Congress of the United States
Washington, DC 20515

April 25, 2022

The Honorable Gary Gensler
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (SEC Release No. IA-5955; File No. S7-03-22 (February 9, 2022)).

Dear Chairman Gensler,

We write to you today regarding the Securities & Exchange Commission's ("SEC" or "Commission") proposed rulemaking on private fund advisers. We are concerned that the proposed rulemaking represents a meaningful shift in the SEC's historical approach to private funds; exceeds the SEC's statutory authority; is not consistent with the Commission's statutory duty to promote efficiency, competition and capital formation; and in our judgment, is arbitrary and capricious.

The U.S. capital markets are the largest, deepest, and most attractive for global investors. They support both U.S.-based, global companies and rural small business alike. Private funds are a central feature of that robust capital markets ecosystem. These funds deploy private capital for a broad spectrum of businesses across the country and enable important investments across a variety of asset classes. The SEC has long maintained a comprehensive regime to ensure the appropriate level of disclosure for investors commensurate with the private nature of funds, and the sophistication of counterparties. This regime has worked remarkably well.

On February 9, 2022, the SEC proposed a number of amendments (the "Proposed Rules") to regulations under the Investment Advisers Act of 1940 (the "Advisers Act") related to private funds. The Proposed Rules would impose unprecedented new prohibitions on various activities of investment advisers to private funds, expand burdens for both investors and private fund advisers in many additional contexts and establish new financial reporting requirements. While we share the SEC's general view of the importance of market transparency, we are concerned that the Proposed Rules reflect a serious overreach by the SEC.

As this rulemaking process moves forward, we request you consider the following points and appropriately respond to our questions.

First, we question the SEC's authority to promulgate these rules under the Advisers Act. As the U.S. Court of Appeals for the D.C. Circuit recently stated in *N.Y Stock Exch. LLC v. SEC,* like other federal agencies, the SEC "literally has no power to act...unless and until Congress confers power upon it."[1] The SEC points to Section 206[2] and 211[3] of the Advisers Act as sources of authority[4], but neither of these provisions authorizes the Proposed Rules' prohibitions on longstanding business arrangements and detailed new requirements.

Second, the SEC's Proposed Rules would impose an expansive framework of extremely costly and unnecessary disclosures, along with a paternalistic prohibition on longstanding business practices. The Proposed Rules would not only subject private funds to the same type of regulation as funds registered under the Investment Company Act of 1940 (the "1940 Act") funds, they impose restrictions on private funds that in some respects are *more* stringent. The 1940 Act sets forth a detailed regulatory structure for registered investment companies, governing almost every aspect of investment companies' operations. Congress, however, explicitly exempted private funds from this broad regulatory regime. The intent behind this exemption was recognition that the investors in private funds are sophisticated investors. These investors are well positioned to "evaluate on their own behalf matters such as the level of a fund's management fees, governance provisions, transactions with affiliates, investment risk, leverage, and redemption rights."[5] However, the Proposed Rules would do away with this distinction between the regulatory treatment of 1940 Act funds and private funds by affording "retail-like protections to accredited investors." We agree with Commissioner Hester Peirce, who said that this new approach "[calls] into question the rationale for dividing retail from accredited investors" and signals a new belief from the Commission that all investments should be open to all investors.

Moreover, Congress provided that 1940 Act funds with retail investors could not indemnify their investment adviser for "gross negligence" but could do so for simple negligence.[6] Yet, under the Proposed Rules, the SEC would bar private funds – with large, sophisticated investors – from indemnifying their investment advisers for even simple negligence. The federal government's paternalism underpins many provisions of these Proposed Rules and defies the SEC's long recognized position that "the federal securities laws...are based on a simple and straightforward concept: everyone should be treated fairly and have access to certain facts about investments and those who sell them"[7]. If the facts and conflicts of interest are fairly disclosed, it is not the SEC's

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[1] *N.Y. Stock Exch. LLC v. SEC,* 962 F.3d 541, 553 (D.C. Cir. 2020) (ellipsis in original) (quoting *La. Pub. Serv. Comm'n v. FCC,* 476 U.S. 355, 374 (1986)).

