NSCP
NATIONAL SOCIETY OF
COMPLIANCE PROFESSIONALS

April 19, 2022

VIA SEC COMMENT SUBMISSION PORTAL

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (File No. S7-03-22)

Dear Ms. Countryman:

The National Society of Compliance Professionals ("NSCP")[1] appreciates the opportunity to provide comments to the United States Securities and Exchange Commission (the "Commission") on proposed new rules under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), as well as amendments to certain existing Advisers Act rules, in each case to regulate private fund advisers (the "Proposed Amendments").[2] The NSCP is uniquely positioned to comment on the Proposed Amendments as it has recently examined the practical challenges firms, and particularly Chief Compliance Officers ("CCOs"), face in a context that includes, but goes beyond, the technical aspects of compliance.[3] While the NSCP strongly supports the Commission's efforts to protect investors, the NSCP nevertheless has significant concerns about the lack of clarity in the Proposed Amendments and the significant additional burden they will place on compliance in general, if adopted as

[1] The proposal includes new Advisers Act rules 211(h)(1)-1, 211(h)(1)-2, 206(4)-10, 211(h)(2)-1, 211(h)(2)-2, and 211(h)(2)-3, as well as amendments to Advisers Act rules 206(4)-7 (Compliance) and 204-2 (Books and Records). The Proposed Amendments are of considerable interest to NSCP and its members. NSCP is a nonprofit, membership organization with approximately 2,000 financial services compliance professionals dedicated to advancing the expertise of financial services compliance professionals and the long-term success of the compliance profession. The principal purpose of NSCP is to provide its membership best in class resources, provide opportunities for professional development, promote the exchange of knowledge and advocate for the compliance profession.

NSCP's membership is drawn principally from traditional broker-dealers, investment advisers, bank and insurance affiliated firms, as well as the law firms, accounting firms, and consultants that serve them. The asset management members of NSCP span a wide spectrum of firms, including employees from the largest brokerage and investment management firms to those operations with only a handful of employees. The diversity of our membership allows NSCP to represent a large variety of perspectives in the asset management industry.

[2] See "Proposed Rule: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews;" Release No. IA- -5955, File No. S7-03-22, February 9, 2022 (the "Proposing Release").

[3] In December 2020, the NSCP conducted a member survey in connection with its proposed Firm and CCO Liability Framework (the "NSCP Framework"). The survey included 230 members participating and covered their concerns regarding the lack of parameters and clear regulatory standards for CCO liability (the "CCO Liability Survey"). In 2021, the NSCP conducted a second survey in connection with its proposed NSCP Framework, which included a 135 compliance officers and others performing similar functions, regarding CCO empowerment, the adequacy of resources and extent of responsibility or authority that they possess (the "CCO Empowerment and Resource Survey"). In connection with the NSCP's preparation of this comment letter March 2022, it conducted a survey of 214 members, which specifically focused on the annual review process (the "Annual Review Survey").

proposed. Our views and comments on the Proposed Amendments, as well as our requests for the final version of the rules are discussed below.

A. Written Annual Report

The Proposed Amendments would amend the Advisers Act Compliance Rule 206(4)-7 to require all SEC registered advisers to document the annual review of their compliance policies and procedures in writing. The Staff has requested comment on whether the Commission should specify certain elements that must be included in the written documentation of the annual review. The NSCP strongly supports the Commission's flexible approach to the proposed written documentation requirement and agrees advisers should be able to continue to use the review procedures they have developed and found most effective. Out of the 214 members who participated in our recent Annual Review Survey, 137 responded that they document their annual review with a lengthy written report with supporting documentation.[4] The survey options included pre-filled response options from which respondents could pick all that apply: (i) A lengthy written report with supporting documentation (137); (ii) quarterly documentation, aggregated at year end; (iii) a presentation to the board (52); (iv) a short memorandum summarizing the findings (64); and (v) informal documentation (*e.g.* notes) (22). We also received a wide variety of "other" responses, which showcase the tailored approach advisers currently take to document their annual reviews.[5]

