

# Client Alert

Investment Funds and Asset Management

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## What Does a Second Trump Administration Mean for the Private Funds Industry?

The incoming Trump administration will bring significant changes to regulatory policy as it relates to the asset management industry, and private funds, in particular.

In this note we explore four areas of private funds regulation and consider impacts heralded by a change in administration:

- SEC rulemaking;
- IRS carried interest tax policy;
- Cryptocurrency policy; and
- ESG rulemaking.

### I. SEC RULEMAKING

The Trump administration will soon take control of the SEC, and indications are the administration will implement an affirmatively deregulatory SEC regime. Looking at recent SEC initiatives and the outstanding agenda, we discuss below four main areas where SEC regulation will change: the Private Funds Rule, the Marketing Rule, the Safeguarding Rule, and the requirement for registered investment advisers and exempt reporting advisers to adopt AML policies and procedures.

#### 1.1 Private Funds Rule

In August 2023, the SEC adopted a significant set of Private Fund Reform Rules that included significant changes to disclosure and new requirements for private fund advisers.<sup>1</sup> The adopted rules included specific prohibitions on specified adviser charges and relationships, as well as prohibitions on granting rights or giving information to an investor if such action may have negative effects on other investors. The adopted

rules also included a statement requirement and required audits for private funds. In June 2024, the 5<sup>th</sup> Circuit Court of Appeals struck down these rules

In our view, it is unlikely that the SEC under the Trump administration will seek to reinstate the rules in any meaningful way.

### **1.2 Marketing Rule**

In late 2020, the SEC overhauled the Marketing and Solicitation Rules for registered investment advisers. This significant change instituted required changes to advisers' public communications through additional mandatory disclosure requirements and principles.<sup>2</sup> Since adoption, the SEC has principally engaged in efforts to provide clarity on how advisers can comply with the rule through guidance—and sometimes through examinations and enforcement action.

Given industry views and statements about the burdens of the new rule, this is an area where a reconstituted SEC may explore deregulatory changes.

### **1.3 Safeguarding Rule**

The proposed Safeguarding Rule incorporates requirements for investment advisers on how they hold specific client assets. The SEC has proposed a pending overhaul of the existing Custody Rule that will have significant consequences for both private fund managers and the custodians of fund assets. The Safeguarding Rule would, among other things: expand the ambit of the rule to all client assets, regardless of form; require advisers to maintain custody of assets with a qualified custodian; require qualified custodians to provide assurances to advisers regarding custody practices; modify rules relating to custody of privately offered securities; and amend adviser recordkeeping and disclosure rules in connection with custody of client assets.

The Safeguarding Rule is a high priority for the SEC under the current administration. One possibility is that the rule will be approved during the "lame-duck" period before the change in administration. If that were to occur, it is an open question as to whether the new administration will thereafter reverse or revise the rule.

Alternatively, as we feel is more likely, if the proposed rule is not adopted by January 2025, we would expect deceleration or complete termination of the proposed rule's momentum. There could be additional review which will slow down adoption of the rule, a request for additional comment, or the proposed rule could be pulled or reduced in scope, in line with the incoming Trump administration's deregulatory approach.

### **1.4 AML Rule**

In conjunction with the SEC, the Treasury Department's Financial Crimes Enforcement Network has adopted a rule that will implement anti-money laundering requirements for registered investment advisers.<sup>3</sup> The rule will create, among other things, the requirement for registered investment advisers and SEC-exempt reporting advisers to establish and maintain anti-money laundering policies and procedures, including enhanced AML due diligence requirements for RIAs.

Given the political imperatives surrounding financial institution prevention of money laundering and terrorist financing, we speculate that the incoming Trump administration will maintain implementation of this rule.

## **II. IRS CARRIED INTEREST TAX POLICY**

With respect to taxing carried interest, the incoming Trump administration is less likely to tax carried interest than the current Biden administration. Further, given the 2021 implementation of a three-year holding period as a precondition to recognizing long-term capital gains on carried interest due to investment professionals, we do not believe that

modifying regulation relating to taxation of carried interest is something the Biden administration intends to do before leaving office. However, it is important to note there are provisions in the Republican passed Tax Cuts and Jobs Act of 2017 that are less friendly to non-taxation of carried interest. In case the incoming Trump administration is looking to offset new or extended tax cuts, some of these anti-carried interest provisions may be extended.

