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April 25, 2022

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

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

Dear Secretary Countryman:

CFA Institute respectfully submits this comment letter to the Securities and Exchange Commission ("SEC" or "Commission") in response to its published notice of proposed rules for Private Fund Advisers[1] (the "Proposed Rules" or "Proposing Release.")

CFA Institute[2] is a global, not-for-profit professional association with more than 80,000 U.S.- based members who function as chief investment officers, investment advisers, and portfolio managers on the buy side of the market; as brokers, investment bankers, and financial analysts on the sell side; and as consultants, chief financial officers, regulators, and academics elsewhere in the financial markets. Our membership is bound by a common commitment to the CFA Institute Code of Ethics and Standards of Professional Conduct ("Code and Standards") that require all members and candidates to "place their clients' interests before their employer's or their own interests."[3] CFA Institute speaks on behalf of its members and advocates for investor protection and market integrity before standard setters, regulatory authorities, and legislative bodies worldwide.

Summary

CFA Institute generally supports the Proposed Rules that align with the CFA Institute Code and Standards and our organization's voluntary industry standards.

In our letter, CFA Institute is responding to proposals that are relevant to our profession and our belief in the principles of free and fair markets. Due to the length and complexity of the Proposed Rules, and the short comment period, herein we are not responding to all questions that were asked about the Proposed Rules. Our decision to not respond to any specific question should not be viewed as an indication of support or opposition to such matters. We plan to submit an additional comment letter that responds to some of the questions included in the Proposing Release.

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[1] SEC, "Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews," 87 FR 16886 (March 24, 2022), https://www.govinfo.gov/content/pkg/FR-2022-03-24/pdf/2022-03212.pdf

[2] CFA Institute membership includes more than 185,000 investment analysts, advisers, portfolios managers, and other investment professionals in 163 countries, with more than 178,500 holding the Chartered Financial Analyst (CFA®) designation.

[3] CFA Institute Code of Ethics and Standards of Professional Conduct: https://www.cfainstitute.org/-/media/documents/code/code-ethics-standards/code-of-ethics-standards-professional-conduct.pdf

There are several areas in the Proposing Release where we oppose the suggested change to SEC rules, generally on the basis that full and fair disclosure (not prohibition) of certain business terms and practices between private commercial interests preserves free market practice. A government prohibition in this private market context will impinge on free markets and the private right of contract.

Notwithstanding our preference for disclosure over SEC prohibitions, we and other investor protection stakeholders have urged the private fund industry to change its business practices and address several of the issues identified in the Proposing Release under "prohibited activities." Various sales practices, conflicts of interest, expense allocations, and compensation schemes strongly favor the fund adviser over fund investors. Many of these activities are antithetical to our CFA Institute Code and Standards and reflect a serious disregard for investors, potentially their beneficiaries, and market integrity in general. The industry should address these unfair practices and improve market ethics or face a more severe regulatory response. The Proposed Rules are fair warning of the need to change unfair business practices.

Likewise, for many years, we have encouraged the private fund investor community to advance standard terms and conditions that would better protect their interests and eliminate glaring conflicts of interest that only serve private fund advisers. In the end, private fund investors have the right to determine which terms they will accept and whether to collectively oppose many of the "prohibited activities" included in the Proposed Rules.

Discussion of the Proposed Rules

Quarterly Statements

We agree with requiring standardized, periodic reporting of fee, expense, and performance information to investors. We recommend, where possible, aligning requirements with existing industry standards or practices, including financial statement requirements, commonly used fund templates, and the performance requirements of the Global Investment Performance Standards (GIPS®). Aligning requirements with industry standards and practices would streamline reporting and would ease the compliance burden.

Many investors have negotiated with private fund advisers to receive information that meets their specific needs, often to meet statutory or regulatory requirements. We recommend clarifying within the Adopting Release that the final private fund rules would not prevent an investor from negotiating with a private fund adviser to receive information needed to satisfy their specific needs. Also, many investors are currently receiving information that has previously been negotiated or has been routinely provided to investors. We recommend clarifying that the final private fund rules are not intended to replace current investor reporting practices, and instead reflect the minimum information that must be presented to investors.

To better meet the policy goal of having private fund advisers provide information that allows investors to understand the full cost of investing in private funds and the performance of such private funds, we offer the following comments.

Format and Delivery of Reporting

The Proposed Rules would require the quarterly statement to be provided to investors within 45 days after each calendar quarter end. While some private fund advisers provide information to investors

more quickly, it is common industry practice for private fund advisers of illiquid funds to provide quarterly financial reporting within 60 days of quarter end. Given this industry standard, we recommend using the same deadline of 60 days for all private funds. However, we also recommend that funds-of-funds (FOFs) and funds-of-funds-of-funds (FOFOFs) should have a longer time to report because these funds need to receive information from the underlying funds to confirm data and finalize their information. We recommend, therefore, taking a staggered approach. Specifically, we recommend the following quarterly reporting deadlines:

- 60 days for a fund that does not invest in underlying funds,
- 120 days for FOFs, and
- 180 days for FOFOFs.

A staggered approach would allow all private fund advisers to provide information that is more likely to be finalized and would be more useful to investors.

We recommend using a different deadline for any quarter that is the fund's fiscal year end. We also recommend aligning this requirement with the deadlines for delivering annual audited financial statements if relying on the "audit exception" to Rule 206(4)-2 requirements relating to reporting and surprise custody examinations.[4] These financial statement delivery deadlines are:

- 120 days for a fund that does not invest in underlying funds,
- 180 days for FOFs, and
- 260 days for FOFOFs.

Investors are already accustomed to these financial statement reporting deadlines, and we believe it is appropriate to use a guideline that is already in place rather than creating a new deadline, particularly given that these timelines are practical. Aligning a fund's fiscal year end quarterly statement deadline with the financial statement reporting deadline will ensure investors receive information within the quarterly statement that is finalized and consistent with audited information within the financial statements.

