

April 18, 2022

Vanessa A. Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Release No. IA-5955; File Number S7-03-22

Dear Ms. Countryman:

Thank you for the opportunity to comment on the Securities and Exchange Commission's (the Commission or the SEC) Private Fund Advisers Proposal.<sup>1</sup> I disagree with the Proposal and respectfully urge the Commission to withdraw it.<sup>2</sup>

First, I believe that many aspects of the Proposal exceed the Commission's authority. The Proposal attempts to regulate a private fund by imposing disclosure obligations on its affiliated registered adviser. I disagree with this aspect of the Proposal for the following reasons:

- It would exceed the Commission's authority by seeking to eliminate the congressionally mandated distinction between private and public offerings;
- It would address alleged opacity in the private placement market, while ignoring the Commission's own efforts that discourage private issuers and investors from communicating;
- It would circumvent the measured approach Congress took when it chose to regulate hedge fund managers<sup>3</sup>;
- It would assert authority to adopt certain aspect of the Proposal by cherry picking references in the Investment Advisers Act of 1940 (Advisers Act), while ignoring their context; and
- It would presume authority to regulate fees-that the Commission does not have.

Second, the proposed specific prohibitions on self-dealing are at best superfluous and at worst undercut the concept that investment advisers owe broad fiduciary duties to their clients.

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<sup>1</sup> Release No. IA-5955 (Feb, 9, 2022); 87 FR 16886 (March 24, 2022) (the Proposal).

<sup>2</sup> My comments are entirely my own. I do not represent any client or organization. No one is paying me to write this letter.

<sup>3</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203; 124 Stat. 1376 (2010) (the Dodd Frank Act).

I discuss my concerns below.

## **The Proposal**

### *Disclosure Requirements*

The Proposal includes new Rule 211(h) that would require an adviser registered (or required to be registered) under Section 203 of the Advisers Act:

to prepare a quarterly statement that complies with paragraphs (a)-(g) of this section for any private fund that it advises, directly or indirectly, that has at least two full calendar quarters of operating results, and distribute the quarterly statement to the private fund's investors within 45 days after each calendar quarter end, unless such a quarterly statement is prepared and distributed by another person.

Subsequent subsections of the proposed rule would require the adviser to prepare quarterly statements for each private fund that it manages. These statements would include:

- A fund table;
- A portfolio investment table;
- An explanation of how the fund calculates expenses, payments, allocations, and other information;
- Disclosure of fund performance, distinguishing between liquid and illiquid funds; and
- A consolidated report to cover substantially similar pools of assets.

The Proposal would require such statements to be in a format that is clear and concise and uses plain English.

### *Objections*

#### *The Proposal Ignores the Distinction between Public and Private Offerings.*

The Commission has no authority to force registered investment advisers to disclose information about the private funds that the adviser manages. The Proposal would upend the regulatory framework that Congress established in the federal securities laws that distinguishes public and private offerings.

The Commission notes:

[P]rivate fund investments are often opaque; advisers frequently do not provide investors with sufficiently detailed information about private fund investments. Without sufficiently clear, comparable

information, even sophisticated investors would be unable to protect their interests or make sound investment decisions.

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Investors also often lack sufficient transparency into how private fund performance is calculated. Advisers frequently present fund performance reflecting different assumptions, making it difficult to measure and compare data across funds and advisers or compare the fund's performance to the investor's chosen benchmarks, even where the assumptions are disclosed.

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This lack of transparency regarding costs, performance, and preferential terms causes an information imbalance between advisers and private fund investors, which, in many cases, prevents private bilateral negotiations from effectively remedying shortcomings in the private funds market. We believe that this imbalance serves only the adviser's interest and leaves many investors without the tools they need to effectively protect their interests, whether through negotiations or otherwise.

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Enhanced information about costs, performance, and preferential treatment, would help an investor better decide whether to invest or to remain invested in a particular private fund, how to invest other assets in the investor's portfolio, and whether to invest in private funds managed by the adviser or its related persons in the future. More standardized information would improve comparability among private funds with similar characteristics.<sup>4</sup>

This suggestion may be interesting to some, but it is irrelevant in this rulemaking proceeding. Congress clearly did not empower the Commission to adopt disclosure rules for private placements.

