



1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

April 25, 2022

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

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

Dear Ms. Countryman:

The Investment Company Institute¹ is writing to express our views on the SEC's proposal on private fund advisers.² While the proposal does not directly apply to registered funds, we are concerned that registered funds and their shareholders would be needlessly and inadvertently impacted by the proposed "look through" requiring a private fund adviser to distribute quarterly statements to investors in certain pooled investment vehicles that invest in a private fund, which could include registered funds. As we discuss below, registered funds may invest in private funds for a variety of reasons. Distributing private fund quarterly statements to shareholders in those registered funds is likely to confuse rather than allow shareholders to better understand the nature of their registered fund investment. Further, those statements would be superfluous given the disclosure registered funds already provide to their shareholders.

We recommend that the Commission exclude an investment company registered under the Investment Company Act of 1940 from any look through requirement. This approach would be consistent with well-established staff guidance under the Investment Advisers Act Custody Rule on the delivery of private fund audited financial statements to registered funds.

¹ The [Investment Company Institute](http://www.ici.org) (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions (collectively, "registered funds"). Its members manage total assets of \$31.0 trillion in the United States, serving more than 100 million investors, and an additional \$10.0 trillion in assets outside the United States. ICI has offices in Washington, DC, Brussels, London, and Hong Kong and carries out its international work through [ICI Global](http://www.ici.org).

² See *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, Release No. IA-5955 (Feb. 9, 2022), available at <https://www.sec.gov/rules/proposed/2022/ia-5955.pdf> ("Proposal"). Investment Advisers Act section 202(a)(29) defines "private fund" as an issuer that would be an investment company under Investment Company Act section 3 but for section 3(c)(1) or 3(c)(7) of that Act.

I. Introduction

Among other new and amended rules under the Investment Advisers Act, the SEC proposes requiring investment advisers to prepare a quarterly statement disclosing private fund fees, expenses, and performance and to distribute the statement to the private fund's investors.³ The SEC expects the quarterly statement would "allow investors to understand and monitor their private fund investments better."⁴

In circumstances where a private fund investor is itself a pooled investment vehicle that is "controlling, controlled by, or under common control with" the private fund adviser,⁵ the Proposal would require the private fund adviser to send the quarterly statement to the investors in the pooled vehicle.⁶ The SEC provides examples where it expects such a look through would be helpful, including when advisers to private funds establish special purpose vehicles or master-feeder structures.⁷ The SEC, however, does not define "pooled investment vehicle" for purposes of this requirement. We are concerned that the term could be construed to include registered investment companies as well as the private or other pooled vehicles that the SEC is targeting with its look through requirement.⁸

As the SEC is aware, registered funds often invest in affiliated private funds to more efficiently and effectively serve their investment objectives and shareholders. Registered funds are subject to a robust disclosure framework to provide their shareholders with the key information they need to assess and monitor their fund investments and to make informed decisions. Requiring advisers to send private fund quarterly statements to registered fund shareholders would unnecessarily complicate already-robust registered fund disclosure, cause pointless confusion for fund shareholders, and push beyond the limits of effective disclosure. We thus urge the SEC to exclude investment companies registered under the Investment Company Act from any look through requirement.

³ See proposed Advisers Act rule 211(h)(1)-2.

⁴ Proposal at 18-19.

⁵ Or related persons of the adviser.

⁶ We refer to this as the "look through" requirement throughout this letter. See proposed Advisers Act rule 211(h)(1)-1 (defining "control" and "distribute") and Proposal at 86-87.

⁷ Proposal at 86-87.

⁸ For example, "pooled investment vehicle" is defined for purposes of Advisers Act rule 206(4)-8(b) to mean "any investment company as defined in section 3(a) of the Investment Company Act of 1940 or any company that would be an investment company under section 3(a) of that Act but for the exclusion provided from that definition by either section 3(c)(1) or section 3(c)(7) of that Act." Elsewhere in the Proposal, the SEC distinguishes between registered funds and other types of pooled investment vehicles. See proposed Advisers Act rule 211(h)(1)-1 (defining "substantially similar pool of assets" to mean a "pooled investment vehicle (other than an investment company registered under the Investment Company Act of 1940 or a company that elects to be regulated as such) [...]").

