Managed Funds Association
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

March 22, 2019

Via Electronic Submission: rule-comments@sec.gov

Ms. Vanessa Countryman, Acting Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; File No. S7-09-18

Dear Ms. Countryman:

MFA[1] is submitting this letter as a supplement to our letter of August 7, 2018 regarding the SEC's Proposed Interpretation Regarding Standard of Conduct for Investment Advisers ("Proposed Interpretation")[2] and in response to the letters submitted on February 12, 2019 by the Institutional Limited Partners Association ("ILPA Letter") and on February 25, 2019 by the American Investment Council ("AIC Letter") regarding the Proposed Interpretation.

We generally agree with the discussion in the AIC Letter, which we believe raises a number of important concerns with the recommendations in the ILPA Letter. Although the ILPA Letter expressly addresses investments in closed-end private equity funds, its recommendations have broad implications for managers of open-end alternative investment products as well, and we write to offer some additional thoughts from that perspective.

Investment advisers owe to their clients a well-established fiduciary duty that is based on equitable common law principles and decades of jurisprudence. This duty is fundamental to investment advisers' relationships with their clients under the Investment Advisers Act of 1940 ("Advisers Act") and has worked well for many years in shaping and governing those relationships.

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[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

[2] Investment Advisers Act Release No. 4889 (Apr. 18, 2018), 83 F.R. 21203 (May 9, 2018).

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The SEC's stated objective in issuing the Proposed Interpretation, in light of the comprehensive nature of its additional proposed rulemakings,[3] was to address in one release and reaffirm – and in some cases clarify – certain aspects of the fiduciary duty that an investment adviser owes to its clients.

Accordingly, we provided comments in August[4] responding to the issues discussed in the Proposed Interpretation regarding an investment adviser's fiduciary duty to its *clients*, which in the case of advisers to private funds, are the funds to which they provide investment advice.[5] We believe that many of the recommendations made in the ILPA Letter, which relate primarily to the terms of agreements between advisers and the underlying institutional *investors* in private funds, fall outside the scope of the Proposed Interpretation, and it is not clear to us why they have been raised in response to the Proposed Interpretation. Even outside the context of private funds, where institutions may be clients of advisers,[6] we believe that many of the recommendations made in the ILPA Letter fall outside the scope of an adviser's fiduciary obligations and, therefore, outside the scope of the Proposed Interpretation.

Moreover, many of ILPA's recommendations pertain to issues that are the subject of vigorous negotiations between advisers and sophisticated investors as part of the intense due diligence process conducted by those investors and their agents prior to subscribing for an interest in a private fund. The description in the AIC Letter of this process is closely similar to the process that takes place prior to investment by sophisticated investors in many open-ended alternative vehicles.[7] This diligence and negotiation process allows advisers and sophisticated investors the freedom and flexibility to construct their own commercial relationship. It is thus consistent with the overall statutory framework within which most private funds operate, which is premised on the theory that sophisticated investors "can adequately safeguard their interests in a pooled investment vehicle without extensive federal regulation."[8]

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[3] *See* Securities Exchange Act Release No. 83062 (Apr. 18, 2018), 83 F.R. 21574 (May 9, 2018) (Regulation Best Interest) and Investment Advisers Act Release No. 4888 (Apr. 18, 2018), 83 F.R. 21416 (May 9, 2018) (CRS Regulation).

[4] Letter from Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, MFA and Jiri Krol, Deputy CEO, Global Head of Government Affairs, AIMA, to Brent J. Fields, Secretary, SEC (Aug. 7, 2018), available at: https://www.managedfunds.org/wp-content/uploads/2018/08/MFA-AIMA-standards-of-conduct-comment-letter.pdf.

[5] In the context of providing investment advice to a pooled investment fund, the investment adviser owes its fiduciary duty to the pooled investment vehicle and not to the underlying investors in such vehicle. *See* Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006); *see e.g.,* Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles, Investment Advisers Release 2628 (August 9, 2007) ("Rule 206(4)–8 does not create under the Advisers Act a fiduciary duty to investors or prospective investors in a pooled investment vehicle not otherwise imposed by law.")

[6] A client relationship may exist, for example, in a separately managed account arrangement with an institution.

[7] The specific terms negotiated between investments advisers and institutional investors will differ, of course, for open-end and closed-end funds based on the different features of the funds.

