Statement

# Uprooted: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews

Commissioner Hester M. Peirce

**Aug. 23, 2023**

Thank you, Chair Gensler. The rulemaking is ahistorical, unjustified, unlawful, impractical, confusing, and harmful. Accordingly, I cannot support it.

## I. Ahistorical

Until last month, a giant white oak tree stood near where I live in suburban Maryland. Known as the Linden Oak, this 300-year-old tree had witnessed a lot of history and stood tall as a cherished landmark. When the Metrorail was built fifty years ago, its route was altered to spare the Linden Oak.[1] But last month the tree—at least most of its 100-foot height—was cut down after prolonged deterioration.[2] The thirty-day draft of this release arrived at just about the same time the Linden Oak was felled, and I could not help but see a parallel. Like the Linden Oak, the SEC's approach to private fund regulation has been deeply rooted—deeply rooted not in soil, but in our governing statutes and historical practice. Private funds have grown up, as Congress planned, outside of the requirements that govern registered investment companies, which are designed for the general public. Private ordering has worked for private funds. Uprooting the historical approach to regulating private funds, as we are doing with this rulemaking, will irreparably mar the regulatory landscape.

Private fund investors are wealthy individuals and sophisticated institutions. Institutional investors—university endowments, pension funds, insurance companies, and sovereign wealth funds, to name several—are well represented by highly qualified professionals in their search for and negotiations with private fund advisers. With many advisers offering their services and would-be advisers ready to jump into the game, investors' negotiation leverage is high—if they choose to use it. The regulatory regime reflects the sophistication of the parties and the dynamism of the adviser population. Under the current regime, private parties come to mutually agreeable terms.[3] The government, appropriately, stays out of the negotiations.

Today, we are gearing up to impose a retail-like framework on this very institutional marketplace. We are adopting a prescriptive regime that edges out mutually agreed upon ground rules for private funds. While the prescriptions being recommended for adoption today are less constricting than those originally proposed, they are nevertheless unnecessary government interferences in, and sometimes outright bans of, well-established practices. As long as investors understand the terms on which they are investing, why should the government care what those terms are?

The Commission justifies its new approach to private fund regulation by dismissively recasting private fund investors as unsophisticated. Pension plans might have financial wizards running them, but the actual pension plan participants might be "public service workers, including law enforcement officers, firefighters, public

school educators and community service workers."[4] The reality is that those pensioners are paying, often quite handsomely, teams—often quite large teams—of financial markets experts, MBAs, and lawyers to invest their money wisely. If this rulemaking is designed to usurp the roles of these professionals, then any rationale for keeping retail investors out of private funds falls away.[5] By abandoning, as we are today, the notion that qualified purchasers—who are an even more selective group than accredited investors—can fend for themselves in a way that retail investors cannot, we erase the distinction that has limited access to private funds.

## II. Unjustified

After reading through more than 600 pages of release text, the question that remains is why the Commission feels it necessary to undertake this rulemaking. The Commission struggles mightily to paint a picture of a failed market desperately in need of a prescriptive regulatory solution. The release's lengthy discussion of market failure boils down to a belief that private fund advisers and large investors wield undue bargaining and coordination power in negotiations over terms, and investors cannot simply walk away from those negotiations. [6]

This rulemaking is premised on a stubborn refusal to accept an inconvenient reality: private fund investors have the ability to "negotiate the terms that are important to them."[7] Vexingly, these terms are not always the ones that are important to us, and preferred terms are not uniform across investors or over time. An investor who faces missing out on participating in a particular fund, for example, may agree to terms that the investor otherwise would not accept and may agree only grudgingly. That investors grapple with trade-offs is not a sign of market failure, but a fact of life. Despite our concerns,[8] the lack of homogeneity in the private market is to be expected in a world ordered by individual negotiation and contract. Sophisticated investors are adept at navigating these complexities.[9] While in-demand advisers and large investors have market power, countervailing forces push back on this power. Investors employ experienced consultants, have worked together to build standardized disclosure templates, and form limited partner advisory committees. Investors dissatisfied with a particular manager's refusal to agree to certain conditions are free to shop around among the thousands of other managers eager for their capital, even if they have to amend their investment guidelines to facilitate using new advisers. Or they can forgo the private market altogether and put their money in a registered product. Some investors are not enthusiastic about the terms they are getting from some advisers, but the market has not failed.

