



September 24, 2019

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

*Re: Concept Release on Harmonization of Securities Offering Exemptions (File No. S7-08-19)*

Dear Ms. Countryman:

The Investment Company Institute<sup>1</sup> supports the Securities and Exchange Commission examining the current regulatory framework for exempt offerings. We understand that the private markets have accounted for significantly larger amounts of new capital compared to registered offerings since 2009. We therefore appreciate that the Commission is exploring ideas to expand investment opportunities for retail investors while maintaining investor protections.<sup>2</sup> As the Commission considers next steps, we urge that any changes that provide retail investors with greater access to private markets be coupled with fundamental investor protection measures. The Commission can accomplish this by facilitating that access through regulated funds. At the same time, we urge the Commission to recognize and address the detrimental effects that recent overregulation has imposed on these important retail products.

## **I. Executive Summary**

We welcome the Commission taking steps towards providing Main Street investors with access to new investment opportunities. Regulators and market participants have long understood that public market

---

<sup>1</sup> The [Investment Company Institute](https://www.ici.org) (“ICI”) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s members manage total assets of US\$23.5 trillion in the United States, serving more than 100 million US shareholders, and US\$6.9 trillion in assets in other jurisdictions. ICI carries out its international work through [ICI Global](https://www.ici.org/global), with offices in London, Hong Kong, and Washington, DC.

<sup>2</sup> See Concept Release on Harmonization of Securities Offerings Exemptions, Securities Act Release No. 10649 (June 18, 2019) (“Concept Release”), available at <https://www.sec.gov/rules/concept/2019/33-10649.pdf>. See also Jay Clayton, Chairman, SEC, *Remarks to the Economic Club of New York* (Sept. 9, 2019) (“Clayton Speech”), available at <https://www.sec.gov/news/speech/speech-clayton-2019-09-09> (stating that registered offerings accounted for \$1.4 trillion of new capital compared to approximately \$2.9 trillion that the staff estimates was raised through exempt offering channels).

and private market offerings present different risks and rewards for investors.<sup>3</sup> As the Commission examines permitting retail investors greater private market access, we recommend that it foster investor protection through three broad channels.

First, we urge the Commission to promote growth in registered funds, which are already widely available to retail investors, by easing regulatory burdens. More specifically:

- Additional disclosure and reporting obligations have increased compliance costs greatly over time, and therefore it is imperative for the Commission to examine ways to reduce compliance costs for registered funds.

Second, we urge the Commission to recognize the fundamental differences between private and public market offerings that may make private market offerings unsuitable for direct retail investment. Given those differences, the Commission should appropriately calibrate investor protection by:

- Maintaining the requirement that individual investors meet certain financial thresholds to qualify as accredited investors while also modernizing those thresholds to account for the effects of inflation.
- Requiring that exempt issuers making a general solicitation comply with investor protection measures to mitigate the potential for publishing misleading advertising that will impede investor understanding.

Third and finally, we strongly recommend that the Commission encourage investor protection by increasing retail investors' access to private markets through regulated funds.<sup>4</sup> These funds have proven to be highly suitable vehicles for facilitating retail investor access to the overall securities markets. They can serve the same role for providing greater access to private offerings while ensuring strong investor protection. More specifically:

- We recommend several changes to make it easier for closed-end funds, including interval funds, tender offer funds, and business development companies, to invest in private offerings.

---

<sup>3</sup> *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953) (“Exemption from the registration requirements of the Securities Act is the question. The design of the statute is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.”).

<sup>4</sup> Hereinafter, we use the term “regulated fund” to refer to business development companies (“BDCs”) and registered open-end and closed-end funds. We use the term “closed-end fund” to refer to all closed-end funds, including BDCs, interval funds and tender offer funds.

### A. Ease the Burdens of Regulation for Publicly Offered Registered Investment Companies

It is clear that recently, the private market has grown substantially.<sup>5</sup> Companies are waiting longer to go public, are remaining private,<sup>6</sup> or even privatizing their previously public forms.<sup>7</sup> Facilitating greater retail investor access to potentially beneficial investment opportunities is a laudable goal. And there are multiple ways to achieve this. We believe the best way is to lift burdens on publicly offered registered funds, thereby supporting growth in investment products already accessible to Main Street investors and required to operate consistent with retail investor protection.

Chairman Clayton recently highlighted the measures the Commission already has taken to ease burdens on public companies.<sup>8</sup> Yet, one area of SEC public company regulation – publicly offered registered investment companies – does not fit within the Chairman’s rubric. In fact, the regulatory and compliance burdens associated with being a registered investment company have increased greatly in the past few years primarily due to Commission’s liquidity risk management rule and Form N-PORT filing requirements.

We surveyed our members in 2017 to better understand trends in regulatory and compliance burdens over the past five years, in response to new regulations (*e.g.*, the now vacated DOL fiduciary rule; the SEC’s money market fund, enhanced fund reporting, and liquidity rulemakings; and FATCA compliance).<sup>9</sup> At that time, members reported a *median* increase in compliance costs of an estimated *twenty percent* over the previous five years.<sup>10</sup> Members cited one-time compliance costs (*e.g.*, legal costs, preparation of new policies and procedures, creation of internal controls, and staff training), increased technology expenditures, increased use of third-party fund service providers (*i.e.*, vendors), increased vendor costs,<sup>11</sup> increased oversight of vendors and intermediaries, and increased staffing needs as primary drivers of these overall cost increases. And these numbers do not necessarily capture associated

---

<sup>5</sup> See Concept Release, *supra* note 2, at 16.

<sup>6</sup> See Frank Partnoy, *The Death of the IPO*, *The Atlantic* (Nov. 2018), available at <https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/>.

<sup>7</sup> See Mark McSherry, *70 Billion Reasons For a Public Company To Go Private*, *Forbes Magazine* (Aug. 16, 2013), available at <https://www.forbes.com/sites/markmcsberry/2013/08/16/70-billion-reasons-for-a-public-company-to-go-private/#7793b3b12b6f>.

<sup>8</sup> See Clayton Speech, *supra* note 2; see also Hester M. Peirce, Commissioner, SEC, *Cleveland, Kondo, and Capital: Remarks before the American Chamber of Commerce* (Aug. 7, 2019), available at <https://www.sec.gov/news/speech/speech-peirce-080719> (“The regulation of public companies is a part of our jurisdiction that is crying out for reform.”).

<sup>9</sup> See Appendix A Excerpts from ICI’s Compliance Cost Survey 2017. 42 ICI member firms responded, representing 46 percent of US registered fund assets.

<sup>10</sup> 35 of the 42 respondent firms were able to quantify the percent by which compliance costs had increased over the past five years. In comparison, over the five-year period from December 2011 to December 2016, consumer prices, as measured by the personal consumption expenditure index, rose 6.3 percent. Also, in comparison, over the same five-year period, the employment cost index for professional, scientific, and technical sectors rose by 8.7 percent.

<sup>11</sup> Because of the prevalent use of vendors by funds, increased vendor costs directly and significantly impact overall fund costs. Nearly all of the members who responded (40 of 42) reported using vendors to obtain at least some of the services funds need to operate. Of these 40 members, 75 percent (30 of 40) reported that over the past five years vendors had increased their charges for such services, citing higher compliance costs.

opportunity costs, including the diversion of resources that may have otherwise gone to bolstering portfolio and risk management capabilities, enhancing oversight of existing legal, compliance, and accounting obligations, improving customer service, and product innovation.

We appreciate that the Commission, under Chairman Clayton's leadership, has taken steps to respond to important concerns of the fund industry, but, we continue to hear from our members, both larger and smaller, that these regulations have driven up costs substantially. We therefore urge the Commission as it moves forward with offering reform to consider both the investment opportunities that registered investment companies can make available to Main Street investors and the detrimental effects overregulation can impose on these important retail products.

We recommend several specific steps the Commission should take to make these products more attractive for issuers and investors in Sections IV.B and V below.

### **B. Recognize the Fundamental Differences Between Public and Private Market Offerings**

The Commission rightly aims to provide retail investors with more investment opportunities with potentially greater returns. But it must recognize that the risks of private offerings continue to be substantial. We therefore recommend that the Commission take steps to maintain important investor protections.

The structures, characteristics, terms, transparency, and risks of private and public offerings consistently have been, and still are, exceptionally different. Compared to exempt issuers, public companies are typically bigger, more mature in the market, and more stable.<sup>12</sup> Private issuers may offer investments on fundamentally different terms than terms found in the public market. Private funds in particular have a variety of terms and conditions.<sup>13</sup> For example, there may be varying lock-up periods or terms related to side pockets or capital calls.<sup>14</sup>

Compared to the public market, the downsides of private market offerings for retail investors may include:

- *Reduced Protections.* Investors in unregistered offerings are subject to risks not associated with registered offerings because some securities law liability provisions do not apply to private

---

<sup>12</sup> See *Why a Lack of Private Market Data Exposes Investors to More Risk*, Pitchbook (May 28, 2019), available at <https://pitchbook.com/blog/why-a-lack-of-private-market-data-exposes-investors-to-more-risk>. See also Anne Butte, *An IPO Isn't Just a Way to Raise Money — It Shows a Company Is Mature and Deserving of Trust*, Entrepreneur (Mar. 9, 2018), available at <https://www.entrepreneur.com/article/309894> (“[G]oing public . . . means a company has met that higher standard of transparency and financial responsibility in the form of bylaws, independent directors, regular disclosure, and checks and balances on accounts . . . It means establishing a clear mission and creating consistent metrics.”).

<sup>13</sup> We use the term “private fund” throughout the letter consistent with the definition in Section 202(a)(9) of the Investment Advisers Act: “an issuer that would be an investment company, as defined in Section 3 of the Investment Company Act, but for Section 3(c)(1) or 3(c)(7) of that Act.” These funds include private equity, hedge, and venture capital funds.

<sup>14</sup> See *infra* Section IV.A.

offerings. For example, private funds are not subject to the prescriptions of the Investment Company Act, including restrictions on affiliated transactions, rules on valuation or governance, or periodic reporting and disclosure requirements.<sup>15</sup>

- *Reduced Transparency.* The purpose of registration is to provide investors with full and fair disclosure of material information about public issuers so that investors can make their own informed investment decisions.<sup>16</sup> Exempt issuers generally are not required to provide information comparable to that included in a registration statement,<sup>17</sup> and the Commission staff does not review information that may be provided to investors. As a result, any information that an exempt issuer provides may not present risks in a balanced and understandable manner.
- *Reduced Redeemability.* Generally, most securities acquired in a private placement will be restricted securities.<sup>18</sup> As a result, investors cannot easily sell their investments in exempt offerings.

The Commission takes note of these differences in discussing the value of the public market. For example, Chairman Clayton recently lauded the public markets for providing “[p]rices for stocks, bonds, and other assets, generated by markets, that are transparent, information-rich, and fair.”<sup>19</sup> In contrast to Chairman Clayton’s praise for public market price transparency, many market participants have questioned the valuations of private companies, which may be based on elusive and opaque metrics.<sup>20</sup>

---

<sup>15</sup> The differences between public and private issuers generally apply to regulated and private funds as well, although we recognize that managers of both regulated funds and private funds are both generally subject to the Investment Advisers Act and the rules thereunder, which separately impose their own obligations and disclosure requirements. However, as discussed below in Section IV, the regulated and private fund frameworks contain fundamental investor protection differences.

<sup>16</sup> See Concept Release, *supra* note 2, at 5 (citing Commissioner Francis M. Wheat, *Disclosure to Investors — A Reappraisal of Federal Administrative Policies under the ’33 and ’34 Acts* (Mar. 1969)).

<sup>17</sup> The Commission echoed these concerns about private funds when it stated that private funds do not report or recordkeep information to “provide an adequate basis for monitoring compliance” with the recently proposed fund of funds rule. As a result, it declined to propose to permit private funds to be acquiring funds under the proposed rule. See Fund of Funds Arrangements, Securities Act Release No. 10590 (Dec. 19, 2018) at 18-20, available at <https://www.sec.gov/rules/proposed/2018/33-10590.pdf>.

<sup>18</sup> See Office of Investor Education and Advocacy, SEC, *Investor Bulletin: Private Placements Under Regulation D* (Sept. 24, 2014), available at [https://www.sec.gov/oiea/investor-alerts-bulletins/ib\\_privateplacements.html](https://www.sec.gov/oiea/investor-alerts-bulletins/ib_privateplacements.html); Office of Investor Education and Advocacy, SEC, *Investor Alert: Advertising for Unregistered Securities Offerings* (Sept. 23, 2013), available at [https://www.sec.gov/investor/alerts/ia\\_solicitation.pdf](https://www.sec.gov/investor/alerts/ia_solicitation.pdf).

<sup>19</sup> See Clayton Speech, *supra* note 2.

<sup>20</sup> See, e.g., Jason Zweig, *How We Should Bust an Investing Myth*, Wall Street Journal (Sept. 20, 2019), available at [https://www.wsj.com/articles/how-we-should-bust-an-investing-myth-11568991786?mod=hp\\_lead\\_pos8](https://www.wsj.com/articles/how-we-should-bust-an-investing-myth-11568991786?mod=hp_lead_pos8) (“[C]onventional valuation methods may overstate what private funds’ venture holdings are worth. Often, several share classes are valued equally even though they aren’t all entitled to the same payoffs.”); Annie Palmer, *WeWork’s Valuation Would Fall Below \$15 Billion in IPO, Down from \$47 Billion Private Valuation*, CNBC (Sept. 13, 2019), available at

The risks for retail investors in the private market have been the same since Congress enacted the Securities Act and the Investment Company Act in the 1930s and 1940s.<sup>21</sup> The Commission likewise has differentiated the regulatory treatment to account for these fundamental differences and risks. Overall, the current exempt offering framework aims to protect retail investors from the unique risks of private offerings, some deemed too harsh or difficult to bear, such as by requiring investors to meet minimum financial thresholds or limiting the amounts of their investments.

We urge the Commission to keep these risks in mind in considering how to provide retail investors with access to private market investment opportunities. We discuss our specific recommendations regarding the accredited investor definition, general solicitation of exempt offerings, and private pooled investment vehicles in Sections II, III, IV.A, and IV.C below.

### **C. Encourage Investor Protection By Increasing Retail Investor Access To Private Markets Through Regulated Funds**

Given the potential risks of private market offerings to retail investors, we recommend that the Commission encourage greater access to those offerings through regulated funds. Regulated funds provide investor protection through a professionally managed investment vehicle with a strong governance framework, subject to comprehensive regulation.

Regulated funds must provide investors and prospective investors with the fund's prospectus containing key information, in plain English, in a standardized order and format.<sup>22</sup> Further, the Investment Company Act, among other things, provides important safeguards requiring regulated funds to: confine their use of leverage;<sup>23</sup> restrict their transactions with affiliates;<sup>24</sup> custody their assets

---

<https://www.cnbc.com/2019/09/13/wework-makes-sweeping-corporate-governance-changes-ahead-of-ipo.html>. In addition, misleading performance and valuation claims by private funds in soliciting investors has been the subject of recent criminal actions, SEC civil litigation, and SEC enforcement activity. See *United States v. Abuja*, Criminal Action No. 1:18-cr-00328 (S.D.N.Y., filed May 9, 2019) (charging defendant with securities fraud for deceptively mismarking performance of existing funds, in part to persuade prospective investors to invest in a fund), see also *SEC v. Premium Point Investments LP*, Litigation Release No. 24138 (May 9, 2018) (discussing a related civil action); *In re Timothy S. Dembski*, Securities Act Release No. 10329 (Mar. 24, 2017) (finding investment adviser committed fraud when soliciting investment in a hedge fund by providing misleading back-tested performance data).

<sup>21</sup> See SEC, *What We Do*, available at <http://www.sec.gov/about/whatwedo.shtml> (stating that the Securities Act “has two basic objectives: (1) require that investors receive financial and other significant information concerning securities being offered for public sale; and (2) prohibit deceit, misrepresentations, and other fraud in the sale of securities.”).

