National Association of Private Fund Managers

301 Commerce Street, Suite 2600
Fort Worth, Texas, 76102

April 25, 2022

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

Via email to rule-comments@sec.gov

Re: File Number S7-03-22; Release No. IA-5955
Comments on Proposed Rules for Private Fund Advisers

Dear Ms. Countryman:

The National Association of Private Fund Managers (the "Association") submits this letter in response to the request of the Securities and Exchange Commission (the "Commission") for comment upon the proposed rules and rule amendments under the Investment Advisers Act of 1940, published in Release IA-5955, File No. S7-03-22 on February 9, 2022 (the "Proposed Rules"). The Association is a Texas-domiciled non-profit organization whose members include investment advisers in the private fund management industry. The Association was founded for, among other things, providing education to its members and representing their legal and economic interests before the government and in the courts. We appreciate the opportunity to provide comments and perspective on the Proposed Rules.

The Association and its members understand the intent of the Proposed Rules and very much appreciate the work of the Commission staff in their formulation. However, we believe they should not be adopted as proposed. Due to the impact, cost and business difficulties for both investors and advisers in the private fund industry, the Proposed Rules require further consideration and substantive modifications before they are finalized.

We are aware of comment letters submitted, and others being prepared for submission, by other entities and individuals raising concerns about the Proposed Rules and recommending that the Proposed Rules not be adopted or that the Commission undertake further study to significantly revise them. To avoid redundancy and repetition, the Association wishes to incorporate as outlined below the well-supported objections and comments posed by the Managed Funds Association, the ABA Private Funds Subcommittee, the Alternative Investment Management Association, Professor (and former Commissioner) Joseph Grundfest, and the Honorable Harvey L. Pitt (former Commission Chairman), in their letters to the Commission regarding the Proposed Rules.

The Association concurs with those commenting that the Proposed Rules are not in the public interest, are arbitrary and capricious, and lack both evidentiary and statutory foundation for their adoption. We will not repeat here all of the legal analysis and arguments which are well-articulated by those notable and well-regarded commentators and instead have summarized the points which we hope the Commission will consider. Based on the comments, we hope the

Commission will withdraw the rules as proposed and will engage in thoughtful reconsideration before adopting rules so significantly impacting the private fund industry (including its institutional investors and their underlying constituents). Our summary of the primary concerns are as follows:

- The Commission lacks authority for the Proposed Rules. Congress established a regime which established exemptions from registration for private funds and, despite many years of changes to securities laws, has never suggested that the structure should be modified. Indeed, the only significant modification relevant to this topic was the *expansion* of the private-funds related exemption from the Investment Company Act for private funds with the adoption of Section 3(c)(7) of the Investment Company Act of 1940 (the "ICA") in 1996. There is no provision of authority, under the Dodd-Frank Wall Street Reform and Consumer Protection Act or otherwise, that allows the restrictions and requirements in the Proposed Rules to be imposed upon private funds and their investment adviser managers. Although the Commission articulates several theories for its authority, the theories do not justify the proposed rules, including the change to the standard of care, prohibitions on contractual rights such as preferential information sharing terms or expense allocations that do not implicate fraud, and the recordkeeping, reporting, and audit requirements.

- The rules as proposed are inconsistent with the exemptions provided under Sections 3(c)(1) and 3(c)(7) of the ICA. The Proposed Rules attempt to impose obligations and regulations that the ICA specifically directed to be inapplicable to private funds; indeed, even going beyond the standards applicable to public funds for the protection of retail investors. Congress established exemptions for private funds under the ICA because it believed investors with investment sophistication and significant financial means did not need the terms prescribed as to retail and less experienced investors. The Proposed Rules would be a departure from the longstanding regulation of advisers, from statements by the Commission and its staff emphasizing the disclosure regime over prescriptive rules, and from existing market standards regarding the contractual nature of advisory contracts between private funds and their investors.

- Because the Proposed Rules result in unsupported discriminatory treatment of private funds and their advisers, they are arbitrary and capricious. If adopted, more restrictive rules would apply to private funds, where investors are required to be sophisticated and qualified, than the rules applicable to public funds or to retail advisory accounts where the investment sophistication of the investor is lower. The Commission's Proposed Rules would treat private fund investors as typical "retail" investors. This is wholly contrary to the previously expressed positions of the Commission that private funds were appropriate only for certain sophisticated clients and, given that such funds were not available to retail investors, private funds did not need to be subject to the same restrictions as public funds.

