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September 24, 2019

VIA ELECTRONIC DELIVERY

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

Re: Investment Company Act Release No. IC-33512 (File No. S7-08-19); Concept Release on Harmonization of Securities Offering Exemptions

Dear Ms. Countryman,

We appreciate the opportunity to respond to the request by the U.S. Securities and Exchange Commission ("SEC" or "Commission") for comments regarding the above-referenced release (the "Concept Release").[1] The Commission is seeking public comment "on ways to simplify, harmonize, and improve" the framework for exemptions from registration under the Securities Act of 1933, as amended (the "Securities Act"), in order to promote capital formation while protecting investors.[2] We agree with the Commission that Congressional acts and SEC rules have altered the exempt offering framework over time, causing "gaps and complexities" as well as confusion, and that this framework could benefit from a comprehensive review.[3] We intend for this comment to respond, in particular, to the Commission's request for comment on: (1) the possible revisions to the accredited investor definition under Rule 501 of Regulation D promulgated under the Securities Act (at comment 25); (2) the potential expansion of the newer integration analysis that separately evaluates whether each offering complied with the exemption requirements to determine whether an offering triggers registration under Section 5 of the Securities Act in the absence of a safe harbor (at comment 105); (3) whether to shorten the six-month integration safe harbor of Rule 502(a)

[1] Concept Release on Harmonization of Securities Offering Exemptions, SEC Rel. No. IC-33512 (June 18, 2019).

[2] *Id.*

[3] *Id.*

promulgated under Regulation D of the Securities Act ("Rule 502(a)") (at comment 106); (4) restrictions on the ability of closed-end funds to invest in private funds (at comment 115); (5) possible revisions to rules regarding closed-end interval funds (at comment 116); and (6) restrictions on performance fees under the Investment Advisers Act of 1940, as amended ("Advisers Act") (at comment 123).

Dechert LLP is an international law firm with a wide-ranging financial services practice that serves clients in the United States and abroad. In the United States, we represent a substantial number of U.S. mutual fund complexes, closed-end funds, exchange-traded funds ("ETFs"), business development companies ("BDCs"), private funds, fund boards, fund independent directors, fund advisers and fund service providers. An extensive part of our services for these clients involves assistance with the federal securities laws in the organization, distribution and operation of investment funds. In developing these comments, we have drawn on our extensive experience in the financial services industry generally. The comments herein reflect our own views and not necessarily the views of our clients.

We appreciate the SEC's initiative in considering how to streamline and enhance the exempt offering framework in light of the critical importance of private offerings to the economy. While the scope of our comments is limited, we appreciate the opportunity to submit these comments.

I. Accredited Investor Definition Should Include Similar Thresholds Governing Advisers and Private Funds to Simplify Exempt Offerings

Request for comment number 25 of the Concept Release asks (among other items) whether there are "other changes to the [accredited investor] definition that we should consider when harmonizing our exempt offering rules."[4]

Regardless of any changes made to the accredited investor definition[5], the Commission should include other similar standards related to the Advisers Act and to funds that rely on the private fund exceptions from the definition of "investment company" set forth in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940, as amended ("1940 Act").

[4] Concept Release at 57.

[5] Rule 501 of Regulation D under Securities Act defines an "accredited investor" to include (i) any entity with total assets in excess of $5 million; (ii) any natural person whose net worth exceeds $1 million; or (iii) any natural person whose individual income exceeds $200,000, or joint income with the person's spouse exceeds $300,000, in each of the two most recent years.

The various standards for investing in private funds have multiplied and expanded. While all of them are intended to accomplish similar goals as the accredited investor definition, and the standards are generally higher than the accredited investor standards, there are, in our view, certain unintended and unnecessary discrepancies in the standards. The complexity of dealing with so many different standards for some types of investors adds unnecessary costs in private offerings. For example, an adviser to private funds may need to inquire (with varying standards of inquiry over various periods of time) as to various investors' status as an accredited investor, qualified purchaser[6] and qualified client[7]. The need to make all of these determinations causes subscription documents and/or advisory agreements to require potential investors to make or complete an extensive array of representations and questionnaires.

Ultimately, these standards are all aimed at ensuring the sophistication of the potential client, and most do so by either a net-worth test or an assets-under-management test. The qualified client definition under the Advisers Act recognizes the sophistication of officers, and of employees who participate in investment activities for at least twelve months ("knowledgeable employees"). These sophistication standards reflect a patchwork of Commission rules that have long recognized that certain persons can protect themselves, and such standards could be simplified while preserving the same level of investor protection.

