No. 23-60471

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; and NATIONAL VENTURE CAPITAL ASSOICATION,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

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

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BRIEF OF BETTER MARKETS, INC., AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT AND DENYING THE PETITION FOR REVIEW

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SUPPLEMENTAL CERTIFICATE OF INTERESTED PERSONS

No. 23-60471, National Association of Private Fund Managers et al. v. Securities and Exchange Commission

The undersigned counsel of record certifies that, in addition to the persons and entities listed in the parties' briefs, the following additional persons and entities as described in the fourth sentence of Fifth Circuit Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal:

Amicus curiae Better Markets, Inc., ("Better Markets") is a non-profit organization founded to promote the public interest in the financial markets. It advocates for greater transparency, accountability, and oversight in the financial system. Better Markets has no parent corporation and no publicly held corporation owns 10% or more of its stock.

Better Markets is represented by John Paul Schnapper-Casteras of Schnapper-Casteras PLLC, 1717 K Street NW, Suite 900, Washington, DC 20006.

/s/ John Paul Schnapper-Casteras
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STATEMENT OF INTEREST OF *AMICUS CURIAE*

Better Markets, Inc. ("Better Markets") is a nonprofit, nonpartisan organization that promotes the public interest in the financial markets through participation in the rulemaking process at the financial regulatory agencies, Congressional testimony, *amicus curiae* briefs, independent research, and public advocacy.[1] It advocates for reforms that stabilize our financial system, prevent financial crises, and protect investors and consumers from fraud and abuse, ultimately so that our financial system serves all Americans more equitably. Its goals include strong investor protections and disclosure requirements to ensure that our securities markets foster fair, transparent, and efficient capital formation.

Better Markets has an interest in this case because petitioners challenge the SEC's Private Fund Advisers Rule ("Rule"), which is designed to protect investors who directly or indirectly invest in private funds by requiring that private fund advisers disclose more information about the funds they manage and by restricting certain adviser activity that is contrary to the public interest. *Private Fund Advisers*, 88 Fed. Reg. 63,206, 63,206, 63,209 (Sept. 14, 2023). Petitioners claim that the Rule is unnecessary because private fund investors are wealthy and sophisticated and

[1] No party's counsel authored this brief in whole or in part; no party or party's counsel contributed money to fund the preparation or submission of this brief; and no person—other than Better Markets, its members, or its counsel—contributed money to fund the preparation or submission of this brief. Fed. R. App. P. 29(c)(5). All parties have consented to the filing of this brief. Fed. R. App. P. 29(a)(2).

therefore able to fend for themselves; they also say the Rule should be invalidated under the major questions doctrine and because the SEC failed to conduct an appropriate economic analysis. As demonstrated by the SEC and in this brief, these claims have no merit. Private fund investors, especially the pension funds that invest in private funds and hold the savings of everyday Americans, need the protections of the Rule. Moreover, the Rule does not effect the type of economic upheaval necessary to trigger the major questions doctrine, and in any event, the SEC has clear authority to promulgate the Rule. Finally, the SEC satisfied its obligations governing the rulemaking process, including the duty to assess the economic impact of the Rule. A decision to the contrary will limit or nullify important investor protections, undermining one of Better Markets' primary advocacy goals.

SUMMARY OF ARGUMENT

Petitioners' argument that the Rule is unnecessary because private fund investors are sophisticated rests on fundamental misconceptions. **First**, even supposedly sophisticated investors need relevant disclosures to make sound investment decisions. And in light of the greater bargaining power that private fund advisers exert over private fund investors, the potential ability to negotiate for certain disclosures is not a substitute for mandating that private fund advisers provide investors with the information that they need. **Second**, the fact that private fund investors may be sophisticated does not mean they can fend for themselves.

Sophisticated investors are no less prone to suffer losses at the hands of fraud and mismanagement than other investors. **Third**, most private fund investors are not as petitioners portray them—petitioners cite the Abu Dhabi Investment Authority as a stereotypical private fund investor. The reality is that most private fund investors represent more vulnerable beneficiaries such as the public pension funds that hold the retirement savings of the retail investors that petitioners say repeatedly do not invest in private funds. With these more accurate understandings of private fund investors, the Rule makes perfect sense.

Petitioners' contentions that the Rule should be invalidated due to the major questions doctrine and the SEC's economic analysis must also be rejected. Congress delegated clear authority to adopt rules regulating investment advisers to the SEC, an agency with expertise and experience regulating the investment adviser industry, and the SEC's rule claims no broader power to regulate the national economy. Applying the major questions doctrine here would represent a significant and unwarranted expansion of its scope. As to the SEC's economic analysis, this Court recently said that a qualitative discussion is sufficient, and the SEC conducted a qualitative analysis that weighed the costs and benefits of the Rule and concluded that it would likely enhance efficiency, competition, and capital formation. Requiring that the SEC do more would undermine its ability to promulgate and defend a host of rules that are essential for protecting the public.