While we fully support a flexible approach to written annual review documentation, we are concerned the written requirement will lead to increased pressure on CCOs regarding its content and exposure to personal liability. Our Annual Review Survey shows CCOs are generally responsible for determining what goes into the annual review documentation.[6] Over 58% of respondents said they were personally concerned about CCO liability when considering which details to leave out/add in the annual review documentation. The NSCP believes their concerns are well-founded and supported by the Staff's intentions of using the proposed required documentation to identify potential violations that could lead to deficiency findings or enforcement, instead of evidencing a working compliance function or continuous improvement by the compliance department. In the Proposing Release the Staff states, "*. . . we believe that the proposed amendment would result in records of annual compliance reviews that would allow our staff to determine whether an adviser has complied with the review requirement of the compliance rule.*"[7] The Staff further states, "*Our examination staff relies on documentation of the annual review to . . . determine whether the adviser is complying with the rule, and identify potential weaknesses in the compliance program.*"[8]

The NSCP strongly urges the Commission to recognize the often challenging work dynamics CCOs face in their role as administrator of firm compliance. In the context of the Compliance Rule's adopting release in 2003, the Commission described the authority an individual should possess to be designated for the role of CCO as follows:

> "*Such a person must be competent and knowledgeable regarding the Advisers Act and should be empowered with full responsibility and authority to develop and enforce appropriate policies and*

[4] We note only 1 out of 214 responded that they do not document their annual review.
[5] "Other" responses included: comprehensive memorandum, which includes a risk assessment; a matrix tracking all that was reviewed with findings if any and remedial steps; a test report in categories and then a final report, although it is not lengthy; a written memorandum detailing what was reviewed, any exceptions noted and the resolution; an annual report that summarizes compliance activities performed during the period; an Excel spreadsheet; a lengthy PowerPoint with summary of testing initiatives, prepared annually; and a spreadsheet for each item tested and a summary provided to the board.
[6] For over 90% of our respondents, the CCO is solely responsible for making that determination. Another 8.45% responded "other" but even for many of those who responded "other," the CCO was still primarily involved or jointly responsible.
[7] Proposing Release, p. 178.
[8] Proposing Release, p. 179.

procedures for the firm. Thus, the compliance officer should have a position of sufficient seniority and authority within the organization to compel others to adhere to the compliance policies and procedures.[9]

In that 2003 adopting release, the Commission discusses the importance of independence of a registered fund CCO from fund management, the Commission notes such independence places the CCO in a better position to fulfill her responsibilities and would render the CCO less likely to be intimidated in the performance of their duties.[10] The Commission's discussion on CCO independence in the 2003 adopting release relates to CCOs of registered funds. However, the Commission also makes note of the fact that a CCO employed by a registered fund's investment adviser might be conflicted in their duties and the investment adviser's business interests might discourage the adviser from making forthright disclosure to fund directors of its compliance failures.[11] The Commission also observed that executives at service providers have overruled their own compliance personnel because of business considerations.[12] The NSCP believes these pressures of conflicting duties and lack of power over senior management sometimes exist not just for CCOs of registered funds, but for CCOs of all registered advisers more generally. As observed by the Commission, CCOs employed by the fund's investment adviser are subject to additional pressures, including those stemming from business interests conflicts.

The annual review process is a likely area for these types of conflicts to emerge. Sensitive findings are typically discussed among the CCO, senior management, compliance consultants and outside counsel. While compliance may be responsible for conducting the review, CCOs are often in the difficult position of consulting with senior management regarding the review's scope and findings. Senior management may dictate the content of any written documentation. For example, a CCO may have a different opinion than senior management and firm service providers as to whether certain events or information should be included in the written documentation. Depending on the facts and circumstances and the risk of enforcement associated with the event or information at hand, the CCO may seek inclusion to support the work of compliance for detecting compliance exceptions and remediating the same. Such documentation may also help mitigate a CCO's personal liability. However, senior management and firm service providers may seek to include only what is deemed necessary to satisfy the firm's legal obligations. Senior management and firm service providers may also seek privilege of certain information, which may limit the scope of information that can be included without effecting a waiver. In other cases, a CCO may seek to limit the over-inclusion of similar information over concerns that upon examination the CCO's good work may be second guessed in hindsight by the Staff. CCOs may also be met with resistance on how to phrase certain descriptions included in the annual review written documentation. In extreme instances the CCO may be misled by senior management or fraudulently influenced for the purpose of concealing noncompliance in general or specific items in the annual review documentation—and while these instances are likely rare, CCOs experience significant distress over the possibility of personal liability for wholesale failure for having insufficient documentation.

