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

Re: Request for Comment: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews – File No. S7-03-22

Dear Madam Secretary:

Segal Advisors, Inc., d/b/a Segal Marco Advisors ("Segal Marco") appreciates the opportunity to comment on the proposed rules regarding *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews – File No. S7-03-22* (the "Proposed Rules" or the "Release"), which seeks to amend certain of the duties and obligations of private fund advisers.

We support the spirit of the Proposed Rules regarding fee transparency, reporting and auditing for private market investments; however, we feel that there are some important nuances that Securities and Exchange Commission (the "Commission") should take into account prior to implementing the Proposed Rules. In this letter, we offer our commentary below on the nuances of implementation on key provisions.

Background

Segal Marco is registered with the Commission as an investment adviser. As reported in our most recent ADV 2A Brochure dated as of December 31, 2021, we provide (i) discretionary consulting services with respect to approximately $11.8 billion in assets, (ii) non-discretionary consulting services to clients with approximately $366 billion in total assets and (iii) proxy voting only services to clients whose aggregate plan holdings total approximately $174 billion. In addition, the Firm provided model portfolio, manager research and due diligence services to financial intermediary clients that consult to approximately $188.4 billion in total assets.

Segal Marco's Perspective on the Proposed Rules

Proposed Quarterly Statement Reporting and Disclosure Provision

Segal Marco largely supports the Proposed Rules surrounding quarterly statement reporting and disclosure. According to the McKinsey Global Private Markets Review 2022, "[I]nstitutional investors have continued to increase allocations to private markets at the expense of public

markets […]"[1] In fact, the Release notes that "[T]here are currently 5,037 registered private fund advisers with over $18 trillion in private fund assets under management."[2] In our view, the increased utility and attraction of private investment funds is warranted, as these investment strategies tend to provide investors with robust diversification and correlation benefits (when compared with more traditional public equity and fixed income asset class allocations), all the while offering the prospect of differentiated and attractive performance characteristics.

Segal Marco Advisors agrees that clear and useful disclosure of private investment fund fees and expenses is currently limited and can be improved.

We generally agree with the Commission's assessment of the "[…] opaque nature of the fees and expenses typically associated with private fund investments"[3], and would be in support of certain reporting and disclosure requirements on a recurring basis, especially as demand for these strategies intensifies.

Aside from the headline management fees, performance-based fees, and associated administrative expenses, investors in private investment funds may be subject to additional fees (e.g., private fund adviser-generated consulting fees, monitoring fees, servicing fees, transaction fees, director's fees, among others) in connection with the management and oversight of specific private fund portfolio investments. What is more, these private fund portfolio investment-specific fees tend to be variable in nature and thus run the risk of introducing investors to added performance modelling challenges along with greater levels of confusion and skepticism. We would encourage the Commission to create a new rule under Section 206 to require private fund advisers to report all direct and indirect fees, expenses, and fee offsets applied in connection with the sponsor and its affiliates.

The required disclosure of all fees and expenses can bring "problematic" activities and actions to light.

As noted in the Release:

> "The Commission has brought enforcement actions related to the disclosure and allocation of fees and expenses by private fund advisers. […] Staff has observed similarly problematic compensation schemes and sales practices in its examinations of private fund advisers. For example, staff has observed advisers that charge private funds for expenses not permitted under the fund documents. Staff has also observed advisers improperly allocate shared expenses, such as broken-deal, due diligence, and consultant expenses, among private fund clients and their own accounts."[4]

Segal Marco agrees that the practices associated with any impermissible charging of certain fees and costs along with improper allocation of shared expenses as noted, must be clearly disclosed and ended. However, it is important to recognize that certain fees generated by a private fund adviser associated with direct managing of portfolio investments (i.e., monitoring,

[1] *McKinsey Global Private Markets Review 2022, at 5.*
[2] See Release, at 8; Form ADV data current as of November 30, 2021.
[3] See Release, at 18.
[4] See Release, at 26-27.

advisory or board level governance, etc.) can reduce the overall management fee cost to the investor through direct rebates, offsets or waivers. Rules designed to provide greater fee transparency overall will deliver the additional benefit of increasing investor awareness of the economic relief provided from fee offsets.

Segal Marco views the proposed reporting and disclosure provision as an opportunity for the private fund adviser community to not only offer existing and prospective investors greater clarity and improved comparability across similar offerings, but to showcase the positive actions taken to act in investors' best interests.

