THE REGULATORY FUNDAMENTALS GROUP LLC
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December 3, 2022

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

Submitted via email to rules-comments@sec.gov

Re: Proposed Rule on Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (Release Nos. IA-5955; File No. S7-03-22)

Dear Ms. Countryman:

On behalf of the Regulatory Fundamentals Group ("RFG"), I am writing to thank the staff for taking the time to meet with us to discuss the above-referenced proposal and for discussing some of the key concerns laid out in our comment letter dated April 25, 2022.[1] As a consortium of leading nonprofit organizations (including major research universities and charitable foundations) that have made substantial investments in the private markets to advance our institutions' missions and to enhance the common good, RFG appreciates the SEC's commitment to investor protection and efforts to improve the flow of information in support of transparency and fairness.

As we discussed during our meeting with staff, our highest priority issue arising under the proposed rules as they relate to private open-end funds is that effectively banning transparency and liquidity practices under proposed rule 275.211(h)(2)-3(a) ("Proposed Rule 3(a)") would harm investors by reducing overall transparency and liquidity options without an overriding benefit. We recognize that Proposed Rule 3(a) includes an allowance for negotiated differences that do not result in a "material negative effect" on other investors, but that standard is vague and would chill market practices that are beneficial to investors. We are concerned about the ability

[1] https://www.sec.gov/comments/s7-03-22/s70322-20126563-287199.pdf

to access diversified investments in a manner that is consistent with the goals, fiduciary obligations and mandates of our nonprofit missions. Put differently, the potential purported benefits from Proposed Rule 3(a) do not come close to outweighing the potential widespread harm we, as investors, will experience.

Proposed Rule 3(a) is also a departure from the SEC's historical approach of using full and fair disclosure to address potential harms to investors. Given the expected harm to investors from the proposed new remedy and the efficacy of existing regulatory tools, we respectfully request that Proposed Rule 3(a) be withdrawn.

At the same time, we acknowledge the potential benefits of an explicit requirement that transparency and liquidity arrangements and related risks be disclosed to investors. Appendix A contains proposed text which is designed to achieve that end while preserving beneficial practices undertaken by investors.

Although RFG's members are not the largest institutional investors, each spends significant resources to decide how best to satisfy its fiduciary, business and legal needs. These needs are often unique and there is no cookie-cutter approach that works for all. The rule as proposed may have the unintended consequence of providing the advisers to funds in which RFG members invest with a rationale for refusing to honor institution-specific needs that often benefit not just the members themselves, but investors as a whole.

Proposed Rule 3(a) risks a race-to-the-bottom approach on transparency by incentivizing advisers to disclose as little as possible, which would undermine diversified approaches to investment monitoring and other activities of investors. This would compromise investors' ability to carry out their fiduciary duties. Current transparency practices aid investors beyond helping them make sounder investment decisions. For example, institutional non-profit investors require transparency to meet internal asset allocation targets, manage legal compliance efforts, monitor divestment or restricted securities lists, follow ESG mandates and respond to regulatory and stakeholder inquiries.

All investors in a portfolio benefit when one investor uses its transparency to ensure that the adviser is complying with its business, legal, and ethical obligations. Because of that common benefit, we are not troubled by the prospect that other investors have different needs and may receive rights that are considered more generous in some circumstances. Although RFG members seek to invest with advisers that adhere to the highest ethical standards, we expect Proposed Rule 3(a) would make it easier for unscrupulous advisers to reduce this collective monitoring and turn their funds into black boxes. That would make it easier for bad actors to hide fraud from investors as a whole and increase the burden on the SEC to find bad conduct that may have otherwise been discovered by investors themselves under existing transparency practices.

Proposed Rule 3(a) would also reduce liquidity options for investors, thereby reducing efficiency in the market and harming investors, without a countervailing benefit. Private funds have legitimate reasons for offering – and investors have sound business reasons for agreeing to – different liquidity options, including a desire to incentivize investors to lock up their capital longer by offering lower fees in exchange for less liquidity, or to accommodate investors who are subject to special regulations (for example, accommodating investors subject to ERISA who wish to avoid a prohibited transaction). Narrowing such options reduces the range of choice in the market. Moreover, we are not aware of any actual harms that have resulted from varying liquidity rights, other than in a small number of enforcement cases that involved deception and were ably addressed with existing enforcement tools. Once again, we are concerned that a vague "material negative effect" standard would incentivize an adviser to make self-protective decisions, such as reducing liquidity options or even dropping some investors.

