



April 25, 2022

Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-0609

RE: SEC File S7-03-22 - Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews

Dear Madam Secretary:

We appreciate the opportunity to provide comments on the proposed rules released on February 9, 2022, by the Securities Exchange Commission (the "Commission"), SEC File S7-03-22 - Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (the "proposed rules").

NACUBO represents college and university business officers, including vice presidents for finance and administration, chief financial officers, and chief investment officers, at more than 1,700 public and private nonprofit colleges and universities. We are dedicated to sound fiscal and administrative practices at institutions of higher education.

The annual NACUBO-TIAA Study of Endowments® is the preeminent analysis of the financial, investment, and governance policies and practices of the nation's higher education endowments and affiliated foundations. The most recent study reflects the responses of 720 institutions representing \$821 billion in endowment assets and covers the fiscal year July 1, 2020–June 30, 2021.

While our annual study is not a census of our entire membership, and it does not reflect the entire universe of institutions of higher education with investment assets under management, it illustrates the diversity of the college and university sector when it comes to assets under management. While the average size of endowments in the survey was \$1.1 billion, the median endowment was about \$200 million. More than half of participating endowments were less than \$250 million.

Our comments reflect NACUBO's concerns for this broad range of institutions.

General Observations

We have a generally favorable view of the proposed rules and believe they represent a potential step forward for efficiency, competition, and transparency.

Nevertheless, we strongly believe that an extension of the April 25, 2022 comment deadline would enable all industry participants to carefully analyze the proposed rules and provide more thorough and well-considered feedback to the Commission. Given the scope of the proposed rules and the short time in which to comment, the absence of an extension will almost certainly reduce the quality of the feedback the Commission receives overall. Without such quality feedback, we are concerned whether certain well-intentioned aspects of the proposed rules will have unintended consequences, with the possibility of inconsistent outcomes.

Reporting; Prohibition on Certain Preferential Information Rights

We believe the increased level of information that the proposed rules require private fund advisers to provide in their quarterly reporting will benefit and further assist the investor community. Investors will be able to better manage their risk and make more informed decisions if they have clearer, uniform, and equally available information with respect to (i) the true and total cost of investing in a private fund and (ii) an accurate reporting of a private fund adviser's historical performance.

However, we are concerned that certain advisers may use the prohibition on disclosing preferential information if such disclosure would have a material, negative effect on other investors as a pretext, even when there is no potential harm to the other investors, to reduce the amount of information currently provided to certain investors rather than expanding the group of investors with access to such preferential information. In this regard, investors with particular concerns including, but not limited to, regulatory monitoring, provincial priorities, ESG compliance, and contract compliance may find their requests for additional information ignored.

While the Commission expressed concerns that different transparency rights could allow investors to front-run funds, we note that there are legitimate reasons to request portfolio transparency, principally to enable investors to assess an adviser's performance and skill in portfolio construction and management. Furthermore, many private fund agreements address front-running concerns by imposing contractual restrictions on the use of information by investors for reasons other than monitoring their investment in the private fund. Because good actors comply with such restrictions, the proposed rules would deprive such good actors of the legitimate uses of the transparency they receive, instead of providing added incentive to avoid front-running. Also, investors' existing liquidity and transparency rights should not be retroactively modified by the proposal because investors have traded off other rights for the benefit of such liquidity terms and transparency rights, such as less favorable fee terms.

We agree that any such preferential rights granted to investors should be disclosed on an anonymized basis to all of the other investors in a fund. Moreover, in the case of liquid funds, we believe that investors should continue to be able to use such disclosure to decide whether to invest in or redeem their interests in a fund.



Allocation of Regulatory Compliance Expenses

Although it would appear that the proposed rules would reverse a trend of certain advisers attempting to transfer their regulatory compliance expenses to their private fund clients and investors, we are concerned that there will potentially be a material increase in fund expenses, insurance costs, and management fees as a result of the proposed rules. We would like clarity from the Commission as to whether the proposed prohibition on advisers passing on compliance costs to their investors applies to the costs of complying with the proposed rules and what would prevent advisers from simply raising their management fees in response to the proposed rules.

In connection with the Commission's inquiry as to whether the proposed rules would lead to higher insurance premiums, we would suggest that the Commission require the adviser and any general partner or manager entity sponsored by it to bear its own insurance premiums rather than passing such expense to its advised client funds. In general, the reporting and disclosure requirements and rules prohibiting certain adviser conduct may provide tangible economic benefits for investors that outweigh any potential expenses likely to be generated by complying with the proposed rules, but additional time is needed to assess the impact of the proposed rules on fund expenses.