The Release continues:

> "[C]ertain advisers have shifted expenses related to their advisory business to private fund clients. For example, some advisers charge private fund clients for salaries and benefits related to personnel of the adviser. Such expenses historically have been paid by advisers with management fee proceeds or other revenue streams, but are increasingly being charged as separate expenses that may not be transparent to fund investors."[5]

The issue described immediately above has grown more pervasive in recent years, that being the shifting of adviser operating costs to partnership expenses. While broadly seen across sponsor sizes, the larger private fund advisers have established in-house teams of legal, technology, fund administration, consultants, and other middle- and back-office teams/platforms to help the private fund adviser maintain its operations. Traditionally, these were costs covered by the private fund adviser's top-line revenue generated from management fee income. It is important to note that these teams were effectively built and paid for through investor capital commitments that translated into management fee revenue. However, it has become more commonplace for these teams to be spun out into standalone operating companies that are "affiliates" of the private fund adviser, either wholly owned or majority owned, and now charge partnerships directly for their services. In many cases, these spinoffs are engaging in third-party work with non-partnership clients that may or may not charge back in a pro-rata manner with no "bill" of "invoice" reported for investors to assess.

The proverbial "keeping the lights on" cost of doing business is now becoming an additional expense line item for investors and in many cases, they are now being charged for services that they essentially already paid to build and were once covered by management fees. This shift in private fund adviser operating expenses to partnership expenses have effectively removed the purpose of management fees as a means of revenue to cover operating costs to an even greater source of profit for private fund advisers, all at the expense of investors. While some sponsors have done a better job than others in disclosing such matters, the fact remains that private fund advisers are continuing to use investor capital to build their businesses while eventually turning these once basic costs to operate into an additional source of revenue. We would encourage the SEC to issue guidance under Section 206 on what should be covered by a private fund adviser's management fee as opposed to expenses charged to the private fund to address the continued cost-shifting experienced in the industry over the past few years.

[5] See Release, at 31.

Consider applying aspects of the quarterly statement provision differently to fund of funds' advisers ("FOFs"), outsourced chief investment officer programs ("OCIO"), and other investment platforms that allocate to private fund advisers.

Segal Marco agrees that the Proposed Rules' provision on quarterly statement reporting and disclosures should apply broadly. However, we believe that certain aspects of the proposed provision should apply differently to different types of private fund advisers to properly reflect such factors as: (i) direct management proximity to and familiarity of underlying portfolio investments; and (ii) the need for and reliability of third-party data accuracy and timely dissemination.

As an example, the Release notes that "[…] a fund of funds may indirectly invest in hundreds of issuers or entities. Depending on the underlying structure, control relationship, and reporting, the fund of funds' adviser may have limited knowledge regarding such underlying entities or issuers."[6] The Release continues, "[W]e understand that preparing quarterly statements may require coordination with, and reliance on, third parties. This may be the case, for example, when a private fund itself invests in other private funds or portfolio companies."[7]

Segal Marco respectfully suggests that the Commission apply a portfolio investment proximity test that would distinguish: (i) investments into private investment funds managed by private fund advisers from (ii) investments into private fund advisers.

The portfolio investment proximity test would consider factors including fund structure and fund investment mandate, in addition to factors the Commission deems appropriate and relevant to determine whether investors garner direct access to underlying portfolio investments (and thus require private fund adviser compliance of the quarterly statement provision as laid out in the Proposed Rules), or if they indirectly access underlying portfolio investments through investments in a series of private fund advisers (and thus would be subject to modified reporting and disclosure requirements).

Specifically, we respectfully suggest that investment platforms that allocate to private fund advisers – notably Fund of Funds ("FOF's") and Outsourced Chief Investment Officer ("OCIO") programs – be required to "roll up" or aggregate all fees and expenses associated with each private fund adviser investment. This suggestion would be in lieu of FOFs, OCIO programs, and other investment platforms that allocate to private fund advisers providing a detailed accounting of all fees, expenses, and compensation for each specific underlying portfolio investment held across each private fund adviser allocation, as originally proposed.

Segal Marco agrees that timely distribution of comprehensive data is of the utmost importance. And doing so may require a bit more flexibility than is presently proposed.

We would suggest that the Commission consider greater flexibility with respect to the time allotted for the preparation and distribution of quarterly statements, as outlined in the Proposed Rules' provision on quarterly statement reporting and disclosures. Specifically, we believe

[6] See Release, at 47.
[7] See Release, at 88.

loosening the timing of quarterly statement distribution from a defined 45 days after each quarter-end to a more flexible "prompt delivery after quarter-end, but best efforts to be no later than 45 days following" demonstrates the Commission's acknowledgement of the comprehensive nature of the Proposed Rules' provision on quarterly statement reporting and disclosure and is a sign of good faith. Moreover, this flexible approach will allow FOF's, OCIO programs, and other investment platforms that rely on other private fund advisers for data to receive, assess, and prepare their own quarterly reports.