<sup>22</sup> See Section 5(b)(2) of the Securities Act. See also Forms N-1A and N-2. Closed-end funds are only required to provide prospectuses during their initial offering. Registration statements for open-end funds (Form N-1A) and closed-end funds (Form N-2), which include the prospectus, must be filed on EDGAR.

<sup>23</sup> The Investment Company Act and related SEC and staff guidance strictly limit regulated funds' ability to use leverage. Generally speaking, open-end funds can borrow from a bank, provided there is at least 300 percent asset coverage. Closed-end funds may issue one class of debt, provided there is at least 300 percent asset coverage. They also may issue one class of preferred stock, provided there is at least 200 percent asset coverage. BDCs may issue debt, provided they have at least 150 percent asset coverage. See Sections 18 and 61 of the Investment Company Act.

<sup>24</sup> The Investment Company Act generally prohibits transactions between regulated funds and their affiliates, such as fund managers, a corporate parent of fund managers, or an entity under common control with fund managers. Among other

with qualified custodians;<sup>25</sup> diversify their holdings;<sup>26</sup> retain fidelity bonds for their officers and employees to protect against larceny and embezzlement;<sup>27</sup> obtain annual audits of their financial statements from independent accountants registered with the Public Company Accounting Oversight Board;<sup>28</sup> and maintain certain books and records.<sup>29</sup> The Investment Company Act also requires regulated funds value their assets pursuant to board-approved valuation procedures<sup>30</sup> and disclose these values, along with their holdings, periodically.<sup>31</sup>

In complying with these provisions, each fund must follow formalized practices pursuant to written policies and procedures reasonably designed to prevent federal securities law violations.<sup>32</sup> Further, regulated funds are required to have a board of directors, which generally have at least a majority of members who are independent of the fund's manager.<sup>33</sup> The board oversees the management,

---

things, the Act prohibits transactions between regulated funds and affiliates buying for their own account. It also prohibits joint transactions between regulated funds and their affiliates. *See* Sections 17(a), 17(d), and 57 of the Investment Company Act.

<sup>25</sup> The Investment Company Act requires regulated funds to keep their assets separate from the assets of fund managers to protect against theft or misappropriation. *See* Section 17(f) of the Investment Company Act.

<sup>26</sup> Regulated funds select whether to adhere to the diversification requirements of the Investment Company Act. If they do (and most do), with respect to 75 percent of their portfolio, no more than 5 percent may be invested in any one issuer. *See* Section 5(b) of the Investment Company Act. In addition, Subchapter M of the Internal Revenue Code provides regulated funds with an exemption from full corporate taxation only if they are diversified. Generally speaking, to be diversified under Subchapter M, a regulated fund may not invest more than 25 percent of its assets in the securities of any issuer. So, under Subchapter M, a regulated fund with no cash position must be invested in the securities of at least 12 issuers. The typical regulated fund invests in many more issuers — as of December 2018, the median number of stocks held by US equity mutual funds was 81. *See* ICI, *2019 Investment Company Fact Book*, Appendix A, available at <https://www.icifactbook.org>.

<sup>27</sup> *See* Section 17(g) of the Investment Company Act and Rule 17g-1 thereunder.

<sup>28</sup> *See* Section 30(g) of the Investment Company Act.

<sup>29</sup> *See* Section 31 of the Investment Company Act.

<sup>30</sup> Regulated funds generally use market values to price portfolio securities for which market quotations are readily available. When market quotations are not readily available, such as for certain exempt offerings, regulated funds must price portfolio securities and all other assets using "fair value" as determined in good faith by the fund's board of directors. *See* Section 2(a)(41) of the Investment Company Act. We recognize that it may be difficult, if not impossible, for a regulated fund to value their investments in certain exempt offerings. We would expect, however, that regulated funds would choose their investments in a manner that allows compliance with these requirements.

<sup>31</sup> To meet periodic disclosure requirements, regulated funds must compute and provide their net asset value ("NAV") at least quarterly. More than 90 percent of closed-end funds calculate the value of their portfolios every business day, while others calculate their portfolio values weekly or on some other basis. *See* ICI, *A Guide to Closed-End Funds* (July 2019), available at [https://www.ici.org/cef/background/bro\\_g2\\_ce](https://www.ici.org/cef/background/bro_g2_ce). Open-end funds must compute and disclose NAVs daily. *See* Rule 22c-1 under the Investment Company Act. Open-end and closed-end funds also provide their holdings quarterly on Form N-PORT or N-CSR filings. BDCs provide their holdings on Form 10-Q or 10-K filings.

<sup>32</sup> Rule 38a-1 under the Investment Company Act requires funds to adopt policies and procedures to prevent violations of the federal securities laws. *See also* Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 26299 (Dec. 17, 2003), available at <https://www.sec.gov/rules/final/2016/33-10233.pdf>.

<sup>33</sup> On most fund boards, independent directors make up at least 75 percent of its members. *See* ICI/IDC, *Overview of Fund Governance Practices, 1994-2017*, available at [https://www.idc.org/pdf/pub\\_17\\_fund\\_governance.pdf](https://www.idc.org/pdf/pub_17_fund_governance.pdf).

operations and investment performance of the fund and is subject to state law duties of care and loyalty and has specified responsibilities under the Investment Company Act.

The structure and protections offered by regulated funds has no equivalent in the private markets. As a result, a regulated fund can be helpful tool for providing retail investor access to private offerings with an overlay of governance and regulation.

We discuss our recommendations for the Commission to encourage regulated funds as the vehicles through which Main Street investors can access private market growth in Section IV.B.1 below.

## **II. Modernize the Accredited Investor Definition**

The Commission requests comment on whether to modify the definition of accredited investor in several respects, including the income and net worth tests.<sup>34</sup> Notably these thresholds have not been modified in any comprehensive manner for almost 40 years, and, as a result, the specific financial thresholds do not capture the same category of eligible investors originally targeted. We therefore recommend that, in modifying the accredited investor definition, the Commission prioritize capturing the pool of investors that the definition originally intended.<sup>35</sup>

### **A. The Accredited Investor Definition Has Eroded**

The Commission created the accredited investor definition as a “keystone” of Regulation D exempt offerings.<sup>36</sup> Regulation D established bright-line tests for individuals to qualify as accredited investors based on their income or net worth as follows:

- Any natural person who had individual income in excess of \$200,000 in each of the two most recent years or joint income with that person’s spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.

---

<sup>34</sup> See Concept Release, *supra* note 2, at 54-60, Questions 20-32.

<sup>35</sup> We also recommend that the Commission modernize the definition of Qualified Institutional Buyer (“QIB”) under Rule 144A. See Concept Release, *supra* note 2, at 197-99. Specifically, the current QIB definition does not include some legal entities that otherwise meet the substantive requirements of Rule 144A (*i.e.*, acting for its own account or the accounts of other QIBs and owning and investing on a discretionary basis at least \$100 million in securities of unaffiliated issuers) from meeting the definition of QIB, solely on the basis of legal form or organization. One way the Commission may consider modernizing the QIB definition would be to amend Rule 144A to clarify that the term “similar business trust” under subsection (a)(1)(H) includes any centrally managed trust that meets the substantive requirements of Rule 144A and is managed by a foreign or domestic bank or a professional investment manager that itself meets the QIB definition. Such amendments would create certainty that foreign mutual funds that are organized as trusts meet the QIB definition, just as foreign funds organized as corporations or partnerships already do under the rule.

<sup>36</sup> See Proposed Revision of Certain Exemptions from the Registration Provisions of the Securities Act of 1933 for Transactions Involving Limited Offers and Sales, Securities Act Release No. 6339 (Aug. 7, 1981). See also Regulation D Revisions, Securities Act Release No. 6758 (Mar. 3, 1988) (“Regulation D Revisions Release”) (“A keystone of Regulation D is the concept of the accredited investor.”).



- Any natural person whose individual net worth, or joint net worth with that person's spouse, exceeds \$1 million.<sup>37</sup>

Other than expanding the income test to include a joint income component and excluding the value of one's primary residence from the net worth calculation, the Commission has not revised the income and net worth tests since 1982.<sup>38</sup> Consequently, general inflationary effects have expanded significantly the pool that qualifies as accredited investors.<sup>39</sup>

Figure 1 illustrates this for the income test.<sup>40</sup> The lower black line, which adjusts Adjusted Gross Income (AGI) for inflation, shows the proportion of returns that would have reported AGI over \$200,000 if inflation had been zero. As seen, in this case, a much lower 1.2 percent of returns would have exceeded the \$200,000 threshold in 2016. The difference between the top and bottom lines demonstrates that the proportion of households qualifying for accredited investor status is much higher now than in 1982 simply because of inflation.

---

<sup>37</sup> See Rule 501(a) of Regulation D.

<sup>38</sup> See Regulation D Revisions Release, *supra* note 36; Net Worth Standard for Accredited Investors, Securities Act Release No. 9287 (Dec. 21, 2011), available at <https://www.sec.gov/rules/final/2011/33-9287.pdf>.

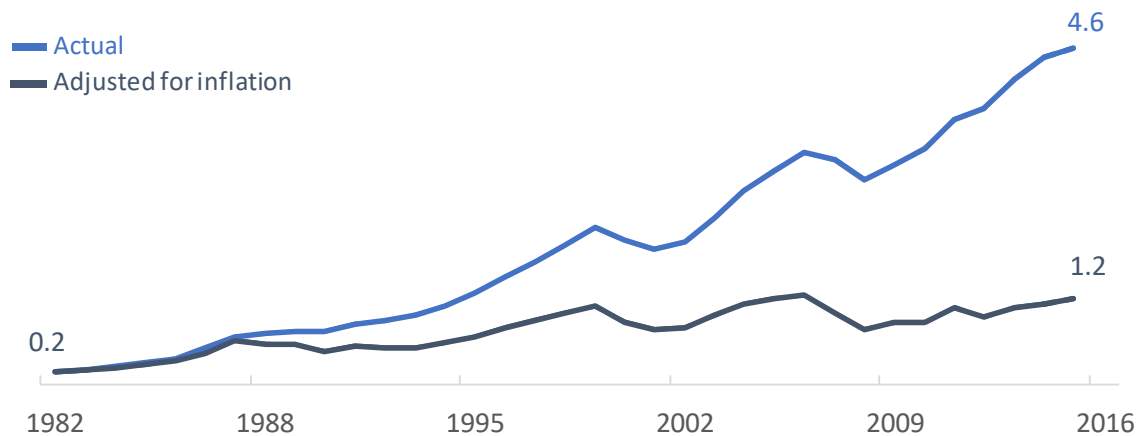
<sup>39</sup> See, e.g., Statement of Professor Robert B. Thompson, Peter P. Weidenbruch Professor of Business Law, Georgetown University Law Center, at Hearings Before the House Subcomm. on Capital Markets and Government Sponsored Enterprises (Sept. 13, 2012), available at <https://financialservices.house.gov/uploadedfiles/hrg-112-ba16-wstate-rthompson-20120913.pdf> (noting that "measured as a percentage of the pool of individual taxpayers, the number of individuals whose income is above \$200,000 is now [in 2012] 20 times larger than at the time of the enactment of Regulation D.").

<sup>40</sup> We do not generally report findings based on the joint income threshold for accredited investor status (\$300,000), consistent with the Concept Release (*see* Concept Release, *supra* note 2, at 35-36 n.78).

---

**Figure 1**  
**Inflation Has Moved Many More Tax Returns over the \$200,000 Income Threshold**

Percentage of tax returns reporting Adjusted Gross Income of \$200,000 or more, tax years 1982–2016



Note: Data from 1982 through 2015 are from Justin Bryan, “High-Income Tax Returns for Tax Year 2015,” *Statistics of Income Bulletin*, Internal Revenue Service (Fall 2018), available at <https://www.irs.gov/pub/irs-soi/soi-a-hint-id1806.pdf>. Real data for 2016 were derived by ICI computation of IRS data using IRS’ method for estimation. IRS 2016 nominal data are from SOI individual income tax returns tables, available at <https://www.irs.gov/statistics/soi-tax-stats-individual-high-income-tax-returns# tables>. Data for CPI-U are from the Bureau of Labor Statistics, available at <https://www.bls.gov/data/>. Sources: ICI analysis using data from IRS Statistics of Income and Bureau of Labor Statistics.

---

Similarly, the Commission staff found that 1.8 percent of US households qualified as accredited investors in 1983,<sup>41</sup> whereas 13 percent of US households qualified in 2016.<sup>42</sup> In other words, the Commission estimates that qualification has expanded from fewer than one in 50 households to greater than one in eight.

---

<sup>41</sup> See SEC Staff, *Report on the Review of the Definition of “Accredited Investor”* (Dec. 18, 2015) at 105, tbl. 10.5, available at <https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf> (“2015 Staff Report”) (using 1983 Survey of Consumer Finances (SCF) data). The unit of analysis in the SCF is a household, and the Commission discusses some limitations of SCF data in the Concept Release at 35-36, n.78.

<sup>42</sup> See Concept Release, *supra* note 2, at 36, tbl. 3.

Our independent analyses of household finances using SCF data over the period from 1983 to 2016 are consistent with the conclusions of the Commission staff.<sup>43</sup> As summarized in Figure 2:

- In 1983, 0.6 percent of US households qualified as accredited investors based on income and 1.7 percent based on net worth.<sup>44</sup> Because some households would have qualified by either test, we estimate that overall, 1.8 percent of households qualified in 1983.
- In 2016, because the Commission has not adjusted the tests for inflation, 8.1 percent of households qualified based on income and 8.9 percent on net worth. Overall, we find 11.8 percent of households qualified under either test in 2016.
- If the test thresholds had been adjusted for inflation from 1983 to 2016, between 1.9 and 2.2 percent of households would have qualified based on income, and between 4.7 and 5.6 percent based on net worth. Overall, we estimate that between 5.0 and 6.0 percent of households would have qualified for accredited investor status had the Commission adjusted the tests for inflation – about half as many households that qualified in 2016 under the unadjusted tests.

We also estimate what the income and net worth tests would have been in 2016 if the same percentage of US households were to qualify as accredited investors then as qualified in 1983. The individual income threshold would have been roughly \$1.2 million, and the net worth threshold would have been \$5.9 million.<sup>45</sup> Using these test thresholds, 1.8 percent of households would have qualified overall as accredited investors in 2016.<sup>46</sup>

---

<sup>43</sup> See *infra* Figure 2. Differences between our estimates and those that the Commission provides in the Concept Release are explained by our use of 2016 household income and net worth data as reported, compared with Commission use of that data adjusted for inflation to 2019.

<sup>44</sup> The Commission staff estimates that 0.5 percent of households qualified based on the income threshold and that 1.7 percent qualified based on net worth in 1983, which pre-dates the joint income qualification. Overall the Commission staff estimates that 1.8 percent of US households qualified under either test. See 2015 Staff Report, *supra* note 41, tbls. 10.1, 10.2 & 10.5.

<sup>45</sup> Excluding home equity.

<sup>46</sup> We estimate that 0.8 million households would have qualified under the income test, and 2.1 million households under the net worth test; as with elsewhere in this table, because some households are eligible by either standard, overall 2.3 million households would have qualified as accredited investors in 2016.