ARGUMENT

I. Private fund investors need the protections that the Rule affords them.

Petitioners argue that the SEC need not "regulate private funds as if they were mass-market investment vehicles for ordinary investors" and "insert itself between private funds and their highly sophisticated investors." Br. at 10. Indeed, the view that the SEC should not regulate private funds because their investors are sophisticated permeates petitioners' brief. Petitioners repeatedly invoke the supposed sophistication of private fund investors to suggest the Rule is unnecessary. *See, e.g.*, Br. at 1, 5, 7, 8, 10, 47. In light of this supposed sophistication, petitioners claim that private fund investors do not need "the prescriptive regulation applicable to retail-oriented investment companies." Br. at 9. Instead, petitioners say that private fund investors can simply negotiate with private fund advisers to protect themselves. Br. at 8, 47. The entire premise of petitioners' argument is flawed, as investor sophistication is largely a myth and, in any event, even sophisticated investors need robust disclosures and protections against abusive practices.[2]

[2] Similarly flawed is petitioners' suggestion that regulation is unnecessary because the private funds market is thriving. Br. at 1, 9, 10. The market for exchange-traded funds is thriving too. Steve Johnson, *Assets invested in global exchange traded funds hit record $10.32tn*, FINANCIAL TIMES (June 19, 2023), https://www.ft.com/content/23b3c88a-3e76-47c1-bda7-0e5bd53b03c6. Yet "ETFs are subject to extensive regulation." Henry T.C. Hu & John D. Morley, *A Regulatory Framework for Exchange-Traded Funds*, 91 S. CAL. L. REV. 839, 844 (2018). What the "thriving" nature of the private funds market fails to reveal are any of the abuses and inequities that investors in those funds are experiencing.

A. Many institutional investors and wealthy individuals lack sophistication, and those that are sophisticated still need relevant disclosures.

As a threshold matter, the premise that institutional investors and affluent individual investors are in fact sophisticated is increasingly questionable. Lisa M. Fairfax, *The Securities Law Implications of Financial Illiteracy*, 104 VA. L. REV. 1065, 1103 (2018). Although some investors are undoubtedly sophisticated, substantial evidence supports the notion that some investors that the law treats as sophisticated are not. *Id.* at 1103-04; *see also* Daniel J. Morrissey, *The Securities Act at its Diamond Jubilee: Renewing the Case for a Robust Registration Requirement*, 11 U. PA. J. BUS. L. 749, 772 n.138 (2009) ("'Experience indicates that the wealthy often do not have the sophistication to demand access to material information or otherwise to evaluate the merits and risks of a prospective investment.'" (internal citation omitted)). Indeed, "the best available data suggest that there is a distinct possibility that at least some of the institutions and investors we believe to be sophisticated are not." Fairfax, 104 VA. L. REV. at 1104-05. The fact that many supposedly sophisticated investors may not be as sophisticated as petitioners claim undermines the entire premise of their argument, as it means that these investors should not be left to fend for themselves but should be equipped with better disclosures to make better investment decisions and guard against fraud.

In any event, the supposed sophistication of private fund investors—even if true—does not mean regulation is unnecessary. Private fund investors still need relevant disclosures about an investment. The ability to negotiate with private fund advisers, to the extent it is real, is not a substitute for mandatory disclosures.

1. Private fund investments are exceedingly complex, and even supposedly sophisticated investors need relevant disclosures about private funds to make good investment decisions.

Petitioners argue that the Rule is unnecessary because private fund investors are "capable of protecting their own interests." Br. at 37. But even supposedly sophisticated investors need relevant information to make good investment decisions. And the complex nature of private funds makes the provision of relevant information to prospective investors even more important for investor protection.

Although some institutional investors may enjoy a higher level of sophistication than a typical investor, "even the most sophisticated institutional investor cannot overcome incomplete or bad data, both of which can arise from a lack of regulation or oversight." Deidre Farrell, Note, *Increasing Investor Protection Through Improving Hedge Fund Valuation*, 92 ST. JOHN'S L. REV. 149, 156 (2018). In light of the complexities of the trading strategies of some private funds, it can be difficult for even sophisticated investors to adequately assess their risk exposure in an investment, "even if they spend a significant amount of time performing due diligence on a particular fund." Cary Martin, *Is Systemic Risk*

Prevention the New Paradigm? A Proposal to Expand Investor Protection Principles to the Hedge Fund Industry, 86 ST. JOHN'S L. REV. 87, 114-15 (2012). In addition to these complexities, any disclosures that private fund investors receive will vary across funds because disclosures are not standardized; as a result, even the most sophisticated of elite investors may find it difficult to optimize hedge fund selections. Cary Martin Shelby, *How Did We Get Here? Dissecting the Hedge Fund Conundrum Through an Institutional Theory Lens*, 74 BUS. LAW. 735, 747 (2019).