As the Commission well knows, Congress created two channels for selling securities in interstate commerce:

- For public offerings, Congress required that issuers provide information to prospective investors, who lacked the means and the sophistication to demand answers to questions about a prospective offering. Under the authority of the Securities Act and the Exchange Act, the Commission has refined its integrated disclosure system to provide material information to public investors.

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<sup>4</sup> Proposal, at 16888.

- For private placements, Congress concluded that investors with sophistication and financial means did not need the government's help obtaining information about a proposed offering.<sup>5</sup> Congress concluded that investors in private placements would fend for themselves and were in a position to demand information that they deemed necessary before investing their funds. Of course, Congress enacted Section 17(a) of the Securities Act, among other provisions, to protect investors from fraud, whether the offering was public or private.

In the intervening almost ninety-years, Congress amended and expanded the federal securities laws numerous times. Congress never once altered the fundamental distinction between public and private offerings. Moreover, Congress has never authorized the Commission to condition private placements by requiring that registered entities provide disclosures that the Commission mandated.

Since 1934 for broker-dealers, and 1940 for investment advisers, Congress and the Commission have recognized (and indeed required) that under most circumstances, certain entities must register with the Commission when they are involved in selling or providing investment advice with respect to many types of securities, whether public or private.

The Proposal would eliminate this fundamental aspect of Congress's statutory scheme and for the first time, would seek to use its authority over investment advisers to mandate disclosure requirements for private offerings. Such an approach will not withstand judicial scrutiny.

I am aware of no other instance in which the Commission has mandated private fund disclosure by imposing rules on an investment adviser or broker-dealer.<sup>6</sup> In a limited number of instances, the Commission has required issuers that choose to use Regulation D to provide some

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<sup>5</sup> Section 4(1) of the original Securities Act provides:

SEC. 4. The provisions of section 5 shall not apply to any of the following transactions:

- (1) Transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not with or through an underwriter and not involving any public offering.....

H.R. 5480, Securities Act of 1933, 73d. Cong. Sess. I.

<sup>6</sup> For example, Regulation D conditions the sale of private placements on the issuer's disclosure of specified information to a purchaser who is not an accredited investor. 17 CFR §230.502(b) provides:

- (b) Information requirements— (1) When information must be furnished. If the issuer sells securities under §230.506(b) to any purchaser that is not an accredited investor, the issuer shall furnish the information specified in paragraph (b)(2) of this section to such purchaser a reasonable time prior to sale. The issuer is not required to furnish the specified information to purchasers when it sells securities under § 230.504, or to any accredited investor.

information to investors.<sup>7</sup> By its own terms, Regulation D only applies to issuers.<sup>8</sup> Further, the federal securities laws do not require an issuer to offer privately placed securities in accordance with Regulation D.<sup>9</sup> By contrast, the proposal would mandate that advisers to private funds make the disclosures that the Proposal outlines. Such a requirement is unique and inconsistent with the statutory framework of the federal securities laws.

*The Commission is objecting to an opaque market that it helped create.*

The Commission's objections to the lack of transparency in the private placement market are remarkable for another reason. For a period of nearly ninety years, the Commission strenuously has discouraged issuers from disclosing information about private placements, except under the most limited of circumstances.<sup>10</sup> Perhaps most importantly, the Commission has refused to define what is, and what is not, general solicitation.<sup>11</sup> As a consequence, issuers face a legal

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<sup>7</sup> There appears to be a typographical error in the Code of Federal Regulations version of [Regulation D](#).

**§ 230.501 Definitions and terms used in Regulation D.**

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(e) Calculation of number of purchasers. For purposes of calculating the number of purchasers under § 230.506(b) and 230.506(b) only, the following shall apply....

I believe that the second reference is incorrect and should be "506(c)" not "506(b)".

<sup>8</sup> Regulation 501(d) provides:

Regulation D is available only to the issuer of the securities and not to any affiliate of that issuer or to any other person for resales of the issuer's securities. Regulation D provides an exemption only for the transactions in which the securities are offered or sold by the issuer, not for the securities themselves.

<sup>9</sup> Regulation 501(c) provides:

Attempted compliance with any rule in Regulation D does not act as an exclusive election; the issuer can also claim the availability of any other applicable exemption. For instance, an issuer's failure to satisfy all the terms and conditions of rule 506(b) (§230.506(b)) shall not raise any presumption that the exemption provided by section 4(a)(2) of the Act (15 U.S.C. 77d(2)) is not available.