I. Registered Funds Regularly Invest in Private Funds

A registered fund may invest in a private fund and be controlled by or under common control with the private fund's adviser⁹ for many reasons. As the SEC previously recognized, registered funds may invest in other funds, including private funds, to “efficiently manage uninvested cash, to address specific regulatory or tax limitations, or to facilitate certain transactions.”¹⁰

For example, certain mutual funds may use wholly owned private funds to facilitate investment in swaps, commodities futures, and commodities options, as described and disclosed in the fund's registration statement. Registered funds use this subsidiary structure for tax purposes to ensure that their commodity investments produce qualifying income under Subchapter M of the Internal Revenue Code.¹¹

Similarly, registered funds, either solely or alongside other registered funds managed by a common adviser, may invest in private funds to more efficiently or effectively carry out investments for registered funds, such as (i) acting as a conduit to foreign market securities,¹² (ii) facilitating real estate investments,¹³ (iii) making investments in whole loans governed by the laws of particular states, (iv) holding assets that are otherwise difficult to transfer, or (v) making short term investments from cash collateral.¹⁴ Like the wholly owned private funds used by some mutual funds, these private funds are created to promote efficiency, save transaction and other fees, advance the registered fund's investment objective, and/or resolve tax and other regulatory matters. Such uses of private funds by registered funds are well known to the SEC staff and others through the registration and exemptive relief processes.

II. Private Fund Quarterly Financial Statements Should Be Delivered to Registered Funds, Consistent with Existing Custody Rule Guidance

We recommend that the SEC take the same approach for the distribution of private fund quarterly statements as its staff has advised for the delivery of audited financial statements under

⁹ Or related persons of those advisers.

¹⁰ See Funds of Funds Arrangements, Release No. IC-34045 (Oct. 7, 2020) (“Fund of Funds Adopting Release”) at 112, available <https://www.sec.gov/rules/final/2020/33-10871.pdf>. Note that these vehicles may or may not always be 3(c)(1) or 3(c)(7) private funds, depending on facts and circumstances.

¹¹ Direct investments by a registered fund in commodity-related instruments generally do not, under IRS published rulings, produce qualifying income under Subchapter M. In response, certain registered funds have received private letter rulings from the IRS that income from a wholly owned subsidiary that invests in commodity and financial futures and options, swaps and other similar investments constitutes qualifying income. These registered funds have established wholly owned private funds to ensure those commodity investments produce qualifying income.

¹² See, e.g., Nicholas-Applegate Capital Management, File No. 812-12648, Notice Release No. IC- 25876, Order Release No. IC- 25906 (Jan. 21, 2003) (granting exemptive relief to permit mutual funds to invest in an affiliated 3(c)(7) fund organized in the Republic of Mauritius that invested in Indian securities).

¹³ See, e.g., Principal Funds, Inc., File No. 812-14866, Notice Release No. IC-33843, Order Release No. IC-33886 (May 20, 2020) (granting relief from Investment Company Act sections 17(a) and 17(d) and rule 17d-1 to permit registered management investment companies that are advised by the same adviser to invest in a private investment vehicle to invest directly in real estate).

¹⁴ See, e.g., The Chase Manhattan Bank No-Action Letter (Investment Company Act Section 17(d)) (July 24, 2001).

the Advisers Act Custody Rule.¹⁵ The “audit provision” of that rule requires a private fund adviser to distribute the fund’s audited annual financial statements to investors. Similar to the look through requirement in this proposal, the Custody Rule states that distributing the audited financial statements to investors that are themselves pooled investment vehicles and related persons of the private fund adviser would not satisfy the rule.