These issues mean that even the "most sophisticated investors may be unable to overcome the high level of information asymmetry they suffer as against sellers of complex financial instruments." Richard E. Mendales, *Fitting an Old Tiger with New Teeth: Protecting Public Employee Funds Investing in Complex Financial Instruments*, 96 MARQ. L. REV. 241, 296 n.296 (2012). So meaningful disclosures are no less important for sophisticated private fund investors than other investors. Enhancing transparency would provide these investors "with pertinent information to make better investment decisions." Cary Martin, *Private Investment Companies in the Wake of the Financial Crisis: Rethinking the Effectiveness of the Sophisticated Investor Exemption*, 37 DEL. J. CORP. L. 49, 107 (2012).

2. The ability to negotiate with private fund advisers is not a substitute for mandatory disclosures of relevant information.

Petitioners also argue that the Rule is unnecessary because sophisticated private fund investors can extract sufficient disclosures by bargaining with private fund advisers. According to petitioners, private fund advisers provide private fund investors with "robust disclosures" through "arms-length bargaining between these well-counseled parties." Br. at 54. "With these tailored disclosures," petitioners assert, "investors *already* have the information they need to monitor fund performance, evaluate adviser services to the fund, and compare investment returns across funds." *Id.* (emphasis in original). These assertions lead petitioners to claim that private fund investors are able to "negotiate for their specific information needs without federal micromanagement." *Id*. at 15. Yet the reality is very different.

Petitioners' brief mirrors the defense that the private equity funds industry often asserts against criticism—that large investors in private equity funds use their bargaining power to negotiate for robust protections in fund agreements, and that because fund agreements are highly negotiated, concerns about the substantive quality of their terms must be unwarranted. William W. Clayton, *The Private Equity Negotiation Myth*, 37 YALE J. ON REG. 67, 69 (2020). The problem is that the court "should not simply take the negotiation myth at face value." *Id.* at 71. Just because private fund investors may be sophisticated, it cannot be "assumed that fund agreements will always have robust protections for all investors in them." *Id.*

The idea that "sophisticated parties to any voluntary agreement will agree to final terms" that protect their interests "is elegant in theory" but not "in practice." William W. Clayton, *High-End Bargaining Problems*, 75 VAND. L. REV. 703, 708

(2022). In practice, at least with respect to the private funds industry, "this does not appear to be how the private equity industry works at all." *Id.* The substance of common private equity fund terms is often "one-sided" and "unlikely to maximize the joint welfare of all involved." *Id.* That is because the terms "vary greatly depending on the balance of bargaining power between managers and investors." *Id.* Unsurprisingly, the balance of power favors managers.

"As private equity managers have enjoyed extraordinary success in increasing assets under management over the past decade, institutional investors have frequently complained about an imbalance in bargaining power that leads to manager-favorable governance terms in private equity funds." William W. Clayton, *How Public Pensions Have Shaped Private Equity,* 81 MD. L. REV. 840, 845 (2022); *see also* Clayton, 75 VAND. L. REV. at 733-44 (explaining that, as the private equity industry has experienced massive growth, "industry participants report that governance terms have moved dramatically in favor of managers"). So the ability to negotiate for relevant disclosures and other terms of a private equity investment is not the cure-all "that a surface-level view of the industry might suggest." Clayton, 81 MD. L. REV. at 846. Instead, it appears that the absence of specific disclosure requirements creates "the possibility of negotiations for limited disclosures and extreme divergences in the information known about" the investment. Eizabeth Pollman, *Private Company Lies*, 109 GEO. L.J. 353, 374 (2020).

As a result, the possibility that private fund investors may be able to negotiate with private fund advisers is not a substitute for mandating that private fund advisers provide investors with the information that they need. The limited public disclosure regime surrounding private funds makes it "exceptionally difficult for investors to adequately investigate a particular hedge fund investment." Martin, 86 ST. JOHN'S L. REV. at 90. The fact remains that, without the Rule, private fund investors do not have the information that they need to "adequately protect themselves from the unique information challenges associated with hedge fund investments." *Id.*

B. Fraud and mismanagement victimize sophisticated investors.

Despite these challenges, securities fraud in the private markets receives relatively little attention due to the conventional wisdom that "this market features only sophisticated investors who can fend for themselves." Pollman, 109 GEO. L.J. at 356. "A different reality, however, has started to become clear." *Id.* The mandatory disclosure of relevant information is especially important because recent history shows that, despite what petitioners say, the fact that private fund investors may be sophisticated does not mean they can fend for themselves. Sophisticated investors are no less prone to suffer losses at the hands of fraud and mismanagement than other investors. The Rule obviously will not insulate private fund investors from fraud and mismanagement, but it will deter such misconduct in the first instance and better equip *all* investors to protect themselves.

