favored nation" (MFN) process after the private fund's final closing.

Any preferential treatment (even if unrelated to economic terms) must be disclosed after an investor is admitted to a "liquid fund" or after the final closing of an "illiquid fund." The Rules define an "illiquid fund" as a private fund that (i) is not required to redeem interests on an investor's request (other than for legal, regulatory or policy reasons, such as a pension plan required to redeem its interests under state or local law) and (ii) has limited opportunities, if any, for investors to withdraw

before termination of the fund. The Rules define a "liquid fund" as any private fund that is not an illiquid fund. Most traditional hedge funds likely fall into the liquid fund category and most venture capital, traditional private equity and other similar closed-end funds would generally be classified as illiquid funds so long as opportunities to redeem are limited. All funds must be classified as one or the other (i.e., no hybrid funds).

The Rules do not impose a specific deadline for such disclosures of non-material preferential terms to investors, but the SEC has indicated that it would be appropriate to provide these disclosures within four weeks of an investor's admission to a liquid fund or at the end of an illiquid fund's fundraising period. If new preferential terms are subsequently granted to any investor, they must be annually disclosed in detail to all fund investors. Legacy Status is not provided for permissible preferential treatment. Information containing preferential treatment terms in side letters that existed before the Compliance Date must be disclosed to investors who invest in the fund after the Compliance Date. Investment Advisers can, however, anonymize the identity of the investor that received a preferential term.

Restricted Activities Rule - Rule 211(h)(2)-1. Under the Restricted Activities Rule, all Investment Advisers of private funds are prohibited from engaging in the following activities, unless a disclosure or consent exemption or Legacy Status applies:

Charging a private fund investigation expenses (permitted with disclosure and prior written consent, unless the investigation results in Adviser Act sanctions). Investment Advisers must obtain written consent from a majority in interest of a private fund's investors that are not related persons of the Investment Adviser prior to charging that fund fees or expenses associated with an investigation of the Investment Adviser or its related persons by a governmental or regulatory authority, even if the Investment Adviser would otherwise be entitled to indemnification under the fund's governing documents. Investment Advisers are completely prohibited from charging private funds for expenses relating to any such investigation that results in sanctions by a court or governmental authority for Advisers Act violations. An Investment Adviser that has obtained the requisite investor consent to charge a private fund but is ultimately sanctioned as described above must reimburse the fund for such expenses for such charges. If an Investment Adviser does not know it is under investigation, this restriction is determined based on information available to the Investment Adviser. Legacy Status is permitted for investigation expenses that do not result in sanctions, but it is not permitted for investigation expenses that result in sanctions.

Charging a private fund regulatory, compliance and examination expenses (permitted with subsequent disclosure). Investment Advisers are restricted from charging a fund any regulatory or compliance fees or expenses associated with an examination of the Investment Adviser or its related persons, unless the Investment Adviser distributes a written notice of such fees or expenses, including the dollar amount, to investors within 45 days of the end of the fiscal quarter in which the expense is incurred. Legacy Status is not permitted with respect to this disclosure of regulatory, compliance or examination expenses charged to the fund.

Reducing clawbacks for taxes (permitted with subsequent disclosure). Investment Advisers are restricted from reducing any clawback by actual or potential taxes, unless the Investment Adviser distributes a written notice to investors within 45 days of the end of the fiscal quarter when the clawback occurs. This written notice must include the aggregate dollar amount of the clawback,

before and after the deduction for actual, potential or hypothetical taxes. Legacy Status is not permitted for this activity under the Restricted Activities Rule.

Non-pro rata fee and expense allocations (permitted with prior notice). Investment Advisers may not charge or allocate fees and expenses relating to portfolio investments or potential portfolio investments (for example, "broken deal" expenses) on a non-pro rata basis when other private funds advised by the Investment Adviser (or its related persons) plan to or have invested in the same investments. This restriction does not apply if the charge or fee allocation is fair and equitable under the circumstances and each investor in the private fund is provided with written notice before such expense is charged that includes (i) the amount of the non-pro rata charge or expense and (ii) a description of how the allocation is fair and equitable under the circumstances. Legacy Status does not apply to the notice required for this activity under the Restricted Activities Rule.

Borrowing from private funds (permitted with disclosure and prior written consent). Investment Advisers and their related persons may not borrow funds, securities or other assets, or receive a loan or line of credit, from a private fund unless the Investment Adviser obtains written consent from a majority in interest of the fund's investors that are not related persons of the Investment Adviser. The Investment Adviser must disclose the materials terms of the borrowing, including the amount, interest rate and repayment schedule. Legacy Status is permitted for this activity under the Restricted Activities Rule.

RULES AFFECTING REGISTERED ADVISERS TO PRIVATE FUNDS

Quarterly Statement Rule - Rule 211(h)(1)-2. The Quarterly Statement Rule requires Registered Advisers to provide investors of private funds with quarterly statements with a "fund table," a "portfolio investment table" and specific fund performance calculations. If the private fund advised by a Registered Adviser is not a fund of funds, these quarterly statements must be delivered to all investors in the private fund 45 days following the end of each of the first three fiscal quarters and 90 days after the end of each fiscal year. Fund of funds must deliver those quarterly statements within 75 days of the end of each of the first three quarters and 120 days after the end of the fiscal year. When a private fund is newly formed, its initial quarterly statement will include its first two full fiscal quarters of operating results. The Rules require quarterly statements to include prominent disclosures in plain English regarding the method in which the fund table and portfolio investment table is calculated and cross-references to the fund's governing documents that describe this calculation methodology. Legacy Status is not applicable to the Quarterly Statement Rule.

