May 1, 2019

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

VIA ELECTRONIC MAIL: rule-comments@sec.gov

Re: File No. S7-24-15 Use of Derivatives by Registered Investment Companies and Business Development Companies

Dear Ms. Countryman,

Aditum Alternatives and Aditum Asset Management welcome the opportunity to respond to the SEC's request for comments on re-proposed rule 18f-4 under the Investment Company Act of 1940, intended to address the investor protection purposes and concerns underlying section 18 of the Act. Our comments are directed toward the proposed rule's regulation of the use of unfunded commitments by registered investment companies ("40 Act funds"), particularly those 40 Act funds which invest in private market assets.

Commitments to 3c7 Private Market Funds

Investing in private market assets, such as the equity of private companies, is an opaque process because private companies are resistant to disclosing information to the investing public at large. For this reason, private companies have often confined their disclosures to sponsors with knowledge and experience which qualifies them to make informed decisions regarding investing in private companies, and with access to large pools of investment capital, often in the form of partnerships that are exempt from investment company registration under section 3(c)(7) ("3c7 private market funds"). Given the extended identification and due diligence processes for private market assets, as well as their illiquid nature, episodic availability and the complexity associated with purchasing such assets, investors subscribe to 3c7 private market funds as limited partners by making capital commitments. These capital commitments are not funded at the time of subscription but are available to a 3c7 private market fund over a future investment period during which capital is incrementally called against these unfunded commitments, on a pro rata basis across limited partner investors, as needed by the 3c7 fund to apply to investments (or fund operations). These investment periods ("vintages") are typically identified by when capital is first deployed in an underlying private market investment. Similarly, when a 3c7 private market fund has sold or recapitalized an underlying private market investment to harvest capital, the 3c7 fund will generally distribute the harvested capital to its limited partners. Figure 1 displays a capital use pattern typical of 3c7 private market funds.

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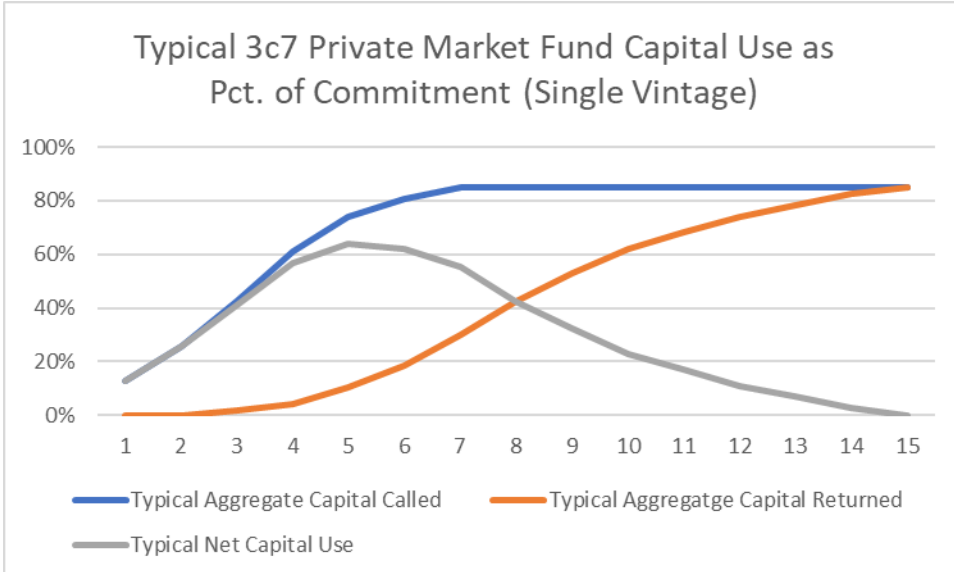

Figure 1

40 Act funds often access the private markets as limited partners in 3c7 private market funds, making (or otherwise acquiring) accompanying unfunded commitments. Some 40 Act funds are themselves subscribed by their investors in the form of unfunded commitments, mirroring the aggregate capital use (i.e. capital call and distribution) of the underlying 3c7 private market funds in which they invest. Other 40 Act funds ("evergreen funds") require that their investors contribute the full amount of the investors' at-risk capital at the time of subscription and recycle their investor contributed capital across 3c7 private market funds of successive vintages. Such evergreen funds endeavor to manage their underlying investments so that, whenever capital is called against their unfunded commitments, their available liquid assets are adequate to answer the call. However, at the same time, these evergreen funds try to avoid maintaining on-going excess balances of cash and cash equivalents which will dampen the rate of return generated by underlying 3c7 private market funds, creating "cash drag."

