September 29, 2022

VIA ELECTRONIC SUBMISSION

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

Re: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews: Release No. IA-5955; File No. S7-03-22

Ladies & Gentlemen:

The Private Investor Coalition ("PIC") is submitting this comment letter in follow up to our prior comments[1] to the solicitation by the Securities and Exchange Commission (the "SEC" or the "Commission") of public comments in connection with the Commission's rule proposal (the "Proposed Rule")[2] under the Investment Advisers Act of 1940 (the "Advisers Act") titled *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews* (the "Proposing Release").

Supplemental Comments

Many "family offices" and their "family clients," in each case as defined under the Family Office Rule,[3] as well as other family investment partnerships and collective investment vehicles that do not qualify as family offices or family clients, are "private funds" under the Proposed Rule because they would be an "investment company" but for the Section 3(c)(1) and/or 3(c)(7) exceptions under the Investment Company Act of 1940. The Proposed Rule does not distinguish between private funds sponsored, governed and/or controlled by a registered investment adviser ("RIA"), or an affiliate of the RIA, and private funds that are owned, governed and controlled by the investors, such as a family office/family client or investors who establish an investment vehicle for themselves and who are not required to register under the Advisers Act.

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[1] PIC Letter dated June 14, 2022 to Vanessa A. Countryman, Secretary, SEC, re: Release No. IA-5955; File No. S7-03-22 ("June Comment Letter").

[2] Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, SEC Release IA-5955 (Feb. 9, 2022).

[3] Rule 202(a)(11)(G)-1 under the Advisers Act.

We believe the Proposed Rule creates unintended consequences for this class of investors (which includes family offices/clients) who are technically "private funds" as defined under the Proposed Rule, but who are not controlled or governed by a registered investment adviser (or its affiliate) that provides direct investment advice and/or services to such investors. Many family offices retain RIA services directly for family clients that the family office itself controls and governs. In many cases, the family office will retain multiple RIAs to provide investment advice and other services to a family client or several family clients in separately managed accounts or other similar arrangements. The RIA typically does not know what other RIAs are retained by the family office. The RIA may be retained to provide advice and services to the entire portfolio or only a portion of the portfolio of a particular family client. The family office itself might manage a family client's total portfolio including the various RIAs utilized (a "manager of managers") as well as any investment activities conducted directly by the family office. Under these scenarios, the RIA's investment advice covers only a portion of the total portfolio of the family client in question. In most instances, the family office/family client is prohibited by contract from disclosing the RIA's strategy, trading, positions and other proprietary information to any third party, including other RIAs providing advice and services to the same family office or family client. These RIA arrangements are often, but not always, established as separately managed accounts where the RIA has visibility only to an account that custodies that RIA's strategy and nothing else.

Under these arrangements, the family office/client is in control. The family office can typically terminate the RIA at will (sometimes with fixed notice periods) and, as the owner of the account, shut down the RIA's access to the account upon notice to the applicable custodial entity. Further, the family office has total and complete transparency to the account, including the performance of the account (i.e., the RIA's strategy). The RIA is typically only granted trading rights with respect to the account – the RIA does not have authority to transfer assets into or out of the account. Sometimes, the RIA provides the trades to the family office and the family offices executes them in the account of the applicable family client, in which case the RIA might be given "view only" access to its sleeve of the portfolio with no other rights with respect to the account. Finally, the investor terms set forth for the family office/client are known to the investors as they (i.e., the family members) are all clients of the family office and the family office is established to serve and protect their interests. Despite the characteristics of these family office/client arrangements, the Proposed Rule would nevertheless impose the new RIA private fund requirements on them. In two instances (liquid/illiquid determinations and audits), this would require RIAs to inject themselves into the family office/client's affairs where they are not needed and where the RIA does not belong. We believe this result is both unwarranted and unintentional.

The Proposing Release sets forth the Commission's primary motivations behind the Proposed Rule. First, private funds are opaque and do not provide investors with sufficiently detailed information about investments.[4] Second, investors lack transparency into how private fund

[4] Proposing Release, at 9.

performance is calculated.[5] Third, investors do not have information regarding preferred terms granted to other investors.[6] The Proposing Release sums this up as providing "[e]nhanced information about costs, performance, and preferential treatment" to private fund investors. The Proposing Release then expands on the rationale to include addressing the problems of "advisers acting on conflicts of interest that are not transparent to investors" such as where "the adviser can influence or control the portfolio company" in which the private fund invests, and the Commission's view that "private funds typically lack governance mechanisms that would help check overreaching by private fund advisers."[7]

"In contrast, outside of the private fund context, … the adviser's ability to influence or control [a portfolio] company is generally constrained."[8] The Proposing Release notes that the Proposed Rule is "designed to address the specific concerns that arise out of the lack of transparency and governance mechanisms prevalent in the private fund structure."

The retaining of RIA services by a family office/client for direct advice and services does not raise the concerns targeted by the Proposed Rule. The RIA advice is given to an entity formed, governed, and controlled by the family office and owned by the family itself. The family client's portfolio is completely transparent to the family office, and the family office knows the terms given to any family investor. The outside adviser has no control over the family office or family client and only has the ability to advise and/or trade that portion of the family client's portfolio that the family office authorizes. Finally, a family client governed by the family office will not "lack governance mechanisms that would help check overreaching by private fund advisers."[9] To the contrary, the family office will have complete control of the portfolio, the accounts and the family client itself. In sum, the enumerated concerns that led the Commission to consider the Proposed Rules simply do not apply to a family office/client that engages an outside adviser for direct investment advice and/or services.

