

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

Submitted via email to rule-comments@sec.gov

September 7, 2022

Dear Ms. Countryman,

Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (File Number S7-03-22)

The Alternative Investment Management Association Limited (“AIMA”)¹ appreciates the opportunity to provide this supplemental response to the Securities and Exchange Commission (the “Commission” or “SEC”) with respect to the proposed new rules and amendments under the Investment Advisers Act of 1940, as amended (the “Advisers Act”), governing the activities of private fund advisers (such proposed new rules and amendments are collectively referred to herein as the “Proposal”).²

In response to the Commission’s proposal to prohibit an adviser from charging a fund for certain regulatory, compliance, and examination-related fees and expenses, we argued that “[i]t is not obvious how this would be a preferential outcome for investors, particularly investors in a fund that uses a pass-through model, who now will have less visibility into specific fees and expenses and who will be subject to a re-structured fee model different from what they had originally bargained for.”³ We also provided data from an EY report which showed that a “a significant

¹ AIMA, the Alternative Investment Management Association, is the global representative of the alternative investment industry, with more than 2,100 corporate members in over 60 countries. AIMA’s fund manager members collectively manage more than \$2.5 trillion in assets. AIMA draws upon the expertise and diversity of its membership to provide leadership in industry initiatives such as advocacy, policy and regulatory engagement, educational programmes and sound practice guides. AIMA works to raise media and public awareness of the value of the industry. AIMA is committed to developing skills and education standards and is a co-founder of the Chartered Alternative Investment Analyst designation (CAIA) – the first and only specialised educational standard for alternative investment specialists. AIMA is governed by its Council (Board of Directors). For further information, please visit AIMA’s website, www.aima.org.

² SEC, Proposing Release, Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, 87 FR 16886 (March 24, 2022) (the “Proposing Release”).

³ AIMA and Alternative Credit Council response to Proposal (April 25, 2022), available at <https://www.sec.gov/comments/s7-03-22/s70322-20128423-291344.pdf> at page 7.



percentage [(21%)] responded that they *preferred* a cost pass-through model in lieu of management fees – an option that the Commission has proposed to ban” (emphasis added).⁴

We also argued:

“To the extent that investors may seek different fee and expense practices and arrangements than what an adviser is offering, they should be empowered to determine for themselves the optimal approach and be given the opportunity to negotiate with the adviser to best align their preferences, rather than have the Commission impose its own commercial preferences. Many advisers have expanded beyond just the “2 and 20” model by virtue of negotiations with investors; some have adopted, for example, “tiered fee” structures in which a declining management fee is paid as the fund’s assets under management increases, or a pass-through fee model, or discounted management fees that vary with the fund’s strategy. [footnote omitted]

Flexible fee arrangements have developed out of the specific preferences of certain investors, while others have continued to invest in private funds that deploy a “2 and 20” model, thereby expressing their continued satisfaction with this model. The Commission should continue to encourage innovation in fee structures and to allow sophisticated investors to negotiate in their own interests rather than prohibiting specific commercial arrangements.”⁵

On July 6, 2022, AIMA members and staff met with Director Birdthistle and other members of the SEC staff regarding the Proposal. As part of that discussion, we spoke about full and partial pass-through fee and expense arrangements and SEC staff members indicated an interest in having additional data in this area.

In this supplemental response following up from that discussion, we are sharing some data analysis performed by Barclays Prime Services Capital Solutions (the “Barclays Team”) comparing the performance of multi-manager hedge funds with various types of pass-throughs versus traditional hedge funds.⁶

To prepare their analysis, the Barclays Team looked at the fee structure, management fee levels, performance fee level, AUM and annualized performance (net returns, alpha⁷ and the Sharpe ratio) of approximately 290 hedge funds, including around 40 multi-manager funds with average AUM of \$7 billion and around 250 traditional hedge funds with an average AUM of \$2 billion.⁸

⁴ *Id.*, at page 15 (citing EY, Can the difference of one year move you years ahead? 2021 Global Alternative Fund Survey, at page 14.).

⁵ *Id.*, at page 32.

⁶ Barclays Team PowerPoint presentation, Performance by Fee Type and Level (July 2022) (“Barclays Report”). A copy of that presentation has been attached with permission from the Barclays Team. AIMA did not participate in the analysis/final report nor did it request, instigate or finance its development.

⁷ The alpha calculation was Jensen’s alpha (Return of the funds - LIBOR - static beta x (MSCI LIBOR)). See Barclays Report, at page 2.

⁸ The sampled data was derived from HFR, HFM and internal Barclays Prime Services Capital Solutions sources.