Although the securities laws usually follow petitioners' assumption "that wealthy investors are sophisticated and can fend for themselves," Susanna Kim Ripken, *Paternalism and Securities Regulation*, 21 STAN. J.L. BUS. & FIN. 1, 43 (2015), this assumption is unfounded as private fund investors no less than others "are vulnerable to investment frauds." Salvatore Massa, *Outside a Black Box: Court and Regulatory Review of Investment Valuations of Hard-To-Value Securities*, 8 WM. & MARY BUS. LAW REV. 1, 60 (2016). Indeed, there is "plenty of evidence of wealthy investors fending for themselves very poorly." Ripken, 21 STAN. J.L. BUS. & FIN. at 43; *accord* Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the Jobs Act*, 101 GEO. L.J. 337, 362 (2013). The last 15 years alone provide ample evidence that sophisticated investors "are not immune from harm." Ripken, 21 STAN. J.L. BUS & FIN. at 43.

In 2008, Bernie Madoff revealed his massive Ponzi scheme that ensnared dozens of "supposedly sophisticated financial firms." The Madoff affair, THE ECONOMIST (Dec. 18, 2008), http://www.economist.com/node/12818310/. Madoff was able to conceal his fraud while amassing billions of dollars from sophisticated institutional clients on Wall Street and around the world. Cheryl Nichols, *Addressing Inept SEC Enforcement Efforts: Lessons from Madoff, The Hedge Fund Industry, and Title IV of the Dodd-Frank Act for U.S. and Global Financial Systems*, 31 NW. J. INT'L L. & BUS. 637, 638 (2011). These victims, along with other Madoff investors, suffered losses of over $50 billion. Alexandros Seretakis, *Taming the Locusts? Embattled Hedge Funds in the E.U.*, 10 N.Y.U. J.L. & BUS. 115, 126 n.37 (2013). "Madoff's tragic, historic, and unprecedented investment duplicity and the resulting consequential fallout strongly evinces that policymakers should reexamine the wisdom of continued reliance on the statutory model of sophisticated investors being left to fend for themselves." Felicia Smith, *Madoff Ponzi Scheme Exposes "The Myth of the Sophisticated Investor,"* 40 U. BALT. L. REV. 215, 231 (2010).

The 2008 financial crisis similarly made clear that, despite the presumption that some investors are sophisticated enough to make informed investment decisions without mandatory disclosures, "wealthy and ostensibly sophisticated investors can make tremendous mistakes and suffer enormous losses." Jonathan D. Glater, *Private Offerings and Public Ends: Reconsidering the Regime for Classification of Investors Under the Securities Act of 1933*, 48 CONN. L. REV. 355, 355 (2015). For example, sophisticated investors suffered severe losses due to their participation in credit default swaps. Notwithstanding their supposed sophistication, they did not fully understand the risks of these complex financial transactions. The losses that these investors suffered when AIG collapsed helped ignite the crisis and resulted in catastrophic consequences for retail investors and the public.[3] The financial crisis

[3] Better Markets, *The Cost of the Crisis*, at 1 (July 2015) (finding that the crisis cost the American people at least $20 trillion), https://bettermarkets.org/wp-content/uploads/2021/07/Better-Markets-Cost-of-the-Crisis.pdf.

thus undermines the assumption that sophisticated investors can fend for themselves. Martin, 86 ST. JOHN'S L. REV. at 130; *see also* Ripken, 21 STAN. J.L. BUS. & FIN. at 43 ("Scholars have argued that in the 2008 financial crisis, it was sophisticated investors' errors and poor decisionmaking that 'fueled a bubble' and led to investments that proved 'disastrous for the broader society.'" (citations omitted)).

Even more recently, the Theranos scandal belies the notion that sophisticated investors need less protection. Elizabeth Holmes was able to "rais[e] millions of dollars from an assortment of wealthy investors." Pollman, 109 GEO. L.J. at 355. Her trial "offered an especially clear picture of the many ways that sophisticated investors can be swept up in the hype of a hot start-up." Erin Griffith, What Red Flags? Elizabeth Holmes Trial Exposes Investors' Carelessness, N.Y. TIMES (Nov. 23, 2021), https://www.nytimes.com/2021/11/04/technology/theranos-elizabeth-holmes-investors-diligence.html. It also exposed the fact that investor sophistication is no substitute for receiving complete information. *Id.*; *see also* Verity Winship, *Private Company Fraud*, 54 U.C. DAVIS L. REV. 663, 707-08 (2020) (noting the limited information in Theranos's Form D and that "even sophisticated investors may get limited information"). Theranos, in other words, served to "ring[] the alarm bell on securities fraud in the private market." Pollman, 109 GEO. L.J. at 356.

