

**No. 23-60471**

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**IN THE UNITED STATES COURT OF APPEALS  
FOR THE FIFTH CIRCUIT**

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NATIONAL ASSOCIATION OF PRIVATE FUND MANAGERS;  
ALTERNATIVE INVESTMENT MANAGEMENT ASSOCIATION, LIMITED;  
AMERICAN INVESTMENT COUNCIL; LOAN SYNDICATIONS AND TRADING  
ASSOCIATION; MANAGED FUNDS ASSOCIATION; NATIONAL VENTURE  
CAPITAL ASSOCIATION,

*Petitioners,*

v.

SECURITIES AND EXCHANGE COMMISSION,

*Respondent.*

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On Petition for Review of an Order of the  
Securities & Exchange Commission

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**BRIEF OF *AMICUS CURIAE* SECURITIES INDUSTRY  
AND FINANCIAL MARKETS ASSOCIATION  
IN SUPPORT OF PETITIONERS**

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**CERTIFICATE OF INTERESTED PERSONS AND  
CORPORATE DISCLOSURE STATEMENT**

In accordance with Fifth Circuit Rule 28.2.1, counsel for *amicus curiae* Securities Industry and Financial Markets Association certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. Those representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

Further, pursuant to Federal Rule of Appellate Procedure 26.1, counsel certifies that the Securities Industry and Financial Markets Association is a nonprofit corporation. It is not publicly owned and has no parent corporation.

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## INTEREST OF *AMICUS CURIAE*

The Securities Industry and Financial Markets Association (SIFMA) is the leading securities industry trade association for broker-dealers, investment banks, and asset managers operating in the capital markets. SIFMA serves as an industry-coordinating body to support and promote a strong financial industry, fair and orderly markets, informed regulatory compliance, efficient market operations, and trust and confidence in the financial markets. SIFMA routinely files *amicus* briefs in cases that are important to its members and to the functioning of the financial markets.<sup>1</sup>

The Securities and Exchange Commission (SEC) rule at issue imposes sweeping regulations on private fund advisers, contrary to Congress's longstanding hands-off approach to offerings made to sophisticated investors. Congress has for decades preferred a contract-based model through which advisers, acting on behalf of private funds, negotiate mutually agreeable terms with sophisticated individual investors. But now the SEC has decided to upend that regime, which will hamstring private fund advisers

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<sup>1</sup> No party or counsel for a party authored this brief in whole or in part and no person other than *amicus curiae*, its members, or its counsel has made any monetary contribution intended to fund the preparation or submission of this brief. See Fed. R. App. P. 29a(4)(E). All parties have consented to the filing of this brief.

and ultimately hurt the funds' investors. *Amicus* therefore has a substantial interest in the outcome of this case.

## **INTRODUCTION AND SUMMARY OF ARGUMENT**

Private funds are the investment vehicles of choice for sophisticated investors that seek customized, flexible investment options. Private funds play a vital role in the capital markets by providing capital to privately held companies and start-ups and improving the accuracy of valuations for over- and underpriced securities. Investors increasingly have recognized that private funds offer unique opportunities to diversify portfolios. Since 2013, private capital markets have more than doubled in gross asset value to \$26 trillion.

Congress has long exempted private funds from regulations placed on securities offered to the general public. Securities and investment advisers available to the general public are subject to extensive regulation to protect retail investors. In contrast, private fund advisers operate on a contract-based model through which they act on behalf of private funds to negotiate mutually agreeable terms with sophisticated individual investors. That model allows private funds to tailor their offerings to the specific needs of different investors. It also reflects Congress's understanding that allowing institutional investors or high net-worth individuals to negotiate their own

terms with private funds best promotes the development of successful investment strategies.

The private fund advisers rule (the Rule), 88 Fed. Reg. 63,206 (Sept. 14, 2023), imposes sweeping reporting and disclosure obligations on private fund advisers. The Rule has many problems. First and most importantly, Congress never gave the SEC the statutory authority to impose the requirements in the Rule. Neither of the two statutory provisions on which the SEC relies gives the SEC authority to start regulating the relationship between investors and private fund advisers. If Congress had intended to change its whole approach to regulation of private funds, it would have said so expressly.

The Rule also is arbitrary and capricious for several reasons. The SEC does not provide a reasoned explanation for extending protections for retail investors to sophisticated investors. The institutional and high net-worth investors that choose private funds already negotiate the terms that are important to them. The system has been working well for decades. Further, not only does the Rule impose onerous disclosure requirements, but it extends them to unrelated entities within the same corporate family as a private fund adviser. The SEC provided no sufficient justification for that related-person provision. Finally, the SEC's analysis of the Rule's economic

impacts failed entirely to account for the cumulative effects that its actions will have on private funds, their advisers, and investors.

This Court should vacate the Rule.

