

COMMITTEE ON CAPITAL MARKETS REGULATION

January 13, 2021

Ed Bernard
Chair, Asset Management Advisory Committee
c/o T. Rowe Price Group
100 East Pratt Street
Baltimore, Maryland 21202

Rama Subramaniam
Chair, AMAC Private Investments Subcommittee
c/o GTS
545 Madison Ave.
New York, NY 10022

Re: AMAC Recommendation on Registered Funds of Private Funds

Dear Mr. Bernard and Mr. Subramaniam:

The Committee on Capital Markets Regulation (the “**Committee**”) is submitting this letter to the Asset Management Advisory Committee (“**AMAC**”) and its Private Investments Subcommittee on behalf of sponsors of closed-end funds registered under the Investment Company Act of 1940, as amended (the “**1940 Act**”) that invest a significant portion (more than 15%) of their assets in private equity funds and other types of private funds relying on Sections 3(c)(1) and 3(c)(7) of the Investment Company Act (such funds, “**registered funds of private funds**”).

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes forty leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Dean, Columbia Business School) and John L. Thornton (Chairman, The Brookings Institution) and led by Hal S. Scott (Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

We understand that the AMAC and its Private Investments Subcommittee are exploring the prospect of widening retail investor access to private markets investments.¹ We are submitting our position on one potential solution to address this issue for the AMAC’s consideration and to help inform its ultimate recommendations to the SEC. This letter is based on and consistent with the Committee’s recommendations set forth in our October 2018 report, *Expanding Access and*

¹ See, e.g., U.S. SEC. & EXCH. COMM’N ASSET MANAGEMENT ADVISORY COMMITTEE, *Private Investments Subcommittee Update* (Dec. 1, 2020), <https://www.sec.gov/spotlight/amac/amac-private-investments-subcommittee-update-120120.pdf>.

Opportunities for U.S. Investors: Private Equity,² as well as comment letters that the Committee submitted to the SEC in 2019 and 2020.³

Historically, the staff of the Securities and Exchange Commission (the “SEC”) has taken the position in the registration statement disclosure review process that registered funds of private funds must limit their offerings to accredited investors. The Committee believes that the SEC staff should rescind this informal position in the circumstances outlined below, because by doing so, the SEC staff would greatly expand the ability of retail investors to access professionally managed funds that make investments in private companies without compromising core investor protections. Therefore, we encourage the AMAC and its Private Investments Subcommittee to consider our position when formulating its own recommendations to the SEC.

We note that the Committee’s position is consistent with former SEC Chairman Jay Clayton’s December 2020 letter to the AMAC and its Private Investments Subcommittee.⁴ In the letter, former Chairman Clayton expressed support, in his personal capacity, for expanding retail investor access to registered funds of private funds.⁵ He also expressed support for allowing private equity managers to offer a registered funds that invest in private equity funds sponsored by the same manager.⁶ Lastly, former Chairman Clayton suggested that registered funds of private funds could be particularly attractive for retail investors if they constituted a modest portion of a target date fund’s overall portfolio.⁷

I. Overview

The SEC staff has historically raised investor protection concerns if a registered fund of private funds were offered to retail investors. In response to the SEC’s 2019 Concept Release, a wide range of industry participants, including the Committee, called on the SEC staff to revisit its position limiting offerings of registered funds of private funds to accredited investors. In a speech on July 28, 2020, Dalia Blass, Director of the SEC’s Division of Investment Management, solicited industry feedback on how registered funds of private funds could be made available to retail investors in a manner consistent with the SEC’s commitment to investment protection. In her speech, Director Blass raised a series of five overarching issues/questions. In the following discussion, we respond to each of Director Blass’ questions and propose conditions under which a registered fund of private funds could be made available to retail investors.

² COMMITTEE ON CAPITAL MARKETS REGULATION, *Expanding Opportunities for Investors and Retirees: Private Equity* (Nov. 2018), <https://www.capmksreg.org/wp-content/uploads/2018/10/Private-Equity-Report-FINAL-1.pdf>.

³ COMMITTEE ON CAPITAL MARKETS REGULATION, *Comment Letter to the SEC re: Concept Release on Harmonization of Securities Offering Exemptions* (Sept. 19, 2019), <https://www.capmksreg.org/wp-content/uploads/2019/09/CCMR-Comment-Letter-Submission-File-Number-S7-08-19.pdf>; COMMITTEE ON CAPITAL MARKETS REGULATION, *Comment Letter to the SEC re: Amending the “Accredited Investor” Definition* (Jan. 31, 2020), <https://www.capmksreg.org/wp-content/uploads/2020/01/CCMR-Comment-Letter-to-SEC-File-Number-S7-25-19-Amending-the-%E2%80%9CAccredited-Investor%E2%80%9D-Definition-the-%E2%80%9CProposal%E2%80%9D.pdf>.