Where both the firm and the CCO are exposed to liability, the context is ripe for conflict. While the position of a CCO requires empowerment and independence, CCO are in fact employed by the firm. CCOs are uniquely situated to be concerned over personal liability to the Commission on the one hand, and job insecurity on the other. To be clear, the NSCP is not advocating for CCOs who are refraining from reporting compliance concerns to senior management, ignoring red flags, or otherwise obstructing the Commission's Division of Examinations by omitting material information in required books and records. The NSCP is highlighting the realities of a CCO's workplace dynamics that add to the stress and pressures of the CCO position in general, and particularly when

[9] Final Rule: Compliance Programs of Investment Companies and Investment Advisers, Release Nos. IA-2204 (2003) https://www.sec.gov/rules/final/ia-2204.htm, at note 76.
[10] Id. At note 76.
[11] Final Rule: Compliance Programs of Investment Companies and Investment Advisers, Release Nos. IA-2204 (2003) https://www.sec.gov/rules/final/ia-2204.htm.
[12] Id.

the CCO is the primary author of annual review documentation and subject to potential personal liability for the firm's compliance failures.

The NSCP requests the Commission to add to the Proposed Amendments to the Compliance Rule a provision to protect CCOs from undue influence by senior management and fund service providers. We specifically request a provision similar to the protective provisions of Investment Company Act Rule 38a-1,[13] prohibiting the adviser's officers, directors, employees or any person acting under the direction of these persons, from directly or indirectly taking any action to coerce, manipulate, mislead or fraudulently influence the CCO in the performance of her responsibilities under the Compliance Rule. The Commission recently included similar provision in its proposed rules on the Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions. The proposal includes new Securities Exchange Act Rule 15Fh-4(c), which is aimed at protecting the independence and objectivity of CCOs of "security-based swap dealers" and "major security-based swap participants" (each an, SBS Entity") by preventing the personnel of an SBS Entity from taking actions to coerce, mislead, or otherwise interfere with the CCO.[14]

Based on our CCO Empowerment and Resources Survey, 20% of respondents reported their firm's Compliance Department does not have sufficient authority to develop and enforce compliance policies and procedures.[15] Accordingly, the NSCP requests the Commission empower CCOs, reduce the risk of intimidation, and enhance CCOs' effectiveness by adding the following provision to the Compliance Rule:

"(d) *No undue influence over chief compliance officer*. It shall be unlawful for any officer, director, supervised person, or employee of an investment adviser registered or required to be registered under section 203 of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3), or any person acting under such person's direction, to directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the chief compliance officer in the performance of their duties hereunder."

B. Quarterly Statements

The Proposed Amendments would require private funds advisers to prepare and distribute quarterly statements to private fund investors, within 45 days after each calendar quarter end, that include certain standardized disclosures regarding the cost of investing in the private fund and the private fund's performance. If adopted as proposed, the statement would have to include prominent disclosure regarding the manner in which all expenses, payments, allocations, rebates, waivers, and offsets are calculated and include cross references to the sections of the private

[13] Investment Company Act Rule 38a-1 provides: "*Undue influence prohibited.* No officer, director, or employee of the fund, its investment adviser, or principal underwriter, or any person acting under such person's direction may directly or indirectly take any action to coerce, manipulate, mislead, or fraudulently influence the fund's chief compliance officer in the performance of his or her duties under this section."

[14] See, Prohibition Against Fraud, Manipulation, or Deception in Connection with Security-Based Swaps; Prohibition against Undue Influence over Chief Compliance Officers; Position Reporting of Large Security-Based Swap Positions, Exchange Act Rel. No. 93784 (Dec. 15, 2021) at note 105 (*expressly referencing the Advisers Act Compliance Rule adopting release when comparing Rule 15Fh-4(c) to Section 303(a) of the Sarbanes-Oxley Act and rule 13b2-2(b)(1) under the Securities Exchange Act, which prohibits unduly influencing auditors*). The Commission previously considered adopting a similar requirement in 2016 but declined for reasons which then included a belief that the CCO's independence and effectiveness was a majority of the board was required to approve the compensation and removal of the CCO is appropriate to promote the CCO's independence and effectiveness. *See* Business Conduct Standards for Security-Based Swap Dealers and Major Security Based Swap Participants, Release No. 77617 (Apr. 14, 2016), 81 FR 29960.