## ARGUMENT

### **I. Congress’s Hands-Off Approach To Private Funds Has Provided Critical Value To Investors And Has Allowed Capital Markets To Flourish**

#### **A. Congress Chose A Hands-Off Approach To Private Funds To Facilitate Innovative Capital Formation**

Private funds are pooled investment vehicles that are not offered to the general public. Congress deliberately chose not to subject private fund advisers to heavy regulation because private funds are limited to sophisticated investors who have both the knowledge and resources to negotiate favorable terms to protect their interests.

That decision traces back to the Investment Advisers Act of 1940, Pub. L. No. 76-768, 54 Stat. 847, which Congress “designed to eliminate certain abuses in the securities industry” that “contributed to the stock market crash of 1929 and the depression of the 1930’s,” *SEC v. Cap. Gains Research Bureau, Inc.*, 375 U.S. 180, 186 (1963). The Advisers Act required advisers who offered services to the general public to register with the SEC. *See* Title II, § 203, 54 Stat. at 850. Congress required that registration so that the SEC could “better respond to, initiate, and take remedial action on complaints” about fraud on members of the public. *Goldstein v. SEC*, 451 F.3d

873, 876 (D.C. Cir. 2006). The Advisers Act specifically exempted from the registration requirement any adviser “who does not hold himself out generally to the public.” Title II, § 203, 54 Stat. at 850.

So from the beginning, Congress treated advisers who do not serve the general public differently from those who do. That distinction was the genesis of the current contract-based model for private fund advisers, where the advisers act on behalf of private funds to negotiate with investors mutually acceptable terms for the distribution of profits, the timing of investment withdrawals, the metrics for calculating bonuses, the frequency and form of disclosures, and other contract terms.

Congress’s decision to focus regulatory efforts on public-facing advisers, rather than private fund advisers, also is reflected in the Investment Company Act of 1940, Pub. L. No. 76-768, 54 Stat. 789, which set out what qualifies as a private fund. The Investment Company Act authorizes the SEC to regulate an “investment company” engaged in “the business of investing, reinvesting, or trading in securities.” 15 U.S.C. § 80a-3(a)(1)(A). However, Congress exempted funds with securities owned by 100 or fewer people that did not offer their securities to the public. Title I, § 3, 54 Stat. at 798.

As a result, the Act prescribed a “rigid, proscriptive and highly constraining framework for regulating” investments available to the public, but exempted investments “available only to sufficiently wealthy individuals



and large institutions.” Letter from Former Chairs, Commissioners, and Employees of the U.S. Sec. and Exch. Comm’n, to Vanessa Countryman, Secretary, U.S. Sec. and Exch. Comm’n 3 (Apr. 25, 2022), <https://bit.ly/45FxW9X> (*Former Chairs Letter*). Congress distinguished the public securities market and private funds because investors “with a very high degree of sophistication . . . are readily able to negotiate for the terms that are important to them.” *Id.* at 4.

Congress later added another exemption to allow private funds to have more than 100 investors. *See* 15 U.S.C. §§ 80a-2(a)(51), 80a-3(c)(7). In so doing, Congress recognized that “financially sophisticated investors are in a position to appreciate the risks associated with investment pools that do not have the Investment Company Act’s protections.” S. Rep. No. 104-293, at 10 (1996). At the time, the SEC supported that change. *Securities Investment Promotion Act of 1996: Hearing on S. 1815 Before the S. Comm. On Banking, Housing, & Urban Affairs*, 104th Cong. 28-35 (1996) (statement of Arthur Levitt, Chairman, U.S. Sec. and Exch. Comm’n).

Even after the 2008 global financial crisis, Congress still chose to maintain different regulatory regimes for the public securities market and private funds. Title IV of the Dodd-Frank Wall Street Reform And Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), eliminated the broad registration exemption for private fund advisers and required them to submit reports on their assets under management, 15 U.S.C.

§§ 80b-3(m), 80b-4(b). But Congress added new exemptions for advisers to venture capital funds and advisers of all private funds that managed less than \$150 million in assets. *Id.* § 80b-3(l), (m).

Significantly, Congress never attempted to regulate the terms of contracts between private funds and fund investors. In fact, it clarified that a private fund adviser's client is the fund itself, not the investors in the fund, so an adviser's fiduciary duty is to the fund, not investors. *See* 15 U.S.C. § 80b-11(a); *Goldstein*, 451 F.3d at 880-82. Congress thus continued to allow institutional investors that are "highly sophisticated in financial matters" to "negotiate for themselves the terms and conditions governing their investments." *Former Chairs Letter* 2-3.

For many years before the Rule at issue, the SEC recognized and embraced Congress's approach. For example, the SEC adopted Rule 144A to enable private companies to raise capital outside the highly regulated public-offering process. 55 Fed. Reg. 17,933 (Apr. 30, 1990). Rule 144A allows issuers to offer fixed-income securities to "qualified institutional buyers," *i.e.*, entities that invest at least \$100 million in securities, without public disclosure. 17 C.F.R. § 230.144A(a)(1), (d)(1). Thus, in exchange for access to a limited number of sophisticated institutional investors, issuers of Rule 144A securities remain exempt from public-disclosure requirements. The SEC thus has long understood Congress's direction that sophisticated investors need less regulatory protection than members of the general public.

