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# Fifth Circuit Vacates the SEC's Private Fund Adviser Rules – What Now?

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# SEC Private Fund Adviser Rules



- In August 2023, the SEC adopted a new set of private fund adviser rules (Rules) designed to reduce conflicts of interest and protect private fund investors through a variety of disclosure and practice requirements
- In September 2023, industry trade groups brought a petition in the Fifth Circuit, seeking to have the Rules vacated on the basis that the Rules exceeded the SEC's statutory authority, violated the SEC's rulemaking obligations under the Advisers Act, and violated the Administrative Procedure Act
- In June 2024, the Fifth Circuit vacated the Private Fund Adviser Rules in *National Association of Private Fund Managers v. SEC*

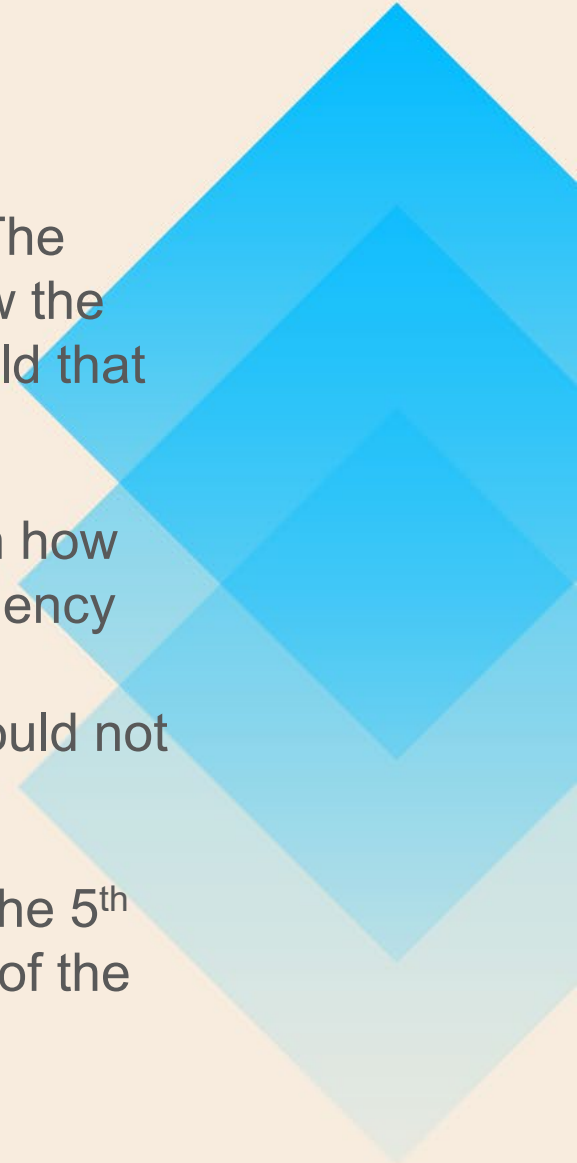
# Fifth Circuit Decision



- The 5<sup>th</sup> Circuit held that the SEC lacked authority to issue the Rules because the statutory provisions it relied on for that authority had to be read in the context of the statute as a whole to cover only “retail customers” and were not rationally related to addressing fraud. “Because the promulgation of the Final Rule was unauthorized, no part of it can stand.”
- The court thus vacated the Rules in their entirety, meaning they are of no force and effect with the issuance of the mandate.
- SEC Appeal Options
  - Deadline to seek rehearing by the 5<sup>th</sup> Circuit panel or the full court has passed.
  - Supreme Court review – must be sought by September 3, 2024 unless the time is extended.