Over-commitment Strategies

As Figure 2 illustrates, given a typical 3c7 private market fund capital use cycle, a balanced allocation of commitments across vintages may result in only 30% to 40% of committed capital generally being invested in private market assets. Thus, an evergreen fund that limits its commitments to always being less than or equal to its net assets, may have significant un- and under invested assets, resulting in significant cash drag. To avoid this, a number of evergreen funds have implemented over-commitment strategies. The success of an over-commitment strategy depends on the ability of the evergreen fund to align the capital use cycles of its underlying 3c7 private market funds, so that the highest capital use of some of its underlying 3c7 private market funds corresponds to the lowest capital use of other of its underlying 3c7 private market funds.

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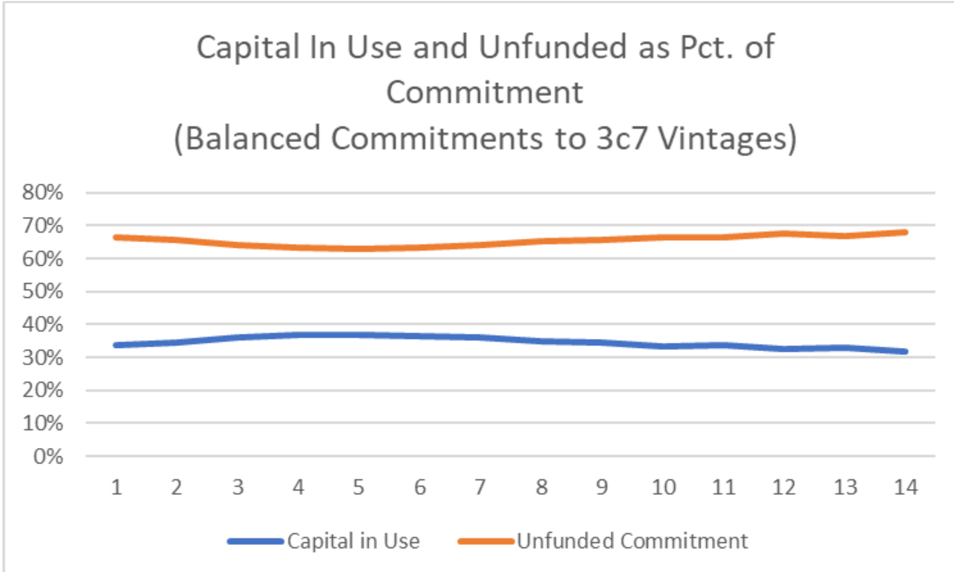

Figure 2

Capital Use Models and Market Conditions

Private market investors have harvested massive amounts of data regarding the historical timing of capital called and distributed by many 3c7 fund sponsors, including the most prominent and many smaller players. Using this historical data and their capital commitments to specific underlying funds of specific vintages in their fund's portfolio, the advisers of an evergreen fund can develop a capital use model, in an attempt to predict the expected future calls and distributions to be issued by the evergreen fund's underlying 3c7 private market funds.

There are a number of factors that impact any capital use model. Among these factors are:

- the allocation of unfunded commitments across vintage years and underlying 3c7 funds,
- the rate at which capital is expected to be called by each 3c7 fund against the commitments,
- the rate at which capital is expected to be distributed by each 3c7 fund, allowing the capital to be re-applied in response to a subsequent call, and
- the percentage of the unfunded commitment that will ultimately be called in aggregate by each 3c7 fund. (This is usually less than 100% of the originally subscribed commitment.)