Even if we assume that the Commission's Dickensian tale of hapless and helpless investors is true,[10] the solution is not more regulation. Instead, the Commission should explore whether it needs to modify or eliminate existing regulations to facilitate the entrance and flourishing of new advisers. These advisers can compete for the assets of investors who feel they have no option but to negotiate with incumbent advisers. These new advisers will serve as a competitive check on industry practices that are not favorable to investors. A fresh look at existing regulation also can address transparency concerns.[11] A commenter pointed to one problem: the Commission "now complains about the lack of transparency in a market that it worked so diligently to make opaque" by failing to clarify what constitutes general solicitation.[12]

And, as we think about solutions, we should keep the problems in perspective. The release acknowledges that "private fund assets under management have steadily increased over the past decade."[13] Even one investor who would like to see some practices change reminded us that "we cannot consider these reforms in a vacuum. The private markets have thrived—in spite of the self-interested practices described in the Commission's Proposal—because in many instances, investors have been well-compensated for their risks."[14] New entrants have been coming into the industry to compete with incumbents,[15] a trend that—if we do not squelch it—will whittle away at adviser conduct that investors do not like. The signs point not to an anti-competitive industry, but to one that is flourishing.

## III. Unlawful

Even if we had identified a market failure and demonstrated that new prescriptive regulations were warranted, we would need congressional authorization to proceed. The solution we are considering today lacks a statutory basis. As authority for the rulemaking, the Commission is largely relying on Sections 206(4) and

211(h) of the Investment Advisers Act. Section 206(4) makes it “unlawful for any investment adviser . . . to engage in any act, practice, or course of business which is fraudulent, deceptive, or manipulative” and gives the Commission authority to “by rules and regulations define, and prescribe means reasonably designed to prevent, such acts, practices, and courses of business as are fraudulent, deceptive, or manipulative.”[16] The Commission uses this authority to mandate private fund audits. As I have objected with respect to other rules adopted under Section 206(4), that section is an uncomfortable home for routine compliance obligations as it turns violations of those rules, even foot-faults, into enforcement actions under Section 206, which is an antifraud provision.

The Dodd-Frank Act gave us Section 211(h), the statutory section upon which we rely for most of the rest of the rulemaking. Section 211(h)(1) directs the Commission to “facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with . . . investment advisers, including any material conflicts of interest.” This provision forms the basis for the quarterly statement requirement. Section 211(h)(2) directs the Commission, “where appropriate,” to “promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.”[17] This provision forms the basis for the restricted activity, adviser-led secondaries, and preferential treatment rules.

These statutory provisions are inadequate to support the rules we are adopting today. These provisions fall within a subsection titled “Authority to Establish a Fiduciary Duty for Brokers and Dealers,” which is part of a section added to Dodd-Frank to address concerns around standards of care for retail investment advisers and broker-dealers.[18] Relying on a statutory provision that is clearly aimed at retail investors’ relationships with their financial professionals is questionable, to say the least. The release nevertheless strains to use a provision aimed at “sales practices, conflicts of interest, and compensation schemes” to place itself in the middle of negotiations between private fund advisers and investors. While the release acknowledges that section 913 makes numerous references to “retail investors,”[19] it takes comfort in the fact that “Congress spoke of ‘investors,’ and in so doing gave no indication that it was referring to ‘retail customers[]’ . . . .” There *was* an indication that it was still focused on retail, even though it was using the term “investor”; that indication came in the fact that the whole section is retail-oriented. The use of the term “investor” instead of “customer” in section 211(h)(2) is not designed to pull in private fund investors, but allows the Commission to regulate interactions between financial professionals and retail investors before they become customers. I doubt that the key to understanding Section 913—and thus the Commission’s authority to act today—is to focus on what Congress did not say in one sub-section while ignoring the totality of section 913 and its undeniable focus on standards of conduct as they apply to retail investors.[20]

