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The Fifth Circuit Vacates the SEC's Private Fund Rules

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On June 5, 2024, the U.S. Court of Appeals for the Fifth Circuit vacated—in their entirety—the controversial private fund reforms adopted by the Securities and Exchange Commission (the "SEC") in August 2023 (collectively, the "Private Fund Rules").[1] The highly anticipated decision in *National Association of Private Fund Managers, et al., v. SEC*[2] follows oral arguments heard by the Fifth Circuit in February of this year, in which the trade associations that challenged the Private Fund Rules argued that the SEC overstepped the bounds of its statutory authority in passing the Private Fund Rules (for additional detail, please see our preview of the challenge to the Private Fund Rules, *available here*).

In the ruling, the Fifth Circuit determined that the SEC lacked the statutory authority to adopt the Private Fund Rules. The SEC had claimed such rulemaking authority pursuant to Section 211(h) and/or Section 206(4) of the Investment Advisers Act of 1940 ("Advisers Act"). In reaching its conclusion, the Fifth Circuit rejected the SEC's contention that Section 211(h) of the Advisers Act includes authority with respect to private funds and their investors, and instead determined that this section applies more narrowly to rulemakings for "retail customers." In addition, the Fifth Circuit held that the SEC could not rely on Section 206(4) of the Advisers Act to adopt the Private Fund Rules because the SEC did not articulate a "rational connection" between fraud and any part of the Private Fund Rules, and the Private Fund Rules did not fit within the statutory design of the Investment Company Act of 1940 and the Advisers Act.

Why the Decision Matters

The highly anticipated decision by the Fifth Circuit will have significant ripple effects in the industry.

- The Fifth Circuit's decision vacating the Private Fund Rules in their entirety means that, at least for now, fund sponsors and funds will not need to comply with any part of the rules.
    - Private fund sponsors should have the flexibility to re-evaluate or delay compliance workstreams related to the Private Fund Rules (which were set to go into effect for many advisers later this year) while any subsequent litigation or revised rulemakings proceed.

[1] The Private Fund Rules consist of multiple component rules, including the following: the preferential treatment rule, restricted activities rule, quarterly statement rule, adviser-led secondaries rule, audit rule and a rule amendment requiring a written annual compliance program review. Each of these measures was vacated in the Fifth Circuit's decision. For additional detail regarding the Private Fund Rules, please see our summary, *available here*.
[2] National Association of Private Fund Managers, et al., v. SEC, Case No. 23-60471.

- As for future appeals, the SEC could (i) seek a rehearing en banc, meaning the SEC could ask the full Fifth Circuit to determine whether all the judges on the Fifth Circuit, not just the three-judge panel that issued the June 5 ruling, should hear the case, or (ii) petition the Supreme Court to review the case.
- However, it remains to be seen how investors and industry investor groups will react, including whether such groups will seek provisions analogous to those included in the Private Fund Rules as a matter of negotiation despite the rule formally being struck down. Thus, even without the rule, private fund sponsors may face increased pressure from investors to provide additional transparency.
- With a slate of other significant pending rules applicable to private fund advisers (and other registered investment advisers) that have been the subject of considerable commentary, the ruling could have downstream effects on the SEC's timeline for implementation and potential for additional legal challenges.

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