PANTHEON

March 28, 2016

Brent J. Fields, Secretary
Securities and Exchange Commission
Division of Investment Management
100 F Street NE
Washington, D.C. 20549-1090

Re: Comments on Proposed Derivatives Rules (File No. S7-24-15)

Dear Mr. Fields:

We are writing to offer our comments on the Securities and Exchange Commission's (the "Commission") proposed rules relating to the use of derivatives by registered investment companies.[1] Pantheon Ventures (US) LP ("Pantheon") is the investment adviser of AMG Pantheon Fund, LLC (the "Fund"), a registered closed-end investment company that operates as a registered fund of private funds.[2] As part of the Fund's investment strategy, the Fund makes capital commitments to private funds and portfolio companies that are drawn at the discretion of the private fund's general partner or manager (such general partner, manager or equivalent a "Private Fund Manager"), a practice that may be included within the proposed rule's definition of "financial commitment transaction." Without implying that the proposed rule would necessarily limit the Fund's ability to pursue this investment strategy, we offer some suggestions that we believe may be helpful to the Commission in considering the application of the proposed rule to registered closed-end investment companies.

I. Background

The Fund pursues its investment strategy in part by making capital commitments to private funds and portfolio companies. As a condition of investment in a private fund, the Fund is typically

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[1] *Use of Derivatives by Registered Investment Companies and Business Development Companies,* SEC Release No. IC-31933, 80 Fed. Reg. 80884 (Dec. 28, 2015), *available at* https://www.gpo.gov/fdsys/pkg/FR-2015-12-28/pdf/2015-31704.pdf.

[2] The Fund invests substantially all of its assets in AMG Pantheon Master Fund, LLC (the "Master Fund"), a registered closed-end investment company, as part of an investment structure commonly known as a "master-feeder" arrangement. Unless otherwise noted, references to the "Fund" and its investments are intended to include the Fund's indirect exposure through the Master Fund to the underlying investments of the Master Fund.

obligated to commit a certain amount of capital to the private fund. The amount of capital committed to a private fund is generally not immediately invested and is instead drawn down and invested over time, as underlying investments are identified by the Private Fund Manager. Under normal circumstances, approximately 50% of the amount of capital committed to a private fund is invested within 3 years, the next 30% is invested within 5 years, the next 10-15% is invested within 8-9 years, and the remaining 5-10% is not always invested. In addition, it is our experience that approximately 15% of the commitment is funded by distributions from the private fund. Without necessarily agreeing that its unfunded commitments are "senior securities" within the meaning of Section 18 of the Investment Company Act of 1940, as amended (the "1940 Act"), the Fund currently segregates liquid assets in an amount at least equal to its unfunded commitments and, to the extent that such unfunded commitments were to exceed the value of such liquid assets, would maintain asset coverage of at least 300% in accordance with Section 18(a)(1).

The proposed rule permits registered investment companies to enter into derivatives transactions and financial commitment transactions (as those terms are defined in the proposed rule) notwithstanding the prohibitions and restrictions on the issuance of senior securities under Section 18, subject to the conditions of the proposed rule. Of particular interest to Pantheon and the Fund is the proposed rule's definition of "financial commitment transaction," which includes any agreement under which a fund has obligated itself to invest equity in a fund or company by making a capital commitment to a private fund or portfolio company that can be drawn at the discretion of the Private Fund Manager.[3] We believe the Commission intends to include within the proposed rule's definition of "financial commitment transaction" the types of capital commitments the Fund makes to private funds and portfolio companies in pursuing its investment strategy.[4]

In order to rely on the exemption provided by the proposed rule, a fund would be required to maintain qualifying coverage assets equal to at least the amount of the financial commitment

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[3] The proposed rule defines a "financial commitment transaction" as "any reverse repurchase agreement, short sale borrowing, or any firm or standby commitment agreement or similar agreement (such as an agreement under which a fund has obligated itself, conditionally or unconditionally, to make a loan to a company or to invest equity in a company, including by making a capital commitment to a private fund that can be drawn at the discretion of the fund's general partner)." Proposed Rule 18f-4(c)(4).