A congressional decision to direct by omission would be particularly puzzling given the absence of a companion provision to eliminate the exemption from Investment Company Act regulation that Congress created for private funds.[21] Congress, by exempting private funds from the Investment Company Act, set up a system in which private funds would not be subject to the same level of regulation as retail-oriented registered investment companies. The release dismisses such objections by arguing that the final rules “regulate the activities of investment advisers to private funds” and “are not an indirect mechanism for regulating private funds because the rules focus on the adviser and do not apply to or restrict the private fund itself.”[22] So too we could argue that imposing material limitations on a football team’s management and coaching staff on questions of trades, plays, and salary negotiations do not restrict the football team itself. Had Congress given us the authority to impose a whole new regulatory framework for investment advisers, presumably it would have done so in Title IV of the Dodd-Frank Act, which Congress deemed the “Private Fund Investment Adviser Registration Act.”[23] That private fund adviser title did not authorize us to take the interventionist measures in today’s release, so now we scrounge around other provisions of Dodd-Frank for authority that does not exist.

## IV. Impractical and Confusing

Even if our regulatory approach were consistent with our statutory authority, it is not practical. Admittedly, today’s rule is better than the one we proposed, but it still raises numerous implementation challenges. The uniformity of the disclosures required, the breadth and ambiguity of the rule’s defined terms, the operational

difficulties of providing advance notice of any preferential treatment related to material economic terms, the process for obtaining investor consent, the chilling of communications between advisers and investors, and the brevity of the compliance period, are among the many issues that remain in this final rule.

The rulemaking also raises new questions. Conditioning preferential rights on offering them to everyone sounds like a ban on offering preferential rights, but the release does not characterize what we are doing as a ban.[24] The release states that other activities that would have been prohibited under the proposal need not be prohibited because they already violate advisers' fiduciary duty.[25] If they were prohibited already, why did we need to propose a prohibition? Because of questions around cost-shifting for rule violations, the new rule could cause advisers to be unduly conservative in selecting and carrying out investment strategies.[26] Finally, the release does not do a good job at assessing how this rule, interacts with other rules the Commission has adopted and is considering.

## V. Harmful

Today's rulemaking will harm investors, advisers, and the economy. In the name of fostering competition, we are squelching it. Large incumbent advisers will figure out how to comply, but newer, smaller advisers will struggle to enter the industry and compete with incumbents.[27] The stylized disclosure requirements, the additional layers of complexity around offering preferential treatment to investors, and the general suspicion cast on advisers trying to attract assets[28] will deter small and new advisers from gaining traction. The release acknowledges that small advisers could face burdens as a result of the new rule, but magics them away by pointing to mitigating factors, including the option for smaller advisers to shrink.[29] The Commission at least acknowledges, albeit with little regret, that other advisers may decide to exit the market and that "competition may be reduced."[30] This rule is not the only one on the Commission's docket, and our consideration of it in isolation likely means that we underestimate the pressures advisers are facing. If advisers choose not to serve private funds, companies throughout the economy will suffer because private funds are an essential source of capital.

The rule will impede the ability of the marketplace to serve unique needs. An investor trying to negotiate particular terms, or a company seeking funding from a specialized venture capital fund will find it more difficult in the new regime. Investors will not be able to waive the rule's protections even if doing so would secure something better for them.[31] The fact that investors might be eager to leverage such a waiver to gain some other benefit of greater value to them (such as participation in a fund) is, from the Commission's perspective, neither here nor there.[32]

Another effect of this rule is to double-down on the Commission's shift of resources from protecting retail investors to protecting highly sophisticated players. Allocation of Commission resources is a zero sum game: the Investment Management, Exams, and Enforcement personnel we assign to overseeing the private markets must necessarily come at the expense of retail investors. Simply put, our misguided re-branding of sophisticated private market participants as lost lambs will result in a material degradation of our ability to serve retail investors.