Transparency and liquidity rights are often necessary conditions for investments into funds managed by emerging advisers in particular, as these rights provide the comfort required to execute higher-risk, higher-return investments associated with emerging advisers and novel strategies. This is especially relevant for RFG members that are focused on traditionally underrepresented advisers or target investments in communities and innovation important to their missions.

If the SEC feels compelled to act in this area, we support disclosure-based rules in the spirit of proposed rule 211(h)(2)-3(b) rather than effectively banning specific practices, particularly since (i) the SEC already has ample authority, including under Section 206 of the Advisers Act, to address abuses concerning preferential liquidity and transparency, and (ii) existing private fund features and market tools (e.g., redemption notice periods, contractual limits on front-running, fund/investor gates, side pocket mechanics and redemption suspension tools) provide adequate protections to investors in private open-end funds.

Finally, we re-emphasize that retroactive application of Proposed Rule 3(a) would shortchange investors and result in a deluge of amendments to legal documents. As we noted in our prior comment letter, we are not suggesting that adopting Proposed Rule 3(a) while preserving existing arrangements would be a good compromise for investors; we are simply noting that adopting the rule without exempting existing arrangements would make a bad outcome even worse.

In sum, we respectfully request that Proposed Rule 3(a) be withdrawn because it would harm investors by reducing overall transparency and liquidity options without an overriding benefit. To the extent the SEC has any concerns in this area, we respectfully request the adoption of a disclosure-based rule, not an effective ban on practices that benefit investors as whole. Full and fair disclosure of transparency and liquidity practices would enhance the SEC's ability to fulfill its mission without causing substantial harm to investors.

We would like to once again thank the SEC for its continued efforts to protect investors.

Respectfully,

Deborah Prutzman
Chief Executive Officer

cc: The Hon. Gary Gensler, SEC Chair
The Hon. Hester M. Peirce, SEC Commissioner
The Hon. Caroline A. Crenshaw, SEC Commissioner
The Hon. Mark T. Uyeda, SEC Commissioner
The Hon. Jaime Lizárraga, SEC Commissioner
Mr. William Birdthistle, Director, Division of Investment Management

<u>Appendix A: Draft Proposed Rule Text (with proposed changes highlighted)</u>

§ 275.211(h)(2)-3: Preferential treatment.

(a) ~~An investment adviser to a private fund may not, directly or indirectly, do the following with respect to the private fund, or any investor in that private fund:~~

~~(1) Grant an investor in the private fund or in a *substantially similar pool of assets* the ability to redeem its interest on terms that the adviser reasonably expects to have a material, negative effect on other investors in that private fund or in a *substantially similar pool of assets*; or~~

~~(2) Provide information regarding the portfolio holdings or exposures of the private fund,or of a *substantially similar pool of assets*, to any investor if the adviser reasonably expects that providing the information would have a material, negative effect on other investors in that private fund or in a *substantially similar pool of assets*.~~

(b) An investment adviser to a private fund may not, directly or indirectly, provide any ~~other~~ preferential treatment to any investor in the private fund unless the adviser provides written notices as follows:

(1) *Advance written notice for prospective investors in a private fund*. The investment adviser shall provide to each prospective investor in the private fund, prior to the investor's investment in the private fund, a written notice that provides specific information regarding any preferential treatment the adviser or its related persons provide to other investors in the same private fund**<u>, subject to § 275.211(h)(2)-3(b)(3)</u>**.

(2) *Annual written notice for current investors in a private fund*. The investment adviser shall *distribute* to current investors, on at least an annual basis, a written notice that provides specific information regarding any preferential treatment provided by the adviser or its related persons to other investors in the same private fund since the last written notice provided in accordance with this section, if any**<u>, subject to § 275.211(h)(2)-3(b)(3)</u>**.

(3) ***<u>Redemption terms and information regarding portfolio holdings.</u>*** **<u>The investment adviser may provide either different redemption terms or information regarding the portfolio holdings or exposures of a private fund to any investor in the private fund or a *substantially similar pool of assets* if (i) the investment adviser provides each prospective investor in the private fund and each *substantially similar pool of assets*, prior to the investor's investment in the private fund or *substantially similar pool of assets*, with disclosure of the risks associated with receipt of different redemption or information rights and a summary of any binding rights concerning such terms and (ii) the investment adviser provides updates to such disclosures to all investors in the private fund and each *substantially similar pool of assets* on at least an annual basis following the investment.</u>**

(c) For purposes of this section, defined terms shall have the meanings set forth in §275.211(h)(1)-1.