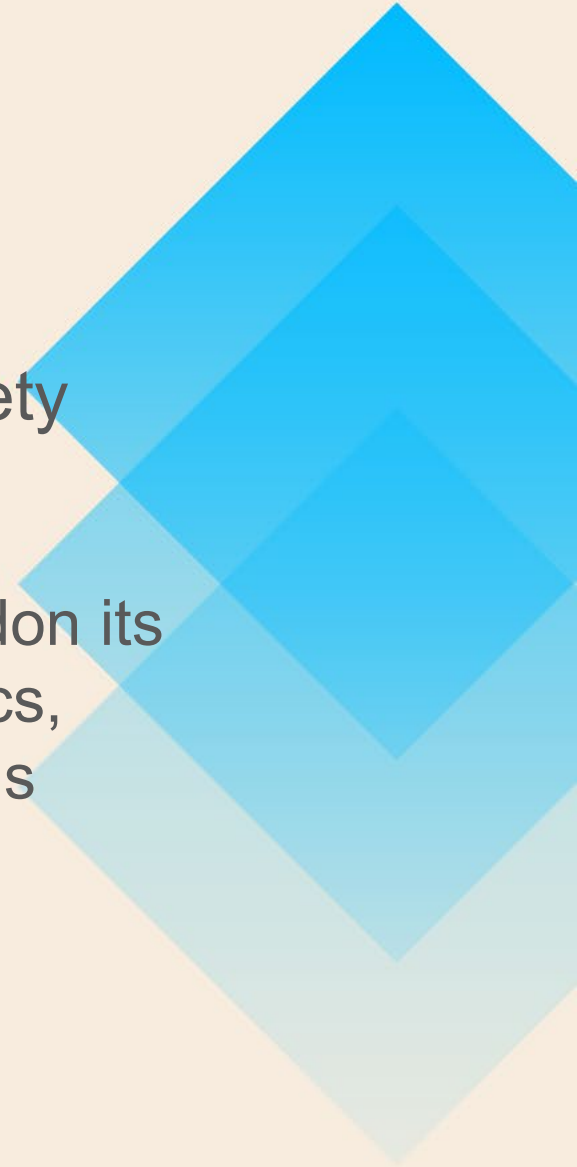
# Potential Next Steps

- SEC cannot repropose the Rules unless it finds another basis of authority. The court's holding was not based on an assertion that the agency failed to follow the proper procedures or to make the proper findings under Section 211(h); it held that Section 211(h) does not provide any authority to issue the Rules.
- SEC's reliance on Section 206(4) was inadequate because it "fails to explain how the Final Rule would prevent fraud." While this would appear to allow the agency to offer a better explanation, the court also held that Section 206(4) "fails to authorize the Commission to require disclosure and reporting," and that it would not "fit the statutory design to use it to regulate private funds."
- Impact of the Presidential Election – the SEC has limited if any room under the 5<sup>th</sup> Circuit's decision and could well drop the effort altogether if the composition of the agency changes, as the vote to adopt the Rules was 3-2.