## VI. Conclusion

Unlike the Linden Oak, which was dying or dead before it was cut down, private funds are flourishing. Regardless, the Commission has chosen to haul out its chainsaw and start whacking away at the regulatory framework upon which it rests. When I walk by the spot where the Linden Oak stood, I avert my gaze because it makes me sad to see the sorry stump of what was once such a majestic tree. I also would like to avert my gaze from the maimed regulatory framework that today's rule leaves behind, but the undertaking before us will demand continued attention by the Commission and by the staff in the Division of Investment Management. On that note, let me thank the IM staff for its work on what has been another in a regrettably long line of pressure-filled, weekend-consuming regulatory rollercoasters. My respect for the gifted and dedicated staff in the Division of Investment Management, and their colleagues in the Division of Economic and Risk Analysis, and the Office of the General Counsel continues to increase. Although I am unable to support this rulemaking, I am grateful to each of you for your patience, good-humor, and rock-like stamina. A special shout-out to Tom

Strumpf, who has shown himself ready to engage at the drop-of-a-hat in in-depth discussion of the rule's finer points.

I have a number of questions.

1. Given how dire the release suggests the current situation is for private fund investors, why have they been pouring increasing amounts of money into these funds over recent years?
2. What are the biggest departures from current market practice in the rule we are considering today?
3. What is grandfathered and what is not under the final rule?
4. Under the final rule, can adviser waive liability for negligent acts?
5. If an adviser has to offer the same preferential treatment to everyone, how is the treatment preferential?
6. Commenters were concerned about being second-guessed on their determinations about whether something would have a material, negative effect on private fund investors. Advisers might not know individual investors' circumstances, and sometimes things look different in hindsight. Our response to these concerns seemed to be that we want "this standard to remain evergreen so that it can be applied to various types of arrangements between advisers and investors and fund structures."
    - Can't we provide any clarity to industry on where the tripwires are?
    - In this instance and in other places, the release seems to assume that advisers have a fiduciary duty to investors in the fund, as opposed to just to the fund itself. Is that an accurate reading of the release?
7. The proposal would have prohibited some practices that the adopting release says are already illegal.
    - Why did we propose to prohibit practices that were already illegal?
    - Given that we are now for the first time definitively characterizing them as illegal, will we give advisers time to come into compliance?
8. How are non-advisory services treated under the final rule?
9. Will an adviser be able to email with a particular fund investor without sending the communication to all other investors?
10. Under the new rules, would advisers be allowed to pass along fund reporting costs to the relevant fund?
11. Private funds will be required to be audited by a PCAOB-registered auditor. Congress authorized the PCAOB to inspect only audits of public companies and broker-dealers. Won't requiring PCAOB-registered firms to serve this population give investors a false sense of security?
12. For DERA, do you anticipate that advisory fees will increase as a result of this rule?
13. For DERA, do you anticipate that, on balance, smaller advisory firms will find it harder to compete with larger advisers after the rule takes effect?
14. We proposing to amend rule 206(4)-7 to require all registered advisers to document the annual review in writing.
    - Do you worry that imposing this requirement in order to facilitate exams will result in less comprehensive reviews because they will be perceived as being a roadmap for Exams and Enforcement, rather than a document to help the adviser improve its compliance?
    - What is your plan for publicizing this change, as it is tucked into a rule aimed at private fund advisers?

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[1] "The Linden Oak," https://www.atlasobscura.com/places/the-linden-oak. Retrieved 22 Aug. 23.

[2] Olmo, Joseph and Rampani, Lori, "300-year-old Linden oak tree cut down in Montgomery County," Channel Four NBC News, Washington, 18 July, 2023, https://www.nbcwashington.com/news/local/300-year-old-linden-oak-tree-cut-down-in-montgomery-county/3386896/.

[3] Comment Letter from the American Investment Council at 5 ("These, and other prohibitions in the Proposal, improperly insert the Commission into arm's-length negotiations between some of the most sophisticated and best-advised counterparties in the world, conferring new contractual rights and terms on investors that they do not need, and that the Commission lacks the authority to bestow."), https://www.sec.gov/comments/s7-03-22/s70322-20126669-287340.pdf.