We believe that the Proposed Rules strike the correct balance between flexibility and standardization by requiring expenses to be reported in a tabular format but not requiring a specific tabular format. It would be impossible to create a template that would be appropriate for all funds, given the variety of fund types and the variety of fees and expenses. We also recognize that many investors do not receive detailed information about fund earnings or fees and costs - these amounts are often "netted" within the periodic partner capital account statements - and the Proposed Rules attempt to address this issue. We appreciate that this fee and expense information, combined with the information included in the statement of contributions and distributions, is intended to allow an investor to assess a fund's performance. While we do not believe a specific template should be mandated, we recommend including in the Adopting Release examples of how that tabular format might look at the fund level. We created two example tables for your consideration that combine detailed information from the fund table and summary information that appears in the statement of contributions and distributions, and presents a complete picture of the fund's quarterly activity, giving context for fund performance (see

[4] See Staff Responses to Questions About the Custody Rule, Question VI.9: https://www.sec.gov/divisions/investment/custody_faq_030510.htm

Appendix A). This information is consistent with information that appears in financial statements. We combined key items from the Statement of Operations and the Statement of Partners' Capital. Based on our experience as standard setters, we have found that the industry greatly appreciates having sample templates to modify.

Private fund managers would be required to distribute the quarterly statements to investors and to keep detailed records to prove the quarterly statements were distributed. We recommend allowing private fund managers to meet this distribution requirement by either providing quarterly statements to investors or making the quarterly statements available to investors. Many private fund advisers have client portals where information is routinely shared with investors. Providing this second option would also accommodate those investors who do not wish to receive the quarterly statements. Not requiring the information to be delivered to investors would better accommodate the continual evolution of technology.

If this recommended approach is taken, then private fund advisers would need to establish procedures that allow them to demonstrate to the Commission that quarterly statements were made available to investors in accordance with the reporting deadline. Throughout the rest of our comments on the quarterly statements, we did not, in each instance, refer to our recommendation to modify "provide" to "provide or make available."

We agree that the first reporting period should be based on the first two full quarters plus any initial stub period, as described in footnote 31 in the Proposing Release. However, the proposed definition of "reporting period" would exclude the initial stub period. We recommend editing the definition of reporting period as follows:

> *Reporting period* means the private fund's calendar quarter covered by the quarterly statement or, for the initial quarterly statement of a newly formed private fund, the period ~~covering the~~ from the private fund's inception date through the first two full calendar quarters of operating results.

The Proposed Rules define the reporting period for a newly formed fund, but do not address what it means for a fund to be "formed." Some advisers do not consider a fund to be incepted until the first capital call is made, even though the fund has charged fees or made investments using funds from a subscription facility. To ensure that investors receive complete historical information about new funds on a timely basis, we recommend clarifying in the Adopting Release that a private fund is considered to be formed or incepted once it commences any operations, including charging fees or undertaking any subscription facility activity.

Level of Fee, Expense, and Performance Information

The Proposed Rules would require advisers to provide fee, expense, and performance information only at the fund level. Funds often contain multiple share classes that have different fee arrangements, or have different investments. Funds can also include assets that pay reduced or no fees (e.g., general partner assets or friends and family accounts.) In many cases, aggregating fee, expense, and performance information at only the fund level would not provide meaningful information to any specific investor, would not allow an investor to understand their full cost of investing in a private fund, nor would it allow an investor to check the fee, expense, or performance calculations. Accordingly, we recommend the following approach:

- Fee and Expense Information: We agree with requiring fund-level fee and expense information because this information will allow an investor to determine if the proper fees and expenses were charged to the fund. When all investors in a private fund share ratably in the same investments and pay the same fees, an investor would be able to calculate their pro-rata portion of fees and expenses. However, fund-level information may not allow an investor to determine their pro-rata portion of fees and expenses when all investors do not have the same terms. In such cases, we recommend requiring advisers to also provide (or make available) investor-level information. In some cases, such as for liquid funds with multiple share classes, this could be accomplished by providing representative investor-level information (e.g., share classlevel information) that enables an investor to calculate their pro rata allocation of fees and expenses. This information is necessary for many investors who are required to report their pro rata portion of private fund fees and costs to their governing bodies.[5]
- Performance information: Fund-level returns typically do not represent any specific investor's experience. To meet the stated goal of allowing investors to monitor for abnormalities and better understand the impact of fees and expenses on their investments, we recommend requiring advisers to provide returns that are appropriate for the investor. For example, when there are multiple share classes, we recommend requiring advisers to provide the appropriate share class return to each investor. If an adviser is concerned that it would be difficult to determine which performance information should be provided to each investor, the adviser could instead provide returns for all share classes to all investors.

Fee and Expense Categories

The Proposed Rules would require a detailed accounting of all fees and expenses paid by the private fund during the reporting period. We recommend allowing for an "other expenses" category, which would include any individual expense that is less than 5% of total expenses. This approach would be consistent with Rule 6-07 of Regulation S-X[6], which requires separate disclosure of each expense exceeding five percent of total expenses.

We recommend modifying the definition of performance-based compensation to include the concept of income. A private fund's total return is composed of capital gains/losses and income. Performance-based fees and carried interest are usually based on a total return. It may be easier to instead modify the definition to refer to the private fund's performance or returns instead of the fund's capital gains and/or capital appreciation.

One of the stated goals is to make it easier for investors to assess whether fees and expenses borne by the private fund are consistent with the fund's governing agreements. The Proposed Rules would require an adviser to disclose, for all expenses, payments, allocations, rebates, waivers, and offsets, where the applicable calculation methodology is located within the fund's organizational and offering documents. Because this information will not change quarter to quarter, we recommend requiring advisers to provide this information to all investors once, when they receive their initial quarterly statement.