**Figure 2**  
**Accredited Investor Thresholds in 1983 and 2016**

<i>Under current thresholds</i> (nominal dollar values)	<b>1983</b>	<b>Number of qualifying households</b>	<b>Qualifying households as a percentage of US households</b>
Income of \$200,000 or more		0.5 million	0.6%
Net worth of \$1 million or more		1.4 million	1.7%
Overall		1.5 million	1.8%
<b>(nominal dollar values)</b>	<b>2016</b>		
Income of \$200,000 or more		10.2 million	8.1%
Net worth of \$1 million or more (excluding home equity)		11.3 million	8.9%
Overall		14.9 million	11.8%
<b>Conditional on 1983 thresholds being indexed for inflation to 2016</b>			
<b>(real dollar values)</b>	<b>2016</b>		
Income of \$200,000 or more			
PCE	\$433,500	2.8 million	2.2%
CPI-U	\$497,000	2.4 million	1.9%
Net worth of \$1 million or more (excluding home equity)			
PCE	\$2,167,500	7.1 million	5.6%
CPI-U	\$2,485,000	5.9 million	4.7%
Overall			
PCE		7.6 million	6.0%
CPI-U		6.3 million	5.0%
<b>Conditional on percentage of households being maintained at 1983 levels</b>			
<b>(nominal dollar values)</b>	<b>2016</b>		
Income of <u>\$1,195,900</u> or more		0.8 million	0.6%
Net worth of <u>\$5,886,500</u> or more (excluding home equity)		2.1 million	1.7%
Overall		2.3 million	1.8%

Sources: ICI tabulations of Survey of Consumer Finances data, available at <https://www.federalreserve.gov/econres/scfindex.htm>; calculation of inflation based on data for CPI-U from the Bureau of Labor Statistics, available at <https://www.bls.gov/data/>; and data for the PCE from the Bureau of Economic Analysis, available at <https://www.bea.gov/data/personal-consumption-expenditures-price-index>.

## B. Update the Accredited Investor Definition

We therefore recommend that the Commission modernize the accredited investor definition to adjust the income and net worth thresholds for inflation since 1982. Further, we recommend instituting a requirement that the thresholds be re-adjusted for inflation every five years. This approach would be

consistent with that under the Investment Advisers Act for the “qualified client” definition.<sup>47</sup> Alternatively, the Commission could set the thresholds to encompass the same percentage of US households as the accredited definition did in 1982. The Commission also could add a threshold based on the amount of investments that an investor owns, similar to one of the tests in the definition of “qualified purchaser” under the Investment Company Act.<sup>48</sup>

We do not believe that the Commission should alter the accredited investor definition with simply a goal “to expand the pool of sophisticated investors.”<sup>49</sup> Rather, the guiding principle for the Commission must be modernizing the definition consistent with investor protection.

We recommend that the Commission not permit individual investors that are advised by registered financial professionals to be considered accredited investors. We acknowledge the potential value of recommendations by registered investment advisers and broker-dealers for retail investors; however, for investments in the private markets we believe that an additional layer of substantive protection, such as that provided under the Investment Company Act, is necessary to ensure adequate investor protection.<sup>50</sup> Not only are investment advisers to a regulated fund registered under the Investment Advisers Act of 1940,<sup>51</sup> but also the fund is subject to the Investment Company Act and the Securities Act.

---

<sup>47</sup> See Section 205(c) of the Investment Advisers Act. Generally, we recommend that the accredited investor, qualified client, and qualified purchaser definitions all be adjusted for inflation in a methodologically consistent way in order to preserve each standard in relative proportion to its role. In addition to the erosion of the accredited investor definition, the qualified purchaser has also eroded from inflation since its introduction in 1996. We estimate that to adjust for inflation measured by either the PCE or CPI-U indices, the Commission should increase the \$5 million investment threshold for qualified purchasers to between \$7.4 million (PCE) and \$7.9 million (CPI-U).

<sup>48</sup> Individual investors can meet the qualified purchaser test by owning not less than \$5 million in investments. See Section 2(a)(51) of the Investment Company Act. The Commission previously proposed but did not adopt a similar test that individuals would need to satisfy to invest in certain private pooled investment vehicles relying on Rule 506. See Prohibition of Fraud by Advisers to Certain Pooled Investment Vehicles; Accredited Investors in Certain Private Investment Vehicles, Investment Advisers Act Release No. 2576 (Dec. 27, 2006), available at <https://www.sec.gov/rules/proposed/2006/33-8766.pdf>.

<sup>49</sup> See Concept Release, *supra* note 2, at 57, Question 27.

<sup>50</sup> See Regulation Best Interest: The Broker-Dealer Standard of Conduct, Securities Exchange Act Release No. 86031 (June 5, 2019), available at <https://www.sec.gov/rules/final/2019/34-86031.pdf>. ICI generally supported Regulation Best Interest. See Letter of Paul Schott Stevens, President and CEO, ICI, to Brent J. Fields, Secretary, SEC, available at <https://www.sec.gov/comments/s7-07-18/s70718-4184208-172550.pdf>. Our support for Regulation Best Interest was in the context of the investment opportunities that were available to retail investors at the time of the rulemaking. If the Commission were to expand the ability of retail investors to access exempt offerings, we would consider whether to recommend additional measures to protect investors. See also Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Investment Advisers Act Release No. 5248 (June 5, 2019) (“Investment Adviser Interpretation”), available at <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>.

<sup>51</sup> Managers of BDCs with less than \$25 million of assets under management are not subject to the Investment Advisers Act. See Section 203A(a)(2)(A) of the Advisers Act. See also Item 2.A.(6) of Part 1A of Form ADV. For purposes of this letter, we limit our discussion to managers of BDCs that have at least \$25 million of assets under management and managers of registered open-end and closed-end funds, all of whom are subject to the Investment Advisers Act.

As the Commission itself states, being advised by a financial professional historically has not substituted for the protections of the Securities Act or the Investment Company Act.<sup>52</sup> For example, exempt issuers do not make standardized or public disclosures concerning material facts about their businesses, such as valuation and performance – making it difficult for retail investors or their financial professionals to evaluate or compare the offering.<sup>53</sup> Further, registered financial professionals, even if they are working in an investor’s best interest or a fiduciary capacity, can vary in their levels of financial sophistication and knowledge.<sup>54</sup> For riskier exempt offerings that provide less information in the public domain, it may be difficult for many financial professionals to evaluate the offering and difficult for the investor to assess the work of the financial professional.<sup>55</sup>

We also believe that having financial professionals advise individual investors who do not have sufficient income or net worth to meet the current definition of accredited investor raises concerns about economies of scale and adverse selection. While larger or institutional investors with research staffs and large pools of capital to offer can access the more-attractive investment opportunities and negotiate pricing, rights, and access to information, smaller individual investors and their financial professionals only may be able to access less-attractive opportunities, without the expertise to properly evaluate those investments.

Therefore, rather than permitting individual investors that are advised by registered financial professionals to access private market offerings, the Commission should remove certain regulatory barriers to facilitate closed-end fund investment in private offerings. In addition to fund advisers being subject to the Investment Advisers Act, the Securities Act and Investment Company Act impose critical

---

<sup>52</sup> See Concept Release, *supra* note 2, at 57, Question 27.

<sup>53</sup> See Rey Mashayeki, *Doesn't Pass the Smell Test: Investors Question Recent Developments at WeWork Ahead of IPO*, Fortune (July 25, 2019), available at <https://fortune.com/2019/07/25/wework-ipo-adam-neumann-ceo/> (noting that a private company has profitability and corporate governance issues — “something that may not be of great concern to private investors, but is a trickier sell in the public markets.”).

<sup>54</sup> In addition, analysis of regulatory records has raised questions about the conduct of broker-dealers that more typically sell private offerings to individual investors. The Wall Street Journal reported last year that brokers who sold private offerings to individuals were more likely to work at firms with a negative disciplinary history. Jean Eaglesham and Coulter Jones, *Firms with Troubled Brokers Are Often Behind Sales of Private Stakes*, Wall Street Journal (June 24, 2018), available at <https://www.wsj.com/articles/firms-with-troubled-brokers-are-often-behind-sales-of-private-stakes-1529838000> (“[T]he Journal identified over a hundred firms where 10% to 60% of the in-house brokers had three or more investor complaints, regulatory actions, criminal charges or other red flags on their record — significant outliers in the investment community.”). See, e.g., *In re Advanced Equities, Inc., Dwight O. Badger & Keith G. Daubenspeck*, Securities Act Release No. 9362 (Sept. 18, 2012), available at <https://www.sec.gov/litigation/admin/2012/33-9362.pdf> (alleging broker-dealer and investment adviser misstatements and omissions during a private equity offering on behalf of a non-public alternative energy company).

<sup>55</sup> See Mark Schoeff, Jr., *Advisers May Not Be Equipped to Help Clients Navigate Private Markets*, Investment News (Aug. 9, 2019), available at <https://www.investmentnews.com/> (“Advisers may be relied upon as intermediaries if more of their clients become eligible to buy private placements. But there’s no guarantee that they’ll know any more than their clients do about often complex, risky and illiquid private equity and hedge funds and other private vehicles.”).

investment protection obligations on regulated funds and their advisers. This combination provides the robust investor protections needed if retail investors are granted greater access to exempt offerings.<sup>56</sup>

### **III. General Solicitation for Exempt Offerings**

The Commission requests comment on a number of ideas that expand exempt issuers' use of general solicitation. The Commission asks generally about revising the exempt offerings framework to focus on investor protections at the time of sale rather than at the time of offer.<sup>57</sup> The Commission also requests comment on the investor protection measures of Rule 506(c) of Regulation D, which permits some exempt issuers to advertise generally but limit sales to accredited investors.<sup>58</sup> At the same time, the Commission requests comment on several ideas that would have the effect of blurring the lines between public and private offerings, including by allowing non-accredited investors to purchase securities in exempt offerings.<sup>59</sup>

As discussed below, the premise for allowing general solicitation for exempt offerings has been that those offerings are limited to sophisticated investors. Especially if general solicitation is allowed for exempt offerings *not* limited to sophisticated investors, we recommend that the Commission put in place measures to reduce the potential for investor confusion and even misleading solicitations.

#### **A. General Solicitation for Exempt Offerings Presents Risks for Unsophisticated Investors**

Exempt offerings present different risks from public offerings. When the Commission adopted Rule 506(c) of Regulation D to permit general solicitation for some exempt offerings, it purposely maintained the requirement that only sophisticated investors could purchase those offerings. In considering amendments to Rule 506(c), the Commission declined to adopt several recommended investor protection measures, including requiring standardized private fund performance. It reasoned that those measures were not necessary because only relatively sophisticated investors could purchase 506(c) offerings.<sup>60</sup> The premise for such regulatory treatment – the sophisticated nature of the investors – would evaporate if the Commission were to expand the ability of retail investors to purchase these securities.

The Commission must help retail investors understand the distinctions – both risks and rewards – of different types of investments. General solicitation by private funds particularly can be confusing

---

<sup>56</sup> See *infra* Section IV.B (discussing recommendations for regulated funds).

<sup>57</sup> See Concept Release, *supra* note 2, at 25, Question 5.

<sup>58</sup> *Id.* at 82, Question 33.

<sup>59</sup> *Id.* at 85, Question 44.

<sup>60</sup> See Amendments to Regulation D, Form D and Rule 156, Securities Act Release No. 9416 (July 10, 2013) (“2013 Proposing Release”) at 84-85, available at <https://www.sec.gov/rules/proposed/2013/33-9416.pdf>.

because the distinctions between regulated funds and private funds are not always apparent to the public or the press.<sup>61</sup>

### **B. Adopt Measures to Mitigate Investor Confusion**

We therefore recommend that the Commission adopt certain measures designed to mitigate investor confusion and the potential for misleading solicitations.<sup>62</sup>

First, the Commission should adopt a rule for private funds similar to Securities Act Rule 156 that would make it unlawful for any person to use sales literature that is materially misleading in connection with the offer or sale of interests in private funds, as the rule currently does for investment companies. In 2013, the Commission seemed to agree with this sentiment, suggesting that “private funds should now be considering the principles underlying Rule 156 to avoid making fraudulent statements in their sales literature.”<sup>63</sup> We recommend that the Commission explicitly prohibit these practices for private funds.<sup>64</sup> The protections afforded by Rule 156 are equally important for investors in private funds, including prohibitions against misleading representations about performance and unwarranted or partially explained comparisons to other investment vehicles or to indexes.

The Commission also should develop a rule to standardize private fund performance advertising similar to Securities Act Rule 482, which regulates mutual fund performance advertising.<sup>65</sup> While we

---

<sup>61</sup> One example of public confusion about types of regulated and private funds occurred in 2012, when the United States Attorney’s Office in the Southern District of New York issued a press release reporting that a defendant who “served as Chairman of the Advisory Board of Praetorian Global Fund Ltd. (‘Praetorian’), a professional mutual fund,” had pleaded guilty to securities fraud. See Press Release, U.S. Attorney’s Office, S.D.N.Y., *Florida Businessman Sentenced in Manhattan Federal Court to 11 Years in Prison in Connection with \$13 Million Fraud Scheme Involving Phony Facebook and Groupon Stock* (June 21, 2013), available at <https://www.justice.gov/usao-sdny/pr/florida-businessman-sentenced-manhattan-federal-court-11-years-prison-connection-13>. The fund at issue, however, was not a mutual fund, but, as described by the SEC in its press release about the related civil litigation, “a newly minted hedge fund.” See SEC Litigation Release No. 22160 (Nov. 17, 2011), available at <https://www.sec.gov/news/press/2011/2011-245.htm>.

<sup>62</sup> We recommend that the Commission adopt restrictions for private fund advertising beyond the anti-fraud requirements of Section 206(4) of the Investment Advisers Act and Rule 206(4)-8 thereunder. If those regulations alone were enough to dispel investor confusion and prevent misleading solicitation, then the myriad rules and staff guidance applicable to regulated funds that the Commission and staff as well as FINRA have developed over decades would not be necessary.

<sup>63</sup> See 2013 Proposing Release, *supra* note 60, at 78.

<sup>64</sup> Alternatively, if the Commission finds such a prohibition to be unnecessary for private funds, we recommend that the Commission consider if it is also unnecessary for regulated funds. Particularly, if the Commission determines that no additional content restrictions are necessary to private fund advertisements for Rule 506(c) offerings, then it also should consider the necessity of restrictions currently applicable to sales material for mutual funds and other registered investment companies that is only available to institutional investors.

<sup>65</sup> See Covered Investment Fund Research Reports, Securities Act Release No. 10580 (Nov. 30, 2018) at 57-58, available at <https://www.sec.gov/rules/final/2018/33-10580.pdf> (agreeing that comparing mutual fund performance is a significant consideration for investors and requiring that research reports that include open-end fund performance must present this information in accord with Rule 482).



are not recommending that the Commission adopt an identical rule for private funds,<sup>66</sup> we believe a tailored rule would benefit investors by promoting comparability among fund performance claims.<sup>67</sup>

Further, the Commission should require that private fund general solicitations bear a prominent, plain English legend that distinguishes the private fund from regulated funds using language retail investors can understand.<sup>68</sup> Such a legend would alert investors that the product they are considering is not required to comply with fundamental investor protections under the Investment Company Act. Further, such a legend is consistent with the Commission's recent adoption of the Form CRS Relationship Summary as a disclosure to reduce retail investor confusion and inform investment choices.<sup>69</sup>

#### IV. Pooled Investment Vehicles

The Commission requests comment on whether to permit retail investors to access exempt offerings through pooled investment vehicles, including regulated funds or certain private funds.<sup>70</sup> The Commission highlights several advantages to accessing exempt offerings through pooled investment vehicles. While we agree generally on some of the advantages, the Commission does not oversee all pooled investment vehicles in the same manner, and therefore retail investors would not receive the same level of protections, for example, in a private fund exempt from registration under Sections 3(c)(1) or 3(c)(7) of the Investment Company Act as compared to a regulated fund.<sup>71</sup> Consequently,

---

<sup>66</sup> As the Commission stated, "legitimate reasons may result in different approaches to calculating performance for private funds," including the type of the fund, assumptions underlying the calculations and investor preferences. See 2013 Proposing Release, *supra* note 60, at 84-85.

<sup>67</sup> See Advertising by Investment Companies; Proposed Rules and Amendments to Rules, Forms, and Guidelines, Investment Company Act Release No. 15315 (Sept. 17, 1986) (stating "uniform standards . . . minimize the possibility of misleading fund performance claims and facilitate meaningful comparisons. This should promote competition among funds and enhance the ability of prospective investors to make informed investment decisions.").

<sup>68</sup> The Commission proposed such a legend as "Rule 509" in 2013. See 2013 Proposing Release, *supra* note 60, at 62-77. We reaffirm our support for that legend, with recommending additional language to alleviate confusion between private and regulated funds. See Letter from Paul Schott Stevens, President and CEO, ICI, to Elizabeth M. Murphy, Secretary, SEC (Sept. 23, 2013), available at <https://www.sec.gov/comments/s7-06-13/s70613-398.pdf>.