- The Commission's proposing release makes assumptions and suggests anecdotal stories as the basis for rulemaking without consideration of the larger industry. The proposing release cites literature applicable to other entities, such as limited liability companies, which are wholly inapplicable to the private fund industry. Moreover, the Commission has failed to assess the true costs to investors and fund managers and further admits the staff does not know such information. The proposing release states: "For example, there is a lack of data on the extent to which advisers engage in certain of the activities that would be prohibited under the Proposed Rules, as well as their significance to the businesses of such advisers. It is, therefore, difficult to quantify how costly it would be to comply with the prohibitions. Similarly, it is difficult to quantify the benefits of these prohibitions, because there is a lack of data regarding how and to what extent the changed business practices of advisers would affect investors, and how advisers may change their behavior in response to these prohibitions." This demonstrates the lack of an evidentiary record and of an appropriate cost-benefit analysis, as well as the capriciousness of the proposals.

- In that same vein, the Commission has failed to consider the public interest in such rulemaking beyond simply citing a questionable "investor protection" component. It does not consider the impact to the fund industry, in costs and jobs, and further overlooks the anticipated negative consequence to investors including the likely reduction in investment options and the undeniable higher management fees that would lead to lower investment returns.

- The proposing release notes the size and scope of the private fund industry which, by all indications, is operating efficiently and effectively. The Commission has failed to provide any examples of market disruption or failures suggesting the need for changes to the current regime and the contractual nature of the advisory arrangements between private funds and their investors. As referenced above, the Commission acknowledges that it cannot quantify or estimate either the benefits of the Proposed Rules or their impact upon the investment industry.

- As outlined repeatedly in comments by others, the Proposed Rules altering the standard of care applicable to investment advisers in the management of private funds are beyond the statutory authority of the Commission, have no support or justification for the different treatment of private fund managers as compared to other advisers, are arbitrary and capricious, and will create new and costly impact to the fund industry. Proposed Rule 211(h)(2)-1(a)(5) would prohibit an adviser to a private fund from seeking reimbursement, indemnification, exculpation or a limitation of its liability for negligence or recklessness in providing services to a private fund. Congress has never suggested that the Commission has the power to alter the standard of care rules to a <u>lower</u> negligence standard for private fund advisers than has been applicable in the industry; nor has Congress suggested that private fund investors should be treated to a higher protection than retail investors in registered funds.

- The Commission's proposed prohibition of preferential terms will lead to less transparency, not more, and will result in precluding many investors from private fund investment opportunities. Once again, the prohibition proposed is not supported by any statutory authority granted by Congress under the Advisers Act. The use of side letters regarding transparency and information sharing have long been the vehicle by which some investors obtain information that they need to ensure compliance with their internal investment parameters or to determine the impact of the fund's holdings on tax reporting or green-energy investing efforts, for example. Conversely, other investors do not want to receive such information as it could impact other aspects of the business including requiring interim assessments that they are not equipped to undertake. Even more significantly, compliance with the proposed rule 211(h)(2)-3(a)(2) would be virtually unmanageable. The Proposed Rules prohibit an adviser from providing information to an investor when "providing the information would have a ***material, negative effect on other investors in that private fund or in a substantially similar pool of assets***." (Emphasis added) This is an unclear standard which would require fund advisers to ascertain whether other investors would be negatively impacted across various funds that may hold the same or similar assets. Many investors require enhanced reporting for tax purposes or to fulfill their internal information requirements.

- The Proposed Rules seek to prevent fund managers from imposing certain compliance costs, consulting services for example, as well as expenses related to the Commission's examination and investigative processes. While the Commission articulates an expectation that this will be a benefit to private fund investors, that is not the expectation of the industry. Instead, the Association expects that this rule will (1) result in increased overall costs for investors as compliance costs must instead be a part of overall management fees; and 2) create perverse disincentives to some fund managers to avoid enacting adequate compliance processes. There is a benefit to the private fund investors to pay for compliance programs that ensure resources are appropriately used for securities compliance and that those costs and services are undertaken when they are need. When specific costs cannot be passed through at the time they are needed, an adviser must choose between estimating potential future costs that would result in increased management fees (and in some instances, such as SEC exams which are infrequent, result in years where fees are more than sufficient to cover costs) or, on the other hand, limiting the inclusion of costs in management fees such that the adviser spends less on routine compliance and investors would be left exposed. And, again, the authority for the prohibition on these pass-through compliance costs is not encompassed in any of the rulemaking authority vested in the Commission.