[4] Adopting Release at 10.

[5] I would welcome such a change, but not if we are turning private funds into mutual funds in the process. Having a dual system—one subject to substantive and disclosure regulation and the other subject only to antifraud liability—and allowing all investors to opt out of the regulated system is my preferred approach.

[6] Adopting Release at VI.B. Enforcement actions sprinkled through the release do little to bolster the Commission's argument. *See*, *e.g*., Adopting Release at 14 ("[W]e have observed three primary factors that contribute to the risks and harms regarding private fund advisers from an investor protection perspective: lack of transparency, conflicts of interest, and lack of governance mechanisms. We have observed that these three factors contribute to significant investor harm, such as an adviser incorrectly, or improperly, charging fees and expenses to the private fund, contrary to the adviser's fiduciary duty, contractual obligations to the fund, or disclosures by the adviser. The Commission has pursued enforcement actions against private fund advisers for fraudulent practices related to fee and expense charges or allocations that are influenced by the advisers' conflicts of interest."). But these enforcement actions, most of which were settlements, illustrate that we already can bring cases where necessary and are a weak basis for regulatory action. *See*, *e.g*., Comment Letter from Jay Clayton, *et al* at 7 (Apr. 25, 2022) ("The Proposing Release cites only 24 cases over 17 years—an astonishingly low number for an industry with over 5,000 active managers. Moreover, while those cases are identified as evidence of improper behavior, 22 of them were settled matters, and neither we, nor the Commission, can determine from a settled matter whether there was any underlying improper behavior or, if there was, whether it was material in the circumstances.") https://www.sec.gov/comments/s7-03-22/s70322-20126482-287124.pdf ("Clayton Letter"). We seem to be frustrated by our inability to expunge the market wholly of bad acts. Adopting Release at 15 ("Despite these enforcement and examination efforts, problematic practices persist."). Our mandate is to regulate the U.S. capital markets – building Utopia is not in our brief. In any event, persistent bad acts in the retail markets are a greater concern.

[7] *See*, *e.g*., Clayton Letter at 4.

[8] *See*, *e.g.*, Adopting Release at 69 ("For example, private fund advisers currently use different metrics and specifications for calculating performance, which makes it difficult for investors to compare data across funds and advisers, even when advisers disclose the assumptions they used.").

[9] *See, e.g.*, Comment Letter from Alternative Investment Management Association Limited and the Alternative Credit Council at 10 (Apr. 25, 2022) ("Our members instead find that private fund investors, and the professional advisors they employ, do in fact engage in lengthy, rigorous and detailed due diligence and negotiation before investing. Such investors frequently demand—and receive—ongoing reporting on returns, costs, investment outcomes and other matters that enables them to carefully monitor their investments and, in open-end funds, to decide whether to remain invested or redeem. Notwithstanding the Commission's apparent belief to the contrary, the terms embodied in private fund contracts reflect an informed and careful balancing of relevant costs, benefits and allocations of risk that have developed over time through vigorous negotiation by sophisticated parties."), https://www.sec.gov/comments/s7-03-22/s70322-20126739-287453.pdf.

[10] The release attempts to recast sophisticated market players as members of a Dickensian underclass at the mercy of Fagin-like characters. A word search of the document for the word "sophisticated" rings in at an anemic 21 hits. Instead, the release emphasizes "smaller [private fund] investors, who may have sufficient capital to meet the regulatory requirements to invest in private funds but lack experience with the complexity of

private funds and the practices of their advisers" and who "may be more vulnerable and thus still be harmed even with disclosure and if investor consent is obtained." Adopting Release at 362 and 378.

[11] *See*, *e.g.*, Adopting Release at 16 ("Private fund investments are often opaque, and advisers do not frequently or consistently provide investors with sufficiently detailed information about the terms of the advisers' relationships with funds and their investors.").