<sup>69</sup> See Form CRS Relationship Summary; Amendments to Form ADV, Securities Exchange Act Release No. 85032 (June 5, 2019), available at <https://www.sec.gov/rules/final/2019/34-86032.pdf>.

<sup>70</sup> See Concept Release, *supra* note 2, at 58, Question 28, and at 187-93, Questions 111-129.

<sup>71</sup> Private funds that are exempt under Section 3(c)(1) of the Investment Company Act must be beneficially owned by not more than 100 persons, who generally are accredited investors. Section 3(c)(1) reflects Congress's view that privately placed investment companies owned by a limited number of investors do not rise to the level of federal interest under the Investment Company Act. See Division of Investment Management, SEC, *Implications of the Growth of Hedge Funds* ("2003 Hedge Fund Report") (Sept. 2003), available at <https://www.sec.gov/news/studies/hedgefunds0903.pdf>. Section 504 of the Economic Growth Act amended Section 3(c)(1) to increase the limit to 250 persons in the case of a "qualifying venture capital fund," which is defined as a venture capital fund with not more than \$10 million in aggregate capital contributions and uncalled committed capital. The legislative history of this amendment indicates Congress's intention to "further promote capital formation at the earliest stages of a business's life cycle." See H.R. Rep. 115-70 (2017), available at <https://www.congress.gov/congressional-report/115th-congress/house-report/70/1>. We do not recommend any changes to Section 3(1) except to reaffirm our recommendations for modernizing the definition of accredited investors. See Section II.B above. In addition, we recommend that the Commission continue to maintain robust integration rules to prevent fund

we believe that access through a regulated fund is superior and would provide the needed investor protection for retail investors. Closed-end funds in particular are an ideal type of regulated fund vehicle to facilitate more retail investor access to exempt offerings.<sup>72</sup>

### A. Private Funds

We would oppose the Commission permitting retail investors direct access to private funds. As discussed above, exempt offerings, such as private funds, face less regulation than public offerings, and the market for exempt offerings has grown without consideration to retail investor participation in these investments. This is both from a legal and practical standpoint as far as the design and structure of such investments. At the same time, we recognize that investment in private offerings could provide retail investors with investment opportunities. We therefore recommend that the Commission explore ways to expand retail investor access to private offerings through a regulated fund.

The securities laws do not require prescribed, standardized, or plain English information about private funds, including about their holdings and valuation.<sup>73</sup> Instead, private fund advisers typically provide potential investors with a non-public private placement memorandum. The adviser may have broad discretion in valuing the fund's assets.<sup>74</sup> Private fund reporting also may be customized to particular investors upon request.<sup>75</sup>

Private funds also often have distinctive features that may be difficult for retail investors to evaluate. For example, private equity fund investors typically commit to make an investment in the fund of a certain size. Based on this commitment, there may be "capital calls" to fulfill those commitments over the life of the fund. Investors may find such a call to provide capital months or years after their initial investment to be daunting. Private funds also may have "lock up periods" during which time investors

---

managers from launching multiple Section 3(c)(1) funds to circumvent Investment Company Act regulation requirements. See Concept Release, *supra* note 2, at 171, Question 106.

<sup>72</sup> See *infra* Section IV.B.

<sup>73</sup> Advisers to private funds with assets under management of \$150 million or more are required to file Form ADV. Part 2 of Form ADV requires advisers to provide a narrative description of their investment strategies and risk of loss but does not provide information about fund performance or holdings. Those advisers also must file Form PF, which requires reporting on fund performance and certain holdings. Form PF is non-public, however. See Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Investment Advisers Act Release No. 3308 (Oct. 31, 2011), available at <https://www.sec.gov/rules/final/2011/ia-3308.pdf>; see also SEC Office of Investor Education and Advocacy, *Fast Answers Hedge Funds*, available at <https://www.sec.gov/fast-answers/answershedghtml.html>. Further, some information that private funds may make public voluntarily, like performance information for funds engaging in Rule 506(c) general solicitation, is not standardized, making it difficult for investors to evaluate and make comparisons.

<sup>74</sup> See 2003 Hedge Fund Report, *supra* note 71. Private fund managers' valuation of fund assets is subject to the anti-fraud provisions of the Investment Advisers Act.

<sup>75</sup> See Ernst & Young, *2018 Global Alternative Fund Survey*, available at [https://assets.ey.com/content/dam/ey-sites/ey-com/en\\_gl/topics/wealth-and-asset-management/ey-2018-global-alternative-fund-survey.pdf](https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/wealth-and-asset-management/ey-2018-global-alternative-fund-survey.pdf) (finding that 42 percent of surveyed investors expected to increase their investments in funds that offer customized transparency or reporting).

are not permitted to liquidate their investments.<sup>76</sup> After the initial lockup period, investors only may be able to redeem their interests at certain periods or with certain notice that the fund determines. The terms of the fund's governing documents also may allow fund managers to suspend redemptions at any time.<sup>77</sup> In addition, private funds may have complex structures where the fund sponsor, manager, general partner, or service providers are affiliated, and may enter into co investment transactions with affiliates. Many investors may find understanding such potential conflicts of interest to be challenging and unfamiliar.

We therefore recommend maintaining the qualified purchaser standard for private funds exempted from registration under Section 3(c)(7) of the Investment Company Act. Qualified purchasers who are natural persons must own not less than \$5 million in investments to qualify.<sup>78</sup> It would be contrary to Congressional intent and the interest of investors for the Commission to interpret Section 3(c)(7) in a manner that would allow such a different and broad class of investors to invest in private funds.<sup>79</sup>

We similarly recommend maintaining qualified client standards to identify those investors for whom investing in private funds with performance fees is appropriate.<sup>80</sup> Qualified clients are natural persons who have at least \$1 million in assets under management with an adviser or a net worth of more than

---

<sup>76</sup> See Paul Atkins, Commissioner, SEC, *Keynote Remarks at the Inaugural Edward Laneretticker Speaker Series: Protecting Investors Through Hedge Fund Advisor Registration: Long on Costs, Short on Returns* (Mar. 30, 2006), available at [https://www.bu.edu/rbf/files/2013/09/Atkins\\_HedgeFundRule\\_Final.pdf](https://www.bu.edu/rbf/files/2013/09/Atkins_HedgeFundRule_Final.pdf) (“Longer lock-up periods [may] lessen the pressure on advisors to do their job well in order to discourage investors from leaving . . . Investors whose money is locked up for longer terms will not be able to vote effectively with their feet if the fund’s style shifts in a way that is not to their liking.”).

<sup>77</sup> See George O. Aragon, Tolga Ergun, Mila Getmansky & Giulio Girardi, Division of Economic and Risk Analysis, SEC, *Hedge Funds: Portfolio, Investor, and Financing Liquidity* (May 17, 2017), available at [https://www.sec.gov/files/dera\\_hf\\_liquidity.pdf](https://www.sec.gov/files/dera_hf_liquidity.pdf) (finding that 80 percent of investors’ shares in a typical hedge fund cannot be redeemed within 30 days and the average term of investor illiquidity is 172 days). Investors in private funds who cannot redeem their shares face “substantial” transaction costs in selling those shares on the secondary market, to the extent one exists. See Laurent Belsie, *The Liquidity Cost of Private Equity Investments*, NBER Digest (Oct. 2016), available at <https://www.nber.org/digest/oct16/w22404.html>.

<sup>78</sup> See Section 2(a)(51) of the Investment Company Act. When Congress created the Section 3(c)(7) exemption for qualified purchasers, it recognized that only “financially sophisticated investors are in a position to appreciate the risks associated with investment pools that do not have the Investment Company Act’s protections. Generally, these investors can evaluate on their own behalf matters such as the level of a fund’s management fees, governance provisions, transactions with affiliates, investment risk, leverage, and redemption rights.” See S. Rep. No. 104-293 (1996), available at <https://www.congress.gov/congressional-report/104th-congress/senate-report/293/1>; see also 2015 Staff Report, *supra* note 41, at 25-27.

<sup>79</sup> See also Letter from Paul Schott Stevens, Senior Vice President and General Counsel, ICI, to Jonathan G. Katz, Secretary, SEC, (Feb. 10, 1997), available at [https://www.ici.org/policy/comments/97\\_SEC\\_HEDGE\\_RULES\\_COM](https://www.ici.org/policy/comments/97_SEC_HEDGE_RULES_COM) (supporting the creation of a then-new “exemption for qualified purchaser pools provided its parameters were narrowly drawn by Congress...to only persons that may fend for themselves without the protection of the Investment Company Act.”); see also Letter from Elizabeth Krentzman, ICI, to Nancy M. Morris, Secretary, SEC (Mar. 9, 2009), available at <https://www.sec.gov/comments/s7-25-06/s72506-565.pdf> (stating that “private pools should be available only to investors with the sophistication to identify, analyze, and bear the risks of investing in complex, illiquid, or opaque investments.”).

<sup>80</sup> See Concept Release, *supra* note 2, at 191, Question 123.

\$2.1 million.<sup>81</sup> As the Commission noted, the qualified client standard limits private fund performance fees to only those clients “who are financially experienced and able to bear the risks.”<sup>82</sup>

Conversely, if the Commission were to permit greater retail investor direct access to private funds, then the Commission and the private fund market must consider appropriate adjustments to accommodate and protect retail investors, including eliminating some of the flexibility of private funds. For example, it may be necessary to consider measures to address conflicts of interest that are permitted in private fund structures, such as affiliated managers, sponsors, and general partners. Equally, the Commission may need to consider whether any specific rights for retail investors are needed as such investors may have significantly smaller capital contributions than other investors in the fund. For example, larger investors in private funds may use side letters to negotiate terms for their benefit versus the terms for other investors.<sup>83</sup> Investor protection measures for retail investors therefore might include prohibiting or limiting certain affiliated transactions, prohibiting side letters, alternative ways to address conflicts of interest, redemption rights, and valuation methods. Some of these constraints would be antithetical to private fund operations.<sup>84</sup> Yet, some changes would be appropriate and necessary to provide the investor protection envisioned for retail investors under our securities laws.

## **B. Regulated Funds**

### **1. Promote Retail Investor Access to Exempt Offerings through Regulated Funds**

The Commission can responsibly promote and expand access to private offerings through regulated funds and particularly through closed-end funds. Doing so would offer investors a strong degree of protection. In addition to Securities Act protections, the Investment Company Act subjects regulated funds to comprehensive requirements. Investment advisers to regulated funds also must be registered

---

<sup>81</sup> Rule 205-3 under the Investment Advisers Act.

<sup>82</sup> See Performance-Based Investment Advisory Fees, Investment Advisers Act Release No. 4388 (May 18, 2016) at 2-3, available at <https://www.sec.gov/rules/other/2016/ia-4388.pdf>.

<sup>83</sup> See Susan Ferris Wyderko, Director, Office of Investor Education and Assistance, SEC, Testimony Concerning Hedge Funds before United States Senate Subcomm. on Securities and Investment (May 16, 2006), available at <https://www.sec.gov/news/testimony/ts051606sfw.htm> (“Some side letters address matters that raise few concerns, such as the ability to make additional investments, receive treatment as favorable as other investors, or limit management fees and incentives. Others, however, are more troubling because they may involve material conflicts of interest that can harm the interests of other investors. Chief among these types of side letter agreements are those that give certain investors liquidity preferences or provide them with more access to portfolio information.”).

<sup>84</sup> We have similar concerns about allowing robo-advisers that provide investors with advice, whether about retirement savings or more generally, to include a limited amount of exposure to exempt offerings as part of their portfolio. Should the Commission permit robo-advisers to act in such a capacity, it should require that robo-advisers do so with the same limitations and investor protections that we discuss regarding private funds. See Concept Release, *supra* note 2, at 191, Question 122.

under the Investment Advisers Act.<sup>85</sup> This combined regulatory framework provides robust protection to investors as compared to investors investing in private funds or other exempt offerings.<sup>86</sup>

As the Commission describes, the Investment Company Act minimizes conflicts of interest and requires funds to disclose their financial condition and investment policies to investors.<sup>87</sup> The focus of the Act is on governing fund structure and operations, as well as ensuring appropriate public disclosure about funds and their investment objectives. These regulations impose substantive requirements on funds to protect their shareholders.<sup>88</sup>

In addition, regulated fund managers must adhere to the Investment Advisers Act, which separately imposes fiduciary obligations<sup>89</sup> and disclosure requirements.<sup>90</sup> Moreover, the SEC has inspection authority over, and is tasked with monitoring and enforcing, regulated funds' compliance with the Investment Company Act and their managers' compliance with the Investment Advisers Act.

These protections clearly distinguish regulated funds and make them eligible for investment by retail investors. Such funds are thus a highly appropriate way for retail investors to access exempt offerings.

While regulated funds already do invest to some extent in private offerings, the Commission could make changes that would enhance the access of regulated funds, especially closed-end funds, to private offerings.

---

<sup>85</sup> See *supra* text surrounding note 51.

<sup>86</sup> See *supra* Section I.C.

<sup>87</sup> See SEC, *The Laws that Govern the Securities Industry* (Aug. 2019), available at <https://www.sec.gov/answers/about-lawsshtml.html#invcoact1940>.

<sup>88</sup> See *supra* Section I.C. See also Andrew J. Donohue, Director of the Division of Investment Management, SEC, *Speech: Investment Company Act of 1940: Regulatory Gap between Paradigm and Reality?*, available at <https://www.sec.gov/news/speech/2009/spch041709ajd.htm> (“The [Investment Company Act] includes substantive protections beyond the disclosure requirements, including the safekeeping and proper valuation of fund assets, restrictions on transactions among affiliates, and governance requirements. Moreover, the [Investment Company] Act limits the amount of leverage that funds may bear . . .”).

<sup>89</sup> The Advisers Act requires regulated fund managers to adhere to fiduciary duties. See Section 206 of the Investment Advisers Act. See also *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963). These fiduciary duties require those managers to vet investments to ensure that they are appropriate for their client funds' investment objectives in a manner that is consistent with the Investment Company Act. See Investment Adviser Interpretation, *supra* note 50 (stating that the Investment Advisers Act requires registered investment advisers to act with a duty of care to provide investment advice that is in the best interest of their clients based on the clients' objectives and a duty of loyalty to avoid providing conflicted advice).

<sup>90</sup> In addition, the Advisers Act requires regulated fund managers to: comply with strong antifraud provisions; observe performance advertising requirements; employ compliance policies and procedures reasonably designed to prevent Investment Advisers Act violations; and maintain certain books and records. See, e.g., Section 206 of the Investment Advisers Act; Rule 206(4)-1 under the Investment Advisers Act; Rule 206(4)-7 under the Investment Advisers Act; Compliance Programs of Investment Companies and Investment Advisers, Investment Company Act Release No. 26299 (December 17, 2003), available at <https://www.sec.gov/rules/final/2016/33-10233.pdf>.

## **2. Eliminate Staff Positions that Limit Closed-End Fund Investments in Exempt Offerings**

The Commission asks whether there are any regulatory practices or provisions that discourage regulated funds from investing in exempt offerings. It also asks what restrictions there should be, if any, on the ability of closed-end funds to invest in private funds and other exempt offerings and to sell their shares to retail investors.<sup>91</sup>

As a starting point, we recommend that the Commission continue to permit all regulated funds to invest in exempt offerings. Further, we recommend that the Commission modify or eliminate certain staff positions that impede the ability of closed-end funds to invest in private funds and other exempt offerings.

Specifically, we recommend that:

- *Investment in private funds.* Each closed end fund that invests in private funds be permitted to sell its securities to any retail investors (*i.e.*, not just to accredited investors who make a minimum initial investment of \$25,000) and, in doing so, not be required to limit its investments in private funds to 15 percent of its net assets; and
- *Investment in private funds and other exempt offerings.* Each closed end fund that invests more than 15 percent of its net assets in private funds and other exempt offerings be permitted to sell its shares to any retail investor and to list on public stock exchanges.