[4] The proposing release notes that these transactions are often referred to as "unfunded commitments." Release No. 31933 at 80900. With respect to these transactions, the proposing release explains that the fund has incurred a conditional or unconditional contractual obligation to pay or deliver assets in the future, and is exposed to the risk that the fund may be required to liquidate other assets to obtain the cash needed to satisfy its obligations, as well as the risk that it may be subject to default remedies available to its counterparties if the fund is unable to meet its obligations. The proposing release notes that if the fund fails to fulfill its commitment to invest in a private fund when called to do so, the fund could be subject to the remedies specified in the private fund's limited partnership agreement (or similar document), including, for example, a forfeiture of some or all of the fund's investment in the private fund. *Id.*

obligation associated with each of its financial commitment transactions.[5] The proposed rule defines "financial commitment obligation" as the amount of cash or other assets that the fund is conditionally or unconditionally obligated to pay or deliver under a financial commitment transaction (essentially, the full notional value of the obligation).[6] The proposed rule defines "qualifying coverage assets" to include, with respect to financial commitment transactions:

> (i) cash and cash equivalents;
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> (ii) assets that may be delivered to fulfill a fund's obligations under a financial commitment transaction; and
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> (iii) assets that are convertible to cash or that will generate cash, equal in amount to the financial commitment obligation, prior to the date on which the fund can be expected to be required to pay such obligation or that have been pledged with respect to the financial commitment obligation and can be expected to satisfy such obligation, determined in accordance with policies and procedures approved by the fund's board of directors.[7]

Accordingly, we believe the proposed rule could be interpreted to require a fund making capital commitments in reliance on the proposed rule to maintain qualifying coverage assets equal in value to the total amount of its unfunded commitments—even if such unfunded commitments are never drawn or are offset by distributions received from the underlying private investments.

II. Comments Regarding Asset Coverage for Financial Commitment Transactions

A. Continuing Availability of Statutory Asset Coverage Requirements

We first seek confirmation that the proposed rule is not intended to limit a registered closed-end fund's ability to issue a class of senior security representing indebtedness in accordance with Sections 18(a)(1) and 18(c) of the 1940 Act. The Fund is a registered closed-end investment company and, as such, may issue a class of senior security representing indebtedness if,

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[5] Proposed Rule 18f-4(b)(1).

[6] Proposed Rule 18f-4(c)(5).

[7] Proposed Rule 18f-4(c)(8). The qualifying coverage assets would be identified on the fund's books and records at least once each business day pursuant to board-approved policies and procedures. Under the proposed rule, the total amount of a fund's qualifying coverage assets could not exceed the fund's net assets, and the assets a fund maintains as qualifying coverage assets could not be used to cover both a derivatives transaction and a financial commitment transaction. *Id.*

immediately thereafter, it has asset coverage of at least 300% and the other requirements of Sections 18(a) and 18(c) are satisfied.[8]

The proposed rule provides that "[a] fund may enter into financial commitment transactions, notwithstanding the requirements of section 18(a)(1), section 18(c), section 18(f)(1) and section 61 of the Investment Company Act," provided that the conditions of the proposed rule are satisfied.[9] We interpret this statement as an acknowledgement that the proposed rule is an exemptive rule that operates to expand the set of legal parameters under which a fund may issue senior securities beyond the statutory prohibitions and restrictions of Section 18. This interpretation, we believe, is consistent with the administrative rulemaking authority granted to the Commission by Section 6(c) of the 1940 Act, which authorizes the Commission by rule or regulation to exempt any class or classes of persons, securities or transactions from any provision(s) of the 1940 Act.

We believe that a registered closed-end investment company that issues senior securities which may be characterized as "financial commitment transactions" should be permitted to continue such practices to the extent they are consistent with Sections 18(a)(1) and 18(c), without interference from the proposed rule. Accordingly, we urge the Commission to clarify that the proposed rule is an exemptive rule that exempts registered investment companies from certain provisions of Section 18 subject to the conditions of the proposed rule, and does not further constrict the existing limitations on issuance of senior securities imposed by Section 18.

B. Measurement of Financial Commitment Obligation

To the extent that a registered closed-end investment company elects to rely on the proposed rule to enter into financial commitment transactions,[10] the fund should not be required to segregate an amount equal to the total unfunded obligation under a capital commitment to a private fund or portfolio company. For funds that make capital commitments to private funds and portfolio companies, a significant portion of the resulting financial commitment obligation is not a "current"

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[8] Section 18(a) provides that "[i]t shall be unlawful for any registered closed-end company to issue any class of senior security, or to sell any such security of which it is the issuer," but goes on to permit the issuance of senior securities by a closed-end fund subject to minimum asset coverage requirements (300% asset coverage for debt securities and 200% asset coverage for equity securities). Section 18(c) provides that a closed-end fund is permitted to have only one class of senior security representing indebtedness and only one class of senior security which is stock.