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[5] We say this, at least in part, to meet requirements of California Assembly Bill 2833 (2016) and Texas Senate Bill 322 (2019), among others.

[6] See https://www.govinfo.gov/content/pkg/CFR-2021-title17-vol3/pdf/CFR-2021-title17-vol3-part210.pdf, p. 313.

Portfolio Investment Table

The Proposed Rules would require advisers to provide a detailed accounting of all portfolio investment compensation allocated or paid to the investment adviser or any of its related persons by each covered portfolio investment during the reporting period. The information would also need to be presented both before and after the deduction of any offsets, rebates, or waivers. We believe that including this information at the individual covered portfolio investment level would not be as helpful as providing the information at the fund level. Fund agreements typically establish offset percentages based on categories of portfolio investment compensation. See the table below for an excerpt from the Institutional Limited Partners Association ("ILPA") Reporting Template[7] that demonstrates how information about these portfolio investment compensation categories and the related offsets are typically presented to investors.

Best Practices Fund II, L.P.			QTD (Oct-15 - Dec-15)
	Compensation	% Offset to LP #5'	Offset
Advisory Fees	625,000	80%	500,000
Broken Deal Fees	400,000	80%	320,000
Transaction & Deal Fees	487,500	80%	390,000
Directors Fees	30,000	100%	30,000
Monitoring Fees	1,500,000	100%	1,500,000
Capital Markets Fees	750,000	100%	750,000
Organization Costs	500,750	80%	400,600
Placement Fees	0	100%	0
Other	0	80%	0
Total Offsets to Fees & Expenses (applied during period):			4,140,600
Reconciliation for Unapplied Offset Balance (Roll-forward) - accrual (earned but not applied)	Unapplied Offset Balance (Roll-forward) - Beginning Balance		250,000
	Plus: Total Offsets to Fees & Expenses (recognized during period)		3,890,600
	Less: Total Offsets to Fees & Expenses (applied during period)		4,140,600
	Unapplied Offset Balance (Roll-forward) - Ending Balance		0

The Proposed Rules would require advisers to report the private fund's ownership percentage of each covered portfolio investment as of the end of the reporting period. If the fund does not have an ownership interest in the covered portfolio investment as of the end of the reporting period, the fund would report a zero percentage ownership interest, along with a brief description of the fund's investment. While this information may be interesting, our experience tells us that, in most cases, investors would not find this information to be useful. In addition, calculating the ownership interest could be quite difficult given the complexity of capital structures. We recommend, therefore, not requiring ownership percentage of each covered portfolio investment to be provided to investors.

If accelerated payments are permitted under the final rules, we recommend requiring investment advisers to disclose any accelerated payments that have occurred during the quarter.

Performance

Fund Classification

The proposed definition of "illiquid fund" generally aligns with U.S. Generally Accepted Accounting Principles ("GAAP") for determining which return type (time-weighted return or internal rate of return) to include within the financial statements. Under U.S. GAAP, a fund must meet each of the specified

[7] See https://ilpa.org/reporting-template/

tests to qualify for presenting an internal rate of return (IRR) as opposed to a time-weighted return. The Proposing Release take a different approach, allowing some flexibility, and states, "some private funds may not neatly fit into the liquid or illiquid designations. For example, a hybrid fund is a type of private fund that can have characteristics of both liquid and illiquid funds, and whether the fund is treated as a liquid or illiquid fund under the rule would depend on the facts and circumstances." We strongly support this more flexible approach, which will allow a private fund adviser to provide investors with the most meaningful performance. To make the rule text consistent with this facts and circumstances language, we recommend adding the word "generally" to the definition of illiquid fund, as follows:

Illiquid fund means a private fund that <u>generally</u>:

(i) Has a limited life;
(ii) Does not continuously raise capital;
(iii) Is not required to redeem interests upon an investor's request;
(iv) Has as a predominant operating strategy the return of the proceeds from disposition of investments to investors;
(v) Has limited opportunities, if any, for investors to withdraw before termination of the fund; and
(vi) Does not routinely acquire (directly or indirectly) as part of its investment strategy market-traded securities and derivative instruments.

To address any concerns that an adviser may inappropriately take advantage of this flexibility, we recommend requiring advisers to maintain records to support their determination as to whether a private fund is classified as liquid or illiquid. These records would also assist Commission staff who conduct routine or cause examinations.

Calculation Methodologies

One of the stated goals in the Proposing Release is to allow investors to compare performance of their private fund investments. To meet this goal, performance must be calculated using similar assumptions and methodologies. We recognize that it would be impossible to provide prescriptive performance calculation requirements that would be appropriate for all types of private funds in all circumstances. One possible approach is to refer to existing industry standards, specifically the widely-adopted GIPS standards. The GIPS standards are ethical standards for calculating and reporting investment performance based on the principles of fair representation and full disclosure. The GIPS standards have been adopted by more than 1,800 organization from 49 countries, including almost 1,400 firms from the U.S. The GIPS standards include calculation requirements that may be applied to any private fund, regardless of structure or investment type. Also, the GIPS standards are updated as needed, to remain current and relevant.

Many private fund advisers may already be calculating private fund performance in accordance with the GIPS standards because their firms have chosen to comply with the GIPS standards. Other private fund advisers that do not claim compliance with the GIPS standards may also be calculating private fund performance consistent with the calculation requirements of the GIPS standards to meet the

requirements of FINRA's Regulatory Notice 20-21.[8] We recommend taking a similar approach to the GIPS standards as was done with the Marketing Rule[9], and stating within the Adopting Release that an adviser that calculates private fund performance consistent with the requirements of the GIPS standards would meet the performance calculation requirements of the final private fund rules.