### **a) Permit Closed-End Funds without Minimum Investor Standards to Invest More than 15 Percent in Private Funds**

The Commission staff currently restricts any closed-end fund from investing more than 15 percent of its net assets in private funds unless the fund only sells its shares to accredited investors who make minimum initial investments of at least \$25,000. Neither the Investment Company Act nor the rules thereunder contain these restrictions, and the Investment Company Act already adequately addresses the staff's concerns.

Nevertheless, the staff will not declare effective any closed-end fund registration statement, unless the fund agrees that it will hold no more than 15 percent of its net assets in private funds.<sup>92</sup> Alternatively,

---

<sup>91</sup> See Concept Release, *supra* note 2, at 188, Questions 114-115.

<sup>92</sup> The SEC staff generally must declare a closed-end fund registration statement effective before the fund can offer its securities because closed-end funds may not “go effective automatically.” A closed-end fund’s only option is to pull its delaying amendment under Rule 473 under the Securities Act. Because this risks an SEC enforcement action, this is not a viable alternative. *But see* Securities Offering Reform for Closed-End Investment Companies, Investment Company Act Release No. 33427 (Mar. 20, 2019) (“CEF Offering Reform Release”), *available at* <https://www.sec.gov/rules/proposed/2019/33-10619.pdf> (proposing rules that would permit existing closed-end funds that have greater than \$700 million in aggregate market value of voting and non-voting common equity shares traded on public trading markets to become effective automatically).

the staff permits the closed-end fund to have greater exposure to private funds if the fund only sells to any accredited investor who makes a minimum initial investment of at least \$25,000.

As a general matter, it does not appear that the staff has the authority to impose these restrictions, and they are at odds with how the Investment Company Act treats closed-end funds. That statute does not restrict the amount of exempt securities or even illiquid investments most closed-end funds may hold.<sup>93</sup> This is appropriate because, unlike open-end funds, most closed-end funds are not required to offer shareholders redemption rights.<sup>94</sup> If these staff restrictions are eliminated, closed-end funds could be a suitable and viable mechanism for retail investors to gain greater exposure to private funds.<sup>95</sup>

The staff has imposed these restrictions through the registration statement disclosure review and comment process. Therefore, the rationale is not entirely clear and has not been tested. The staff articulated some concerns almost fifteen years ago in a staff report, stating that there are concerns about the retailization of private funds (“investments over which neither the Commission nor any other regulatory authority exercises meaningful oversight”), the reliability of private fund valuations, and the lack of private fund transparency.<sup>96</sup> In addition, the staff has included in comment letters concerns that the underlying private funds may be selling shares to the public indirectly through the regulated fund when it could not make such sales directly to retail investors.<sup>97</sup>

Those concerns are all appropriately addressed when a regulated fund subject to the Investment Company Act is inserted between retail investors and private funds. As described above, regulated funds are subject to strict substantive requirements governing their operations and disclosure, over which the SEC has authority and oversight. For example, in order to comply with the Investment Company Act, a regulated fund manager’s due diligence should include an assessment of underlying

---

<sup>93</sup> An “illiquid investment” is one that the fund reasonably expects cannot be sold or disposed of in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the investment. See Rule 22e-4(a)(8) under the Investment Company Act.

<sup>94</sup> Instead, after the fund’s initial public offering, investors typically buy and sell shares in the secondary market. Interval fund and tender offer fund shareholders have limited redemption rights and are discussed below. See *infra* notes 106-07 and accompanying text.

<sup>95</sup> Regulated funds, such as closed-end funds, automatically qualify as “qualified purchasers,” “qualified clients,” and “accredited investors” and, accordingly, meet the minimum investment standards for most exempt offerings. Accordingly, the Commission recognizes that closed-end funds, as regulated vehicles without liquidity requirements, appear to be prime vehicles for investors to gain exposure to exempt offerings. See, e.g., Concept Release, *supra* note 2, at page 174 (“closed-end funds . . . are better suited to holding less liquid securities obtained in exempt offerings because they are not redeemable and therefore are not subject to the same rules on liquidity risk management as open-end funds.”). See also Investment Company Liquidity Risk Management Programs, Investment Company Act Release No. 32315 at n. 97 and accompanying text (Oct. 13, 2016), available at <https://www.sec.gov/rules/final/2016/33-10233.pdf>.

<sup>96</sup> See 2003 Hedge Fund Report, *supra* note 71, at 80-83.

<sup>97</sup> See, e.g., Letter from Steven B. Boehm, Sutherland, Asbill & Brennan LLP (June 28, 2016) (stating and responding to staff comments on a closed-end fund registration statement), available at <https://www.sec.gov/Archives/edgar/data/1665056/000114420416110203/filename1.htm>.

private fund valuation mechanisms to ensure that the regulated fund can meet its own valuation requirements under the Investment Company Act.<sup>98</sup>

In addition, with regard to questions about Section 48(a) of the Investment Company Act and “doing indirectly what is prohibited directly,” the interposition of a regulated fund between public investors and private offerings fundamentally changes the investment. Many regulated funds invest in securities which a retail investor could not otherwise invest in directly, *e.g.*, derivatives, Rule 144A securities, repurchase agreements. The ability to gain exposure to such assets through a regulated fund is an important benefit for regulated fund investors. For example, many bond funds or even funds with specialized strategies hold investments that would be difficult or, in some cases, impossible for a retail investor to invest in directly. Regulated fund investments in private funds should not be viewed differently. Accordingly, with the interposition of a comprehensively regulated fund, the fact that the regulated fund invests in private funds should not be construed as a direct investment in an underlying private fund.

Further, as Chairman Clayton has underscored:

“The Commission’s longstanding position is that all staff statements are nonbinding and create no enforceable legal rights or obligations of the Commission or other parties . . . As we carry out our market oversight functions, I believe we at the Commission should keep this important distinction in mind . . . it is the Commission and only the Commission that adopts rules and regulations that have the force and effect of law.”<sup>99</sup>

Despite that, the SEC staff consistently has required regulated funds to adhere to the 15 percent limit on private funds or only sell to accredited investors with set minimum initial investments before it will declare a registration statement effective. Imposing such requirements only should be accomplished through a full and transparent rulemaking process, explicitly providing a basis and a cost benefit analysis with ample opportunity for the public to comment.<sup>100</sup>

---

<sup>98</sup> Open-end funds are required to compute NAV each trading day. *See* Rule 22c-1 and Rule 2a-4 under the Investment Company Act. Closed-end funds, including BDCs, must compute and provide their NAVs at least quarterly, though more than 90 percent of closed-end funds calculate the value of their portfolios every business day. *See* ICI, *A Guide to Closed-End Funds* (Apr. 2018), available at [https://www.ici.org/cef/background/bro\\_g2\\_ce](https://www.ici.org/cef/background/bro_g2_ce). *See also* SEC, *What We Do*, *supra* note 21.

<sup>99</sup> *See* Jay Clayton, Chairman, SEC, *Statement Regarding SEC Staff Views* (Sept. 13, 2018), available at <https://www.sec.gov/news/public-statement/statement-clayton-091318>. *See also* Hester M. Peirce, Commissioner, SEC, *SECret Garden: Remarks at SEC Speaks* (Apr. 8, 2019), available at <https://www.sec.gov/news/speech/peirce-secret-garden-sec-speaks-040819>.

<sup>100</sup> The SEC staff previously issued a substantially similar comment limiting regulated funds’ investments in *all* private funds, including private REITs, private oil and gas funds, private commodity pools, private real estate funds, and other private vehicles to no more than 35 percent of a fund’s net assets. *See, e.g.*, Letter from David J. Baum, Alston & Bird (Dec. 17, 2014), available at <https://www.sec.gov/Archives/edgar/data/1586009/000114420414074464/filename1.htm>. We understand that the SEC staff is no longer issuing the comment but cannot confirm this. To the extent that the staff is maintaining this position, we recommend that the Commission eliminate it for the same reasons it should eliminate the



**b) Permit Closed-End Funds that Invest in Exempt Offerings to List on Public Exchanges**

The SEC asks whether there should be any regulatory changes to encourage the establishment or improvement of secondary trading opportunities for closed-end funds.<sup>101</sup> The Commission should explicitly permit closed-end funds that invest in exempt offerings to list on public exchanges. Listed closed-end funds are subject to exchange rules in addition to Investment Company Act requirements.<sup>102</sup> Listing on an exchange can attract further retail interest which can benefit the closed-end fund and ultimately promote the Commission's goal of increasing retail investment in exempt offerings.

Current closed-end fund initial listing and continuing listing standards do not restrict closed-end funds that invest in private funds or other exempt offerings from listing and trading on various exchanges.<sup>103</sup> Nonetheless, we understand that various exchanges have required newly listed closed-end funds to confirm that they will not invest in private funds before permitting them to list and trade due to SEC staff positions.<sup>104</sup> To the extent that the SEC staff restricts closed-end funds investing in exempt securities, including private funds, to list on a national securities exchange, we ask that they explain their concerns publicly, so exchanges and issuers have the opportunity to address them.<sup>105</sup>

---

staff positions limiting regulated fund investments in private funds to 15 percent or requiring regulated funds of private funds to only offer their shares to accredited investors with minimum initial investments.

<sup>101</sup> See Concept Release, *supra* note 2, at 193, Question 129.

<sup>102</sup> See, e.g., New York Stock Exchange Listed Company Manual at 201.00 and 202.00 (requiring issuers to quickly release any news or information that might reasonably be expected to materially affect the market for its securities); 302.00 (requiring annual shareholder meetings); 303A.06 and 07 (requiring certain governance standards for audit committees).

<sup>103</sup> See, e.g., New York Stock Exchange Listed Company Manual at 102.04 and 802.01.

<sup>104</sup> See also Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing of Proposed Rule Change Relating to Closed-End Fund of Hedge Fund Listing Requirements, Securities Exchange Act Release No. 58067 (June 30, 2008), available at <https://www.sec.gov/rules/sro/amex/2008/34-58067.pdf> (proposing "generic" listing standards for closed-end funds of hedge funds).

<sup>105</sup> We recommend that the Commission, at the very least, set a maximum threshold under which any listed closed-end fund can invest in exempt offerings (e.g., up to 50 percent of a fund's net assets).

### **3. Amend Regulations to Encourage More Retail Investment in Interval Funds and Tender Offer Funds**

The Commission broadly asks whether it should make changes to its interval fund<sup>106</sup> and tender offer fund<sup>107</sup> rules to encourage retail investment in exempt offerings. Interval funds and tender offer funds are regulated closed-end funds. As such, they are optimal vehicles for retail investors to gain exposure to exempt offerings and from which exempt issuers could access additional capital. Therefore, consistent with the Treasury Department’s recommendations, the SEC should amend its rules to allow interval funds and tender offer funds more flexibility to invest in exempt offerings.<sup>108</sup> Doing so would allow them to tailor products to shareholder preferences and reduce fund shareholder expenses.

We recommend that the Commission permit interval funds to:

- use flexible intervals from at least one month to up to one year;
- eliminate maximum repurchase amounts;
- conduct more frequent discretionary repurchases;
- modify the elements of a repurchase policy that must be deemed “fundamental;” and
- employ a more efficient notification system.

We recommend that the Commission permit tender offer funds to:

- meet their filing and notification requirements using the interval fund rule;<sup>109</sup> and
- file post effective amendments to registration statements that become effective automatically.

---

<sup>106</sup> Interval funds are continuously offered closed-end funds that redeem shares by making periodic repurchase offers at NAV. See Rule 23c-3 under the Investment Company Act. Given the obligation to repurchase a portion of its shares periodically, an interval fund must hold liquid assets equal to the full amount it would be required to repurchase during these periods (“liquid asset minimum”) from the date it sends notice of a repurchase offer to the date it determines NAV for the repurchase. See Rule 23c-3(b)(10) under the Investment Company Act. To the extent that investments in exempt offerings are deemed illiquid, interval funds may be restricted from holding them in amounts that would cause the fund to fall below its liquid asset minimum.

<sup>107</sup> Tender offer funds are continuously offered closed-end funds that periodically repurchase shares at the discretion of the fund’s board. See Rule 13e-4 under the Securities Exchange Act of 1934. As with traditional closed-end funds, tender offer funds may hold an unlimited amount of illiquid assets.

<sup>108</sup> See US Department of the Treasury, *A Financial System that Creates Economic Opportunities—Capital Markets* (2017) (“2017 Treasury Report”) at 37, available at <https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf> (recommending that the SEC review whether more flexible interval fund regulations would encourage more investment in small and private companies).

<sup>109</sup> For purposes of this letter, we sometimes refer to Rule 23c-3 as the “interval fund” rule.

We recommend that the Commission permit *both* interval funds and tender offer funds to:

- issue multiple share classes;
- utilize multi series trusts;
- engage in additional types of affiliated transactions with “downstream” control affiliates; and
- rely on transitory relief from diversification requirements for two years after launch.

#### a) Interval Funds

##### (1) Permit Flexible Intervals from One Month to One Year

The Commission asks whether it should modify the periodic intervals for interval funds and whether it should permit those funds to have flexibility to determine the length of the intervals.<sup>110</sup> We recommend that the Commission permit funds to determine their own set intervals for any period of at least one month to up to one year. Importantly, the Commission already has experience allowing these funds to have shorter intervals than currently permitted under Rule 23c 3.

Rule 23c 3 under the Investment Company Act requires funds to set intervals at which they will repurchase their shares at either 3, 6, or 12 months.<sup>111</sup> In adopting the rule, the Commission reasoned that intervals over 12 months may be confusing for investors<sup>112</sup> and intervals shorter than 3 months would be incompatible with the rule’s notification requirements, *i.e.*, to notify each record shareholder no less than 21 days and no more than 42 days prior to the repurchase request deadline.<sup>113</sup>

Consistent with several exemptive orders already granted to funds, the Commission should permit all interval funds to choose shorter intervals (*e.g.*, one month).<sup>114</sup> Shorter intervals provide more liquidity to shareholders and, in turn, could improve demand for such funds. To obtain the exemptive relief for intervals under 3 months, funds have represented that they will provide repurchase offer notifications in a tighter window. For example, instead of sending notifications no less than 21 days and no more than 42 days prior to the repurchase request deadline, the notice period has been shortened to no less

---

<sup>110</sup> See Concept Release, *supra* note 2, at 188, Question 116.

<sup>111</sup> See Rule 23c-3(a)(1) under the Investment Company Act.

<sup>112</sup> The Commission also pointed out that closed-end funds could execute other types of repurchase offers as so-called “discretionary repurchase offers.” As we further describe below, discretionary repurchase offers are repurchase offers made at the issuer’s discretion and not pursuant to any periodic interval. See Repurchase Offers by Closed-End Management Investment Companies, Investment Company Act Release No. 19399 (Apr. 7, 1993) at Section II.A.4. The subsection governing discretionary repurchase offers (Rule 23c-3(c)) permits funds, under certain conditions, to repurchase their common stock from holders outside of a fundamental policy not less than two years after the last discretionary repurchase offer was made.

<sup>113</sup> See Rule 23c-3(b)(4) under the Investment Company Act.

<sup>114</sup> See, *e.g.*, Weiss Strategic Interval Fund and Weiss Multi-Strategy Advisers LLC, Investment Company Act Release Nos. 33101 (May 21, 2018) (Notice); and 33124 (June 18, 2018) (Order)(providing exemptive relief for an interval fund to have one-month intervals).

than 7 days and no more than 14 days prior to the repurchase deadline.<sup>115</sup> With the exemptive relief experience, the Commission has a clear basis to permit the shorter interval with the tighter notification periods.

## (2) Eliminate Maximum Repurchase Amounts

The Commission asks whether it should eliminate minimum and maximum repurchase offer amounts.<sup>116</sup> We recommend that the Commission eliminate the maximum repurchase offer amount but retain the minimum repurchase offer amount.