<sup>10</sup> *E.g.*, Release 33-4552 (Nov. 6, 1962); 27 FR11316 (Nov. 16, 1962). This release notes:

Negotiations or conversations with or general solicitations of an unrestricted and unrelated group of prospective purchasers for the purpose of ascertaining who would be willing to accept an offer of securities is inconsistent with a claim that the transaction does not involve a public offering even though ultimately there may only be a few knowledgeable purchasers.

The Commission reiterated this view in the adopting release *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*. Release No. 33-9415 (July 10, 2013); 78 FR 44771 (July 24, 2013), at note 40

<sup>11</sup> For example, in a description of Section 4(a)(2) of the Securities Act, the Commission notes:

environment in which the boundary lines are invisible to all but the Commission. Understandably, issuers are reluctant to release information that, with the benefit of hindsight, the Commission could characterize as general solicitation. Issuers that explore the limits of the unseen boundary risk violating Section 5 of the Securities Act, among other provisions.<sup>12</sup> The legal and economic penalties of such a mistake are substantial. As a consequence, diligent issuers are very circumspect about the information that they reveal and under what circumstances.

I appreciate that the Proposal refers to information that issuers provide to investors, not information that the issuer releases publicly.<sup>13</sup> Nonetheless, the Commission ignores this history and now complains about the lack of transparency in a market that it worked so diligently to make opaque. More sunlight might have encouraged issuers to provide prospective investors and existing with more information, and created the opportunity for more comparison shopping. Instead, the Commission has created an environment that encourages opacity and timidity.

Congress has granted the Commission the means to address this concern.

First, it could clarify the scope of the private placement exemption and general solicitation. The Commission has resisted establishing clearer guidelines for decades, fearing that such a line-drawing exercise would be underinclusive.<sup>14</sup> But the Commission's unwillingness

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The precise limits of the private placement exemption are not defined by rule. As the number of purchasers increases and their relationship to the company and its management becomes more remote, it is more difficult to show that the offering qualifies for this exemption. If your company offers securities to even one person who does not meet the necessary conditions, the entire offering may be in violation of the Securities Act.

SEC Website, [Small Business Exempt Offerings, Private Placements – Rule 506\(b\)](#).

One notable departure from this policy is Regulation S regarding off-shore offerings. 17 C.F.R. §230.901 through §230.904.

<sup>12</sup> *E.g.*, Section 12(a)(1) of the Securities Act.

<sup>13</sup> The Release indicates some confusion as to which problem the Commission seeks to address. For the reader's convenience, I repeat some information noted above. Proposed Rule § 275. 211(h)(1)–2(a) would provide:

Quarterly statements. As a means reasonably designed to prevent such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative, an investment adviser that is registered or required to be registered under section 203 of the Investment Advisers Act of 1940 shall prepare a quarterly statement that complies with paragraphs (a) through (g) of this section for any private fund that it advises, directly or indirectly, that has at least two full calendar quarters of operating results, and **distribute the quarterly statement to the private fund's investors** within 45 days after each calendar quarter end, unless such a quarterly statement is prepared and distributed by another person. **[Emphasis added]**

Release, at 16976.

However, the discussion notes:

Enhanced information about costs, performance, and preferential treatment, would help an investor better decide **whether to invest** or to remain invested in a particular private fund, how to invest other assets in the investor's portfolio, and **whether to invest in private funds managed by the**

to define the private placement exemption and to define general solicitation with greater clarity needlessly has raised the cost of capital for issuers and unnecessarily limited investors' choices.

Second, the Commission strongly could encourage issuers to make use of Rule 506(c) under the Securities Act.<sup>15</sup> Section 201(a) of Title II of the JOBS Act directed the Commission to revise Rule 506 under the Securities Act. As the Commission knows, this provision states “that the prohibition against general solicitation or general advertising contained in section 230.502(c) of such title shall not apply to offers and sales of securities made pursuant to section 230.506, provided that all purchasers of the securities are accredited investors.” The Commission adopted Rule 506(c) in accordance with Congress's mandate. The Commission could indicate that such offerings offer the opportunity for greater transparency and might lower the cost of capital. With such encouragement, more issuers might employ Rule 506(c) and more competition might increase transparency.<sup>16</sup>

Chairman Gary Gensler recently stated: “If we can use our authorities to bring greater transparency and competition into that market, that helps portfolio companies on the one hand, and the pensions and endowments that are investing in that space on the other.”<sup>17</sup> The steps outlined above would be more effective at achieving these goals, rather than a “command and control” approach of mandating certain disclosures.