Market Distortions

A market distortion could significantly impact these scenarios, possibly resulting in an underlying fund drawing more rapidly on unfunded commitments and reflected in greater than expected capital call amounts. It is important to note that such a market distortion could be created by negative (e.g. portfolio companies needing more capital to survive) or positive (e.g. having more/larger than anticipated investment opportunities) market conditions impacting underlying funds. Thus, like a long-term weather forecast, there are limits to the predictive value of any capital use model. Just as coastal homes should be built to withstand hurricanes, an evergreen fund's capital use model should be constructed to survive potential market distortions that could occur more than once within the 12-15 year life of a typical private

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market vintage. This means planning to have access to a greater amount of liquid assets than the model would otherwise require.

Limited Liquidity via Borrowing

Some evergreen funds have implemented credit arrangements whereby they may post their illiquid holdings as collateral in order to borrow liquid assets necessary to meet their operational and investment needs, including responding to capital calls from their underlying 3c7 private market funds. They have noted that any such borrowing must at all times comply with and be limited by Section 18 of the Act. We believe that, during a market disruption, limitations on borrowing are less likely to be Section 18 restrictions and more likely to be the practices of lenders. In a market distortion, such as has occurred as a result of the COVID-19 pandemic, the illiquid holdings of evergreen funds being pledged as collateral, already subject to a significant valuation haircut due to their illiquidity, are likely to be subject to an additional haircut related to the staleness of the most recent valuations provided by 3c7 fund sponsors. This will in turn limit the amount available for an evergreen fund to borrow during a market distortion. Additionally, typical evergreen fund credit arrangements have covenants that restrict the usage of borrowed funds, often prohibiting the use of borrowed funds for purposes such as funding share repurchases. During a market distortion, such restrictions may make extended use of a credit arrangement by an evergreen fund problematic.

Not Leverage, but with an Asymmetric Risk of Default

While we agree with prior commenters that unfunded commitments do not constitute a form of leverage as contemplated by Section 18 of the Act, we believe it is important to keep in mind that in one significant aspect, the use of leverage and the use of unfunded commitments have a common downside: the potential for asset forfeiture. For example, the Model Partnership Agreement published in October 2019 by the Institutional Limited Partner Association states that an underlying 3c7 fund's sponsor may "determine that the Defaulting Partner must forfeit up to 100% of its Interest in the Fund without payment or other consideration therefor." So, we believe that the potential downside risk of an excessive unfunded commitment is asymmetric to the potential upside reward.

Expectations in the Current Market Environment

There are several existing evergreen funds which, in our view, have excessive amounts of unfunded commitments relative to their liquid assets available to meet such commitments. Given the market disruption associated with COVID 19, our view is that these evergreen funds will have difficulty meeting their unfunded commitments in the latter part of 2020 and in 2021, and are likely to sell their illiquid holdings at a significant discount to then contemporaneous 3c7 fund values and/or default on their unfunded commitments. We have three expectations informing this view:

- Capital calls from underlying 3c7 private market funds will be accelerated (vs. previously modeled capital use) as underlying 3c7 funds will look to re-capitalize existing portfolio companies and purchase new portfolio companies at new lower valuations.

- Distributions will be delayed (vs. previously modeled capital use) as underlying 3c7 funds will hold investments longer in order to recover lost value.

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- The ability of these evergreen funds to borrow against their holdings will be significantly reduced (vs. February 2020 and prior expectations).

Reasonable Belief Necessary but Not Sufficient

We believe that an over-commitment strategy is an appropriate component of an evergreen fund's investment strategy. We further believe:

- that it is necessary for a fund which employs unfunded commitments to have a "reasonable belief" in its ability to meet its unfunded commitments as a pre-condition to making any such commitment or other investment (which through its use of the fund's capital might impact the fund's ability to meet its unfunded commitments);

- that this reasonable belief should exclude any expectation of additional fund subscriptions and any expectation of the availability of borrowed funds (both expectations of which may be questionable during a market distortion); and

- that this reasonable belief should be corroborated by the fund's capital use model, which should be periodically reviewed by the fund's board of directors.

