IN THE

United States Court of Appeals

FOR THE FIFTH CIRCUIT

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.

ON PETITION FROM THE SECURITIES & EXCHANGE COMMISSION

BRIEF FOR *AMICUS CURIAE* COMMITTEE ON CAPITAL MARKETS REGULATION IN SUPPORT OF PETITIONERS

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CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rules of Appellate Procedure 26.1, *amicus curiae*, the Committee on Capital Markets Regulation, states that it is a not-for-profit association and has no parent corporations, subsidiaries, or affiliates. No publicly held corporation owns ten percent or more of its stock.

Dated: November 8, 2023

Washington, D.C.

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SUPPLEMENTAL STATEMENT OF INTERESTED PARTIES

Pursuant to Fifth Circuit Rule 29.2, counsel for *amicus* certifies that, in addition to the interested parties identified by Petitioners in their opening brief, the following listed persons and entities have an interest in the outcome of this case. These representations are made so that the judges of this Court may evaluate possible disqualification or recusal.

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INTEREST OF AMICUS CURIAE[1]

Founded in 2006, the Committee on Capital Markets Regulation (the "Committee") is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Committee believes that advisers to private equity funds, venture capital funds, and hedge funds play a critical role in the U.S. capital markets and economy. Over the past three decades they have achieved compelling returns for their investors, which include pension funds, university and hospital endowments, and other non-profit foundations. Investor demand for private fund adviser services has thus been growing rapidly: Total assets managed by private fund advisers grew from $9.8 trillion in 2012 to $27 trillion as of 2022. *See* Final Rule, *infra*, at 63,207.

Hedge funds play a vital role in capital markets by contributing to price discovery, market efficiency, and capital allocation. Private equity funds support the real economy by not only investing in but also operating private companies. U.S. companies increasingly rely on private capital markets relative to public markets. For example, U.S. companies now raise almost four times as much capital each year

[1] The parties have consented to this filing. No party's counsel authored this brief in whole or part, and no one other than the Committee, its members, or counsel contributed money for the brief's preparation or submission.

in private markets than from public offerings. *See* SEC, Fiscal Year 2022 Office of Small Business Advisor Annual Report, at 19 (2022), available at https://www.sec.gov/files/2022-oasb-annual-report.pdf. The growth of private companies would have been impossible without the investment advisers that design and implement private funds' investment strategies.

INTRODUCTION AND SUMMARY OF ARGUMENT

On August 23, 2023, the Securities and Exchange Commission (the "SEC") promulgated new rules under the Investment Advisers Act of 1940 (the "Advisers Act") that are set forth in Release No. IA-6383, SEC, Private Fund Advisers; Documentation of Registered Investment Adviser Compliance, Advisers Act Release No. IA-6383, 88 Fed. Reg. 63,206 (Sept. 14, 2023) (AR.493) [hereinafter, the "Final Rule"]. The Final Rule is an unprecedented expansion of SEC regulation into the private market for investment advisory services.

The Final Rule will overhaul the private fund industry by prohibiting certain freely negotiated contractual terms between the advisers to private investment funds and their well-informed and sophisticated investors. It will also require private-fund advisers to issue quarterly disclosure statements to their investors on a highly burdensome timeframe. *See* Final Rule at 63,388-89. Until now, these parties have been free to negotiate their own terms, consistent with the pervasive recognition throughout the Advisers Act, other statutes, and prior SEC regulatory practice, that the same regulatory restrictions necessary for the protection of retail investors in public markets are not necessary to protect the high-net worth and sophisticated institutional investors to whom investment in private funds is limited.

The SEC's rationale for the Final Rule is that there has been a failure of competition in the private-funds market that has resulted in investors paying

excessive fees and receiving suboptimal contractual terms when they invest in private funds. For example, the Final Rule repeatedly asserts the existence of "market failures," speculates that "[p]rivate fund adviser fees may currently total in the hundreds of billions of dollars per year," and claims that by imposing regulatory restrictions on the private funds-market the Final Rule "may enhance competition" and "may lead to lower fees." Final Rule at 63,360.