The interval fund rule currently requires funds to make repurchase offers of not less than 5 percent and not more than 25 percent of the amount of common stock outstanding on the repurchase request deadline.<sup>117</sup> In adopting the standard, the Commission indicated that the 25 percent maximum limit would distinguish interval funds from open-end funds.<sup>118</sup> The Commission stated that the 5 percent minimum is intended to ensure a minimum degree of certainty that a fund will repurchase some of its securities in each offer.<sup>119</sup>

We believe that the Commission should permit funds to set their own maximum limits, so long as they disclose the limit and provide notice if the amount is changed. Investors do not need interval funds to adopt an arbitrary 25 percent limit to distinguish repurchase offers from an open-end fund's daily redemptions. Unlike open-end fund redemptions, repurchase offers already are not continuous and interval fund shareholders cannot at any time tender their shares to receive their approximate NAV.<sup>120</sup> In addition, eliminating the mandatory 25 percent limit increases the likelihood that investors who tender their shares will receive the full amount of proceeds they desire (rather than receiving a smaller, prorated amount).<sup>121</sup>

---

<sup>115</sup> *See id.* (requiring an interval fund with one-month intervals to provide notice of the repurchase offer no less than 7 days and no more than 14 days prior to the repurchase request deadline).

<sup>116</sup> *See* Concept Release, *supra* note 2, at 188, Question 116. A repurchase offer amount is the amount of stock that an interval fund will offer to repurchase during any particular interval. *See* Rule 23c-3(a)(3) under the Investment Company Act (defining "repurchase offer amount").

<sup>117</sup> *See id.*

<sup>118</sup> It also noted that funds could exceed the maximum limit by offering to repurchase more shares through discretionary repurchase offers. *See* Periodic Repurchases by Closed-End Management Investment Companies; Redemptions by Open-End Management Investment Companies and Registered Separate Accounts at Periodic Intervals or With Extended Payment, Investment Company Act Release No. 18869 (July 28, 1992) at Section II.A.3.a.

<sup>119</sup> *See id.*

<sup>120</sup> *See, e.g.*, Section 2(a)(32) of the Investment Company Act (defining "redeemable securities" that open-end funds issue as permitting their holders to receive their approximate NAV upon tender to the fund).

<sup>121</sup> Of course, funds should monitor their liquidity needs and provide appropriate disclosures regarding any maximum repurchase amounts. *See, e.g.*, Rule 22e-4 under the Investment Company Act.

The minimum repurchase amount should remain at 5 percent. This minimum amount ensures that any repurchase offer is a *bona fide* offer that, if accepted, will result in a repurchase of more than a nominal amount of the fund's shares.

### **(3) Permit More Frequent Discretionary Repurchases**

The Commission asks whether it should shorten the minimum time at which interval funds and other closed-end funds may make discretionary repurchase offers.<sup>122</sup> We recommend that the Commission shorten the discretionary repurchase offer period to once every 367 days. This will allow managers more flexibility to align repurchase offers and management of the fund's assets. This flexibility also will help the Commission's goal of facilitating investments in private offerings.

The interval fund rule currently permits interval funds and other closed-end funds that do not make periodic repurchase offers to make discretionary repurchases not more frequently than once every two years.<sup>123</sup> In adopting the rule, the Commission decided that a two year limitation would ensure that funds do not circumvent the requirement to adopt fundamental policies that set forth the parameters of their periodic repurchase offers by conducting frequent discretionary repurchase offers.<sup>124</sup>

Limiting discretionary repurchase offers to not more than once every 367 days would accomplish the Commission's goal of ensuring that interval funds adhere to the fundamental policy requirement, while providing closed-end funds with additional flexibility to conduct discretionary repurchases.<sup>125</sup> This discretion also would facilitate management of portfolio assets, including private offerings. The possibility for more frequent discretionary repurchases also could be more attractive for some investors.

### **(4) Modify the Repurchase Policy Elements that Must be "Fundamental"**

The Commission asks whether it should modify the elements of an interval fund's repurchase policy that must be "fundamental" (changeable only by vote of a majority of the outstanding voting securities).<sup>126</sup> The Commission only should require three items to be fundamental policies:

- the fact that a fund will make repurchase offers;
- the minimum repurchase amounts; and
- the maximum interval periods of a repurchase offer program (*e.g.*, that repurchase offers will be made no less frequently than semi annually).

---

<sup>122</sup> See Concept Release, *supra* note 2, at 189, Question 117.

<sup>123</sup> See Rule 23c-3(c) under the Investment Company Act.

<sup>124</sup> See Rule 23c-3(b)(2)(i) under the Investment Company Act (requiring that interval funds adopt fundamental policies describing their periodic repurchase offers).

<sup>125</sup> We understand that interval funds have intervals of one year or less and, thus, would be required to continue to adopt fundamental policies for their periodic repurchase offers.

<sup>126</sup> See Concept Release at 189, Question 118.

The interval fund rule currently requires interval funds to make repurchases pursuant to a fundamental policy, specifying that the fund will make repurchase offers and providing certain terms of those offers.<sup>127</sup> Those terms are: the intervals between the repurchase request deadlines; the schedule of the repurchase request deadlines; and the timing of repurchase pricing dates.

The current fundamental items, which generally are operational in nature, unnecessarily restrict the flexibility of interval fund programs to the detriment of shareholders. Requiring a shareholder vote each time a fund wishes to change an aspect of its repurchase program is expensive and the time and costs effectively discourage funds from making otherwise beneficial changes.<sup>128</sup>

These elements of the repurchase program are appropriately left to the discretion of the fund board. The Commission should require only structural aspects of the program, such as the ones we recommend, to be deemed fundamental.

### **(5) Employ a More Efficient Notification System**

The Commission asks whether there are measures that can be taken to increase the efficiency of the interval fund notification process, such as facilitating electronic or other notifications.<sup>129</sup> We believe that the Commission should facilitate electronic notifications. We note however that short of making full electronic delivery the default delivery mechanism for all shareholders, any other approach would not yield much in shareholder cost savings.

Interval funds currently must deliver to shareholders of record and to each beneficial owner notification that they are conducting a repurchase offer, along with specific details about the repurchase offer, no less than 21 days and no more than 42 days before each repurchase request deadline.<sup>130</sup> These notifications must be delivered in paper form to all shareholders that do not otherwise opt for electronic delivery.

The Commission could make online delivery the default mechanism for various fund disclosures, such as the repurchase offer notifications, with paper reports available upon request. In this regard, in lieu of requiring default paper delivery of the notifications, the Commission could require interval funds to disclose in their prospectus and in each annual and semi-annual shareholder report that the repurchase offer notifications are available at a specified website address or in paper, upon request. While ensuring that funds honor every shareholder's delivery preference, this approach also would significantly reduce

---

<sup>127</sup> See Rule 23c-3(b)(2)(i) under the Investment Company Act.

<sup>128</sup> We also recommend that the Commission explore ways to facilitate the conversion of a tender offer fund to an interval fund (*e.g.*, easing shareholder voting requirements associated with the conversion). See, *e.g.*, Rule 35d-1(a)(2)(ii) and (a)(3)(iii) under the Investment Company Act (permitting a fund to change its policy under the "names rule" that at least 80 percent of the value of its assets be in particular investments in the industry or geographic region suggested by its name upon 60 days prior notice of the change to shareholders).

<sup>129</sup> See Concept Release, *supra* note 2, at 190, Question 119.

<sup>130</sup> See Rule 23c-3(b)(4)(i) under the Investment Company Act.

delivery costs for interval funds and save shareholders money. Eliminating excess costs associated with interval fund notifications could encourage interval funds to offer more frequent repurchases and liquidity to shareholders.

An approach similar to Rule 30e 3 under the Investment Company Act would not yield much cost savings.<sup>131</sup> We understand that repurchase offer notifications generally are short in length (typically 8 pages or less) and that a large proportion of the costs is attributable to postage and other mailing related services (in some informal estimates, between 95-99 percent of the costs). Because a delivery method modeled on Rule 30e 3 still would entail some form of paper delivery, the required mailings would not result in much cost savings.

## **b) Tender Offer Funds**

### **(1) Permit Compliance with Filing and Notification Requirements Using Interval Fund Rules**

The Commission asks whether it should permit tender offer funds to use discretionary repurchase offers under the interval fund rule.<sup>132</sup> Given the increased flexibility that tender offer funds have with respect to their repurchases, we do not necessarily believe this is needed. Instead, because the tender offer notice requirements are designed primarily for operating companies, the Commission could best help tender offer funds by permitting them to use the interval fund filing and notification requirements.

Tender offer funds are very similar to interval funds. Many tender offer funds pursue strategies that are identical, or substantially identical, to those of interval funds, investing typically in less liquid investments (*e.g.*, real estate, below investment grade debt). As such, these funds are well suited to invest in private offerings too. In addition, both types of funds are continuously offered closed-end funds with limited scopes of business that offer their investors regular opportunities to sell their shares back to the issuer. Despite these similarities, the regulatory conditions under which they must conduct their repurchase offers differ substantially.

Tender offer funds conduct tender offers under Rule 13e 4 under the Securities Exchange Act (which we refer to as the “tender offer rule”) primarily because they do not meet the full conditions of the interval fund rule.<sup>133</sup> The funds often intend to, but are not required to, offer investors the

---

<sup>131</sup> Rule 30e-3 under the Investment Company Act provides an optional “notice and access” method to allow funds to satisfy their obligations to transmit shareholder reports. Under Rule 30e-3, a fund could mail shareholders a paper notice of each shareholder report’s availability at a specified website address in lieu of mailing the full report. *See* Rule 30e-3 under the Investment Company Act.

<sup>132</sup> *See* Concept Release, *supra* note 2, at 191, Question 121.

<sup>133</sup> For example, some tender offer funds may choose to offer to repurchase shares on a quarterly or other stated interval but only upon the continued approval of the fund’s board of directors.

opportunities to sell their shares back at fixed intervals and otherwise do not meet the requirements for discretionary repurchases under subsection (c) of the interval fund rule.<sup>134</sup>

Notwithstanding their substantially similar investment strategies and characteristics, tender offer funds must comply with a far more onerous set of filing and notification requirements under the Securities Exchange Act simply because they choose to repurchase their shares differently than interval funds. The tender offer rule includes a requirement to file a Schedule TO with the Commission and to provide shareholders specific details of the tender offer. While the schedule includes important details about the tender offer, it also includes extraneous information about the entity making the tender, such as: the identity and background of filing persons; certain affiliated transactions of such persons; significant corporate events; agreements involving the fund's securities; and the requirement to file audited financial statements of the filing persons.<sup>135</sup>

In contrast, interval funds must file and distribute information on Form N-23-C, which focuses solely on the repurchase offer. Figure 3 below highlights differences between the more onerous tender offer fund disclosures (on Schedule TO) and the interval fund disclosures (on Form N-23-C).<sup>136</sup>

---

<sup>134</sup> Subsection (c) of the interval fund rule, among other things, requires funds to:

- limit discretionary repurchases to once every two years;
- avoid conditioning a repurchase offer upon the tender of a minimum number of shares; and
- make repurchases at net asset value.

*See* Rule 23c-3(c) under the Investment Company Act. *But see supra* Section IV.B.3.a.3 (recommending that the Commission reduce the discretionary repurchase period to 367 days). Some tender offer funds may offer to repurchase shares that are not pursuant to fixed intervals and that occur more frequently than once every two years. Also, some tender offer funds may condition their repurchases on the tender of a minimum number of shares. Further, some tender offer funds may choose to repurchase shares at a price other than NAV.

<sup>135</sup> *See, e.g.*, Schedule TO.

<sup>136</sup> *See* Schedule TO, Form N-23-C and Rule 23c-3(b)(4)(i) under the Investment Company Act. *See also* Chapman and Cutler LLP, Interval and Tender Offer Closed-End Funds: Investment Company Alternatives to Traditional Funds (Mar. 2019), available at [https://www.chapman.com/media/publication/917\\_Chapman\\_Interval\\_Tender\\_Offer\\_Closed-End\\_Funds\\_Investment\\_Companies\\_0319.pdf](https://www.chapman.com/media/publication/917_Chapman_Interval_Tender_Offer_Closed-End_Funds_Investment_Companies_0319.pdf).



**Figure 3**  
**Comparison of Schedule TO Requirements with Form N-23-C**

<b>Requirement</b>	<b>Schedule TO</b>	<b>Form N-23-C</b>
<b>Summary of Tender/Repurchase Offer</b>	A term sheet is required.	N/A
<b>Information about Tender/Repurchase Offer</b>	<p>The full terms of the tender offer, including:</p> <ul style="list-style-type: none"> <li>• amount to be repurchased;</li> <li>• how long shareholders have to tender;</li> <li>• any applicable redemption or other fees;</li> <li>• how and when redemption proceeds will be paid; and</li> <li>• other terms of the tender offer (e.g., a description of <i>pro rata</i> purchases and circumstances in which the fund may suspend or postpone a tender).</li> </ul>	<p>The terms of the repurchase offer, including:</p> <ul style="list-style-type: none"> <li>• a statement that the fund is repurchasing securities at NAV;</li> <li>• fees applicable to the repurchase;</li> <li>• the repurchase offer amount;</li> <li>• dates of the repurchase request deadline, pricing date, and repurchase pricing date;</li> <li>• procedures for tendering shares or modifying/withdrawing previous tenders;</li> <li>• a description of <i>pro rata</i> purchases;</li> <li>• circumstances in which a fund may suspend or postpone a repurchase order; and</li> <li>• the NAV/market price of the fund's shares.</li> </ul>
<b>Purpose of Tender/Repurchase Offer</b>	A description of the purpose of the tender offer.	N/A
<b>Affiliated Transactions</b>	A description of certain affiliated transactions and significant corporate events over the past 2 years, and any agreements involving the fund's securities.	N/A
<b>Source and Amount of Tender/Redemption Proceeds</b>	A description of where the tender offer proceeds will come from.	N/A
<b>Engaged Parties</b>	Disclosure of all advisers or solicitors the fund has engaged with respect to the tender offer.	N/A
<b>Financial Statements</b>	Audited financial statements for the last two years and unaudited financial statements for the most recent fiscal quarter.	N/A

The Commission developed the tender offer requirements based on experience with operating companies' tender offers, yet such companies and their tender offers fundamentally differ from those by tender offer funds. Tender offer funds are akin to interval funds in that both are closed-end funds with limited scopes of business focused on investing in underlying securities. Both also offer investors regular opportunities to sell their shares back to the issuer. In this regard, offers to repurchase fund shares come directly from the issuer.

Operating companies, on the other hand, engage in a multitude of activities and have a variety of assets, that require more fulsome explanation and disclosure. In addition, tender offers for operating companies often come from third-parties for whom much more information is needed.

The Schedule TO is generally designed to capture information for those operating company entities and third-parties that make tender offers for those operating company shares. It is inapt and includes extraneous information for tender offer fund shareholders that receive their offers directly from the issuer. In these scenarios, only detailed information about the tender offer is necessary, similar to information about an interval fund's repurchase offer.

We therefore recommend that the Commission permit tender offer funds to rely on the more appropriate filing and notification requirements in the interval fund rules. At a minimum, the Commission should develop a more streamlined and appropriate tender offer form for tender offer funds.

## **(2) Permit Post-Effective Amendments to Registration Statements to become Effective Automatically**

The Commission asks generally whether it should change any of its rules regarding tender offer funds.<sup>137</sup> As we suggested in our comment letter on the Commission's proposed closed-end fund offering reform amendments, the Commission should permit all tender offer funds to rely on Rule 486 under the Securities Act.<sup>138</sup>

Rule 486 permits interval funds to file post-effective amendments to their registration statements that contain non material changes, updates to financial statements, or specified other changes that become effective automatically. Because tender offer funds do not rely on the interval fund rule, they cannot rely on Rule 486. The Commission created the rule as a complement to Rule 485 under the Securities Act, because it recognized that interval funds, like open-end funds, are continuously offered and would benefit if certain filings could become effective automatically.<sup>139</sup> As tender offer funds likewise are

---

<sup>137</sup> See Concept Release, *supra* note 2, at 191, Question 121.