[8] "Protecting Investors: A Half Century of Investment Company Regulation," SEC Division of Investment Management (May 1992) at 110 (recommending that Congress add Section 3(c)(7) to the Investment Company Act to except from the Act any issuer whose securities are beneficially owned exclusively by one or more persons who,

The SEC should not undermine this longstanding policy by adding unnecessary restrictions on the negotiated relationships between advisers and sophisticated investors.

Finally, in light of the focus in the ILPA Letter on the Heitman Capital Management no-action letter ("Heitman Letter"),[9] we would like to offer specific thoughts on this topic. The request to rescind the Heitman Letter appears to be based on a mistaken view of an adviser's fiduciary duty and a desire to limit by regulatory intervention the ability of advisers and sophisticated investors to establish the terms of their relationship based on full knowledge of the relevant, material facts and circumstances.[10]

The Heitman Letter does not address the scope of an investment adviser's fiduciary duty, nor has the SEC included a discussion of the Letter in the Proposed Interpretation. Instead, in the Heitman Letter, the SEC staff was asked for its views on the use of a specific hedge clause and non-waiver disclosure in an investment advisory agreement with certain sophisticated clients, and whether the use of that specific hedge clause would raise issues under Sections 206(1) and (2) of the Advisers Act.

Sections 206(1) and 206(2) of the Advisers Act make it unlawful for any investment adviser to employ any device, scheme, or artifice to defraud, or to engage in any transaction, practice, or course of business that operates as fraud or deceit on clients or prospective clients. The SEC staff previously had indicated that those antifraud provisions may be violated by the use of a hedge clause or other exculpatory provision in an investment advisory agreement which is likely to lead an investment advisory client to believe that he or she has waived certain non-waivable rights.

In the Heitman Letter, the SEC staff confirmed that inclusion of a hedge clause in an advisory agreement is not *per se* misleading under the Advisers Act, and explained that whether an investment adviser that uses hedge clauses in investment advisory agreements that purport to limit that adviser's liability to acts of gross negligence or willful malfeasance violates Sections 206(1) and 206(2) of the Advisers Act would depend on all of the surrounding facts and circumstances. In making this determination, the staff would consider the form and content of the hedge clause (*e.g.*, its accuracy), any oral or written communications between the investment adviser and the client about the hedge clause, and the particular circumstances of the client. Moreover, the staff indicated that it "will not provide no-action or interpretive assurances under Sections 206(1) or (2) of the Advisers Act regarding an investment adviser's use of any particular hedge clause with its clients."

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at the time of acquisition, are "qualified purchasers"). Similarly, private funds often conduct offerings in reliance on Rule 506 of Regulation D under the Securities Act of 1933, which is generally limited to "accredited investors." The definition of accredited investor is "intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act's registration process unnecessary." "Report on the Review of the Definition of Accredited Investor," SEC Staff (Dec. 18, 2015) at 2.

[9] Heitman Capital Management, LLC, SEC Staff No-Action Letter (Feb. 12, 2007).

[10] In an August 6, 2018 letter to the SEC, ILPA also suggested that its recommendation regarding the Heitman Letter was intended to address state law fiduciary issues. We believe that state law regarding fiduciary duties is not relevant to the status of staff guidance under the Advisers Act.

Accordingly, the Heitman Letter simply deals with the use of hedge clauses and the circumstances that will affect whether such clauses may be misleading under the anti-fraud provisions of the Advisers Act, and is not within the scope of the Proposed Interpretation. Further, we believe that the Heitman Letter appropriately concludes that whether a particular hedge clause is consistent with Section 206 of the Advisers Act is dependent on the surrounding facts and circumstances. The legal analysis in the Heitman Letter is correct, and while rescinding the Letter would not change the legal analysis we are concerned that it could create unnecessary confusion and uncertainty for sophisticated investors and advisers. As a result, we do not believe it would be appropriate to rescind the Heitman Letter.

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MFA appreciates the opportunity to provide these comments in response to the Proposed Interpretation. If you have any questions about these comments, or if we can provide further information about these issues, please do not hesitate to contact either of the undersigned at (202) 730-2600.

Respectfully submitted,

/s/ Matthew Newell

Matthew Newell
Associate General Counsel

/s/ Benjamin Allensworth

Benjamin Allensworth
Associate General Counsel