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April 25, 2022

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

Re: Comments to Proposed Rules and Rule Amendments Regarding Private Fund Advisers (File No. S7-03-22)

Dear Ms. Countryman:

We are responding to the request of the Securities and Exchange Commission (the "Commission") for comments to the proposed rules and rule amendments related to private fund advisers (the "Proposed Rules").[1] We recognize the time and effort invested by the Commission and the staff of the Division of Investment Management (the "Staff") in formulating the Proposed Rules and appreciate the opportunity to comment.

Schulte Roth & Zabel LLP is an international law firm with offices in New York, London and Washington, D.C. Our clients include several hundred investment advisers to private funds that would be affected by the Proposed Rules as well as institutional investors and limited partners. We regularly advise private fund managers with respect to compliance with the Investment Advisers Act of 1940[2] (the "Advisers Act") and the establishment and ongoing needs of their fund businesses. These comments, while informed by our experience in representing our clients, represent our own views and are not intended to reflect the views of the clients of the firm.

I. Introduction

On February 9, 2022, the Commission proposed six new rules applicable to private fund advisers, as well as two rule amendments (see footnote for defined terms).[3] If adopted, the Proposed Rules

[1] Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Inv. Advisers Act Release No. IA-5955 (Feb. 9, 2022), *available at* https://www.sec.gov/rules/proposed/2022/ia-5955.pdf (the "Proposing Release").

[2] Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 et seq. (the "Advisers Act").

[3] The Commission has proposed the following rules under the Advisers Act: (i) Rule 211(h)(1)-2 (the "Quarterly Statement Rule"), (ii) Rule 211(h)(2)-1 (the "Prohibited Activities Rule"), (iii) Rule 211(h)(2)-2, (iv) Rule 211(h)(2)-3 (the "Preferential Treatment

would significantly alter the existing and future relationships between private fund advisers and investors in the funds they advise. We believe there are substantial questions as to the Commission's authority to promulgate the Proposed Rules, the need for such rules, and the cost-benefit analysis. We respectfully suggest the Commission consider less drastic means to more precisely address those issues it has identified as needing a new approach.

In this letter we specifically address the following points:

- **Authority**. The Commission first cites Section 206 of the Advisers Act as a basis for its proposed rulemaking. Section 206 prohibits fraud, but the Proposed Rules are explicitly unrelated to deception – the Commission expressly acknowledges that the Proposed Rules do not allow sophisticated investors to give their informed consent to the current practices the Rules would change or prohibit. The Commission also cites Advisers Act section 221(h) ("Section 211(h)"), which was enacted by Dodd-Frank Section 913,[4] as a basis for its proposed rulemaking. Dodd-Frank Section 913 addressed the differing duties of broker-dealers and investment advisers. Although that section authorized rulemaking with respect to the harmonization of standards between broker-dealers and investment advisers, it did not give the Commission blanket authority to adopt new rules governing private fund advisers. Even if there were statutory authority for the Proposed Rules, the Commission has not identified evidence supporting the need for such rulemaking and has not shown that the cost of such rulemaking is outweighed by any benefit.

- **Application to Non-Registered Advisers**. The Prohibited Activities Rule and the Preferential Treatment Rule apply to both registered investment advisers and non-registered advisers. Applying such requirements to non-registered advisers is inconsistent with Congressional intent in exempting such advisers from registration and would have an outsized impact on non-U.S. private fund advisers. Non-registered advisers should be exempt.

- **Limitations on Liability, Reimbursement, Indemnification and Exculpation**. The Prohibited Activities Rule proposes to prohibit advisers to private funds from seeking reimbursement, indemnification, exculpation or limitation of its liability by the private fund or its investors for a breach of fiduciary duty, willful misfeasance, bad faith, negligence or recklessness in providing services to the private fund. Industry-wide, private fund advisers and investors agree that the adviser will not be protected from its wrongdoing. The Commission's proposal would upend this standard, making advisers liable for simple negligence. The private funds industry has grown by innovation – mandating a conservative approach will limit opportunities for the very investors on which the Commission focuses in this proposed rulemaking. We request that the

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Rule"), (v) Rule 211(h)(1)-1 (defining certain terms included in the other Proposed Rules), (vi) Rule 206(4)-10 (the "Private Fund Audit Rule"). The Proposed Rules also include amendments to Advisers Act Rule 206(4)-7 (requiring the documentation of annual compliance reviews) and Rule 204-2 (adding books and records requirements relevant to the other Proposed Rules).

[4] "Dodd-Frank Section 913" refers to section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913, 124 Stat. 1376, 1824-30 (2010) (emphasis added) (the "Dodd-Frank Act").

Commission not move forward with this proposal.

- **Prohibited Fees and Expenses**. The Commission proposes to establish certain categories of fees and expenses so problematic that even sophisticated investors cannot consent to them. Investors would be prohibited from agreeing to pay fees and expenses for government examinations and investigations of the adviser and for the adviser's "regulatory and compliance". But there are no definitions as to what is a fee or expense "of the adviser" (which investors cannot agree to pay) or "of the fund" (which investors can agree to pay). Nor is there any definition as to fees and expenses for the adviser's "regulatory and compliance". Investors are already protected from paying for any wrongdoing by a private fund manager by the fact that limitation of liability and indemnification standards do not protect the adviser from its gross negligence, willful misconduct or bad faith. We do not believe it is in the best interest of investors to move forward with this rule.