[15] The CCO Empowerment and Resource Survey asked, "*Does the Compliance Department have sufficient authority to develop and enforce compliance policies and procedures?*" Of the 20% of respondents who did not report "Yes," 10% of respondents reported "No" and 10% reported "Other" (sometimes, only have authority if the issue is "black and white," given no authority to raise issues of concern).

fund's organizational and offering documents that set forth the applicable calculation methodology. The NSCP is generally concerned about the lack of clarity in the Proposing Release and the Proposed Amendments on how to calculate performance. In particular, the Proposed Amendments include methodologies for only two types of private funds. Our members are concerned certain types of private funds, including collateralized loan obligations (CLOs), may not be able to use either methodology. The NSCP urges the Staff to consider a flexible approach to performance calculations such that they can be tailored to the particulars of a given type of private fund. The NSCP also requests confirmation of the ability to use footnotes to explain how advisers to these types of nonconforming funds calculated performance and how such calculations may deviate from the two prescribed methodologies.

The NSCP is also concerned that for some advisers compliance with the performance reporting and the associated books and records requirements may be impossible. The rule presumes all advisers have been reporting performance in a similar manner. Given the prescribed methodologies for calculating performance, some advisers may not have sufficient books and records necessary to substantiate performance for the required periods.

The NSCP also seeks clarity on a number of inconsistencies between the Proposed Amendments and the Commission's new Marketing Rule, Advisers Act 206(4)-1. Particularly, the Proposed Amendments would require reporting of private fund performance over one-, five-, and 10-year periods. The final Marketing Rule also requires advisers advertising performance results to provide metrics for the same times periods. However, in the final Marketing Rule's adopting release, the Commission specifically excepted private fund advisers from presenting performance for those prescribed time periods because, "*requiring advisers to provide performance results of private funds over one-, five-, and ten-year periods in advertisements will not provide investors with useful insight into how the advertised portfolio(s) performed during different market or economic conditions*."[16] The NSCP believes the inconsistencies between these rules are ripe for confusion both for advisers implementing the rules and investors who receive the performance information. Additionally, the NSCP is concerned compliance with both rules may not be possible. The Commission's statement in the Marketing Rule's final adopting release suggests that the inclusion of such information may be deemed misleading under the rule's general prohibitions. Advisers who want to advertise performance information would be forced to provide different performance information for reporting and advertising purposes, which also could lead to potentially misleading information under the anti-fraud provisions of the securities laws. The NSCP urges the Commission to consider a flexible approach to performance reporting so those advisers who determine the presentation of performance for the prescribed periods may not be useful given different market or economic conditions. The NSCP also requests flexibility to determine calculation methodologies consistent with the Marketing Rule. The NSCP alternatively requests confirmation that the Commission will not seek enforcement against advisers for reporting performance as required under the Proposed Amendments while reporting performance differently in its advertisements under the Marketing Rule.

C. Regulatory and Compliance Fees and Expenses

Proposed rule 211(h)(2)-1(a)(3) would prohibit advisers from charging private funds for any regulatory or compliance fees or expenses of the adviser or its related persons. The Proposing Release states that advisers would be permitted to continue charging private funds for regulatory, compliance, and other similar fees and expenses directly related to the activities of the private fund, such as the costs associated with a regulatory filing of the fund, including Form D. However, in the Proposing Release the Staff acknowledges that it may not be clear whether certain fees and expenses relate to the fund or the adviser, or it may not be clear until after a significant amount of time has passed in certain cases. We agree the distinction is unclear. We note

[16] *See Investment Adviser Marketing, SEC Release No. IA-5653 (Dec. 22, 2020)* https://www.sec.gov/rules/final/2020/ia-5653.pdf at page 182.

there are a number of requirements under the Advisers Act that result in the incurrence of fees and expenses; however, in some instances at least, those fees and expenses appear to be obvious fees and expenses of the private funds. For example, the Advisers Act Custody Rule, rule 204(6)-2, requires registered advisers (and those required to be registered) with custody of client assets to maintain client funds and securities with qualified custodians. While the obligation to use a qualified custodian is a regulatory obligation of the adviser, fees and expenses of qualified custodians are allocated to the clients they serve. The Staff suggests in these circumstances that an adviser "*generally should allocate such fees and expenses in a manner that it believes in good faith is fair and equitable and is consistent with its fiduciary duty.*"[17] Given the strict prohibitive nature of the proposal, we request the Commission provide more clarity on the types of fees and expenses that would be permissible for advisers to charge to funds, especially where such fees and expenses incurred relate to the advisers' obligations under the Advisers Act.