As the above examples illustrate, if the question is whether large or wealthy investors can protect themselves, "the answer is surely no." Langevoort &

Thompson, 101 GEO. L.J. at 36. The due diligence that supposedly sophisticated private fund investors conduct does not always protect them. *See* Matt Levine, *You Never Want to Be Suckered This Badly: Even with Due Diligence, Sophisticated Investors Still Get Hoodwinked by Fraudulent Business*, BLOOMBERG (May 17, 2018), https://www.bloomberg.com/view/articles/2018-05-17/securities-fraud-can-happen-with-private-transactions. "Names such as AIG, Enron, WorldCom, and Madoff serve as reminders for more, not less, regulation of those who wield economic power." Peter C. Lagarias and Robert S. Boulter, *The Modern Reality of the Controlling Franchisor: The Case for More, not Less, Franchisee Protections*, 29-WTR FRANCHISE L.J. 139, 140 (2010) (noting that "[m]odern-day hucksters masquerading as 'titans of industry' continue to engage in fraud and deceptive practices, costing billions in losses to even the most sophisticated investors").

C. The need to provide private fund investors with relevant disclosures and to protect them from fraud is especially acute because most private fund investors these days are pension funds.

The premise of petitioners' argument—that regulating private funds is unnecessary because private fund investors are wealthy and sophisticated—would be flawed even if the court accepted petitioners' invitation to think of private fund investors as "the Abu Dhabi Investment Authority and Yale University endowment." Br. at 1. As demonstrated above, even the wealthiest and most experienced of investors need adequate disclosures and protection against fraud. Still, under petitioners' view, "one might argue that investors in private capital markets" at the least "can bear the loss and are not a vulnerable class." Pollman, 109 GEO. L.J. at 392. But the reality is that most private fund investors are not as petitioners portray them, as to either their sophistication *or* their ability to sustain losses unscathed. The reality is that most private fund investors represent more vulnerable beneficiaries such as the public pension funds that hold the retirement savings of the retail investors that petitioners say repeatedly do not invest in private funds.

Public pension plans have collectively become the largest investors in the private equity fund industry. Clayton, 81 MD. L. REV. at 842; *see also* Clayton, 75 VAND. L. REV. at 740 ("The bulk of the capital in private equity funds is invested by taxpayer-backed public pension plans, private pension plans investing the retirement savings of private employees, and endowments and charities investing for nonprofit causes."). These plans invest the retirement savings of public servants across the nation, including teachers, firefighters, and policemen, and they are typically backed by the taxpayers in the jurisdiction sponsoring the plan. Clayton, 81 MD. L. REV. at 843. This affects the investor protection calculus in the private fund industry by increasing the number of regular people impacted by fund operations. *Id.*

> Because pension funds, charities, and universities can qualify and claim to be sophisticated, they regularly now expose human investors and society as a whole to the risks that come with hedge fund investing. Many pension funds are not in fact well positioned to prudently select hedge funds or other nonregistered investments . . . . And although the direct investor who makes these investments is accredited, it is the

> human investor (who is supposedly unable to invest in these vehicles) who in fact bears the risk of investment losses.

Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1935-36 (2017); *see also* Pollman, 109 GEO. L.J. at 373 (stating that public pension funds' investments in private companies "expose retail investors to the private markets" despite not having "long track records of investing in this asset class" and managing "the special challenges they pose").

The massive growth of public pension investment in private funds "calls into question some of the basic assumptions on which private fund regulatory policy long has been based." William W. Clayton, *Public Investors, Private Funds, and State Law*, 72 BAYLOR L. REV. 294, 304 (2020); *see also* Leo E. Strine, Jr., *Stewardship 2021: The Centrality of Institutional Investor Regulation to Restoring a Fair and Sustainable American Economy*, 24 U. PA. J. BUS. L. 1, 3-4 (2021) (stating that the fact that the "growth of hedge funds and private equity funds has been fueled not primarily by rich individual investors who bear the risk of losses themselves, but by other institutional investors like pension funds, charities, university endowments, and other institutions whose soundness is important to Americans and society as a whole," undermines the assumption that some investors may, "without harm to society, invest in opaque vehicles on a caveat emptor basis"). As "more and more of the industry's capital comes from public plans," it is "increasingly unclear" if private fund investors really do have the ability to bear any economic loss as well as the degree of sophistication that leaves them able to fend for themselves. Clayton, 72 BAYLOR L. REV. at 304. The chronic underfunding of public pension plans means that they are actually in a very poor position to sustain economic losses from failed investments, and the management problems that plague public pension plans means they may not be as sophisticated an investor as it seems. *Id.* at 352-53.

