September 24, 2019
Ms. Vanessa A. Countryman
Secretary Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Concept Release on Harmonization of Securities Offering Exemptions – File Number S7-08-19

Dear Ms. Countryman:

We appreciate the opportunity to share our views on how best to simplify, harmonize, and improve the exempt offering framework to promote capital formation and expand investment opportunities while maintaining appropriate investor protections.

Institutional Capital Network ("iCapital Network") is a financial technology platform working to improve the offering of alternative investments through tech-based solutions for advisors, their high-net-worth clients, asset managers, and banks. Our flagship platform offers advisors a curated menu of private equity, private credit, and hedge funds at lower minimums and with institutional-quality due diligence and administrative support within a secure digital environment. Asset managers and banks leverage our tech-enabled services to streamline and scale their private investments operational infrastructure.

THE IMPORTANCE OF PRIVATE MARKETS

As has been widely covered, the investable universe of public companies is shrinking at a steady pace. Over the past 20 years, the number of publicly listed U.S. companies has been cut nearly in half, from 8,090 in 1996 to 4,397 in 2018, despite the fact that U.S. GDP doubled during that period.[1]

The implications of this trend are profound. Companies that remain public are older and more mature, on average, than listed firms in years past.[2] Companies are staying private longer and, by the time they IPO (if they do at all), most of their growth and value creation is often behind them, reaped by a relatively small number of private investors, most of which are institutions.

Private markets exposure offers the potential for diversification and improved returns versus public equity and fixed income markets. This may be particularly important for investors saving for retirement. EBRI's 2019 Retirement Security Projection Model estimates that 40% of all U.S. households with a head of the household that is between 35 and 64 years of age are projected to run short of money in retirement.[3]

Despite the relative attractiveness of private markets and the need for additional sources of portfolio returns, a recent survey of the global private wealth management industry found individual investors have dismally low private market allocations – less than 1%.[4] This is far below the levels commonly held by the highest-performing institutional investors, a growing number of which are now more than 40% invested in private markets.[5] Top-quartile endowments, meanwhile, have at least 15% of their portfolios invested in the private markets, according to Cambridge Associates.[6]

High-net-worth investors looking to add private market exposure are often prevented from doing so because of high investment minimums and restrictions on the types of investors who can access these funds. Additionally, well-established, high-performing fund managers generally lack the operational infrastructure to efficiently administer small retail accounts at scale.

BROADENING ACCESS TO PRIVATE INVESTMENTS

The benefits of private market exposure are significant enough to warrant amendments to the framework governing exempt offerings. We believe there are three critical changes that need to occur to simplify the exempt offering framework while broadening investor access in a responsible way.

1. Increase accessibility of 3(c)(7) funds
2. Expand the accredited investor definition
3. Increase investor protections

1. Increase accessibility of 3(c)(7) funds

The primary way for accredited investors to access the private equity market today is through registered '40 Act funds. However, their options are limited as less than 1% of managers have created registered funds incorporating private equity. Moreover, fees for these registered funds are typically higher than what the underlying managers charge limited partners, so less wealthy investors are paying more to access these funds than the institutions or family offices who can afford to make direct investments. Finally, the highest-performing managers have little incentive to launch registered funds because it involves an expensive and time-consuming process, and they have access to ample capital from institutional investors. Many of these firms, however, have been willing to accept capital from pooled investment vehicles such as feeder funds that utilize the 3(c)(7) fund structure, which is restricted to qualified purchasers ("QPs").

Taking a step back, the vast majority of private equity firms lack the infrastructure to handle high volumes of small investments. Even if more investors qualified to access these funds, many top-performing private equity firms would be unable or unwilling to accept small individual investments without an efficient aggregation vehicle with which to manage sub-scale accounts.

Today, feeder funds allow the aggregation of smaller investments into private funds with investment minimums that otherwise can exceed $10 million. Technology enables this through electronic subscriptions and a streamlined process for executing capital calls, distributions, and reporting.

The 3(c)(7) fund structure utilized by most feeder funds, however, is currently limited to less than 2,000 QPs. The most logical and cost-efficient way to enable accredited investors who are not QPs to gain access to high-quality, well-established fund managers is to lower the investor suitability threshold of 3(c)(7) feeder funds and increase or eliminate the limit on the number of investors who may participate in them because these vehicles are already widely accepted by the industry. In addition, as a result of existing technology solutions, it would be relatively easy for these feeder vehicles to accommodate large numbers of accredited investors.

Again, we believe allowing accredited investors who fall below the QP threshold to participate in 3(c)(7) feeder funds would be the simplest, fastest, and most cost-efficient way to open significant numbers of quality private equity funds to individuals. Relying on registered fund structures alone would likely continue to greatly limit access to top-quartile managers. Furthermore, if the SEC were to offer some form of safe-harbor relief to allow these 3(c)(7) feeder vehicles into 401(k) programs, then average investors would be able take advantage of the same private equity investment opportunities that institutional investors currently enjoy and that exist in their defined benefit pension plans.

2. Expand the accredited investor definition

Access to exempt offerings is tied to wealth levels, but wealth alone does not confer investment acumen. We believe that understanding the characteristics, risks, and liquidity constraints of alternatives is essential before investing in them. As such, using income or asset levels as the only door through which investors gain access to exempt offerings leaves open the possibility that investors in these funds may not understand them.