As a result, we recommend that the Commission provide that any person who is a qualified purchaser for purposes of Section 3(c)(7) of the 1940 Act, a qualified client under the Advisers Act or a knowledgeable employee for purposes of Section 3(c)(7) of the 1940 Act also be an accredited investor without further inquiry.[8] The Commission has seen the wisdom and utility of this approach in the past, by including a qualified purchaser as defined in Section 2(a)(51)(A) of the 1940 Act at the time of entering into the advisory contract in the definition of qualified client under the Advisers

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[6] Section 2(a)(51) of the 1940 Act generally defines a "qualified purchaser" to include: (i) a natural person who owns not less than $5 million in investments; (ii) a trust that meets certain requirements; and (iii) any person (including an investment adviser) who in the aggregate owns and invests on a discretionary basis not less than $25 million in investments.

[7] Rule 205-3(d)(1) under the Advisers Act generally defines a "qualified client" as a: (i) natural person or company that has at least $1 million under management with the investment adviser immediately after entering into the contract, (ii) a natural person or company that the investment adviser reasonably believes has a net worth of more than $2.1 million at the time the contract is entered into, (iii) qualified purchaser, or (iv) knowledgeable employee of the investment adviser.

[8] In the case of a knowledgeable employee, this would be only with respect to issuers for which such person need not be a qualified purchaser.

Act.[9] Subscription materials and other documents could then be simplified by allowing, for example, investors in a private fund relying on Section 3(c)(7) of the 1940 Act to only make representations and complete questionnaires relating to the qualified purchaser standard without also addressing the generally lower but sometimes different thresholds set forth in the accredited investor definition. This approach would maintain existing financial thresholds and investor protections while simplifying the regime governing private offerings.

II. Newer Integration Standard Available to Small Issuers Should be Extended to Additional Offerings to Simplify Compliance with the Frameworks and Allow Issuers to Adapt to Market Changes

Request for comment number 105 of the Concept Release asks (among other items) whether, in respect of the "Securities Act rules, where a safe harbor does not apply, should we [the Commission] replace the five-factor test with the new analysis articulated in connection with Regulation A and Rules 147 and 147A (*i.e.*, whether each offering complies with the requirements of the exemption that is being relied on for the particular offering)."[10]

We are supportive of efforts to modernize and simplify the integration analysis and believe the most effective way to do so is by expanding the ability of issuers to rely on the new integration analysis of Regulation A, Regulation Crowdfunding, and Rules 147 and 147A. As recognized by the Commission in the Concept Release, this newer integration framework "provides issuers with greater certainty as to the availability of an exemption for a given offering and increased consistency in the application of the integration doctrine among the exempt offering rules available to smaller issuers, while preserving important investor protections provided in each exemption."[11]

As integration analyses are dependent upon the facts and circumstances of each offering, it is our experience that such analyses can become complex for an issuer, who could instead choose to rely on a safe harbor, if such a safe harbor is available. The Concept Release points to several scenarios where such a safe harbor is not available. We believe that, for example, an issuer should be able to rely on Rule 506(b) of Regulation D ("Rule 506(b)"), notwithstanding the fact that the issuer may have (intentionally or unintentionally) engaged in a general solicitation or advertising (as permitted by Rule 506(c) of Regulation D, for example), if certain steps were taken.[12] In order to prevent

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[9] Rule 205-3(d)(1)(ii)(B) under the Advisers Act.

[10] Concept Release at 171.

[11] Concept Release at 167.

[12] Rule 506(b) permits an unlimited number of accredited investors to invest, and securities may be sold to 35 non-accredited investors that are sophisticated, as long as there is no general solicitation or advertising

circumvention of the requirements of Rule 506(b), the issuer would be required to show that it took reasonable steps to avoid having the general solicitation result in sales seeking to be exempt under Rule 506(b). An issuer may be able to do so by showing that all of the purchasers had a pre-existing relationship with the issuer or its placement agent, such that the purchaser could have been included in the offering in the absence of the general solicitation. Investors identified as a result of the general solicitation would not be permitted to purchase in the Rule 506(b) offering.

As a result, we recommend the Commission articulate a general integration standard similar to that for concurrent offerings involving Regulation A, Regulation Crowdfunding, and Rules 147 and 147A. The standard should provide that each offering can stand on its own regardless of other offerings that may be happening, even at the same time. Specifically, the standard should provide that to the extent each exempt offering meets its requisite conditions, an issuer need not conduct further integration analysis. Doing so preserves the investor protections of each exemption and would allow issuers to navigate changing circumstances, markets and environments with more certainty. Articulating a general integration standard also prevents the need to address additional integration safe harbors, additional transactions excepted from integration or other potentially concurrent offerings, and would allow the exempt offering framework to more nimbly adapt to future legislative and rule changes.

III. Integration Safe Harbor Period for Rule 502(a) Should be Shortened to Promote Capital Formation While Preserving Investor Protections

Request for comment number 106 of the Concept Release asks (among other items) whether the "six-month integration safe harbor in Rule 502(a)" should be shortened and "[i]f so, what time period is appropriate" (*e.g.*, 90 days, 30 days).