Fund Table. The quarterly statement must include a table that discloses, at a minimum, for the applicable quarter, separate line items addressing (i) a detailed accounting of all compensation and performance allocations paid to the Investment Adviser and its related persons, with separate line items for each category of allocation or payment reflecting the total dollar amount, (ii) a detailed accounting of all fees and expenses allocated or paid during that period, with 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, (iii) the amount of any offsets or rebates carried forward during that quarter to subsequent periods to reduce future payments or allocations to the Investment Adviser or its related persons.

Portfolio Investment Table. The quarterly statement must include a separate table that discloses, at a minimum, a detailed accounting of all portfolio investment compensation paid or allocated to the Investment Adviser or its related persons by each covered portfolio investment during the reporting period, with a separate line item for each category of allocation or payment reflecting the total dollar amount, presented both before and after the application of any offsets, rebates or waivers. The Rules define "covered portfolio investments" as portfolio investments that paid or allocated portfolio investment compensation to the Investment Adviser during the reporting period. The applicable compensation includes, but is not limited to, origination, management, consulting, monitoring, servicing, transaction, administrative, advisory, closing, disposition or director or trustee payments.

Fund Performance. The required performance information in the quarterly statements varies depending on whether the private fund is an illiquid or liquid fund (see above for definitions of "illiquid funds" and "liquid funds").

Illiquid funds must show, since inception, the (i) gross and net IRR, (ii) gross and net MOIC and (iii) gross IRR and gross MOIC for the realized and unrealized portions of the fund's portfolio, with the realized and unrealized performance shown separately. The foregoing performance measurements must also be calculated both with and without the impact of fund-level subscription lines. Finally, the quarterly statement for illiquid funds must include a statement of contributions and distributions.

Liquid funds must show (i) annual net total return for each of the past 10 fiscal years (or since inception, whichever is shorter), (ii) average net total returns over the past 1, 5 and 10 fiscal years and (iii) the cumulative net total return for the most recent fiscal year.

The Rules (and the related SEC adopting Release No. IA-6383) should be consulted when preparing quarterly statements, as it prescribes how these metrics must be calculated and displayed. For example, substantially similar funds must be consolidated if that disclosure is "meaningful" and not misleading. The SEC has stated that the Investment Adviser and its affiliates' interests should generally be excluded when calculating performance for the quarterly statements to prevent the performance from being misleading, and noted as an example that an Investment Adviser's interest in a private fund typically does not pay management fees or carried interest.

The different categories of required performance information must be displayed with equal prominence, and the criteria used and assumptions made in calculating the performance must be prominently disclosed.

Audit Rule - Rule 206(4)-10. The Audit Rule requires all private funds of Registered Advisers to have an annual audit performed by an independent public accountant, satisfying the Advisers Act Custody Rule (Rule 206(4)-2). Registered Advisers will no longer be able to elect surprise examinations instead of an audit for any private fund. This audit must be circulated to current investors within 120 days of the end of the fiscal year (or within 180 days if the private fund is a fund of funds). Legacy Status is not applicable to the Audit Rule.

Adviser-Led Secondaries Rule - Rule 211(h)(2)-2. The Adviser-Led Secondaries Rule requires Registered Advisers to obtain either a fairness opinion or a valuation opinion from an

independent opinion provider when conducting an adviser-led secondary transaction. This opinion must be circulated to investors prior to the due date of the transaction's election form, and it must include a summary of the material business relationship between the fund's Registered Adviser and the independent opinion provider. This rule is intended to check a Registered Adviser's inherent conflict of interest when leading secondary transactions by providing additional information to investors. Legacy Status is not applicable to the Adviser-Led Secondaries Rule.

Compliance Rule Amendment - Rule 206(4)-7. The Rules amend Advisers Act Rule 206(4)-7 (the "Compliance Rule") to require Registered Advisers to document, in writing, an annual review of their compliance policies and procedures, as well as those policies' effectiveness. This Compliance Rule Amendment applies to all Registered Advisers, not only those that manage private funds. The Compliance Date for the Compliance Rule Amendment is November 13, 2023, which is earlier than the other Rules. Legacy Status is not applicable to the Compliance Rule Amendment.

COMPLIANCE DEADLINES

The Compliance Rule Amendment is enforceable on November 13, 2023 for all Registered Advisers. Investment Advisers with less than $1.5 billion of private fund assets under management as of the end of their most recent fiscal year (for most advisers this will be December 31, 2022) will see all other applicable rules come into effect on March 14, 2025. Investment Advisers with $1.5 billion or more of private fund assets under management as of the end of their most recent fiscal year have until September 14, 2024 to comply with the Preferential Treatment, Restricted Activities and Adviser-Led Secondaries rules, and until March 14, 2025, to comply with the Quarterly Statement and Audit Rule.

RECOMMENDATIONS

This alert does not describe many of the nuances of the Rules, which mark a sweeping change to the regulation of private funds. Compliance with the Rules will require thoughtful analysis and will vary depending on the scope of an Investment Adviser's operations.

In anticipation of the applicable Compliance Dates (as outlined above), all Investment Advisers should identify which of their activities will be restricted or prohibited in the future, evaluate what additional disclosures are required for their operations for both current and prospective investors and consider updating their policies and procedures for such changes. In addition, Registered Advisers should prepare to populate a detailed form of quarterly statement for each private fund they advise (in compliance with the specific table requirements under the Quarterly Statement Rule) and plan to engage an auditor to conduct an audit of any private fund that had been relying on surprise exams. Investment Advisers seeking to launch new funds should be mindful of the upcoming Compliance Dates that affect their operations and plan accordingly.

Please contact one of the Shartsis Friese attorneys in the Investment Funds & Advisers Group if you have any questions about your obligations under the Rules.

SHARTSIS FRIESE LLP