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**adviser or its related persons in the future.** More standardized information would improve comparability among private funds with similar characteristics. This information also would help a private fund investor better monitor and assess the true cost of its investments, the value of the services for which the fund is paying, and potential conflicts of interest. **[Emphasis added]**

Release, at 16888

If the proposed rule only would require an investment adviser to provide information to existing investors, it is difficult to understand how it would achieve the Commission's broader goal of improving transparency both for existing and potential investors. Improving transparency for potential investors would require the Commission to address the general solicitation issue noted above.

Moreover, by proposing a rule that mandating that advisers provide disclosure to fund investors, the Commission's proposal may be inconsistent with the Dodd Frank Act's prohibition that the SEC may not redefine the term “customer” in a private fund. *See* discussion below.

<sup>14</sup> An issuer that seeks to comply with Rule 506(b) (17 CFR §230.506(b)) of Regulation D must comply with, among other provisions, Rule 502(c), which limits the manner of offering. Rule 506(b) provides a safe harbor with respect to offerees, but does not provide any guidance with respect to the definition of general solicitation.

<sup>15</sup> 17 CFR §230.506(c).

<sup>16</sup> The Commission also might issue guidance under Rule 506(b) that would remove some impediments to greater transparency, while staying within the boundaries of that rule.

<sup>17</sup> The Honorable Gary Gensler, Chairman, SEC, Prepared Remarks: “[Dynamic Regulation for a Dynamic Society](#)” Before the Exchequer Club of Washington, D.C., Jan. 19, 2022.

*The Proposal Ignores the Dodd Frank Act's Approach to Regulating Hedge Fund Managers*

When Congress enacted the Dodd Frank Act, it amended the Advisers Act to provide for the registration of advisers to private funds. The Dodd Frank Act did not impose disclosure obligations on advisers to private funds. Congress clearly chose not to subject private funds to the requirements of the Investment Company Act of 1940 (1940 Act) or to create some new public disclosure system for private funds. Section 403 of the Dodd Frank Act amended the Advisers Act as to provide for the registration of advisers to private funds and nothing more.<sup>18</sup> That provision added another subsection to Section 204(b) of the Advisers Act that provides as follows:

The Commission may require any investment adviser registered under this title—

(A) to maintain such records of, and file with the Commission such reports regarding, private funds advised by the investment adviser, as necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk by the Financial Stability Oversight Council (in this subsection referred to as the ‘Council’); and

(B) to provide or make available to the Council those reports or records or the information contained therein.

Additional provisions ensure that the Commission, the Council, and other Council members protect the confidentiality of the information. Although the provision incidentally grants more conventional recordkeeping authority to the Commission for the purpose of protecting the public and investors, the primary focus of this provision is to equip the Council to identify potential systemic risks in the financial system.

These amendments clearly do not authorize the Commission to establish a disclosure system for private funds. They also do not permit the Commission to circumvent these provisions by requiring registered advisers to disclose information about the private funds that they manage.

Other provisions of the Dodd Frank Act carefully limit the Commission’s authority over private funds. For example, Section 406 amends the Commission’s rulemaking authority in Section 211(a) of the Advisers Act. That amendment states that “the Commission may not define the term ‘client’ for purposes of paragraphs (1) and (2) of section 206 to include an investor in a private fund managed by an investment adviser, if such private fund has entered into an advisory contract with such adviser ....”<sup>19</sup>

The Commission erroneously claims that the Dodd Frank Act gave it plenary authority to adopt the rules included in the Proposal. The Proposal notes that Section 913(h) of the Dodd Frank

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<sup>18</sup> See Attachment.

<sup>19</sup> As discussed below, Congress added a similar provision to Section 211(g).



Act amended Section 211 of the Advisers Act, authorizing the Commission to adopt these disclosure rules.

The Dodd-Frank Act also added section 211(h) to the Advisers Act, which, among other things, directs the Commission to “facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with...investment advisers” and “promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for investment advisers.”<sup>20</sup>

The Commission is misreading Section 913(h) in the hope of achieving a purpose that Congress rejected. Congress enacted Section 913 in response to the longstanding concern that retail investors did not appreciate the distinctions between investment advisers and broker-dealers. It is important to examine Section 913 in its entirety.

