Statement

Statement on Proposed Private Fund Advisers; Documentation of Investment Adviser Compliance Reviews Rulemaking

Commissioner Hester M. Peirce

Feb. 9, 2022

Today's proposal represents a sea change. It embodies a belief that many sophisticated institutions and high net worth individuals are not competent or assertive enough to obtain and analyze the information they need to make good investment decisions or to structure appropriately their relationships with private funds. Therefore, the Commission judges it wise to divert resources from the protection of retail investors to safeguard these wealthy investors who are represented by sophisticated, experienced investment professionals. I disagree with both assessments; these well-heeled, well-represented investors are able to fend for themselves, and our resources are better spent on retail investor protection. Accordingly, I am voting no on today's proposal.

As you have heard, if finalized, the proposal would impose a host of new mandates on private fund advisers. Among other things, registered private fund advisers would have to provide to investors detailed, standardized, quarterly information on fees, expenses, and performance, including data on portfolio investment compensation; to obtain annual financial statement audits by a Public Company Accounting Oversight Board-registered auditor; and to document in writing their annual compliance reviews. The proposal would require registered private fund advisers to provide investors with an independent fairness opinion for any adviser-led secondary transaction. Further, the proposal would prohibit all private fund advisers, even those not registered with the Commission, from directly or indirectly engaging in certain sales practices, conflicts of interest, and compensation schemes, including charging certain types of fees and expenses to a private fund or portfolio investment, allocating certain fees and expenses in a non-pro rata fashion, and providing certain types of preferential treatment.

These changes represent a meaningful recasting of the SEC's mission. First, the proposal's focus on protecting private fund investors by shaking information loose from what *we* deem to be uncommunicative private funds and shutting down practices *we* deem to be unfair is a departure from the Commission's historical view that these types of investors can fend for themselves. As we reiterated when we proposed a modest expansion of the scope of the accredited investor subset of sophisticated investors[1] two years ago, we have justified setting accredited investors apart from their retail compatriots because we deem the former able "to gain access to information about an issuer or about an investment opportunity – or . . . to bear the risk of a loss."[2] I personally have never found the sophistication narrative a compelling rationale for keeping unaccredited investors out of the private markets, and, maybe a silver lining of today's rules is that it signals a new belief that all investments should be open to all investors.[3] After all, with this proposal which affords retail-like protections to accredited investors, this Commission is publicly calling into question the rationale for dividing retail from accredited investors.

Second, and related, the Commission undoubtedly will devote examination and enforcement resources to ensure that private fund advisers adhere to their new prescriptions. We are not blessed with unlimited resources, and each year we make difficult decisions about how to expend our examination and enforcement energies. Not surprisingly, the Commission historically has placed retail investor protection near the top of the list of agency priorities, even after the Dodd-Frank Act's private fund registration mandate.[4] If we adopt today's proposal, will we choose to redeploy Examinations and Enforcement resources away from their current focus on retail investor protection to the apparently pressing need of protecting millionaire investors from private fund advisers?

Third, the application of new prohibitions on private fund advisers that are exempt from registering with us takes another step toward erasing any distinction afforded by the exemption from registration. Commissioner Troy Paredes foresaw this problem in 2011 when the Commission imposed mandatory public disclosure requirements on venture capital ("VC") funds. He was concerned "that the Commission is shaping a regulatory regime that ultimately will come at the expense of capital formation, innovation, entrepreneurism, and jobs. As the VC fund industry is required to bear more regulatory burdens and demands, the risk is that capital formation will be unduly hindered."[5] This proposal, if finalized, could hinder capital formation.

I offer my thanks to the staff of the Divisions of Investment Management, Economic and Risk Analysis, and Examinations, and the Offices of the Chief Accountant and General Counsel. Although I am unable to support today's proposal, I appreciate all of the work and effort staff put into this well-written proposal and the time you took to discuss it with me. I look forward to hearing from commenters about whether my concerns about my proposal are justified or misplaced.

---

[1] To qualify as an accredited investor, an individual (alone or with his or her spouse) must have a net worth of more than $1million (excluding the value of the investor's primary residence) or have annual income of at least $200,000 ($300,000 for married couples) for the last two years. (17 CFR 230.501(a)(5)-(6).)

[2] Amending the "Accredited Investor" Definition, Release Nos. 33–10734; 34–87784 (Dec. 18, 2019) at 16, https://www.sec.gov/rules/proposed/2019/33-10734.pdf.

[3] *See e.g.*, Statement on Amending the "Accredited Investor" Definition (Aug. 26, 2020), available at https://www.sec.gov/news/public-statement/peirce-accredited-investor-2020-08-26.

[4] Even after this mandate went into effect, retail investor protection was paramount as we looked at private fund advisers. The Examinations staff stated in 2013, for example, that it intended to "confirm that the registrant has controls in place to monitor the side-by-side management of its performance-based fee accounts, such as certain private investment vehicles, and registered investment companies, or other non-incentive fee-based accounts, with similar investment objectives, especially if the same portfolio manager is responsible for making investment decisions for both kinds of client accounts or funds." National Examination Program Examination Priorities for 2013 (Feb. 21, 2013), at 4 https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2013.pdf. *See also* National Examination Program Examination Priorities for 2016, at 5 https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2016.pdf; and SEC Office of Compliance Inspections and Examinations 2020 Examination Priorities (Jan. 7, 2020), at 16, available at https://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2020.pdf ("OCIE will continue to focus on RIAs to private funds that have a greater impact on retail investors, such as firms that provide management to separately managed accounts side by-side with private funds.").

[5] Remarks of SEC Commissioner Troy A. Paredes, "Statement at SEC Open Meeting: Rules Implementing Amendments to the Investment Advisers Act of 1940 and Exemptions for Advisers to Venture Capital Funds,

Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers" (June 22, 2011), available at http://www.sec.gov/news/speech/2011/spch062211tapitems-1-2.htm.