- **Preferential Treatment**. The Proposed Rules would prohibit side letter terms providing for preferential liquidity or information rights that the adviser reasonably expects to have a material negative effect on other investors in the private fund. The Commission does not define "preferential treatment" or provide parameters to assess what might be a "reasonable belief" and what a "material negative effect" on other investors in the private fund might be. The Commission has not identified a need for a far-reaching and unclear prohibition such as this. The fact that there could be a negative effect on other investors if certain investors in a liquid fund had greater transparency and liquidity might be a legitimate concern. But we have not seen this in practice, and the Commission does not provide evidence of such examples and harm to any investors. We request that the Commission not move forward with this rule.

- **Fairness Opinion Requirement for Adviser-Led Secondaries**. Sophisticated investors benefit from the ability to sell their interests in a private fund or exchange their interests for another fund with the same adviser. There is also typically a consent requirement for such transactions. The Proposed Rules would require a fairness opinion for every such transaction, regardless of the specific facts and circumstances and whether the investors and adviser would prefer not to incur the cost and delay of such an opinion. We believe the Proposed Rules are not supported by any findings of harm to investors that would outweigh the significant costs of such opinions. We note this issue is addressed in greater detail in the comment letters submitted by the American Bar Association's Committee on the Federal Regulation of Securities and by the Private Investment Fund Forum, and we support the points made therein with respect to this issue.

- **Prohibition on Reducing Certain Adviser Clawbacks**. Sophisticated investors and private fund managers work with tax accountants and attorneys to structure private funds in ways beneficial to both investors and advisers. One example is provisions that reduce adviser clawbacks to the extent the clawback would otherwise cause the adviser to return more than what it retained after paying taxes. We believe the proposed rulemaking is premised on a misunderstanding of standard industry practice, fails to take into account how managers are taxed and does not consider the incentives the

proposed rule would create, which could be harmful to investors. We note that this issue is addressed in greater detail in the comment letter submitted by the Private Investment Fund Forum, and we support the points made therein.

- **Standardized Reporting of Fees, Expenses and Performance**. Investor reporting is an important part of the relationship between private fund advisers and the investors in the funds they advise, and such reporting is tailored to the particular fund structures and strategies. We believe the Commission's proposed "one size fits all" approach to such reporting would be more confusing than beneficial to investors. If the Commission does adopt such requirements, we request that it do so in ways that permit advisers to present the information in a more meaningful manner to investors.

- **Private Fund Audit Rule**. The Private Fund Audit Rule would duplicate the audit provision relied upon by the vast majority of private fund advisers to satisfy the Custody Rule.[5] The Commission does not identify a need to supplement the Custody Rule's protections of investors. If the Commission does move forward with this rulemaking, we believe it would be beneficial to investors and advisers to harmonize the rule with the Custody Rule and specifically exempt investment advisers that have their principal office and place of business outside the U.S.

- **Grandfathering**. The adoption of the Proposed Rules, particularly the Prohibited Activities Rule and the Preferential Treatment Rule, would significantly alter existing contractual arrangements. Consistent with the Commission's historic approach to rules that would impact existing arrangements, the Commission should exempt from the Proposed Rules any private funds in existence as of the effective date of such rules.

II. The Commission Lacks Clear Authority to Issue Several of the Proposed Rules.

The Proposing Release states that the Commission's statutory authority to promulgate the Proposed Rules is based on sections 204, 206(4), 211(a) and 211(h) of the Advisers Act.[6] All of the Proposed Rules, except for the Private Fund Audit Proposal and amendments to Rules 206(4)-7 and 204-2, appear to be primarily based upon the Commission's rulemaking authority under Section 211(h).[7] The Commission has not provided any substantive explanation for its authority to issue any of the Proposed Rules, depriving commenters of the ability to specifically address the Commission's assertions of statutory authority. Adopting rules limited to private fund advisers that prohibit conflicts of interest that are already often disclosed to investors would starkly contrast with Congress' and the Commission's approaches to 80-plus years of regulating advisers to private funds. The Commission has not adequately explained what has occurred in the past three years since issuing its interpretation of investment advisers' fiduciary duties (the "Fiduciary Interpretation")[8] to warrant such a reversal.

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[5] Advisers Act Rule 206(4)-2.

[6] Proposing Release at 325.

[7] This inference is drawn from the numbering of such rules under Section 211.

[8] *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Release No. IA-5248; File No. S7-07-18.

The Commission lacks clear authority under Section 211(h) to promulgate rules that are specifically limited to private funds. Section 211(h) was added to the Advisers Act by Dodd-Frank Section 913 as part of a package of reforms that Congress clearly intended to harmonize the standards of care between broker-dealers and investment advisers, with the express intention of enhancing protections for retail investors. Congress, the Commission and the Staff have consistently shaped the regulatory regime relating to private funds in a manner that distinguishes private funds from retail-focused investment companies, with investment in the former strictly limited to sophisticated investors in comparison to the latter. The Commission's proposal to prohibit practices that are routinely and effectively addressed through disclosure and informed consent, as well as establish, in some cases, more stringent standards on private funds than those applicable to retail-focused investment companies, is inconsistent with Congressional intent in passing the Dodd-Frank Act and the disclosure-based regime of the Advisers Act.