⁴ U.S. SEC. & EXCH. COMM’N, *Letter from Chairman Jay Clayton to Ed Bernard, Chair of the Asset Management Advisory Committee, and Rama Subramaniam, Chair of the AMAC Private Investments Subcommittee, re: Thoughts on Future Progress of Private Investment Subcommittee* (Dec. 22, 2020), <https://www.sec.gov/files/clayton-amac-letter-2020-12-22.pdf>.

⁵ *Id.* at 2-3.

⁶ *Id.* at 3.

⁷ *Id.* at 4.

II. Discussion

- A. *What criteria would promote access to high quality private market investments? For example, should closed-end funds of private funds invest with fund managers that meet certain experience and scale criteria?*

The primary investor protections provided by a registered fund of private funds structure are and should be found by the structure itself, which is designed by law to provide investment management by registered investment advisers with fiduciary duties to the funds they manage, under the oversight of a majority independent board, and sold by intermediaries who must act in the best interest of the investor. The registered investment adviser to a registered fund of private funds would, for example, be expected to conduct appropriate diligence on private funds, including the tenure of the investment team, success of the investment team and private fund sponsor over multiple vintages and market cycles and appropriateness of the terms of the private fund.

Nonetheless, we propose that a registered fund of private funds may be offered to retail investors only if such fund invests primarily in private funds where the manager meets threshold scale and experience criteria.

In particular, we propose that with respect to the portion of a registered fund of private funds' assets invested in private funds, the registered fund be required to invest more than 80% of such assets in private funds that accept more than 50% of their capital commitments from qualified purchasers that are not natural persons or registered investment companies. We believe a strong sophisticated investor base is the best proxy for sufficient scale and experience as these investors are unlikely to invest in private funds that lack a history of strong performance and seasoned management.

- B. *What closed-end fund structures would be most appropriate for Main Street investors? For example, would an interval fund or tender offer fund provide the right mix of liquidity and access? If so, are there any limitations on an interval fund of private funds strategy given the liquidity requirements in the interval fund rule? Should we consider changes to existing rules to make these funds a more viable option in this context?*

We propose that a registered fund of private funds that is offered to retail investors be required to provide periodic liquidity to investors in one of three ways: (i) listing on a national securities exchange (a listed closed-end fund); (ii) periodic mandatory repurchase offers (an interval fund); or (iii) periodic discretionary tenders (a tender offer fund). We further propose that, any registered fund of private funds that operates as a tender offer fund must liquidate in an orderly fashion if during any consecutive 12-month period it has not made a tender offer to shareholders.

We recognize that listing a registered fund of private funds on a national securities exchange may require the exchange to seek SEC approval to revise its listing standards. We encourage the SEC to coordinate with national securities exchanges to revise listing standards, as appropriate. Nonetheless, we believe the SEC staff should rescind its informal position, even in the absence of an update to exchange listing standards to permit the listing of a registered fund of private funds. Interval funds and tender offer funds can be publicly offered and would provide retail investors with an appropriate alternative source of periodic liquidity in a manner consistent with investor protection.⁸

- C. *What types of advisory compensation arrangements would result in the most optimal alignment of economic interests between Main Street investors and the fund adviser? For example, would performance-based compensation better serve this goal? Or perhaps compensation in the form of fund shares? If so, how should we structure such relief?*

We acknowledge that performance-based compensation at the registered fund level or payment of management fees in fund shares are two possible ways to align the adviser's incentives with the interests of retail investors. However, we do not believe a specific advisory compensation arrangement is essential for a registered fund of private funds to be offered to retail investors in a manner consistent with investor protection. Rather, we believe it is most appropriate for the registered fund's board of directors to continue to review and evaluate the advisory compensation arrangement under Section 15 of the 1940 Act. In considering whether an advisory agreement is in the best interests of shareholders, a registered fund's board of directors may consider whether a particular compensation arrangement, such as performance-based compensation, would better serve shareholders.