- Section 913(a) through (e) require that the SEC conduct a study that focuses on retail investors who receive personalized advice about securities from a broker-dealer or an investment adviser. Congress outlined numerous issues that the study should encompass required that the Commission submit the report to Congress.
- Section 913(f) authorizes the Commission to undertake a rulemaking for the public interest and the protection of *retail* customers “to address the legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to such retail customers.”
- Section 913(g) – Authority to Establish A Fiduciary Duty For Brokers and Dealers.

(1) This provision amends Section 15 of the Exchange Act, adding a new subsection (k). This addition authorizes the Commission to establish a fiduciary standard for broker-dealers when providing advice to retail customers. Although the provision also includes authority for the Commission to adopt rules for other customers, Congress focused on retail investors. This provision applies to broker-dealers and not to investment advisers.

(2) This subsection amends Section 211 of the Advisers Act in a similar fashion.<sup>21</sup> It is important to note that after the provisions equalizing the fiduciary standard primarily for retail customers, Congress stated: “the Commission shall not ascribe a meaning to the term ‘customer’ that would include an investor in a private fund managed by an

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<sup>20</sup> Proposal, at 16887 and accompanying note 4.

<sup>21</sup> There appears to be some confusion in the heading of Section 913 of the Dodd Frank Act. Section 913(g) states “Authority to Establish A Fiduciary Duty for Broker and Dealers,” and subsection (1) addresses broker-dealers. However, subsection (2) amended Section 211 of the Advisers Act to authorize the Commission to adopt rules regarding “the standard of conduct for brokers, dealers, and investment advisers.” This subsection adds subsection (g) to Section 211 of the Advisers Act even though there is no subsection (f).

investment adviser, where such private fund has entered into an advisory contract with such adviser.” [Emphasis added.]

Congress wanted the Commission to use this new authority to equalize and inform investors about the differing services and obligations that broker-dealers and investment advisers provide to customers.<sup>22</sup> Congress did not intend for the Commission to use this authority as a basis for interfering with the legal framework governing investors in private funds.

- Section 913(h) – Other Matters. This provision directs the Commission to:
  - (1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest; and
  - (2) examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.

In subsection (1), Congress does not grant the Commission any specific authority, but only directs it to “facilitate” simple and clear disclosure. Subsection (2) does grant the Commission rulemaking authority. Fairly read, this provision only applies to the numerous provisions above it regarding the Congress’s focus on retail investors obtaining advice from broker-dealers and investment advisers. It is at best a clarifying amendment that Congress included to allow the Commission to make modest changes to achieve the goals Congress established in Section 913 of the Dodd Frank Act.<sup>23</sup>

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<sup>22</sup> Form CRS, Release No. 34-86032 (June 5, 2019); 84 FR 33492 (July 12, 2019); Regulation Best Interest, Release No. 34-86031, (June 5, 2019); 84 FR 3318 (July 12, 2019). *See also* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Release IA-5248 (June 5, 2019); 84 FR 33669 (July 12, 2019); and Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, IA-5249 (June 5, 2019); 84 FR 33681 (July 12, 2019).

<sup>23</sup> There is further evidence that Congress did not intend Section 211(h) of the Advisers Act to grant the broad authority relating to private funds that the Commission claims. Section 406 of the Dodd Frank Act amended Section 211 of the Advisers Act by adding a new subsection (e) – “Disclosure Rules of Private Funds.” This provision provides:

The Commission and the Commodity Futures Trading Commission shall, after consultation with the Council but not later than 12 months after the date of enactment of the Private Fund Investment Advisers Registration Act of 2010, jointly promulgate rules to establish the form and content of the reports required to be filed with the Commission under subsection 204(b) and with the Commodity Futures Trading Commission by investment advisers that are registered both under this title and the Commodity Exchange Act (7 U.S.C. 1a et seq.)

Section 204(b) of the Advisers Act refers to the confidential records related to investor protection and systemic risk that the Financial Stability Oversight Council requires. Section 211(e) precedes Sections 211(g), (h), and (i) of the Advisers Act, relating to the standard of conduct for retail investors. (As noted, there is no subsection (f).) Although Congress amended Section 211 of the Advisers Act in two separate provisions of the Dodd Frank Act, the private fund provision and the standard of conduct provision are immediately adjacent to each other in the statute. It is

It is this provision to which the Commission points as granting it plenary power to impose disclosure requirements on advisers to private funds. Such a suggestion ignores both the context of the entire provision, the specific prohibition in Section 211(g)(1) of the Advisers Act, and the overall framework for private funds that Congress created.