The Proposing Release includes minimal guidance as to concepts that must be reflected within return calculations. If the Commission chooses not to refer to the GIPS standards within the Adopting Release, we recommend including within the Adopting Release key concepts that should be reflected within the return calculations. Requiring certain calculation concepts would ensure that investors do not receive performance information that is false or misleading. We recommend including the following key calculation concepts within the Adopting Release:

- Returns are based on actual assets and not hypothetical assets
- Private fund values used in return calculations are fair values
- Returns are based on total returns (reflecting both income and capital gains/losses)
- Private fund values are net of leverage (except for returns that are required to be calculated without the impact of subscription facilities)
- Returns for periods of less than one year are not annualized

Consistency of Periods Presented

The Proposing Release states that an investment adviser would be able to report performance using valuations as of a previous date, as long as it is labeled with that date. Specifically, it states "to the extent quarter-end numbers are not available at the time of distribution of the quarterly statement, an adviser would be required to include performance measures through the most recent practicable date, which we generally believe would be through the end of the quarter immediately preceding the quarter covered by the quarterly statement. The proposed rule would require the quarterly statement to reference the date the performance information is current through (*e.g.,* December 31, 2021)." We believe that it would be confusing, and possibly misleading, to have performance calculated through a date that is different from the date of other information included in the quarterly statement, including fees and costs. We believe that a better approach, as we described previously, is to establish staggered reporting deadlines based on the type of fund. Such an approach would alleviate the need to provide for an exception when underlying fund information is not available within the 45-day deadline that is proposed for all private funds. If a staggered approach is allowed, then we believe it would be appropriate to require advisers to provide performance that reflects fair value as of the date of the quarterly statement. Fair values would not need to be based on third-party valuations and could be based on an internal review process.

[8] The Notice provides guidance to help member firms comply with FINRA Rule 2210, Communications with the Public, when creating, reviewing, approving, distributing, or using retail communications concerning private placement offerings. https://www.finra.org/rules-guidance/notices/20-21

[9] "An adviser may use the same criteria to construct any composites to meet the GIPS standards in order to satisfy the 'substantially similar' requirement of the final rule's definition of 'related portfolio.'" See Investment Adviser Marketing, SEC Release No. IA-5653 (December 22, 2020), https://www.sec.gov/rules/final/2020/ia-5653.pdf, p. 194.

Gross and Net Returns

The Proposed Rules require gross and net IRRs for illiquid funds, but require only net returns for liquid funds. We believe that gross returns should also be required for liquid funds. Requiring both gross and net returns for all funds will provide the same transparency to all investors, allowing them to see the impact of fees on their performance and to compare performance with other funds. While it is common practice for many private funds to report gross returns, for those liquid funds that have not previously calculated gross returns, this would not be a difficult calculation. We would also like to suggest a second option for providing transparency for liquid funds. We recommend requiring an investment adviser to provide the liquid fund's annualized expense ratio along with the net return. An investor could then estimate the fund's gross return by adding back the expense ratio to the net return. We believe the first option is a better approach, because the gross return will be more accurate and will provide better information to investors.

The Proposed Rules define net IRR as the internal rate of return that is calculated net of all fees, expenses, and performance-based compensation borne by the private fund. We offer the following comments about this definition:

- Private funds often include non-fee-paying assets, such as general partner assets or seed capital used to launch the fund. If this is the case, calculating a fund net IRR using actual fees, as required by the definition, would generate a return that is not meaningful to investors, and would also conflict with the requirements of the Marketing Rule. (The Marketing Rule Adopting Release generally requires a model investment management fee to be applied to non-fee-paying assets.[10]) For funds with a partnership structure, common industry practice is to calculate net performance using only limited partner (i.e., fee-paying) assets. We recommend clarifying in the Adopting Release that net IRRs should be calculated excluding any non-fee-paying assets. If the Adopting Release does not require advisers to exclude non-fee-paying assets when calculating net IRRs, and net IRRs are allowed to reflect assets that are non-fee-paying, we recommend requiring disclosure of this fact.
- The Proposed Rules do not include a definition for "net total return" that would be required for liquid funds. We recommend including a definition for net total return, but we have the same concern about potential non-fee-paying assets, and recommend considering this fact when developing a definition. Assuming the concept of excluding non-fee-paying assets is not included within the definition of net total return, and this point is made within the Adopting Release, to align with the definition for net IRR, the definition could state: Net total return means a time-weighted return that is calculated net of all fees, expenses, and performance-based compensation borne by the private fund.

The definition of gross IRR for illiquid funds would require an adviser to calculate an IRR that is gross of all fees, expenses, and performance-based compensation borne by the private fund. In addition to administrative expenses, these expenses would include investment-related expenses, such as dividends on short positions and broken deal expenses. We believe that the cost of investing in short positions, or expenses resulting from an investment opportunity that was not completed, should be reflected as a deduction when calculating gross returns. Furthermore, it is not common practice for private funds to

[10] See Investment Adviser Marketing, SEC Release No. IA-5653 (December 22, 2020), https://www.sec.gov/rules/final/2020/ia-5653.pdf, discussion of non-fee-paying clients, pp. 178-179.

calculate gross returns that have been grossed up by administrative expenses. Typically, the difference between gross and net returns for private funds is attributable only to management fees and performance-based compensation. We therefore recommend defining gross IRR as a return that is gross of management fees and performance-based compensation borne by the private fund. Similarly, we recommend defining gross MOIC as a multiple of invested capital that is calculated gross of management fees and performance-based compensation borne by the private fund. Our proposed definition of gross IRR would be consistent with the Marketing Rule, which defines gross performance as "the performance results of a portfolio (or portions of a portfolio that are included in extracted performance, if applicable) before the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio."[11] In our view, "management fees and performance-based compensation" within the private fund rules would be equivalent to "investment advisory services" within the Marketing Rule. Finally, if the final rules include a requirement to provide a gross total return for liquid funds, we recommend taking a similar approach when defining this term.