Due to the very real and substantial impact of ceasing offering activities for any period of time, we believe that 30 days is sufficient to ensure that issuers do not abuse their ability to conduct separate offerings. As Rule 502(a) of Regulation D effectively places five conditions on conducting a

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and additional disclosure is provided to the non-accredited investors. Rule 506(c) permits a general solicitation and advertising, if: all purchasers are accredited investors; the issuer takes reasonable steps to verify the status of such purchasers; and certain other conditions are met. All offerings made pursuant to Rule 506: are subject to "bad actor" disqualifications; result in restricted securities that have resale limitations; and potentially require state filings by issuers. Similarly, Rule 152 provides that once a Section 4(a)(2) private placement has been completed, a public offering or filing of a registration statement can begin (even if the filing was contemplated while the private placement was ongoing), so long as the applicable requirements for the private placement and the public offering are met. Concept Release at 164-65. However, Rule 152 would need to be amended to address the questions raised by Rule 506(c) (which allows a general solicitation), if a private offering were to be followed by a registered offering. *Id*.

Regulation D offering, shortening the timeframe where sales of the same offering are integrated preserves the critical investor protections (no general solicitation is permitted, sales must be accompanied by disclosure and result in restricted securities).

We recommend that the six-month integration safe harbor of Rule 502(a) be shortened to 30 days.

IV. Retail Investors Generally Should be Permitted to Invest in Closed-End Funds of Private Funds

Request for comment number 115 of the Concept Release asks (among other items) whether there should be any restrictions on the ability of closed-end funds of private funds to offer their shares to retail investors. As noted in the Concept Release, the ability for retail investors to obtain exposure to exempt offerings is currently limited to indirect exposure via an investment in publicly offered registered investment companies and BDCs.[13] Only retail investors who qualify as accredited investors, qualified purchasers and/or qualified clients can currently directly invest in exempt offerings. As indicated in the Concept Release, most private funds rely on Section 3(c)(7) for their 1940 Act exemption and, as a result, are offered only to qualified purchasers. In addition, the high minimum investment amounts often maintained by hedge funds and private equity funds preclude most accredited investors from being able to invest in such vehicles.[14]

Outside of the context of direct investment in private funds, these barriers to entry also exist in the closed-end fund of funds structure. The Concept Release notes that "all closed-end funds that invest primarily in private funds are offered only to investors who meet certain wealth requirements (*e.g.*, the tests for accredited investor), and require significant minimum initial investments."[15] We understand the Staff has historically taken the position that closed-end funds of private funds are not suitable investment options for retail investors who could not otherwise directly invest in private funds. We believe that the potential benefits to investors (as further described below) of obtaining exposure to private funds through professionally managed closed-end funds of funds strongly outweigh the potential risks regarding valuation of underlying private fund securities, transparency and layering of fees.

Investor interest in certain private fund products, particularly private equity and private debt, has risen drastically in recent years. Aggregate net asset value ("NAV") reported by U.S. private equity

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[13] *See* Concept Release at 183.

[14] *See* Staff Report to the United States Securities and Exchange Commission, Implications of the Growth of Hedge Funds (Sept. 2003), at 80, available at https://www.sec.gov/news/studies/hedgefunds0903.pdf.

[15] *See* Concept Release at 187.

funds increased from approximately $2 trillion in the first quarter of 2017 to approximately $2.8 trillion as of the end of 2018 and the number of U.S. private equity funds also increased from over 10,000 to over 12,000 over the same period.[16] Private equity funds raised approximately $714 billion from investors during 2018 (the 3rd largest amount in the industry's history), an increase from approximately $105 billion raised in 2003, and the total amount of capital raised by private equity funds since 2014 is approximately $3.7 trillion.[17] Total buyout value of private equity deals rose 10% to $582 billion within the past five years, resulting in a particularly strong performance period for the private equity fund industry.[18] The number of U.S. hedge funds and aggregate NAV of U.S. hedge funds reported for 2017-2018 also increased, although at a more incremental rate than private equity funds.[19] Private credit funds have also experienced rapid growth over the last decade to become an established asset class. Assets under management in private credit has grown by 16% annually since 2006, with the most significant growth occurring in the past decade, and private credit funds experienced a record fundraising year in 2017.[20] These trends reflect the historical and growing appeal of significant yield premiums and favorable credit terms of private credit investments (particularly as compared with traditional fixed income products) and of the relatively high returns of private equity investments (as compared with other asset classes).

We believe that retail investors generally should be permitted to access the alternative investment strategies of private funds currently afforded to institutional and individual investors who are able to meet the qualified purchaser, accredited investor and qualified client requirements. The structure of closed-end funds and their lack of "liquidity and valuation-related constraints"[21] permit greater flexibility to invest in private funds. In addition, as noted in the Concept Release, closed-end funds "would be considered qualified purchasers for purposes of investment in private funds, including hedge funds and private equity funds, offered pursuant to Section 3(c)(7) of the 1940 Act."[22]

In a closed-end fund of funds structure, retail investors would rely on the expertise and experience of SEC-registered investment advisers to make informed and appropriate investment decisions with

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[16] *See* Private Fund Statistics, Fourth Calendar Quarter 2018, a Report of the Staff of the Division of Investment Management's Analytics Office of the SEC (July 23, 2019) at 4-5.