This means that the lack of disclosure from private fund advisors, the need for private fund investors to negotiate for that disclosure, and the risk of fraud that results from informational asymmetries in the private funds market are all the more problematic. Exacerbating the vulnerability of public pension funds and their investors "is the reality that the lack of disclosure puts consumers like pension funds and college investment funds in a poor position to shop knowledgably because track record information is unclear and unreliable, and fund managers seem to be able to tout publicly return records that put to the side their past failures." Strine, 126 YALE L.J. at 1936; *see also* Shelby, 74 BUS. LAW. at 777 (stating that pension funds and endowments are unable "to properly assess hedge funds" given their "unstandardized mechanisms for reporting fees and performance"). "Although hedge funds and private equity funds should not be required to disclose proprietary information about their trading strategies that would inhibit their ability to conduct their unique approach to investing, it is long past time when they should be permitted to cloak their track records, their terms of investment, special deals to their favorites, and other important information because their investors should be presumed to operate on a caveat emptor basis." Strine, 24 U. PA. J. BUS. L. at 23. The rules governing private fund investments "were not intended to allow pension funds, universities, or charitable institutions to put money in risky investments not backed up by appropriate disclosures and standards of integrity." *Id.*

The potential ability to negotiate for appropriate disclosures will not protect public pension fund investors in hedge funds given the "unequal bargaining power" that they hold. Shelby, 74 BUS. LAW. at 777. Public pension funds often agree to one-sided terms and tolerate an environment of weak transparency, which extends to private fund advisers charging fees without specific disclosures. Clayton, 72 BAYLOR L. REV. at 298. So public pension funds remain unable to "adequately protect[] the interests of their beneficiaries in this highly contractarian setting." *Id.*

In light of these conditions, it is unsurprising that some pension funds "have gotten burned after they rushed to alternative asset managers, like hedge funds, to fill funding gaps." Strine, 126 YALE L.J. at 1936 n.216 (citing the "steep decline" after "the Austin Police Retirement System moved almost half of its assets to alternative managers"); *see also, e.g.*, Cary Martin Shelby, *Are Hedge Funds Still Private? Exploring Publicness in the Face of Incoherency*, 69 SMU L. REV. 405, 442-43 (2016) (noting that the San Diego County Employees Retirement

Association lost its approximately $87 million investment in a hedge fund). Pension funds and charities simply "lack enough reliable information to prudently assess whether these investments are appropriate for their portfolio." Strine, 24 U. PA. J. BUS. L. at 24. Even the most sophisticated funds, such as CALPERS and the Texas Teachers Fund, suffered losses from improvident investments in the complex financial instruments at issue in the financial crisis. Mendales, 96 MARQ. L. REV. at 303. Now some pension funds, such as CALPERS, have divested their hedge fund allocations due to concerns related to excessive complexity and inadequate results. Shelby, 69 SMU L. REV. at 442. Regulations that arm pension funds with the information they need to invest in private funds are especially important because any losses that public pension funds suffer hurt not only workers but also society at large, as taxpayers may have to fill the resulting holes. Strine, 24 U. PA. J. BUS. L. at 24.

Finally, pension funds' own actions belie the notion that they can fend for themselves in the private funds market. In 2015, a dozen comptrollers and treasurers from cities and states including New York, California, and South Carolina sent the SEC a letter requesting that the SEC force private equity funds to make greater disclosures regarding fees and expenses. The signatories said that clearer and more consistent disclosures would give large retirement systems "'a stronger negotiating position, ultimately resulting in more efficient investment options.'" Timothy W. Martin, *States, Cities to Ask SEC to Beef Up Disclosures for Private-Equity Firms*, WALL ST. J. (July 21, 2015), https://www.wsj.com/articles/states-cities-to-ask-sec-to-beef-up-disclosures-for-private-equity-firms-1437522627. Petitioners argue that the SEC should trust "the experienced, well-counseled investors in private funds to negotiate for themselves." Br. 26. But these very investors have instead said that they need more information to be able to negotiate on an equal footing with private funds and have themselves asked the SEC to do exactly what it did here.

II. <u>The major questions doctrine is irrelevant to this case.</u>

Petitioners claim that the Supreme Court's "major questions" doctrine "confirms the Commission lacks the authority" to adopt the Rule. Br. at 37. According to petitioners, this case involves a "major question" because the Rule represents a "'transformative expansion' of a hitherto 'unheralded power.'" *Id.* at 38 (quoting *West Virginia v. EPA*, 142 S. Ct. 2587, 2610 (2022)). But the Rule is neither transformative nor lacking a clear statutory basis. Rather, application of the doctrine here would prevent the SEC from using its rulemaking powers to regulate industries that fall squarely and traditionally within its domain.