Part of the allure and historical success of private investment funds stems from highly controlled disclosure and dissemination of proprietary information to investors.

While Segal Marco largely agrees with the Proposed Rules' provision on quarterly statement reporting and disclosure, we caution that excessive public disclosure of certain data could jeopardize private fund advisers' overarching value propositions and could potentially negatively impact performance results and forward-looking return expectations for investors. In other words, private investment funds tend to offer investors access to proprietary sourcing channels and bespoke transactions with negotiated terms and conditions that, if executed effectively, have the potential to generate highly attractive and differentiated returns.

To protect private fund advisers' confidentiality and investor interests, we respectfully recommend that the Commission relieve private fund advisers of any requirements to disclose datapoints including but not limited to: (i) actual names of underlying portfolio investments; (ii) descriptions of underlying portfolio investments, including trade expressions; and (iii) actual names and descriptions of underlying private fund advisers (for those private fund advisers categorized as FOF's, OCIO, or other).

The Proposed Rules' provision on quarterly statement reporting and disclosure requirements could result in increased fees and expenses for investors.

The Release states, and we would agree, that "[…] fund expenses have risen significantly in recent years for certain private funds due to, among other things, complex fund structures, global marketing and investment efforts, and increased service provider costs."[8] If the Proposed Rules are ratified as is, we would expect these costs to increase further as private fund advisers grapple with the added costs associated with compiling, analyzing, and recording the data necessary to comply with the Proposed Rules' provision on quarterly statement reporting and disclosure requirements.

Moreover, we believe the Proposed Rules' provision on quarterly statement reporting and disclosure requirements could potentially bring rise to certain unintended consequences that further exacerbate the total cost equation for investors. To compensate for the potentially higher costs associated with operating their businesses and executing their strategies as a direct result of the Proposed Rules, we speculate that private fund advisers could embark on any combination of the following: (i) eliminate administrative fee caps for any and all private fund offerings; (ii) adjust fee schedules (i.e., management fee rates, performance-based fee rates,

[8] See Release, at 31.

hurdle rates/preferred return rates, etc.); (iii) modify fee offset/rebate/waiver provisions; (iv) revise or eliminate previously negotiated agreements involving the preparation and dissemination of personalized statements and reports; (v) among other things.

Segal Marco would find any and all reactive measures of this ilk by private fund advisers unfavorable and at odds with the spirit of investor partnership.

Proposed Mandatory Audit Provision

Segal Marco agrees that mandatory financial statement audits at least annually and upon liquidation are an important way to verify the existence of pooled investment vehicle investments and provide meaningful protections for investors with flexibility around the timeliness of completing and distributing the audits.

Based on an initial reading of proposed new rule 206(4)-10 under the Investment Advisers Act of 1940 (the "Advisers Act"), the audit requirement is mandatory to the extent the adviser provides investment advice to a private fund. Furthermore, the respondents to these collections of information requirements would be investment advisers that are registered or required to be registered with the Commission that advise one or more private funds. It is our understanding that prior rulemaking, such as the custody rule, only applies to registered fund advisors and not fund advisers that are not registered. Further guidance would be helpful regarding the applicability of the rule relative to the registration status of investment advisers.

The Proposed Rules' provision on mandatory audits formalizes the cases under which audits are required in fund documents, such as in the case of a tender offer, where existing investors are bought out and the new investors are rolled into another fund vehicle. Similarly, an audit would be required if a fund is being restructured, GP interests were transferred, and/or a continuation vehicle created.

We agree that these financial statement audits should be distributed in a timely fashion. However, we would suggest that the Commission consider greater flexibility with respect to the time allotted for the preparation and distribution of audited financial statements as it may depend on the type of vehicle and the time it takes to coordinate the underlying information from investment managers and other sources. We generally agree that within 120 days of a private fund's fiscal year-end is appropriate for direct managers; however, we note that FOFs, OCIO, and other investment platforms that allocate to private fund advisers may take longer to distribute their audited financial statements due to reliance on third parties and should be allotted additional time as a result.