The Commission relies on broad wording in Section 211(h) as the basis for its authority without taking into account the context of Section 211(h)'s enactment as part of Dodd-Frank Section 913. Dodd-Frank Section 913 ordered the Commission to conduct a study of standards of conduct relating to broker-dealers and investment advisers, which was entirely focused on retail investors and made no substantive mention of private funds.[9] Three very similar provisions to the Securities Exchange Act of 1934[10] (the "Exchange Act") and the Advisers Act were also added by Dodd-Frank Section 913. The first (included in section 211(g) of the Advisers Act) gives the Commission authority to issue a standard of conduct for broker-dealers and investment advisers with respect to their activities for "retail customers", and specifically provided for disclosure and consent of material conflicts of interest between advisers and retail customers.[11] The third (included in section 211(i) of the Advisers Act) addresses harmonization of the Commission's enforcement activities with respect to violations of such standards of conduct in connection with services to retail customers by broker dealers[12] and investment advisers.[13] Inserted between them is Section 211(h), phrased identically in both the Exchange Act[14] and the Advisers Act, which gives the Commission authority to issue rules mandating investor disclosures and prohibiting compensation arrangements, sales practices and conflicts of interest to the extent that the Commission deems such matters to be in the public interest. In this context, it appears far more likely that Congress intended to grant the authority specified in Section 211(h) in connection with the other retail-

[9] Staff of the U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Jan. 2011), *available at* https://www.sec.gov/news/studies/2011/913studyfinal.pdf.

[10] Securities Exchange Act of 1934, 15 U.S.C. § 78o (the "Exchange Act").

[11] Advisers Act § 211(g) ("The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice. *In accordance with such rules, any material conflicts of interest shall be disclosed and may be consented to by the customer".* (emphasis added)). *See also* Exchange Act § 15(k) ("Notwithstanding any other provision of this Act or the Investment Advisers Act of 1940, the Commission may promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice about securities to a retail customer . . . .").

[12] Exchange Act § 15(m).

[13] Advisers Act § 211(i).

[14] *Compare* Advisers Act § 211(h) *with* Exchange Act § 15(l).

focused requirements added to the Advisers Act, rather than granting the Commission broad authority to issue rules prohibiting compensation arrangements, sales practices or conflicts of interest that solely impact advisers' activities with sophisticated non-retail investors.

The Proposed Rules are also inconsistent with how the Supreme Court has interpreted Congressional intent in enacting the Advisers Act as well as the Commission's historical approach to regulating private funds. The Advisers Act establishes a disclosure-based regime that addresses conflicts of interest by disclosure and informed consent. The Supreme Court ruled in *SEC v. Capital Gains Research Bureau, Inc.* that the Advisers Act "reflects a . . . congressional intent to eliminate, or at least to expose, all conflicts of interest that might incline an investment adviser—consciously or unconsciously—to render advice that was not disinterested".[15] Less than three years ago, the Commission re-affirmed that disclosure and informed consent are the most appropriate approach to addressing conflicts of interest,[16] in particular with respect to sophisticated investors.[17] Congress has long recognized the distinction between retail investors and private fund investors, including, for example, the 1996 enactment of section 3(c)(7) of the Investment Company Act of 1940[18] (the "Company Act") and the exclusion of private fund investors from the definition of "retail customers" in Dodd-Frank Section 913.

The Commission also cites section 206(4) of the Advisers Act ("Section 206(4)") as a source of its authority for the Proposed Rules. Section 206(4) is an antifraud statute that prohibits investment advisers from engaging in any "act, practice, or course of business which is fraudulent, deceptive, or manipulative".[19] Notwithstanding that Section 206(4) specifically addresses fraudulent, deceptive or manipulative conduct, the Proposing Release states that the prohibitions contained in the Proposed Rules would apply regardless of disclosure and informed consent.[20] As an antifraud statute, Section 206(4) cannot reasonably be read to prohibit conduct where no fraud is involved, especially where disclosure and informed consent has been obtained.

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[15] *SEC v. Capital Gains Research Bureau, Inc.*, 275 U.S. 180, 186 (1963).

[16] In the adopting release for the Fiduciary Interpretation, the Commission reconsidered the approach initially included in the proposing release, which originally stated that certain conflicts could not be effectively disclosed, in which case an adviser must seek to avoid such conflicts. Fiduciary Interpretation at 27-28 n. 69 ("[i]n the Proposed Interpretation, we stated that inferring or accepting client consent to a conflict would not be consistent with the fiduciary duty where 'the material facts concerning the conflict could not be fully and fairly disclosed.' Some commenters expressed agreement with this statement . . . Other commenters expressed doubt that such disclosure could be impossible . . . In response to commenters, we have replaced the general statement about an inability to fully and fairly disclose material facts about the conflict with more specific examples of how advisers can make such full and fair disclosure".). The Commission further made clear that "institutional clients generally have a greater capacity and more resources than retail clients to analyze and understand complex conflicts and their ramifications". Fiduciary Interpretation at 28, n. 70.