**B. The Contract-Based Model Is Fundamental To Attracting Certain Investors And Maintaining Well-Functioning Capital Markets**

Private funds are important to the U.S. economy. In recent years, private funds have become key investment options for institutional investors, including employee benefit plans and retirement funds, and university endowments. See Morgan Stanley, *Public to Private Equity in the United States: A Long-Term Look* 4 (Aug. 4, 2020), <https://bit.ly/3FrXtZz> (*Public to Private Equity*). Between 1998 and 2018, the net asset value for private equity, private real estate, and private debt funds increased 15-fold. See Ernst & Young and Inst. for Private Capital, *A New Equilibrium: Private Equity's Growing Role In Capital Formation And The Critical Implications For Investors* 2 (Oct. 2019), <https://bit.ly/46V4mhC>. Today, investments in private funds are valued at \$26.6 trillion, 88 Fed. Reg. at 63,207, and account for approximately 70% of new capital investments, 85 Fed. Reg. 17,956, 17,957 (Mar. 31, 2020); *Public to Private Equity* 4.

This growth has been fueled by investors seeking the freedom to negotiate innovative and flexible investment contracts. See Letter from Sec. Industry and Fin. Mkts. Ass'n, to Vanessa Countryman, Secretary, U.S. Sec. and Exch. Comm'n 3 (Apr. 25, 2022), <https://bit.ly/3Sal9cA> (*SIFMA Letter*).

Funds available to the general public do not tailor investment terms to individual investors. See Elisabeth de Fontenay & Yaron Nili, *Side Letter Governance*, 100 Wash. U. L. Rev. 907, 921 (2023). In contrast, private funds have the freedom to accommodate investors seeking to negotiate, for example, how proceeds are distributed, when investments can be withdrawn, and how compensation clawbacks are calculated. See *id.*; *SIFMA Letter 3*; 24A William M. Prifti, *Securities Pub. & Priv. Offerings* § 6.3 (2d ed. 2023). Those negotiations between highly sophisticated parties can be complex. Attorneys and financial experts on both sides bargain for terms based on their market predictions and tolerance for risk. See Letter from Managed Funds Ass'n, to Vanessa Countryman, Secretary, U.S. Sec. and Exch. Comm'n 12 (Apr. 25, 2022), <https://bit.ly/46RBBTB>. And because a nearly limitless combination of terms are possible, innovation flourishes.

The flexibility to negotiate innovative investment terms benefits investors. Private funds enable investors to diversify their portfolios with products not available to retail investors that carry the chance for higher returns, fixed-income-type products that have steadier rates of return, and other products that have the potential to produce returns not correlated to the broader capital markets. See Cary Martin Shelby, *Privileged Access to*

*Financial Innovation*, 47 Loy. U. Chi. L.J. 315, 318-19 (2015); *SIFMA Letter 3*. Institutional investors thus are able to assemble tailor-made portfolios that seek to maximize returns and hedge against risk. Institutional investors' increased asset allocations to private markets is a testament to their preference for these flexible investment options. *See Public to Private Equity 4*.

Private funds also play an important role in capital markets more broadly. For instance, hedge funds help provide price discovery in public markets – *i.e.*, identify accurate prices for assets – by researching mispriced securities that they buy or sell. *SIFMA Letter 3*. Private equity funds and venture capital funds provide funding and management expertise to those who cannot access other sources of capital, such as privately held companies seeking to pivot from financial stress and start-ups trying to scale their operations. *Id.*; Kelli A. Alces, *Legal Diversification*, 113 Colum. L. Rev. 1977, 2014-15 (2013). Private funds also can be structured as collateralized loan obligations that provide debt financing for companies and consistent fixed-income returns for investors. *SIFMA Letter 3*; Letter from Loan Syndications and Trading Ass'n, to Vanessa Countryman, Secretary, U.S. Sec. and Exch. Comm'n 5, Ex. A at 6-7 (Apr. 25, 2022), <https://bit.ly/3smEX1J>.

In short, the existing contract-based model has allowed private funds to design products that meet the specific needs of sophisticated investors and has improved capital markets. The future success of private funds depends on the continued ability of advisers and sophisticated investors to negotiate investment terms that best suit their specific needs.

## **II. The Rule Is Invalid**

### **A. The SEC Lacks The Authority To Regulate The Relationship Between Investors And Private Fund Advisers**

Congress has repeatedly exempted private funds from the extensive SEC regulation and disclosure requirements imposed on securities available to retail investors. The SEC previously accepted that regulatory distinction and focused its rulemaking efforts on the public securities market. But now the SEC has tried to regulate the relationship between investors and private fund advisers for the first time. It simply does not have the authority to do so.

The SEC relies on Sections 206(4) and 211(h) of the Advisers Act, contending that they authorize it to regulate the relationship between private fund advisers and investors. Neither provision does. Those ancillary provisions do not give the SEC the broad authority that it claims to “alter the fundamental details” of Congress’s chosen regulatory scheme. *Whitman v. Am. Trucking Ass’ns*, 531 U.S. 457, 468 (2001).