[12] Comment Letter from Stuart Kaswell, Esq. at 6 (Apr. 18, 2022), https://www.sec.gov/comments/s7-03-22/s70322-20123935-280074.pdfhttps://www.sec.gov/comments/s7-03-22/s70322-20123935-280074.pdf. As the commenter explained, "For a period of nearly ninety years, the Commission strenuously has discouraged issuers from disclosing information about private placements, except under the most limited of circumstances." *Id*. at 5 (footnote omitted).

[13] Adopting Release at 321. *See also* Adopting Release at text accompanying notes 10 and 11 ("Investment advisers' private fund assets under management have steadily increased over the past decade, growing from $9.8 trillion in 2012 to $26.6 trillion in 2022. Similarly, the number of private funds has increased from 31,717 in 2012 to 100,947 in 2022.") (footnotes omitted).

[14] Comment Letter from the Ohio Public Employees Retirement System at 2 (Apr. 25, 2022), https://www.sec.gov/comments/s7-03-22/s70322-20126471-287115.pdf.

[15] *See*, *e.g.*, Comment Letter from Thin Line Capital at 2 (Apr. 21, 2022) ("The venture capital industry is going through an extremely healthy period of growth, where the power of venture capital managers no longer rests in the hands of a few, large, generalist funds, but is now being spread across an array of specialist funds.") https://www.sec.gov/comments/s7-03-22/s70322-20126071-286643.pdf ("Thin Line Letter").

[16] Section 206(4) of the Investment Advisers Act.

[17] Dodd-Frank §913(g)(2).

[18] Dodd-Frank §913(g). That subsection falls within a section titled "Study and Rulemaking Regarding Obligations of Brokers, Dealers, and Investment Advisers." Dodd-Frank § 913.

[19] Section 913(g)(2) adds ion paragraph (g)(1) of Section 211 of the Advisers Act a directive to the Commission not to cover in its standard of conduct rulemaking "an investor in a private fund managed by an investment adviser, where such private fund has entered into an advisory contract with such an adviser."

[20] As one commenter diplomatically phrased it: "To the extent the SEC interprets Section 211(h) [of the Advisers Act] in isolation from the rest of Section 211, all of which addresses circumstances in which broker-dealers and investment advisers provide advice to retail investors, we believe that the SEC misreads that section." Comment Letter from the Private Investment Funds Forum (Apr. 25, 2022) at 35 https://www.sec.gov/comments/s7-03-22/s70322-20126625-287267.pdf. *See also* Comment Letter from the New York City Bar at 51 (Apr. 25, 2022) ("Taken as a whole, the Committees believe it is clear that the animating purpose behind Section 913 was not to create a new standard of conduct solely for investment advisers under the Advisers Act, but rather, to require the Commission to evaluate the differences between broker dealers and investment advisers as relating to the services they provide—with the primary emphasis on retail investors—and to authorize rulemaking in furtherance of the Commission's findings.") https://www.sec.gov/comments/s7-03-22/s70322-20126635-287272.pdf.

[21] *See*, *e.g.*, Clayton Letter at 2 (" . . . Proposed Rule 211(h)(2)-1 under the Investment Advisers Act of 1940 ('Advisers Act') is broadly inconsistent with Congress's 1996 determination (in response to the Commission's urging at the time) that private fund investors have the means and ability, in a competitive market, to negotiate for themselves the terms and conditions governing their investments in pooled investment vehicles, including terms related to fund governance. That Congressional determination is expressed in Section 3(c)(7) of the Investment Company Act of 1940 ('Investment Company Act' or 'ICA'), which exempts certain pooled vehicles, such as private funds, from the rigors and prescriptive policies of the Investment Company Act. But the Commission now proposes, without presenting adequate justification, to use the Advisers Act to subject private funds to a regulatory regime comparable in relevant part to that of the Investment Company Act. In essence

and practical effect, the proposed rules would subject private funds to regulation in a form that Congress precluded.") https://www.sec.gov/comments/s7-03-22/s70322-20126482-287124.pdf.

[22] Adopting Release at 36.

[23] Dodd-Frank §401.

[24] *See*, *e.g.*, Adopting Release at 278 ("[A]n adviser is not prohibited from offering preferential redemption rights if the adviser has offered the same redemption ability to all other existing investors and will continue to offer such redemption ability to all future investors in the same private fund or any similar pool of assets.").

