THE CITY OF NEW YORK
OFFICE OF THE COMPTROLLER
BRAD LANDER

April 21, 2022

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-03-22: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews

Dear Secretary Countryman,

This comment letter is in response to Release No. IA-5955; File No. S7-03-22 (the "Release") in which the U.S. Securities and Exchange Commission (the "Commission" or the "SEC") solicits comments on proposed new rules under the Investment Advisers Act of 1940 (the "Advisers Act"), as set forth in the Release (the "Proposed Rules").

The Office of the Comptroller of the City of New York (the "Comptroller's Office" or "we") appreciates the opportunity to provide comments to the Commission regarding the Proposed Rules. We respectfully submit the following comments and request that the SEC consider them before adopting the Proposed Rules.

Overall, we support the enhanced investor protections provided by the Proposed Rules, which we believe are valuable in providing greater transparency about the full cost of investing in and the performance of private funds, prohibiting conflicts of interest, and providing a more level playing field to enhance fairness and competition in the marketplace. The Comptroller's Office joined other public pension fund fiduciaries in requesting some of these rules in a letter to the SEC in 2015.

At the same time, we feel strongly that certain clarifications and modifications to the Proposed Rules are necessary to address potential negative implications for government pension plans and similar types of investors, and to better protect investors from conduct that is inconsistent with the Advisers Act.

Background

The Comptroller's Office serves as the investment adviser to the New York City Employees' Retirement System, the Teachers' Retirement System of the City of New York, the New York City

Fire Department Pension Fund, the New York City Police Pension Fund and the Board of Education Retirement System of the City of New York (collectively, the "New York City Retirement Systems"). As of January 2022, the New York City Retirement Systems had approximately $266 billion in aggregate assets under management, of which approximately $21.5 billion was invested in private equity private funds, approximately $14.3 billion was invested in real estate private funds, approximately $4 billion was invested in hedge funds, approximately $3.9 billion was invested in infrastructure private funds, and approximately $23.5 billion was invested in opportunistic fixed income funds and high yield investments. As the investment adviser to one of the largest government pension plans in the United States and an active participant in private fund investments, the Comptroller's Office has extensive experience reviewing terms of private funds, negotiating fund documentation with private fund advisers and overseeing and monitoring investments in private funds. Accordingly, the Comptroller's Office staff is very familiar with private fund terms and potential issues that arise in private fund transactions.

The Comptroller's Office recognizes and appreciates the efforts of our private fund advisers to secure the retirement of teachers, firefighters, police officers and other city employees by being an important source of return to meet the New York City Retirement Systems' financial obligations. Given the private fund investments of the New York City Retirement Systems, the Proposed Rules would benefit the New York City Retirements Systems and their ultimate pension beneficiaries by providing all investors with much needed transparency in the private funds market. The Proposed Rules would also formalize long-held policy goals promoted by the Comptroller's Office on behalf of the New York City Retirement Systems that we believe are in the best interests of investors and address certain terms that private fund advisers have been unwilling to agree to, or even negotiate, with investors, notwithstanding SEC guidance that such terms are inconsistent with investor protection and fiduciary standards under the Advisers Act.

(1) Preferential Treatment

Under §275.211(h)(2)-3 (Preferential Treatment), the Proposed Rules would prohibit all private fund advisers from (a) granting investors preferential redemption rights that the adviser reasonably expects to have a material, negative effect on other investors in that fund, (b) providing information regarding the portfolio holdings or exposures to any investor that the adviser reasonably expects would have a material, negative effect on other investors in that fund, and (c) providing any other preferential treatment to any investor unless such preferential terms are disclosed to prospective and current investors in the same fund (collectively, the "Preferential Treatment Rules").

The Comptroller's Office supports the Preferential Treatment Rules and believes that these rules would protect investors from being disadvantaged by other investors' preferential liquidity and information rights and provide a more transparent and level playing field for all investors with respect to fund terms. However, the Comptroller's Office also strongly urges the Commission to consider, and address by applicable revisions to the final version of these rules, significant challenges investors may face under the Preferential Treatment Rules arising from (a) the lack of sufficient guidance on the potential impact on existing fund documents, (b) the unique liquidity needs of government pension plans related to their legal, regulatory and/or policy requirements, (c) the inadequacy of information and redemption rights under hedge fund documentation, and (d) the different information needs of investors that act as members of a limited partner advisory committee (the "LPAC") of a fund, given that members of an LPAC typically exercise governance and oversight functions on behalf of all investors in the fund.