**1. Section 206(4) of the Advisers Act does not provide authority for the Rule**

Congress enacted Section 206(4) in 1960 to authorize the SEC to target fraud. It authorizes the SEC to “prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.” 15 U.S.C. § 80b-6(4).

The SEC takes the view that Section 206(4) authorizes the Rule because it requires disclosure of potential and actual conflicts of interest, which “decreases the likelihood that investors will be defrauded.” 88 Fed. Reg. at 63,216. The SEC also suggests that the Rule’s disclosure requirement for certain adviser activities will “prevent fraud, deception, or manipulation.” *Id.*

Section 206(4) does not allow the SEC to fundamentally alter Congress’s decision to treat the public securities market and private funds differently. Section 206(4) is specific about the types of regulation it permits. The SEC may “prescribe means reasonably designed to prevent” fraud, deception or manipulation by any investment adviser. 15 U.S.C. § 80b-6(4). Now, for the first time, the SEC has invoked Section 206(4) not to target fraud or deception, but instead to require quarterly disclosures and regulate all contracts between investors and private funds. If Congress had “wished to assign” that broad power to the SEC, it “would have done so expressly,”

*King v. Burwell*, 576 U.S. 473, 486 (2015), not through the “subtle device” of Section 206(4), *MCI Telecommc’ns Corp. v. American Tel. & Tel. Co.*, 512 U.S. 218, 231 (1994).

The lack of express authority under Section 206(4) to establish the wide-ranging regulatory regime envisioned by the SEC is especially glaring in light of Congress’s decision not to subject private funds to the heavy regulations applicable to funds available to the general public. Yet that is exactly what the Rule does. It creates extensive disclosure and audit requirements akin to the requirements that apply to registered funds. *Compare* 17 C.F.R. §§ 275.206(4)-10, 275.211(h)(1)-2, *with id.* §§ 270.8b-16, 270.30e-1. The same is true of the Rule’s prohibition on charging fees and expenses to private funds without disclosure or consent. *Compare* 17 C.F.R. § 275.211(h)(2)-1, *with* U.S. Sec. & Exch. Comm’n, *Form N-1A*, <https://bit.ly/49v0G8L> (requiring fee disclosure at Item 3).

As one of the dissenting Commissioners explained, the Rule undermines an “essential characteristic” of the dual regulatory schemes that Congress created. *MCI Telecommc’ns*, 512 U.S. at 231; *see* Commissioner Hester M. Peirce, U.S. Sec. and Exch. Comm’n, *Uprooted: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews* (Aug. 23, 2023), <https://bit.ly/3Sc58ml> (*Peirce Dissent*). Section 206(4) is



narrowly focused on regulations “reasonably designed to prevent” fraud, 15 U.S.C. § 80b-6(4), and it does not give the SEC broad permission to “impose a retail-like framework” on private funds, *Peirce Dissent*. Section 206(4) thus does not provide a statutory basis for the Rule.

**2. Section 211(h) of the Advisers Act does not provide authority for the Rule**

The SEC also relied on Section 211(h) of the Advisers Act to promulgate the Rule. Congress enacted Section 211(h) in the Dodd-Frank Act to strengthen protections for retail investors. *See* 124 Stat. at 1822-1955. It authorizes the SEC to promulgate rules “prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes” in order to “protect[] . . . investors.” 15 U.S.C. § 80b-11(h)(2). Section 211(h) was enacted through the Dodd-Frank Act, which supplies clear contextual evidence that it relates to retail investors and has nothing to do with private funds.

Congress addressed private fund advisers in Title IV of the Dodd-Frank Act. Title IV addresses the SEC’s “oversight responsibilit[ies] for private fund advisers.” 88 Fed. Reg. at 63,213. It requires some private fund advisers to register with the SEC and mandates that advisers file reports regarding the assets under management in their private funds. 15 U.S.C. §§ 80b-3(l), (m), 80b-4(b). But Title IV does not regulate the relationship

between investors and private fund advisers at all. That is, investors and private fund advisers remain free to negotiate the distribution of profits, the timing of investment withdrawals, the calculation of compensation clawbacks, and other terms, just as they always have been.

Section 211(h) is in a part of the Dodd-Frank Act that addresses retail investors. It is in Title IX of the Act, 124 Stat. at 1822-1955, and the specific part of Title IX that concerns the relationship between retail investors and the brokers, dealers, and advisers that serve them, *id.* at 1824-30. That part of the statute defines “retail customer”; directs the SEC to study the effectiveness of existing standards of care for retail customers and to identify “gaps . . . in the protection of retail customers”; and authorizes the SEC to promulgate a rule “for the protection of retail customers.” *Id.* at 1824-28. Then Section 211(h) gives the SEC the authority to promulgate rules on “certain sales practices, conflicts of interest, and compensation schemes” in order to “protect[] . . . investors.” 15 U.S.C. § 80b-11(h)(2). In context, it is clear that this language is referring to retail investors, the subject of Title IX of the Dodd-Frank Act – not private funds.