Subscription Facilities

The Proposed Rules would require all IRRs to be calculated without the impact of subscription facilities, and we strongly support this requirement. However, the IRR with the impact of the subscription facilities is typically used to calculate performance-based compensation, and this return also reflects the actual investor return. We recommend, therefore, requiring IRRs both with and without the impact of subscription facilities. This approach would allow investors to understand the impact of the adviser's decision to use a subscription facility. Such a requirement, moreover, would be consistent with the GIPS standards requirements. The GIPS standards differentiate between using a subscription facility for shorter term, efficiency purposes and using a subscription facility for longer time-periods, where the goal may be to increase returns. When a subscription facility is used for very short time periods, (e.g., for bridging capital calls), returns with and without the impact of subscription facilities will be very similar. We recommend exempting from this requirement those private funds that use a subscription facility only for short term purposes, which would align with the GIPS standards. The GIPS standards do not require a firm to present returns without the impact of the subscription facility when the subscription facility was repaid within 120 days using committed capital that is drawn down through a capital call, and the subscription facility was not used to fund distributions. We recommend taking the same approach here.

Under the Proposed Rules, advisers would be required to exclude fees and expenses associated with subscription facilities when calculating net returns without the impact of subscription facilities, as well as when preparing the statement of contributions and distributions. We have two primary concerns with this approach.

- First, we believe that when calculating a return without the impact of subscription facilities, the exclusion of fees and expenses associated with these subscription facilities should be optional. For those advisers that have not previously calculated IRRs without the impact of subscription facilities, it could be extremely challenging to identify all activity related to these subscription facilities, particularly for those funds that have long histories. Advisers

[11] See Investment Adviser Marketing, SEC Release No. IA-5653 (December 22, 2020), https://www.sec.gov/rules/final/2020/ia-5653.pdf, p. 415.

could be directed to disclose how these fees and expenses have been reflected in the return as one of the criteria used and assumptions made in calculating the performance. When creating the 2020 edition of the GIPS standards, we debated this specific point at length. We concluded that while these fees and expenses could be significant, the greatest impact for using subscription facilities typically comes from the shortened time period over which the IRR is measured.

- Second, we struggle to understand how it would be helpful to exclude fees and expenses associated with the subscription facility when preparing the statement of contributions and distributions. This approach also seems to contradict the definition of the statement of contributions and distributions, which is defined to include all capital inflows and outflows to and from investors. We believe that the statement of contributions and distributions should reflect the actual investor cash flow activity.

Realized and Unrealized Gross IRRs

In our view, realized and unrealized gross IRRs for illiquid funds would provide helpful information to investors. Although the Proposing Release states that information in the quarterly statement required by the Proposed Rules would not be considered an “advertisement” under the Marketing Rule, presenting only gross realized and unrealized IRRs without comparable net IRRs may not be consistent with the requirements of the Marketing Rule. We are not suggesting realized and net unrealized IRRs should be required. We fully agree with the comments within the Proposing Release that these net calculations would be complex and subjective.

The Proposed Rules do not include definitions for realized and unrealized IRRs. In the Adopting Release, we recommend addressing the fact that advisers will need to determine how partially realized investments are treated within these calculations. Some investment advisers classify partially realized investments as unrealized investments, while other advisers create a third category for partially realized investments (i.e., the investment adviser would have three IRRs - realized, unrealized, and partially realized). Advisers may also take different approaches for determining when an investment is realized, e.g., based on the sale date to a third party, or based on the date when the proceeds were distributed to investors. We recommend allowing flexibility here, but recommend requiring advisers to disclose their assumptions and maintain records to support these assumptions.

Periods Presented

The Proposed Rules would require annual returns since inception for liquid funds. Some of these funds have decades of history, and we do not believe that such a long performance history would be meaningful. Rather, we recommend requiring advisers to present annual returns for liquid funds for the past ten years. This would be consistent with industry practice, including the periods required to be presented by the GIPS standards.

The Proposed Rules would require liquid funds to present average annual returns for the one-, five-, and ten-year periods as of the most recent calendar year end. While this requirement aligns with the prescribed time periods required by the Marketing Rule, the Marketing Rule exempts private funds from presenting performance for these prescribed time periods. The Marketing Rule Adopting Release states, “we agree that requiring advisers to provide performance results of private funds over one-, five-, and ten-year periods in advertisements will not provide investors with useful insight into how the advertised

portfolio(s) performed during different market or economic conditions."[12] If the Commission determines that it is appropriate to require returns that align with the prescribed time periods, we recommend requiring one-, five-, and ten-year average annual returns to be presented as of the most recent quarter end. We also recommend requiring the since-inception average annual return when the private fund has not been in existence for any of the required (i.e., one-, five-, or ten-year) periods for which average annual returns must be presented. Finally, we believe that the use of the word "cumulative" within the Proposed Rule is confusing. This term is typically used to refer to the linking of returns over multiple years, e.g., a five-year cumulative return. The industry uses the term "year-to-date" and we recommend using this term instead.

Benchmarks

The Proposed Rules are silent as to whether returns for benchmarks should be included within the quarterly statement. We believe that benchmark returns are very important when evaluating private fund performance. However, we also recognize that many private funds do not have an appropriate benchmark. For those private funds that do have an appropriate benchmark, we recommend requiring such funds to present benchmark returns for the same periods that are presented for the private fund.

Supporting Information for an Investor to Validate Fee, Expense, and Performance Calculations

The Proposed Rules would require an adviser to present, among other items, the following information in the quarterly statement:

- Prominent disclosure regarding the manner in which all expenses, payments, allocations, rebates, waivers, and offsets are calculated and include cross references to the sections of the private fund's organizational and offering documents that set forth the applicable calculation methodology, and
- For liquid funds, a statement of contributions and distributions.