[9] Proposed Rule 18f-4(b).

[10] Notwithstanding the statutory permission to obtain a certain amount of leverage through the issuance of senior securities in accordance with Section 18(a)(1), a registered closed-end fund may wish to rely on the proposed rule to enter into derivatives or financial commitment transactions beyond the limits specified in Section 18(a)(1). Because the 300% asset coverage requirement is a meaningful limit on the amount of leverage a closed-end fund can obtain through the issuance of senior securities, the fund may seek to rely on another exemption—such as the existing Commission and staff guidance regarding the maintenance of segregated accounts or the exemption provided by the proposed rule—to use derivatives and financial commitment transactions beyond the limits of Section 18(a)(1).

liability of the investing fund and is contingent on the Private Fund Manager's decision to draw down the commitment. Under normal circumstances, approximately 50% of the amount of capital committed by the Fund will not give rise to a payment obligation within 3 years, and approximately 5-10% of the Fund's capital commitment may not give rise to a payment obligation at any point. In addition, as noted above, it is our experience that approximately 15% of the commitment is funded by distributions from the private fund.[11] Accordingly, the total unfunded commitment amount significantly overestimates the amount of liquid assets that the Fund would likely need at any given time in order to meet its obligations.

The proposing release states that the proposed rule's requirement to maintain qualifying coverage assets is designed primarily to address concerns about a fund's ability to meet its obligations.[12] The "qualifying coverage assets" requirement draws on the asset segregation guidance provided in Investment Company Act Release 10666,[13] which the Commission initially believed would address two central but very different investor protection purposes underlying Section 18: (1) imposing a limit on the leverage a fund may obtain through the use of senior securities, and (2) requiring the fund to maintain liquid assets to meet its obligations arising from those transactions.[14] These rationales are grounded, in turn, on the "undue speculation" and "asset sufficiency" concerns expressed in Sections 1(b)(7) and 1(b)(8) of the 1940 Act, respectively. As the proposing release explains, however, the Commission now believes that current industry practices based on the application of existing asset segregation guidance no longer impose an effective limit on the amount of leverage that funds can obtain and no longer ensure that funds have adequate assets to meet their obligations. Accordingly, the proposed rule bifurcates the "undue speculation" and "asset sufficiency" concerns underlying Section 18 and employs different means to address each concern.[15]

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[11] A private fund may reinvest distributions otherwise payable to the investing fund in order to satisfy a capital call. In our experience, approximately 15% of the capital commitment to a private fund is offset in this way by distributions from the private fund, such that the capital calls are satisfied by distributions to which the investing fund otherwise would have been entitled. Together with the portion of the commitment that is not always invested (roughly 5-10%), our experience is that approximately 20% of the commitment will not require a payment by the investing fund at any point.

[12] Release No. 31933 at 80899.

[13] *See Securities Trading Practices of Registered Investment Companies*, Investment Company Act Release No. 10666 (Apr. 18, 1979).

[14] Release No. 31933 at 80892.

[15] *See* Release No. 31933 at 80899 ("The proposed rule's portfolio limitations are designed primarily to address concerns about a fund's ability to obtain leverage through derivatives transactions, whereas the proposed rule's requirements to maintain qualifying coverage assets are designed primarily to address concerns about a fund's ability to meet its obligations.").

The proposed rule seeks to address the "undue speculation" concern expressed in Section 1(b)(7) primarily through exposure-based and risk-based portfolio limitations on the amount of leverage a fund can obtain through the issuance of senior securities.[16] Under the proposed rule, financial commitment transactions entered into in reliance on the rule would be included in the calculation of both the exposure-based and risk-based portfolio limitations. Because these portfolio limitations would effectively limit a fund's ability to obtain leverage through the use of financial commitment transactions, we believe the requirement to maintain qualifying coverage assets in an amount equal to the total unfunded commitment amount is difficult to justify as a means of addressing the "undue speculation" concern expressed in Section 1(b)(7). Requiring segregation against the full notional value of a financial commitment transaction—which, under the proposed rule, would already be subject to portfolio-level imitations—would unduly burden a fund's ability to obtain leverage without necessarily contributing to the fund's ability to meet its obligations. We believe that any requirement to maintain qualifying coverage assets should therefore be narrowly tailored to achieve the proposed rule's stated purpose of ensuring a fund's ability to meet its obligations.