That view is confirmed by the provisions surrounding Section 211(h) and the other language in Section 211(h). Section 211(g) prescribes stand-

ards of conduct for when advisers provide investment advice to “retail customers,” and defines “retail customers” as those who use “personalized investment advice” “primarily for personal, family, or household purposes.” 15 U.S.C. § 80b-11(g). Section 211(i) clarifies that the standard of conduct applicable to advisers should be coextensive with the standard of conduct for brokers or dealers who “provid[e] personalized investment advice” “to a retail customer.” *Id.* § 80b-11(i).

Then Section 211(h), entitled “[o]ther matters,” provides additional provisions applicable to retail customers. In addition to providing the SEC with certain authority to regulate to protect those retail investors, it also states that the SEC should “facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers.” *Id.* § 80b-11(h)(1). That language, too, makes clear that Congress was referring to the retail customers addressed in Title IX. They are the non-experts who invest “primarily for personal, family, or household purposes” and who Congress wanted to protect. *Id.* § 80b-11(g)(2)(B).

When the SEC promulgated the Rule, the dissenting Commissioners recognized that Section 211(h) applies only to retail customers and does not provide the requisite authority to issue the Rule. The “undeniable focus” of

Title IX of the Dodd-Frank Act is retail investors, not investors in private funds. *Peirce Dissent*. The SEC has authority under Section 211(h) to “address concerns around standards of care for retail investment advisers and broker-dealers,” but not to regulate private fund advisers. *Id.* The SEC’s “tortured reading of Section 211(h)(2)” to provide general authority to regulate private funds “ignores th[at] entire context.” Commissioner Mark T. Uyeda, U.S. Sec. and Exch. Comm’n, *Statement on Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews* (Aug. 23, 2023), <https://bit.ly/3MfHEca> (*Uyeda Dissent*). Section 211(h) simply does not provide a statutory basis for the Rule.

### **3. This Rule is part of a pattern of SEC overreach**

The Rule fits into the recent pattern of the SEC overreading its authorizing statutes to justify broad regulations. For example, a recent SEC proposed rule would impose significant reporting requirements on public companies with respect to their “climate-related risks.” 87 Fed. Reg. 21,334 (April 11, 2022); see Commissioner Hester Peirce, U.S. Sec. and Exch. Comm’n, *It’s Not Just Scope 3: Remarks at the American Enterprise Institute* (Dec. 7, 2022), <https://bit.ly/3tN3aPl>. The SEC has never required public companies to assess and disclose their environmental impacts or the eco-

conomic risks they face from natural disasters, and the SEC itself acknowledges that its proposal would triple public companies' compliance costs, *see* 87 Fed. Reg. at 21,460-62. The SEC claims authority for these sweeping requirements based only on its general authority to require disclosures from public companies. *Id.* at 21,464-65.

The climate-change proposal is far from alone. The SEC recently proposed changes to its rules on safeguarding client assets to regulate indirectly the conduct of qualified custodians of assets by imposing restrictions on the advisers who work with them. 88 Fed. Reg. 14,672 (Mar. 9, 2023). But it is not clear that the SEC has authority to regulate the banks that serve as custodians, which are not subject to the Advisers Act. *See* Letter from The American Bankers Ass'n, to Vanessa Countryman, Secretary, U.S. Sec. and Exch. Comm'n 4-5 (May 8, 2023), <https://bit.ly/3MvHeyL>. The SEC also has proposed redefining a securities "exchange" in order to regulate cryptocurrency markets, 87 Fed. Reg. 15,496 (Mar. 18, 2022), even though its authority over those markets is questionable, *see* Amanda Tuminelli, *The SEC's Campaign To Define 'Exchange' Should Concern Every American – Even Those Without Ties To Crypto*, *Fortune* (June 18, 2023), <https://bit.ly/46DtmKG>.

Further, the SEC has proposed disclosure obligations on transactions involving special purpose acquisition vehicles and expanding potential liability faced by transaction participants, 87 Fed. Reg. 29,458 (May 13, 2022), despite arguments that these changes exceed the SEC's authority, *see* Letter from Sec. Industry and Fin. Mkts. Ass'n, to Vanessa Countryman, Secretary, U.S. Sec. and Exch. Comm'n 2-3 (June 10, 2022), <https://bit.ly/4948Q7I>; Letter from American Bar Ass'n, to Vanessa Countryman, Secretary, U.S. Sec. and Exch. Comm'n 25-28 (June 17, 2022), <https://bit.ly/45KdAML>. The SEC also has proposed changes to the definitions of "dealer" and "government securities dealer" in the Securities and Exchange Act, 87 Fed. Reg. 23,054 (Apr. 18, 2022), that would undermine Congress's decision to exempt certain activities from registration, *see* Letter from Sec. Industry and Fin. Mkts. Ass'n, to Vanessa Countryman, Secretary, U.S. Sec. and Exch. Comm'n 4 (May 27, 2022), <https://bit.ly/3slcnOp>.

