THOMPSON HINE

# Investment Management Update

**June 2024**

## Fifth Circuit Strikes Down SEC Private Fund Adviser Rule

On June 5, the U.S. Court of Appeals for the Fifth Circuit struck down an SEC final rule that would have substantially increased private investment fund adviser and venture capital reporting requirements, holding that the SEC improperly interpreted its authority to regulate this activity.[1]

### Background Legislation

Prior to 2010, there were two key regulations aimed at preventing investment fund fraud and other abuses: the Investment Company Act (ICA) and the Investment Advisers Act (Advisers Act), typically read in tandem. The ICA does not include private funds in its scope, while the Advisers Act created standards requiring advisers to concern themselves with overall fund performance. Historically, private investment funds have not been subjected to the same type of regulation as public funds because private investors are typically regarded as highly sophisticated parties who do not need the same protections as everyday consumers. Following the 2008 financial crisis, the Dodd-Frank Act subjected private advisers to new requirements from which they were previously exempted. Though the SEC based its authority in these prior statutes and Section 206(4) when creating the recent final rule, the Fifth Circuit, largely relying on these same statutes, disagreed.

### Proposed and Final Rules

The SEC proposed a rule in response to its perceived "need to enhance the regulation of private fund advisers to protect investors, promote more efficient capital markets, and encourage capital formation."[2] After a 3-2 vote, the SEC adopted a final rule[3] intended to implement three primary obligations: to prohibit private advisers from giving any investor preferential treatment if it could negatively impact other investors; to prohibit advisers from charging investors fees associated with compliance, regulatory, or investigatory expenses;[4] and to require private fund advisers to provide investors detailed quarterly reports about the fund's performance.

### Fifth Circuit Ruling

Six entities brought suit against the SEC, challenging whether the final rule was a valid exercise of its statutory authority. When analyzing the ICA and the Advisers Act "harmoniously," the court noted that Congress intended to exempt private funds from the same regulation to which public funds are subject and found that authority over private funds cannot be derived from the Advisers Act.[5] Further, the court found that the SEC failed to establish how the alleged acts or practices were fraudulent or manipulative prior to creating the means to prevent such acts or practices.

It is unclear if the SEC intends to appeal this repudiation by the Fifth Circuit. Impacted companies are encouraged to seek competent counsel. Thompson Hine will continue to monitor the rulemaking and update its clients.

### FOR MORE INFORMATION

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[1] *Nat'l Ass'n of Priv. Fund Managers v. SEC*, No. 23-60471, 2024 U.S. App. LEXIS 13645, at *34 (5th Cir. Jun. 5, 2024).
[2] *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, 87 Fed. Reg. 16889-90.
[3] Release No. IA-6383.
[4] This prohibition maintained two exceptions: the disclosure-and-consent-based exception and the disclosure-based exception.
[5] The court's analysis looked specifically to Section 211(h) and to the Dodd-Frank Act, for which it found that the SEC relied on Title IX thereof, when only Title IV pertains to private fund advisers.