



April 25, 2022

VIA ELECTRONIC FILING

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

Re: File No. S7-03-22

Dear Ms. Countryman:

Impact Capital Managers, Inc. welcomes the opportunity to submit comments in response to the Securities and Exchange Commission's (SEC) proposed new rules under the Investment Advisers Act of 1940 establishing certain requirements for registered investment advisors to private funds¹ (Proposed Rule).

Impact Capital Managers, Inc. (ICM)² is a trade association representing the best-in-class private capital fund managers investing for superior financial returns along with meaningful positive impact. Our mission is to accelerate the performance of our members and to scale the private capital impact investing market with integrity and authenticity. Launched in December 2018 with 25 members which collectively managed over \$5 billion in private fund assets, ICM has grown rapidly since then. While membership is by invitation only, the network now includes almost 90 members collectively representing more than \$30 billion in impact-focused capital that includes venture capital, private equity, private debt and real estate.

ICM members are active or former investors in over 1,400 portfolio companies, and many of those are now large private and public companies responsible for generating hundreds of thousands of quality jobs across the U.S. and demonstrating that businesses focused on addressing some of today's most urgent problems – from mitigating climate change, to increasing access and education for underserved communities – can be both socially responsible *and* profitable. Thus, we believe that encouraging capital formation for *impact* companies brings significant societal benefits and should be facilitated by regulatory requirements.

Aligning with our mission, ICM's members overall strongly support the *spirit* of the Proposed Rule particularly those provisions that would increase transparency for investors. We want to dis-incentivize bad behaviors and punish bad actors. However, we also want to incentivize good behaviors, encourage good actors, and make it easier – not harder – for partners to raise impact funds and for investors to allocate capital to diverse and women-owned funds.

¹ See Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Investment Advisers Act Release No. 5,955, 87 Fed. Reg. 16,886, 16,886 (proposed Feb. 9, 2022), <https://www.federalregister.gov/documents/2022/03/24/2022-03212/private-fund-advisers-documentation-of-registered-investment-adviser-compliance-reviews>.

² For more information about the Impact Capital Managers including its board and members, please visit ICM's website at <https://www.impactcapitalmanagers.com>.

In preparation for submitting this letter, ICM surveyed our members to understand what the implications/effects of the Proposed Rule would be from their practitioners' perspective. Of ICM's 86 members, 37 have assets under management (AUM) between \$100 - 500 million and 30 have AUM between \$50 - 100 million. Many of our members with AUM below \$100 million are owned by partners who identify as women and people of color, a phenomenon we believe aligns with the broader (non-impact oriented) market:

Smaller and emerging managers tend to be disproportionately diverse and female-owned. This is well-supported by numerous studies. According to a [Knight Foundation study](#) conducted in partnership with Professor Josh Lerner of Harvard Business School and [Bella Private Markets](#), released in December 2021, "Capital allocation to women- and minority-owned asset management firms remains far lower than allocation to other firms... only 1.4% of total U.S.-based AUM in our sample is managed by diverse-owned firms as of September 2021... although there may be a relatively large number of minority-owned firms, the size of these firms (as measured by AUM) is much smaller than their non-diverse-owned peers." "The nominal amount of AUM managed by diverse-owned firms still pales in comparison to that managed by non-diverse-owned firms: as of September 2021, the total AUM of non-diverse-owned firms across these four asset classes amounted to \$81.05 trillion, compared to \$1.19 trillion of capital managed by diverse-owned firms."

The results from our survey of members yield areas of agreement, other areas of concern and suggestions for improvements regarding the Proposed Rule.³

Areas of agreement with the Proposed Rule:

- **Prohibiting American Waterfalls.** Over 50% of members surveyed responded, "Eliminating American waterfalls would have minimal impact and private funds would easily adapt to new capital gain distribution models." However, many of our members believe that this should be up to the general partner (GP): "GPs should have the discretion to choose waterfall arrangement and disclose to their sophisticated investors." We generally support the Prohibited Activities Rule [more broadly] but would need more time to examine whether any unintended consequences should be considered.
- **Prescriptive performance statistics in quarterly reports for illiquid funds.** Over 70% of respondents surveyed said that they already report gross and net IRR and MOIC, as well as gross IRR and MOIC for realized and unrealized portions of the fund portfolio.
- **Annual GAAP financial audits, conducted by PCAOB registered auditors.** Most of our members do this already and, when they do, use PCAOB-registered auditors.
- **Fairness opinions.** Our members generally agree with aspects of the Proposed Rule related to fairness opinions.

Areas of concern with the Proposed Rule, where caution in proceeding is advised:

- **Potential fee structure changes.** Over 82% of survey respondents indicated that "Eliminating '2 and 20' would severely dis-incentivize private fund formation and investment."
- **Potentially unnecessary additional fee and performance reporting.** Over 96% of respondents indicated, "[We] seldom hear from investors that they want more information regarding fees and expenses charged by a fund than what is required by the LPA." Over 70% of respondents indicated, "We seldom hear from investors that they want more information regarding historical performance of a fund."

³ Quotations are from our survey of ICM members conducted during March 2022.