However, given the potential impact of a market distortion on a fund's ability to meet its unfunded commitments and the negative impact that a failure to meet its unfunded commitments would have on a fund's investors, we also believe that a well-defined limitation on the use of unfunded commitments by registered investment companies is needed. For example, we suggest that a registered investment company which employs unfunded commitments, should not acquire an investment if, immediately after the acquisition, the liquid assets available to the fund (e.g. current investments and commitments from the fund's own investors that can be converted to cash within seven days) are less than a meaningful portion (e.g. 40%) of the fund's unfunded commitments.

Our responses to the specific questions posed by the Commission are below:

233. Are unfunded commitment agreements distinguishable from derivatives transactions? Can funds use unfunded commitment agreements for speculation or to accomplish leveraging? If so, how? What types of funds enter into unfunded commitment agreements, and for what purposes?

Unfunded commitment agreements are distinguishable from derivatives transactions in several ways. Most significantly, unfunded commitments do not create embedded leverage as derivative transactions do. As described above, registered funds often employ unfunded commitments when accessing private market investment opportunities, which by their nature are episodic.

234. Does funds' use of unfunded commitment agreements raise the undue speculation and/or the assets sufficiency concerns underlying section 18 of the Investment Company Act? Why or why not?

As described above, excessive unfunded commitments, even made or acquired as the result of careful planning, may engender asset sufficiency concerns, particularly in the context of a market distortion. For this reason, we believe that a registered investment company that employs unfunded commitments should

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not acquire an investment if, immediately after the acquisition, the liquid assets then available to the fund are less than a pre-defined, meaningful portion of the fund's unfunded commitments.

235. Is the proposed approach to unfunded commitment agreements appropriate? Would the proposed approach appropriately address any asset sufficiency concerns that funds' use of unfunded commitment agreements might entail? Why or why not?

For the reasons described above, we believe that the Commission's proposed approach is reasonable and necessary, but not sufficient. We further believe that a fund that employs unfunded commitments should not engage in any investment activity which results in the liquid assets then available to the fund being less than a pre-defined, meaningful portion of the fund's unfunded commitments

236. Is the proposed requirement that a fund must have a "reasonable belief" regarding its ability to meet its unfunded commitment obligations, at the time it enters into an unfunded commitment agreement, appropriate? Should the rule instead, or also, require a fund to reassess whether this belief remains reasonable at various points during the period of the unfunded commitment agreement?

As described above, we believe that such a reasonable belief is necessary and appropriate and should be corroborated by the fund's capital use model (as described above). Such a model should be revised with each capital event pertaining to the fund's unfunded commitments and reviewed periodically by the fund's board of directors

237. Are the rule's provisions regarding the factors that a fund must consider in determining whether it has the required "reasonable belief" appropriate? Why or why not? Are they sufficiently clear? Should we specify other factors that a fund could consider? Should the rule provide, for example, that a fund may consider potential borrowings only to the extent the fund has committed lines of credit or other committed borrowing capacity? If so, how should we define "committed" for this purpose?

As noted above, because the most significant threat to a fund's ability to satisfy its unfunded commitments is likely to occur in the context of a market distortion, in our opinion a "reasonable belief" should exclude any expectation of additional fund subscriptions and exclude (or at least dramatically reduce) any expectation of the availability of borrowed funds.

238. Under the proposed rule, a fund's reasonable belief that it has sufficient cash to satisfy its unfunded commitments may not be based on cash that may become available from issuing additional equity. Do commenters agree that a fund's ability to raise capital in the future, and the amount of any such additional capital, are based on factors that are too speculative to support a fund's reasonable belief that it could use that capital to fund an unfunded commitment? Are there circumstances in which a fund can expect to raise capital in the future, such as expected inflows from retirement plan platforms, that would not raise the same concerns about supporting a reasonable belief under the proposed rule? Should the rule permit a fund to consider such additional capital as a basis for forming a reasonable belief?

Please see our answer to question 237 above.