SEC Chair Gensler's ubiquitous public statements confirm that the Final Rule is based on the false premise that the private-funds industry is an uncompetitive market, and that the Final Rule is intended to solve this problem. For example, Chair Gensler has speculated that private-fund advisers are receiving "$250 billion a year" in fees and that these supposedly excessive fees are the reason "to bring more sunshine and competition in this space." SEC, *Why Do Private Funds Matter?: Office Hours with Gary Gensler*, (Feb. 9, 2022), available at https://www.youtube.com/watch?v=FD1HUeqmsSM [hereinafter "Office Hours"].[2]

[2] *See also* Gary Gensler, "The '90s: Rom-coms, the Spice Girls, & MFA," Remarks Before the Managed Funds Association (May 2, 2023), available at https://www.sec.gov/news/speech/gensler-remarks-managed-funds-association-050223 ("This proposal uses the tools of transparency and market integrity to promote competition and efficiency."). Chair Gensler has also drawn comparisons between the fees charged by private-fund advisers and those charged by advisers to publicly offered mutual funds and index funds to suggest that private fund adviser fees are too high. *See Office Hours* ("[W]e've seen significant reductions over time in the fees of mutual funds or those index funds that we might invest in. The private fund fees though, they haven't come down in a comparable way."). However, the advisers to public funds, particularly index funds, implement investment strategies that adhere to much more narrowly defined investment criteria than private fund advisers, and thus provide a service that is wholly distinct from private fund advisers. The public-funds market therefore does not in any way provide a useful reference point as to what fees should be in the private-funds market.

Chair Gensler also stated that private-fund advisers are likely collecting "excess profits above what robust market competition would provide." Gary Gensler, "Competition and the Two SECs," Remarks Before the SIFMA Annual Meeting (Oct. 24, 2022), available at https://www.sec.gov/news/speech/gensler-sifma-speech-102422. He also speculated that the fees that private equity advisers charge are "not that different from when I was on Wall Street" and "might be even higher." Gary Gensler, Prepared Remarks At the Institutional Limited Partners Association Summit (Nov. 10, 2021), available at https://www.sec.gov/news/speech/gensler-ilpa-20211110 [hereinafter "ILPA Remarks"]. However, as we detail throughout this brief, these assertions that fees are excessive and need to be lowered are not backed by any objective evidence or data and are in fact refuted by the evidence and data that commenters presented to the SEC and that the SEC then ignored.

Indeed, the data and other objective evidence clearly indicate that the U.S. private-funds market is neither uncompetitive nor affected by market failures. On the contrary, the private-funds market is highly competitive and becoming more competitive. Chair Gensler's and the SEC's fundamental policy rationale for the Final Rule is therefore fatally flawed. Moreover, and most importantly for this Court, the Final Rule is also a violation of U.S. federal law.

By failing to conduct an adequate economic analysis of its own rulemaking, the SEC has violated its statutory obligation under Section 202(c) of the Advisers

Act to "consider" whether its rulemakings under the Advisers Act "will promote efficiency, competition, and capital formation." 15 U.S.C. § 80b-2(c). As a result, the court must invalidate the Final Rule as "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law" pursuant to Section 706 of the Administrative Procedure Act [hereinafter, the "APA"]. 5 U.S.C. § 706.

More specifically, federal courts have held that the SEC must "determine as best it can the economic implications of the rule it has proposed" by conducting a rigorous and objective economic analysis of its rulemakings. *Chamber of Com. V. SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005). In doing so, the federal courts have articulated specific criteria for these economic analyses – which are commonly referred to as "cost-benefit analyses" – and have repeatedly invalidated SEC rulemakings for failing to meet these criteria. *See, e.g.*, *id*; *see also Am. Equity Inv. Life Ins. Co. v SEC*, 613 F.3d 166 (D.C. Cir. 2009).

Most recently, this Court held that, when the SEC asserts that the primary basis for a rulemaking is that there is a "genuine problem" with a market, then the SEC must substantiate this claim as part of its economic analysis. *Chamber of Com. v. SEC*, No. 23-60255, 2023 WL 7147273 (5th Cir. Oct. 31, 2023); *see also Nat'l Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006). If the SEC fails to do so, then the SEC cannot assess the rulemaking's benefits, and therefore cannot conduct an adequate cost-benefit analysis. This Court further determined that the

SEC cannot ignore data and arguments provided by commenters that are relevant to whether a problem with the market exists. *Id*. The economic analysis (the "EA") of the Final Rule violates the Advisers Act because it fails to meet these criteria.

Our brief focuses on three critical failures, each of which is a violation of federal law and each of which requires the Court to invalidate the Final Rule:

First, the EA failed adequately to consider the effects of the Final Rule on competition because the EA ignored the fundamental metrics that both government authorities and academic experts use to measure whether a market is competitive, including price competition and industry concentration. Moreover, the evidence that the SEC ignored demonstrates decisively that the private-funds market is highly competitive.

