

Client Alert

Investment Funds and Asset Management

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Fifth Circuit Vacates Private Fund Adviser Rules

On Wednesday, the U.S. Court of Appeals for the Fifth Circuit (the “**court**”) held that the Securities and Exchange Commission (“**Commission**”) exceeded its statutory authority when it adopted the Private Fund Adviser Rules (“**PFAR**”) last August. The decision vacates PFAR’s five component rules, rejecting Commission statutory arguments under both Advisers Act Sections 206(4) (anti-fraud) and 211(h) (added to the Advisers Act by the Dodd-Frank Act). The decision also vacates the Commission’s amendment to existing Rule 206(4)-7 regarding documentation of compliance reviews, and recordkeeping rule amendments related to PFAR.

PFAR has thus been vacated in full. The Commission’s potential avenues for appeal are discussed below. Unless the Commission requests extraordinary relief and is granted it, the filing of any such appeal in and of itself would not revive PFAR.

BACKGROUND

PFAR was adopted by the Commission in August 2023 in a 3-2 vote, and included significant disclosure and consent requirements, certain prohibitions regarding redemption and transparency rights, requirements for adviser-led secondaries, and elimination of the surprise examination option for Custody Rule compliance for private funds, among other provisions. Portions of PFAR applied not only to Commission-Registered Investment Advisers, but also to Exempt Reporting Advisers and other investment advisers. See our August 2023 client alert for more background.

REASONING

The petitioners asserted that (1) the Commission exceeded its statutory authority in adopting PFAR, (2) the PFAR final rule is not a logical outgrowth of the rule as proposed, (3) PFAR is arbitrary and capricious under the Administrative Procedure Act, and (4) the Commission failed to adequately consider the final rule’s impact on efficiency, competition, and



capital formation. The court held that the Commission exceeded its statutory authority, and as such, the court did not reach the remaining issues.

With respect to the Commission’s Section 206(4) statutory argument, the court held that the Commission did not articulate a rational connection between the prevention of fraud and PFAR.

With respect to the Commission’s Section 211(h) statutory argument, the court held that the section applies to retail customers and “has nothing to do with private funds.”

The court also distinguished between Congress’ intent concerning public fund regulation and private fund regulation, stating that in adopting divergent schemes under the Investment Company Act and the Advisers Act, “Congress clearly chose **not** to impose the same prescriptive framework on private funds.” [emphasis in original]

NEXT STEPS

The Commission can request an *en banc* rehearing with the full Fifth Circuit or petition the U.S. Supreme Court for *certiorari*. Because the court vacated PFAR, that rule is not in effect. If the Commission petitions for rehearing or *certiorari*, the new status quo—the rule is vacated and not in effect—would normally remain pending any further judicial review. While the Commission could potentially request an immediate stay of the court’s decision and seek to have PFAR go into effect pending further judicial review, such immediate relief would be extraordinary.

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