The Rule here is another attempt by the SEC to exert unprecedented control over market participants. But the SEC, like every agency, has no authority except "those authorities conferred upon it by Congress." *Michigan v. EPA*, 268 F.3d 1075, 1081 (D.C. Cir. 2001). "In the absence of statutory authorization for its act, an agency's action is plainly contrary to law

and cannot stand.” *Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 8 (D.C. Cir. 2002) (quotation marks omitted). Accordingly, the Court should vacate the Rule.

**B. The Private Fund Advisers Rule Is Arbitrary, Capricious, And Contrary To Law**

**1. The Rule’s disclosure and consent requirements are not necessary or appropriate**

The SEC may issue a regulation under the Advisers Act only if doing so is “necessary or appropriate in the public interest.” 15 U.S.C. § 80b-2(c). In so doing, the SEC must comply with the basic Administrative Procedure Act (APA) requirement to “examine the relevant data and articulate a satisfactory explanation,” “including a rational connection between the facts found and the choices made.” *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins.*, 463 U.S. 29, 43 (1983).

Here, the SEC failed to provide a reasoned explanation for why the Rule’s disclosure and consent requirements are necessary or appropriate. *See* Pet. Br. 42-47. The SEC found that requiring advisers to disclose “timely, regular, and detailed fee and expense information” will allow investors to “monitor effectively whether . . . fee and expense misallocations are occurring,” and that requiring consent for charging certain fees to and borrowing from a fund is in the public interest, 88 Fed. Reg. at 63,227, 63,270-72. In support, the SEC cited enforcement actions involving advisers who

allegedly failed to disclose compensation to investors or allocated expenses and fees in ways that were inconsistent with their disclosures. *Id.* at 63,226-27. In those actions, the SEC asserted that the advisers committed fraud in violation of Section 206 of the Advisers Act. *Id.* But most of those actions ended in settlement. *Id.* at 63,209. It is impossible to determine from those settled actions whether there was any underlying violation. *See* Pet. Br. 44. Further, there is no reason to think that additional disclosure or consent requirements will make alleged bad actors less likely to hide their fraudulent activity.

For example, in one of the enforcement actions cited by the SEC, the adviser allegedly violated his investment management agreement by overcharging performance fees and failing to have the fund audited. *See In the Matter of Finser Int'l Corp.*, Investment Advisers Act Release No. 5593 (Sept. 24, 2020) (cited at 88 Fed. Reg. at 63,223). In another action, the private fund adviser allegedly mischarged expenses to the fund and used money from the fund to pay off a loan. *In the Matter of Corinthian Cap. Grp., LLC*, Investment Advisers Act Release No. 5229 (May 6, 2019) (cited at 88 Fed. Reg. at 63,223). The SEC provides no explanation for how additional disclosures or consent would prevent that sort of conduct. Advisers who are violating Section 206 will not announce their fraud to investors.



Further, the SEC already has authority to investigate fraud, *see* 17 C.F.R. § 275.206(4)-8.

Dissenting Commissioner Uyeda agreed that the Rule’s obligations are unnecessary. He explained that the past enforcement actions cited by the SEC demonstrate “that the Commission already has the authority to bring enforcement actions against private fund advisers to address fraudulent practices” and that the Rule’s requirements are not needed, and highly unlikely, to curb fraud. *Uyeda Dissent* (quotation marks omitted). The goal of the Rule appears to be to provide investors with information to better monitor whether advisers are misallocating fees and expenses in violation of Section 206. 88 Fed. Reg. at 63,227. But the vast majority of advisers comply with the law, and there is no reason to believe that the rare advisers who do violate Section 206 would divulge their fraud as mandated by the Rule.

**2. The SEC failed to justify extending the Rule’s disclosure requirements to “related persons”**

The SEC also failed to provide a reasoned explanation for extending the Rule’s disclosure requirements to “related persons,” which include entities that are operationally independent from private fund advisers. *See* Pet. Br. 56-57.

The Rule mandates extensive disclosure requirements under the rationale that disclosures will help investors identify when private fund advisers have conflicts of interest, such as investing in entities with which the advisers have relationships. 88 Fed. Reg. at 63,231-33. Advisers must issue quarterly statements to investors that disclose compensation, fees, expenses, and returns. 17 C.F.R. § 275.211(h)(1)-2. The statements must contain information about “portfolio investment compensation,” *id.* § 275.211(h)(1)-2(c), which the Rule defines as “any compensation, fees, and other amounts allocated or paid to the investment adviser or any of its *related persons* by” an entity or issuer in which the fund has invested that is “attributable to the private fund’s interest in” the investment, *id.* § 275.211(h)(1)-1 (emphasis added).

The Rule’s broad definition of “related persons” makes that disclosure obligation potentially enormous. A “related person” includes “[a]ny person under common control with the adviser.” 17 C.F.R. § 275.211(h)(1)-1. The Rule “presume[s]” that an entity has “control” over a corporation when it has the right to vote or sell “25 percent or more of a class of the corporation’s voting securities.” *Id.* Entities within the same corporate family as a private fund adviser therefore qualify as “related persons.”