Second, the EA fails to consider relevant data contained in the Form PF filings that the SEC requires private-fund advisers to submit to the SEC for the purpose of informing rulemakings. These filings are not available to the public, *see* 17 C.F.R. § 275.204(b)-1, and are highly relevant to evaluating competition in the private-funds market. For example, Form PF contains detailed data on fees and net-of-fee returns for thousands of private funds going back to 2013. The SEC could thus have used these data to determine whether a "market failure" exists.

Third, the EA fails to respond to significant issues raised and evidence presented by commenters, despite having requested these materials from

commenters. For example, from a sample of 221 separate, relevant, empirical studies and data sources submitted by the Committee and two other commenters, the Final Rule acknowledges only 24 – equal to 11% of the total. The Final Rule ignores the other 89%.

ARGUMENT

The EA fails to adhere to the criteria established by Congress as articulated by the federal courts in three critical respects, each of which requires the Court to invalidate the Final Rule.

I. The EA fails to substantiate a "genuine problem" with competition in the private-funds market.

In *American Equity*, the D.C. Circuit considered the validity of an SEC rulemaking under the Securities Act of 1933 that would have extended SEC regulations over certain annuity investment products that were not previously subject to SEC regulation. *See generally* 613 F.3d 166. The court invalidated the rulemaking under Section 706 of the APA because the SEC failed adequately to consider the effects of the new rule on "efficiency, competition and capital formation." *Id.* at 177-79. The court specifically faulted the SEC's economic analysis for failing to assess the "existing level of competition" in the marketplace for the annuity products at issue and held that the SEC's failure to do so meant that it could not, and did not, assess "any potential increase or decrease in competition" in that marketplace stemming from the rulemaking. *Id*. at 178. Establishing the baseline level of

competition is thus necessary for an economic analysis, since considering the effects of a rulemaking is impossible without first establishing the status quo against which these effects can be measured. Moreover, in *Chamber of Commerce*, this Court overturned an SEC rule because the SEC's economic analysis failed to substantiate the existence of a "genuine problem" that underlies the SEC's "justification and explanation" for the rule. *Chamber of Com.*, 2023 WL 7147273 at *11. The Court found that this error "permeat[ed] – and therefore infect[ed] – the entire rule" because it meant that the rule's "primary benefit" was "inadequately substantiated." *Id.* at *12.

The EA for the Final Rule must therefore assess both the existing "baseline" level of competition in the private-funds industry and seek to estimate the effect of the Final Rule on that level of competition. Furthermore, because the SEC has justified its rulemaking by claiming that there are competitive market failures in the private-funds market that the Final Rule will address, the EA must substantiate the existence of a "genuine problem" with competition in that market. However, the EA fails to consider any of the metrics that would allow it to assess whether a "genuine problem" with competition in the private-funds market exists.

We acknowledge that this Court also ruled that the SEC need not necessarily quantify the effects of its rulemaking on all occasions. *Chamber of Com.*, 2023 WL 7147273 at *6-7. This is not our argument. Rather, our argument is that the SEC has

failed to use any reasonable method, quantitative or qualitative, to assess the existing level of competition in the private-funds market. Whereas the challenged rule in *Chamber of Commerce* related to the impact of share repurchase disclosures, a relatively narrow topic with comparatively little relevant empirical data, the Final Rule relates to competition across a large sector of the U.S. capital markets for which years of detailed and wide-ranging data are readily available to the SEC. Thus, while the SEC is not always required to quantify effects, it is difficult if not impossible to conceive of a coherent analysis of competition in the private-funds market that fails to consider any of the relevant data that we review.

Moreover, this Court also held that if the SEC claims that a quantitative analysis is not possible *and* ignores comments demonstrating that such a quantification is in fact readily possible, then the SEC's actions are "arbitrary and capricious." *Id.* at *8-10. Indeed, this is precisely what occurred in the Final Rule. The SEC claims in the EA that it "lacks the information necessary" to quantify its analysis. Final Rule at 63,293. However, as we detail below, commenters provided the SEC with ample data and other evidence that would have allowed for a quantification of the competitiveness of the private-funds market. Therefore, not only is the EA's consideration of competition generally inadequate, the EA's specific failure to attempt a quantification of the competitiveness of the private-funds market also conflicts with *Chamber of Commerce*.

(i) The EA fails to consider price competition.

The most fundamental way that service providers compete is by lowering the prices that they charge relative to the value of the services that they provide or increasing the value of service relative to price ("price competition"). *See, e.g.,* U.S. Dep't of Just. & F.T.C., Horizontal Merger Guidelines (Aug. 19, 2010) at § 1, available at https://www.justice.gov/atr/horizontal-merger-guidelines-08192010 [hereinafter "DOJ Guidelines"]. Data on price competition are thus *the* fundamental indicator of the competitiveness of any market, and no reasonable consideration of competition could fail to analyze how much consumers are paying relative to the value of the services that they receive.