[17] *See* Global Private Equity Report 2019, Bain & Company at 21.

[18] *See id.* at 3.

[19] *Id.*

[20] *See* Performance of Private Credit Funds: A First Look, Institute for Private Capital (July 2, 2018) at 2-3.

[21] Concept Release at 185.

[22] Concept Release at 186.

respect to the underlying private funds, which should sufficiently counteract any concerns with respect to the level of sophistication of retail investors and their inability to meet traditional wealth requirements. Closed-end funds of funds can qualify as regulated investment companies under the Internal Revenue Code of 1986, as amended, and, as such, can provide tax-efficient diversification of underlying investments for retail investors. Permitting closed-end funds of private funds to make public offerings to retail investors could also provide such investors with exposure to innovative alternative strategies devised and managed by some of the most successful global private fund investment advisers. The utilization of independent valuation agents by private fund investment advisers can alleviate certain concerns with respect to valuation risks inherent in private fund securities. Disclosure in private fund offering materials with respect to fees and expenses of private funds has been enhanced in recent years[23] and broader disclosure with respect to such fees and expenses by closed-end funds to retail investors, in turn, may increase transparency and reduce the potential for retail investors taking on unknown or greater risks in their overall portfolios. In addition, the existence of a secondary market for shares of listed closed-end funds of funds[24] and the ability of unlisted closed-end funds of funds to make quarterly tender offers at NAV pursuant to Rule 13e-4 under the Securities Exchange Act of 1934, as amended, mitigate the risks associated with the illiquid nature of investments in the underlying private funds.

V. The SEC Should Make Certain Reforms to the Regulatory Framework for Interval Funds

A. *An interval fund's minimum "repurchase offer amount" should depend on its periodic interval. We propose that the minimum "repurchase offer amount" be revised such that (i) an interval fund with a three month periodic interval must repurchase no less than 2.5% of its common stock outstanding on each repurchase request deadline; (ii) an interval fund with a six month periodic interval must repurchase no less than 5% of its common stock outstanding on each repurchase request deadline; and (iii) an interval fund with a twelve month periodic interval must repurchase no less than 10% of its common stock outstanding on each repurchase request deadline.*

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[23] We note that certain private fund investment advisers have appeared to provide more detail and specificity regarding fees and expenses in private placement and offering memorandums, particularly in response to a risk alert issued by the SEC's Office of Compliance Inspections and Examinations ("OCIE") in April 2018. *See* SEC OCIE National Exam Program Risk Alert, O*verview of the Most Frequent Advisory Fee and Expense Compliance Issues Identified in Examinations of Investment Advisers* (Apr. 12, 2018).

[24] We acknowledge that the shares of a listed closed-end fund of funds, like any other listed closed-end fund, may at times trade at a premium or discount to the fund's NAV. We believe retail investors will rely on the advice of their financial intermediaries to make informed decisions as to whether and at what price to sell their shares on any given day.

Rule 23c-3 under the Investment Company Act requires an interval fund to periodically offer to repurchase between 5% and 25% of its outstanding common stock (with the amount determined by the fund's board of directors). A fund's "periodic interval," which is a fundamental policy, can be three, six, or twelve months. In practice, almost all active interval funds have a periodic interval of three months and consistently elect to offer to repurchase 5% of their outstanding common stock.[25] Interval fund sponsors have apparently determined that investors favor more frequent opportunities to access liquidity and are comfortable receiving the smallest individual repurchase offers permitted by law.

Over time, however, quarterly 5% repurchase offers can place significant pressure on an interval fund. This limits the extent to which an interval fund can focus in less liquid or illiquid asset classes, including the securities of smaller, private issuers, as contemplated by an October 2017 report published by the U.S. Department of the Treasury.[26] In this regard, even if an interval fund does not expect its repurchase offer to be fully subscribed, it nevertheless must maintain sufficient liquidity to satisfy the full amount of the offer.[27] Maintaining this liquidity requires a significant portion of the portfolio to be invested in liquid assets, which generally pay a lower interest rate than illiquid investments, or that the manager be prepared to sell less liquid investments at a potential discount in advance of the repurchase date. This can substantially depress an interval fund's yield potential and harm long-term buy-and-hold investors that depend on the fund as a source of income.

Further, assuming a fairly static portfolio, an interval fund could lose up to 20% of its NAV in a given year, which can increase the impact of fixed costs on long-term buy-and-hold investors in such products. Additionally, this presents a looming threat to an adviser's ability to make a business case for using the interval fund wrapper as compared to a traditional private fund to offer retail investors access to its illiquid investment strategies. The fact that interval funds typically pursue fixed-income strategies compounds the problem as these interval funds generally lack the opportunity to replenish lost capital through investment appreciation.