In summary, both Sections 406 and 913(g) of the Dodd Frank Act amended Section 211 of the Advisers Act direct the Commission not to adopt rules that would alter the relationship of advisers and private funds. Despite including two admonitions to the contrary, the Commission seeks to do exactly what Congress expressly prohibited by twisting the language of an incidental provision that serves an entirely different purpose. More significantly, the Commission's reading of Section 211(h) misinterprets one minor provision of the Dodd Act and seeks to use it as justification for upsetting nearly 90 years of securities law and the more recent careful balance that Congress struck when subjecting hedge fund managers, but not hedge funds, to regulation under the federal securities laws.

### *Prohibited Activity Rule*

#### *Fee Prohibition*

The Commission is proposing rule 211(h)(2)-1 that would prohibit an investment adviser to a private fund from directly or indirectly imposing any of the following with respect to the private fund, or any investor in that private fund:

- (1) Charge a portfolio investment for monitoring, servicing, consulting, or other fees in respect of any services that the investment adviser does not, or does not reasonably expect to, provide to the portfolio investment;
- (2) Charge the private fund for fees or expenses associated with an examination or investigation of the adviser or its related persons by any governmental or regulatory authority;
- (3) Charge the private fund for any regulatory or compliance fees or expenses of the adviser or its related persons;
- (4) Reduce the amount of any adviser clawback by actual, potential, or hypothetical taxes applicable to the adviser, its related persons, or their respective owners or interest holders;
- (5) Seek reimbursement, indemnification, exculpation, or limitation of its liability by the private fund or its investors for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to the private fund;

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inconceivable that Congress intended Section 211(h) to grant the broad private fund disclosure authority it claims when Congress spoke with such precision within the same section of the Advisers Act.

(6) Charge or allocate fees and expenses related to a portfolio investment (or potential portfolio investment) on a non-pro rata basis when multiple private funds and other clients advised by the adviser or its related persons have invested (or propose to invest) in the same portfolio investment; and

(7) Borrow money, securities, or other private fund assets, or receive a loan or an extension of credit, from a private fund client.

The Commission does not explain why it believes billionaire investors, major institutions, or sovereign wealth funds are too timid to ask about the fees that the funds charge or to decline to invest in funds that impose fees to which the investor objects. It also does not have authority to “protect” some qualified purchases and not others.

Furthermore, the Commission does not have authority to regulate fees for most private funds. Section 205(a) of the Advisers Act grants the Commission authority regulate fees in certain circumstances. However, Subsection (b) includes the following exception:

(b) Paragraph (1) of subsection (a) shall not—

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(4) apply to an investment advisory contract with a company excepted from the definition of an investment company under section 3(c)(7) of title I of this Act

Most hedge funds rely on the exclusion in Section 3(c)(7) of the 1940 Act. Unless the Commission is directing its request for comment to other types of funds, Congress has stated clearly that the Commission may not regulate advisory fees for (3)(c)(7) funds. The Commission would need an act of Congress to impose such restrictions<sup>24</sup>

I assume that the Commission again is relying primarily on Section 211(h) of the Advisers Act to adopt a rule limiting fees. As noted above, Section 211(h) does not confer such sweeping authority on the Commission, but is limited to a very narrow context. It is not sensible to assume that such a minor provision *sub silentio* overturned Section 205(b)(4) of the Advisers Act and that Congress did so with no comment. Further, it is inconsistent with the statutory scheme for the Commission to try to use its authority over advisers to impose conditions on private funds. Section 3(c)(7) of the 1940 Act is not an exemption; it excludes private funds from the very definition of “investment company.”

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<sup>24</sup> The Proposal also asks: “should we establish maximum fees that advisers may charge at the fund level? Should we prohibit certain compensation arrangements, such as the ‘2 and 20’ model? Proposal at 16891. The Proposal at note 265 cites various news stories indicating that “2 and 20” is the exception, not the rule. If the marketplace indicates that investors are able to negotiate fee arrangements, why should the Commission consider imposing fee restrictions on a competitive market (assuming *arguendo* that it has the authority to do so)?

