DCALTA
Defined Contribution
Alternatives Association

September 9, 2019

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

RE: Concept Release on Harmonization of Securities Offering Exemptions
File No. S7-08-19

Dear Ms. Countryman:

The Defined Contribution Alternatives Association ("DCALTA") is pleased to have the opportunity to comment on the Securities and Exchange Commission's ("SEC" or "Commission") Concept Release (the "Release") soliciting comments on ways to simplify, harmonize, and improve the existing exempt offerings framework. The SEC poses two questions with significant implications for retirement savers. In Question 28, the SEC asks if investors advised by registered financial professionals, such as retirement plan savers, should be considered accredited investors and therefore have increased access to exempt offerings; and in question 122, the SEC asks if target date funds should be allowed to seek a limited amount of exposure to exempt offerings. In both questions, DCALTA believes that the SEC has identified an area where U.S. retirement savers would be better served by rules modernized to provide greater access to exempt offerings.

The SEC's request demonstrates that the Commission understands that we have reached a crossroads. Regulations that were designed to protect main street investors have not kept pace with a marketplace increasingly dominated by private capital. In fact, the current regulatory framework harms main street investors. Some supporting statistics include:

1. The universe of publicly listed companies is shrinking in the U.S. with new businesses offering shares to the public at less than half the rate of the 1980s and 1990s.[1]
2. About 3,600 firms were listed on U.S. stock exchanges at the end of 2017, down more than half from 1997.
3. Private equity firms are taking companies out of the public markets at their fastest pace in a decade. Just in 2019, U.S. private equity investors have taken public companies private with $69.6 billion in deals, up from $54.3 billion in all of 2018 (sourced by Dealogic).

Current regulations have, instead, limited investment opportunities and created a gulf between those who have access to portfolio diversifying investments and those who do not, thereby contributing to income and wealth inequality. This is clearest in the retirement space where defined benefit plans, benefit from an illiquidity premium available through investment in private funds while defined contribution plans have limited access to illiquid investments

Research Shows Transformational Power of Alternative Asset Classes

DCALTA and the Institute for Private Capital have conducted extensive research on the private markets. Specifically, we wanted to learn what would have been achieved over the past 25 years in a diversified portfolio of U.S. stocks and bonds by adding allocations to Private Equity and Venture Capital using actual historical results of funds, cash flows and net asset values that were randomly selected, rather than relying on averages or blended data. The primary results from the DCALTA/IPC Research – 2019 are as follows:

1. Investment returns are consistently higher for portfolios that incorporate U.S. buyout funds and venture capital funds
2. Risk is consistently lower for portfolios that include U.S. buyout funds
3. Sharpe Ratios (risk-adjusted returns) are consistently higher for portfolios with U.S. buyout funds and a combination of U.S. buyout and venture capital funds.

Further, defined contribution plan participants will be especially disadvantaged during an economic slowdown as alternative investment diversification provides a hedge against economic uncertainty. To address this disparity, the SEC should change the accredited investor definition, permit defined contribution plan participants to invest in exempt offerings, and allow target date funds to include alternative investments in their asset allocation products. This change will level

[1] https://www.bloomberg.com/opinion/articles/2018-04-09/where-have-all-the-u-s-public-companies-gone.

the ability for investors to benefit from the same opportunity set of investments and create better outcomes for U.S. retirement savers.

DCALTA advocates on behalf of plan sponsors, plan fiduciaries, asset servicers, investment managers, and others within the retirement industry who believe that alternative investments provide benefits to retirement savers. We support the SEC as it reevaluates the accredited investor rules to provide retirement plan savers much needed access to private funds.

DCALTA was created to raise awareness about the benefits of expanding the opportunity set of investments available to defined contribution plans to include alternative investments. Through its education, outreach, research, and advocacy efforts, DCALTA is committed to securing optimal retirement outcomes for plan participants. The continually evolving regulatory environment and innovations in investment products and methods have changed the operational landscape for plan fiduciaries and investors. Alternative investments, including hedge funds and private equity, can be used in professionally managed multi-asset portfolios and other structures to minimize participant risk and maximize returns. DCALTA has a strong interest in the emergence of modernizing solutions that adequately respond to market developments and broaden the opportunity set of investments available to plan participants within the context of sound decision-making by investment fiduciaries.

DCALTA is encouraged by the SEC's recognition that the current restrictions designed to protect retail investors may inappropriately limit their investment opportunities. We applaud the Commission for its farsightedness in understanding that there may be a need to revise the rules to create a more rational approach to retirement saver protection. By expanding participation in exempt offerings, the SEC would send a clear signal that retirement savers should have access to asset classes other than traditional equity and debt.