Imposing an additional limit on the leverage a registered closed-end fund may obtain through the issuance of senior securities would also create tension with the statutory text of Section 18(a)(1). The 300% asset coverage requirement effectively limits the amount of leverage a registered closed-end investment company can obtain through the issuance of a class of senior security. Section 18(a)(1) reflects a determination by Congress that the 300% asset coverage requirement is the appropriate limitation on leverage for closed-end funds to address the "undue speculation" concern expressed in Section 1(b)(7) of the 1940 Act. Accordingly, a requirement to maintain qualifying coverage assets against the full notional value of financial commitment transactions is especially difficult to justify as a practical limit on the amount of leverage a *closed-end* fund could obtain through the use of such transactions. Assuming the intent of the proposed rule is not to thwart the intent of Congress regarding permissible leverage for closed-end funds, we believe the appropriate justification for a "qualifying coverage assets" requirement is to ensure the fund's ability to meet its obligations under financial commitment transactions.

Because a significant portion of an unfunded capital commitment to a private fund is a not a "current" liability of the investing fund, an asset coverage amount equal to the full notional value of the unfunded commitment significantly exceeds the amount of liquid assets that the fund would likely need at any given time to meet its obligations as they come due. The contingent nature of the investing fund's ultimate payment obligation under a capital commitment is reflected in the accounting treatment of unfunded commitments under U.S. generally accepted accounting

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[16] *See* Release No. 31933 at 80899 ("By addressing concerns related to a fund's ability to obtain leverage through derivatives transactions primarily through the proposed portfolio limitations and separately addressing concerns related to a fund's ability to meet its derivatives obligations primarily through the proposed requirements to maintain qualifying coverage assets, the proposed rule is designed to address each concern more directly, while still providing a flexible framework that can be applied by funds to various types of derivatives as they are developed in the marketplace.").

principles ("GAAP") and their exclusion from the calculation of borrowing limits under a fund's line of credit. We note that undrawn commitments are not required to be reflected as a balance sheet liability in the investing fund's financial statements under current U.S. GAAP, and are instead reflected as a liability for accounting purposes only when the capital is actually called by a Private Fund Manager.[17] Likewise, an investing fund's lenders do not take into account unfunded commitments when calculating the borrowing limit under a fund's line of credit. The fund's covenant under the credit agreement is instead with respect to borrowing and other forms of "true" leverage (and not with respect to satisfying capital call obligations to private funds or portfolio companies) and is triggered only when the fund draws down on the credit facility.

For these reasons, we believe that requiring a registered closed-end fund to maintain liquid assets equal to the full notional value of its capital commitments would be overbroad in relation to the proposed rule's stated purpose of ensuring the fund's ability to meet its obligations. An alternative approach could require a closed-end fund to segregate a "risk-adjusted" amount that is conceptually similar to the proposed rule's asset segregation requirements for derivatives transactions. Such an approach could take into account the uncertainty and temporal remoteness of future payments under the fund's capital commitments, as determined in accordance with board-approved policies and procedures.[18] For example, the fund could estimate the likelihood that its unfunded commitments could be drawn in each of the next four calendar quarters and maintain qualifying coverage assets in an amount equal to the estimated capital that could be called over such four quarters.

C. Composition of Qualifying Coverage Assets

If a registered closed-end fund relying on the proposed rule would be required to maintain qualifying coverage assets against the entire unfunded obligation under a capital commitment to a private fund or portfolio company, we encourage the Commission to clarify that eligible qualifying

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[17] The aggregate amount of unfunded commitments is disclosed as a contingent liability in the notes to the investing fund's financial statements but is not reflected in the balance sheet itself. Similarly, when a capital call is paid by the fund, the amount of the capital called is reflected in the balance sheet as an investment.

[18] The "risk-based coverage" concept is already employed by the Commission in the context of the proposed rule's asset segregation requirements for derivatives transactions. The proposing release explains that the risk-based coverage amount must be a "reasonable estimate of the potential amount payable by the fund if the fund were to exit the derivatives transaction under stressed conditions, regardless of whether the fund is currently required to make such payments under the terms of the derivatives contract." Release No. 31933 at 80930. The rationale for a risk-based coverage amount is that it represents a "cushion" on the mark-to-market settlement value of a derivatives contract. In the context of a capital commitment to a private fund, the closest analogy to a risk-based coverage amount may be the amount the investing fund would have to pay another investor to take over the capital commitment in stressed conditions. However, the more significant uncertainty regarding the ultimate payment obligation under a capital commitment relates to the timing and aggregate amount of the payments, rather than the risk associated with exiting the commitment (under stressed conditions or otherwise). Accordingly, a "risk-adjusted" approach to asset coverage for capital commitments could also consider the uncertainty associated with the timing and magnitude of future payments.