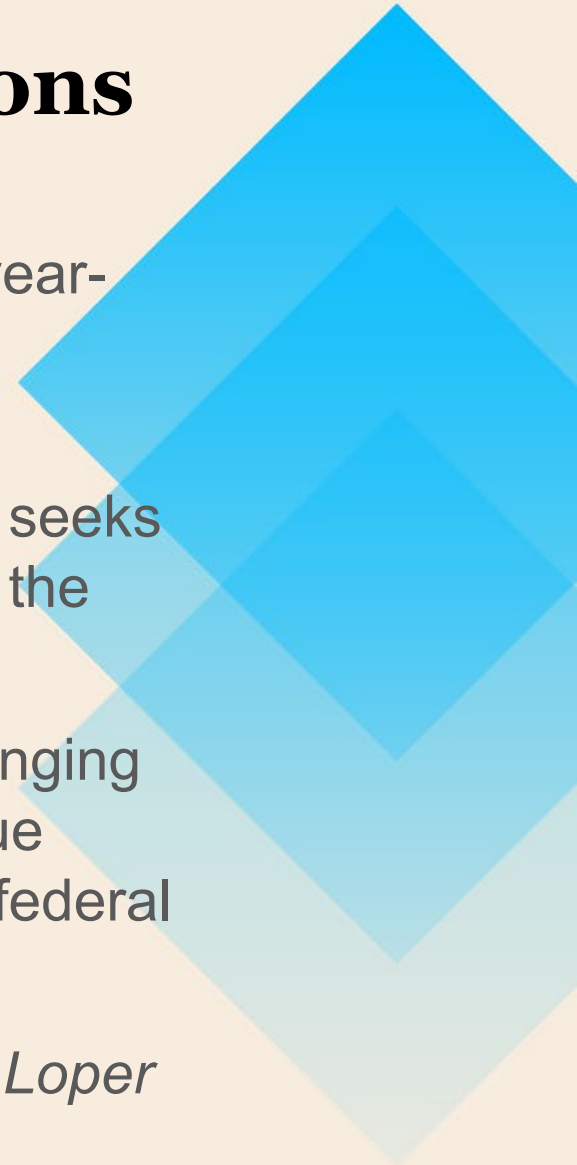
# Industry Reaction

- Relief!
- Many were surprised the Rules were vacated in their entirety
- Trade groups are aiming to expand scope of decision
  - 9 July 2024 letter to SEC arguing that the SEC should abandon its proposed new rules on cybersecurity, predictive data analytics, and investment adviser outsourcing or carve out private funds from the scope of these rules
- Other SEC rules may be up for challenge?



# Increasing Court Scrutiny Of Agency Actions

- *Loper Bright*: on 28 June 2024 the Supreme Court overturned the 40-year-old *Chevron* doctrine, eliminating the requirement that courts defer to agencies' interpretations of ambiguous statutes
- *Jarkesy*: on 27 June 2024 the Supreme Court held that when the SEC seeks civil penalties against a defendant based on claims of securities fraud, the Seventh Amendment entitles the defendant to a jury trial
  - Increased costs and uncertainty could discourage the SEC from bringing “edge” or “novel” cases, but the SEC will certainly continue to pursue enforcement of its anti-fraud regulations even if it has to do so in a federal district court
- The 5<sup>th</sup> Circuit overturned the Private Fund Adviser Rules even before *Loper Bright*, and *Loper Bright* will not make the SEC's task any easier.



# Increasing Court Scrutiny Of Agency Actions

(cont'd)

- Three weeks after overturning the Private Fund Adviser Rules the 5<sup>th</sup> Circuit vacated the SEC's 2022 rescission of its 2020 proxy firm disclosure rule (*Nat'l Ass'n of Manufacturers v. SEC*)
- The court's decision was not based on a lack of statutory authority, but on an asserted failure to explain why the agency was reversing a decision made in the prior administration
- The court held in essence that the agency could not come to a different policy judgment on the same facts



# Increasing Frequency of Change Elections

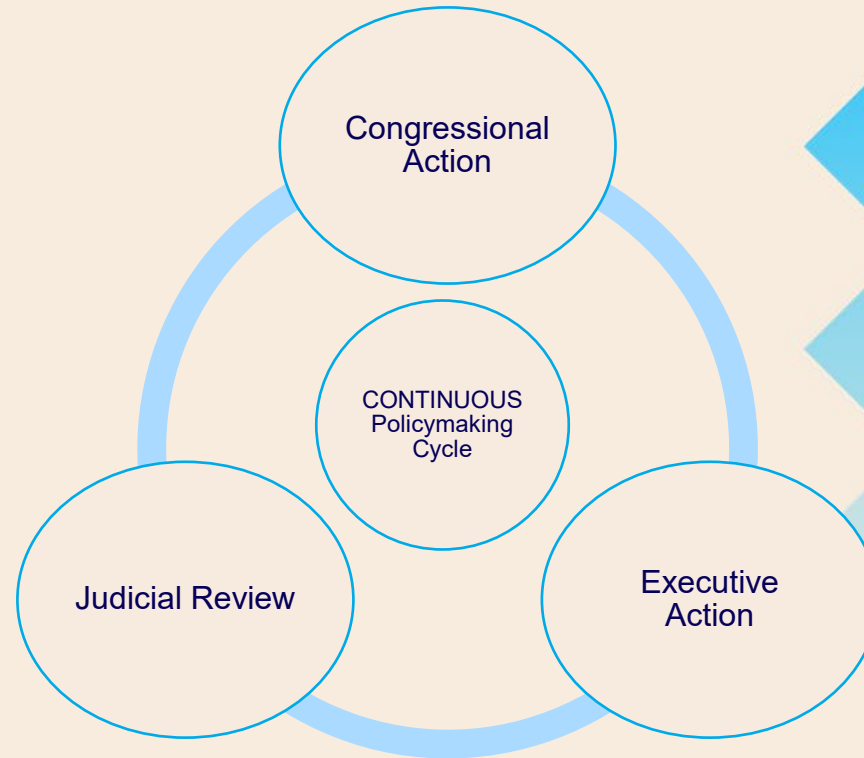
1960	1962	1964	1966	1968	1970	1972	1974	1976	1978
1980	1982	1984	1986	1988	1990	1992	1994	1996	1998