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239. Should the rule otherwise limit funds' use of unfunded commitment agreements? If so, how? For example, should the rule specify that funds' unfunded commitment agreements, in the aggregate, may not exceed the fund's net asset value? Or should we adopt different requirements for unfunded commitment agreements for different types of funds, based on their ability to borrow money under the Investment Company Act? Should the rule limit the agreements' counterparties or otherwise restrict the agreements' terms in any way? If so, how? Should we adopt different requirements for unfunded loan commitments, which generally will be contingent upon a borrower meeting certain "milestones," as compared to commitments to invest in a private fund due upon demand by the fund's adviser? If so, which requirements should apply to each type of transaction and why?

When contemplating a significant market distortion, we see no practical difference in the risk to a fund of an unfunded loan agreement and an unfunded commitment to a private fund.

As noted above, a fund which employs unfunded commitments and limits its commitments to always being less than or equal to its net assets, may have significant un- and under invested assets, resulting in significant cash drag. As such, we do not believe this would be an appropriate restriction. Instead, we believe that such a fund and its investors would be better served by:

- a capital use model, subject to periodic review by the fund's board of directors, developed without the expectation of additional subscriptions, with the expectation of no or very limited borrowed funds available, and which forms the basis of a reasonable expectation that the fund will meet its unfunded commitments; and

- a requirement that such fund not acquire an investment if, immediately after the acquisition, the liquid assets available to the fund (e.g. current investments and commitments from the fund's own investors that can be converted to cash within seven days) are less than a meaningful portion (e.g. 40%) of the fund's unfunded commitments.

240. Should the rule instead treat all—or a specified subset of—unfunded commitment agreements in the same way that it treats derivatives transactions? If a subset of these agreements, should the rule specify that certain characteristics of these agreements are indicative that these agreements are "similar instruments" in the proposed rule's definition of "derivatives transaction"? Should a fund that enters into unfunded commitment agreements, but that otherwise does not use derivatives (or that limits its derivatives exposure, either as the proposed rule specifies in the limited derivative user provisions or otherwise) be subject to the proposed VaR-based limit on fund leverage risk? Should such a fund be exempt from any of the proposed rule's other requirements, and if so, which ones and why?

We do not believe VaR is an appropriate measure of the risk associated with unfunded commitments. However, to the degree that VaR measures the risk that a fund which utilizes derivatives may have a smaller quantity of liquid assets available for that fund to meet its unfunded commitments, VaR should be incorporated into the capital use model which forms the basis of the fund's reasonable expectation of satisfying its unfunded commitments.

241. Is the proposed definition of "unfunded commitment agreement" clear and appropriate? If not, how should the Commission modify it? Should the Commission clarify any aspect of the

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definition (e.g., should the Commission further define or provide guidance regarding agreements that involve a commitment to "make a loan to a company" or to "invest equity in a company in the future")? Would funds experience any challenges in practice differentiating between unfunded commitments, on the one hand, and firm or standby commitment agreements or other transactions included in the definition of "derivatives transaction," on the other? If so, how should the Commission provide additional clarity?

We find the proposed definition of "unfunded commitment agreement" to be clear, appropriate and complete.

242. Are there other types of transactions that we should identify and treat as similar to unfunded commitment agreements? What are they and why should they be treated accordingly? Are there any transactions that may be viewed as firm or standby commitment agreements, but that commenters believe should be given the same treatment as unfunded commitments under the proposed rule? What kinds of transactions and why?

We are not aware of transactions that would both fall outside the proposed definition of "unfunded commitment agreement" and merit similar treatment.

243. Would any adverse market effects result from the proposed treatment of unfunded commitment agreements? For example, would the proposal lead funds to restructure transactions as unfunded commitment agreements, and if so would this adversely affect investor protection? Would any modifications to the proposed rule, or additional Commission guidance, help mitigate potential adverse market effects?

As noted above, we believe the Commission's proposed treatment of unfunded commitment agreements to be necessary, but not sufficient.

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Thank you again for the opportunity to comment on these matters of critical importance to the investing public. Should you have any questions, please feel free to e-mail me at [redacted]

Respectfully,

Ken McGuire
President
Aditum Alternatives & Aditum Asset Management

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