(a) Lack of Sufficient Guidance on Potential Impact on Existing Fund Documents

The Preferential Treatment Rules do not provide sufficient guidance on the treatment of preferential terms in existing fund documents following the adoption of these rules. The Comptroller's Office believes that such lack of additional guidance would inevitably lead to ambiguity surrounding existing fund documents which could significantly harm investors in many existing funds. Without additional guidance from the SEC, current investors in existing funds are likely to experience difficulty in enforcing their existing rights and would incur, as a result, significant operational burdens and legal expenses. We believe that this would create an untenable situation and may lead to many existing funds potentially being in violation of the Preferential Treatment Rules. If amendments to existing fund documents and side letters were required, it would not only be impractical given the high number of currently existing private funds, but could re-open other existing fund terms for negotiation and leave investors with worse terms than they have today. Furthermore, redemption and information rights are most relevant in the context of hedge funds and other open-ended funds where such rights provide crucial protections and remedies to fund investors. We strongly encourage the SEC to prioritize providing clear guidance to investors and private fund advisers with respect to the treatment of preferential terms in existing fund documents following the adoption of these rules.

In order to minimize the potential harmful effects on investors and prevent potential market disruption, the Comptroller's Office believes it would be reasonable for the Preferential Treatment Rules, in their final format, to apply only on a going forward basis to open-ended funds and for existing arrangements in open-ended funds to be "grandfathered" in as permissible under the Preferential Treatment Rules.

(b) Unique Liquidity Needs of Government Pension Plans

As provided in the Release, the SEC requested comments on whether there are certain investors who require different liquidity terms. Government pension plans and other similar investors are such investors as they are subject to certain regulations, laws or policies that lead them to require specific redemption terms in order to be able to invest into the private funds while still complying with such regulations, laws and policies.

The Comptroller's Office considers side letters essential to the ability of the New York City Retirement Systems to invest in private funds, as means of securing critical governance, statutory, or regulatory protections that may not be included in the Limited Partnership Agreements. Side letters allow for provisions that accrue critical benefits to institutional investors without negatively harming other investors in the fund. By way of example, the New York City Retirement Systems (similar to other government pension plans) have in place a placement agent ban policy, as well as policy requiring compliance with the "pay-to-play" rules of the Advisers Act. The application of these two policies results in the Comptroller's Office, on behalf of the New York City Retirement Systems, requiring different liquidity terms in their private funds. Specifically, in connection with investments in hedge funds, we require a right to be able to redeem the investment without being subject to any gates and without incurring any penalty (including any redemption, withdrawal, lock-up or similar fees), if the investment adviser or manager has violated the placement agent ban policy or the "pay-to-play" rules applicable to such investor. We believe that this remedy serves as a highly effective deterrent ensuring that investment advisers comply with placement agent policy bans and with the "pay-to-play" rules.

The Comptroller's Office encourages the SEC to modify the Preferential Treatment Rules to permit different/preferential liquidity terms for those investors that are required to obtain such terms because of policies, regulations and laws that are applicable to those investors or where the continued participation by a government plan in such fund would result in violations of law, regulation or policy applicable to such government plan. Permitting preferential liquidity for legal, regulatory and policy reasons should not be considered as disadvantageous to other investors because these preferential redemption rights are not necessarily triggered at a time of stress on a fund's liquidity or in connection with an event where many other investors in such funds want to exercise their redemption rights and, as a result, such terms are not reasonably expected to have a material, negative effect on other investors in that fund. Accordingly, the SEC should clarify that following the adoption of the Preferential Treatment Rules, institutional investors, such as government pension plans, would still be able to enter into side letter arrangements with private fund advisers to secure essential institution-specific requirements.