[17] Fiduciary Interpretation at 28, n. 70 ("Whether the disclosure is full and fair will depend upon, among other things, the nature of the client, the scope of the services, and the material fact or conflict. Full and fair disclosure for an institutional client (including the specificity, level of detail, and explanation of terminology) can differ, in some cases significantly, from full and fair disclosure for a retail client because institutional clients generally have a greater capacity and more resources than retail clients to analyze and understand complex conflicts and their ramifications.").

[18] Investment Company Act of 1940, 15 U.S.C. § 80a et seq. ("Company Act").

[19] Advisers Act § 206(4).

[20] Proposing Release at 132-33 ("The proposed rule would prohibit these activities regardless of whether the private fund's governing documents permit such activities or the adviser otherwise discloses the practices and regardless of whether the private fund investors . . . have consented to the activities[.]").

Furthermore, throughout the proposal, the Commission highlights the lack of data related to its Proposed Rules. In some instances, the Commission has asked commenters to provide their own statistics and data regarding the private fund industry, private fund investments and the likely costs and benefits associated with the proposed rule changes. For example, the Commission notes that "the data [does] not exist to estimate how funds or investors may respond to the [proposed quarterly] reporting requirements"[21] and also that "there is a lack of data on the frequency with which advisers grant certain investors the preferential treatment that would be prohibited under the proposed rules . . . and to what extent [the disclosure of preferential terms] affect investor behavior".[22]

In light of the wide-reaching changes that would be imposed by the Proposed Rules, we believe that the Commission should have more data to rely on than what the public can fill in during a brief notice and comment period. We therefore respectfully request that the Commission gather and study the necessary data before finalizing the Proposed Rules.

III. The Prohibited Activities Rule and the Preferential Treatment Rule Should Not Be Applied to Non-Registered Advisers.

As proposed, the Prohibited Activities Rule and Preferential Treatment Rule would apply to all investment advisers – including advisers that are exempt reporting advisers ("ERAs") and any non-registered investment adviser (collectively with ERAs, "Non-Registered Advisers"). Applying such requirements to Non-Registered Advisers is contrary to clear Congressional intent evidenced by the structure of the Dodd-Frank Act.

In Title IV of the Dodd-Frank Act, Congress repealed the previous exemption from registration under section 203(b)(3) of the Advisers Act in order to "extend registration to advisers to hedge funds and many other private funds"[23] – it enacted more limited exemptions in order to expressly exempt certain types of investment advisers from the requirements that come with registration (the "Dodd-Frank Exemptions").[24] Many advisory firms have structured their businesses in good faith to avail themselves of the Dodd-Frank Exemptions – if Congress intended to subject such firms to onerous regulatory requirements it would have foregone enactment of these registration exemptions, and the Commission should not undo that decision now.

We would like to draw the Commission's attention to the fact that many Non-Registered Advisers have principal offices and places of business outside the U.S. The Commission itself noted in its release accompanying rulemaking related to the Dodd-Frank Exemptions that these exemptions, in particular Advisers Act Rule 203(m)-1 served the crucial goal of encouraging "the participation

[21] Proposing Release at 226.

[22] Proposing Release at 232-34.

[23] Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, Investment Advisers Act Release No. IA-3222, 3 (Jun. 22, 2011) (the "Exemptions Release").

[24] Two of these exemptions– section 203(m) of the Advisers Act and Rule 203(m)-1 (the "Private Fund Adviser Exemption") and section 203(l) of the Advisers Act and Rule 203(l)-1 (the "Venture Capital Exemption") – require advisers to file an abbreviated Form ADV and claim status as ERAs, and a third established by section 202(a)(30) of the Advisers Act and Rule 202(a)(30)-1 (the "Foreign Private Adviser Exemption") did not require such a filing and is applicable to non-U.S. advisers with a de minimis number of U.S. clients or private fund investors. *See generally id*.

of non-U.S. advisers in the U.S. market by applying U.S. laws in a manner that does not impose U.S. regulatory and operational requirements on a non-U.S. adviser's non-U.S. advisory business"[25] and does so "in keeping with general principles of international comity".[26] Applying the Prohibited Activities Rule and the Preferential Treatment Rule to Non-Registered Advisers would have a particularly significant impact on non-U.S. firms that have structured their businesses to remain exempt from Commission regulation in a manner consistent with the Commission's approach to the extraterritorial application of the Advisers Act.

IV. The Commission Should Not Prohibit Reimbursement, Exculpation, Indemnification or Limitation of Liability for Ordinary Negligence.

The proposed Prohibited Activities Rule would prohibit all private fund advisers from directly or indirectly seeking reimbursement, indemnification, exculpation or limitation of the private fund adviser's liability for a breach of fiduciary duty, willful misfeasance, bad faith, negligence or recklessness. This is a significant departure from the approach currently used in private fund agreements and imposes a lower threshold of liability on advisers to private funds in comparison to advisers to retail-oriented investment companies.