[2] 15 U.S.C. § 80b-6.
[3] 15 U.S.C. § 80b-11(h).
[4] *See* Proposing Release at 16,974.
[5] *Prohibition of Fraud By Advisers of Certain Pooled Investment Vehicles,* Securities Act Release No. 8766, 2006 WL 3814994, at *8 n.45 (Dec. 27, 2006).
[6] *See* 15 U.S.C. § 80a-17(i).
[7] *What We Do,* SEC, https://www.sec.gov/about/whatwe-do.html (last visited Apr. 3, 2022); *see also, e.g.,* Investment Trusts and Investment Companies: Hearings Before the Subcomm. on Sec. & Exch. of the S. Comm. on

role to limit access to investments based the SEC's subjective view. Without question, the Proposed Rules will prohibit the largest and most sophisticated investors from continuing to select popular, widely used private funds structures.

Third, the Proposed Rules will result in harmful and counterproductive consequences affecting private funds, investors, and the beneficiaries who rely on historically strong returns. For example:

- The Proposed Rules will increase fund expenses and decrease returns for investors. Several provisions in the Proposed Rule will be costly to implement and maintain. For example, insurance costs will increase due to the imposition of a negligence liability standard, and private funds will incur significantly higher financial reporting costs and high administrative costs resulting from the requirement to disclose side letter terms before closing of a fund. These costs will ultimately be borne by fund investors.

- The Proposed Rules limit investor choice. The restrictions on side letters will limit the ability of pension plans, university endowments, high net worth investors (the very investors that the release suggests are worth protecting) to negotiate terms that most benefit their stakeholders. The reporting provisions, which impose granular and onerous requirements (both in content and because they are subject to a 45-day deadline), could result in advisers being unwilling to take on any additional specialized reporting via side letter for investors such as state pension plans that may need specialized reporting, particularly because the Proposed Rules would require the adviser to provide this specialized reporting to all investors.

- The Proposed Rules will create uncertainty and delay investors' ability to participate in investments. The Proposed Rules as drafted would apply to private funds in existence at the time the rules are adopted. Because of the rules' broad scope, advisers to private funds may pause fundraises, suspend funds' investment periods, or otherwise wind up funds in existence rather than try to comply with rules aimed at very specific aspects of fund and adviser operations. Advisers may choose not to raise new funds until they have brought their firms into compliance with the new rules. This upheaval will result in significantly reduced returns for the entire investing community.

As you consider the points above, we also ask that you respond to the following questions and document requests related to the Proposed Rules.

1. Please provide a detailed legal analysis of the SEC's statutory authority under the Advisers Act to promulgate the Proposed Rules.
2. The SEC's cost-benefit analysis described in the Proposed Rules are inadequate in scope and substance. Please provide a detailed cost-benefit analysis that evaluates the impact of the Proposed Rules on investment returns and availability of investment options.

Banking & Currency, 76th Cong. 233 (1940) (statement of David Schenker, Chief Counsel, SEC) ("If [a fund is] going to be a speculative investment trust, and they disclose that fact to their investors, and the investors want to invest in that type of investment company, who are we to say, 'No, you shall not invest in that type of company?'").

3. Has the SEC conducted an analysis of impact of the Proposed Rules on women and minority owned fund sponsors? If not, before finalizing any proposed amendments the SEC should conduct such a study.
4. Did the SEC perform extensive stakeholder outreach to support the Proposed Rules before issuing them? If so, please provide a list of organizations the SEC consulted before the issuing the Proposed Rules.

As the SEC has failed to provide an adequate public comment period for a number of incredibly complex and massively consequential rules, and due to the concerns identified above, we request that you respond in writing to our concerns, questions, and comments by May 25, 2020. Under no scenario should the SEC move forward in finalizing this rulemaking until our concerns have been addressed.

Sincerely,

Bill Huizenga
Member of Congress

French Hill
Member of Congress