

United States Senate

WASHINGTON, DC 20510

December 12, 2022

The Honorable Gary Gensler
Chair
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Dear Chair Gensler,

We write you today to convey our concerns to the U.S. Securities and Exchange Commission's (the "**SEC**" or the "**Commission**") proposed rule on "Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews" (the "**Proposal**").¹

We are deeply concerned with the substance and process of the Proposal. As has been noted by numerous comment letters, the SEC lacks the statutory authority necessary to implement the Proposal. Furthermore, the SEC's economic analysis of the impact of the Proposal is insufficient. Finally, the Proposal would have a disproportionate impact on small, diverse and female owned market participants.

The Proposal is not within the SEC's authority as delegated by Congress, raises questions under the major questions doctrine similar to the issues raised by other SEC proposals,² and would constitute an unauthorized expansion of the SEC's regulatory authority by relying on murky and broad anti-fraud provisions. Additionally, the SEC's delegated power does not extend to retroactive regulation. As drafted, the Proposal would apply to current, negotiated contracts between highly sophisticated parties that raise questions of due process. Further, Congress has repeatedly and deliberately applied different regulatory regimes and requirements to private funds and their investors than those applicable to registered investment companies, retail investors and their brokers.³ This conscious choice exempts private funds from the more extensively regulated regime applicable to retail products.

The SEC inappropriately seeks to impose new onerous requirements on private funds, which in some instances are more stringent than the requirements imposed by Congress on the more regulated retail environment. It is wrong that the SEC is attempting to dictate the terms between sophisticated private parties and limit their ability to freely contract.

¹ Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 87 Fed. Reg. 16,886 (Mar. 24, 2022). All citations to the Proposal will refer to the Federal Register page unless otherwise indicated.

² See, e.g., the SEC's proposed rule on "The Enhancement and Standardization of Climate-Related Disclosures for Investors".

³ In adopting the Investment Company Act of 1940 (the "**Investment Company Act**"), Congress exempted private funds from the regulatory architecture for registered investment companies. In passing the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "**Dodd Frank Act**"), Congress elected not to revisit and adjust this exemption.

In the face of Congress repeatedly exempting private funds from the extensively regulated regime applicable to retail products, the Proposal's attempt to impose stringent requirements on private funds, implicating broad economic and political significance, encroaches on a major question that remains the domain of Congress.

The Proposal is inconsistent with the SEC's statutory obligation to conduct a thorough economic analysis of its impact. The Commission's economic analysis of the financial impact on the private funds market grossly underestimates the costs that market participants will incur in order to comply with the Proposal or the impact that the massive cost will have on the market by stifling competition and deterring capital formation. By the SEC's own admission, it was "unable to quantify certain economic effects because it lacks the information necessary to provide estimates or ranges of costs".⁴ Furthermore, the Commission's economic analysis was done in a vacuum, without taking into account the cumulative impact of the Commission's breakneck rulemaking agenda that began at the end of 2021 and continues to this day. As the SEC is proposing more than double the number of rules than it had in each of the past two years, and the most it has in each of the past five years, the cumulative cost of navigating and complying with the proposed rules would be compounding on market participants. This aspect is not a factor in the SEC's economic analysis.

Additionally, the economic analysis conducted by the Commission does not address the relationship between the Proposal and the apparent dysfunction already observed within the SEC in connection with a recent inspector general report, as attrition has been increasing and roles remain unfilled or staffed by inexperienced detailees. The economic impact of the Proposal must not only be viewed in the context of the other rule making that the Commission has been engaging in at a breakneck pace, but also in the context of the impact the rule making is having on the Commission itself. The tempo of rulemaking will increase the difficulty faced by the SEC in meeting its basic enforcement and regulatory needs, as well as increasing the risk of litigation. The Commission must conduct a more fulsome economic analysis that looks at the cumulative impact of its full rulemaking agenda before its moves forward with the Proposal.

Finally, we wish to convey our objection to the Proposal over its likely disproportionate impact on emerging and smaller sponsors, and in particular, female and minority-owned sponsors. Emerging and smaller fund sponsors often lack the same back-office infrastructure as larger more established sponsors, which will be necessary to comply with onerous requirements imposed by the Proposal. The massive costs of compliance with the Proposal will stifle the ability of smaller and less established sponsors to operate, raise new capital and take entrepreneurial risks, ultimately pushing them out of the market. Because new entrants and smaller fund sponsors are more likely to be female or minority-owned than the larger more established sponsors, the Proposal would help pave the way to a less diverse market with fewer options and opportunities for investment for investors. A less diverse market with fewer opportunities for investors will further hinder the economic potential of historically underfinanced populations and reinforce the racial and gender wealth gaps in this country.

⁴ The Proposal at 184.

We feel compelled to remind you that you and your colleagues on the Commission are not elected legislators. You are statutorily obligated to implement and execute the authority to govern the Commission, as mandated by Congress. Furthermore, at a time when this country is suffering its highest level of inflation in over 40 years and the impact from a devastating recession, you are acting in derelict of your statutory mandate to facilitate capital formation. Indeed, this unauthorized rulemaking will shut down capital formation, further exacerbating our current economic state. This proposal must be withdrawn.

Sincerely,

A handwritten signature in blue ink, appearing to read "Tim Scott", written above a horizontal line.

Tim Scott
U.S. Senator

A handwritten signature in blue ink, appearing to read "Bill Hagerty", written above a horizontal line.

Bill Hagerty
U.S. Senator