(c) Inadequacy of Information and Redemption Rights under Hedge Fund Documentation

Based on our experience investing in hedge funds on behalf of the New York City Retirement Systems, we have observed that hedge fund governing documents often lack robust information and redemption rights and do not provide sufficient legal protection for investors. Accordingly, the Comptroller's Office has historically negotiated side letter terms for the benefit of the New York City Retirement Systems which require hedge fund advisers to provide notices of material events such as, for example, key person departures, bad acts by the adviser, withdrawals by the adviser or the other investors, or a material change in the overall investment strategy of the hedge fund, and accelerated withdrawal rights resulting from such material events. Without the SEC addressing the inadequacy of hedge fund governing documents, we are concerned that following the adoption of the Proposed Rules, investors in hedge funds will be left with only the limited notice and redemption provisions already provided for in the hedge fund documents and without the ability to request additional notice provisions in their side letters, severely harming investors and only serving to place hedge fund advisers in a more advantageous position to deny investors' requests for basic information rights and legal protections.

Similar to the SEC's recently released Form PF Amendments, we encourage the SEC to consider requiring that hedge fund governing documents provide for notice to investors of specified material events and accelerated redemptions rights for the investors if such key events occur. Such modification to the Proposed Rules would ensure the prompt and appropriate level of transparency that we view is lacking in many current hedge fund governing documents.

(d) Different Information Terms Required by LPAC Members

The Preferential Treatment Rules do not contemplate that there may be situations where investors who act as members of the private fund LPAC receive information regarding the portfolio holdings in order to exercise their governance and oversight functions on behalf of all investors in the fund. We encourage the SEC to clarify in the Preferential Treatment Rules that additional information received by investors in their role as LPAC members in connection with their service on the LPAC would not be prohibited by these rules.

(2) Prohibited Activities

Under §275.211(h)(2)-1 (Private fund adviser prohibited activities), the Proposed Rules would prohibit all private fund advisers from engaging in certain activities and practices that are contrary to the public interest and the protection of investors (the "Prohibited Activities Rules").

The Comptroller's Office supports the Prohibited Activities Rules and believes that that these rules would protect investors from advisers engaging in activities that are contrary to the investor protection principles under the Advisers Act. Furthermore, the Comptroller's Office encourages the Commission to consider expanding certain provisions of the Prohibited Activities Rules to strengthen the fiduciary standards under the Advisers Act, by addressing (a) the lack of sufficient guidance on the types of contractual provisions that are prohibited by the Prohibited Activities Rules, (b) inclusion of related persons in indemnification and exculpation provisions, and (c) clarification of types of fees and expenses covered by the Prohibited Activities Rules.

(a) Lack of Sufficient Guidance on Types of Contractual Provisions Prohibited

The Prohibited Activities Rules would prohibit all private fund advisers from seeking reimbursement, indemnification or limitation of liability for breaches of fiduciary duty, willful misfeasance, bad faith, negligence or recklessness.

While the Comptroller's Office fully supports the SEC's proposal to restrict the adviser from potentially placing its interests above those of a private fund or its investors by limiting liability for adviser misconduct, we do not believe the Prohibited Activities Rules provide sufficient guidance on all types of contractual provisions that would be invalid under the Prohibited Activities Rules or that are otherwise inconsistent with or contrary to the fiduciary obligations of the advisers to their investors. In addition to provisions cited in the Release that provide that a general partner is not subject to any duties or standards existing under law or will not be liable to the fund for breaching its fiduciary duties (which provisions are addressed by the Prohibited Activities Rules), fund documents often contain numerous other provisions that further erode the standard of care and the duty of loyalty owed by private fund advisers and substantively limit fiduciary obligations of such advisers to their investors. Accordingly, the Prohibited Activities Rules should clarify that such additional provisions are also being prohibited as contrary to the public interest and protection of investors.

By way of example, we encounter many fund documents that include contractual language stating that notwithstanding any provision of law, the adviser is entitled, in exercising discretion under the fund documents to consider its own interests and has no duty or obligation to consider the interests of the fund or that of its investors. In addition, private placement memoranda for many private funds also include language that by investing in the fund, investors have consented to the existence of *any* actual, apparent and potential conflicts of interest and waived any claim with respect to liability arising from the existence of such conflicts.