Certain regulatory filings, such as Form PF, are technically regulatory obligations of the adviser under Advisers Act rule 204(b)-1. However, Form PF was adopted under the authority of the Dodd- Frank Wall Street Reform and Consumer Protection Act of 2010 for the purpose of providing information to the Financial Sustainability Oversight Council for the purpose of monitoring system risk. While Form PF must be provided by advisers, the information required to be reported relates solely to the activities of the private fund. Many of our members' funds include in their governing documents express disclosure regarding the allocation of Form PF costs as an expense of the fund. Accordingly, we request clarification that costs associated specifically with filing Form PF may be borne by the funds as permitted by their governing documents.

The Proposing Release states numerous times that the Staff expects current practices of charging certain costs to funds to continue in compliance with the Proposed Amendments. The NSCP requests clarity as to when it would be permissible to continue these current practices, particularly with respect to costs and expenses related to the proposed quarterly statements, audits, and preferential treatment disclosure, which, if adopted, would be regulatory obligations of the adviser. With respect to costs associated with preparing the proposed quarterly statements, the Staff states:

> "*For example, under current practice, advisers to private funds generally charge disclosure and reporting costs to the funds, so that those costs are ultimately paid by the fund investors. Also, currently, to the extent advisers use service providers to assist with preparing statements (e.g., fund administrators), those costs often are borne by the fund (and thus indirectly investors). To the extent not prohibited, we expect similar arrangements may be made going forward to comply with the proposed rule.*"[18]

With respect to costs associated with the proposed audit requirement, the Staff states:

> "*Under current practice, the costs of undergoing a financial statement audit are often paid by the fund, and therefore, ultimately, by the fund investors, though in some cases the costs may be partially or fully paid by the adviser. To the extent not prohibited, we expect similar arrangements may be made going forward to comply with the proposed rule: in some instances, the fund will bear the audit expense, in others the adviser will bear it, and there also may be arrangements in which both the adviser and fund will share the expense.*"[19]

With respect to costs associated with the proposed disclosure of preferential treatment, the Staff states:

> " . . . *we anticipate that the disclosure of preferential treatment would impose an aggregate annual*

[17] Proposing Release, p. 142.
[18] Proposing Release, p. 225.
[19] Proposing Release, p. 255. See also, Proposing Release, p. 256 at note 366.

internal cost of $128,902,375 and an aggregate annual external cost of $32,550,000, or a total cost of $161,452,375 annually. To the extent that advisers are not prohibited from categorizing all or a portion of these costs as expenses to be borne by the fund, then these costs may be borne indirectly by investors to the fund instead of advisers."[20]

The NSCP requests clarification as to whether advisers may charge their funds for costs and expenses related to the proposed quarterly statements, audits and preferential treatment disclosure to the extent the fund governing documents reflect agreement among the parties by providing express authorization for the funds to bear such costs and expenses. The NSCP further requests clarification as to whether advisers may charge their funds for other costs and expenses to the extent the fund governing documents reflect agreement among the parties by providing express authorization for the funds to bear such costs and expenses.

D. <u>Prompt Audit</u>

The Proposed Amendments would explicitly require audits of private funds and the dissemination of such audited financial statements to current investors "promptly" after the completion of the audit. The Proposing Release includes a statement to the effect that the 120-day delivery requirement set forth under the Custody Rule is generally appropriate, but does not explicitly state that if a private fund manager delivers the audited financials within that timeframe (assuming that the fund has a December 31 fiscal year-end, and is not a fund-of-funds arrangement), such delivery would be deemed "prompt."[21] We request the Commission confirm compliance with the Custody Rule delivery times will satisfy the "prompt" delivery requirement for the purposes of the Proposed Amendments or otherwise clarify the circumstances under which a shorter period would be required.