Sophisticated investors have the freedom to choose between investment funds subject to the prescriptive limitations of the Company Act, or private funds not subject to those limitations. Investors in either public or private funds can agree to indemnify or limit the liability of advisers as long as the adviser doesn't act with gross negligence, bad faith or willful misconduct. The Prohibited Activities Rule would prohibit such arrangements with respect to private fund advisers, meaning that private fund advisers must be liable to the investors in their funds for simple negligence. Such a prohibition could have tremendous impacts – either advisers will find increased insurance coverage (which will likely be much more expensive and charged to the investors) or certain advisers (particularly small advisers) will stop pursuing the very strategies the investors wish for them to pursue (of course, both of these outcomes could occur). Support for such a radical change seems illusory—the Commission does not cite studies or cases showing that sophisticated investors' investment opportunities should be limited because advisers are acting negligently.

The Commission's proposal to prohibit negotiated protections and expose advisers to an ordinary negligence standard applies a higher standard on private funds than Congress decided to apply to retail-focused investment companies,[27] or that would otherwise be applicable in the context of a direct investment advisory contract between an adviser and a retail client.[28] Ordinary negligence is defined by a lack of intent, willfulness or even the extreme indifference that characterizes gross

[25] Exemptions Release at 96.

[26] *Id.*

[27] Company Act § 17(i) ("no contract or agreement under which any person undertakes to act as investment adviser of, or principal underwriter for, a registered investment company shall contain any provision which protects or purports to protect such person against any liability to such company or its security holders to which he would otherwise be subject by reason of willful misfeasance, bad faith, or gross negligence, in the performance of his duties, or by reason of his reckless disregard of his obligations and duties under such contract or agreement[.]").

[28] The Advisers Act does not establish a minimum standard of care applicable to advisory contracts.

negligence.[29] A prohibition on a private fund adviser's ability to protect itself against claims for ordinary negligence would constitute a significant departure from the expectations of private fund investors and advisers. Rather than promote investor protection, the mostly likely result of the proposed prohibition is to drive management costs higher for the advisers that can bear the additional risk and serve as a barrier to entry for the advisers that cannot.

Industry Standards. An industry-wide liability standard that limits liability for ordinary negligence has arisen from decades of risk allocation negotiations with sophisticated private fund investors. It reflects the market's understanding that unintentional error is an operational inevitability even when due care is exercised and that some degree of liability protection is necessary to incentivize managers to undertake the risks associated with complex and innovative investment strategies that have the greatest potential to produce the returns sought by private fund investors. Limitations on liability for ordinary negligence are so widely accepted that investment advisers to investment companies and retail clients have also historically relied on its protections. Section 17(j) of the Company Act specifically permits indemnification by investment companies for acts that do not constitute willful misfeasance, bad faith, gross negligence or reckless disregard, demonstrating clear Congressional intent to permit indemnification for ordinary negligence in the retail context. The Commission has further taken the position that investment companies may advance expenses and attorney's fees to directors and officers defending against such claims.[30]

By analogy, Delaware, which has one of the most well developed and highly respected bodies of corporate law in the world, has long recognized that protecting entities and their officers and directors from liability is a key component of investor protection and necessary to allow entities to properly run their businesses. Such protections include broad indemnification, the provision of insurance and the protections afforded by the business judgment rule – the goal of which is to avoid "second guessing" of good faith business decisions and the chilling effect that too low a standard of liability can have on attracting talented executives.[31]

Investor Suits. Unlimited liability for ordinary negligence would effectively mean that no innocent mistake, oversight or error in judgement would be shielded from frivolous suits or the threat of such suits. The adoption of this section of the Prohibited Activities Rule would effectively establish a *de facto* private right of action for claims of ordinary negligence against private fund advisers. The operation of such a *de facto* right would be inconsistent with the private right of action

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[29] *See, e.g.*, *Robare Grp. v. Sec. & Exch. Comm'n*, 922 F.3d 468, 480 (D.C. Cir. 2019) ("Negligence, by contrast, means acting "without having purpose or certainty required for intent" but in a manner that is nevertheless unreasonable").

[30] Indemnification by Investment Companies," Investment Company Act Release No. 11330 (Sept. 4, 1980).

[31] *See Gagliardi v. Trifoods Intern., Inc.*, 683 A.2d 1049, 1052-53 (Del. Ch. 1996):

> Obviously, it is in the shareholders' economic interest to offer sufficient protection to directors from liability for negligence, etc., to allow directors to conclude that, as a practical matter, there is no risk that, if they act in good faith and meet minimal proceduralist standards of attention, they can face liability as a result of a business loss….The law *protects shareholder investment interests* against the uneconomic consequences that the presence of such second-guessing risk would have on director action and shareholder wealth in a number of ways. It authorizes corporations to pay for director and officer liability insurance and authorizes corporate indemnification in a broad range of cases, for example. But the first protection against a threat of sub-optimal risk acceptance is the so-called business judgment rule . That "rule" in effect provides that where a director is independent and disinterested, there can be no liability for corporate loss, unless the facts are such that no person could possibly authorize such a transaction if he or she were attempting in good faith to meet their duty. *Saxe v. Brady,* 184 A.2d 602 (Del. Ch. 1962).

