April 25, 2022

Re: File No. S7-03-22
Comments on Proposed New Rules for Private Funds

To the Securities and Exchange Commission:

I am writing to comment on the proposed new rules for private funds, in my capacity as managing member of an exempt reporting adviser, which is the general partner and investment adviser to a private fund operating as a "hedge fund" as generally defined. For the sake of privacy, these comments are being submitted anonymously.

My comments address two matters, the first concerning the duration of the comment period allowed for the proposed rules affecting private funds, and the second about an unintended negative consequence of the quarterly reporting requirements that are contemplated by the proposed rules. The two concerns that I am expressing here dovetail with remarks about rulemaking at the Securities and Exchange Commission ("SEC"), expressed by Representative Patrick McHenry and Senator Pat Toomey in a letter to SEC Chair Gary Gensler, dated January 10, 2022 (the "Congressional Letter"), available to the public on the SEC website. The Congressional Letter questions the recent SEC practice of proposing important new rules without providing public comment periods of a duration appropriate to the scope and complexity of the proposed rules. The Congressional Letter asserts, with reference to precedent, law (and seemingly common sense), that comment periods of 90 to 120 days are appropriate when complex rulemakings are undertaken, or when numerous rulemakings are undertaken simultaneously.

The Congressional Letter underscores, "The-notice-and-comment process is critical to effective SEC rulemaking. The opportunity to comment on proposed rulemaking ensures the public can provide substantive analysis, *warn of unintended negative consequences* [emphasis added], and suggest alternative approaches with rationale for the SEC to consider."

In the specific case of the proposed rules governing private funds, the SEC has allowed only 75 days for public comments. This relatively brief comment period pertains to a rulemaking proposal of 341 pages, which if adopted as proposed, would constitute a vast change to the regulatory framework affecting private fund advisers, both those registered with the SEC, and those not required to be registered. It is notable that this comment period overlaps a federal holiday, and three major religious holidays commonly practiced in the United States. Additionally, where investment advisers to private funds are concerned (who understandably might wish to express considered opinions about the proposed rules), the comment period overlaps an administratively taxing period, commonly involving annual audits of fund financial statements, regulatory filing updates, tax filing preparations, including distributions of K-1 and K-3 tax forms to fund partners, and both formal and inter-personal communications with fund partners that are typically concentrated in the quarter following the close of a calendar year. None of these important responsibilities, some of which are required of certain investment advisers by the SEC itself, can be deferred for the sake of reading, understanding, and responding to a sweeping rulemaking proposal hundreds of pages in length.

And so, what surely will occur as a result, is the elimination of well-formulated comments about an important SEC rulemaking proposal by the very targets of that proposal. To this extent, the public comments the SEC receives will be weighted by the opinions and analysis of other interested parties, whose opinions are surely valuable, but surely not more valuable than those of the affected investment advisers themselves.

In consideration of all the facts and circumstances delineated above, the SEC should extend the public comment period to a date no less than 120 days after the date of the rulemaking proposal in question, February 9th, 2022.

The second matter I wish to comment upon is a potential unintended negative consequence of the quarterly reporting requirement of the proposed rules. To be clear, I am writing as the managing member of an exempt reporting adviser. As proposed, the quarterly reporting requirement would not apply to exempt reporting advisers, but only to investment advisers required to be registered with the SEC. However, the proposed rules specifically raises the question, and solicits public comment about, whether the quarterly reporting requirement *should* apply to exempt reporting advisers.

It should not. Valid reasons are expressed below, but first it should be noted that there exists a broader question about whether a quarterly reporting requirement should be applied to any private fund, whether registered with the SEC or not, or whether a SEC rule that imposes a quarterly reporting requirement on a private fund has proper foundation under current law. Other public comments have spoken to these questions, which will not be addressed here.

Addressed here is the specific example of how a quarterly reporting requirement would be detrimental to the fund that my firm advises, and to the investors of that fund.

The fund my firm advises invests exclusively in common stocks on a long-term, unleveraged basis. Meaning, as a rule, this fund invests in stocks with the intention of holding them for years, with an expectation of long-term gains, but without concern for shorter-term quotational fluctuations, plus or minus, which may be considerable. This investment approach is disclosed in the fund's offering documents, and is underscored to investors in informal conversations or communications both before and after they commit investment dollars to the fund. All the investors in the fund acknowledged the fund's long-term investment strategy before they invested in the fund, and agreed to it.