By proposing the rules discussed above, the Commission is seeking to circumvent specific limitations on its authority by asserting a general authority over investment advisers. As noted, this approach is inconsistent with broad principles of the federal securities laws as well as with its specific prohibitions. The Commission may wish to recall Section 20(b) of the Exchange Act. That subsection provides that “it shall be unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the provisions of this title or any rule or regulation thereunder through or by means of any other person.” Although Congress did not apply this prohibition to the SEC itself, the Commission would do well to recall its purpose.

### *Anti-Conflict of Interest Provisions*

The Proposal includes a new rule 211(h)(2)-3, which includes a number of specific prohibitions to prevent favoring some fund investors over others. The Proposal explains:

Private funds typically lack governance mechanisms that would help check overreaching by private fund advisers. For example, although some private funds may have limited partner advisory committees (“LPACs”) or boards of directors, these types of bodies may not have the necessary independence, authority, or accountability to oversee and consent to these conflicts or other harmful practices. Private funds also do not have comprehensive mechanisms for private fund investors to exercise effective governance, which is exacerbated by the fact that private fund advisers often provide certain investors with preferential terms that can create potential conflicts among the fund’s investors. Moreover, the interests of one or more private fund investors may not represent the interests of, or may otherwise conflict with the interests of, other investors in the private fund due to, among other things, business or personal relationships or other private fund investments.<sup>25</sup>

The Proposal is suggesting that advisers have no limitations on their activities because of the lack of certain governance provisions in some private funds. As a consequence, the Commission deems it necessary to establish specific prohibitions against favoring some investors in funds over others.<sup>26</sup>

This is a remarkable argument for the Commission to make. As the Commission well knows, investment advisers are fiduciaries.<sup>27</sup> By adopting a specific set of prohibitions, the Commission would undercut the broad prohibitions against any type of self-dealing or favoring some investors at the expense of others. Instead, it would start down the road of enumerating specific prohibitions, *i.e.*, a “check the box approach.” Moreover, the presence or absence of one fund governance structure or another has no effect on whether an adviser is a fiduciary or whether

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<sup>25</sup> Proposal, at 16889.

<sup>26</sup> The Proposal would add 17 CFR §275.211(h)(2)-3.

<sup>27</sup> Securities and Exchange Commission v. Capital Gains Research Bureau, Inc. et al., 375 U.S. 180 (1963)

its activities are consistent with the fiduciary standard. The animating philosophy of the Advisers Act is for advisers to treat their customers with the fiduciary standard of care.<sup>28</sup> The Commission should not abandon that approach, which has served investors and the public so well.

## Conclusion

For both legal and public policy reasons discussed above, I strongly urge the Commission to withdraw the Proposal. As discussed, the Proposal includes several proposed regulations that would exceed the Commission's authority and would be inconsistent with one of the key principles underlying the federal securities laws. Moreover, the Proposal has not demonstrated that the Proposal would meet the standard that Congress established in Section 202(c) of the Advisers Act.<sup>29</sup> Assuming *arguendo* that the Commission has authority to adopt the proposed disclosure rules, it has not identified any market failure that would justify them.

If the Commission adopts the proposed disclosure and fee rules, it is likely to face an outcome similar to when it sought to “correct” by rule the exemption from registration that existed for advisers with fewer than 15 clients<sup>30</sup> and when it sought to repeal the Glass Steagall Act on its own by adopting Rule 3b-9 under the Exchange Act.<sup>31</sup> If the Commission wishes to advance the public policy goals that it uses to justify these rule proposals, it should present its arguments to Congress.

By adopting specific prohibitions on self-dealing or dealing unfairly with investors, the Commission will undermine the broad fiduciary standard that prohibits improper activity of every stripe. It will move the Commission and the investment advisory industry away from a broad

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<sup>28</sup> See Commission [Interpretation](#) Regarding Standard of Conduct for Investment Advisers, Release No. IA-5248 (June 5, 2019); 84 FR 33669 (July 12, 2019).

<sup>29</sup> Section 202(c) of the Advisers Act provides:

CONSIDERATION OF PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION. — Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

See discussion of fees, *supra*.

<sup>30</sup> [Goldstein v. SEC](#), 451 F.3d 873 (D.C. Cir. 2006).

<sup>31</sup> [American Bankers Association v. SEC](#), 804 F.2d 739 (D.C. Cir. 1986).

fiduciary standard to a check the box mentality. That change will not benefit investors or the public.

I would be happy to meet with Members of the Commission or the Staff to discuss my concerns at your convenience.