In the private-funds industry, price is reflected in the fees that the adviser charges its investors. Advisers typically receive: (1) an annual management fee equal to a percentage of the total value of the assets that the adviser manages; and (2) a performance fee equal to a percentage of the investment returns that the adviser obtains for its investors. Service quality in the private fund industry can be measured by the returns the adviser achieves for investors minus the management and performance fees the investor pays, (the "net return"). If the private-funds market were uncompetitive, one would expect to observe increasing fees or reduced investment performance, and thus lower net returns, since advisers would be free to increase their prices or provide lower performance without losing investors to a

competitor. By contrast, if the market is competitive, one would expect to observe reduced fees and higher net returns over time as private-fund advisers vigorously compete for investors. The fundamental relevance of fees and net returns in measuring price competition in the market for investment management services is well established in the empirical literature. *See, e.g.*, John C. Coates IV & R. Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 J. CORP. L. 151 (2007).

A reasonable analysis of competition in the private-funds market must therefore consider fees and net returns and whether they are increasing or decreasing over time. Fortunately, private fund surveys exist that can provide insight into fees. And databases, including Preqin and Compustat, provide historical information on private fund net returns from advisers that voluntarily self-report their returns. Indeed, the Committee and other commenters provided the SEC with the available surveys and data in response to the proposed rule. *See, e.g.*, Comm. on Cap. Mkts. Regul., Comment Letter on Proposed Rule on Private Fund Advisers, *A Competitive Analysis of the U.S. Private Equity Fund Market*, at 31-32 (Apr. 12, 2023), available at https://www.sec.gov/comments/s7-03-22/s70322-20164111-334040.pdf (AR.360) [hereinafter "CCMR Private Equity Report"]; *see also* Comm. on Cap. Mkts. Regul., Comment Letter on Proposed Rule on Private Fund Advisers, *A Competitive Analysis of the U.S. Hedge Fund Market* (May 25, 2023), available at

https://www.sec.gov/comments/s7-03-22/s70322-194719-386922.pdf (AR.366) [hereinafter "CCMR Hedge Fund Report"]; Am. Inv. Council, Comment Letter on Proposed Rule on Private Fund Advisers (Apr. 25, 2022), available at https://www.sec.gov/comments/s7-03-22/s70322-20126669-287340.pdf (AR.145) [hereinafter "AIC Comment Letter I"]; Managed Funds Ass'n, Comment Letter on Proposed Rule on Private Fund Advisers (Apr. 25, 2022), available at https://www.sec.gov/comments/s7-03-22/s70322-20126631-287270.pdf (AR.182); Alt. Inv. Mgmt. Ass'n Ltd. & Alt. Credit Council, Comment Letter on Proposed Rule on Private Fund Advisers (Apr. 25, 2022), available at https://www.sec.gov/comments/s7-03-22/s70322-20126739-287453.pdf (AR.177). However, the EA omits any consideration of these data in its analysis of competition in the private-funds market.

This omission is particularly problematic because the available data clearly indicate that the private-funds market is highly competitive and growing increasingly competitive, thus entirely undercutting the rationale for the Final Rule.

As the Committee explained in its comment letters and as established by numerous academic studies, net-of-fee performance is the best measure of price competition in the private-funds market, because the competitiveness of gross fees in any marketplace must be evaluated relative to the quality or amount of the goods or services provided. CCMR Private Equity Report at 15-16. The quality or value of

investment advisory services is unique as compared to other services because it can be precisely quantified by net-of-fee returns.

Commenters including the Committee presented voluminous evidence showing that net returns in the private-funds market have been strong for a long time and have also increased over time. For example, the Committee's comment letters cited eight empirical studies as well as various reports that all concluded that the returns for private equity funds exceeded returns to comparable investments in public equity markets consistently and significantly over the prior three decades. CCMR Private Equity Report at 24-26. In the case of hedge funds, the Committee cited numerous academic studies showing that hedge funds have provided investors with excess net-of-fee risk-adjusted returns for decades. CCMR Hedge Fund Report at 12-14.

The Committee and other commenters also presented comprehensive evidence that the superior performance offered by private funds has increased over time. For example, Preqin data that the Committee cited in its comment letter indicate that the average net-of-fee return across private equity funds has increased over the past 20 years by a factor of nearly three. CCMR Private Equity Report at 22. These data refute Chair Gensler's unsupported assertion that private fund advisers earn excessive fees. If fees were excessive then net returns would be low.