2000	2002	2004	2006	2008	2010	2012	2014	2016	2018
2020	2022	?							

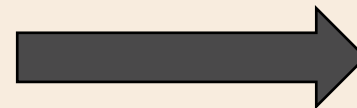
1960-1999: 7 change elections  
Since 2000: 10 change elections



# Continuous Policy Making: Long-term Policy Uncertainty



- DOL Fiduciary Rule
- SEC Climate Risk Disclosure Rule

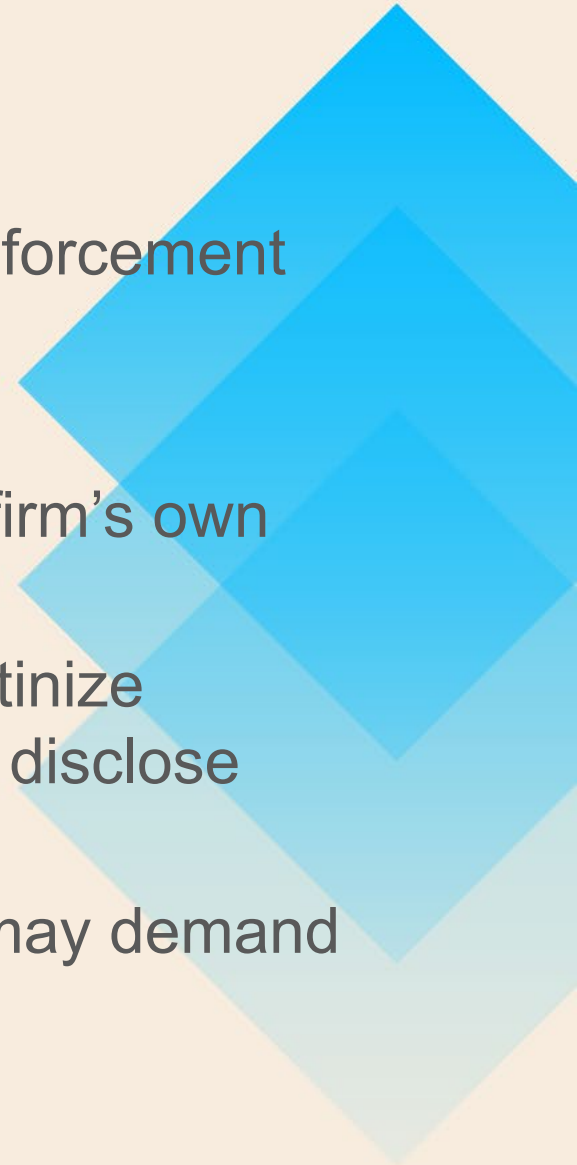


Change in Stakeholder  
Behavior



# Implications

- Examination blueprint – SEC staff will use examinations and enforcement proceedings to get at the same conduct
- Release essentially becomes a long Risk Alert
- Firms cannot violate the vacated Rules, but could violate the firm's own policies and procedures and/or offering documents
- Fiduciary duties – SEC has in the past and will continue to scrutinize adviser conduct under fiduciary obligations, such as the duty to disclose actual or potential conflicts of interest
- Investor relations – certain investors welcomed the Rules and may demand more from advisers
- Some components of the Rules may become best practices



# Practical Takeaways

- Quarterly Reporting
  - Many firms built up their infrastructure for client reporting
  - PFA requirements highlighted diversity of practices
  - Demonstrated the importance of industry standards
  - Spillover to the SEC Marketing Rule
  - Industry practices likely to evolve
    - Investors may ask for new level of detail
    - ILPA Templates