<sup>138</sup> See, e.g., Letter from Susan Olson, General Counsel, ICI, to Vanessa Countryman, Acting Secretary, SEC (June 10, 2019) ("ICI Closed-End Fund Offering Reform Letter"), available at <https://www.sec.gov/comments/s7-03-19/s70319-5650770-185712.pdf> (providing comments on closed-end offering reform).

<sup>139</sup> See Post-Effective Amendments to Investment Company Registration Statements, Investment Company Act Release No. 20486 (Aug. 17, 1994), available at <https://www.govinfo.gov/content/pkg/FR-1994-08-24/html/94-20624.htm> (adopting Rule 486 under the Securities Act permitting, among other things, post-effective amendments to an interval

continuously offered and would benefit from filings that become effective automatically, the Commission should permit those funds to use Rule 486.

**c) Both Interval Funds and Tender Offer Funds**  
**(1) Enable Multi-Share Class Structures**

The Commission asks whether it should create rules that would permit interval funds to have multi share class structures.<sup>140</sup> We recommend that it do so. Similarly, tender offer funds should be able to have multi share class structures. An exemptive rule permitting multi-class interval funds and tender offer funds would be consistent with existing rules for open-end funds and exemptive relief already granted to these funds. Multiple-class arrangements, for example, could provide funds the opportunity to tailor classes with specific distribution charges, allowing them to impose differing fees for differing services. Importantly, the Commission already has granted such relief in more than 60 exemptive orders for interval funds and tender offer funds. By codifying the exemptive relief, the costs associated with seeking such relief would be eliminated and Commission resources used to provide such relief would be freed up for other priorities.<sup>141</sup>

The Investment Company Act generally restricts regulated funds from offering senior securities, including multiple share classes. In 1995, the Commission adopted Rule 18f 3, permitting open end funds to offer multiple classes subject to certain conditions.<sup>142</sup> As closed end funds, interval funds and tender offer funds cannot rely on Rule 18f 3 to offer multiple classes. However, the Commission has granted many interval funds and tender offer funds exemptive relief to issue multiple classes of shares.<sup>143</sup> The relief is subject to the same conditions that open end funds are subject to under Rule 18f 3. In fact, the Commission has granted more than 60 similar orders over the past twelve years, and, not surprisingly, the relief and its associated conditions have become standardized.

---

fund registration statement to become effective automatically). Rule 485 under the Securities Act permits post-effective amendments to an open-end fund or unit investment trust registration statement to become effective automatically.

<sup>140</sup> See Concept Release, *supra* note 2, at 190, Question 119.

<sup>141</sup> We understand that the Commission is considering providing similar multi-share class relief to BDCs. See, e.g., Amendment No. 3 to the Application Pursuant to Section 6(c) of the Investment Company Act, for an Order Granting Exemptions from Sections 18(a)(2), 18(c), 18(i) and 61(a) of the 1940 Act, filed by FS Energy and Power Fund and FS/EIG Advisor, LLC (File No. 812-14383) (June 28, 2019). To the extent the Commission grants exemptive relief to BDCs, it could consider including them in any exemptive rule.

<sup>142</sup> See Exemption for Open-End Management Investment Companies Issuing Multiple Classes of Shares; Disclosure by Multiple Class and Master-Feeder Funds; Class Voting on Distribution Plans, Investment Company Act Release No. 20915 (Feb. 23, 1995), available at <https://www.sec.gov/rules/final/finend.txt>. Under the rule, open-end funds may issue separate share classes that impose different fees for distribution services, shareholder services and administrative services but that generally charge the same advisory or custodial fees for each class. In adopting the rule, the Commission noted that a multi-class structure may enable funds to: attract larger asset bases (permitting funds to spread fixed costs over more shares), qualify for advisory fee breakpoint discounts; and otherwise experience economies of scale, resulting in lower fees and expenses.

<sup>143</sup> See, e.g., Lord Abbett Credit Opportunities Fund, Investment Company Act Release Nos. 33513 (June 19, 2019) (Notice); and 33558 (July 16, 2019) (Order).

To give interval fund and tender offer fund issuers the same benefits that open end funds have, the Commission should codify these exemptive orders in an exemptive rule. The Commission can base any such rule on Rule 18f 3 and the conditions in the exemptive relief that the Commission has granted in the orders.<sup>144</sup>

## (2) Permit Multi-Series Trusts

The Commission asks whether it should permit interval funds to use the series trust structure that open-end funds use.<sup>145</sup> We recommend that the Commission do so, permitting interval funds and tender offer funds to establish multi series trusts, given their similarities to open-end funds.

As noted above, Section 18 of the Investment Company Act generally restricts regulated funds from offering senior securities. Rule 18f 2 under the Investment Company Act provides open-end funds with a safe harbor to establish multi series trusts, with each series pursuing a distinct investment strategy and holding segregated assets separate and apart from the other series.

Because interval funds and tender offer funds are not open-end funds that may rely on Rule 18f 2 and have no parallel forms of relief, these funds have not been organized as multi series trusts. This is unfortunate, because series trusts can provide many benefits. They enable issuers to leverage a common trust composed of separate funds sharing common directors and officers, chief compliance officers, governing documents, agreements, and other operating costs. Utilizing this structure, new funds can share operating costs, either eliminating or substantially reducing many of the expenses associated with creating a new stand-alone fund. Small and mid sized asset managers, which may incur some of these upfront and ongoing costs with fund shareholders, may find the benefits and cost savings of a multi series trust to be particularly helpful.<sup>146</sup>

As the Commission has recognized, interval funds and tender offer funds share many similarities with open-end funds. They all are continuously offered and give investors the right to sell their shares back to the regulated fund issuer at NAV or at a price near to NAV. For these reasons, the Commission has

---

<sup>144</sup> For example, the Commission could require that fund classes:

- have different arrangements generally only for shareholder services or the distribution of securities or both;
- have exclusive voting rights on matters submitted to shareholders relating solely to its arrangement;
- have separate voting rights on matters submitted to shareholders in which the interests of one class differs from the interests of any other class; and
- have the same rights and obligations as each other class in all other respects.

*See, e.g.*, Rule 18f-3(a)(2) through (4). Any conditions could ensure that the allocation of expenses relating to distribution and voting rights among multiple classes is equitable and will not discriminate against any group or class of shareholders.

<sup>145</sup> *See* Concept Release, *supra* note 2, at 190, Question 119.

<sup>146</sup> The staff of the SEC's Division of Investment Management currently is engaged in an initiative to eliminate barriers to small- and mid-sized fund advisers. *See, e.g.*, Dalia Blass, Director, Division of Investment Management, SEC, *Keynote Address: ICI Mutual Funds and Investment Management Conference* (Mar. 18, 2019), available at <https://www.sec.gov/news/speech/speech-blass-031819>.

permitted interval funds and tender offer funds to rely on various relief granted to open-end funds, *e.g.*, relief to issue multiple classes.<sup>147</sup> The Commission also permits interval funds to use rules allowing their post-effective amendments to become effective automatically and has proposed permitting interval funds to utilize the streamlined payment method that open-end funds use to net the sales of their shares against redemptions for purposes of securities registration fees.<sup>148</sup>

We believe that the Commission should consider developing similar relief for interval funds and tender offer funds on the same basis.

We note that there are unique complexities to be considered as these funds are closed-end funds. For example, interval funds and tender offer funds can issue preferred shares under Section 18 of the Investment Company Act. When a closed-end fund issues preferred shares, preferred shareholders have the right to appoint two directors to the fund's board of directors at all times.<sup>149</sup> In addition, when a closed-end fund fails to issue dividends to the preferred shareholders in an amount equal to two years of preferred share dividends, the preferred shareholders have the right to appoint a majority of the closed-end fund's board of directors (trustees).<sup>150</sup> This presents issues that must be considered for closed-end fund multi series trusts. For example, there could be a situation where the trust has one interval fund series that has issued preferred shares that has not paid more than two years' worth of preferred share dividends. The preferred shareholders of that series would be entitled to elect the majority of the fund's board of directors. With a common board at the trust level, would the trust be required to create two separate boards or continue to have one common board with additional directors that the series' preferred shareholders appointed or take some other action? If the SEC were to permit interval funds and tender offer funds to multi series trusts, it will need to address this issue.

### **(3) Permit Certain Affiliated Transactions with “Downstream” Control Affiliates**

The Commission asks whether it should grant relief for affiliated transactions when an interval fund pursues a private equity or venture capital strategy that may result in the interval fund controlling the portfolio company.<sup>151</sup> The Commission should consider granting interval funds and tender offer funds relief to engage in affiliated transactions with “downstream” control affiliates in these circumstances. This would treat these funds, which might offer services comparable to BDCs, similarly to BDCs.

---

<sup>147</sup> See *supra* Section IV.B.3.c.1.

<sup>148</sup> See Rule 486 under the Securities Act. See also CEF Offering Reform Release, *supra* note 92 (proposing to allow interval funds to rely on Rule 24F-2 under the Investment Company Act in the same way as open-end funds do). For similar reasons, ICI has recommended that the SEC consider extending both these sets of rules to tender offer funds. See ICI Closed-End Fund Offering Reform Letter, *supra* note 138.

<sup>149</sup> See Section 18(a)(2)(C) of the Investment Company Act.

<sup>150</sup> *Id.*

<sup>151</sup> See Concept Release, *supra* note 2, at 190-91, Question 120.

Section 17(a) of the Investment Company Act prohibits any affiliate of a fund, acting as principal, from knowingly purchasing or selling any property to the fund.<sup>152</sup> Section 17(d) of the Investment Company Act generally prohibits any affiliate, acting as principal, from effecting any transaction in which the fund is a joint participant. These provisions were designed to prohibit self-dealing and other scenarios where an affiliate can take advantage of a fund.

Regulated funds thus generally cannot engage in transactions with their affiliates absent an exemption or other relief. In many instances, however, the Commission has viewed transactions with pure “downstream” affiliates—entities that are affiliates simply because a fund owns them—more permissively, exempting many of them from Section 17(a)’s requirements.<sup>153</sup> The Commission historically has been willing to distinguish these types of relationships from other types of affiliated transactions, because downstream affiliates typically have little ability or incentive to overreach the regulated fund that owns it. Similarly, the Investment Company Act permits BDCs to engage in direct transactions with downstream affiliates that the BDC controls (through its ownership of more than 25 percent of the downstream affiliate’s outstanding voting securities). In these situations, a BDC can enter into affiliated transactions with such downstream control affiliates without any conditions.<sup>154</sup>

This treatment would be appropriate for interval funds and tender offer funds engaging in private equity or venture capital strategies because, in many ways, they would be acting substantially similarly to BDCs. All are closed-end funds that are not required to redeem tendered shares. To the extent that interval funds and tender offer funds engage in such strategies, they also may be advising or offering to provide “significant managerial assistance” to the portfolio company, in much the same way a BDC might.<sup>155</sup>

Given these similarities and the nature of the downstream affiliations and their historic treatment under Section 17 and Section 57 and by the Commission, it follows that the Commission should permit interval funds and tender offer funds to engage in affiliated transactions with their downstream control affiliates.

---

<sup>152</sup> See Section 2(a)(3) of the Investment Company Act (defining “affiliated person”).

<sup>153</sup> See, e.g., Rule 17a-6 under the Investment Company Act (permitting funds to enter into transactions with certain downstream affiliates). The rule requires that no affiliates or insiders of the fund be parties to the transaction or have any material financial interest in the transaction. See also Exemptions of Transactions by Investment Companies with Certain Affiliated Persons, Investment Company Act Release No. 10828 (Aug. 13, 1979) (amending Rule 17a-6).

<sup>154</sup> See Section 57(b)(2) of the Investment Company Act and Rule 57b-1 thereunder. Under Section 57(b)(2) of the Investment Company Act, a person controlled by a BDC would be prohibited from knowingly selling, purchasing, or borrowing money or other property from the BDC. Rule 57b-1 exempts “downstream” control affiliates from these prohibitions.

<sup>155</sup> See Section 55(a) of the Investment Company Act.

#### **(4) Allow a Transitory Exemption from Diversification Requirements**

The SEC asks whether it should provide a transitory exemption from the Investment Company Act's diversification requirements<sup>156</sup> to interval funds during their initial stages, so managers have sufficient time to identify and invest in appropriate portfolio companies.<sup>157</sup> It has heard from existing sponsors that these diversification restrictions can pose challenges to making investments during the start up period. To address this, the Commission could provide a temporary two year transitory exemption for interval funds and other closed-end funds (*e.g.*, tender offer funds) that primarily hold private fund assets and elect to be diversified.

The Investment Company Act requires that funds electing to be "diversified" maintain at least 75 percent of their total assets in cash and cash items, government securities, securities of other investment companies, and other securities limited in respect of any issuer to an amount not greater than 5 percent of their total assets and to not more than 10 percent of the outstanding voting securities of such issuer.<sup>158</sup>

In effect, these restrictions limit diversified funds from holding more than 25 percent of their net assets in the securities of each of two issuers and not more than 5 percent in the securities of other issuers. These limitations create issues for funds that start out with limited investor capital and wish to access exempt offerings (*e.g.*, private funds with high investment minimums and lock-up periods). As a result, funds looking to comply with the Act's diversification requirements may be precluded from investing in these opportunities, thereby limiting their investment choices.

Permitting interval funds this limited exemption would permit them the flexibility to decide what investment opportunities best match their investment objectives and strategies without the need to also consider the diversification requirements. This could open the door for better investment choices, including private offerings, for these funds and thereby support the Commission's goal of increasing retail investor exposure to private offerings.

---

<sup>156</sup> See Section 5(b)(1) of the Investment Company Act.

<sup>157</sup> See Concept Release, *supra* note 2, at 190, Question 120.

<sup>158</sup> Funds electing to be "non-diversified" do not need to adhere to the diversification requirements of Section 5(b)(1) of the Investment Company Act. However, if a non-diversified fund is acting as "diversified" for a period of three years or more, the SEC staff takes the position that the fund must obtain shareholder approval to convert to a "diversified" fund. See, *e.g.*, Section 13 of the Investment Company Act and Rule 13a-1 thereunder.

#### 4. Provide Retail Exposure to Private Offerings Through Target Date Funds

The Commission requests comment on whether it should take measures to enable target date funds to seek more exposure to exempt offerings.<sup>159</sup> We do not recommend doing so. Target date funds are organized as open-end funds and should not be differentiated from other open-end funds. Target date funds, like other open-end funds, already can make investments in private offerings subject to meeting Investment Company Act requirements, including those related to liquidity and valuation. For example, as open-end funds, target date funds are subject to Rule 22e 4, which prohibits open-end funds from holding more than 15 percent of their net assets in illiquid investments.<sup>160</sup>

Close to half of all mutual fund assets are held in retirement accounts.<sup>161</sup> Target date funds (also known as lifecycle funds) are popular options for saving for (and through) retirement in 401(k) plans and individual retirement accounts (IRAs).<sup>162</sup> Target date funds usually invest through a fund of funds structure, meaning they primarily invest in and hold shares of other mutual funds—95 percent of target date funds are funds of funds, and 43 percent of funds of funds are target date funds as of June 30, 2019. These funds are designed to rebalance over time as the fund approaches and passes the target date. The target date typically is close to, or at, the year the fund’s investors expect to retire. To do this, a target date fund is typically constructed to follow a predetermined asset allocation path that rebalances the portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund.

Target date funds are open-end funds. Although target date funds can provide investors with exposure to exempt offerings, these funds also are subject to regulations that present challenges to providing large scale exposure. For example, as open-end funds, target date funds are required to redeem their securities on demand from shareholders at a price approximating their proportionate share of the fund’s net asset value at the time of redemption.<sup>163</sup> Although the Commission states that an investor’s intended holding period for a target date fund may be longer than an investor’s holding period for other types of open-end funds,<sup>164</sup> this does not change the obligation to meet redemptions as an open end fund.

---

<sup>159</sup> See Concept Release, *supra* note 2, at 191, Question 122. For purposes of this letter, we use the term “target date fund” to refer to open-end target date funds registered with the Commission.

