Cynthia Lo Bessette
SVP, Deputy General Counsel
245 Summer Street V13E, Boston, MA 02210
[redacted]

September 24, 2019

Submitted electronically through http://www.regulations.gov

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: **Concept Release on Harmonization of Securities Offering Exemptions: File Number S7-08-19**

Dear Ms. Countryman,

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") on the Concept Release on Harmonization of Securities Offering Exemptions, that solicits comment on ways to harmonize, simplify, and improve the current exempt offering framework to promote capital formation and expand investment opportunities, while maintaining appropriate customer protections (the "Concept Release")[2].

We applaud the SEC for seeking to expand opportunities in the private market for retail investors who historically have not had access to these investment opportunities. As the Concept Release outlines, the current regulatory framework is extensive and complicated to navigate both for investors and for investment managers seeking to create new products that may be appropriate for retail investors.[3] Fidelity has extensive experience investing in the exempt offering marketplace and is pleased to share its perspective. For over a decade, Fidelity has invested in both public and private companies at various stages of growth for Fidelity's mutual funds. Additionally, Fidelity's institutional asset management unit provides collective investment trusts, separate accounts, and privately offered funds to institutional investors, including pension and profit sharing plans, corporate entities, endowments, and government plans.

[1] Fidelity is one of the world's largest providers of financial services, including investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 27 million individuals and institutions, as well as through 12,500 financial intermediary firms. Fidelity submits this letter on behalf of Fidelity Management & Research Company and FMR Co., Inc., the investment advisers to the Fidelity family of mutual funds as well as Fidelity Institutional Asset Management Trust Company, FIAM LLC and Fidelity Management Trust Company.

[2] *See* Concept Release on Harmonization of Securities Offering Exemptions, Release Nos. 33–10649; 24-86129; IA-5256; IC–33512; 84 Fed. Reg. 123 (June 26, 2019), *available at* https://www.sec.gov/rules/concept/2019/33-10649.pdf (the "*Release*").

[3] *Id* at 6.

Below we provide examples of current restrictions that are applicable to registered and unregistered vehicles that we believe impede fund sponsors' ability to offer innovative products, thus limiting the opportunities for broader retail participation in the exempt offering market today. We also offer recommendations for enhancements to the current framework that we believe would help to spur additional investment opportunities that meet the SEC's goals.

I. EXECUTIVE SUMMARY

Fidelity offers the following suggestions, described in more detail below, to improve the current exempt offering framework for issuers and retail investors:

- Permit interfunding of illiquid securities and allow the Rule 17a-7 "market quotation" requirement to be satisfied by the private issuer's follow-on offering price or an independent auditor valuation;

- Exempt, through rulemaking, limitations applicable to closed-end funds that relate to multiple-share class structures, concentration, and diversification requirements. These requirements, which have proven unworkable for funds investing in private market securities, are not required for unregistered funds investing in similar illiquid assets;

- Expand investment opportunities by creating additional exemptions for an unregistered vehicle that combines the characteristics of funds exempt under Sections 3(c)(1) and (3)(c)(7); and

- Address the inconsistent treatment of H.R. 10 plans under the definition of "qualified institutional buyer" (QIB), which results in an H.R. 10 plan that qualifies as a QIB being able to buy Rule 144A securities itself, but when investing in a collective investment trust, disqualifies the collective investment trust from buying Rule 144A securities.

II. RECOMMENDATIONS FOR THE EXEMPT OFFERING FRAMEWORK

A. Recommendations for Registered Vehicles

As acknowledged in the Concept Release, there are potential advantages for retail investors to seek exposure to growth-stage issuers through a pooled investment fund, including the ability to have an interest in a diversified portfolio that can reduce risk relative to the risk of holding a security of a single issuer.[4] We also agree with the SEC's observation that later-dated target date retirement funds are particularly well-suited to holding less liquid securities since these funds are intended for long-term investors saving for retirement, rather than other types of funds where the investor may have a shorter time horizon.[5] We believe it is important for the SEC to continue to permit a target date retirement fund to seek exposure to exempt offerings in its portfolio, subject

[4] Release at 8.

[5] *Id.* at 184.

to existing restrictions for registered funds. Under the regulatory framework applicable to funds of funds, Fidelity's target date mutual funds have the flexibility to invest either directly in such securities or indirectly by holding another fund that invests in such securities. In addition, Rule 22e-4 of the Investment Company Act of 1940 (the "1940 Act") provides that a fund may not hold more than 15% of its assets in illiquid securities; we believe this limit provides sufficient flexibility to mutual funds investing in unregistered securities.