Proposed Adviser-Led Secondaries Provision

Segal Marco agrees that the proposed requirement for a private fund adviser to obtain a fairness opinion in connection with certain adviser-led secondary transactions will provide an important check against an adviser's conflicts of interest in structuring and leading a transaction.

In line with greater transparency around private funds, Segal Marco generally supports proposed rule 211 (h) (2)-2, which would make it unlawful for a private fund adviser that is registered or required to be registered with the Commission to complete an adviser-led secondary transaction with respect to any private fund, where an adviser (or its related persons) offers fund investors the option to sell their interests in the private fund, or to convert or exchange them for new interests in another vehicle advised by the adviser or its related persons, unless the adviser, prior to the closing of the transaction, distributes to investors in the private fund 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. Examples of such transactions may include single asset transactions, strip sale transactions, and full fund restructurings.

We agree that the requirement for the private fund adviser to distribute to investors the opinion and any other material business relationship summary of the fairness opinion provider with the adviser can help investors receive independent price assessments. Also, we believe that the scope of the rule applying to private fund transactions initiated by the private fund adviser, or its related persons, is appropriate. A fairness opinion for related party transactions has been good practice and should also fall under the types of transactions requiring a fairness opinion.

We believe that the fairness opinion should include valuations for each remaining asset and relative comparative statistics and data for each asset. In a similar vein, we would suggest that all bids provided, either through a formal process or more informally, include a breakdown of pricing/valuations attributed to each of the remaining assets in addition to the already standard bid value for the portfolio as a whole.

Last, we agree that these fairness opinions should ideally be obtained and disseminated at an actionable period of time prior to the deal execution, which may involve requesting investor approvals and subsequent investor capital calls. However, we agree that for certain adviser-led transactions, the closing of the underlying deal may not occur simultaneously with the closing of the new vehicle managed by the private fund adviser. Hence, a broad definition of an "actionable" time period for the dissemination of the opinion would be more practicable.

Proposed Prohibited Activities Provision

The prohibited activities provision aims to create fair treatment of investors; however, prohibitions on fees charged by private fund advisers likely will not prevent investor costs and expenses from continuing to accrue.

We generally agree with the prohibitions in proposed rule 211 (h) (2)-1 which aims to create fair treatment and allocation of fees and expenses among all investors. While some of the fees charged by private fund advisers may seem excessive or egregious practice, preventing private fund advisers from customizing certain fee arrangements based on legitimate factors such as, for example, the amount of capital an investor places at risk or the fundraising phase in which a commitment is made, may result in increased operating costs that have historically been charged to private funds. An unintended consequence of greater pass-through expenses is,

potentially, a lesser willingness by private fund advisers to rebate management fees even though the rule does not explicitly prohibit portfolio investment fee offsets.

From the perspective of a fiduciary, clients of Segal Marco have benefited from potential fee rebates, offsets, and preferential pricing as early investors into funds. Early investors tend to receive more favorable terms to compensate for a "blind pool risk", unlike later investors who may have more visibility into portfolio holdings. These preferred early investor fees are typically disclosed in marketing documents. From the perspective of a private fund adviser for discretionary clients, some of the disclosure requirements will likely result in additional compliance hours and associated costs.

Proposed Preferential Treatment Provision

Segal Marco agrees with certain aspects of the provision on preferential treatment but would respectfully request that the Commission address and/or reconsider other related items with potentially unintended consequences before ratifying the Proposed Rules.

Segal Marco largely agrees with the Commission's stance on preferential liquidity.

The Release notes that "[…] granting preferential liquidity terms on terms that the adviser reasonably expects to have material, negative effect on other investors in the private fund or in a substantially similar pool of assets is a sales practice that is harmful to the fund and its investors."[9] In our opinion, no investor – irrespective of commitment size, scale, or reputation – should be afforded liquidity terms that disadvantage other investors. Segal Marco agrees that doing so could, for example, cause the private fund to be left with a less liquid pool of assets, thus inhibiting the private fund adviser's ability to execute its strategy or promptly fulfill other investors' redemption requests.[10]

With respect to more liquid private funds, Segal Marco does support the continued practice of private fund advisers offering investors a variety of share class options with different liquidity and corresponding fee terms. In our view, so long as the differing liquidity terms do not materially impact the private fund advisers' abilities to execute their strategies and manage potential redemptions, these arrangements allow investors to determine for themselves what is most important and most practical given their specific circumstances. For example, a private fund adviser may offer a Share Class A which offers quarterly liquidity and charges a 1.50% management fee and a 20% performance fee, while Share Class B offers a one-year initial lock-up, followed by quarterly liquidity and charges a 1.25% management fee and a 17.5% performance fee. In this hypothetical example, the private fund adviser values certainty of capital available and is willing to charge a lower fee for that added certainty. We believe this type of arrangement is justified and reasonable.