established by section 10(b) of the Exchange Act, which requires a finding of scienter.[32] Congress did not enact a private right of action under the Advisers Act, and the Commission should not issue a rule that would essentially create one, especially when such a *de facto* right would only be utilized by sophisticated investors in private funds. By mandating the standards between advisers and private fund clients, the Prohibited Activities Rule would run counter to existing law and authority, without citing any support for the suggestion that private fund managers are acting counter to the interests of their private fund clients (and investors). The impact of such suits and their resulting costs are difficult to quantify in advance, and could include higher management fees and a decrease in competitiveness and innovation by private fund advisers, as described below. Such concerns are especially pronounced for smaller private fund advisers, which would be more susceptible to such suits because they are more likely to lack the resources to defend themselves.

Service Provider Liability. In our experience, service providers to private funds such as consultants, custodians, administrators and brokers generally limit their own liability to gross negligence and intentional misconduct. The Proposed Rules would create a liability standard for private fund advisers that is out of line with the standard applicable to their service providers. Because private fund advisers would be held to an ordinary negligence standard of liability, they could effectively end up "backstopping" their service providers' negligence because they would be an easier litigation target even when the service provider was at fault, but its conduct did not rise to gross negligence or willful misconduct.

Insurance. The additional liability risk of an ordinary negligence standard would necessitate increased reliance on insurance coverage. We believe, based on the current structure of these products, that there is likely to be, at minimum, a significant impact on costs borne by the insureds in the form of increased premiums and/or higher deductibles. The limits of offerings generally available in the market for a particular line of insurance are substantively driven by how insurers assess risk. A rule that substantially increases the risk of frivolous, resource-intensive litigation would likely lead to increased premiums and deductibles, lower coverage limits or, in the worst case, a lack of coverage options in the market.

Competition and Innovation. An ordinary negligence standard would remove the protection from liability that private fund advisers rely on when pursuing novel sectors, new geographic markets and innovative strategies. These pursuits, despite their attendant cost and risks, have historically benefited financial markets by helping investors to minimize economic losses during market downturns and maximize risk adjusted returns over time.[33] Prohibiting liability limitations for unintentional errors that are an inherent part of the development and pursuit of these strategies will have a chilling impact on existing private fund advisers who might otherwise explore these strategies. This would also create a significant disincentive for new managers with creative ideas from raising funds to test their theories in the market, stifling competition among fund managers

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[32] Exchange Act § 10(b); *see, e.g.*, *Ernst and Ernst v. Hochfelder*, 425 U.S. 185, 186 (1976) ("[t]he use of the words 'manipulative,' 'device,' and 'contrivance' in § 10(b) clearly shows that it was intended to proscribe a type of conduct quite different from negligence, and, more particularly, the use of the word "manipulative," virtually a term of art used in connection with securities markets, connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities").

[33] *See, e.g.*, Shadab, Houman, *The Law and Economics of Hedge Funds: Financial Innovation and Investor Protection*, 6 Berkeley Bus. L.J. 240 (2009).

and reducing the range of opportunities available to investors.

We therefore respectfully request that the Commission omit this prohibition in the final rule and preserve private fund advisers' ability to seek reimbursement, indemnification, exculpation and limitation of liability for ordinary negligence. This approach is consistent with well-established corporate law principles and is consistent with the standard of liability that Congress established for retail investors.

V. Conflicts Relating to Fees and Expenses Are Addressed Better Through Disclosure Than by Strict Prohibitions.

The Prohibited Activities Rule would prohibit the following fee and expense practices due to the potential for conflicts of interest between advisers and their private fund clients, denying sophisticated investors the opportunity to review and negotiate an agreed-upon scope of fees and expenses:

- charging the private fund for fees or expenses associated with (i) an examination or investigation of the private fund adviser or its related persons by any governmental or regulatory authority, or (ii) regulatory or compliance fees or expenses of the private fund adviser or its related persons; and

- 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 private fund adviser or its related persons have invested (or propose to invest) in the same portfolio investment.

We acknowledge that the fee and expense practices contemplated by the Prohibited Activities Rule can create potential conflicts of interest. However, such conflicts are more suitably addressed by disclosure and informed consent than through rigid regulatory prohibition. Indeed, an inflexible prohibition will likely only drive management fees higher for most private fund advisers and limit options for investors that prefer an expense pass-through model for some or all of their investments.[34]

Compliance, Regulatory, Examination or Investigation Expenses. Advisers to private funds are in the business of making investments on behalf of their fund clients. Inherent in this business model is the requirement to comply with applicable laws and regulations. As such, examinations and investigations are expected in the course of managing private funds. There is a significant distinction between private funds bearing regulatory, compliance, examination or investigation expenses related to the adviser's work on behalf of the fund, on the one hand, and such expenses unrelated to the adviser's work on behalf of the fund, on the other. Sophisticated investors are perfectly capable of assessing an adviser's expense policies and practices and deciding whether to invest in a fund where the adviser is permitted to be reimbursed by the fund for expenses related

[34] The fact that the expense pass-through model exists belies the Commission's notion that sophisticated investors "do not have sufficient information regarding private fund or portfolio company fees and expenses to make informed investment decisions". Proposing Release at 10. On the contrary, sophisticated investors are well positioned to explore and negotiate issues regarding fees and expenses prior to investing and to make an informed decision.

to its work for the fund.