- D. *Should registered funds limit exposure to private funds that are sponsored or advised by a single adviser? Would allocating assets across multiple advisers promote competition and minimize the risk of unattractive or unsuitable investments? What other risk measures could be put in place by closed-end funds of private funds that would diminish incentives for advisers to take undue risks?*

Depending on the breadth of a single asset manager's business, a registered fund of private funds that allocated to a single sponsor could provide similar diversification and risk mitigation benefits to a fund that invests in funds of multiple sponsors. Ultimately, the adviser to the registered fund would make allocation and investment decisions consistent with its fiduciary duty to the registered fund. If the adviser determined it was no longer appropriate or desirable to focus on a single sponsor, the adviser would adjust the registered fund's investment strategy accordingly. Accordingly, we do not believe that there should be any limitation that would prevent a registered fund of private funds from investing in the funds of a single private fund sponsor.

Nonetheless, we believe other conditions designed to encourage diversification at the registered fund level and prevent the registered fund from being used to seed or prop up private funds would be appropriate. Accordingly, we propose that a registered fund of private funds offered to retail investors be limited to (i) investing no more than 25% of its assets in any single private fund and

⁸ Indeed, interval funds and tender offer funds may be preferable structures to listed vehicles for sponsors and investors alike. From a sponsor's perspective, deploying capital that comes in over time as opposed to in one single offering may be beneficial from an asset deployment perspective given the underlying asset class. From an investor's standpoint, because listed closed-end funds sometimes trade at a discount, an unlisted vehicle may be more attractive because of the ability to redeem at net asset value, even if redemption opportunities are more limited than for a listed vehicle.

(ii) owning no more than 25% of the outstanding interests of any single private fund strategy managed by a sponsor.

E. *How can the structure be shaped in a manner that would not involve an extra layer of fees and expenses?*

The affiliated transaction restrictions in the 1940 Act currently prohibit a registered fund from investing in affiliated private funds managed by the same sponsor. As a result, a registered fund of private funds is unable to access private markets through a vehicle or entity advised by its adviser (or its control affiliate), even if the adviser determines consistent with its fiduciary duties that such investment is in the best interests of the regulated fund and its shareholders. Providing an exemption from this restriction would be the ideal way to mitigate fee-layering concerns associated with a fund of funds structure, as the sponsor could waive fees at either the registered fund or private fund level. Absent such an exemption, a third-party adviser is required for the registered fund, and that adviser should be compensated for their services.

In addition to fees paid to the adviser of the registered fund of private funds and the sponsors of the underlying private funds, retail investors also pay fees to financial intermediaries, such as brokers and dealers. Notwithstanding FINRA limits on compensation paid to such intermediaries (currently 8.5% of the offering price, or 7.25% if the fund charges a service fee), we propose that any registered fund of private funds that is offered to retail investors limit front-end sales loads or commissions to 3.5% of the offering price.

III. Conditions

The Committee believes that the SEC staff rescind its position limiting the offering of registered funds of private funds to accredited investors, provided that:

1. The registered fund of private funds only invests in private funds that are sponsored by managers with sufficient scale and expertise (as determined by the registered fund's adviser);
2. With respect to the portion of the registered fund of private funds' assets invested in private funds, the registered fund of private funds invests more than 80% of such assets in private funds that accept more than 50% of their capital commitments from qualified purchasers that are not natural persons or registered investment companies;
3. The registered fund of private funds provides periodic liquidity to investors in one of three ways: (i) listing on a national securities exchange (a listed closed-end fund); (ii) periodic mandatory repurchase offers (an interval fund); or (iii) periodic discretionary tender offers (a tender offer fund);
4. With respect to any registered fund of private funds that operates as a tender offer fund, the registered fund liquidates in an orderly fashion if during any consecutive 12-month period it has not made a tender offer;
5. The registered fund of private funds does not commit to invest more than 25% of its total assets in a single underlying private fund;

6. The registered fund of private funds does not commit to acquire more than 25% of the outstanding interests of any single underlying private fund; and
7. The registered fund of private funds limits front-end sales loads or commissions to 3.5% of the offering price.

We encourage the AMAC and its Private Investments Subcommittee to consider this course of action when formulating its own recommendations to the SEC.

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Thank you very much for your consideration of the Committee's position. Should you have any questions or concerns, please do not hesitate to contact the Committee's President, Professor Hal S. Scott (hscott@law.harvard.edu), or Executive Director, John Gulliver (jgulliver@capmksreg.org), at your convenience.



cc: Rajib Chanda, Simpson Thacher & Bartlett LLP