Following analysis of the data, the Barclays Team concluded that:

- within the multi-manager space, pass-through fees have become common, noting that 26% of the multi-manager funds reviewed (representing 55% of the multi-manager AUM) operated on a full pass-through fee structure with no management fee and a further 37% of the multi-manager funds reviewed (representing a further 30% of the multi-manager AUM) operated a partial pass-through fee structure characterized by passing through performance based-portfolio manager compensation and strategic specific expenses with a management fee to pay for infrastructure costs;
- pass-through fees are acceptable to investors as evidenced by the fact that most of the recent launches have had them in some form;
- the comparison of returns and other performance metrics appears to show that multi-managers that include a full or partial pass-through have outpaced both multi-managers that do not charge a pass-through as well as those with traditional hedge fund fees across net returns, alpha and Sharpe;
- While the difference in net returns is stark for the multi-manager funds with/without pass-through fees, across the traditional fee models, it appears that there was little difference in net returns, but there were significant differences across alpha and risk-adjusted returns.

We believe that this data also supports these additional conclusions:

- in this study, passing through fees is correlated with better outcomes, perhaps pass-throughs are likely to be used for technology build, data purchases, and other expenses that help portfolio managers focus on alpha delivery. If the investment adviser is not constrained by a management fee and it knows that it is 'investing' the expense into something that will contribute to overall higher net returns, the investment adviser will make that expenditure because it knows that even if gross costs are high, the expenditures will likely lead to high net returns;
- the comparisons have been done without regard to the strategy or business model in place, which suggests that right incentives and fee models can be associated with significant outperformance;
- investors in multi-manager funds clearly believe that a pass-through arrangement can be an appropriate method of aligning their interests with investment advisers of these types of funds and they can make an informed and rational choice to do business under this fee structure;
- prohibiting passing through certain fees and expenses could disproportionately affect the largest and best performing funds (and the investors who benefit from that performance), but also a significant percentage of all funds given the popularity of the arrangement; and
- requiring firms currently using a pass-through model to amend negotiated arrangements ultimately may harm their performance, thereby harming their investors. The data demonstrate a correlation between the pass-through model and higher returns/alpha.



In addition, investors who prefer to forego these superior net returns due to an objection in principle to expense pass-through arrangements are free to invest with the many investment advisers who offer different fee and expense arrangements, of which there is no shortage.

For these reasons, we continue to believe that the Commission should withdraw the proposed prohibition on passing through certain fees and expenses in its entirety. As it relates to the matters discussed in this letter without affecting other statements made in our initial April response to Proposal, if the Commission nevertheless adopts the rule, it should, at a minimum:

- permit a principles-based approach, which would allow advisers to determine the appropriate characterization of fees and expenses (and make proper disclosure to investors); and
- provide a full exception for advisers utilizing a pass-through expense model.

We would be happy to elaborate further on any of the points raised in this letter. For further information please contact Jennifer Wood, Managing Director, Global Head of Asset Management Regulation & Sound Practices at [REDACTED].

Yours sincerely,

A handwritten signature in blue ink, appearing to read "J. Król", is positioned below the closing text.

Jiří Król
Deputy CEO, Global Head of Government Affairs, AIMA

Cc: The Honorable Gary Gensler, Chair
The Honorable Hester M. Peirce, Commissioner
The Honorable Caroline A. Crenshaw, Commissioner
The Honorable Mark T. Uyeda, Commissioner
The Honorable Jaime Lizárraga, Commissioner
Mr. William Birdthistle, Director of the Division of Investment Management
Mr. Dan Berkovitz, General Counsel



Performance by Fee Type and Level

Prime Services Capital Solutions

July 2022

For Professional and Institutional Investors only. Not for further distribution or distribution to Retail Investors.

For Information purposes only. No Advice is given.

Not a product of Barclays Research.

See additional disclaimer on back cover.

Fee Structures by HF Business Model

Within the Multi-Manager (MM) space, pass-through fees have become common and are likely to stay as most of the recent launches have had them in some form