Below we offer suggestions for modifications to the current framework that we believe may result in expanding opportunities for exempt offering investments in pooled investment funds.

1. Permit Interfunding to Increase Secondary Market Liquidity

The Concept Release identifies secondary market liquidity as integral to facilitating capital formation and seeks comment on ways to improve the status quo. While Fidelity's mutual funds invest in exempt offerings today, limited secondary market liquidity for illiquid securities is a consideration for funds seeking to pursue additional investment opportunities using pooled investment vehicles. One suggestion for alleviating this obstacle is to ease the current restriction for interfunding illiquid securities.

Interfunding of illiquid securities among affiliates is largely prohibited by Rule 17a-7 of the 1940 Act, which permits securities transactions between affiliated registered investment companies only for transactions for which "market quotations are readily available," at the "independent current market price."[6] Since illiquid securities do not trade on an exchange and would not have a readily available market quotation, they generally do not meet the requirements of Rule 17a-7(b). On occasion, the SEC Staff has permitted exceptions for interfunding of certain securities where a market quotation was unavailable, however, this relief has not been codified, nor extended to securities other than municipal securities.[7]

There are several potential advantages to permitting interfunding between mutually interested funds. Interfunding increases the secondary market liquidity of illiquid securities and enhances a fund's ability to complete a purchase and/or sale transaction that is determined to be in the fund's best interest. Interfunding also provides a fund an opportunity to acquire a security for which access is often limited. Indeed, allowing interfunding of privately offered securities between mutual funds recognizes that as mutual fund investment strategies change, whether due to rebalancing, market dynamics, benchmark changes, or otherwise, privately offered securities that were once favored for one fund may be less so, and what was once not favored for another fund may become so. When these dynamics overlap, interfunding allows two funds liquidity and access opportunities where before there were none. Furthermore, both funds to the transaction

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[6] Rule 17a-7(b) of the 40 Act.

[7] *See e.g., United Municipal Bond Fund* (July 30, 1992) (SEC staff agreed to permit a municipal bond fund to effect cross trades in municipal securities for which market prices were not readily available where funds involved would trade the securities at the price provided by an independent pricing service, which would be approved by the funds' board of directors and audited by their independent public accountant); and *Federated Municipal Funds* (Nov, 20, 2006).

would benefit by saving on transactions costs generated from any open market transaction such as commissions, and the transaction would also avoid generating a market impact for existing shareholders. As a practical matter, permitting interfunding would not require changes to existing investment documents, since these documents already contemplate transfers between affiliates and currently investors other than registered investment companies are able to take advantage of these sources of additional liquidity.

In order to increase opportunities for interfunding, we suggest that the SEC consider alternatives for satisfying the Rule 17a-7 "market quotation" requirement that contemplates exempt offering securities. These alternatives could include for example: (1) the independent price obtained by the private issuer when it engages in an initial or follow-on offering, or (2) an independent auditor valuation.

We believe these options represent reliable and independent evaluations of a "market quotation," which will ensure that an investment adviser obtains the best price and execution on behalf of both funds participating in the interfunding transaction. This interpretation is also consistent with the policy goals of Section 17(a), which was designed to prevent self-dealing and other forms of overreaching of a registered investment company by its affiliates. Both alternatives are provided by third-party, unaffiliated entities. The initial or follow-on offering price, in particular, is the product of an arms-length, hard-fought negotiation between the issuer and private investors, involving input from various counsel, investment banks, and auditors. In our view there is no more independent, fair price for an illiquid security than the negotiated price that an investor is willing to pay in an offering, and therefore we believe this price should be considered the equivalent of a "market quotation" for purposes of Section 17(a) for up to 90 days beyond the offering or such other time that the SEC deems reasonable.[8]

2. *Codify into Rulemaking Relief for Closed-End Funds Relating to Multiple Share Class Structures, Concentration, and Diversification Requirements*

The Concept Release identifies certain types of registered investment companies, such as closed-end funds, as particularly suited to holding less liquid securities obtained in exempt offerings. Investors benefit from a closed-end fund structure since these are registered products that are subject to the protections of the 1940 Act. However, the benefits of this structure are discounted by certain restrictions that apply to closed-end funds, solely by virtue of these funds being registered under the 1940 Act, that are unworkable in the context of exempt offering investments. Currently, registered funds may obtain exemptive relief to lift certain of these restrictions, however, such relief is time consuming and costly for the funds. Alternatively, a fund can create an unregistered vehicle in order to pursue illiquid investments, but this structure does not provide the numerous protections of a registered fund to retail investors.