If adopted, our recommendation would actually create a *higher* annual minimum repurchase offer percentage than is now permitted under Rule 23c-3. Currently, an interval fund whose periodic

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[25] All of the funds with total net assets above one billion dollars as of the most recent quarter have periodic intervals of three months and all but two of the funds offered to repurchase 5% in the most recent tender.

[26] *See* A Financial System That Creates Economic Opportunities Capital Markets, U.S. Dept. of the Treasury (Oct. 2017), *available at* https://www.treasury.gov/press-center/press-releases/documents/afinancial-system-capital-markets-final-final.pdf, at p. 44.

[27] 17 CFR § 270.23c-3(b)(10).

interval is twelve months can choose to offer to repurchase as little as 5% of its shares each year. Our proposal would essentially establish an annual floor of 10%.[28]

We believe that shareholder interests would be appropriately protected under this approach by the requirement that each repurchase offer amount be approved by a fund's board of directors. If shareholders tender more than the repurchase offer amount, an interval fund's board may exercise the flexibility afforded by Rule 23c-3 and repurchase up to an additional 2% of its common stock. Competition from other interval funds (as well as mutual funds and ETFs) and the demands of major brokerage platforms also serve as substantial market check on interval funds offering sufficient liquidity to their shareholders.

B. *An interval fund should be permitted to defer its first repurchase request deadline for up to two years after the effective date of the fund's initial registration statement on Form N-2 subject to approval by the fund's board of directors.*

Nearly all interval funds elect to repurchase their shares on a quarterly basis. They therefore must begin making repurchase offers six months after launch. This is too soon and causes interval funds to incur potentially substantial unnecessary costs to offer liquidity that is not being demanded by their investors.

Specifically, because interval funds are continuously offered through syndicates assembled over the course of many years, rather than through an initial public offering like traditional listed closed-end funds, they typically have limited third-party assets and little to no demand for liquidity during their early years of operations. We note in particular that many large distribution wire-houses will only consider funds with multi-year track records and that interval funds' small footprint in the registered fund market and their unique regulatory framework often require years of effort to onboard onto even platforms that do not have this multi-year performance requirement.

An interval fund must incur substantial costs to prepare, mail, and file each repurchase offer notification form. The adviser also must allocate significant operational resources to comply with Rule 23c-3's liquidity standard and NAV calculation requirements (discussed further below), which are triggered by each repurchase offer.

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[28] Technically, assuming no adjustments are made for fund inflows, appreciation/depreciation, or expenses, a fund with a periodic interval of three months would be required to offer to repurchase approximately 9.63% of its outstanding common stock in a year, and a fund with a periodic interval of six months would be required to offer to repurchase 9.75% of its outstanding common stock for the year.

In our opinion, an optional two year initial lock-up period strikes an appropriate balance. We believe our proposal would reduce fund expenses in the start-up phase of an interval fund's life and thereby benefit interval fund investors that have a long-term investment horizon. The change would also be positive for interval fund managers – many of which invest substantial seed capital in the fund and reimburse or waive expenses – and thus could encourage new managers to embrace the interval fund structure. The timing of the first repurchase offer would be prominently disclosed in the prospectus and would thus be known to any investors that choose to invest during an interval fund's early stages. And investors with greater liquidity needs always have the option of pursuing an interval fund whose lock-up period had expired, a publicly-traded closed-end fund, or an open-end fund.

C. *The additional net asset value calculation requirements under Rule 23c-3(b)(7)(i) and (ii) should be repealed.*

Rule 23c-3(b)(7)(i) requires an interval fund to calculate its NAV no less frequently than weekly, regardless of when it accepts subscriptions or makes repurchase offers. Rule 23c-3(b)(7)(ii) requires an interval fund to determine the current NAV of its common stock on each of the five business days preceding the repurchase request deadline. The combined effect of these two provisions is that an interval fund that accepts subscriptions and repurchases its shares quarterly must determine its NAV on an additional 64 separate occasions merely for compliance purposes. The additional NAV computations tie up fund resources and provide no clear benefits to fund shareholders. As the SEC intended,[29] many interval funds invest a large portion of their assets in non-traded securities that have low levels of liquidity. These securities often have few (if any) observable pricing inputs. Many interval funds that pursue illiquid or less liquid credit strategies hold a significant portion of their assets in level 3 investments. These investments typically do not have readily available market quotations and therefore must be fair valued. This requires nuanced and subjective assessments regarding the issuer's financial performance, the nature of collateral (if any), the markets in which the issuer participates, and a variety of other potential factors that are labor intensive and expensive to evaluate.