### **III. CRYPTOCURRENCY POLICY**

The incoming Trump administration has expressed an openness and desire to accommodate cryptocurrency and blockchain-based assets as an affirmative policy of the new administration. This is in stark contrast to the Biden administration, where the SEC took numerous enforcement measures against cryptocurrency products and exchanges. If the Trump administration follows through on permissive cryptocurrency policy, a separate regulatory framework for cryptocurrency will have to be designed and implemented. This would involve questions of whether and when cryptocurrency is a security or a commodity, and the accompanying SEC / CFTC regulations that would result. Given the prominence that President-elect Trump himself gave to cryptocurrency as he was campaigning, we anticipate the implementation of affirmative policy will be a priority in his administration. There is also an open question as to how Federal agencies, especially the SEC, handle outstanding litigation against companies in the cryptocurrency industry.

### **IV. ESG RULEMAKING**

The Trump administration and its allies have indicated a significant break from the Biden administration on ESG rulemaking. The Biden administration took steps to promote ESG rulemaking, including adopting prominent public company disclosure rules that have been stayed pending challenges in the courts. The SEC under the incoming Trump administration will likely rewrite, repeal, or amend the SEC rules with policy geared towards less stringent or even outright prohibition of ESG requirements.

With respect to private funds, there may also be a dichotomy that emerges between US rules, and European fund rules, such as Sustainable Finance Disclosure Regulation, or SFDR. A challenge for the incoming administration will be managing regulatory policy in a circumstance where U.S. and global fund managers are subject to conflicting ESG regulatory frameworks. It is even possible that SEC guidance will dissuade emphasis on ESG standards by fund managers, in direct contrast to EU regulation.

#### **4.1 ESG Rulemaking and ERISA**

On October 30, 2020, under the Trump administration, revised 29 CFR 2550.404a-1- the key Department of Labor ("DOL") regulation that addresses fiduciary duties of prudence and loyalty. In connection with that rulemaking, the DOL provided that a fiduciary may only consider pecuniary factors (i.e., factors that could have a material effect on the risk or return of an investment). Non-pecuniary factors could only be considered when a plan fiduciary is unable to distinguish between investment options based on pecuniary factors alone. In the preamble to that regulation, the DOL suggested that that such a circumstance would be rare.

On November 2022, under the Biden administration, the DOL revised this rule - specifically recognizing that ESG related factors could be relevant to the risk and/or return of an investment. This revised rule further provided that a fiduciary could determine any factors it reasonably determines to be relevant to a risk-return analysis and relaxed the circumstances when a collateral factor could be used in connection with making investment decision. Nonetheless, a fiduciary still could not "accept expected reduced returns or greater risks to secure such" collateral benefits.

This back-and-forth between the level of consideration that could be given to factors that may not be purely related to economic risk and return has been occurring since the Bush administration - with less formal guidance (e.g., Field Assistance Bulletins). However, the Trump administration sought to really restrict the consideration of ESG-related

factors by revising a regulation. The Biden administration then revised the same regulation just two years later. We can make an educated guess that the Trump administration will try to return to the regulation it finalized in October 2020.

## V. NEXT STEPS

As mentioned above, the incoming administration's approach with private fund regulatory matters promise to follow a deregulatory approach. We are watching carefully.

Our team would be glad to discuss any items of interest for your team.

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<sup>1</sup> King & Spalding, Client Alert, "SEC Adopts Private Fund Reform Rules", August 25, 2023. [August 2023 Client Alert](#).

<sup>2</sup> King & Spalding, Client Alert, "SEC Investment Adviser Marketing Rule: Compliance Date is Nov. 4, 2022", March 22, 2022. [March 2022 Client Alert](#).

<sup>3</sup> King & Spalding, Client Alert, "FinCEN Issues Final Rule Expanding Anti-Money Laundering/ Countering the Financing of Terrorism Requirements for Investment Advisers", September 9, 2024. [September 2024 Client Alert](#).