[8] Should the SEC agree to expand the definition of a "market quotation" for an illiquid security as we have proposed, we would also ask that consideration be given to allowing interfunding, under these requirements, to occur between affiliated unregistered and registered funds, in addition to between solely affiliated registered funds.

Below we provide examples where SEC rulemaking could alleviate some of the current restrictions for registered closed-end funds, which we believe would spur the launch of additional registered products that could invest in exempt offerings.

i. Multiple Share Class Structures

As recognized in the Concept Release[9], the SEC has on several occasions permitted closed-end funds, for a portion of their shares, to implement a multiple-class structure, subject to certain conditions. We recommend the SEC codify into rulemaking the exemptive relief previously provided to closed-end funds that allows them to issue multiple classes of shares and impose asset-based distribution and/or service fees, subject to conditions including that: (i) the fees applicable to the different classes of shares of each fund are equitable and would not discriminate against any group of shareholders, (ii) the fees are fully disclosed in each fund's prospectus, and (iii) the fund complies with any applicable requirements that the Commission or the Financial Industry Regulatory Authority ("FINRA") may adopt regarding disclosure and conflicts of interest.

ii. Concentration and Diversification

Under Section 8(b)(1)(E) of the 1940 Act, registered funds, including closed-end funds, must have a policy on concentration of investments within any industry group.[10] Section 5(b)(1) of the 1940 Act also requires that registered fund be categorized as a "diversified" or "non-diversified company." For a closed-end fund investing in exempt offering securities, the 1940 Act concentration and diversification requirements – which are not required for unregistered funds that may invest in the same illiquid securities – are impractical to meet and burdensome to monitor, particularly during both winding up and winding down periods, and serve as a barrier to investing in privately offered investments.

Due to the structure, nature, and purpose of the illiquid investments in a registered product, a fund may have a limited number of holdings, particularly as it begins the process of investing, which may be concentrated in a single industry or group of industries. Moreover, as the fund is winding down, there may be illiquid securities that the adviser is not able to liquidate, resulting in the fund becoming concentrated.

Absent relief from Section 8(b)(1)(E), the fund would be required to disclose and adhere to a concentration policy, and any routine portfolio change that results in a fund "concentrating" its investments would need the approval of a majority of the outstanding voting securities of the fund in accordance with Section 13 of the 1940 Act. Requiring the fund to obtain a shareholder vote every time it crossed the 25% "concentration" threshold would be unnecessary and

[9] Release at 190, fn. 587.

[10] A fund that intends to invest more than 25% of the value of its assets in the securities of any one industry or group of industries must disclose that policy and must at all times concentrate its investment in that industry. A fund that does not declare a policy of concentrating its investments may not invest more than 25% of the value of its assets in the securities engaged in any one industry or group of industries.

cumbersome. Similarly, the diversification of the fund could fluctuate, particularly as the adviser identifies, invests, and ramps up investments in portfolio companies and also during the winding down stage as positions are liquidated.

We recommend that the SEC exempt closed-end funds from the concentration and diversification requirements in the 1940 Act, as fully disclosed by the fund to investors in its registration statement. This would mimic the flexibility that is permitted for unregistered funds, while still providing investors the benefits derived from registered vehicles, including board and SEC oversight and compliance with other 1940 Act requirements. It would also permit, during the life of a closed-end fund (and particularly during winding up and winding down periods), for the fund to have the flexibility of changing the industry in which it may concentrate and fluctuate between being concentrated and not concentrated and being diversified and non-diversified, as necessary.

B. Recommendations for Unregistered Vehicles

As the Concept Release recognizes, private funds generally rely on one of two exclusions from the definition of "investment company" under the 1940 Act for creating unregistered vehicles, Section 3(c)(1) or Section 3(c)(7).[11] Each presents its own limitations and restrictions. With respect to the number and type of investors, Section 3(c)(1) is limited to not more than 100 beneficial owners, while Section 3(c)(7) has no limitation on the number of investors, but restricts investment to only "qualified purchasers." Based on our experience, the current limitations on the number and types of investors who can invest in Sections 3(c)(1) and 3(c)(7) funds do not make these funds amenable for offering at scale to a larger population of sophisticated investors who may not meet the standards required under the current exemptions.