In *West Virginia*, the Supreme Court applied the major questions doctrine to an assertion of what it characterized as "'extravagant statutory power over the national economy.'" 142 S. Ct. at 2609 (citation omitted). The Supreme Court stated that the EPA had "'claim[ed] to discover in a long-extant statute an unheralded power' representing a 'transformative expansion in [its] regulatory authority.'" *Id.*

at 2610 (citation omitted) (alterations in original). The SEC's adoption of the Rule does not involve an assertion of extravagant power over the national economy or a transformative expansion of its regulatory authority under the federal securities laws.

Petitioners themselves recognize that the Commission "does regulate *advisers* to private funds in specific, limited respects through the Investment Advisers Act of 1940." Br. at 10-11 (emphasis in original). They recognize further that although "the statute once exempted many private-fund advisers," the Dodd-Frank Act, which Congress passed in 2010, repealed that exemption and "made most private-fund advisers subject to the same limited requirements as other investment advisers." *Id*. at 11. And the SEC has long regulated those "other" investment advisers. The "regulation of investment advisers and investment companies is considered to be properly part of the [SEC's] core mission." Yoon-Ho Alex Lee, *Beyond Agency Core Mission*, 68 ADMIN. L. REV. 551, 566 (2016). The Dodd-Frank amendments to the Advisers Act basically "were designed to more effectively regulate investment advisers to private funds." Anita K. Krug, *Rethinking U.S. Investment Adviser Regulation*, 87 ST. JOHN'S L. REV. 451, 454 (2013). So far from invoking the Dodd-Frank Act to transform its regulatory authority and reorder the national economy, the SEC is simply using its rulemaking authority to address issues that have arisen in a space that it has overseen since passage of the Investment Advisers Act of 1940.

As a result, applying the major questions doctrine here would represent a significant and unwarranted expansion of its scope. The doctrine currently "applies to curtail administrative discretion when an agency stretches the boundaries of statutory interpretation to claim new authority to address big problems that, previously, were not obviously within the agency's purview." Kristin E. Hickman, *The Roberts Court's Structural Incrementalism*, 136 HARV. L. REV. F. 75, 86 (2022). Here, the SEC addressed problems well within its purview.

That makes this case similar to *Loper Bright Enterprises, Inc. v. Raimondo*, 45 F.4th 359 (D.C. Cir. 2022). There, the D.C. Circuit noted that the "'major questions doctrine' applies only in those 'extraordinary cases' in which the 'history and breadth of the authority that [the agency] has asserted,' and the 'economic and political significance' of that assertion, provide a 'reason to hesitate before concluding that Congress' meant to confer such authority." *Id.* at 364-65 (quoting *West Virginia*, 142 S. Ct. at 2595 (internal quotation marks and citation omitted (alteration in original))). The court found that the doctrine did not apply where Congress "delegated broad authority to an agency with expertise and experience within a specific industry, and the agency action is so confined, claiming no broader power to regulate the national economy." *Id.* at 365. In the Dodd-Frank Act, Congress delegated the authority to adopt new rules regulating investment advisers to the SEC, an agency with expertise and experience regulating the investment adviser industry, and the SEC's rule claims no broader power to regulate the national economy. The major questions doctrine does not apply.

Otherwise, the major questions doctrine will prevent agencies from using existing statutory authority to address any new challenges that arise as financial industries evolve, even when the agency does not seek to regulate the national economy in areas beyond its normal purview. The SEC must be able to use its existing statutory authority to address issues that arise in the industries it regulates. As relevant here, there is no question that in recent years capital markets "have evolved significantly." J. Robert Brown, Jr., *Mother Nature on the Run: The SEC, Climate Disclosure, and the Major Questions Doctrine*, 60 SAN DIEGO L. REV. 321, 369 (2023). "Yet the existing system of required disclosure largely reflects the concerns of an earlier era." *Id.* at 370. The private fund advisers rule is part of a series of rules proposed by the Commission to modernize disclosure requirements. But if the major questions doctrine is used to limit the SEC's authority to respond to changing markets, "it could upend those efforts at modernization." *Id.* And the consequences of doing so "are entirely predictable." *Id.* at 371. Investors "will be forced to rely on voluntary disclosure, with all of the attendant limitations." *Id.* As a result, investors "will be less informed and capital markets less efficient." *Id*. The major questions doctrine must not prevent agencies from adopting new regulatory approaches in the areas core to their missions. *See* Daniel T. Deacon and Leah M.

Littman, *The New Major Questions Doctrine*, 109 VA. L. REV. 1009, 1081 (2023) (arguing against applying the major questions doctrine simply when "the agency's considered expertise, perhaps in conjunction with unanticipated changes or new information, counsels a previously untried regulatory approach").

III. The SEC conducted a sufficient economic analysis.

Petitioners contend that the SEC failed in its duty to determine the economic implications of the Rule by including only an insufficient "'qualitative' discussion" of the Rule's effects. Br. at 68 (quoting 88 Fed. Reg. at 63,293). But this Court recently affirmed that a qualitive discussion is sufficient. And the SEC's qualitative discussion satisfied its duty to determine the Rule's economic effects as best it can.