However, as many investment advisers might attest, it is not unusual for individual investors to profess affinity for a long-term investments strategy with indifference to short-term volatility. But many investment advisers might equally attest that many such self-proclaimed long-term investors quickly turn into short-term investors, or former investors, when markets become volatile and portfolio values decline precipitously. This is understandable. When stock prices fall, people get scared. And when people get scared, high-minded aspirations about patient long-term investing frequently evaporate.

Commercially astute investment advisers will often adopt strategies to cope with adverse investor reactions to market volatility. These strategies are varied, but frequently center on broad investment diversification to mitigate the peaks and valleys of portfolio performance, portfolio hedging strategies of various sorts, and not least, extreme attentiveness to the emotional needs of investors, sometimes through frequent written updates to reassure investors about the validity of the adviser's investment strategy, or to the same end, personal conversations, meetings, presentations, etc. Some of these adaptive strategies may be sound if properly implemented, and no criticism is implied toward any investment adviser utilizing intelligently and to honorable effect.

My firm, however, has adopted a somewhat different approach to handling investor sensitivity to quotational volatility. And that is, for three quarters of each year, the investors in our fund are simply not informed about the fund's performance. Instead, the fund's investors receive a single report after year-end that discloses the fund's results for the past year, which includes a discussion of the fund's investment strategy that led to those results, and an update about the anticipated application of that strategy for the year ahead. Additionally, in compliance with the custody rule, within 120 days of year-end, we distribute to investors the fund's audited financial statements, which includes disclosure of the

fund's year-end portfolio holdings as required under GAAP accounting. *And that's it.* Generally, no other formal communications are provided to the investors in the fund.

For our fund, this spare approach to reporting has worked well. To be clear, all the investors in the fund agreed to the above-described system of reporting before they invested. Based on my firm's experience, this approach has a tremendous advantage. The advantage is that investors who proclaim a long-term orientation to investments, and who in keeping with that professed orientation, agree to forgo monthly, quarterly, or semi-annual statements of performance, generally live up to their stated preference for a long-term investment strategy. While many investors say they want a long-term approach to investments, but then change their mind, our investors really mean it. All of the current investors in the fund have retained their respective investments for many years, through many quotational upheavals along the way. And how do they react to those periodic quotational upheavals? Mostly, they don't even call to say hello.

With a partner-base of this sort, my firm, the adviser to the fund, generally is able to implement the fund's investment strategy freely, with minimal distraction. There are no interim quarterly reports to write, and no phone calls or emails from investors to field throughout the year, expressing say, the latest upset in the market. As a result, my firm can allocate most of its time and energy to pure investment work for most of the year – to the advantage of all investors. Moreover, in keeping with the fund's investment objectives, the fund's capital can be heavily concentrated in specific securities without regard to the psychological impact of intra-year volatility, which a concentrated approach to capital allocation is prone to generate (which the fund's investors have no awareness of in real-time).

On several occasions, investors in the fund have confessed relief at *not* being exposed to the quarterly fluctuations of the fund's value. They recognize that witnessing the natural ups and downs of marketable securities quotations is stressful. Part of the "service" the fund is providing them, besides generation of substantial long-term gains (to date), is relief from observing these quotational twists and turns.

Would the reporting approach described above be appropriate for investment funds offered to the public? Absolutely not. The approach works here because each investor in the fund has a substantial pre-existing relationship with the managing member of the general partner and investment adviser to the fund. The investors in the fund know on a personal level with whom they are investing, and have decided that under the particular circumstances of this private fund, they are comfortable with annual but not interim reports.

The SEC should not ban a private arrangement of this nature by imposing quarterly reporting requirements on a fund that, by any reasonable definition, is a wholly private partnership, operating under negotiated terms accepted by all partners, who believe the reporting terms described above are not to their detriment, but to their *benefit*.

<u>Therefore, the SEC should *not* alter the proposed rules and apply quarterly reporting requirements to exempt reporting advisers.</u> The SEC should maintain a bright line between the regulatory structure applied to advisers that are required to be registered with the SEC, and those that are not required to be registered. The example of our fund underscores why this bright line is important. It exists so that investors can consensually enter into private partnerships and adopt terms beneficial to their specific circumstances and interests, terms which may not be appropriate to funds offered to investors on a more general basis, which arguably, should be regulated to a strict common standard.

Moreover, as noted in the first part of these comments, the SEC should not adopt *any* new rules of a highly consequential nature without providing for a substantial public comment period. As the Congressional Letter pointed out, rulemaking without allowance for a substantial public comment

periods invites unintended negative consequences, one example of which has been discussed in these comments.