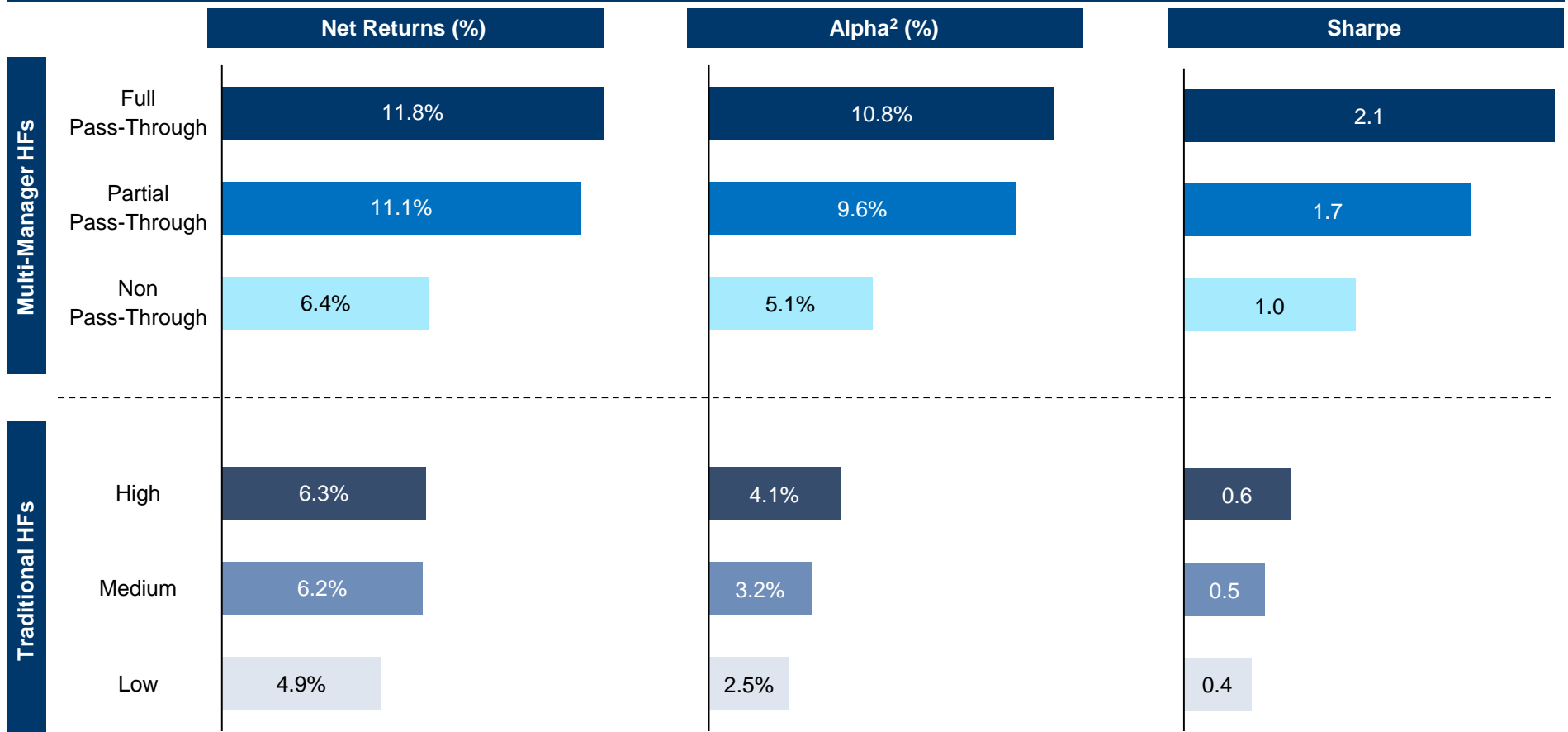
Funds by Fee Models					
Sample	Fee Structure	Pass-Through Expenses	Common / Average Fees ¹	% of Sample	% of AUM
Multi-Manager: ~40 Funds Avg: AUM: ~7bn	Non Pass-Through	None (investors are only charged standard fund-level expenses)	<ul style="list-style-type: none"> 2/20 standard (up to 3/30) Some managers offer multiple share class options, which trade off lower MF for higher PF 	37%	~15%
	Partial Pass-Through	<ul style="list-style-type: none"> Performance-based PM compensation Strategy-Specific Expenses 	<ul style="list-style-type: none"> MF up to 2% to pay for infrastructure costs In a few cases, particularly if charging 2/20, pass through expenses are capped PF from 0% (only one instance) to 20% 	~37%	~30%
	Full Pass-Through	<ul style="list-style-type: none"> Performance-based Compensation to PMs and Strategy-Specific Expenses Infrastructure costs (Operations, IT, etc.) 	MF: 0% PF: 20%	26%	~55%
Traditional HFs²: ~250 Funds Avg: AUM: ~2bn	High	None	MF: 2% PF: 20%	~30%	~50%
	Medium	None	MF: 1.4% PF: 19%	~50%	~30%
	Low	None	MF: 1.0% PF: 13%	~20%	~20%

Source: HFR, HFM, Capital Solutions, 1) Common / Average fees refer to headline rates, not the average; 2) Sample includes HFs with >\$500mn

Performance Comparison by Fee Structure

It appears that the HFs with pass-throughs and / or higher traditional fees have generated superior net returns, as well as more alpha, while achieving a higher Sharpe

Annualized Performance Comparison by Business Model / Fees (Last 3 Years) – MM: type of pass through; Traditional: ~level of fees¹