The Staff requests comment as to whether the rule should provide that compliance with proposed rule 206(4)-10 would satisfy the audit requirements under the Custody Rule (and vice versa). Proposed rule 206(4)-10 has additional requirements pertaining to a written agreement with the auditor and notification to the Commission regarding terminations and modified opinions but is otherwise substantively identical to the audit requirements of the Custody Rule. Therefore, we believe compliance with proposed rule 206(4)-10 would satisfy the relevant requirements under the Custody Rule. Given the additional requirements in proposed rule 206(4)-10, however, we do not believe satisfying the audit requirements of the Custody Rule would satisfy proposed rule 206(4)-10.

We also request the Commission adopt the audit requirement with modifications in line with the Division of Investment Management's 2014 guidance regarding private funds and the application of the Custody Rule to special purpose vehicles ("SPVs") and escrow accounts (the "2014 Guidance"). To the extent advisers

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[20] Proposing Release, p. 249.

[21] The Proposing Release at pages 108-109 states:

"*Based on our experience administering the custody rule, we believe that a 120-day time period is generally appropriate to allow the financial statements of an entity to be audited and to provide investors with timely information. We also understand, however, that preparing audited financial statements for some arrangements, such as fund of funds arrangements, may require reliance on third parties, which could cause an adviser to fail to meet the 120-day timing requirements for distributing audited financial statements regardless of actions it takes to meet the requirements. We also recognize there may be times when an adviser reasonably believes that a fund's audited financial statements would be distributed within the required timeframe but fails to have them distributed in time under certain unforeseeable circumstances. For example, during the COVID-19 pandemic, some advisers were unable to deliver audited financial statements in the timeframes required under the custody rule due to logistical disruptions. Accordingly, and in light of the fact that there is not an alternative method by which to satisfy the proposed rule as there is under the custody rule (i.e., undergo a surprise examination), we would require the audited financial statements to be distributed "promptly," rather than pursuant to a specific deadline. This would provide some flexibility without affecting investor protection*."

to private funds utilize SPVs when making investments, we request the Commission permit advisers to include the SPV assets within the scope of the private fund's audit as permitted by the 2014 Guidance, rather than requiring a separate audit of each SPV.

E. The Role of the CCO and Firm Responsibility for Implementation of the Compliance Rule

The NSCP encourages the Commission to take the opportunity in its adopting release to provide a statement on CCO liability. In the absence of clear Commission guidance, a variety of organizations, including the NSCP, have sought to provide guidance to the industry.[22] As of the date of this letter, there have been at least 15 Commission rule proposals and 2 re-opening of comment periods since January 1, 2022.[23] The increasing compliance burden, coupled with uncertainty over CCOs' personal liability, has the unintended consequence of weakening investor protection by undermining the potential success of the compliance function.

As stated above, over 58% of Annual Review Survey respondents said they are personally concerned about CCO liability when considering which details to leave out/add in the annual report. The Commission's intentions to use the documentation to identify compliance violations exacerbates the stress CCOs experience in managing their potential exposure to personal liability.

As reflected in our February 7, 2020 Comment Letter to the Commission regarding then-proposed Rule 206(4)-1, our membership continues to be concerned about the risk of liability for compliance professionals, particularly given the challenges of applying principles-based rules and the extensive number and complexity of judgments that they are called upon to make. We understand the proposed amendment to Rule 206(4)-7(b) as speaking to the obligation of the investment advisory firm. We suggest that the Commission expressly so state in its adopting release. We also request that the Commission state in the release that as a matter of discretion it does not anticipate seeking to discipline compliance professionals who, in that capacity, make a good faith error in the fulfillment of their responsibilities under Rule 206(4)-7 or compliance responsibilities generally.

We conducted the CCO Liability Survey in December 2020, which revealed that CCOs remain concerned that personal liability will be imposed in cases in which compliance:

- acted negligently rather than recklessly (53%);
- relied on inaccurate data from another employee (66%); and
- did not participate in the violations caused by the company or other executives (63%).

Other surveys support our findings of concern regarding personal liability of compliance officers. In 2021, the Corporate Compliance Insights ("CCI") also conducted a survey of 240 compliance officers from a variety of industries finding similar results. In its findings report CCI found 69% of respondents either agreeing or strongly agreeing that the pace of changing regulations is stressful. Furthermore, nearly half (48%) of the respondents said the threat of personal liability is a significant stressor for them. Alarmingly, the majority (59%) of respondents feel burned out; 56% feel their mental health has been negatively affected by work; and 51% said they have "a lot" or "extreme" job-related stress. The NSCP is tremendously concerned about the mental health and wellbeing of our members who may feel they must live up to an unattainable standard of perfection and "*can't get anything wrong*."