The frequent NAV calculations required under Rule 23c-3(b)(7)(i) and (ii) provide no discernible value to shareholders. Notably, the Adopting Release failed to identify a compelling reason for the weekly NAV calculation requirement. The release merely observed that commenters on the proposed rule believed the NAV calculation requirement "generally should be sufficient and should

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[29] "The proposed rules are intended to facilitate greater investment in less liquid securities than is permitted for open-end companies, including venture capital investments, securities issued by small businesses, and less liquid securities issued by foreign issuers…." Periodic Repurchases by Closed-End Management Investment Companies, SEC Rel. No. 33-6948 (July 28, 1992) (Proposing Release).

not be burdensome."[30] The rationale for the requirement that an interval fund compute its NAV during the five business days preceding the repurchase request deadline is equally unclear. This requirement was not included in the original rule proposal. The SEC chose to adopt the requirement because some commenters suggested that "more frequent pricing should be required after the beginning of a repurchase offer."[31]

If interval funds publicly disclosed their NAV after each calculation then one might argue that the requirements provide shareholders a means to more closely monitor the performance of their investment. However, none of the eight active interval funds with net assets above one billion dollars publish their NAV more frequently than as required to price fund subscriptions and repurchase offers.

It's also possible that the NAV calculation requirements were intended to compel interval fund advisers to more closely monitor the fund's portfolio to ensure it maintains sufficient liquid assets to satisfy future repurchase requests. This goal is more directly accomplished by Rule 23c-3(b)(10), which requires an interval fund to maintain sufficient liquidity to satisfy 100% of the repurchase amount for the duration of each offer and adopt formal compliance procedures for that purpose, and by the requirement pursuant to Rule 23c-3(b)(7)(iii) that interval funds calculate a NAV each day they are offering their shares. Notably, the SEC excluded interval funds from the scope of Rule 22e-4 under the 1940 Act due to the predictable frequency and size of interval fund repurchase offers and the requirement for tendering shareholders to provide advance notice.[32] We believe these factors similarly provide justification for eliminating Rule 23c-3(b)(7)(i) and (ii).

D. *The SEC should promulgate new rules or amend existing rules to permit interval funds to offer multiple classes of shares with varying sales loads and asset-based distribution and/or service fees.*

Presently, an interval fund that wishes to offer multiple classes of shares with varying sales loads and asset-based distribution and/or service fees must obtain an SEC exemptive order. The application process – which can include multiple rounds of SEC staff comments – is often costly and drawn out. We believe the application process for multiple-class closed-end funds is ripe for SEC rulemaking.

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[30] Repurchase Offers by Closed-End Management Investment Companies, SEC Rel. No. IC-19399 (Apr. 7, 1993) (Final Rule), at 13.

[31] *Id.*

[32] Investment Company Liquidity Risk Management Programs, SEC Rel. No. IC-32315 (Oct. 13, 2016) (Final Rule), at 52.

In 1995, the SEC promulgated Rule 18f-3 (and amended certain existing rules) to allow open-end funds to establish multiple classes of shares subject to different distribution and servicing expenses. This enabled open-end funds to target a wider universe of potential investors and distribution channels without the need to create an entirely new fund. More recently, certain closed-end funds have obtained exemptive orders that enable them to offer multiple classes of shares in the same manner as mutual funds. These exemptive orders require the applicant closed-end funds to comply with all of the relevant exemptive rules to which multiple class open-end funds are subject, including Rules 6c-10, 12b-1, 17d-3, 18f-3, 22d-1 under the 1940 Act as well as FINRA Rule 2341.

We believe that the use of a multiple-class structure by an interval fund poses no incremental risks to shareholders, conflicts of interest, or potential for overreach as compared to a mutual fund. Like mutual funds, offering multiple share classes with different distribution and servicing fees does not implicate borrowing nor does it increase the speculative character of interval fund shares.

Promulgating new rules or amending existing rules on the issuance of multiple classes of shares would remove a significant hurdle for asset managers that are new to the interval fund space. Legal and compliance costs and filing fees for the submission of an exemptive application can be significant. Interval fund sponsors are often ultimately forced to waive or reimburse these fees to ensure the fund's expense ratio is competitive in the market in the start-up phase of the fund's life. Furthermore, the SEC review process for multiple-class exemptive applications can be lengthy. The six most recent closed-end fund multiple class exemptive applications had a median processing time (from initial filing to receipt of SEC order) of nine months, and required a median of two amendments. While the application is pending, an interval fund sponsor may lose out on attractive distribution opportunities, and the market conditions that prompted the sponsor to pursue launching an interval fund could shift. Rulemaking would eliminate these costs and provide greater certainty to new market entrants.

The SEC staff has recognized that rulemaking has the potential to free up staff resources by focusing the exemptive order process on other important initiatives.[33] We respectfully submit that adopting new or amended rules that provide the same protections as those applicable to mutual funds would promote agency efficiency without subjecting investors to greater risk. It would also level the playing field for interval funds that fit within the scope of the rules by establishing a uniform set of conditions.