These types of provisions have persisted despite the SEC recently providing interpretative guidance on the federal fiduciary standard and despite our best efforts to object to these terms as not in accordance with SEC guidance. In the July 2019 Commission Interpertration Regarding Standard of Conduct for Investment Advisers, the SEC stated, "A contract provision purporting to waive the adviser's federal fiduciary duty generally, such as (i) a statement that the adviser will not act as a fiduciary, (ii) a blanket waiver of all conflicts of interest, or (iii) a waiver of any specific obligation under the Advisers Act, would be inconsistent with the Advisers Act, regardless of the sophistication of the client."[1] We view continued efforts by private fund advisers to include these types of provisions in fund documents as harming investors by permitting the advisers to place their interests above the interests of private fund clients (in effect not acting as a fiduciary).

Over time, we have witnessed more aggressive efforts by private fund advisers to erode the standard of care and the duty of loyalty they owe to funds and investors and expand the use of contractual provisions that could lead investors to believe the adviser is not contractually obligated to comply with their fiduciary duties. We fully support the SEC's proposal and encourage the SEC to provide further guidance on the types of contractual provisions that would be invalid under the rules, including clarifying that provisions referenced above are prohibited by the Prohibited Activities Rules.

(b) <u>Inclusion of Related Persons in Indemnification and Exculpation Prohibitions</u>

Unlike other sections of the Proposed Rules, the rule limiting a private fund adviser from seeking indemnification or exculpation for certain types of misconduct does not cover a private fund adviser's "related persons". Because indemnification and exculpation provisions in fund documents typically cover not only the adviser but also a wide range of the adviser's related persons, we encourage the SEC to clarify that the prohibitions on indemnification and exculpation extend to related persons to avoid undermining the policy goals of the Proposed Rules.

(c) <u>Clarification on Types of Fees and Expenses Covered by Proposed Rules</u>

The Prohibited Activities Rules would prohibit all private fund advisers from charging a private fund fees/expenses associated with examinations or investigations of the adviser or related persons by any governmental or regulatory authority.

We fully support the SEC proposal to prohibit fund advisers from charging the costs of governmental examinations and investigations to private funds and their investors and share the

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[1] *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Investment Advisers Act Release No. 5248 (June 5, 2019) [84 FR 33669 (July 12, 2019)], at 10—11.

SEC's view that allocating these types of costs and expenses to a private fund client is improper and potentially harmful to investors. Consistent with footnote 156 of the Release, we encourage the SEC to clarify in the Prohibited Activities Rules that such costs and expenses include fines, penalties, disgorgements and related legal costs resulting from settlements and judgments with any governmental authority, including settlements where a governmental or regulatory authority alleges wrongdoing but the fund adviser does not admit fault and judgments that are subject to further appeal and that such costs and expenses are not indemnifiable.

The Comptroller's Office on behalf of the New York City Retirement Systems has been requiring private fund advisers to agree to a policy that seeks to prohibit each private fund and its investors from bearing costs and expenses, including any fines, penalties, judgements or settlement payments, resulting from any settlement, verdict or judgment in connection with any examination, investigation or civil or criminal action by a government authority against the fund or the manager, unless such costs are approved by the fund's LPAC and investors. The Comptroller's Office has historically documented this requirement through a side letter provision designed to benefit the fund as a whole by limiting the general partner's ability to seek indemnification and reimbursement for such costs even if a settlement or judgment does not include an admission of guilt or a finding of the types of wrongdoing or misconduct specified in common carve-outs to indemnification provisions. The Comptroller's Office has been successful in having private fund advisers agree to the terms outlined in this paragraph.

In the course of our legal due diligence with advisers who have negotiated settlements with government authorities, including the SEC, we have found that most adviser's practice is to not charge the fund or investors for the costs of the investigations that result in settlements with government authorities. Based on this anecdotal evidence from our side letter negotiations and legal due diligence, we think the proposed rule would not necessarily result in a deviation from current best practices, but would protect investors where advisers seek to exercise rights in a manner not aligned with investors' interests and best practices. Since many private fund documents provide for indemnification of advisers unless there is a "final, non-appealable finding" of wrongdoing, we believe it is important to prohibit investment advisers from settling with governmental authorities prior to a final judgment without admitting fault and seeking to be reimbursed for resulting costs and penalties by private fund investors. Accordingly, we propose that the Prohibited Activities Rules are clarified to expressly cover fines, settlements and judgments with any governmental authority, including non-final judgements and settlements without admission of fault.

