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# Four Months Out: Private Fund Advisors Prepare for September Compliance Deadline Amidst Challenge in the Fifth Circuit

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In September 2023, we covered the Rules (Rule) published by the US Securities and Exchange Commission (SEC), developed to promote transparency for investors by increasing visibility into compensation schemes, sales practices, and conflicts of interest.

Read our previous coverage of the Rules here.

The Rule increases the scope of information and disclosures that are universally available to private fund investors, but critics of these rules argue that they impose significant compliance requirements on private fund investment advisors (PF advisors).

The first major compliance deadline under the Rule is fast approaching. In September 2024, PF advisors with over $1.5 billion in assets under management (AUM) will become subject to many of the Rule's requirements. However, the breadth of those requirements may be limited by the US Court of Appeals for the Fifth Circuit, from which we are awaiting a decision on an industry group's challenge of the SEC's authority to enact the Rule.

Below, we provide a brief recap of the various components of the Rule, followed by a summary of the arguments in the Fifth Circuit case and the possible ramifications of the Court's decision.

## The Final SEC Rules

1. **Quarterly Statement Rule:** Requires registered investment advisors to provide certain disclosures in quarterly statements to private fund investors.
2. **Preferential Treatment Rule:** Requires all investment advisors to make certain disclosures

of preferential terms offered to prospective and current investors. With certain exceptions, it prohibits all private fund advisors from providing certain types of preferential treatment that the advisors reasonably expect to have a material negative effect on other investors.

3. **Restricted Activities Rule:** Restricts all private fund advisors from engaging in certain activities, such as certain sales practices, conflicts of interest, and compensation schemes, with respect to the private fund or any investor in that private fund, with certain exceptions for when the advisor satisfies certain disclosure requirements and, in some cases, when the advisor also satisfies certain consent requirements.
4. **Secondaries Rule:** Requires a registered private fund advisor to obtain an annual financial statement audit of a private fund and, in connection with an advisor-led secondary transaction, an independent fairness or valuation opinion.
5. **Amended Advisors Act Compliance Rule:** Imposes Compliance Rule amendments and recordkeeping requirements, including certain requirements that apply to all advisors regardless of AUM.

## The Fifth Circuit Case

*NA of Private Fund Managers v. SEC* (23-60471), (Fifth Cir., 2024)

The Rule imposes financial and logistical burdens and has been met with significant pushback from industry players. In September 2023, private fund trade groups, including the National Association of Private Fund Managers, Alternative Investment Management Association Ltd., American Investment Council and several others (Petitioners), filed a petition for review of the SEC's adoption of the Rules in the Fifth Circuit, and oral arguments were held on February 5. We expect a decision from the Fifth Circuit in late May or June, although the Court is not bound by any timeline. Following the Fifth Circuit's decision, either side could request the Fifth Circuit rehear the case *en banc* or appeal to the US Supreme Court.

A summary of the Petitioners' and the SEC's arguments is provided below.

### 1. Statutory Authority

The Petitioners argue that the Rule exceeds the SEC's statutory authority, as it violates the statutory framework governing private funds. They argue that the statutory basis for the SEC's authority, Section 913 of Dodd-Frank and Section 206(4) of the Advisers Act, is inapplicable as they are intended for the protection of retail customers. However, these funds deal with institutional investors who have the expertise and resources to bargain for themselves. Additionally, the Petitioners argue that the SEC does not possess the authority based on the Major Questions Doctrine, which requires any agency seeking to decide issues of major national significance to have their actions supported by clear congressional authorization. The Petitioners argue that US Congress has not provided a clear authorization for the SEC to regulate an industry that holds more than $26 trillion dollars in assets. However, the SEC argues that Congress did authorize the SEC to adopt the Rule pursuant to section 211(h) as it covers private-fund advisers and investors, and its statutory terms covering five new rules. The SEC also argues that the final rules are a logical outgrowth of the proposed Rule.

### 2. Opportunity for Comment

The Petitioners argue that the SEC did not provide a meaningful opportunity for comment, a key requirement of 5 U.S.C. § 553(c), requiring agencies to provide interested persons a meaningful opportunity to participate in the rulemaking process. The SEC argues that there was, in fact, a

meaningful opportunity provided to participate in the rulemaking process, pointing to the hundreds of comments the SEC received. The SEC argues that it was only after considering these comments that it revised the proposed rules, consistent with the Administrative Procedure Act's (APA) procedural requirements.

**3. Factual Basis**

The Petitioners argue that there is no factual basis for the Rule and its key provisions, and therefore, the Rule is arbitrary, capricious, and otherwise unlawful. They point to the 600 pages of released text and argue that the SEC has not articulated a satisfactory explanation or identified evidence of real problems to warrant imposing such high compliance costs on PF advisors. The SEC argues that it explained its decision for adopting the Rules, which is all that the APA requires, and that it is the Petitioners who have failed to carry the burden to prove that the rules are arbitrary and capricious.

**4. Rule's Impact**

The Petitioners argue that the SEC failed to adequately consider the Rule's impact on efficiency, competition, and capital formation. They argue that in adopting this Rule, the SEC is disrupting a "well-functioning, and competitive market." The SEC argues that it considered the promotion of economic factors as required by the Advisers Act by analyzing quantitative data, stating that the SEC did not need to consider the potential economic impact of pending proposals as the Fifth Circuit had already faulted the US Food and Drug Administration (FDA) for failing to consider preexisting changes to regulations, not the proposed changes.

## Compliance

As the compliance dates approach, the ArentFox Schiff Private Funds team will be monitoring the developments in the Fifth Circuit case and is available to assist at every turn.

*Compliance with these rules varies based on the sub-rule and the size of the advisor. The deadlines based on that criteria are:*

| **Rule** | **Compliance Deadline**<br>*Advisors with $1.5 billion or more AUM* |
|---|---|
| Quarterly Statement Rule | May 14, 2025 |
| Private Fund Audit Rule | May 14, 2025 |
| Secondaries Rule | September 14, 2024 |
| Preferential Treatment Rule | September 14, 2024 |

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| Restricted Activities Rule | September 14, 2024 |
| Amended Advisors Act Compliance Rule | *November 13, 2023* |



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