Respectfully submitted,

/s/

Stuart J. Kaswell, Esq.

**Attachment**

## Attachment

Prior to the Dodd Frank Act, §203(b) of the Investment Advisers Act provided an exemption from registration to:

(b) The provisions of subsection (a) shall not apply to—

(1) any investment adviser all of whose clients are residents of the State within which such investment adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange;

\*\*\*\*\*

(3) Any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as an investment adviser nor acts as an investment adviser registered under title I of this Act....For purposes of determining the number of clients of an investment adviser under this paragraph, no shareholder, partner, or beneficial owner of a business development company, as defined in this title, shall be deemed to be a client of such investment adviser unless such person is a client of such investment adviser separate and apart from his status as a shareholder, partner, or beneficial owner.

\*\*\*\*\*

(6) any investment adviser that is registered with the Commodity Futures Trading Commission as a commodity trading advisor whose business does not consist primarily of acting as an investment adviser, as defined in section 202(a)(11) of this title, and that does not act as an investment adviser to –

(A) an investment company registered under title I of this Act; or

(B) a company which has elected to be a business development company pursuant to section 54 of title I of this Act and has not withdrawn its election.

\*\*\*\*\*

When Congress enacted the Dodd Frank Act, it amended the registration provisions of the Investment Advisers Act as follows:

Section 203(b) of the Investment Advisers Act of 1940 (15



U.S.C. 80b-3(b)) is amended—

(1) in paragraph (1), by inserting “, other than an investment adviser who acts as an investment adviser to any private fund,” before “all of whose”;

(2) by striking paragraph (3) and inserting the following:

“(3) any investment adviser that is a foreign private adviser;” and

(3) in paragraph (5), by striking “or” at the end;

(4) in paragraph (6)—

(A) by striking “any investment adviser” and inserting “(A) any investment adviser”;

(B) by redesignating subparagraphs (A) and (B) as clauses (i) and (ii), respectively; and  
(C) in clause (ii) (as so redesignated), by striking the period at the end and inserting “; or”;  
and

(D) by adding at the end the following:

“(B) any investment adviser that is registered with the Commodity Futures Trading Commission as a commodity trading advisor and advises a private fund, provided that, if after the date of enactment of the Private Fund Investment Advisers Registration Act of 2010, the business of the advisor should become predominately the provision of securities-related advice, then such adviser shall register with the Commission.”.

The marked-up version (“Ramseyer”) provides:

Section 203(a) Except as provided in subsection (b) and Section 203A, it shall be unlawful for any investment adviser, unless registered under this section, to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser.

Section 203(b) -- The provisions of subsection (a) shall not apply to—

(1) any investment adviser, *other than an investment adviser who acts as an investment adviser to any private fund*, all of whose clients are residents of the State within which such investment adviser maintains his or its principal office and place of business, and who does not furnish advice or issue analyses or reports with respect to securities listed or admitted to unlisted trading privileges on any national securities exchange;

\*\*\*\*\*

(3) ~~Any investment adviser who during the course of the preceding twelve months has had fewer than fifteen clients and who neither holds himself out generally to the public as~~

~~an investment adviser nor acts as an investment adviser registered under title I of this Act....For purposes of determining the number of clients of an investment adviser under this paragraph, no shareholder, partner, or beneficial owner of a business development company, as defined in this title, shall be deemed to be a client of such investment adviser unless such person is a client of such investment adviser separate and apart from his status as a shareholder, partner, or beneficial owner.~~

(3) *any investment adviser that is a foreign private adviser;*

(4) \*\*\*\*\*

(5) \*\*\*\*\*

(6) ~~any investment adviser~~

(A) *any investment adviser that is registered with the Commodity Futures Trading Commission as a commodity trading advisor whose business does not consist primarily of acting as an investment adviser, as defined in section 202(a)(11) of this title, and that does not act as an investment adviser to --*

~~(A)~~ *(i) an investment company registered under title I of this Act; or*

~~(B)~~ *(ii) a company which has elected to be a business development company pursuant to section 54 of title I of this Act and has not withdrawn its election; or*

*(B) any investment adviser that is registered with the Commodity Futures Trading Commission as a commodity trading advisor and advises a private fund, provided that, if after the date of enactment of the Private Fund Investment Advisers Registration Act of 2010, the business of the advisor should become predominately the provision of securities-related advice, then such adviser shall register with the Commission.*

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