- **Prohibitions on side letters and/or confidential preferential treatment of LPs.** “In certain circumstances, we provide investors preferential treatment with respect to access to certain information and for other requests based on their commitment allocation to our funds. This may be negotiated in a side letter. This ability is important to us to develop our relationships with investors, and if the new proposed amendment is adopted in its broad and over-encompassing way, it could hinder our ability to raise capital.” “Investors sometimes request additional information rights.” “It has been our practice to allow investors with long standing historical relationships or large commitments into our funds, certain kinds of preferential treatment and large investors have come to expect this benefit, especially if they are large investors in a given fund. If investors do not get priority when they are taking more risk in a fund than other investors, they may be less motivated to take the risks and make a large investment.”

Considerations for improving the Proposed Rule:

- In the final rulemaking, we would strongly encourage the SEC to consider the ways in which these proposed rules will affect authentic impact fund managers and smaller and/or newer funds, which tend to be disproportionately owned by partners who identify as women or people of color.
- Credible impact managers, like ICM members, are already taking on the additional cost of reporting on impact to limited partners and frequently the public. Requirements that increase costs for these managers should be carefully considered and should meet a high bar in terms of market need and effectiveness.
- The net effect of the proposed rules in their entirety could be to make an arguably already un-level playing field for smaller and impact/diverse funds, even more unequal. Impact funds and those that communicate and report on not only financial performance, but the ways in which investing activity drives net positive impact on Americans and our environment, should be facilitated. Additionally, the information needs and investment objectives of investors in impact funds should be respected; those needs and objectives extend beyond the narrow focus of the Proposed Rules on net financial returns, which could have the unintended effect of reinforcing a focus on quarterly rather than long-term results, both financial and societal.
- We propose that the SEC consider implementing tiers based on regulatory AUM and duration of investment track record when determining whether an adviser should be subject to these rules. Compliance with these new rules may be operationally and economically burdensome for smaller or newer advisers. We propose that the SEC consider implementing exceptions for these rules for advisers that only serve institutional clients. Large institutional investors are sophisticated and have the financial and legal wherewithal to fend for themselves in the private capital market under the current securities law framework. We believe that the new rules will help provide more transparency and bargaining power for individual investors participating in the private fund market.
- To paraphrase one member, the proposed rules may cause more net harm to impact funds and the impact investing market than to traditional funds and markets, primarily because impact funds are smaller in size relative to many private equity funds and the costs of compliance could be significantly more material to impact funds. Additionally, many institutional investors are new to impact investing and the ability to negotiate terms is an important way to incentivize their investment.

More Specific Recommendations:

More specifically, we request that the SEC allow firms with less than \$1 billion in AUM (across all funds) to be exempt from the additional reporting and documentation provisions of the Proposed Rule for the first 36 months of their existence. The Proposed Rule as drafted would exempt Investment Advisers that are not required to register, but that threshold generally is for firms with under \$100 or \$150 million in AUM. The SEC’s own estimate of the annual costs of over \$300,000 for aspects of quarterly reporting means that a \$150 million fund would be spending over 10% of its base 2% management fee on quarterly reports – or requiring its investors to absorb this expense. ICM did not have sufficient time to investigate what actual

costs of implementing the Proposed Rule would be, given the short comment period, but we do think that additional costs would not decrease substantially relative to fund size – except in comparison to much larger funds -- for many of the new requirements. Additional costs as a percent of management fees should be less than 5% in our view. An alternative means to limit somewhat the burden on new or smaller fund managers would be to make the requirements annual rather than quarterly.

We also request that **impact funds** be exempt from Preferential Treatment prohibitions of the Proposed Rule. Investors in impact funds seek both financial returns and positive impacts. Denying or hindering investors in pursuing opportunities to make additional side-pocket investments or seek impact-related information, for example, could well be harmful to capital formation for impact investments. While not all new or impact funds provide “preferential treatment” to certain investors, having the flexibility to vary terms can be important to fund formation or growth. The Proposed Rule is flawed in its approach that investors care only about expenses, fees and financial returns.

In asking for differential treatment of impact investing funds, we recognize that a definition would be required. The generally accepted definition that the Global Impact Investing Network (the GIIN) prescribes is investing for an (a) intentional positive non-financial outcome alongside investor return and (b) measuring the impact.⁴ The following requirements for membership in ICM might also serve as a guide for a regulatory definition, with the first three elements being prior to making investments and the last being post-investment: (i) define clear impact objectives(s) for the portfolio and its investments; (ii) establish an impact management process; (iii) establish the asset manager’s contribution to the investment’s impact; and, (iv) measure the impact of each investment. We would, however, urge flexibility in how these elements would be met.

As it is only in the most recent few years that investors have begun to allocate very modest amounts of capital to funds owned by women and individuals of color, allowing such funds to get started primarily by the “old rules,” i.e., the requirements pre-existing the Proposed Rule would therefore be appropriate on fairness grounds. Applying these rules to such funds could well impede their creation and/or increase their start-up costs. A longer phase-in of two or even three years for new funds would thereby be preferable.

As the SEC is well aware, the field of impact investing – along with its *cousin* ESG investing – is advancing rapidly. At ICM we are eager to share our accumulated experience with the SEC as it crafts these and other regulations. Avoiding unintended consequences, while protecting investors, maintaining fair and efficient markets and supporting capital formation are our common goals.

Thank you for the opportunity to comment and share our impact-focused practitioners’ perspective on the Private Fund Advisers Proposed Rule. I welcome further discussion of our suggestions or concerns.

Yours sincerely,



IMPACT CAPITAL MANAGERS, INC.
Marieke Spence
Executive Director

⁴ <https://thegiin.org/impact-investing/need-to-know/#what-is-impact-investing> “Impact investments are investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return.”