- Among the numerous prohibitions that would be established in the Proposed Rules, the Commission seeks to prevent a private fund manager from charging fees and expenses other than on a pro-rata basis where multiple private funds, or where the fund and other investors, share the same portfolio investment. Such a requirement and across-the-board approach is inappropriate and unwarranted. A pro rata allocation of expenses may not always be the most fair and equitable way to allocate expenses among applicable clients. The Commission should not mandate a single method for the allocation of expenses because it eliminates the flexibility that advisers require to tailor allocation methods to the applicable facts and circumstances. Specifically, this "one size fits all" approach to costs could put the adviser in a fiduciary box in which, for example, the adviser thinks it is in the best interests of applicable funds to allocate expenses in a non-pro rata manner, but the rules prohibit any type of non-pro rata expense allocation.

- The Proposed Rules include a prohibition on adviser clawbacks of carried interest net of taxes and would apply to existing fund agreements after the transition period. If adopted, this rule would be onerous and particularly troubling for fund managers. Essentially this prohibition overrides the standard market practice and makes a historically investor-favorable provision even more beneficial and favorable for investors. In fact, it will likely put advisers in a worse after-tax position than if no performance-based compensation had been paid in the first instance.

- Proposed Rule 211(h)(2)-1(a)(1) would prohibit acceleration of portfolio monitoring fees that a manager might charge to a portfolio company held by the fund, for example where there has been a sale of the portfolio company. The Commission's characterization of the accelerated fees as "fees for services that are not provided" is a mischaracterization and presumes that these fees are "bad." However, if the highly sophisticated and well-advised investors in the fund have agreed to the fees and are aware that the fees could be accelerated in the event of a sale of the portfolio company, there has been full disclosure and no harm. Moreover, as some commentators have noted, allowing the acceleration of certain fees aligns the interests of the private fund with those of investors. If this prohibition is adopted, a disreputable private fund manager could elect to hold onto a portfolio company and continue receiving monitoring fees rather than sell that portfolio company at a price beneficial to fund investors.

- The proposed deadlines for reporting under the Proposed Rules are unreasonable. Preparing quarterly statements, containing the detailed information in the proposed Rule, within 45 days of the end of each calendar quarter would be costly and difficult (and in some instance impossible), and would create risks of problems with an unmeetable deadline. Further, the deadlines in the Proposed Rules are inconsistent with the audit requirements in the Commission's Custody rules and would create multiple, duplicative reporting obligations.

- The Proposed Rules would create conflicts between required information specified solely for private funds as well as the timing concerns noted above. Any rules proposed regarding the private fund industry should consider and align with the metrics and reporting required by other regulators, for example the aggregate fee and expense disclosure required by the National Futures Association. Multiple presentations and differing levels of details will not be useful, but will instead be confusing, to many private fund investors.

- The requirements in the Proposed Rules that adviser-led secondary transactions include an independent third-party fairness opinion as well as disclosures regarding that opinion provider are unnecessary. Advisers to private funds are well-aware of their fiduciary responsibilities and, when appropriate, obtain the necessary valuation and information that they, as well as their investors, believe appropriate. To repeat an important point as to much of the Proposed Rules, the sophisticated nature of private fund investors has resulted in a system in which the investors are participants in negotiating their rights to information and in communicating with advisers when they deem appropriate as to transactions and other matters.

- If adopted, the Proposed Rules would require substantial revisions to the operations of private funds including modifications to existing contracts, side letters, and advisory agreements, in addition to changes to many business functions. The Proposed Rules will alter the existing landscape which was created based on the existing rules and market practices. The Association requests that the Commission, should it adopt the changes, provide for grandfathering of existing funds to reduce the disruption to the industry. To the extent a private fund is subject to a grandfathering provision and an investor wishes to have any new rules as adopted apply to their investment instead, they will have the ability to consider and make new decisions regarding the investment of their assets.

We would welcome the opportunity to continue discussing these issues and the Proposed Rules. Please contact us at the above address should you wish to follow up on or meet with us regarding our concerns with the Proposed Rules.

Sincerely,

NATIONAL ASSOCIATION OF PRIVATE FUND MANAGERS

cc: The Hon. Gary Gensler, SEC Chairman
The Hon. Hester M. Peirce, SEC Commissioner
The Hon. Allison Herren Lee, SEC Commissioner
The Hon. Caroline A. Crenshaw, SEC Commissioner
Mr. William Birdthistle, Director, Division of Investment Management