[25] *See*, *e.g.*, Adopting Release at 367-8 ("[W]e believe that certain activities that we proposed to specifically prohibit are already inconsistent with an adviser's existing fiduciary duty, namely charging fees for unperformed services and attempting to waive an adviser's compliance with its Federal antifraud liability for breach of fiduciary duty to the private fund or with any other provision of the Advisers Act.").

[26] Consider, for example, that should an investigation result in a sanction for *any* violation of the Investment Advisers Act or its rules, that adviser will be prohibited from allocating expenses to the fund altogether. *See* Section 211(h)(2)-(1) (". . . the investment adviser may not charge or allocate to the private fund fees and expenses related to an investigation that results or has resulted in a court or governmental authority imposing a sanction for a violation of the Investment Advisers Act of 1940 or the rules promulgated thereunder . . . "). On first hearing, this prohibition may sound unobjectionable, but when one considers the breadth of the activities codified under the Advisers Act, the wisdom of such a prohibition is less certain. In any case, as with other matters, this one should be left to private negotiation.

[27] *See, e.g.*, Comment Letter from BAM Ventures at 1 (Apr. 21, 2022) ("The mandate to support emerging fund advisers will be undermined by the SEC proposed extensive new rules, which fundamentally change how private fund advisers conduct business.") https://www.sec.gov/comments/s7-03-22/s70322-20126594-287250.pdf; and Thin Line Letter at 1 ("Emerging fund managers will be undermined by the SEC proposed extensive new rules, which fundamentally change how private fund managers conduct business. I feel that many of the rules were proposed without consideration for the realities of new entrants, and their respective resources.") https://www.sec.gov/comments/s7-03-22/s70322-20126071-286643.pdf. *See also* Comment Letter from SIFMA-AMG at 36 (Apr. 25, 2022) ("[D]eparting from the Commission's well established focus on disclosure and informed consent, and voiding negotiated arrangements between private fund managers and sophisticated investors, will likely increase advisers' costs, reduce investor returns, and create new barriers to entry that decrease overall market competition and investor choice."), https://www.sec.gov/comments/s7-03-22/s70322-20126748-287461.pdf.

[28] *See*, *e.g.*, Adopting Release at 268 ("For example, in granting preferential terms to large investors as a way of inducing their investment in the fund, the adviser stands to benefit because its fees increase as fund assets under management increase.").

[29] *See* Adopting Release at 558-9 ("Some registered advisers may therefore have the option of reducing their assets under management to forgo registration, thereby avoiding the costs of the final rule that only apply to registered advisers, such as the mandatory audit rule."). The Commission plays down the competitive consequences of shrinking advisers. *See*, *e.g.*, Adopting Release at 559 ("While advisers responding in this way may negatively affect capital formation, the option for advisers to respond to the rule in this way may mitigate negative competitive effects, as advisers reducing their size to forego registration will still leave them as a partial potential competitive alternative to larger advisers (albeit a less effective competitive alternative than they represented as registered advisers).").

[30] Adopting Release at 558 ("To the extent heightened compliance costs cause certain advisers to exit, competition may be reduced. This may particularly occur through the compliance costs associated with mandatory audits, as those costs are likely to fall disproportionately and have a disproportionate impact on funds managed by smaller advisers, and funds advised by smaller advisers facing new increased compliance costs may be among those most likely to exit the market in response to the final rules.").

[31] *See*, *e.g.*, Adopting Release at 72 (“However, if we were to allow investors to waive the quarterly statement requirement, then some private fund advisers may require investors to do so as a precondition to investing in a fund. Furthermore, even if a private fund adviser does not explicitly require such a waiver as a precondition to investment, a private fund adviser could attempt to anchor negotiations around a waiver by including one in a private fund’s subscription agreement and thereby compelling investors to choose between expending resources to negotiate for quarterly statements or for other important terms related to fund governance and investor protection. Such an outcome would undermine improving transparency for these private fund investors and would fail to address the harms that the rule is intended to address.”).

[32] *Id*.