Instead, net-of-fee returns for private funds are high and yet the EA ignores the implications of strong net-of-fee returns for competition in the private funds market.

Moreover, gross fees also indicate an increasingly competitive private funds market, as surveys demonstrate that private-fund advisers have lowered the fees that they charge investors. For example, according to these surveys, the average management fee for private equity funds has declined by 25% (from 2% to 1.5%) over the past ten years, CCMR Private Equity Report at 19, and average management fees for hedge funds have declined by 10%, from an average of 1.55% in 2008 to 1.4% as of 2020, CCMR Hedge Fund Report at 11. These data refute Chair Gensler's assertion that adviser fees are "not that different from when I was on Wall Street." ILPA Remarks.

(ii) *The EA fails to consider industry concentration*.

Another critical factor in evaluating competition is the degree of concentration among service providers. Industry concentration is one of the most important factors that the Federal Trade Commission and the Department of Justice use to assess competition in an industry when applying antitrust law. *See* DOJ Guidelines at § 5. High concentration indicates that a substantial market share is held by only a few firms and is evidence of a lower degree of competition. Low concentration indicates that market share is widely dispersed among all firms in a market and is evidence of a higher degree of competition. The most prevalent metric of concentration, used by

the Federal Trade Commission and the Department of Justice, is the Herfindahl-Hirschman Index ("HHI"). *See id.* at § 5.3. The FTC and DOJ generally consider an HHI of less than 1500 to be an unconcentrated market, while an HHI greater than 2500 is a highly concentrated market. *Id*.

From 2013 through 2021, the average HHI in the private equity and hedge fund industry was less than 250. *See* CCMR Private Equity Report at 8; CCMR Hedge Fund Report at 3. With measures of HHI for both private equity and hedge funds significantly lower than the threshold for an unconcentrated market, concentration as a measure of competitiveness clearly illustrates a highly competitive private-funds industry. For example, an HHI of 250 is one sixth of the DOJ/FTC maximum threshold of 1500 for an *unconcentrated* marketplace, and less than one tenth of the average HHI of U.S. industries. *Id.* Other metrics drawn from the SEC's own Form ADV data corroborate the unconcentrated nature of the private-funds market. For example, the number of SEC-registered private equity fund advisers grew from 815 in the first quarter of 2013 to 1,628 in the first quarter of 2022. CCMR Private Equity Fund Report at 9. The number of SEC-registered hedge fund advisers grew from 1,469 to 1,853 over the same period. CCMR Hedge Fund Report at 6.

Commenters provided the SEC with detailed HHI analysis and other data on concentration in response to the proposed rule, but the EA makes no use of it to

assess the current level of competition in the private-funds market or the potential effect of the Final Rule on competition. Final Rule at 63,299, n.1037 (citing Comm. on Cap. Mkts. Regul., Comment Letter on Proposed Rule on Private Fund Advisers (Apr. 25, 2022), available at https://www.sec.gov/comments/s7-03-22/s70322-20126562-287198.pdf (AR.175) [hereinafter "CCMR Comment Letter I"]).

(iii) Equal bargaining power is not an indicator of competition.

Rather than adequately consider any of the ample quantitative evidence that commenters presented on price competition, the SEC summarily dismisses its relevance and embarks on an inadequately supported and irrelevant analysis of "non-price" competition. More specifically, the EA's consideration of competition in the private-funds market focuses on how the Final Rule will remedy a purported imbalance of "bargaining power" between investors and advisers. *Id*. at 63,210. The EA presents this purported inequality of bargaining power as a "market failure" that the Final Rule will remedy by prohibiting advisers and investors from voluntarily agreeing to certain contractual terms. *Id*. at 63,294.

However, the claimed existence of this bargaining power imbalance is unsupported by any valid evidence. In support of this claim, the EA relies primarily on an informal survey of a small sample of private fund investors. *Id*. at 63,295, n.983 (citing Institutional Limited Partners Association, "The Future of Private Equity Regulation, Insight into the Limited Partner Experience & the SEC's

Proposed Private Fund Advisers Rule" (2023), available at https://www.sec.gov/comments/s7-03-22/s70322-20158927-326926.pdf (AR.356)). The responses from these investors indicate that some investors occasionally decline to invest in certain funds because the terms they are offered are unacceptable to them, and that at times they have to compromise on their preferred terms. These are not indicators of a bargaining power imbalance but rather features of any legitimate contractual negotiation. In fact, the objective evidence indicates that no bargaining power imbalance exists. Investors in private funds are high-net worth individuals and institutional investors that have significant financial resources, access to high-quality legal counsel and consultants that specialize in advising private fund investors in negotiations with private-fund advisers, and myriad other investment opportunities outside of the private-funds market. Indeed, various commenters presented evidence showing that private fund *advisers* frequently compromise on their preferred terms. *See, e.g.*, AIC Comment Letter I, Kothari Report at ¶¶ 23, 45; Sullivan & Cromwell LLP, Comment Letter on Proposed Rule on Private Fund Advisers, at 9, n.28 (Apr. 25, 2022), available at https://www.sec.gov/comments/s7-03-22/s70322-20127545-288689.pdf. (AR.215). The EA ignores this evidence.