As indicated previously, the Proposed Rule, if applied in the context of investor entities controlled by the investors we describe above, would create a perverse result in two specific instances, causing the family office/client to potentially divulge information to the RIA that the RIA does not need and should not be entitled to and which the family office/client may be under a contractual obligation not to disclose.

If the family office/client is treated as a private fund for purposes of the Proposed Rules, the adviser will be compelled to use reasonable steps to (i) make a liquidity/illiquidity determination about the family office/client's portfolio, and (ii) cause the family client to undergo an audit. In such circumstances, neither the liquidity determination nor the audit could be completed without the family office/client disclosing information about its portfolio that the investment adviser is neither

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[5] *Id.* at 10.
[6] *Id.* at 11.
[7] *Id.* at 13.
[8] *Id.* at 14.
[9] *Id.* at 13, 133.

entitled to nor has any reason to know. As previously indicated, many family offices engage multiple investment advisers for direct investment advice and services for their family clients. The Proposed Rule's liquidity determination and audit requirements would result in a panoply of adviser requests for information that the adviser would otherwise have no reason to see and which the family office/client would have no reason to provide. Moreover, in most cases, the family office/client is contractually prohibited under nondisclosure agreements from sharing information about one RIA's piece of a portfolio with another RIA.

Privacy

Personal financial information is deemed to be highly sensitive and receives heightened protection under federal law. "Section 13(f) . . . explicitly prohibits the Commission from disclosing to the public" such "personal" information.[10] The Commission has acknowledged this as well in the family office context by saying that regulation of family offices under the Advisers Act "would unnecessarily intrude on the privacy of the family involved."[11]

Despite this emphasis, the Proposed Rule would actually require RIAs to seek personal financial information from the family office and their family clients in order to comply with the liquidity determination and audit requirements of the Proposed Rule. In this context, the RIA is simply another member of the "public" with respect to information about the portion of a family office/client's portfolio for which the RIA was not retained. The Advisers Act is supposed to protect investors from its advisers, not add new requirements for clients to provide information to its advisers that do not want to share.

Similarly, since 2000, Regulation S-P has protected customer information from unwarranted sharing. It would seem inconsistent with the Commission's push under Regulation S-P for the maintenance of investor privacy protections if the Proposed Rule would end up causing advisers to collect new information about their family office clients who are in effect private individuals and families. As an example of privacy threats, the Commission staff issued a Risk Alert that included an entire section titled "Policies not implemented or not reasonably designed to safeguard customer records and information."[12]

Request

In consideration of the foregoing, we request that the Final Rule either (i) exempt family offices and family clients from the Proposed Rule when the RIA's investment advice and other services

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[10] Proposing Release, p. 25; *see* Sections 13(f)(4) and (5) of the Exchange Act [15 U.S.C. 78m(f)(4)] [15 U.S.C. 78m(f)(5)]; *see also* Rule 24b-2(b)(2) under the Exchange Act [17 CFR 240.24b-2]; *see generally* Freedom of Information Act [5 U.S.C. 552].

[11] Family Offices, SEC Release No. IA-3098 (Oct. 12, 2010) (proposing release) at 6 n. 13, quoting from S. CONF. REP. NO. 111-176, at 38-39 (2010) (Senate committee report).

[12] Office of Compliance Inspections and Examinations, "Risk Alert: Investment Adviser and Broker-Dealer Compliance Issues Related to Regulation S-P – Privacy Notices and Safeguard Policies" (April 16, 2019), available at https://www.sec.gov/files/OCIE%20Risk%20Alert%20-%20Regulation%20S-P.pdf.

are provided directly to the family office/client as opposed to a private fund in which the family office/client has invested and which is not an affiliate of the family office/client, or (ii) treat a family office and their family clients in the same way as separately managed accounts, rather than as private funds, for the reasons set out in these comments.[13]

Conclusion

In closing, PIC supports the Commission's efforts to increase transparency and fairness for investors in private funds managed and/or operated by outside investment advisers and the Proposed Rule as drafted are meritorious on multiple levels. However, we do not believe applying the Proposed Rule to a family office/client that hires an investment adviser to provide investment advice and services directly to the family office/client is warranted or intended. We respectfully request that the Proposed Rule be modified accordingly when adopted in its final form.

We appreciate your consideration of these comments.

Respectfully submitted,

Timothy P. Terry
Secretary, Private Investor Coalition
[redacted]

[13] As discussed below, "family office" and "family client" would be as defined under the Advisers Act. To illustrate how such an exclusion might read, we refer to the "family investment vehicle" exclusion in FINRA Rule 5130:

> "Family investment vehicle" means a legal entity that is beneficially owned solely by one or more of the following persons: (A) immediate family members; (B) family members, as defined under Rule 202(a)(11)(G)-1 of the Investment Advisers Act; or (C) family clients, as defined under Rule 202(a)(11)(G)-1 of the Investment Advisers Act.