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Investment Funds Update

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SEC Advances “Responsible Retailization” Package of Rule Proposals

Paired with its rule proposals, the SEC also issued five notices seeking comment on additional ways for individuals to qualify as accredited investors under Regulation D.

At its September 30, 2026 open meeting, the Securities and Exchange Commission (the SEC) proposed significant rulemaking designed to modernize the framework for retail investor access to private market investment opportunities through Investment Company Act-regulated funds, including proposals that would:

- amend Rule 205-3 under the Investment Advisers Act to allow advisers to registered funds and business development companies (BDCs) to charge performance fees of up to 20% of a fund’s net gains, including unrealized gains, without investor net worth requirements, and to redefine “qualified client” to include any accredited investor, which would permit registered advisers to Section 3(c)(1) private funds and separately managed accounts to charge carried interest and other performance-based compensation to accredited investors without a separate net worth or assets-under-management screen;
- amend Rule 23c-3 under the Investment Company Act to provide interval funds more flexibility with respect to structuring and operating share repurchase programs; and
- amend Rule 18f-3 under the Investment Company Act to codify exemptive relief for registered closed end funds seeking to issue multiple share classes.

Paired with its rule proposals, the SEC also issued five notices seeking comment on additional ways for individuals to qualify as accredited investors under Regulation D.

At the open meeting, the three sitting SEC commissioners, each of the same political party, unanimously supported the proposals. Though, Commissioner Hester Peirce's planned resignation took effect on October 2 after the meeting, leaving Chairman Atkins and Commissioner Mark Uyeda as the only remaining commissioners, with no nominee announced to fill Commissioner Peirce's seat. When fewer than three commissioners are in office, the SEC's quorum rule treats the members in office as a quorum, so the remaining two commissioners could adopt final rules following the respective comment periods, which will run for 60 days after the proposing releases and notices are published in the Federal Register.^[1]

Performance-Based Compensation for Advisers to Regulated Funds

The SEC proposed amending Rule 205-3 under the Investment Advisers Act to allow advisers to registered funds to receive capital gains-based performance compensation, whether or not the fund's investors meet the "qualified client" standards under the rule, so long as:

- such fees do not exceed 20% of the registered fund's net gains (that is, net capital gains or net capital appreciation, including unrealized appreciation) over a specified period;
- the fund satisfies the fund governance standards of Rule 0-1(a)(7) under the Investment Company Act, which standards require a governing board with a majority of independent directors, selection and nomination of independent directors by the existing independent directors, and independent legal counsel for the independent directors; and
- the fund's board, including a majority of independent directors, determines that the arrangement is in the best interest of the fund and its shareholders and makes specific findings regarding the arrangement's appropriateness, structure, and investor protection features.

The proposed 20% performance fee cap for registered funds mirrors the capital gains incentive fee that Section 205(b)(3) of the Advisers Act already permits for BDCs, but the SEC's new proposal goes further. Section 205(b)(3) limits BDC fees to realized gains only, net of realized losses and unrealized depreciation. The SEC is proposing to allow performance fees for both registered funds and BDCs to reflect net unrealized appreciation. The SEC's rationale is that alternative investment advisers who now reserve private market strategies for private funds serving institutional investors would be more likely to offer them through registered funds if they could earn comparable incentive-based compensation.

The argument for performance fees is that they compensate for results rather than exposure. By allowing these managers to charge the same performance fees for managing registered funds, it may become economically viable for those managers to replicate their more complex alternative investment strategies for non-institutional investors. Notably, the SEC indicated that performance fees may be justified for skill-dependent strategies such as private equity and private credit but would generally be difficult to justify for passive index strategies, and that funds holding assets without readily available market quotations would warrant more intensive board oversight of the valuation process. The SEC specifically cautioned against valuation practices that could inflate

the fee base, such as acquiring private fund interests at a discount and immediately marking them to the underlying fund's net asset value. Because the arrangement would be approved through the Section 15(c) process, a performance fee would also be subject to excessive fee claims under Section 36(b) of the Investment Company Act, a litigation exposure that private fund sponsors do not face on carried interest today.

For BDC sponsors, the proposal would narrow a structural advantage the BDC form has held over registered closed end funds given that BDC sponsors could earn capital gains-based incentive fees (even if on realized gains only). The SEC's new proposal could therefore affect the relative economics of BDCs and registered interval or tender offer funds for sponsors evaluating product types.