Well-settled staff guidance, however, provides a reasonable approach for registered funds that invest in a private fund solely or alongside funds managed by a common adviser. The SEC staff has long held that it would not recommend enforcement action if an adviser sends a private fund audited financial statement to the registered funds that invest in the private fund and not to the registered funds’ shareholders.¹⁶ Specifically, the staff advises that the private fund audited financial statements should be delivered to the registered funds’ officers and boards.¹⁷ We agree with this approach.¹⁸

III. Registered Funds Are Subject to Robust Disclosure Requirements, Making Additional Private Fund Quarterly Statements for Registered Fund Shareholders Unnecessary

Registered funds are subject to more extensive disclosure requirements than any other comparable financial product and provide shareholders with comprehensive information, including related to portfolio holdings. Any additional requirement to distribute a quarterly statement about a controlled or commonly controlled private fund to registered fund shareholders would be unnecessary and confusing. Registered funds already offer fulsome and standardized disclosure to their shareholders including:

- Annual and semiannual shareholder reports, which contain performance and expense information, financial statements, and a list of the fund’s portfolio holdings. Financial statements included in the annual shareholder report must be audited by an independent accountant.
- Current prospectus and summary prospectus, which provide investors with information about the fund, including its investment objectives, investment strategies, risks, fees and

¹⁵ Advisers Act rule 206(4)-2.

¹⁶ See Staff Responses to Questions About the Custody Rule, Question VI.10 (March 5, 2010), available at https://www.sec.gov/divisions/investment/custody_faq_030510.htm. The fact pattern in the guidance specifically discusses “registered fund families [organizing] unregistered money market funds for investment exclusively by their registered investment companies.”

¹⁷ See *id.* (stating “the financial statements are [to be] delivered to each registered investment company's chief compliance officer, audit committee members and the members of the board of directors who are not interested persons of the adviser”).

¹⁸ Additionally, we acknowledge that the SEC could exempt certain private funds owned by registered funds from the requirement to prepare a quarterly statement, consistent with SEC staff guidance that the assets of a private fund owned by registered funds and within the scope of those registered funds’ financial statement audits may be considered the assets of the registered fund owners. See IM Guidance Update No. 2014-07, Private Funds and the Application of the Custody Rule to Special Purpose Vehicles and Escrows (June 2014), available at <https://www.sec.gov/investment/im-guidance-2014-07.pdf>. If the SEC does so, we recommend that the SEC also exclude registered funds from any look through distribution requirement for the reasons discussed in this letter.

expenses, and performance, as well as how to purchase, redeem, and exchange fund shares.

- Statements of additional information (SAIs), which contains additional information about the fund, including information about the history of the fund, offers detailed disclosure on certain investment policies (such as borrowing and concentration policies), and lists officers, directors, and other persons who control the fund.

The combination of prospectuses, SAIs, annual and semiannual shareholder reports, and regulatory filings on Form N-PORT, Form N-CEN, and Form N-PX provide the investing public, regulators, media, and other interested parties with far more information on registered funds than is available for other pooled investment vehicles. As the SEC itself acknowledges in the Proposal, “[i]n the registered fund context, fund-level reporting has, in our view, enabled retail investors to understand their investments better.”¹⁹ Given this comprehensive disclosure for registered funds, no purpose would be served by sending additional, separate quarterly statements to shareholders about an affiliated private fund in which the registered fund invests. In fact, we are concerned it would only confuse fund shareholders.

Moreover, when a registered fund invests in a private fund and controls or is under common control with its adviser, the registered fund may provide shareholders with disclosure about the private fund and related fees and expenses.²⁰ A requirement for an adviser to separately send a quarterly statement to registered fund shareholders would be unnecessary and could undermine longtime SEC staff guidance for how registered funds should disclose private fund holdings.

For example, staff guidance from 2014 directs that the financial statements of a wholly owned subsidiary of a registered fund be consolidated with a registered fund’s financial statements in shareholder reports. Thus, the subsidiary’s investments are disclosed as if the registered fund held them directly.²¹ As the SEC has stated and endorsed, this presentation creates an easily understandable disclosure for registered fund shareholders:

“Because the wholly-owned subsidiary’s financial statements are consolidated with the financial statements of the [registered] fund, we do not believe that this arrangement would be so complex that investors could not understand the nature of such exposure”²²

¹⁹ See Proposal at 20.

²⁰ See, e.g., Form N-1A Item 3, Instruction 3(f)(i) (stating that acquired fund fees are disclosed if the investment is an investment company or would be an investment company but for the exceptions to that definition provided for in sections 3(c)(1) and 3(c)(7)).

