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The ’40 Act Protections Chairman Levitt Overlooks

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Former SEC Chairman Arthur Levitt is right about one thing: Retail investors should not be exposed to private market investments without meaningful safeguards. But in a recent opinion column, he mischaracterizes the SEC’s latest proposals on expanding retail access to private markets while overlooking protections that regulated funds already provide.

The SEC’s recent rule proposals envision retail investors accessing private markets through regulated funds rather than investing directly through private funds. Regulated funds operate under the Investment Company Act of 1940 (’40 Act), arguably the most comprehensive investor protection framework under the securities laws. The SEC’s proposals leverage this framework and preserve core protections related to independent board oversight, valuation, disclosure, and conflicts of interest.

The Safeguards Are Already There

Registered closed-end funds and BDCs, which are the primary types of regulated funds that provide retail access to private markets, are subject to extensive requirements designed to protect investors. Their boards are composed largely of independent directors who are charged under the ’40 Act with a host of responsibilities for oversight of fund operations and addressing conflicts of interest, including review and approval of investment advisory agreements. In addition, under the ’40 Act, regulated funds must disclose their investment strategies, risks, fees, and liquidity limitations in a prescribed format, and provide detailed financial information, including audited financial statements that are certified by the fund’s CEO and CFO.

The ’40 Act also restricts affiliated transactions to prevent self-dealing, and registered closed-end funds and BDCs operate under statutory leverage restrictions and rules governing their redemption opportunities.

These protections apply regardless of whether a fund invests in publicly traded securities, private equity, private credit, or other asset classes.

The Regulatory Framework Has Grown Stronger

Chairman Levitt expresses particular concern that private asset valuations are left to fund

managers without adequate external scrutiny, and that the ability to charge performance fees could disincentivize sound valuation practices. Yet what is missing from his discussion is that regulated funds are subject to SEC rules governing fair value determinations, in which independent oversight and external expertise play critical roles.

In 2020, the SEC adopted Rule 2a-5, establishing rigorous requirements for determining the fair value of fund investments. Those requirements include assessing valuation risks, testing methodologies, overseeing pricing services, and reporting to fund boards.

Furthermore, a recent ICI and PwC survey found that 86% of private credit respondents and 85% of private equity respondents use third-party valuation experts. Management overrides of outside valuations were uncommon across the asset classes surveyed.

Rule 2a-5 is just one example of how the SEC has built upon the solid foundation of the ’40 Act to strengthen oversight of regulated funds over the decades. Several of these reforms were adopted during Levitt’s tenure as SEC Chairman from 1993 to 2001.

During that time, the SEC strengthened the role of independent fund directors, required clearer disclosure of investment risks and performance—including performance bar charts and comparisons with market indexes—and adopted the original fund Names Rule to protect investors from misleading fund names. Chairman Levitt was a tireless champion of retail investor protections, and the protections adopted during his tenure remain today.

Subsequent SEC Chairs carried that baton and continued to strengthen fund oversight. For example, in 2003, the SEC adopted Rule 38a-1, requiring funds to establish comprehensive compliance programs and appoint chief compliance officers who report directly to their boards. Fund disclosure rules have been enhanced and made more investor-friendly under both Republican and Democratic SEC Chairs, including through requirements for quarterly portfolio holdings disclosure, fund summary prospectuses, and tailored shareholder reports.

Multiple Share Classes Are Nothing New

Chairman Levitt also warns that allowing multiple share classes could enable fund managers to impose substantially higher fees on retail investors than on institutional investors.

But he should know that the SEC’s proposal would prohibit such practices. Rule 18f-3, which permits mutual funds to offer multiple share classes without individual exemptive orders, dates to 1995, when Levitt himself was Chairman.

The new proposal would extend a similar regulatory framework to continuously offered, unlisted registered closed-end funds and BDCs, many of which already offer multiple share classes under individual SEC exemptive orders.

These arrangements are subject to important safeguards. Different classes may have different distribution and shareholder servicing fees, but fund-wide expenses, including investment advisory fees, must be allocated equitably. Fund boards must approve written plans governing multiple share classes, and shareholders receive disclosures explaining differences in costs.

The proposal would replace a longstanding case-by-case approval process with a consistent regulatory framework. It would not give advisers a free hand to impose arbitrary fees on retail shareholders.

Expanding Access Without Sacrificing Protections

Private market investments present risks that investors must consider carefully. They can be difficult to value and are often less liquid than publicly traded securities. Regulators should continue to ensure investors receive clear disclosures and meaningful protections.

Those concerns are precisely why the regulated fund framework matters.

The question facing the SEC is not whether ordinary investors should gain access to private markets without safeguards. It is how to expand investment opportunities within a regulatory framework that has protected generations of American investors and grown stronger over time.

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