As proposed, the Proposed Amendments to the Compliance Rule would require advisers to document the annual

[22] See the NSCP Framework and the Framework for Chief Compliance Officer Liability in the Financial Sector prepared by the New York City Bar Association in partnership with Association for Corporate Grown (ACG), American Investment Council and Securities Industry and Financial Markets Association (SIFMA). See also the Financial Industry Regulatory Authority Regulatory Notice 22-10.

[23] See, https://www.sec.gov/rules/proposed.shtml.

review. Most of the respondents to our Annual Review Survey reported the CCO is ultimately responsible for determining the scope of the annual review documentation. Accordingly, our members are concerned that without CCO liability protection, the role of the CCO is expanding to assume responsibility for their firm's overall compliance obligations under the Compliance Rule. On a related note, last month, the Financial Industry Regulatory Authority ("FINRA") issued Regulatory Notice 22-10 to remind FINRA member firms that the responsibility to meet their supervisory obligations under FINRA Rule 3110 rests with a firm's business management, not its compliance officials. More specifically, the notice states, "*the firm's president (or equivalent officer or individual), not its CCO, 'bears ultimate responsibility for compliance with all applicable requirements unless and until he [or she] reasonably delegates particular functions to another person in that firm, and neither knows nor has reason to know that such person's performance is deficient.'*"[24]

Given the concerns referenced above and the ultimate responsibility placed on the CCO under the Proposed Amendments, the time has come for the Commission to provide similar clarity for CCOs under the Advisers Act. In January 2022, the NSCP issued its Firm and CCO Liability Framework to alleviate the uncertainty faced by CCOs and provide a framework that more directly aligns with statements made by SEC and FINRA leadership and industry professionals, and promotes investor protection and market integrity. We urge the Commission to support the efforts of our members and CCOs in general and adopt the NSCP Framework. Alternatively, we request the Commission clarify when a CCO will be held personally liable for the firm having insufficient documentation of its annual review.

F. Effective Date; Transition Period

The Staff has requested comment on the potential impact of the Proposed Amendments on the economy on an annual basis for purposes of determining whether the Proposed Amendments would be deemed "major" rules for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA").[25] We understand the implication of this determination is that "major" rules must be published in the Federal Register at least 60 days prior to their effective date. The NSCP strongly supports a determination that the Proposed Amendments are "major" rules. Indeed, the Proposing Release provides a number of examples where the Proposed Amendments would have an annual impact on the economy in excess of $100,000,000. For example, the Staff anticipates that the compliance costs associated with preparation and distribution of quarterly statements (including the preparation and distribution of fee and expense disclosure, as well as the performance disclosure discussed below) would include an aggregate annual internal cost of $200,643,858 and an aggregate annual external cost of $112,403,250, or a total cost of $313,047,108 annually.[26] The Staff also anticipates the disclosure of preferential treatment would impose an aggregate annual internal cost of $128,902,375 and an aggregate annual external cost of $32,550,000, or a total cost of $161,452,375 annually.[27] Furthermore, the Staff estimates the audit fee for the required private fund audit would be $60,000 per fund on average, which is approximately $2,720 million annually for all private funds.[28]

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[24] FINRA Regulatory Notice 22-10 (March 17, 2022).

[25] A "major" rule under SBREFA generally means any rule that the Administrator of the Office of Information and Regulatory Affairs of the Office of Management and Budget finds has resulted in or is likely to result in (a) an annual effect on the economy of $100,000,000 or more; (b) a major increase in costs or prices for consumers, individual industries, Federal, State, or local government agencies, or geographic regions; or (c) significant adverse effects on competition, employment, investment, productivity, innovation, or on the ability of United States-based enterprises to compete with foreign-based enterprises in domestic and export markets.

[26] Proposing Release, p. 226.

[27] Proposing Release, p. 249.

[28] Proposing Release, p. 255. As stated in the Proposing Release, the Staff believes that the costs incurred for the annual audit may approximate 10% of these amounts, because across all types of funds, approximately 90% of funds are currently audited in connection with the fund adviser's alternative compliance under the Custody Rule. Accordingly, the impact of the Proposed Amendments would be approximately 10% of $2,720 million annually, or $272 million.