²¹ See IM Guidance Update No. 2014-11, Investment Company Consolidation (“Guidance Update”) (Oct. 2014) at n. 15 (“In the staff’s view, RICs in similar circumstances also should consolidate wholly owned subsidiaries”), available at <https://www.sec.gov/investment/im-guidance-2014-11.pdf>; see also Fidelity Select Portfolio No-Action Letter (Regulation S-X under the Securities Exchange Act of 1934 Rule 6-03(c)) (Apr. 29, 2008) (not recommending enforcement action against a registered investment company consolidating its wholly owned subsidiary into the financial statements of the investment company based on representation that doing so “would give shareholders a more accurate picture of the” fund).

²² See Fund of Funds Adopting Release at 117; see also Guidance Update at 3 (stating “the staff believes that consolidation provides investors with the most meaningful financial presentation” in discussion of disclosure of business development company wholly owned subsidiaries in financial statements).

In other arrangements permitted by exemptive orders and no-action letters, there may be different disclosure approaches. Nevertheless, while the approaches may differ, they are similarly tailored and intended to provide meaningful disclosure for registered fund shareholders.²³

IV. Requiring Advisers to Distribute Private Fund Quarterly Statements to Registered Fund Shareholders Would be Costly and Confusing

For any negligible benefit it may provide to registered fund shareholders who already receive comprehensive disclosure, a private fund quarterly statement would also come at a cost.

First, the quarterly statements sent to registered fund shareholders would create investor confusion, undermining the ultimate goal of effective disclosure standards for investment products. Distributing a private fund quarterly statement to shareholders who have knowingly invested in a registered fund, not a private one, may cause those shareholders to misunderstand the nature of their investments. Moreover, doing so would generate an additional document for shareholders who expect all relevant information about their investment to be found in one place—their registered fund shareholder report.

Further, the Proposal would raise costs to advisers to process private fund information in the format that would be required by the proposed rule and to transmit it to registered fund investors. Although the Proposal may allow advisers to distribute the quarterly statement through either paper or electronic means,²⁴ as the SEC knows, communication with registered fund shareholders is a highly regulated process that involves not only advisers and funds but intermediaries such as broker-dealers.²⁵ Thus, any additional transmissions will undoubtedly increase costs for funds and shareholders.²⁶

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²³ See, e.g., TIAA-CREF Funds, et al., File No. 812-13995, Notice Release No. IC-31807 (Sep. 2015), Order Release No. IC-31861 (Oct. 2015) (approving order for exemptive relief from section 17(d) and rule 17d-1 of the Investment Company Act to permit registered funds advised by the same adviser to invest in a private fund established by that adviser to invest in real estate on conditions including that each fund that has invested 5% or more of its net assets in the private fund will attach the private fund's financial statements as an exhibit to its shareholder or quarterly reports).

²⁴ See Proposal at 86, fn. 99.

²⁵ See generally Letter of Dorothy Donohue, Deputy General Counsel, Securities Regulation, ICI, *ICI Recommendations and Supporting Data for Facilitating Electronic Delivery of Information to Fund Shareholders* (Sep. 10, 2020), available at <https://www.sec.gov/comments/265-33/26533-7964920-224992.pdf>.

²⁶ Further, as noted above, while certain registered funds may invest in 3(c)(1) or 3(c)(7) private funds and be under common control with their advisers, other registered funds fulfill similar functions by investing in vehicles that either assert that they do not meet the definition of investment company under section 3(a) of the Investment Company Act or rely on another exception from the definition. It would be arbitrary and capricious for the SEC to require advisers to bear costs to distribute quarterly statements to registered fund shareholders for 3(c)(1) and 3(c)(7) vehicles but not for other vehicles when the function of those vehicles in relation to the registered fund is identical.

Ms. Vanessa A. Countryman

April 25, 2022

Page 7 of 7

Thank you for the opportunity to provide comments on the Proposal. If you have any questions on our comment letter, please feel free to contact Dorothy Donohue at [REDACTED] or Bridget Farrell at [REDACTED].

Sincerely,

/s/ Dorothy M. Donohue

Dorothy M. Donohue

Deputy General Counsel, Securities Regulation

cc: The Honorable Gary Gensler
The Honorable Hester M. Peirce
The Honorable Allison Herren Lee
The Honorable Caroline Crenshaw

William A. Birdthistle, Director
Sarah G. ten Siethoff, Deputy Director
Division of Investment Management,
Securities and Exchange Commission