Certain advisers to private funds establish the funds' governing agreements with investors to provide that the fund will bear the adviser's compliance or regulatory expenses or the expenses of regulatory examinations in connection with advising the fund. We do not believe such arrangements create any perverse incentives – indeed, by taking on the obligation of such expenses the investors are showing how important it is that compliance and regulatory obligations are satisfied. Many private funds do not bear such costs, and sophisticated investors in private funds are in a position to decide whether the benefits of investing in a particular fund are such that they are comfortable bearing compliance expenses.

Expense provisions in private fund governing documents often incorporate initial feedback and/or negotiation with prospective investors, are informed by an assessment of what expense terms are broadly acceptable to the market and are part of the mix of considerations reviewed by both the manager and prospective investors. This is especially true of funds that operate pass-through expense models, which very frequently provide for the fund to pay for costs contemplated by the proposed prohibition. Prohibiting such arrangements by limiting advisers from receiving reimbursement for compliance and regulatory expenses creates fewer incentives for private fund advisers to engage constructively with investors on such arrangements and could result in the use of management fees when a pass-through model would be appropriate, including in circumstances where investors could end up bearing greater costs.

The cost of regulatory investigations is a slightly different matter. If one believed that every regulatory investigation involved malfeasance by the adviser, then having the fund pay for such investigation would raise significant questions. But many – indeed, in our experience, the majority – of SEC investigations related to private fund advisers are fact-finding efforts that do not end with enforcement. The industry standard formulation for such reimbursement requires the adviser to return any such reimbursement if it is determined that the adviser acted with gross negligence, willful misconduct or in bad faith. The mechanism for avoiding a perverse incentive is already there – an adviser knows that if it acts outside of the standard of care it will be responsible for any losses.

If the Commission believes there is a lack of transparency with respect to the costs of compliance, then it could require more granular disclosure of compliance-related costs borne by private funds. The Commission instead proposes to prohibit the charging of certain expenses without circulating for review and comment any definition or standards for what constitutes a "fund" or "adviser" compliance expense—this approach would create substantial uncertainty that we believe would be damaging to private fund investors and advisers.

Non-Pro Rata Expense Allocations. There are a number of circumstances where a strict adherence to a pro rata methodology for allocation of investment-related costs would adversely affect private fund investors. For example, the Commission notes in the Proposing Release that potential co-investors contemplating an investment alongside a private fund in an unconsummated transaction should bear "broken deal" expenses related to such transaction because the co-investors would have benefited if the transaction was consummated, and the fund is disadvantaged by having to

bear such expenses.[35] In our experience, co-investments are a common feature of several investment strategies and, in many cases, a private fund (and the investors therein) benefit from the adviser's ability to rapidly arrange for co-investors to invest alongside the fund. We observe that co-investments play a significant role in allowing funds to make investments critical to the effective execution of stated investment strategies. For various reasons, such transactions are not always consummated. Requiring co-investors to bear broken deal costs would likely make it more difficult to easily arrange co-investments. In our experience, co-investments are often time-sensitive matters and introducing obstacles to such arrangements would make it more likely that a private fund will miss out on valuable opportunities. Sophisticated investors benefit from the investments that such co-investments facilitate (as well as other circumstances that don't involve pro rata allocation of investment expenses), and are in an excellent position to read and understand disclosures relating to non-pro rata expense allocations and make a determination of whether they would like to invest in a fund that bears such expenses.

VI. Preferential Treatment of Certain Private Fund Investors Is Better Addressed Through Disclosure.

The proposed Preferential Treatment Rule would prohibit (i) arrangements where a private fund adviser provides redemption or information rights to an investor in a private fund or substantially similar pool of assets that are reasonably expected to have a material, negative effect on other investors and (ii) granting preferential treatment to any investor in the private fund unless the adviser provides advance and annual written disclosures to prospective and current investors, respectively, in a private fund regarding all preferential treatment granted to other investors in that private fund or a substantially similar pool of assets without clearly establishing any basis for why the prohibition is needed.

The Commission's proposal is inconsistent with the Fiduciary Interpretation and will result in a great deal of uncertainty that will operate to the detriment of private fund investors and advisers. The Preferential Treatment Rule proposes a prohibition without including necessary definitions and standards. The Commission does not define "preferential treatment", stating that "whether any terms are 'preferential' would depend on the facts and circumstances".[36] Similarly, the Commission stated that the determination of "whether an adviser could have a reasonable expectation that the preferential term would have a material, negative effect on other investors in the same private fund or in a substantially similar pool of assets would depend on the facts and circumstances".[37] All of the key elements of the proposed Preferential Treatment Rule require complex, fact-specific inquiries that can be second-guessed in the future.

Harm caused by a lack of critical standards and definitions in the Preferential Treatment Rule would be made more acute by the consequences of an adverse after-the-fact determination. If a side letter term with a private fund investor is not considered "preferential" at the time of the agreement, but is later found by the Commission to be preferential, a contractual term that reflects the agreed-upon bargain between the fund and the investor would effectively be nullified.