[33] *See* Exchange-Traded Funds, SEC Rel. No. IC-33140 (June 28, 2018) (Final Rule), at 7.

E. *The SEC should promulgate new rules or amend existing rules to permit interval funds to establish separate series and register such series pursuant to automatically effective post-effective amendments.*

Section 18(f)(2) of the 1940 Act and Rule 18f-2, the statute's implementing regulation, collectively exempt an open-end investment company organized as a "series company" from restrictions on the issuance of a senior security and require that matters concerning a specific series be approved by the shareholders of that series. Section 18(f)(2) and Rule 18f-2 enable open-end funds to establish separate investment companies in a streamlined fashion and "insure fair and equitable treatment of the holders of each [series] of stock."[34] In addition, Rule 485 under the Securities Act allows open-end funds to register a new series pursuant to an automatically effective post-effective amendment.[35] Collectively, this legal framework has paved the way for mutual fund, and later, ETF, sponsors to establish sweeping fund complexes with relative administrative ease.

We believe it is appropriate to provide interval funds parity with open-end funds in terms of flexibility to establish series companies. Enabling interval funds to register new series pursuant to a fixed SEC review period would facilitate the timely launch of new interval funds in response to favorable market opportunities. Interval funds might also incur lower organizational and offering costs by avoiding legal expenses associated with the preparation and filing of separate charters, bylaws, and other regulatory documents. Interval fund sponsors, officers, and directors could also benefit from greater ease of administration. The ability to launch automatically effective series funds could foster the development of large interval fund complexes – similar to open-end funds – that offer an expanded range of asset classes, strategies, repurchase policies, and other features tailored to investors' unique preferences. In our view, the following arguments proffered by commenters on the proposed Rule 485(a)(2) apply to interval funds with equal force:

> "[T]he new disclosure in a post-effective amendment adding a new series usually is limited to the discussion of investment objectives, policies and risks of investment in the new series and thus such an amendment is not the equivalent of a new registration statement as suggested in the Proposing Release….[T]he level of certainty in the effective date of a post-effective amendment is important for controlling the costs of printing prospectuses and to the successful launch of a new series."

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[34] *See* Investment Company Amendments Act of 1970, P. L. 91-547 (Investment Company Act SEC Rel. No. 6998).

[35] Post-Effective Amendments to Investment Company Registration Statements, SEC Rel. No. IC-20486 (Aug. 17, 1994) (Final rule and form amendments; rescission of rule).

Establishing each new interval fund as a separate investment company is a redundant, cumbersome, and costly process. Our proposed changes would facilitate product development without degrading existing investor protections. In this regard, the SEC would still retain powerful tools to stop abusive practices. Notably, Rule 486(c)(1) allows the SEC to suspend the automatic effectiveness of amendments that contain material inaccuracies or omissions. In addition, if the SEC's recent closed-end fund reform proposals are ultimately adopted, interval funds would be required to disclose in their registration statement any unresolved SEC staff comments deemed to be material – an outcome likely to subject the fund to difficult conversations with selling intermediaries.[36] Moreover, we believe investors and the independent broker-dealer firms and registered investment advisers through which they invest are much better equipped to vet prospective investment options for themselves than in the past. Technological enhancements and modernized regulation – including requirements for an interval fund to make key disclosures available on the internet and include hyperlinks in SEC filings – have dramatically improved third-party access to information regarding interval fund strategies, risks, and financial performance.

VI. Advisers to Registered Investment Companies Generally Should Be Permitted to Charge Capital Gains Performance Fees, Subject to the Same Limitations for BDCs Described in Section 205(b)(3) of the Advisers Act

Request for comment number 123 of the Concept Release asks (among other items) about potential changes to restrictions on performance fees to be charged by registered investment companies and BDCs. Section 205(a)(1) of the Advisers Act generally prohibits an investment adviser from receiving any type of advisory fee calculated as a percentage of capital gains or appreciation in a client's account ("capital gains performance fees").[37] Section 205(a)(1) was intended to eliminate compensation arrangements that could reward an investment adviser for making speculative investments that subject the client to inappropriate risk.[38] Over time, Congress and the SEC have loosened this requirement by adopting exemptions for certain types of investment vehicles and compensation arrangements. Section 205(b) of the Advisers Act provides for certain exceptions from the prohibition on charging a capital gains performance fee, including for (i) fees that increase or decrease proportionately based on a fund's performance relative to an appropriate index or other measure of performance ("fulcrum fees"), (ii) performance-based compensation for investment advisers of BDCs, provided that such compensation does not exceed 20% of the realized capital gains of the BDC, net of realized capital losses and unrealized capital appreciation over a specified

[36] Securities Offering Reform for Closed-End Investment Companies, SEC Rel. No. IC-33427 (Mar. 20, 2019) (Proposed Rule).

[37] *See* Section 205(a)(1) under the Advisers Act.