Perhaps more importantly, a balance of bargaining power between buyers and sellers is not relevant to an assessment of whether a market is competitive. Indeed,

the methodology for the assessment of competition applied by the Federal Trade Commission and Department of Justice – the agencies responsible for administering federal antitrust law and hence evaluating competition across all markets – does not consider equality of bargaining power as part of their assessments. *See generally* DOJ Guidelines. The extensive academic literature on market competition also generally excludes bargaining power as a relevant factor in assessing competition. *See, e.g.*, CCMR Comment Letter I at 14-15.

This is because markets can be highly competitive and provide consumers with quality goods and services at a low cost even if consumers have little to no ability directly to modify the terms on which they receive a good or service from a provider. *Id.* For example, as the Committee explained in its comment letter, in the market for retail footwear, the average purchaser typically has no bargaining power to change the price of a particular shoe or compel a producer to modify its characteristics. CCMR Private Equity Report. The footwear market is nonetheless characterized by intense price competition among providers that keeps prices close to marginal cost, and the existence of multiple providers gives consumers choices about what they purchase and how much they pay. *Id.* The SEC ignored the Committee's comments that a bargaining power imbalance is irrelevant to an assessment of competition in the private-funds market.

The EA's failure to consider the most fundamental indicators of competition in any marketplace means that it has failed adequately to consider the effect of the Final Rule on competition using any reasonable quantitative or qualitative analysis. It has also failed to substantiate the existence of the problem on which the SEC premises its Final Rule. Moreover, the fact that commenters presented the SEC with voluminous data as to these fundamental indicators of competition means that the SEC has also failed to respond to comments that "can be thought to challenge a fundamental premise underlying the proposed agency decision," as this Court required the SEC to do in *Chamber of Commerce*. 2023 WL 7147273, at *8 (quoting *Carlson v. Postal Regul. Comm'n*, 938 F.3d 337, 344 (D.C. Cir. 2019)). The EA thus fails to adequately "consider" the Final Rule's effect on competition as this Court has interpreted that requirement.

II. The SEC fails to examine the available empirical data.

The Supreme Court has held that in any rulemaking, an agency must "*examine the relevant data* and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (emphasis added); *see also Am. Equity,* 572 F.3d at 178. The SEC's own internal guidelines acknowledge the importance of quantifying costs and benefits "even where the available data is imperfect" and identifying "specific data that would be necessary

for or that would assist in quantification." SEC, Current Guidance on Economic Analysis in SEC Rulemakings, at 12 (Mar. 16, 2012), [hereinafter "RSFI Guidance"]. More recently, in *Chamber of Commerce,* this Court faulted an SEC economic analysis for ignoring multiple sources of empirical data directly relevant to substantiating the rulemaking's effects. 2023 WL 7147273 at *9.

Various commenters specifically urged the SEC to examine the ample empirical data at its disposal. *See, e.g.*, Inv. Adviser Ass'n, Comment Letter on Proposed Rule on Private Fund Advisers, at 9 (Apr. 25, 2022), available at https://www.sec.gov/comments/s7-03-22/s70322-20126863-287609.pdf*;* CCMR Private Equity Report. However, the EA fails to examine the significant body of empirical data concerning private funds contained in its own Form PF filings, which could confirm or refute the alleged existence of a problem with competition in the private-funds market. The EA therefore fails to "examine the relevant data," as required by *Motor Vehicle Manufacturers*, to establish the "existing level of competition" in the private-funds market, as required by *American Equity*, and to determine whether a "genuine problem" with competition in the private-funds market exists, as required by *Chamber of Commerce*.

We discuss Form PF filings and the data that they include. We then identify specific ways that the SEC could have used Form PF data to assess the baseline level

of competition in the private-funds market and test whether the market for private funds is in fact uncompetitive.