(d) Other Prohibited Activities

In addition to the above-referenced items, the Prohibited Activities Rules would also prohibit the following advisers' practices of (i) charging portfolio investments fees for services that the adviser does not, or does not reasonably expect to, provide to the portfolio investment, (ii) charging the private fund for any regulatory compliance fees or expenses of the adviser or related persons, (iii) reducing the amount of any general partner clawback by certain tax allowances, (iv) charging or allocating fees related to a portfolio investment on a non-pro-rata basis when multiple clients are invested in such investment, and (v) borrowing money or receiving a loan/extension of credit from a private fund. The Comptroller's Office supports such rules as providing enhanced protections for investors.

(3) Adviser-led Secondaries

Under §275.211(h)(2)-2 (Adviser-led secondaries), the Proposed Rules would require all registered investment advisers, in connection with an adviser-led secondary transaction, to distribute to investors a fairness opinion and a written summary of certain material business relationships between the adviser and the opinion provider (the "Adviser-led Secondaries Rules").

The Comptroller's Office fully supports the Adviser-led Secondaries Rule as providing enhanced protections for investors in adviser-led secondary transactions and encourages the Commission to further consider other challenges investors may face in adviser-led secondary transactions, including (a) the lack of full disclosure of all material facts relating to such transactions and limited time for investor review, (b) fund advisers seeking to exclude such transactions from LPAC or investor approval requirements in private fund governing documents, (c) lack of sufficient timing available to investors with respect to the provision of the pricing information as well as with respect to the deadlines for investor elections in such adviser-led secondary transactions, and (d) limited election options available to investors in these transactions, including, without limitation, fund advisers not providing investors with the option to remain in the current fund or to receive cash distributions if an investor elects not to participate in such transaction. We believe that in these types of transactions, advisers should be required, in addition to obtaining a fairness opinion, to receive the approval of the LPAC or the investors in order to ensure that investors are given an opportunity to provide input on the structure of the transactions, review all material terms and confirm adequate protections are in place to obtain fair value.

(4) Quarterly Reporting

Under §275.211(h)(1)-2 (Private fund quarterly statement), the Proposed Rules would require all registered investment advisers to provide investors with quarterly statements detailing information about private fund performance, fees and expenses (the "Quarterly Reporting Rules").

The Comptroller's Office supports the Quarterly Reporting Rules as providing enhanced protections for investors and encourages the SEC to consider (a) specifying that the advisers also need to comply with the specific LP-level disclosures, including reporting currently included in the reporting templates provided by the Institutional Limited Partners Association (the "ILPA"), (b) expanding a requirement for disclosure of performance metrics to include also metrics "with" the impact of subscription facilities, and (c) clarifying that investors would be able to negotiate for preferred performance reporting formats in addition to the SEC required format.

(5) <u>Annual Audit</u>

Under §275.206(4)-10 (Private fund adviser audits), the Proposed Rules would require all registered investment advisers to obtain an annual audit for each private fund and cause the private fund's auditor to notify the SEC upon certain events (the "<u>Audit Rules</u>").

The Comptroller's Office supports the Audit Rules as providing enhanced protections for investors.

(6) <u>Annual Compliance Review</u>

Under §275.206(4)-7 (Compliance Procedures and Practices), the Proposed Rules would require all registered investment advisers to conduct and document in writing, the annual review of their compliance policies and procedures (the "<u>Compliance Review Rules</u>").

The Comptroller's Office supports the Compliance Review Rules as providing enhanced protections for investors.

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The Comptroller's Office appreciates the opportunity to provide input on this important issue. Please contact Brad Lander with any questions at [redacted] or at [redacted].

Best regards,

Brad Lander
Comptroller of the City of New York

cc: Hon. Gary Gensler, Chairman
Hon. Caroline A. Crenshaw, Commissioner
Hon. Allison Herren Lee, Commissioner
Hon. Hester M. Peirce, Commissioner

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