[38] *See* Investment Adviser Performance Compensation, SEC Rel. No. IA-3372 (February 15, 2012) at 2-3.

time period or as of specified dates[39], (iii) fees paid to investment advisers of private funds excepted from the registration requirements of the 1940 Act pursuant to Section 3(c)(7) of the 1940 Act, and (iv) fees paid by clients that are not U.S. residents.[40] Rule 205-3 permits an investment adviser to certain types of funds (including registered investment companies, BDCs and private funds relying on the exemption from registration pursuant to Section 3(c)(1) under the 1940 Act) to enter into a capital gains performance fee contract only if each investor in the fund is a qualified client.

Registered investment companies that are not BDCs do not qualify for any of the exceptions under Section 205(b) of the Advisers Act and thus must limit their offerings to only qualified clients if the adviser desires to charge capital gains performance fees. We believe this constraint should be removed and advisers to registered investment companies should be permitted to charge capital gains performance fees, subject to the limitations for BDCs described in Section 205(b)(3) noted above, for a number of reasons, as outlined below.[41]

As noted above in the discussion on Section 205(b) of the Advisers Act, BDCs were exempted from the performance fee prohibitions when Congress passed the Small Business Investment Incentive Act ("SBIIA") in 1980.[42] The reforms imposed by the SBIIA – including the more permissive requirements for adviser compensation – were intended to "remove burdens on venture capital activities that might create unnecessary disincentives to the legitimate provision of capital to small businesses."[43] The legislative history suggests that Section 205(b)(3) of the Advisers Act (and certain other relaxed compensation provisions introduced by the SBIIA) were meant to reduce the disparity in incentives with respect to the management of a BDC versus a traditional private fund, and thereby attract skilled investment professionals to this type of vehicle.

We think the rationale underlying the SBIIA with respect to performance fees can be applied to closed-end funds generally. Permitting an adviser to a closed-end fund to charge a capital gains

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[39] *See* Section 205(b)(3) under the Advisers Act.

[40] *See* Section 205(b) under the Advisers Act.

[41] We note that our proposal to remove the relevant restrictions for registered investment companies generally would apply to open-end mutual funds in addition to closed-end funds. However, we think the intensely competitive pricing conditions in the mutual fund marketplace (*see* Morningstar's Annual U.S. Fund Fee Study which notes that mutual fund fees hit a record low in 2018) would likely prevent an adviser to a mutual fund from charging capital gains performance fees. As such, our discussion focuses on removing the qualified client eligibility standard for closed-end funds.

[42] Small Business Investment Incentive Act of 1980, Pub. L. 96-477, 94 Stat. 2275 (Oct. 21, 1980).

[43] S. REP. No. 958, 96th Cong., 2d Seas. 3 (1980).

performance fee could provide retail investors with improved access to additional successful alternative and credit strategies. The SEC has also recognized the importance of giving ordinary investors access to a wide range of investment options so long as appropriate protections are kept in place. The risk and disclosure protections afforded via the registration and offering process would remain in place and continue to benefit investors if advisers to closed-end funds were permitted to charge capital gains performance fees. Capping closed-end fund capital gains performance fees as a percentage of realized gains in the same manner as BDCs pursuant to Section 205(b)(3) of the Advisers Act would help ensure retail investors are not subject to excessive fees. In addition, the ability to charge capital gains performance fees would help make closed-end funds a more appealing opportunity for talented investment advisers and portfolio managers, particularly those accustomed to more permissive compensation models in the private fund industry or other areas.

On a separate note, a growing number of publicly offered interval funds (which are a subset of closed-end funds) have recently been created where the adviser charges an incentive fee on net investment income (as opposed to capital gains). As a result, an increasing number of financial intermediaries are getting comfortable allocating clients' assets to interval funds charging these types of performance fees. Interval funds, and closed-end funds more generally, can serve an important role in providing capital to smaller private companies that are inappropriate investments for mutual funds, which must invest at least 85% of their assets in liquid securities, and other large institutional investors. As distribution channels for interval funds have expanded through networks of broker-dealers and registered investment advisers that represent individual retail clients, such clients have also benefited from the financial advice and expertise of the intermediaries with which they engage. Given that closed-end funds generally are also distributed through similar types of channels, we believe retail investors can similarly make use of recommendations from sophisticated intermediaries with respect to investing in closed-end funds that may charge capital gains performance fees. We believe our proposal to relax the restrictions on capital gains performance fees for registered investment companies generally, consistent with the limitations provided by Section 205(b)(3) of the Advisers Act, strikes the right balance.

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We appreciate the opportunity to comment on the Concept Release. Please feel free to contact Richard Horowitz at [redacted], David Vaughan at ([redacted], Russel Perkins at [redacted], or Jonathan Gaines at [redacted] with any questions about this submission.

Very truly yours,

/s/ Dechert LLP
Dechert LLP