Clawback Calculations

The proposed prohibition on deducting actual or hypothetical tax from any obligation to return performance-based compensation would reverse a long-established adviser market practice of allocating actual or hypothetical tax expenses associated with an adviser's over-allocation and distribution of performance-based income wholly to its investors. However, we recommend that the Commission clarify that the contract between the adviser and its private fund clients be required to contain such an obligation to return performance-based compensation. Without such a requirement in the proposed rules, the proposed prohibition may lead some advisers to eliminate contractual requirements to return performance-based compensation altogether, which would negate any benefit of the proposed prohibition to investors.

We also think the proposed rules should address the treatment of all-partner clawbacks, providing that distribution clawbacks for private fund liabilities generally be required to be returned in inverse order of the private fund's distribution waterfall (*i.e.*, prohibit liability clawback provisions that do not require the adviser's general partner or management entity to return proportionate performance-based compensation).

The Adviser's Standard of Care

The inclusion of a prohibition on advisers seeking limitation of liability by, or reimbursement, indemnification, or exculpation from, its private fund clients or its investors for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to a private fund together with the heightened disclosure and reporting requirements contained in the proposed rules will greatly assist in reducing the amount of legal time and fees involved in the negotiation of an adviser's private fund documentation



and provide robust protection of investors' interests in the event of adviser misconduct. However, we believe a gross negligence standard for an adviser's standard of care, rather than the simple negligence standard proposed in the proposed rules, is appropriate. A simple negligence standard of care likely will cause advisers to become reluctant to take the amount of investment risk necessary to obtain the level of returns consistent with historical private fund returns that our members and other institutional investors seek.

Preferential Liquidity Rights

As investors may have different liquidity needs, we believe that investors in private funds should retain the right to choose to pay different fees in exchange for increased liquidity, such as is commonly addressed by a fund offering different classes of shares. Therefore, to the extent a share class or a package of rights has different liquidity, but that class/package is offered to all investors in a fund, we believe that such a practice should be permissible. We also request clarity with respect to what would constitute the material negative effects on other investors that could arise from a private fund offering different liquidity rights.

Adviser-Led Secondaries

We understand that the proposed adviser-led secondaries rule would prohibit an adviser from completing an adviser-led secondary transaction with respect to any private fund unless the adviser distributes to investors in the private fund, prior to the closing of the transaction, a fairness opinion from an independent opinion provider and a summary of any material business relationships the adviser or any of its related persons has or has had within the past two years with the independent opinion provider. However, we remain concerned that such opinions have questionable value as a means of protecting investors given the wide variance in qualifications of opinion providers and the standards used in producing fairness opinions. We recommend the Commission consider providing investors additional alternatives at the time of an adviser-led secondary such as permitting the investors to extend the term of the private fund on the same terms and conditions as exist at the time of the adviser-led secondary.

Our members have also observed the practice of advisers allocating expenses of adviser-led secondaries to investors who have opted to not participate in such adviser-led secondary. While it is appropriate for investors and the private fund clients that do not participate in the adviser-led secondary to, if applicable, pay the expenses associated with the liquidation of their investments at such time, we believe the investors who opt out of participating in such adviser-led secondaries should not be required to bear the expenses of such adviser-led secondary in which they have not participated.

Impact of Proposed Rule on Emerging Managers

Lastly, we appreciate the proposed rules may generate additional expenses and administrative burden for advisers that may limit the ability of small private funds, particularly those managed by advisers who are emerging managers, to join the industry. We do not think the proposed rules should operate as a barrier to entry for



these advisers and potentially restrict opportunities to diversify the field of private fund managers and the innovations that such firms generate. Therefore, we request the Commission consider providing appropriate exceptions and exemptions for advisers who are emerging managers.

We also question whether the proposed rules will make it more difficult for private funds sponsored by advisers who are emerging managers to differentiate themselves in the marketplace. As some other commenters have highlighted, many emerging managers derive a competitive advantage due to their flexibility in offering more competitive terms and additional rights to investors as compared to their established competitors. We question whether this competitive advantage will be eroded by the loss of contractual freedom imposed by the proposed rules.

Thank you again for the opportunity to comment on the proposed rules. Please do not hesitate to contact NACUBO's policy team at advocacy@nacubo.org for further discussion.

Sincerely yours,



Elizabeth L. Clark
Vice President, Policy and Research

