May 4, 2022

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

Re: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (Release No. IA-5955; File No. S7-03-22)

Dear Ms. Countryman:

The American Securities Association (ASA)[1] writes to express our opposition to the Securities and Exchange Commission's (SEC) proposal to impose substantial regulations on private funds and to fundamentally alter the SEC's authority and role with regard to the private capital markets (Proposal).

The Proposal is notable in that it fails to articulate any type of market failure or investor harm that is occurring in the private capital markets that would warrant the type of costly and consequential mandates included in the Proposal.

Additionally, the SEC lacks the legal authority to regulate private funds in the manner it is considering. We recommend the agency prioritize its resources towards the protection of retail investors in the public markets rather than sophisticated institutions that do not require government agencies to interfere with their decision making.

While ASA wishes to provide our members' perspective on specific aspects of the Proposal, we urge the SEC to withdraw the Proposal in its entirety and consider whether *any* new regulation of private funds is warranted. Our thoughts are described in greater detail below.

I. <u>The SEC has not provided sufficient time for the public to submit feedback on the Proposal and has failed to consider the cumulative impact of outstanding rule proposals.</u>

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[1] The ASA is a trade association that represents the retail and institutional capital markets interests of regional financial services firms who provide Main Street businesses with access to capital and advise hardworking Americans how to create and preserve wealth. The ASA's mission is to promote trust and confidence among investors, facilitate capital formation, and support efficient and competitively balanced capital markets. This mission advances financial independence, stimulates job creation, and increases prosperity. The ASA has a geographically diverse membership of almost one hundred members that spans the Heartland, Southwest, Southeast, Atlantic, and Pacific Northwest regions of the United States.

The Proposal is just one of the many complex and consequential rulemakings the SEC has proposed in recent months. To date, the SEC has proposed sixteen new rulemakings, in addition to several others that were proposed at the end of 2021. Most of these proposals run to hundreds of pages in length, and often include hundreds of questions that commenters must consider when assessing the impact of potential new rules.

The Proposal itself is 342 pages and includes several very specific questions, some of which hint at further mandates that are not fully explored or analyzed in the release. Yet the SEC provided the public only thirty (30) days to comment on the Proposal. This is simply an inadequate amount of time for the public to properly consider how the contents of the Proposal will affect the U.S. securities markets – particularly when many entities are simultaneously considering and developing comments on over a dozen other rulemakings from the SEC, trying to navigate unprecedented market volatility.

The ASA reiterates our call for the SEC to immediately extend the comment period for every outstanding rule proposal by a minimum of ninety (90) days. Doing so would allow the SEC to properly consider specific comments on each proposal and to assess the cumulative effect of its current regulatory agenda.[2]

II. The Proposal fails to provide any justification for why prescriptive, costly mandates for private funds are warranted.

The Proposal states the SEC finds that private fund investments are "often opaque; advisers frequently do not provide investors with sufficiently detailed information about private fund investments."[3] However, aside from a small number of enforcement cases over the last decade, the SEC provides no empirical justification for this assertion. Nor does the SEC consider current market practices and how private funds already provide information to investors regarding, for example, fee and performance disclosure.

Indeed, the SEC has already received comments that question whether private fund investors are actually demanding the type of prescriptive disclosures and quarterly reporting requirements that would be required by the Proposal.[4]

Limited partnership agreements (LPAs) typically cover the type of disclosure that limited partners wish to receive from funds and the format that such disclosure is provided. It is unclear

[2] https://www.americansecurities.org/post/asa-urges-sec-to-extend-comment-period-for-90-days
[3] Proposal at 9.
[4] See e.g. letter from Small Business Investor Alliance, available at https://www.sec.gov/comments/s7-03-22/s70322-20126648-287331.pdf

why it is necessary for the SEC to mandate the format and timing of fee or performance disclosure and how that would benefit investors in private funds.

The ASA agrees with Commissioner Peirce, who noted in her dissenting statement:

> the Commission historically has placed retail investor protection near the top of the list of agency priorities, even after the Dodd-Frank Act's private fund registration mandate. If we adopt today's proposal, will we choose to redeploy Examinations and Enforcement resources away from their current focus on retail investor protection to the apparently pressing need of protecting millionaire investors from private fund advisers?[5]

More fundamentally, the SEC should not seek to interfere or regulate contracts that have long been negotiated between sophisticated private parties under state law. Doing so exceeds the SEC's legal authority as a regulator and certain provisions of the Proposal conflict with existing state law – a fact that the SEC readily admits in the Proposal.

III. The proposed prohibition on reducing clawbacks by taxes already paid would harm all investors in a private fund.

Private funds typically include agreements regarding clawbacks related to carried interest earned by general partners (GPs) throughout the life of the fund. Clawbacks are usually reduced by the tax amounts already paid by GPs on earned carry. These agreements have been widely understood and accepted by investors and the Proposal cites no evidence that reducing clawbacks by taxes already paid somehow puts investors at a disadvantage.

The Proposal would upset this longstanding practice and would likely cause *all* investors in a fund – not just GPs – to amend previously filed tax returns, and funds may have to negotiate retroactive amendments regarding compensation. This would impose significant costs and disruptions upon both LPs and GPs and provide no clear benefit to funds or their investors.

IV. The proposed prohibition on indemnification would conflict with both market standards and state law.

The Proposal would prohibit an adviser to a private fund from seeking "reimbursement, indemnification, exculpation, or limitation of its liability by the private fund or its investors for a breach of fiduciary duty, willful malfeasance, bad faith, negligence or recklessness in providing services to the private fund." The Proposal notes that while these practices are permitted under state law, they create "possible harms" to investors.[6]

[5] https://www.sec.gov/news/statement/peirce-statement-proposed-private-fund-advisers-020922
[6] Proposal at 243-244

As with many other aspects of the Proposal, this provision is in direct contravention of indemnification agreements that private funds have negotiated with sophisticated parties, and conflicts with the *gross negligence* standard that has long been applicable under state law and agreed to by private funds and their investors.

The Proposal would create a regime closer to a strict liability standard[7] and significantly raise liability exposure for private funds. The resulting costs and barriers to entry for new funds would harm investors and the private fund ecosystem generally.

V. The proposed prohibition on allocating fees and expenses associated with regulatory exams will deprive investors of transparency.

The Proposal also would prohibit private fund advisers from charging fees and expense to the fund that are associated with regulatory examinations and/or investigations. The Proposal provides little rationale for why such a prohibition is necessary, and it is unclear at best whether the SEC has the statutory authority to enforce such a provision.

Oddly, the Proposal notes that were such a prohibition to take effect, advisers would be permitted to restructure their fee models to incorporate these expenses. There is no explanation given for why one expense model would be preferable over another, or how other models may have the effect of obfuscating the line-item costs associated with regulatory exams and investigations. Again, applying these expenses to a fund is a longstanding and well understood practice amongst investors, and we urge the SEC to avoid disrupting market practice that works seamlessly today without a clear regulatory benefit.

Conclusion

While we appreciate the opportunity to comment, we believe the SEC should drop this Proposal and reconsider whether any new regulations of private funds are warranted at this time. We look forward to our ongoing engagement with SEC commissioners and staff on this and a host of other issues.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
Chief Executive Officer
American Securities Association

[7] See e.g. April 25th, 2022 letter from Robert W. Baird & Co https://www.sec.gov/comments/s7-03-22/s70322-20126584-287242.pdf