<sup>160</sup> See *supra* note 93 (defining “illiquid” investments).

<sup>161</sup> At the end of March 2019, 47 percent of all mutual fund assets were held in retirement accounts. With regard to long-term mutual fund assets (*e.g.*, equity, hybrid, or bond), 53 percent were held in retirement accounts. See ICI, *Quarterly Retirement Market Data*, available at <https://www.ici.org/research/stats/retirement>.

<sup>162</sup> At the end of March 2019, target date mutual fund assets totaled \$1.2 trillion. Retirement accounts held the bulk (87 percent) of target date mutual fund assets, with 68 percent held through defined contribution retirement plans and 19 percent held through IRAs. See ICI, *Quarterly Retirement Market Data*, *supra* note 161.

<sup>163</sup> See Section 22(d) of the Investment Company Act and Rule 22c-1 thereunder.

<sup>164</sup> See Concept Release, *supra* note 2, at 184.



### C. Regulation Crowdfunding Special Purpose Vehicles

The Commission requests comment on whether to permit crowdfunding issuers to offer securities through special purpose vehicles (“SPVs”).<sup>165</sup> We recommend that the Commission first evaluate the need for creating SPVs for crowdfunding issuers. Given existing market solutions, it may be unnecessary to make legislative or regulatory changes. In addition, we recommend that the Commission consider the costs and risks of SPVs for crowdfunding investors and whether the use of SPVs could allow an end run around Regulation Crowdfunding’s investor protection requirements.

Regulation Crowdfunding currently permits issuers to raise a maximum aggregate amount of \$1.07 million during a 12 month period in an exempt offering while limiting the amount individual investors may invest.<sup>166</sup> As the Commission describes, some potential issuers have elected not to pursue a crowdfunding offering because of the burdens of managing a large number of investors and the logistical challenges of seeking any required shareholder vote.

Others have suggested that the use of SPVs could help simplify crowdfunding issuer capitalization tables by aggregating investors for an issuer.<sup>167</sup> The Securities Act, however, excludes SPVs from eligibility as crowdfunding issuers,<sup>168</sup> and, therefore, SPVs are not able to raise funds under Regulation Crowdfunding.<sup>169</sup>

---

<sup>165</sup> See Concept Release, *supra* note 2, at 151, Question 85. SPVs are entities organized to invest in, or lend money to, a single issuer.

<sup>166</sup> Regulation Crowdfunding has several other requirements, including that all transactions must take place exclusively through a platform operated by a crowdfunding intermediary that is registered with the Commission (either a registered broker-dealer or a registered funding portal). See SEC Staff, *Staff Report to the Commission Regulation Crowdfunding* (June 18, 2019), available at [https://www.sec.gov/files/regulation-crowdfunding-2019\\_0.pdf](https://www.sec.gov/files/regulation-crowdfunding-2019_0.pdf).

<sup>167</sup> See 2017 SEC Government-Business Forum on Small Business Capital Formation Final Report (Mar. 2018) at 18, 21, available at <https://www.sec.gov/files/gbfor36.pdf>. See also 2017 Treasury Report, *supra* note 108, at 40-41.

<sup>168</sup> Specifically, the Securities Act excludes entities that are investment companies or that are excluded from the definition of investment company under Sections 3(b) and 3(c) of the Investment Company Act. See Section 4A(f)(3) of the Securities Act.

<sup>169</sup> We request that the Commission clarify whether the SPVs it is considering would be registered as investment companies or unregistered private funds. If the latter, we request that the Commission clarify whether investors in the SPVs would be required to be qualified purchasers or accredited investors. As discussed above, we recommend generally limiting direct access to private funds to only highly sophisticated investors.

In evaluating the need to change Regulation Crowdfunding, we strongly recommend that the Commission consider other market solutions currently available for issuers. For example, transfer agents can help issuers manage unwieldy capitalization tables. As the Commission has stated previously,

“transfer agents play a critical role with respect to securities settlement...Among their key functions, they may: (i) track, record, and maintain on behalf of issuers the official record of ownership of each issuer’s securities; (ii) cancel old certificates, issue new ones, and perform other processing and recordkeeping functions that facilitate the issuance, cancellation, and transfer of those securities; (iii) facilitate communications between issuers and registered securityholders; and (iv) make dividend, principal, interest, and other distributions to securityholders.”<sup>170</sup>

In light of this, we recommend that the Commission evaluate whether there is a market failure that prevents transfer agents from performing these services for crowdfunding issuers as they do elsewhere in the market.

Further, we recommend that the Commission should consider the costs and risks of SPVs for crowdfunding investors. In particular, if an investment adviser to a crowdfunding SPV were to charge a management fee or a performance fee to investors, the Commission should consider whether and how investors whose net worth or income may not meet the accredited investor, qualified client, or qualified purchaser standard would bear these costs.<sup>171</sup> In addition, the Commission should carefully consider potential conflicts of interest between issuers, lead investors, and other investors.<sup>172</sup> If retail investors are permitted to invest in crowdfunding SPVs, then those SPVs, like private funds, should be required to adopt investor protections providing transparency and addressing those conflicts.<sup>173</sup>

In addition, if the Commission were to permit crowdfunding SPVs, it must ensure that the SPV is not used to avoid Regulation Crowdfunding’s current investor protection requirements. Limiting the amount of individual investments and prohibiting funding portals from handling investor funds are important investor protections that SPVs should not be permitted to circumvent indirectly.

---

<sup>170</sup> See Transfer Agent Regulations, Securities Exchange Act Release No. 76743(Dec. 22, 2015) at 6, *available at* <https://www.sec.gov/rules/concept/2015/34-76743.pdf>.

<sup>171</sup> See *supra* Section IV.A (discussing limiting access to private funds to clients who are financially experienced and able to bear the risks).

<sup>172</sup> See 2017 Treasury Report, *supra* note 108.

<sup>173</sup> See *supra* Sections III and IV.A (recommending investor protection measures for private funds).

If the Commission intentionally contemplated permitting “pooled crowdfunding vehicles,” we note that it is unnecessary.<sup>174</sup> In fact, venture capital funds<sup>175</sup> and BDCs are both pooled investment vehicles that exist to facilitate small business capital formation. The Commission carefully crafted the balance between promoting capital formation and protecting investors for those vehicles. Whether labelled as a pooled crowdfunding vehicle, venture capital fund, or BDC, such vehicles would present the same potential opportunities to investors and efficiencies for issuers.

#### **V. Regulation A and Rule 504 of Regulation D for Small Registered Investment Companies**

The Commission requests comment on extending eligibility to investment companies as issuers under two small offering regulations: Regulation A<sup>176</sup> and Rule 504 of Regulation D.<sup>177</sup> We recommend that the Commission consider permitting small and emerging regulated funds to raise capital under these two regulations.

Regulation A permits two tiers of exempt small offerings: Tier 1, for offerings of up to \$20 million in a 12 month period and Tier 2, for offerings up to \$50 million in a 12 month period. Tier 2 offerings must include additional requirements such as audited financial statements in their offering circulars as well as ongoing reporting to investors. Regulated funds currently are not eligible to rely on either Regulation A Tier 1 or Tier 2 in making an offering.

Similarly, Rule 504 provides an exemption from registration under the Securities Act for the offer and sale of up to \$5 million of securities in a 12 month period. Regulated funds similarly are not currently eligible to rely on Rule 504 in making an offering.

Making regulated funds eligible as issuers under both Regulation A and Rule 504 of Regulation D potentially would promote small and emerging business capital formation. We understand that the Commission initially declined to do so for Regulation A offerings to allow it first to assess the impact

---

<sup>174</sup> The Commission uses the term “pooled crowdfunding vehicle” once in the Concept Release. See Concept Release, *supra* note 2, at 151, Question 85. If the Commission used that term intentionally, we request clarity on whether “pooled crowdfunding vehicles” would be single issuer vehicles like SPVs or pooled funds holding interests in multiple SPVs or multiple issuers.

<sup>175</sup> Generally, a venture capital fund is a type of private fund that represents to investors that it pursues a venture capital strategy, does not provide redemption rights, and holds 80 percent or more of its assets in investments in qualifying portfolio companies — typically companies in the early stages of their development. See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. 3222 (June 21, 2011), *available at* <https://www.sec.gov/rules/final/2011/ia-3222.pdf>. Like other private funds, venture capital funds typically rely on an exemption from Investment Company Act registration through Section 3(c)(1) or 3(c)(7). In addition, advisers to solely venture capital funds are exempt from Advisers Act registration regardless of the amount of assets under management by the adviser. See Section 203(l) of the Investment Advisers Act. A venture capital fund also includes Small Business Investment Companies administered by the US Small Business Administration and Rural Business Investment Companies administered by the US Department of Agriculture.

<sup>176</sup> See Concept Release, *supra* note 2, at 108-09, Question 49.

<sup>177</sup> See Concept Release, *supra* note 2, at 118, Question 68.

Ms. Vanessa Countryman  
September 24, 2019  
Page 44 of 44

of the 2015 Regulation A amendments on the market. The Commission should reevaluate that determination now that it has four years of experience with Regulation A offerings.

\* \* \* \* \*

ICI and its members appreciate the opportunity to comment on the SEC's concept release. If you have any questions or require further information, please contact me ([REDACTED]) Dorothy Donohue, Deputy General Counsel ([REDACTED]) or Kenneth Fang, Assistant General Counsel ([REDACTED]).

Sincerely,

/s/ Susan Olson

Susan Olson  
General Counsel

cc: The Honorable Jay Clayton  
The Honorable Robert J. Jackson Jr.  
The Honorable Hester M. Peirce  
The Honorable Elad L. Roisman  
The Honorable Allison Herren Lee

Dalia O. Blass  
Director, Division of Investment Management

Mark T. Uyeda  
Senior Special Counsel, Division of Investment Management

## **Appendix A**

Excerpts from  
ICI's Compliance Cost Survey 2017

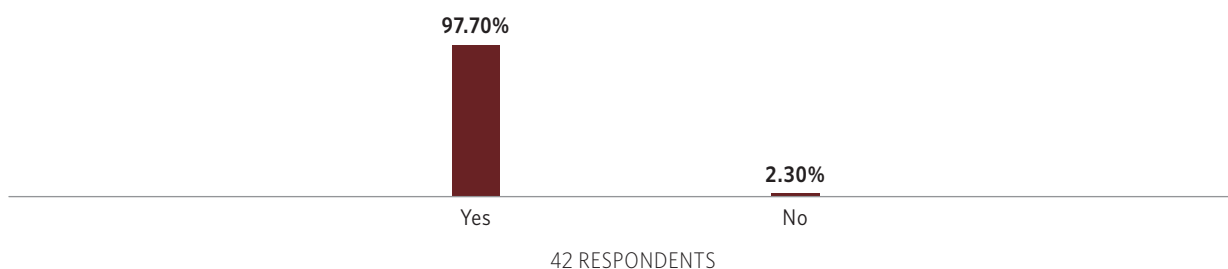
# Appendix A- Excerpts from ICI's Compliance Cost Survey 2017

## Survey Notes

ICI conducted this survey during April 2017; 42 fund complexes provided survey responses. The participating complexes manage approximately \$7,092,852,204 of long-term mutual fund assets,<sup>1</sup> representing about 49.5 percent of open-end funds.

## Survey Results

**1. Has your fund complex experienced an increase in compliance costs over the past five years as the result of new regulations and regulatory expectations (e.g., money market reform, FATCA, DOL fiduciary rule, distribution in guise, report modernization, liquidity risk management program rule)?**



**2. By what percentage have your costs increased over the past five years?**

Members reported an estimated 20 percent median increase in compliance costs over the past five years.<sup>2, 3</sup>

<sup>1</sup> Long-term assets as of March 31, 2017.

<sup>2</sup> The median increase in compliance costs is among 35 members that were able to quantify the percentage by which compliance costs had increased over the past five years.

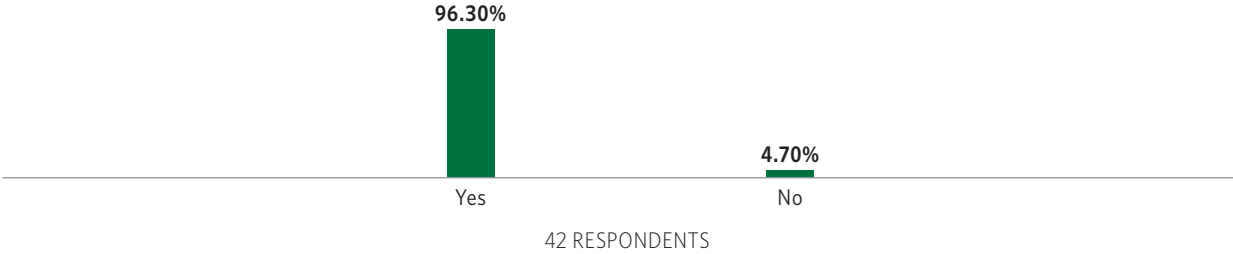
<sup>3</sup> In comparison, over the five-year period from December 2011 to December 2016, consumer prices, as measured by the personal consumption expenditure index, rose 6.3 percent and the employment cost index for professional, scientific, and technical sectors rose by 8.7 percent.

**3. What particular area(s) have been the main drivers in increasing compliance costs? Please rank the drivers listed below by impact on increasing costs (1 being the highest and 6 being the lowest):**

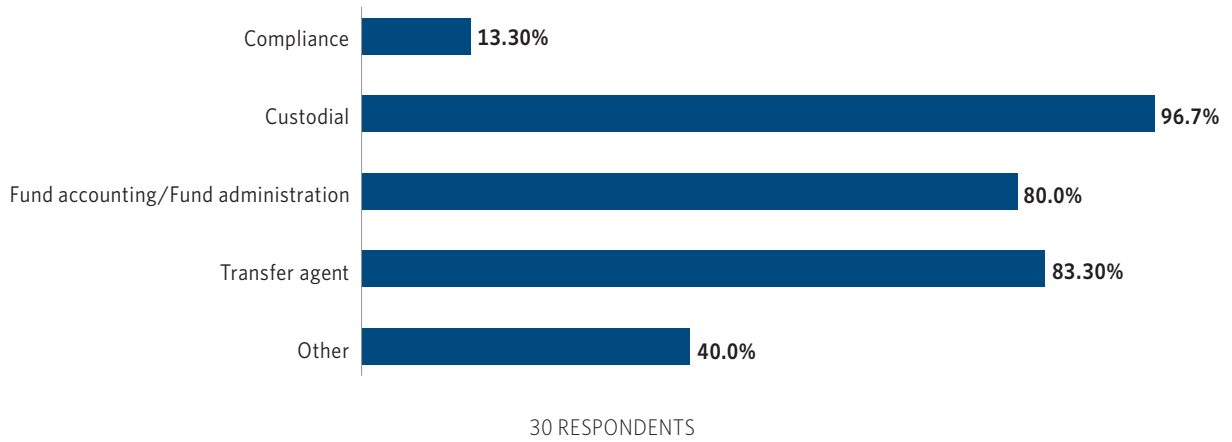
Drivers	1 (highest)	2	3	4	5	6 (lowest)	Rating average	Response count
Compliance with new regulations (e.g., development and board approval of policies and procedures, development of controls, staff training) related to all areas within the fund complex (e.g., compliance, fund accounting/ administration, transfer agent).	18	8	11	4	1	0	2.10	42
Technology to support compliance with regulations	14	10	6	4	3	5	2.69	42
Use of vendors or outside software to support compliance with regulations	6	17	3	7	6	3	2.98	42
Increased oversight of intermediaries	5	2	12	8	11	4	3.71	42
Increased oversight of vendors	2	7	12	7	6	8	3.76	42
Increase in staff to support compliance initiatives	5	9	9	6	8	5	3.43	42

answered question 42  
skipped question 1

**4. Do you outsource specific functions (e.g., fund accounting, custodial, transfer agent)?**



**5. What functions do you outsource (check all that apply)?**



**6. Over the past five years, have vendors increased their charges for services provided, citing higher compliance costs?**



**7. Please indicate the percent increase in cost by function.**