Importantly, the determination under the SBREFA does not turn on *who* bears the increased costs. Regardless of whether the increased costs are borne by advisers or private funds, the Proposed Amendments would cause a major increase in costs in the private funds industry. As noted in the Proposing Release, in addition to the direct costs of the rule requirements, there will be indirect costs as well (e.g., for updating an adviser's internal controls or internal compliance system to verify the accuracy and completeness of the reported performance information and other necessary tasks for compliance implementation). We also expect many firms will want to increase staffing to meet internal compliance demands but will be faced with increasing salary demands and a highly competitive job market. The NSCP also believes the Proposed Amendments could especially have a significant adverse effect on productivity during the initial implementation years as firms manage internal and external staffing and compliance resources. Based on the results of the NSCP CCO Empowerment and Resource Survey, CCOs continue to struggle to obtain sufficient resources to perform core compliance responsibilities. Only 30% of our respondents reported the compliance function at their firm is adequately resourced. Current pressures on resources will only be exacerbated (and the challenge will only be more exasperating) with the added responsibilities. We expect the implementation period to take significant time and attention of compliance personnel, which could have a direct impact on their productivity.

Our members are also concerned an increase in demand for resources across the industry will drive up pricing on critical third-party service providers, including pricing for compliance consultants, audits (including audits for funds currently audited in connection with the fund adviser's alternative compliance under the Custody Rule), and third-party administrators who assist in preparing and delivering investor reports. To the extent advisers are not able to allocate costs to their funds directly, advisers will likely need to significantly increase management fees to cover their increased operating costs. Given the potential annual effect on the economy, major increase in costs across the private fund industry and the significant adverse impact on productivity, the NSCP urges the Commission to adopt an effective date no sooner than 60 days following publication in the Federal Register.

Assuming the Proposed Amendments are adopted by the Commission, the NSCP requests the Commission adopt a multi-prong transition approach to reduce the overall burden on compliance departments. Compliance personnel will require sufficient time to (i) review and update firm policies and procedures in light of the final rules; (ii) coordinate with other firm departments, including legal, operations and accounting; (iii) assess availability of internal and external resources necessary to implement required compliance changes; and (iv) conduct adequate training on new policies and procedures. Many of our members are currently preparing to come into compliance with the Commission's new Marketing Rule. Based on the experience of many of our members, the Marketing Rule's 18-month compliance period has been critical for undertaking such significant changes. We expect the Proposed Amendments to be just as weighty an undertaking. Indeed, we are aware of a growing concern over a lack of third-party service providers available to support the additional requirements, such as the quarterly statements and audit requirement. Also, we believe some firms will want to automate certain functions for efficiency, which takes time to procure, develop and implement. Significant time will also be necessary to amend existing private fund documents to conform to the final rule's requirements. The Proposing Release acknowledges these costs may be particularly high to the extent that advisers renegotiate, re-structure, and/or revise certain existing deals or existing economic arrangements in response to new rules. Accordingly, we request the Commission adopt an 18-month transition period following the effective date.

We also request the Commission implement grandfathering provisions to limit the scope of private funds covered under the final rule to those funds formed on or after the final rule's adoption date. In addition to the increased stress and anxiety the NSCP expects the Proposed Rules, if adopted, will have on compliance professionals as discussed above, the NSCP is particularly concerned with the amount of additional work the rules will require of compliance personnel. While the Proposing Release includes a number of initial and ongoing annual burden

estimates associated with the Proposed Amendments, those estimates do not include the additional time and attention required to review and update existing policies and procedures as well as private fund governing documents to come into compliance with the substantial new requirements. To reduce the burden on compliance personnel, we request that advisers with private funds formed before the final rule's adoption date may continue operating under the requirements of the fund's governing documents, even if inconsistent with the final rule requirements. For example, to the extent an existing fund does not require quarterly investor reports or an annual audit, the adviser would not be required to deliver the same (assuming of course that in the case of the annual audit, the adviser otherwise complies with the Custody Rule).

F. Conclusion

As a compliance industry group, we strongly support the Commission's efforts to protect investors, however, without further clarification and modification we believe that much of what the Proposed Amendments contemplate would place an undue burden on compliance professionals. Accordingly, if the Commission adopts the Proposed Amendments, we urge the Commission to implement requests into the final rules.

Sincerely,

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