The purpose of these requirements is to enable an investor to check fee, expense, and performance calculations. These calculations can be very complicated and difficult to replicate. To enable investors to replicate return calculations, advisers would need to provide information about each contribution and distribution and how the cash was used (e.g., for investment purposes or for management fees.) To calculate gross returns, advisers would also need to provide detailed information about all expenses paid by the fund. This would go well beyond the currently proposed requirement to include the date and value of each inflow and outflow.

We believe that a better approach is to require an adviser to provide these supporting calculations to investors upon request. Those investors that wish to scrutinize fee, expense, and return calculations would then have the ability to obtain the needed information.

With respect to disclosures, we recommend not requiring references to the sections of the private fund's organizational and offering documents that set forth the applicable calculation methodology. We previously recommended providing this information only once, because it is fixed and will not change. If our recommendation to require an adviser to provide supporting calculations upon request is accepted, we recommend requiring accompanying disclosure that is sufficient to allow an investor to understand

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[12] See Investment Adviser Marketing, SEC Release No. IA-5653 (December 22, 2020), https://www.sec.gov/rules/final/2020/ia-5653.pdf, p. 182.

the calculation methodology. If investors are left to replicate returns themselves, we then recommend requiring advisers to provide information sufficient to allow an investor to understand and replicate the calculations. Investors would need a much greater level of detail to be able to do these calculations themselves.

Scope

Many collateralized loan obligations (CLOs) would be included within the scope of the Proposed Rules. Given the structure of CLOs (e.g., the use of tranches) we believe that investors in CLOs typically do not have the same challenges as investors in other private funds with respect to determining the full cost of investing in the CLO and the performance of the CLO. Unlike other private funds, CLOs have a third-party trustee that is responsible for allocating expenses, reporting information on a monthly basis, and is subject to an indenture. We believe that CLOs that have an established third-party trustee that oversees the allocation of expenses, reports information, and is subject to an indenture should be exempt from the quarterly statement portion of the private fund rules. The cost of implementing this additional reporting will be borne by the investors and will provide no additional benefit for these investors.

Mandatory Audits

We generally agree with requiring private fund advisers to obtain an annual audit of the financial statements of the private funds they manage, as well as the requirements for auditors to be independent and qualified. However, we are concerned that the requirement for the public accountant to be registered with, and subject to inspection by, the Public Company Accounting Oversight Board (“PCAOB”) would greatly limit the number of firms that could conduct such audits. We support PCAOB oversight of such auditing firms, but CPA firms have limited options for making themselves be subject to PCAOB oversight. Unless a CPA firm audits a public company, or audits a broker/dealer (which qualifies under the temporary inspection program), the CPA firm would not be subject to PCAOB oversight and, therefore, would not be able to conduct an audit of a private fund. According to the American Institute of CPAs (AICPA)[13], there are over 46,000 CPA firms in the U.S. while, according to the PCAOB,[14] more than 1,700 firms are registered with the PCAOB. This means that less than 4% of CPA firms would be allowed to conduct audits of private funds. We recognize that many CPA firms may not be interested in conducting these types of audits, but we are troubled by the fact that a CPA firm that is interested in doing private fund audits could not voluntarily choose to become subject to PCAOB oversight. We recommend considering if there could be a path for such CPA firms to voluntarily subject themselves to PCAOB oversight.

Advisor-Led Secondaries Rule

We generally agree with this proposal.

Prohibited Activities

CFA Institute is of the view that the items contained in this Prohibited Activities section of the Proposed Rules should remain the purview of the private right of contract between the private fund adviser and the investor. We do support more fulsome disclosure and transparency around each of the items being proposed so the terms are fully explained and prominently displayed in relevant fund documentation

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[13] https://us.aicpa.org/career/careerpaths/publicaccounting “Currently there are more than 46,000 public accounting firms in the United States…”
[14] https://pcaobus.org/oversight/inspections/basics-of-inspections

using plain language disclosures. Our concern is that SEC prohibition of these items will infringe on free markets and the long-standing ability and freedom of sophisticated business parties to negotiate the terms and conditions most suitable to their respective interests. In this regard, CFA Institute takes the view that the focus should be on updating and expanding required disclosures related to such business terms.

In the event the SEC does prohibit or otherwise mandate various business terms and conditions between private fund investment parties, it should be made explicit that Separately Managed Accounts (SMAs) would not be subject to such prohibitions.

We have the following comments in response to specific SEC questions:

- If the SEC does adopt prohibited activities as proposed, they should apply only to registered investment advisors and not to unregistered investment advisors.
- Any such prohibitions should not apply to co-investors/co-investments because co-investors/co-investments should be considered SMAs with customized agreements between the investor and the adviser where these provisions are subject to private right of contract.
- Any such prohibitions should not be applicable to funds established outside of the U.S. (e.g., offshore feeder funds.)

A preferred alternative to government mandates of fee levels, expense pass-through rules, or other private business terms typical in private fund relationships based on established practices would be to allow standard governance mechanisms to serve as oversight and protection against unfair private fund adviser behaviors. Mechanisms such as full and plain language disclosures, approval by investors/limited partners, or creation of an independent fund governing body similar to those established for Regulated Investment Companies are more consistent with free markets.

Fees for Unperformed Services

The Proposed Rules would prohibit an investment adviser from charging a portfolio investment for monitoring, servicing, consulting, or other fees in connection with any services the investment adviser does not, or does not reasonably expect to, provide to the portfolio investment (i.e., accelerated payments).

We do not support a government mandate regarding these business terms. Please see our prior comment noting our urging for much needed change in private fund adviser practices that materially disadvantage private fund investors.