Today's Unwieldy Regulatory Environment

For some time, the SEC has acted incrementally to respond to market shifts that dictate expanded investment diversification, but it has not developed a comprehensive long-term solution. As the Commission notes in the Release, capital-raising exemptions to the Securities Act of 1933 have become unwieldy, with various classes of exemptions containing a variety of conditions and bringing differing consequences for different investors. As an example, since they are not accredited investors, the Investment Company Act's Section 3(c)(1) "look through" rules generally exclude 401(k) participants from investing in private funds that are available for the benefit of participants in traditional pension plans.[2]

[2] 15 U.S.C.A. § 80a-3. Definition of investment company.

In particular, the SEC limited defined contribution plan participants' access to exempt offerings In a series of no action letters, PanAgora Group Trust (1994),[3] Standish Ayer and Wood (1995) and H.E.B. (2001), the SEC provided guidance that allows asset managers and plan fiduciaries to design investment vehicles where there is no need to look through to determine if each participant is an accredited investor; however, under this guidance, such investment vehicles have to be designed to fit a square peg in a round hole resulting in operational and other challenges. Specifically, the SEC indicated that a 401(k) plan would not need to look through if: the participants' discretion would be limited to allocating assets to generic investment options and the decision to make any particular private fund investment or to withdraw assets from that private fund investment would be solely that of the fiduciary that managed the plan; the plan would limit investment in the private fund to less than 50% of its assets invested in any investment option; and no representation would be made to participants that any specific part of their contributions or any specific portion of the assets allocated to a generic investment option would be invested in the fund.[4]

The SEC's Section 22e-4 mutual fund liquidity rules similarly restrict access to alternative investments. Section 22e-4 requires mutual funds to classify each of the investments in its portfolio based on liquidity level.[5] These classifications must be routinely reviewed and used to establish a liquidity threshold (the "highly liquid investment minimum") from which the fund cannot deviate for any prolonged period. The rule also generally prevents funds from investing more than 15% of its assets in illiquid investments. ERISA plan fiduciaries that utilize QDIAs (qualified default investment alternatives) can select from three separate types; Balanced Funds, Target Date Funds and Managed Accounts. In a likely scenario, if a Balanced Fund (mutual fund) was selected as the QDIA and also made available on the plan investment menu, there would be a liquidity threshold applied based on current regulation. This limitation is contradictory to our own research showing that allocations to alternative investments greater than the current threshold of 15% would have produced value added and better risk adjusted portfolio performance. Because of these rules, defined contribution plan participants generally do not have access to private funds. This creates a contrast with defined benefit plans that are not subject to these look-through requirements and in turn invest heavily in exempt offerings. Defined contribution plans, because they are typically not accredited investors, do not.

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[3] The Panagora Grp. Tr., SEC No-Action Letter, 1994 (Apr. 29, 1994).

[4] The Standish, Ayer & Wood, Inc. Stable Value Grp. Tr., SEC No-Action Letter, 1995 (Dec. 28, 1995); The H.E.B. Inv. & Ret. Plan, SEC No-Action Letter, 2001 (May 18, 2001).

[5] 17 C.F.R. § 270.22e-4

The Way Forward

The current rules distinguishing between the accredited investor status of defined benefit plan participants and defined contribution plan participants are arbitrary and have placed defined contribution plan participants at a significant disadvantage. The SEC can protect investors while providing a sound opportunity set of investments to meet their long-term investing needs. An effective answer to the problem caused by the SEC's PanAgora, Standish Ayer and Wood, and H.E.B. no-action letters is to eliminate the requirement to "look through" 401(k) plans to each individual plan participant as long as the decisions are made by an experienced fiduciary. Any individual participant who is investing inside a retirement plan that itself qualifies as an accredited investor should be considered an accredited investor. As it stands, plan participants are sufficiently shielded by the layers of protection offered by their plan's fiduciary.

In addition, target date funds should be permitted to have a greater concentration of illiquid investments. Revising the liquidity rules would allow plan fiduciaries to provide better-designed target date funds that would utilize alternative asset classes for protection, diversification and performance benefits. We encourage the SEC to allow target date funds, balanced funds and managed account products (designed to provide long term portfolio investment horizons) a greater concentration of illiquid holdings.

DCALTA believes that defined contribution plan participants will build stronger and more secure long-term investment portfolios when they have access to portfolio diversifying investments. Traditional pension plan participants have been able to benefit from investment in alternative asset classes while defined contribution plan participants are restricted from the same valuable investment opportunities. The SEC's efforts to democratize investment opportunities are not only commendable, but necessary. We support the SEC as it modernizes its rules to provide plan participants with greater opportunity to investment strategies that align with their long-term lifetime income needs.

We look forward to working with the SEC to develop this important guidance. If DCALTA may be of any assistance, please do not hesitate to contact me at [redacted].

Sincerely,

Jonathan Epstein

Jonathan Epstein
President and Founder, Defined Contribution Alternatives Association