(i) Form PF

Private-fund advisers registered with the SEC are required to report annually, and in some cases quarterly, detailed information to the SEC about their funds' performance, fees, and investor restrictions in Form PF. *See* SEC, Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF: A Small Entity Compliance Guide (Jan. 5, 2012), available at https://www.sec.gov/rules/final/2012/ia-3308-secg.htm [hereinafter "Compliance Guide"]. These data are not public and are available only to the SEC.

The SEC has been collecting Form PF data since 2013. In the fourth quarter of 2022, the SEC collected Form PF data from 47,088 private funds, managed by 3,777 advisers. SEC Private Fund Statistics, Fourth Calendar Quarter 2022 (Jul. 18, 2023), available at https://www.sec.gov/files/investment/private-funds-statistics-2022-q4.pdf. These data therefore represent a vast sample size over a significant time period.

The SEC has itself acknowledged the relevance of Form PF data to ascertain the costs of policymaking decisions with respect to private funds and to "test with evidence assertions about private fund activity." SEC, 2022 Annual Staff Report

Relating to the Use of Form PF Data (Dec. 9, 2022), available at https://www.sec.gov/files/2022-pf-report-congress.pdf. The SEC also claims that Form PF data "informed the [SEC]" in formulating the proposed rule underlying the Final Rule itself. *Id.* However, despite this assertion, the SEC did not use the Form PF data to inform the EA. Moreover, the SEC cannot validly claim that the confidentiality of individual Form PF filings justifies the omission of any analysis of Form PF data on an aggregate or anonymized basis from the EA. Indeed, the SEC recently utilized confidential non-public regulatory data for other economic analyses of its rulemakings, most notably in its use of the private Consolidated Audit Trail data for proposed rules related to equity market structure. *See, e.g.*, SEC, Order Competition Rule, Exchange Act Release No. 34-96495, 88 Fed. Reg. 128, 209 (Jan. 3, 2023).

As we have already explained, the SEC ignored data from publicly available surveys and databases on the fees and net performance of private funds. Ignoring Form PF data is substantially more egregious for three reasons. First, Form PF is comprehensive, as it includes all registered private-fund advisers, so it does not rely on private-fund advisers voluntarily self-reporting fees or net-of-fee returns. Second, Form PF is the only existing database that provides data on private fund *fees*, as existing public information for private-fund fees is based solely on private fund surveys. Third, unlike the existing public databases, private-fund advisers face legal

liability for false Form PF reporting, so inaccurate reporting is significantly less likely.

The data necessary for the SEC's economic analysis are also readily available from Form PF. For example, Section 1b Item C(17) of Form PF requires private-fund advisers to provide monthly gross performance data and monthly net performance (returns net of management and performance fees) data for each reporting fund. *See* 17 C.F.R. § 275.204(b)-1. The difference between the gross performance and net performance of a private fund represents the total fees charged to investors. Total fees can thus be easily calculated from Form PF's performance data. *See* Compliance Guide. The SEC could therefore have constructed an annual time series of average net-of-fee returns and average fees across the entire private fund industry.

Indeed, the Final Rule expresses concern that current fee practices in the private fund industry "can be harmful and have significant negative effects on private fund returns." Final Rule at 63,323. However, despite exclusive access to a vast store of empirical evidence that could indicate whether any of these "negative effects" on returns have occurred (*e.g.*, whether private fund net-of-fee returns are low or declined over time) the EA conducts no empirical analysis of private fund performance using Form PF data or otherwise. The SEC has thus failed to examine

data that are directly relevant to substantiating the existence of the "market failure" that the SEC asserts justifies the Final Rule.

III. The SEC fails to respond to arguments, empirical data, and studies submitted by commenters.

Courts have held that as part of its economic analysis of its rulemaking, the SEC must respond to relevant arguments, data, and studies presented by commenters. For example, the D.C. Circuit invalidated an SEC rule because the SEC "failed to respond to substantial problems raised by commenters." *Bus. Roundtable*, 647 F.3d at 1148-49. The court specifically faulted the SEC for offering responses to commenters that "had no basis beyond mere speculation." *Id*. The court found that the SEC acknowledged empirical studies submitted by commenters but "completely discounted" the studies, which showed that the empirical evidence bearing on the positive economic effects of the rulemaking was "mixed." *Id.* at 1146, 1151 (D.C. Cir. 2011). The SEC's own internal policy documents stress the importance of responding to "data submitted to challenge" the SEC's economic costs and benefits. RSFI Guidance at 13.

In *Chamber of Commerce*, this Court recently invalidated the SEC's economic analysis because the SEC "expressly asked for" commenters to provide "data and information that would help quantify . . . the potential impacts of the proposed rule on efficiency, competition, and capital formation" but then "ignore[d]" data, including "academic studies" provided by commenters, that the SEC "did not want

to consider" and that could be used to substantiate whether the problem the SEC asserted as justification for the rule actually existed. *Chamber of Com. v. SEC*, 2023 WL 7147273 at *9. The SEC has done precisely the same in this case.