To expand investment opportunities using unregistered vehicles, we suggest the SEC consider creating additional exemptions for an unregistered vehicle that combines the characteristics of Section 3(c)(1) and Section (3)(c)(7) funds.

For example, the SEC could create a new exemption that significantly increases the number of investors who can participate in Section 3(c)(1) funds beyond 100. While the 1940 Act does not impose any beneficial owner minimum qualifications for Section 3(c)(1) funds, due to the frequently relied upon Regulation D exemption for private offerings, in most instances investors in Section 3(c)(1) funds are accredited investors. As the Commission has already determined through Regulation D that accredited investors are sufficiently sophisticated to purchase exempt securities outright, which are the same types of securities that a Section 3(c)(1) fund might acquire, we believe it is reasonable for the Commission expand the number of investors in Section 3(c)(1) funds beyond the 100 investor limitation so long as the investors are accredited investors as defined under Regulation D. Furthermore, such an increase would be necessary in order to make a Section 3(c)(1) fund viable at scale; otherwise, fund providers would be incentivized towards Section 3(c)(7) funds, which allow for an unlimited number of investors who, by definition, have more assets to invest than accredited investors. Doing so would also

[11] 15 U.S.C. 80a-3(c)(1) and (c)(7).

more accurately reflect investor preference to have multiple smaller investments in several unregistered vehicles for broader diversification, than to be limited to a single fund.

The SEC could also permit non-qualified purchasers to invest in Section 3(c)(7) funds, or permit such investors who hire a financial intermediary, such as an investment adviser, to assume the intermediary's status for purposes of meeting the requisite standards in relation to investments managed by that intermediary. The qualified purchaser standard of Section 3(c)(7) funds, and, as explained above, the de facto standard of accredited investor for Section 3(c)(1) funds, are premised on investor protection standards, *i.e.*, those investors who meet those qualifications are presumed to require fewer investor protections than those who do not meet those standards. However, when investors employ financial intermediaries to act on their behalf, those financial intermediaries owe duties to those investors. The Commission could take the view that those duties are sufficiently protective and enforceable such that they substitute for the qualified purchaser and accredited investor standards. In other words, those investors that are not in and of themselves qualified purchasers or accredited investors could nonetheless have their assets invested in Section 3(c)(7) funds or Section 3(c)(1) funds, respectively, relying on the financial intermediary's knowledge and sophistication where the financial intermediary employed by the investor determines within the scope of its duties to the end investor that the investment is appropriate.

Finally, the SEC could consider allowing flexibility in the mix of investors to allow both accredited investors and qualified purchasers to participate under a new exemption without affecting the limitation count. Currently, each investor in a Section 3(c)(7) fund must be a qualified purchaser. If a single investor is an accredited investor, the Section 3(c)(7) exemption fails and the fund, absent the availability of any other exemption, effectively becomes a Section 3(c)(1) fund. The Commission could propose a hybrid exemption that allows for an unlimited number of qualified purchasers and an imposed limit on the number of non-qualified purchasers, be it 100 or another number. In this manner, the Commission could expand access to more retail-oriented investors while allowing a fund provider to create a fund at scale by attracting the assets of qualified purchasers.

C. Clarification to Rule 144A QIB Definition

As the SEC is considering further changes to help companies raise capital, we recommend the Commission consider remedying a longstanding glitch in Rule 144A concerning the application of the "qualified institutional buyer" (QIB) definition to H.R. 10 plans that seek to invest in collective investment trusts.

H.R. 10 plans, which are also known as Keogh plans, are qualified retirement plans of self-employed persons. Often, they are the plans of companies formed as partnerships (e.g., accounting, legal, consulting, medical, and engineering types of firms) which includes partners, owners, and employees. There is no definition in the federal securities laws or under ERISA of an H.R. 10 plan. Of the U.S. marketplace of retirement assets, they represent around 1.7% or less than $200 billion of that marketplace. These plans, like many others, seek to invest in Section 3(c)(11) collective investment trusts (CITs) or commingled pools as an alternative to traditional mutual funds as fiduciaries seeking low cost options for their participants.