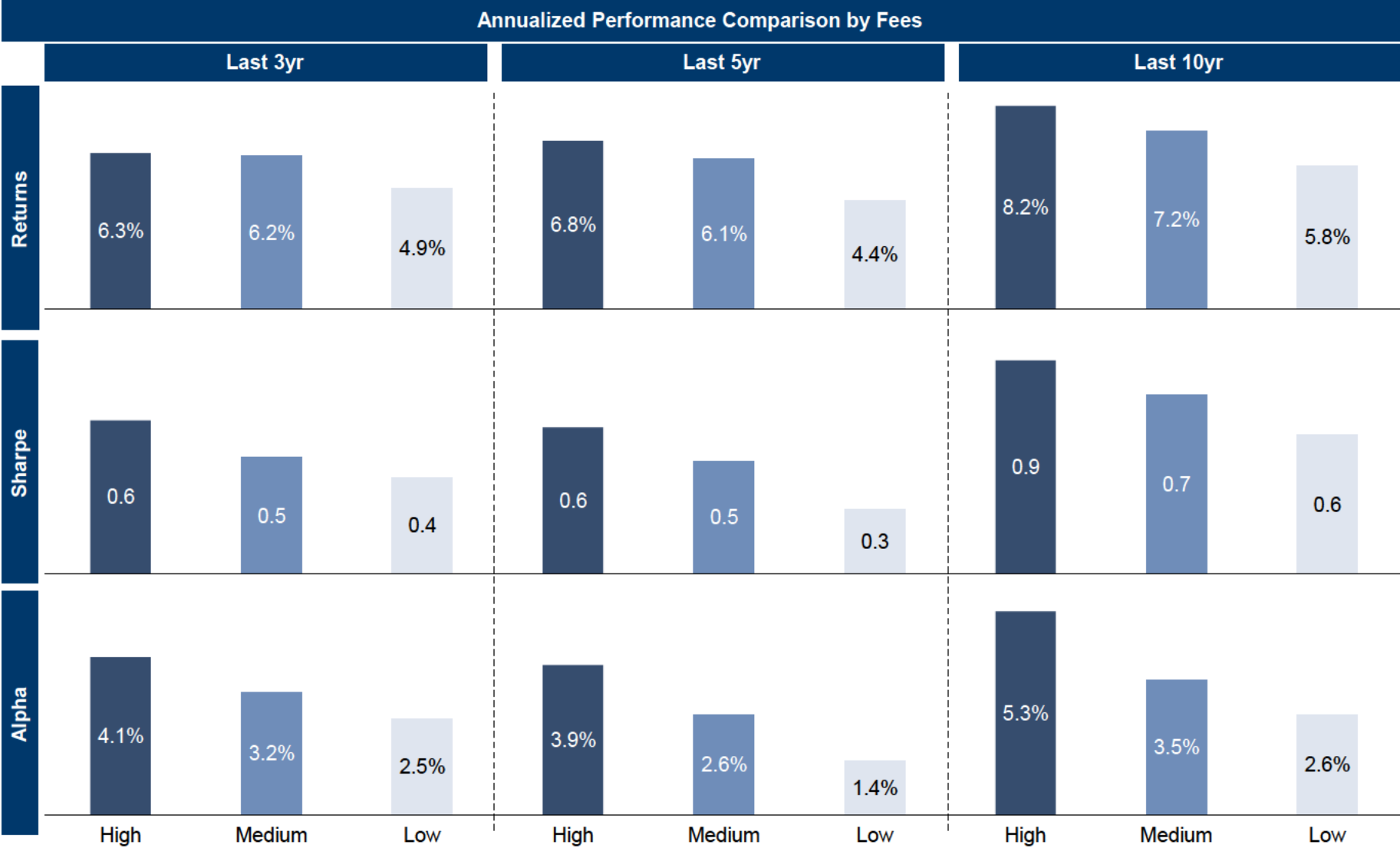


- ◆ The comparison of returns and other performance metrics appears to show that multi-managers that include a partial or full pass through have outpaced both multi-managers that do not charge a pass through as well as those with traditional HF fees across net returns, alpha, and Sharpe
- ◆ While the difference in net returns is stark for the MMs with / without pass through fees, across the Traditional fee model, it appears that there was little difference in net returns, but there were significant differences across alpha and risk-adjusted returns – it appears that higher fees leads to better stability in returns and greater alpha generation

Source: HFR, HFM, Capital Solutions. 1) Traditional Fee Model HFs were split into three groups based on the level of their combined management and performance fees, 2) The alpha calculation we use is Jensen's alpha (Return of the funds – LIBOR – static beta x (MSCI – LIBOR))

Performance Comparison by Fee Structure

Across different time periods, the 'High' fee HFs generated superior performance, especially with respect to risk-adjusted returns and alpha



Source: HFR, HFM, Capital Solutions



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