

U.S. Court of Appeals vacates the SEC's private fund advisers rule

June 5, 2024 | Client Update | 3-minute read

In a closely watched case, the U.S. Court of Appeals for the Fifth Circuit struck down in its entirety the SEC's new private fund advisers rule on the grounds that the rule exceeded the SEC's statutory authority in a win for the private funds industry. The rule imposed several new requirements on private fund advisers which many industry participants have argued significantly, and unnecessarily, increase compliance obligations and costs of private fund advisers.

On June 5, 2024, a three-judge panel on the U.S. Court of Appeals for the Fifth Circuit [unanimously ruled](#) to vacate the SEC's new rules and amendments under the Investment Advisers Act of 1940 (the Advisers Act) that targeted private fund advisers (the Rule). The Rule, adopted by the SEC in August 2023, included several new requirements on private fund advisers, including requirements related to restricted activities, preferential treatment, quarterly statements, private fund audits and adviser-led secondaries.

The SEC had stated at the time of adoption that the Rule was designed to increase investor transparency in to the practices of advisers to private funds in which third parties invest. Many industry participants have argued that the Rule significantly, and unnecessarily, increases compliance obligations and costs of private fund advisers.

In ruling in favor of the private fund industry group plaintiffs, the Fifth Circuit sided with the argument that Section 211(h) of the Advisers Act (adopted in connection with the Dodd-Frank Act of 2010) does not expand the SEC's authority to regulate the relationships between private fund advisers, their private funds and the funds' third-party investors to the extent cited by the SEC. In addition, the Fifth Circuit ruled that the SEC's reliance on the anti-fraud provisions of Section 206(4) of the Advisers Act to adopt the Rule was "pretextual" and that the SEC had failed to articulate a "rational connection" between fraud and any part of the adopted Rule.

For both of those reasons, the Fifth Circuit concluded that the SEC "exceeded its statutory authority in adopting" the Rule and that, because the adoption of the Rule was unauthorized in its entirety, "no part of it can stand." Accordingly, the Fifth Circuit fully vacated the Rule.

The Fifth Circuit's ruling is a significant victory for private fund adviser advocacy groups and advisers themselves that have maintained that the Rule unduly proscribes the contractual relationships between private funds and sophisticated investors and places too much compliance burden on private fund advisers. In addition, the Fifth Circuit's interpretation of the scope of Section 206(4) may have implications for other rulemaking adopted by the SEC in reliance on Section 206(4) in the past and may constrain the ability of the SEC to adopt certain regulatory measures in the future.

It remains to be seen whether the SEC will petition for a rehearing by the Fifth Circuit or appeal to the U.S. Supreme Court.

For further information about the now vacated Rule, please see [our client update](#) from September 2023.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Leor Landa

+1 212 450 6160
leor.landa@davispolk.com

Gregory S. Rowland

+1 212 450 4930
gregory.rowland@davispolk.com

Michael S. Hong

+1 212 450 4048
michael.hong@davispolk.com

Lee Hochbaum

+1 212 450 4736
lee.hochbaum@davispolk.com

Sijia Cai

+1 212 450 3071
sijia.cai@davispolk.com

Jennifer Grant Cooper

+1 212 450 4492
jennifer.cooper@davispolk.com

Benjamin Milder

+1 212 450 3171
benjamin.milder@davispolk.com

Krishnakshi (Kris) Das

+1 650 752 2067
kris.das@davispolk.com

Michael W. Brasher

+1 212 450 3139
michael.brasher@davispolk.com

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