We believe investors would be better served by a more flexible qualification system that enables them to access exempt offerings through a combination of criteria drawn from the following categories (for example, one or two items from each category):

A. Income and asset level
- Investable assets, with a reduced threshold of $500,000
- Annual income of $200,000 or more

B. Knowledge of alternative investments
- Successful completion of an educational course on alternative investment fundamentals
- Prior experience investing in exempt offerings
- Industry experience:
  - » A minimum level of operating experience in the same industry/sector as the target investment
  - » Employees of a general partner who can demonstrate an understanding of the terms of the investment

C. Assumption of risk
- Investor explicitly acknowledges and accepts the risk, time horizon, and liquidity constraints of the exempt offering

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- Advisor has a fiduciary relationship with the client and has received an alternative investments accreditation or certification from recognized industry organization such as the CAIA Association or the CFA Institute

3. Increase investor protections

In coordination with the above-referenced changes to the accredited investor definition, we believe additional protections could benefit individual investors seeking to access private funds.

A. Limits on investment size

- For investors with less than $5 million in investable assets, exposure to private markets investments could be limited to a pre-set maximum of the portfolio, for example 10%-20% of the total portfolio. An exemption could be available for investors who can demonstrate significant knowledge of or experience in private equity. Allocations to single-manager funds and direct deals could carry similar limits, i.e., less than 5% of the portfolio.
- We recommend allowing higher limits for investments in retirement accounts such as IRAs, particularly for investors who are 10 years or more from retirement. While private market investments may carry more risk than public market investments, as part of a balanced portfolio they offer diversification benefits that can improve the portfolio's risk-return profile.
  - » Investors that qualify for exempt offerings could access exempt offerings through direct investments, for example through 3(c)(7) feeder funds within a defined contribution plan or IRA.
  - » Investors that do not qualify for exempt offerings could access private markets through target-date funds that would be enabled to make direct investments in private equity.

B. Limits on types of fund managers that can accept accredited investors

- We recommend employing reasonable safeguards that shield accredited investors from exposure to untested or poor-performing fund managers by enabling access only to GPs that are:
  - » Established, with a minimum 7-year operating history or whose principals have a minimum of 10 years of experience in exempt offerings.
  - » Well researched, with coverage that is available to advisors and investors at a reasonable cost.

A note on research availability

The private funds marketplace garners more research coverage than might be expected. This extensive, high-quality, independent research has historically been produced by numerous well-established organizations almost exclusively for institutional investors and large family offices. However, in the past six years, new entrants into the market have made high-grade research available to individual investors at no cost. If the eligible investor universe were to be expanded, it is likely that much of the existing high-quality research would be quickly made available to accredited investors and their advisors.

THE DEVELOPMENT OF A HEALTHY SECONDARY MARKET

The secondary marketplace for private funds is active and emerging today through platforms like Nasdaq Private Market, but it will take time to further evolve into a vibrant, viable option for investors seeking to exit private funds without incurring a meaningful discount. Enabling more accredited investors to participate in exempt offerings will likely accelerate the development of this marketplace.

In addition to the inevitable development of the secondary market for private funds, we would also note some inherent benefits of the long-term nature of private equity. For private equity firms and their portfolio companies, the ability to pursue long-term strategic initiatives without concern for quarterly earnings calls and the resulting "short-termism" that afflicts many public companies is what enables significant value creation. For investors, the "buy-and-hold" nature of private equity places the exit decisions (when to sell a portfolio company) in the hands of experienced professionals who are closest to the assets. As a result, private market funds impose discipline and help reduce the behavioral risk of emotionally driven decisions to sell or buy.

According to a recent BlackRock study, institutional investors with high spending rates – as high as 8% of the portfolio – can sustainably manage allocations up to 20% in private investments. Advisors and clients following the "4% Rule" – which is generally regarded as a conservative spending rate – could manage a meaningful longer-term private equity allocation.[7] And, again, if individual investors were allowed to access 3(c)(7) feeder vehicles as part of their 401(k) programs, they would have the ability to participate in the longer-term strategic initiatives that enable private equity firms to generate superior returns.

CONCLUSION

The rules in place today that are designed to protect individual investors from the risk and illiquidity of private market investments are potentially placing them at a significant disadvantage and creating an uneven playing field that primarily benefits institutional and very wealthy investors.

We view this concept release as an opportunity to expand opportunities for individuals so that they can invest more like institutions. The infrastructure and high-quality research to enable this are already in place – technology has made it possible to efficiently aggregate and service smaller investments, while implementing restrictions geared toward investor protection.

We believe it is essential that individual investors be given access to better opportunities for performance and diversification. Opening up exempt offerings to a broader audience is an important step in this direction.

Sincerely,
Lawrence Calcano
CEO, iCapital Network

[1] The World Bank.
[2] iCapital Network, "Age Really Does Matter When it Comes to Unicorns," May 2019.
[3] EBRI as of March 2019.
[4] iCapital Network Research, 2019.
[5] Cambridge Associates, "Private Investing For Private Investors," July 2016.
[6] Cambridge Associates, "The 15 Percent Frontier," July 2016.
[7] BlackRock Investment Institute, "The core role of private markets in modern portfolios," March 2019.