In *Chamber of Commerce v. SEC*, 85 F.4th 760, 773 (5th Cir. 2023), this Court "agree[d] with the SEC that, as a general matter, it is not required to undertake a quantitative analysis to determine a proposed rule's economic implications." The relevant statutes "merely command the SEC to 'consider . . . whether the action will promote efficiency, competition, and capital formation.'" *Id.* (quoting 15 U.S.C. §§ 78c(f), 80a-2(c)). The use of the term "consider"—"shorn of modifiers or limiters—does not restrict the universe of otherwise permissible methods by which the SEC can analyze the economic implications of a proposed rule." *Id.* "A rigorous quantitative cost-benefit analysis is one way—but not the only way—to determine whether a proposed rule 'promotes efficiency, competition, and capital formation.'"

Id. (citation omitted). So the SEC need not "analyze economic impacts using quantitative methods whenever it is feasible." *Id.* The SEC has discretion "to determine the mode of analysis that most allows it 'to determine as best it can the economic implications of the rule it has proposed,'" including by relying on a "qualitative analysis for its determination of economic impact." *Id.* at 773-74.

Here, the SEC's qualitative analysis led it to conclude that the Rule would promote efficiency, competition, and capital formation. With respect to efficiency, the SEC stated that Rule "will likely enhance economic efficiency by enabling investors more easily to identify funds that align with their preferences over private fund terms, investment strategies, and investment outcomes, and also by causing fund advisers to align their actions more closely with the interests of investors through the elimination of prohibited practices." 88 Fed. Reg. at 63,358. With respect to competition, the SEC stated that "enhanced competition from additional transparency may lead to lower fees or may direct investor assets to different funds, fund advisers, or other investments." *Id.* at 63,360. And with respect to capital formation, the SEC stated that the Rule "will facilitate capital formation by causing advisers to manage private fund clients more efficiently, by restricting or prohibiting activities that may currently deter investors from private fund investing because they represent possible conflicting arrangements, and by enabling investors to choose more efficiently among funds and fund advisers." *Id*. at 63,363. Far from failing "even 'to hazard a guess' about the likely economic effects of the Rule," Br. at 68 (citation omitted), the SEC said exactly what it expected the economic effects to be.

Petitioners' criticism of the SEC's "conditional assertions" also misses the mark. Br. at 69. The fact that the SEC contemplated many possible ramifications of the Rule shows not a lack of reasoned analysis but rather fulfillment of its duty to "consider" the effects of the Rule. The SEC "may reasonably conduct a 'general [economic] analysis based on informed conjecture.'" *Nasdaq Stock Mkt. LLC v. SEC*, 34 F.4th 1105, 1111 (D.C. Cir. 2022) (internal citation omitted); *see also Sec'y of Agriculture v. Cent. Roig Refining Co.*, 338 U.S. 604, 611-12 (1950) (stating that when statutorily mandated "consideration[s]" are not "mechanical or self-defining standards," they "in turn imply wide areas of judgment and therefore of discretion").

No more persuasive is petitioners' view that the SEC "'inconsistently and opportunistically framed the costs and benefits'" of the Rule in a way that was contradictory. Br. at 70 (citation omitted). The SEC expressed its view that the Rule would enhance efficiency, competition, and capital formation while recognizing the possibility that the Rule could lead to some negative effects on these factors as well. For example, the SEC stated that to the extent the Rule imposed costs that impacted smaller advisers more than larger advisers "competition may be reduced, but these potential negative effects on competition must be evaluated in light of (1) the other pro-competitive aspects of the final rules, in particular the pro-competitive effects from enhancing transparency, which are likely to help smaller advisers effectively compete and may therefore benefit those advisers, and (2) the other benefits of the final rules." 88 Fed. Reg. at 63,362. The SEC was right to recognize various possible effects of the Rule and express its view as to the Rule's most likely effects and the worthwhile benefits. The SEC has never been required to do more than "weigh the costs and benefits" of a rule and "make 'reasonable trade-offs.'" *Nasdaq Stock Mkt.*, 34 F.4th at 1113 (citation omitted). That is what the SEC did here.

CONCLUSION

For the foregoing reasons, the Court should deny the petition for review.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief complies with the type-volume limitation of Fed. R. App. P. 29(a)(5) and 32(a)(7)(B) because it contains 6,495 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(f).

This brief also complies with the typeface requirements of Fed. R. App. P. 32(a)(5) 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 for Microsoft 365 in 14-point Times New Roman font.

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CERTIFICATE OF SERVICE

I certify that on December 22, 2023, I served a copy of the foregoing brief on all counsel of record through this Court's electronic filing system.

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