Certain Fees and Expenses

The Proposed Rules would prevent an adviser from charging to a private fund fees or expenses associated with an examination or investigation of the adviser or its related persons by any governmental or regulatory authority, as well as regulatory and compliance fees of the adviser and its related persons – even where these fees are disclosed.

We do not support a government mandate regarding these business terms. Please see our prior comment noting our urging for much needed change in private fund adviser practices that materially disadvantage private fund investors.

Reducing Adviser Clawbacks for Taxes

The Proposed Rules would prohibit an adviser from reducing the amount of any adviser clawback by actual, potential, or hypothetical taxes applicable to the adviser, its related persons, or their respective owners or interest holders.

We do not support a government mandate regarding these business terms. Please see our prior comment noting our urging for much needed change in private fund adviser practices that materially disadvantage private fund investors.

Limiting or Eliminating Liability for Adviser Misconduct

The Proposed Rules would prohibit an adviser to a private fund from, directly or indirectly, seeking reimbursement, indemnification, exculpation, or limitation of liability by the private fund or its investors for a breach of fiduciary duty, willful malfeasance, bad faith, negligence, or recklessness in providing services to a private fund.

We support the right of exculpation to the extent any exculpatory language is permitted by law and does not limit liability regarding fraud, willful malfeasance, or gross negligence. At a minimum, the duty to prevent or be held accountable for these behaviors is a matter of fundamental fairness and public interest. Furthermore, terms that are contrary to law would be considered ultra vires or acting beyond one's legal power or authority in any event. As we noted above, our preference is for full disclosure over government prohibition of various business terms. In this case, however, we view the practice of contractually limiting liability for what is essentially unlawful behavior falls outside an appropriate private right of contract and is particularly dangerous for market trust and integrity.

Certain Non-Pro Rata Fee and Expense Allocation

The Proposed Rules would prohibit an adviser, directly or indirectly, from charging or allocating fees and expenses related to a portfolio investment (or potential portfolio investment) on a non-pro rata basis when multiple private funds and other clients advised by the adviser, or its related persons, have invested (or propose to invest) in the same portfolio investment.

We do not support a government mandate regarding these business terms. To the extent any of the provisions of this section on fees and expense allocation are adopted by the SEC, it should make clear this relates to deal/transaction costs only and that fees such as management fees may be allocated non-pro-rata across vehicles and/or investors. Please see our prior comment noting our urging for much needed change in private fund adviser practices that materially disadvantage private fund investors.

Borrowing

The Proposed Rules would prohibit an adviser, directly or indirectly, from borrowing money, securities, or other fund assets or receiving a loan or an extension of credit, from a private fund client (collectively a “borrowing”) – i.e., borrowing from the fund.

We do not support a government mandate regarding these business terms. If such a prohibition is adopted in this context, it should be made clear it would not prohibit an investor in the fund from making a loan to the adviser outside of the fund structure using, for example, a side letter arrangement or co-investment agreement between the two commercial parties.

We have the following comments in response to specific SEC questions:

- The SEC should not prohibit co-investment vehicles or other separate contractual arrangements and accounts.
- The SEC should not prohibit the fund/adviser from borrowing using the fund's assets as security for such extensions of credit to the fund. It is typical and generally expected by fund investors that the adviser will look for opportunities to leverage a fund investment as a means of enhancing returns for the fund, with such leveraging activities being fully disclosed and consistent with fund offering documents.

Preferential Treatment

The Proposed Rules would prohibit all private fund advisers, regardless of whether they are registered with the SEC, from providing preferential terms to certain investors regarding redemption or information about portfolio holdings or exposures. The Proposed Rules would also prohibit any other preferential treatment to any investor unless the adviser provides written disclosures to prospective and current investors in a private fund regarding all preferential treatment the adviser or its related persons are providing to other investors in the same fund.

We do not support a government mandate regarding these business terms. The ability to offer variable business terms to fund investors should be properly disclosed and documented. In the event the SEC implements such prohibitions, it should be explicitly stated that SMAs are not included in this rule because these are agreements negotiated between two parties. Please see our prior comment noting our urging for much needed change in private fund adviser practices that materially disadvantage private fund investors.

Prohibited Preferential Redemptions

The Proposed Rules would prohibit a private fund adviser, including indirectly through its related persons, from granting an investor in the private fund or in a substantially similar pool of assets the ability to redeem its interest on terms that the adviser reasonably expects to have a material, negative effect on other investors in that private fund or in a substantially similar pool of assets (such as another feeder fund investing in the same master fund).

We do not support a government mandate regarding these business terms. These arrangements are common and reflect a range of considerations as to whether certain investors have different liquidity requirements, fee arrangements, or co-investment opportunities, to name a few. Examples of typical considerations include the size of the investor's commitment to the fund, whether investors were early supporters of the adviser's fund or prior funds, and whether the investor has successfully negotiated a long-term relationship and loyalty as a preferred customer of the adviser. These are elements that clearly exist in many other business/customer relationships. They are a matter of private right of contract.

Prohibited Preferential Transparency

The Proposed Rules would prohibit an adviser and its related persons from providing information regarding the portfolio holdings or exposures of the private fund or of a substantially similar pool of assets to any investor if the adviser reasonably expects that providing the information would have a

material, negative effect on other investors in that private fund or in a substantially similar pool of assets.

We do not support a government mandate regarding these business terms. For example, having to determine whether the information regarding a communication to an SMA, in the context of a side letter arrangement, or a communication regarding a co-investment relationship, would have a material, negative effect on other investors in a related private fund or substantially similar pool of assets is fraught with uncertainty and ambiguity. In addition, as a practical matter, it likely interferes – and in some cases -- may void these other commercial arrangements, which are generally fully disclosed to other investors. This will quickly become an unworkable definitional challenge.

Other Preferential Treatment

The Proposed Rules would prohibit other preferential terms unless the adviser provides certain written disclosures to current and prospective investors.

