MEMORANDUM

To: File No. S7-08-19 – Concept Release on Harmonization of Securities Offering Exemptions

From: Adam Lovell
Division of Investment Management

Date: November 4, 2019

RE: Meeting with Groom Law Group

On November 1, 2019, Sarah ten Siethoff, Melissa Gainor, Brian Johnson, Mark Uyeda, Bradley Gude, Adam Lovell, and Benjamin Kalish from the Division of Investment Management and Jennifer Zepralka from the Division of Corporation Finance met with Kevin Walsh and David Levine from Groom Law Group.

Among the topics participants discussed was the SEC's concept release relating to the harmonization of securities offering exemptions.

Information provided by Groom Law Group in connection with this meeting is set forth in Annex A.

Annex A

Enhancing Defined Contribution Plan Access to Private Funds

November 1, 2019

David Levine

Kevin Walsh

GROOM LAW GROUP

Agenda

- Retirement Plan Structure Overview
- How the SEC Can Help American Retirement Savers
  - Rule 22e-4
  - “Look Through” Rules

Retail Customer Protections In ERISA

- ERISA has multiple layers of protection for participants
  - ERISA's fiduciary duties of prudence and loyalty
  - The "plan level" fiduciary
  - Department of Labor enforcement and private class action enforcement activities

Retail Customer Protections In ERISA

- Distinguishing defined benefit and defined contribution plans
  - Defined benefit plans – a single pool, often including alternative investments
  - Defined contribution plans – two key layers, current lacking in use of alternative investments
    - Plan level fiduciary and ERISA 404
    - Participant direction and ERISA section 404(c) Protections
      - Opportunity to exercise control
      - Choice between a broad range of investment alternatives
      - Disclosures to participants

Target-Date Funds Problem

- Rule 22e-4
  - 15% limit on illiquid securities
  - Target-date funds are open ended, and therefore subject to unlimited redemptions

Target-Date Funds Solution

- Given stable investor basis inside target-date funds:
  - Higher limit
  - Possibly limit declining as target-date fund approaches maturity

Private Fund Access

- Defined benefit plans have access to private funds and fund managers do not have to “look through” to determine if participants individually meet eligibility rules.
- Subject to limited no action relief, defined contribution plans do not have access to private funds and fund managers do not have to “look through” to determine if participants individually meet eligibility rules.

SEC Defined Contribution Plan "Look Through" Rules

- PanAgora Group Trust (1994)
  - Each participant in a participant directed 401(k) plan has to be counted for purposes of 100-investor ceiling in a 3(c)(1) fund
- Standish Ayer and Wood (1995)
  - Subject to constraints eliminated "look through" rule for 3(c)(1) funds
- H.E.B. (2001)
  - Subject to constraints eliminated "look through" rule for 3(c)(7) funds
- Invesco (2014)
  - Applied similar analysis to participant directed 403(b) plans

SEC Constraints to Avoid "Look Through"

- A plan fiduciary adds the investment option containing the private fund to the plan's investment menu and only provides a generic description of the private fund (i.e., the option is white labelled)
- The investment option invests less than 50 percent of its assets in the private fund
- The investment option does not guarantee plan participants that the investment option will invest any specific amount in the private fund
- Participant decision making is limited to allocating money to or making redemptions from that investment option or other investment options that the plan makes available

“Look Through” Problems

- Defined contribution plan participants have been denied the investment returns and risk mitigation offered by private funds because:
  - Implementing the restrictions and requirements in the no action letters has proven to be challenging for all but that largest 401(k) plans.
  - Because plans cannot provide an assurance that any portion of plan assets will be invested in a specific fund, there has been little incentive for fund managers themselves to design standardized investment vehicles.
  - Because plans cannot provide assurances that a specific fund will be used, they have typically provided generic information which has led to concerns about the opacity of these products.
  - Because the first three reasons have deterred the inclusion of private funds, plaintiffs have alleged that the lack of uptake by defined contribution plans is itself a sign that these products are unsuitable to retirement savers.

“Look Through” Solutions

- Eliminate “look through” for options included in defined contribution plan core lineup
  - Treats defined benefit and defined contribution plans the same
  - Rule applied in other “look through” areas like AML
  - Brings DOL and SEC into closer “harmonization”
  - Can be done quickly through no action letter
- Permit target-date funds to invest more than 15% of their assets in illiquid investments
  - Recognizes long-term nature of target-date funds
  - Provides layer of protection for retirement savers through reliance on target-date fund management
  - Likely requires regulatory project

David Levine
(202) 861-5436
dlevine@groom.com

Kevin Walsh
(202) 861-6645
kwalsh@groom.com

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