# Practical Takeaways (cont'd)

- Fees and Expenses
  - These are and will remain an SEC examination focus
  - Firms should continue to look at clawbacks, expenses, and fees to ensure your fund documentation provides the correct authority and disclosures are accurate and complete



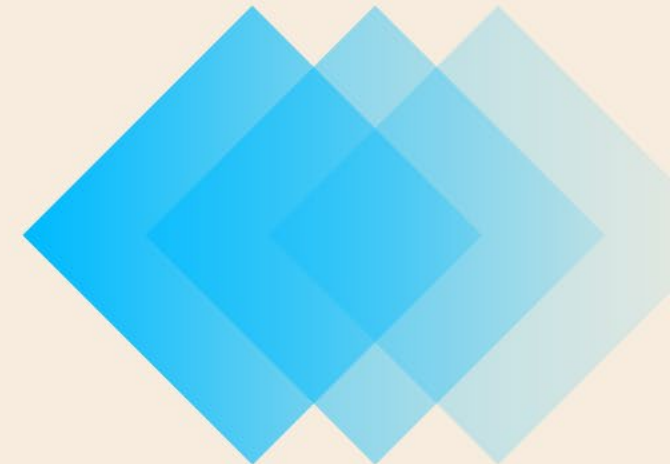
# Practical Takeaways (cont'd)

- Side letter tracking and compliance
  - Review disclosures for undisclosed or improperly disclosed conflicts of interest
- Written Compliance Report
- Private Fund Audit
  - Most private funds already undergo annual audits as part of the Custody Rule
- Adviser-Led Secondaries



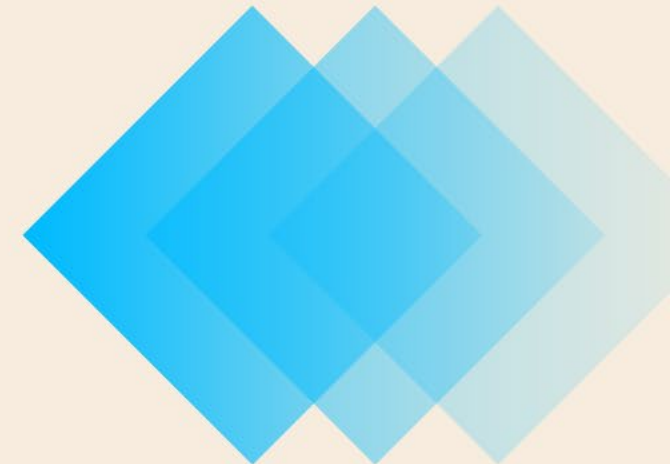
# Resources – K&L Gates

- Sign up for K&L Gates Content [Stay Informed | K&L Gates \(emailcc.com\)](#)
- Consult the K&L Gates Private Fund Adviser Rules Guide to Compliance
- Additional content at The Administrative State: Chevron, Major Questions, and Limits to Regulatory Power
  
- K&L Gates speakers
  - [Pamela A. Grossetti | People | K&L Gates \(klgates.com\)](#)
  - [John Longstreth | People | K&L Gates \(klgates.com\)](#)
  - [Karishma Shah Page | People | K&L Gates \(klgates.com\)](#)



# Resources – CFA Institute

- Subscribe to the GIPS Standards Newsletter
- GIPS Standards website [www.gipsstandards.org](http://www.gipsstandards.org)
  - SEC Private Funds webpage
  - SEC Marketing Rule webpage
- CFA Institute speakers
  - [Ken Robinson Kenneth.Robinson@cfainstitute.org](mailto:Kenneth.Robinson@cfainstitute.org)
  - [Karyn Vincent karyn.Vincent@cfainstitute.org](mailto:karyn.Vincent@cfainstitute.org)
- CFA Institute 28<sup>th</sup> Annual GIPS Standards Conference
  - San Diego, CA
  - September 17-18, 2024
- GIPS Standards Help Desk [gips@cfainstitute.org](mailto:gips@cfainstitute.org)



**Thank You**