In addition to managing private funds, large financial services firms routinely offer many other financial services, such as brokerage services, underwriting, mutual fund management, investment banking, and market making, as well as banking and custodial services. *See* James A. Fanto et al., *Broker-Dealer Law and Regulation* §§ 2.01, 2.03 (5th ed. Supp. 2023). The Rule’s disclosure obligation potentially extends to all of those discrete business units. As a result, the Rule may require private fund advisers to disclose to investors any “amounts allocated or paid,” 17 C.F.R. § 275.211(h)(1)-1, to completely separate divisions of a large corporation, or completely separate entities within a larger corporate family.

The Rule therefore may saddle large firms with sprawling disclosure obligations. *See* Letter from The Goldman Sachs Grp., Inc., to U.S. Sec. and Exch. Comm’n 5-6 (Apr. 25, 2022), <https://bit.ly/45NV7yM> (*Goldman Letter*); *SIFMA Letter* 19-20.<sup>2</sup> Firms would incur substantial compliance costs hunting down and sifting through large amounts of investment information wholly unrelated to their private funds. *SIFMA Letter* 20.

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<sup>2</sup> There is a narrower reading of the quarterly statement requirement. The definition of “[p]ortfolio investment compensation” extends only to compensation that is “attributable to the private fund’s interest in such portfolio investment.” 17 C.F.R. § 275.211(h)(1)-1. That language may limit the disclosure requirement to compensation that arises as a result of the fund’s

The SEC offered no justification for that burdensome requirement. Large firms already guard against potential conflicts of interest through internal information barriers that prevent the disclosure of details about transactions and clients across business units. *See Broker-Dealer Law and Regulation* § 6.09. These barriers are erected to comply with the extensive regulatory regime that requires firms to establish measures to restrict the improper use of material nonpublic information. *See, e.g.,* 15 U.S.C. §§ 78o(g), 6802; 12 C.F.R. § 9.5(b)-(c). Firms also have a fiduciary duty to their clients to avoid conflicts of interest by restricting access to nonpublic information to those employees who need that information to do their jobs. *In re Enron Corp. Sec., Derivative & “ERISA” Litig.*, 238 F. Supp. 3d 799, 890 (S.D. Tex. 2017). These comprehensive internal protocols and procedures help to ensure that the separate business units of financial service firms operate independently in order to avoid conflicts of interest. *SIFMA Letter* 19-20; *Goldman Letter* 2, 4.

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investment. If that is the case, a fund would not need to burden its quarterly statements with information about unrelated payments to other divisions of the corporate parent. Commenters asked the SEC to clarify this issue in the final Rule, *see, e.g., Goldman Letter* 7-8, but it did not do so, and that lack of clarity also renders the Rule arbitrary, *see FTC v. Atl. Richfield Co.*, 567 F.2d 96, 100 (D.C. Cir. 1977).

To comply with the Rule's disclosure requirements, advisers may need to break down those information barriers to gather information from related persons. The Rule thus increases the potential for the very conflicts of interests that the SEC purportedly seeks to eliminate. *See Goldman Letter 6-7; SIFMA Letter 20*. The SEC did not address this issue in the final Rule.

On the other side of the ledger, extending the disclosure requirement to related persons will not help investors identify material conflicts of interest. Large financial services firms are global entities with hundreds of thousands of clients and customers that engage in millions of transactions. *See, e.g., The Goldman Sachs Grp., Inc., Annual Report (Form 10-K) 63 (Feb. 23, 2023), <https://bit.ly/3QjDT6N>; JPMorgan Chase & Co., Annual Report (Form 10-K) 46 (Feb. 21, 2023), <https://bit.ly/460YLFM>*. Reporting on the conduct of a sprawling world-wide network of affiliated entities will drown investors in irrelevant information and make it more difficult for them to identify material information. *See Letter from The Private Inv. Funds Forum, to Vanessa Countryman, Secretary, U.S. Sec. and Exch. Comm'n 26 (Apr. 25, 2022), <https://bit.ly/3FNXhUy>*. The SEC failed entirely to explain

how disclosing payments to related entities that are operationally independent from private fund advisers will help investors identify conflicts of interest.<sup>3</sup>

The quarterly statements also could reveal confidential information about related persons. An adviser's accounting of portfolio investment compensation must "list as a separate line item each category of portfolio investment compensation and the corresponding total dollar amount." 88 Fed. Reg. at 63,231-32. That could require advisers to reveal, for example, confidential transactions or sensitive fee information about separate branches of their firms. *See Goldman Letter* 3, 6. The SEC waved away that concern by noting that investors often are contractually obligated to maintain the confidentiality of advisers' disclosures. *See* 88 Fed. Reg. at 63,233. But investors that receive quarterly statements may be employees