As part of this proposed rulemaking, the SEC would also amend certain registration and reporting forms for registered funds to require enhanced disclosure of performance-based compensation, including in the fund's fee table.

An existing registered fund that wants to add a performance fee based on net gains generally would need shareholder approval of an amended advisory contract under Section 15 of the Investment Company Act, with the associated proxy costs, because the proposal generally would not apply to advisory contracts entered into before the final rule's effective date.

The rule proposal would also update the "qualified client" definition in Rule 205-3(d) to include any investor that the adviser reasonably believes is an "accredited investor" under Regulation D at the time the advisory contract is entered into, and remove the separate net worth (currently \$2.7 million) and assets under management (currently \$1.4 million) thresholds. For registered advisers to Section 3(c)(1) private funds and separately managed accounts, this would eliminate the separate, higher qualified client screen that currently applies on a look-through basis to each investor charged carried interest or an incentive allocation, and would allow sponsors to simplify subscription documents for those vehicles. The look-through would remain, the change would apply prospectively (so existing investors would not need to requalify), and Section 3(c)(7) funds, which are already outside the performance fee prohibition, would be unaffected. Sponsors should note, however, that an entity that qualifies as an accredited investor only on the basis of its assets must have \$5 million in assets, generally a higher bar than the current \$2.7 million net worth test, so some entity investors that are qualified clients today would qualify going forward only under the retained "qualified purchaser" or "knowledgeable employee" prongs.

Separately, the federal change would not automatically flow through to the states: many state private fund adviser exemptions condition the exemption, or an exempt reporting adviser's ability to charge performance-based compensation to investors in a Section 3(c)(1) fund, on investors satisfying the "qualified client" definition in Rule 205-3, and whether those states follow the SEC's harmonization will depend on how each state's rule incorporates the federal definition and on any subsequent state rulemaking, so exempt reporting advisers relying on those exemptions will need to assess their states' rules to determine whether, and when, they may rely on the updated federal test, both to preserve the exemption and to charge carried interest to investors who are accredited investors but would not have met the prior thresholds.

Interval Fund Modernization

The SEC's proposed rulemaking would also amend the interval fund rule, Rule 23c-3 under the Investment Company Act, in several ways. Among other proposed changes, the SEC proposes to modernize the interval fund structure in the following ways:

- ***Deferral of First Repurchase:*** Allow a newly launched interval fund to defer its first repurchase offer for up to two years after its registration statement becomes effective, regardless of its stated repurchase interval, to accommodate private equity-style strategies with portfolios that may not generate liquidity until later in a fund's life. The current rule requires the first repurchase within two intervals (*g.*, a six-month period for an interval fund operating a quarterly share repurchase program). The SEC is seeking industry comments on the appropriate length of the period prior to commencement of an interval fund's share repurchase program but indicated that the proposed two-year period reflects comments on an earlier concept release from the SEC.
- ***Repurchase Frequency:*** Allow an interval fund to make repurchase offers as frequently as monthly without obtaining an exemptive order. The 5% minimum repurchase offer amount per repurchase interval would be retained, and existing orders permitting a 2% minimum for monthly repurchases would be rescinded, although the SEC requested comment on whether a lower monthly minimum should be permitted. Separately, any registered closed end fund, not only an interval fund, could make a discretionary repurchase offer outside its regular schedule once a year rather than once every two years.
- ***Principles-Based Liquidity:*** Allow an interval fund to manage periodic liquidity requirements in accordance with a principles-based standard approved by its board, rather than requiring the fund to hold liquid assets equal to 100% of each repurchase offer amount. A fund would instead have to manage its liquidity so that it can pay repurchase proceeds without selling assets at prices that differ materially from their value.

Replacing the 100% liquid asset requirement could materially change the economics of funds investing in private credit and private equity. Together with monthly intervals and the longer initial deferral, the proposal would give sponsors more flexibility to match repurchase obligations to portfolio liquidity. Sponsors of monthly interval funds that rely on orders permitting a 2% minimum would return to the 5% floor, which could require changes to liquidity planning.

Commissioner Mark Uyeda noted that these rule proposals are meant to modernize the framework for operating interval fund share repurchase programs but they do not change the fundamental exit dynamics with respect to illiquid private market investment opportunities. He cautioned that “[i]nterval fund structures provide periodic liquidity; they are not a promise of frequent redemption.”

Codification of Multiple Share Class Relief for Registered Closed End Funds and BDCs

The SEC is also seeking to amend Investment Company Act Rule 18f-3 to allow registered closed end funds and BDCs to offer multiple share classes and pay asset-based distribution and service fees, without individual exemptive orders.