Segal Marco suggests the Commission consider a "key person provision" in the final version of the rules.

[9] See Release, at 165.
[10] See Release, at 165.

Relatedly, and to ensure consistency in liquidity rights across the investor base, we would like to suggest to the Commission that it incorporate language in the Proposed Rules that requires all private fund advisers to feature and honor a "key person provision" for all private funds on offer. As the Commission is aware, a "key person provision" affords investors an exit from a private fund should the key individuals charged with managing the private fund and/or the private fund adviser more broadly become unable or unwilling to continue in their respective duties during the private fund's term. In our experience, this specific provision has meaningful implications from a liquidity perspective and is inconsistently offered by the private fund adviser community (sometimes only provided when specifically requested in side letter negotiations). We believe that it would serve to benefit the industry if standardized as part of the broader Proposed Rules.

Segal Marco is in support of the spirit of the Proposed Rules' provision on preferential transparency but would like to highlight potential unintended consequences of the proposed requirements.

To be explicit, Segal Marco is opposed to all practices that blatantly and materially disadvantage or harm any investor and will support all aspects of the Proposed Rules' provision on preferential treatment that align with that intention. Segal Marco his mindful of circumstances whereby a small subset of investors receiving preferential transparency of specific portfolio holdings and/or exposures details of a private fund or of a substantially similar pool of assets may not work for the interest of all investors. However, as an investment advisor and fiduciary, we believe that the provision on preferential transparency, as currently proposed, could unintentionally introduce certain repercussions for investors.

As one example, the proposed requirements could conceivably limit private fund advisers' abilities to offer and execute co-investments and, indirectly, inhibit them from optimally effectuating their strategies and creating value for investors. As the Commission is aware, co-investment deal volume and capital commitments have picked up considerably in recent years on the back of attractive performance characteristics and low fees. Equally significant, the uptick in co-investment demand has enabled private fund advisers to scale and optimize allocations of best ideas across appropriate and suitable private fund offerings and substantially similar pools of assets; negotiate more favorable investment terms and protections; and, consequently, enhance investors' return. Procedurally, executing on co-investment opportunities generally requires the participation of select investors with ready access to capital and the ability to swiftly yet comprehensively diligence a specific transaction. In other words, the resources and expertise needed to execute co-investments preclude many investors from participating. In our view, requiring private fund advisers to offer every co-investment to every investor to ensure proper compliance of the Proposed Rules' provision on preferential transparency is not only untenable, but could conceivably inhibit private fund advisers from optimizing their value propositions to investors.

As a separate consequence, the Proposed Rules' provision on preferential transparency could potentially compel private fund advisers to standardize the data and reporting they disseminate, as well as how they engage in side letter negotiations so as to ensure consistency in their treatment of all investors. Segal Marco serves a highly diverse client base with distinct policy needs and contractual objectives that may relate to the specific best interests of their retirement

plan participants and beneficiaries. Working constructively and collaboratively with the private fund adviser community to protect and address the unique objectives and sensitivities of each individual client is of the utmost importance to our firm. While we are in support of private fund advisers disclosing all side letter agreements to existing and prospective investors (in redacted form), we would advocate doing so in a manner that provides our clients and other investors like them with assurances that the breadth, scope, and value of the side letter agreement going forward does not diminish their fiduciary responsibilities

The Proposed Rules are without a "grandfathering" provision.

The Commission can appreciate that a lack of a "grandfathering" provision as part of the Proposed Rules creates, in and of itself, a conflict for the private adviser community at large. According to Kirkland & Ellis, among the industry's largest and most prominent law firms, using multiple metrics, "[W]ithout a 'grandfathering' provision, the Proposed Rules provide implementational challenges for advisers who will be required to choose between attempted compliance with the new regime and a breach of a previously granted side letter provision."[11] To eliminate potential conflicts, we strongly request that the Commission consider adding a "grandfathering" provision to the Proposed Rules.

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Segal Marco appreciates the opportunity to weigh in on this important issue. If we can answer any questions or provide additional information, please do not hesitate to contact us.

Best regards,

Alan Kosan
Senior Vice President, Head of Research

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[11] Kirkland & Ellis LLP, https://www.kirkland.com/publications/Kirkland-aim/2022/02/rule-changes-for-pf-advisers-part-2.