Preferential treatment of various sorts, including such things as side letters, co-investments, liquidity, and fees and expenses, should not be prohibited. We support a disclosure approach regarding, for example, the general partner's authority to negotiate variable business terms among fund investors, while maintaining confidentiality of the identity and specifics of the business terms negotiated by individual investors.

Recordkeeping for Preferential Treatment

The Proposed Rules would amend Rule 204-2 under the Investment Advisers Act to require advisers registered with the Commission to:

- Retain copies of all written notices sent to current and prospective investors.
- Retain copies of each addressee and the corresponding dates sent, addresses, and delivery method for each addressee.

We support efforts to improve the completeness and accuracy of recordkeeping. This is an appropriate and important component for demonstrating proper compliance processes and procedures that are designed to protect investors and prevent violations of applicable laws and regulations by the private fund industry and its advisers.

Discussion of Proposed Written Documentation of All Advisers' Annual Reviews of Compliance Programs

The Proposed Rules would require all SEC-registered advisers to document the annual review of their compliance policies and procedures in writing.

We support this idea and agree that it will help promote a more consistent and diligent review of both the advisory firm and fund compliance policies and procedures. Equally important, it will support SEC periodic reviews and the overall efficiency of the compliance process. It will also enhance investor protection and provide an early warning to compliance professionals looking to prevent violations of applicable laws and regulations.

Transition Period and Compliance Date

With the exception of § 275.211(h)(1)-2, private fund quarterly statements, we recommend that grandfathering provisions should be implemented in the final rules so they would apply only to those funds formed on or after the final rules' effective date. This would avoid the need to renegotiate and "re-paper" existing fund agreements and other documents, the cost of which would most likely be borne by the fund, thus disadvantaging investors.

We believe that advisers should be required to comply with § 275.211(h)(1)-2 by the compliance date. Investors need to receive transparency around fees and costs of private fund investments, as well as performance. However, as previously discussed, advisers may have difficulty calculating historical returns without the impact of subscription facilities. We recommend, therefore, exempting from this specific calculation requirement those funds that used a subscription facility prior to the final rules' effective date.

The Proposing Release includes a one year transition period, allowing advisers one year after the effective date to comply with the final rules. Given the scope and breadth of the Proposed Rules, we recommend allowing at least 18 months for advisers to comply with the final rules.

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Thank you for your consideration of our views and perspectives. We welcome the opportunity to meet with you to answer any questions or provide more detail about our letter.

Sincerely,

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Hedge Fund Sample Fee and Expense Information

	General Partner	Class A LPs	Class B LPs	Total
Beginning partners' capital	$35,529,000	$175,827,000	$117,218,000	$328,574,000
Capital contributions		27,000,000	18,000,000	45,000,000
Capital withdrawals		(21,559,000)	(14,373,000)	(35,932,000)
Early withdrawal fees	24,000	142,000	94,000	260,000
Gross investment income	1,739,821	8,876,517	5,917,662	16,534,000
Management fees, gross		(1,971,446)	(1,314,294)	(3,285,740)
Rebates		161,059	107,373	300,000
Management fees, net*		(1,810,387)	(1,206,921)	(2,985,740)
Performance fees		(2,552,559)	(1,701,701)	(4,254,260)
Dividends on securities sold short	(1,099,410)	(5,609,160)	(3,739,430)	(10,448,000)
Interest on securities sold short	(122,168)	(623,300)	(415,532)	(1,161,000)
Interest expense	(6,208)	(31,675)	(21,117)	(59,000)
Administrative fees	(26,096)	(133,142)	(88,761)	(248,000)
Accounting fees	(31,568)	(161,059)	(107,373)	(300,000)
Legal fees	(7,892)	(40,265)	(26,843)	(75,000)
Servicing fees*	(10,523)	(53,686)	(35,791)	(100,000)
Other expenses	(5,893)	(30,064)	(20,043)	(56,000)
Realized gains/losses	3,939,061	20,096,985	13,397,953	37,434,000
Unrealized gains/losses	6,438,515	32,849,128	21,899,358	61,187,000
Ending partners' capital	$46,360,638	$232,187,332	$154,790,462	$433,370,000

**paid to the investment adviser or related parties*

Private Equity Fund Sample Fee and Expense Information

	General Partner	Limited Partners	Total
Beginning partners' capital	$75,884,000	$682,957,000	$758,841,000
Capital contributions from LPs	250,000	24,750,000	25,000,000
Capital withdrawals to LPs	(373,000)	(36,888,000)	(37,261,000)
Gross investment income	668,260	5,965,740	6,634,000
Management fees, gross		(16,000,000)	(16,000,000)
Management fee offset		7,460,000	7,460,000
Rebates		1,000,000	1,000,000
Waivers		200,000	200,000
Management fees, net*		(7,340,000)	(7,340,000)
Advisory fees*		(89,927)	(100,000)
Accounting fees	(8,059)	(71,941)	(80,000)
Legal fees	(10,073)	(89,927)	(100,000)
Servicing fees*		(62,949)	(70,000)
Administrative fees	(5,037)	(44,963)	(50,000)
Audit fees	(8,059)	(71,941)	(80,000)
Due diligence costs	(114,029)	(1,017,971)	(1,132,000)
Broken deal costs	(20,147)	(179,853)	(200,000)
Interest expense sub LOC	(50,366)	(449,634)	(500,000)
Interest expense permanent leverage	(37,775)	(337,225)	(375,000)
Other expenses	(6,548)	(58,452)	(65,000)
Realized gains/losses	4,295,037	38,342,963	42,638,000
Unrealized gains/losses	120,879	1,079,121	1,200,000
Carried interest to GP	8,051,000	(8,051,000)	-
Ending partners' capital	$88,636,085	$698,341,039	$786,960,000

**paid to the investment adviser or related parties*