coverage assets would include equity securities (including exchange-traded funds) and other assets that could be converted into cash prior to the fund's payment obligations under its financial commitment transactions. We believe that the examples described in the proposing release with respect to "assets convertible to cash" have been drafted too narrowly because they may be interpreted as limited to fixed-income securities. We believe that "assets convertible to cash" should include a broader range of liquid assets, including liquid equity securities, consistent with current Commission and staff guidance,[19] and should not be limited to assets that mature or otherwise convert to cash under the terms of the instrument. So long as a security with sufficient value can be liquidated for cash before the fund is required to make a payment under its financial commitment transactions, the fund is not exposed to the risk that it would be unable to meet its payment obligations and should therefore be permitted to use the security as a qualifying coverage asset.

In addition, we believe that the borrowing limit under a registered closed-end fund's line of credit should be counted toward the amount of qualifying coverage assets required to be maintained against an unfunded commitment to a private fund or portfolio company. As discussed above, a registered closed-end fund's use of financial commitment transactions, under which the fund has a future payment obligation, may implicate the "asset sufficiency" concern expressed in Section 1(b)(8) of the 1940 Act. However, a closed-end fund that has obtained a line of credit, which may be used to meet its obligations under financial commitment transactions, has a means of ensuring its ability to meet those obligations as they come due. Accordingly, we believe that a registered closed-end fund should be permitted to count the borrowing limit under its line of credit toward the amount of qualifying coverage assets required to be maintained against the fund's financial commitment obligations.[20]

We note that this approach is broadly consistent with the flexibility contemplated by the proposed rule with respect to a fund's selection of "qualifying coverage assets." The proposed rule

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[19] *See* Merrill Lynch Asset Management, L.P., SEC No-Action Letter (pub. avail. July 2, 1996) (permitting segregation of any "liquid assets," including equity securities and non-investment grade debt securities).

[20] In considering the appropriate composition of qualifying coverage assets that are required to be maintained against an unfunded commitment, we encourage the Commission to consider not only the nature of the financial commitment transaction, but also the important structural distinctions between closed-end funds and open-end funds. Congress intentionally permitted closed-end funds to issue senior securities to a greater extent than that permitted for open-end funds because of clear differences in the basic offering and operating structures of closed-end funds. Most notably, open-end funds must stand ready to redeem their securities each day, while closed-end funds need not do so. For this reason, closed-end funds are not required to maintain the same degree of liquidity as is required for open-end funds. The proposed rule does not explicitly recognize these structural differences between closed-end funds and open-end funds along this dimension, but we believe they are crucial and are reflected in Congress's choice to treat the issuance of senior securities by closed-end funds and open-end funds differently under Section 18. We therefore encourage the Commission to consider allowing closed-end funds greater flexibility in identifying the types of qualifying coverage assets that are required to be maintained.

allows each fund to establish appropriate policies and procedures to determine its assets' convertibility to cash or ability to generate cash, as well as to determine when it would be required to pay its obligations under its financial commitment transactions.[21] The proposing release acknowledges that funds are best situated to evaluate their own obligations under financial commitment transactions and the eligibility of their assets based on an assessment of their own particular facts and circumstances.

D. Considerations for Funds Offered Only to Accredited Investors

The use of derivatives and financial commitment transactions by a registered investment company that is offered only to accredited investors may not implicate the "undue speculation" or "asset sufficiency" concerns that support limitations on these practices by other registered investment companies. The Fund operates as a registered fund of private funds, and the Commission staff has taken the position that such a fund can be offered only to accredited investors, even when its offering is registered under the Securities Act of 1933.[22] Given that the Fund and other registered funds of private funds may be offered only to accredited investors, we suggest that the Commission consider the extent to which the "undue speculation" and "asset sufficiency" rationales support additional limitations on the use of derivatives and financial commitment transactions by such funds. If the Commission staff's position continues to be a meaningful limit on the extent to which shares of a registered fund of private funds can be offered for sale to the general public, we suggest that the Commission consider allowing those funds greater flexibility in the use derivatives and financial commitment transactions.

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[21] Proposed Rule 18f-4(b)(2).

[22] The staff has consistently taken this position in the registration statement review process for registered funds of private equity and hedge funds.

We appreciate the opportunity to comment on the proposed rule and hope that the Commission and staff will find these comments helpful in the comment process. We would be pleased to discuss any of our comments with members of the Commission staff at their convenience.

Very truly yours,

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