Many interval funds, tender offer funds, and BDCs now operate under individual multi-class and early withdrawal charge orders. A rules-based framework would eliminate the need for new sponsors to obtain comparable exemptive relief. The SEC also proposed to rescind nearly all existing exemptive orders for interval funds and multi-class closed end funds^[2], so fund sponsors with existing orders will need to compare the conditions in their orders with the proposed rule. The SEC proposed a one-year transition period following the effective date of any final rule before existing orders would be rescinded.

Unlike the existing orders, the amended Rule 18f-3 would not condition relief on compliance with FINRA's distribution fee rules (FINRA Rule 2341 for registered closed end funds or FINRA Rule 2310 for BDCs). Registered closed end funds would generally remain subject to those FINRA rules on their own terms, so the practical effect falls mainly on privately offered BDCs, which FINRA Rule 2310 does not otherwise reach.

All registered closed end funds, whether or not they offer multiple classes, would also have to provide enhanced expense disclosure, including a new shareholder report table showing the expenses of an ongoing \$10,000 investment.

Accredited Investor Notices

In connection with its proposed rulemaking, the SEC also approved five notices, each seeking comment on whether holding a specified credential in good standing should qualify an individual as an "accredited investor" under Rule 501(a)(10) of Regulation D, further expanding the SEC's proxies for presumed financial sophistication beyond income and net worth. One notice addresses passage of a new accredited investor exam, to be developed by FINRA. The others address the following credentials:

- Accounting: a license as a U.S. certified public accountant;
- Investment Analysis: a charter as a Chartered Financial Analyst;
- Financial Planning: certification as a Certified Financial Planner; and
- FINRA Licenses: the Investment Banking Representative license (Series 79) and the Research Analyst licenses (Series 86 and 87) (each would independently qualify a holder).

If designated, these credentials would join the Series 7, 65, and 82 licenses the SEC designated in 2020, and would be the first expansion of the credential pathway since then. In each case, "good standing" would be measured by the credentialing body's own standards, and a credential holder would qualify only when investing for his or her own account, not on behalf of others.

The SEC's proposed accredited investor exam would be open to anyone 18 years of age or older, without requiring association with a FINRA member firm, and passing would not qualify a person for FINRA registration. Modeled on the Securities Industry Essentials exam, it would cover investment risks, disclosure and regulatory requirements, financial statements, conflicts of interest, corporate governance, and exempt offering structures. A passing result would be valid for 10 years.

The SEC confirmed that accredited investor status is tested at the time of investment. Losing a credential later would not unwind an existing investment, but the individual could not make follow-on investments without qualifying on another basis. The SEC also noted that other organizations may propose their own exams for designation under Rule 501(a)(10) and that the SEC will continue to evaluate additional credentials.

Note that if qualified client status is redefined to track accredited investor status, any expansion of the accredited investor definition would also expand the group of investors who may be charged performance fees.

[1] Investment Adviser Performance-Based Compensation Modernization, Release No. 33-11443 (Sept. 30, 2026) - <https://www.sec.gov/files/rules/proposed/2026/33-11443.pdf>; Interval Fund Modernization; Expansion of Multiple Share Class to Registered Closed end Management Investment Companies and Business Development Companies, Release No. 33-11444 (Sept. 30, 2026) - <https://www.sec.gov/files/rules/proposed/2026/33-11444.pdf>; Statements of Chairman Paul S. Atkins (<https://www.sec.gov/newsroom/speeches-statements/atkins-statement-open-meeting-093026>) and Commissioners Hester M. Peirce (<https://www.sec.gov/newsroom/speeches-statements/peirce-performance-interval-statement-on-proposals-to-facilitate-retail-investor-access-to-private-investments-093026>) and Mark T. Uyeda (<https://www.sec.gov/newsroom/speeches-statements/uyeda-statement-interval-fund-modernization-093026>) at Sept. 30, 2026 open meeting.

[2] The one exception to the proposed rescission of existing orders is a recent order permitting exchange-listed and tokenized share classes, relief the SEC noted no other fund holds. (<https://www.sec.gov/Archives/edgar/data/1905088/999999999726001524/filename1.pdf>)

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Gibson Dunn's Investment Funds practice group regularly advises asset managers on the matters discussed above. Please do not hesitate to contact the Gibson Dunn lawyer with whom you usually work, or any of the following practice group leaders, with questions.

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