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<sup>3</sup> For similar reasons, the SEC's cost-benefit analysis is flawed. The SEC failed to consider that investors will receive little to no benefit from expansive disclosures that will cost an estimated \$487 million annually for advisers and "related persons" to compile, 88 Fed. Reg. at 63,326-30. That "serious flaw" in the cost-benefit analysis is another reason that the Rule is arbitrary. *Huawei Techs. USA, Inc. v. FCC*, 2 F.4th 421, 452 (5th Cir. 2021); *see Chamber of Commerce of U.S. v. SEC*, 2023 WL 7147273, at \*10-11 (5th Cir. Oct. 31, 2023) (explaining that the cost-benefit analysis must substantiate the benefits of a rule).

of competitors and there is no protection against their use of disclosed information. The SEC suggested that advisers could use “code names” to disguise portfolio investments so long as investors have sufficient information to “understand the nature” of potential conflicts. *Id.* But the SEC does not explain how code names simultaneously could maintain confidentiality and provide sufficient information to identify conflicts of interest.

In sum, extending disclosure requirements to “related persons” is arbitrary and capricious. The SEC failed to provide any reasoned explanation for requiring business units that are related in name only to private fund advisers to disclose transactions involving entities in which the funds have invested.

**3. The SEC failed to consider the cumulative effects of its actions**

Part of engaging in “reasoned decisionmaking” under the APA is assessing all “relevant factors” and all “important aspect[s] of the problem.” *State Farm*, 463 U.S. at 42-43, 52. And when an agency “decides to rely on” a particular type of analysis “as part of its rulemaking, a serious flaw undermining that analysis can render the rule unreasonable.” *Nat’l Ass’n of Home Builders v. EPA*, 682 F.3d 1032, 1040 (D.C. Cir. 2012). Here, the SEC’s analysis of the Rule’s cumulative impacts was unreasonable because it failed to consider the cumulative effects of its regulations, including the

anticipated effects of other proposed rules that will impose significant compliance costs on private fund advisers.

The SEC's analysis of the cumulative economic impacts of the Rule addressed only the "new regulatory requirements" in place at the time of the Rule's adoption, and it ignored future, proposed rules. 88 Fed. Reg. at 63,324. Yet the impacts of an agency's reasonably foreseeable future actions are also "relevant factors" in evaluating the cumulative impacts of a regulation. And that analysis is particularly important here given that the SEC in recent years has proposed and adopted regulations at a frantic pace.

The current Chair has proposed far more rules than his predecessor, and he anticipates proposing at least 14 more. *See* Kenneth E. Bentsen, Jr., *The Unprecedented Speed and Volume of SEC Rulemaking*, SIFMA (Sept. 21, 2023), <https://bit.ly/4955jWy>. Many of those rules target private fund advisers. *See* Letter from The Nat'l Ass'n of Private Fund Managers, to Vanessa Countryman, Secretary, U.S. Sec. and Exch. Comm'n 9-23 (July 21, 2023), <https://bit.ly/40cIhsI>. Adopting all of the proposals "would impose staggering aggregate costs and unprecedented operational and other practical challenges" on private fund advisers. *Id.* at 2.



Yet the SEC ignored the advice of two Commissioners and its Asset Management Advisory Committee to consider its other imminent rulemakings when analyzing the cumulative effects of the Rule. As a dissenting Commissioner explained, the SEC “effectively sidestepp[ed] its economic analysis obligation by refusing to consider the aggregate impact of recent rulemakings for investment advisers.” *Uyeda Dissent*. As a result, the SEC failed to account for the full “breadth, scope, and depth” of its proposed regulatory requirements and the resulting compliance costs for advisers. Asset Mgmt. Advisory Comm., U.S. Sec. and Exch. Comm’n, *Final Report and Recommendation for Small Advisers and Funds* 7 (Nov. 3, 2021), <https://bit.ly/3Fu9Fcr>. The SEC thus downplayed the possibility that the Rule could harm competition by forcing advisers to “exit the market.” *Peirce Dissent*.

The SEC must be cognizant to the full regulatory burden that private fund advisers face. Its existing analysis of cumulative economic impacts, which does not consider all likely rulemakings, is incomplete. The SEC thus failed to consider an “important aspect of the problem” before it, *State Farm*, 463 U.S. at 43, and relied on an analysis about the cumulative effects of its rulemakings that had “a serious flaw,” *Nat’l Ass’n of Home Builders*, 682 at 1040, making the Rule arbitrary and capricious.

## CONCLUSION

The Court should grant the petition for review and vacate the order.

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## CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rule of Appellate Procedure 32(g), undersigned counsel certifies that this brief:

(i) complies with the type-volume limitation of Rule 29(a)(5) because it contains 6,349 words, including footnotes and excluding the parts of the brief exempted by Rule 32(f); and

(ii) complies with the typeface requirements of Rule 32(a)(5) and the type style requirements of Rule 32(a)(6).

*/s/ Nicole A. Saharsky*  
Nicole A. Saharsky

**CERTIFICATE OF SERVICE**

I hereby certify that on November 8, 2023, I filed the foregoing document with the Clerk of the Court using the appellate CM/ECF system, which will transmit a copy of the document to all counsel of record.

*/s/ Nicole A. Saharsky*  
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