In its rule proposal, the SEC expressly requested that commenters provide "data and analysis" relevant to the proposed rule's effects on "competition" and "[i]n particular . . . additional qualitative or quantitative information" the SEC should "consider as part of the baseline for its economic analysis." SEC, Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Advisers Act Release No. IA-5955, 87 Fed. Reg. 16,886, 16,960 (Mar. 24, 2022). However, the EA simply ignores most of the studies and sources cited by commenters in response to the SEC's request. The Committee, the Managed Funds Association, and the American Investment Council submitted several comment letters and reports[3] to the SEC that together included references to 221 empirical studies and other individual data sources bearing on the proposed rule's costs and benefits. Of these, 82 were contained in original reports of academic economists (including former SEC Chief Economists) that considered the proposed rule's effects and that were appended to the commenters' letters. Of the 221 sources, the Final Rule acknowledges only 24 – equal to 11% of the total. The EA ignores the other

[3] *See* AR.145; AR.175; AR.182; AR.253; AR.254; AR.273; AR.330; AR.346; AR.360; AR.366; AR.368; AR.369.

89%. The percentage of ignored sources from the academic expert reports is approximately the same as the full sample.

The EA also ignores multiple sets of data raised by commenters that are relevant to the competitiveness of the private-funds market and the effects of the Final Rule on competition. For example, commenters made extensive reference to data on net-of-fee returns from Preqin, PitchBook, and Compustat *See, e.g.*, AIC Comment Letter I. The EA ignores these databases in its assessment of the private-funds market and does not use them to attempt to quantify or otherwise consider the economic impact of the Final Rule. In addition, the EA ignores the data that the Committee presented as to superior hedge fund performance, claiming incorrectly that the Committee presented data only as to private equity fund performance. *Compare* Final Rule at 63,299, n.1037 *with* CCMR Hedge Fund Report.

The EA also ignores numerous academic empirical studies presented by commenters that bear on a number of subjects that are fundamental to the Final Rule's basic economic rationale, including: (i) investor bargaining power (*e.g.*, David Robinson & Berk A. Sensoy, *Cyclicality, Performance Measurement, and Cash Flow Liquidity in Private Equity*, 122 J. FIN. ECON. 521 (2016)); (ii) private-fund adviser fees (*e.g.*, Howell E. Jackson & Jeffery Y. Zhang, *The Law and Economics of Soft Dollars: A Review of the Literature and Evidence from MiFID II*, 42 REV. BANKING & FIN. L. 1 (2022-2023)); and (iii) private fund net-of-fee

performance (*e.g.*, Mila Getmansky et al., *Hedge Funds:A Dynamic Industry in Transition*, NAT'L BUREAU ECON. RSCH., Working Paper No. 21449 (Aug. 2015)).

The EA has thus failed to respond to relevant arguments, data, and studies presented by commenters in response to the SEC's request for such materials, in violation of the applicable requirements articulated by this Court and other federal courts.

CONCLUSION

SEC Chair Gensler's stated rationale for the Final Rule is his belief that the U.S. private-funds market is uncompetitive, and that imposing greater regulatory disclosures and restrictions on this market will address purported market failures. However, this rationale relies on incorrect, anecdotal evidence while ignoring readily available objective evidence that proves the contrary.

By failing to substantiate the existence of the "genuine problem" that the SEC claims exists, ignoring relevant data, and ignoring commenters, the SEC has violated its statutory obligation under Section 202(c) of the Advisers Act adequately to "consider" whether its rulemakings under the Advisers Act "will promote efficiency, competition, and capital formation." As a result, the Court must invalidate the Final Rule as "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."

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CERTIFICATE OF SERVICE

I hereby certify that, on November 8, 2023, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Fifth Circuit by using the CM/ECF system. I certify that all participants in this case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

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CERTIFICATE OF COMPLIANCE

I certify that:

1. This brief complies with the type-volume limitation of Fed. R. App. P. 29(a)(5) because it contains 6,331 words, excluding the parts of this brief exempted by Fed. R. App. P. 32(f) and Circuit Rule 32.2.

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and Circuit Rule 32.1 and the type-style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word in 14-point font.

3. Any required privacy redactions have been made pursuant to Circuit Rule 25.2.13, the electronic submission is an exact copy of the paper submission, and the brief has been scanned for viruses and is free of viruses.

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