U.S. GOVERNMENT ACCOUNTABILITY OFFICE

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Washington, DC 20548

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September 25, 2023

The Honorable Sherrod Brown
Chairman
The Honorable Tim Scott
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Patrick McHenry
Chairman
The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
House of Representatives

Subject: *Securities and Exchange Commission: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (SEC) entitled "Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews" (RIN: 3235-AN07). We received the rule on August 24, 2023. It was published in the *Federal Register* as a final rule on September 14, 2023. 88 Fed. Reg. 63206. The effective date is November 13, 2023.

According to SEC, the final rule is designed to protect investors who directly or indirectly invest in private funds by increasing visibility into certain practices involving compensation schemes, sales practices, and conflicts of interest through disclosure; establishing requirements to address such practices that have the potential to lead to investor harm; and restricting practices that are contrary to the public interest and the protection of investors. SEC also stated the final rule is likewise designed to prevent fraud, deception, or manipulation by the investment advisers to those funds. Specifically, SEC stated the final rule requires registered investment advisers to private funds to provide transparency to their investors regarding the fees and expenses and other terms of their relationship with private fund advisers and the performance of such private funds. SEC additionally stated the final rule also requires a registered private fund adviser to obtain an annual financial statement audit of each private fund it advises and, in connection with an adviser-led secondary transaction, a fairness opinion or valuation opinion from an independent opinion provider. In addition, SEC announced the final rule restricts all private fund advisers, including those that are not registered with the SEC, from engaging in certain activities unless they provide specified disclosure to and, for certain restricted activities, obtain consent from investors. SEC further stated all private fund advisers are also prohibited from providing certain types of preferential treatment that would have a material, negative effect on other

investors, subject to certain exceptions; and other types of preferential treatment to any investor in a private fund, unless the adviser satisfies certain disclosure obligations.

Enclosed is our assessment of SEC's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shari Brewster, Assistant General Counsel, at (202) 512-6398.

Shirley A. Jones
Managing Associate General Counsel

Enclosure

cc: Vanessa A. Countryman
Secretary
Securities and Exchange Commission

ENCLOSURE

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
SECURITIES AND EXCHANGE COMMISSION
ENTITLED
"PRIVATE FUND ADVISERS;
DOCUMENTATION OF REGISTERED INVESTMENT ADVISER COMPLIANCE REVIEWS"
(RIN: 3235-AN07)

(i) Cost-benefit analysis

The Securities and Exchange Commission (SEC) stated that, in analyzing the effects of the final rule, SEC recognizes that investors may benefit from access to more useful information about the fees, expenses, and performance of private funds. SEC also stated investors may also benefit from more intensive monitoring of funds and fund advisers by third parties, including auditors and persons who prepare assessments of secondary transactions. Finally, SEC stated investors may benefit from more specific disclosure and, in some cases, consent requirements involving certain sales practices, conflicts of interest, and compensation schemes that may result in investor harm, and a restriction of certain practices where they are not specifically disclosed or, in some cases, where investor consent is not obtained.

SEC also stated the costs of the final rule. SEC determined the direct costs of the final rule will include the costs of meeting the minimum regulatory requirements of the rule, including the costs of providing standardized disclosures, in some cases obtaining the required investor consent, and, for some advisers, refraining from restricted activities, and obtaining the required external financial statement audit and fairness opinions or valuation opinions. SEC stated additional costs will arise from the new compliance requirements of the final rule. For example, according to SEC, some advisers will update their compliance programs in response to the requirement to make and keep a record of their annual review of the program's implementation and effectiveness. SEC further stated certain fund advisers may also face costs in the form of declining revenue, declining compensation to fund personnel and a potential resulting loss of employees, or losses of investor capital, and some of these costs may be passed on to investors in the form of higher fees. However, some of these costs, according to SEC, such as declining compensation to fund personnel, will be a transfer to investors depending on the fund's economic arrangement with the adviser. SEC additionally determined other indirect costs of the rule may include unintended consequences to investors, such as potential losses of preferential terms for investors currently receiving them (specifically in the case of preferential terms that would not be prohibited if disclosed, but where the adviser does not want to make the required disclosures), and delays in fund closing processes associated with advisers making disclosures of preferential terms.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603–605, 607, and 609

SEC prepared a Final Regulatory Flexibility Analysis. In the Analysis, SEC discussed: (1) the reasons for and objectives of the final rule; (2) significant issues raised by public comments; (3) the legal basis of the final rule; (4) small entities subject to the final rule; (5) projected reporting, recordkeeping, and compliance requirements; and (6) significant alternatives to the final rule.

(iii) Agency actions relevant to sections 202–205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532–1535

As an independent regulatory commission, SEC is not subject the requirements of the Act.

(iv) Agency actions relevant to the Administrative Pay-As-You-Go-Act of 2023, Pub. L. No. 118-5, div. B, title III, 137 Stat 31 (June 3, 2023)

Section 270 of the Administrative Pay-As-You-Go-Act of 2023 amended 5 U.S.C. § 801(a)(2)(A) to require GAO to assess agency compliance with the Act, which establishes requirements for administrative actions that affect direct spending, in GAO's major rule reports. In guidance to Executive Branch agencies, issued on September 1, 2023, the Office of Management and Budget (OMB) instructed that agencies should include a statement explaining that either: "the Act does not apply to this rule because it does not increase direct spending; the Act does not apply to this rule because it meets one of the Act's exemptions (and specifying the relevant exemption); the OMB Director granted a waiver of the Act's requirements pursuant to section 265(a)(1) or (2) of the Act; or the agency has submitted a notice or written opinion to the OMB Director as required by section 263(a) or (b) of the Act" in their submissions of rules to GAO under the Congressional Review Act. OMB, *Memorandum for the Heads of Executive Departments and Agencies,* Subject: Guidance for Implementation of the Administrative Pay-As-You-Go Act of 2023, M-23-21 (Sept. 1, 2023), at 11–12. OMB also states that directives in the memorandum that supplement the requirements in the Act do not apply to proposed rules that have already been submitted to the Office of Information and Regulatory Affairs, however agencies must comply with any applicable requirements of the Act before finalizing such rules.

SEC does not discuss the Administrative Pay-As-You-Go Act of 2023 in the final rule.

(v) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.*

On March 24, 2022, SEC published a proposed rule. 87 Fed. Reg. 16886. SEC received comments and responded to them in the final rule.

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501–3520

SEC determined the final rule contained information collection requirements (ICRs) subject to PRA. The ICRs are Rule 206(4)-10 (OMB Control Number 3235-0795); Rule 211(h)(1)-2 (OMB Control Number 3235-0796); Rule 211(h)(2)-2 (OMB Control Number 3235-0797); Rule 211(h)(2)-3 (OMB Control Number 3235-0798); Rule 206(4)-7 under the Advisers Act (17 C.F.R. 275.206(4)-7) (OMB Control Number 3235-0585); Rule 204-2 under the Advisers Act (17 C.F.R. 275.204-2) (OMB Control Number 3235-0278); and Rule 211(h)(2)-1 under the Advisers Act. SEC provided estimated burdens and costs for the ICRs in the final rule.

Statutory authorization for the rule

SEC promulgated the final rule pursuant to sections 80b-2, 80b-3, 80b-4, 80b-4a, 80b-6, 80b-6a, and 80b-11 of title 15, United States Code.

Executive Order No. 12866 (Regulatory Planning and Review)

As an independent regulatory commission, SEC is not subject the requirements of the Order.

Executive Order No. 13132 (Federalism)

As an independent regulatory commission, SEC is not subject the requirements of the Order.