Rule 144A of the Securities Act of 1933 provides a safe harbor from the registration requirements for certain private resales of securities to QIBs. Under Rule 144A(a)(1)(i)(F), a CIT will qualify as a "qualified institutional buyer" if in the aggregate the CIT owns and invests on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the collective trust fund, as long as the CIT *does not* include as participants H.R. 10 plans or individual retirement accounts (IRAs). However, under Rule 144A(a)(1)(i)(E), any employee benefit plan as defined in Title I of ERISA, (which would include an H.R. 10 plan with self-employed and employee money), can qualify as a QIB in its own right at $100 million in assets and can invest directly in Rule 144A securities.

By way of example, a large accounting firm's H.R. 10 plan, which by itself is covered by ERISA and has more than $100 million in assets, can purchase Rule 144A securities in its own right. However, should that same H.R. 10 plan seek to invest in a CIT, the plain meaning of Rule 144A would disqualify the CIT from being a QIB and the CIT would no longer be able to buy Rule 144A securities.

The inconsistent treatment of H.R. 10 plans under Rule 144A results in a loss of low cost investment opportunities for H.R. 10 plans as some H.R. 10 plans have been excluded or restricted from CIT investment. CIT managers have reacted in a variety of ways to this issue depending on each manager's analysis and risk tolerance profiles, a situation that has caused inconsistency and confusion in the marketplace.

There is a view that the existing formulation of Rule 144A was aimed at protecting H.R. 10 plans without the protection of ERISA, such that if a plan was covered by ERISA, there would be a sufficient safety net to allow those plans to invest in CITs that buy Rule 144A securities. IRAs are not generally subject to ERISA, so this grouping of H.R. 10 plans and IRAs as it is phrased in the Rule could be viewed through that lens.[12] Plans subject to ERISA are overseen by a prudent fiduciary that can presumably evaluate investment managers and products in a way that does not unduly expose the plan's participants, who may be self-employed, to excessive investment risk. Notably, there is no minimum assets requirement for other ERISA plans or governmental plans to invest in any CIT and not disqualify the CIT from investing in Rule 144A securities. In other words, the protections of ERISA and/or various applicable laws is adequate to allow for those plans' investment in a CIT that may itself invest in Rule 144A securities.

In light of the uneven playing field and confusion in the marketplace as each CIT provider has made an independent risk analysis in the face of this issue, we think the time is ripe for the SEC to issue guidance to clarify Rule 144A's application. This can be accomplished simply by clarifying Rule 144A, through an FAQ, to include a definition of "H.R. 10 plan" that confirms that H.R. 10 plans covered by ERISA would be viewed like any other ERISA plan and, if

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[12] Some language around the 1992 amendments to Rule 144A seem to indicate that H.R. 10 plans were considered analogous to IRAs at the time the rule was drafted. As happens, the market has evolved and today many H.R. 10 plans are covered by ERISA and have over $100 million in assets, and thus do not seem to be the type of H.R. 10 plan that would analogous to an IRA.

invested in the CIT, would not otherwise disqualify the CIT from claiming QIB status. This would fit within a policy argument that the inclusion of the phrase "H.R. 10 plan" in the exclusionary language was to address non-ERISA H.R. 10 plans. Indeed, an H.R. 10 plan overseen by an ERISA fiduciary would have sufficient sophistication to engage an appropriate CIT provider, and it is the professional CIT manager that could make the decision to invest in Rule 144A securities.

Alternatively, the SEC could issue a FAQ clarifying that H.R 10 plans that themselves qualify as QIBs under Rule 144A(a)(1)(i)(E) independently would be deemed eligible participants in CITs under Rule 144A(a)(1)(i)(F). This interpretive guidance is within the four corners of the Rule and would resolve a drafting inconsistency that appears on its face in the Rule. It would also make clear that an H.R. 10 plan covered under ERISA with $100 million in assets would not otherwise disqualify the CIT from meeting the QIB definition.

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Fidelity would be pleased to provide further information, participate in any direct outreach efforts the Commission undertakes, or respond to questions the Commission may have about our comments.

Sincerely,

Cynthia

cc: The Honorable Jay Clayton, Chairman
The Honorable Robert J. Jackson Jr., Commissioner
The Honorable Allison H. Lee, Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner

Dalia Blass, Director, Division of Investment Management
Brett Redfearn, Director, Division of Trading and Markets
William Hinman, Director, Division of Corporation Finance