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[35] Proposing Release at 154.

[36] Proposing Release at 163.

[37] Proposing Release at 164 n. 188.

Similarly, many side letter terms relating to redemption or information rights would not reasonably be expected in advance to have a material, negative effect on other investors. However, in a circumstance where the Commission or Staff were to disagree with that assessment, such terms would similarly be nullified. Moreover, the phrasing of the proposed Preferential Treatment Rule is overbroad and lacks clarity. For example, based on the proposed wording, it is possible that liquidity term differences between share classes could constitute a form of preferential treatment. Whether such differences could reasonably be expected to have a material, negative effect on other investors is difficult to predict with certainty, and one effect of the adoption of this proposal could be a significant reduction in private funds' ability to customize the terms of investment available to all investors in a fund. These outcomes could cause significant harm to investors and advisers, and the fact-specific nature of critical elements of the proposed Preferential Treatment Rule impede the contractual certainty that investors and advisers need to appropriately bargain and structure the terms of the fund.

If the Commission believes that there is a need for greater transparency regarding preferential treatment of certain investors, the better approach would be to propose for comment a differently-constructed proposal requiring more specific disclosures regarding preferential treatment, the violation of which would not automatically result in nullification of agreed-upon contractual terms. Such a proposal would be consistent with the approach for addressing conflicts of interest articulated by the Commission in the Fiduciary Interpretation.

VII. The Proposed Quarterly Statement Rule Should Allow for Greater Flexibility in Reporting.

The proposed Quarterly Statement Rule would require registered investment advisers to distribute to investors a quarterly statement for each private fund within 45 days of the end of the calendar quarter. These statements must include, for the applicable reporting period: (i) detailed accounting of all compensation, fees and other amounts allocated or paid to the adviser or any of its related persons, with separate line items for each category of allocation or payment; (ii) a detailed accounting of all fees and expenses paid during the reporting period, with separate line items for each category of expense; (iii) a detailed accounting of compensation and the fund's ownership percentage of each portfolio investment that paid the adviser or its related persons compensation during that quarter and (iv) prominent disclosures of the calculation methodologies for all expenses, payments, allocations, rebates, waivers and offsets, including cross-references to the private fund's organizational and offering documents.

We are concerned that the Quarterly Statement Rule will have certain unintended consequences by giving investors misleading impressions regarding expenses, prioritizing speed over quality in investor reporting and failing to take into account differences between advisory relationships with private funds and those with retail clients.

Performance is central to investors' and prospective investors' analysis of an adviser's capabilities, which is why investors have negotiated over time, and market practice dictates, that advisers provide performance information to prospective and current investors in a variety of formats and

frequencies.[38] In our experience, private fund investors frequently inquire (and receive) different performance metrics at their request that are tailored to the specifics of the investment strategy, the liquidity terms and other important considerations. Given the range of such strategies and terms, a "one size fits all" approach will not provide useful information to many investors and can create confusion if provided alongside the existing reporting.

The proposal seeks to address this in part by identifying different funds as having "liquid" or "illiquid" investments. However, a large percentage of private funds have assets that fit into both of those categories. The proposal would create complicated new rubrics for reporting not used by advisers and not widely understood by investors. Further, we expect advisers to experience significant challenges in preparing such reporting across a variety of topic areas, including but not limited to preparing reporting regarding six different measurements of liquidity, reporting for funds with substantial private and publicly-traded investments, reporting for funds that change their mix of assets over time and incorporating the performance of side pockets in a standardized fashion. We do not believe that a complex and "one size fits all" method of reporting will meaningfully improve transparency with investors.

In the Fiduciary Interpretation, the Commission stated that institutional clients have "greater capacity and more resources than retail clients to analyze and understand complex conflicts and their ramifications"[39] and that when determining whether a particular investment is in the best interest of a client, it is appropriate for an adviser to take into account the client's financial sophistication.[40] We believe that reporting to private funds should mirror this approach. Private fund investors already receive a wide variety of performance reporting, which combined with their access to resources and level of financial sophistication, renders them well-positioned to understand and compare information across advisory relationships. If the Commission seeks to proceed with a statement requirement, a better alternative would be to supplement the numerous types of reporting that private fund advisers provide by requiring advisers to distribute the proposed reporting on an annual basis. This would substantially reduce the burdens on advisers and serve the goal of greater investor transparency by producing more useful disclosures, while recognizing the existing prevalence of frequent and tailored performance reporting.

Expense Reporting. The Commission asks: "Would the proposed content result in fund-level fee and expense disclosure that is meaningful to investors?"[41] In our experience, fund expenses are generally not incurred uniformly throughout the year. There is no alignment between when vendors invoice for their products and services and when fund performance is calculated. We have seen that there are often quarters where funds bear significant expenses and quarters where funds bear minimal expenses. Enumerating expenses incurred on a quarterly basis rather than annual, at best, would be unhelpful to investors and, at worse, could give a misleading impression of the expense load of a fund. On the other hand, reporting expenses on an annual basis is already

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[38] This can take many forms, including in marketing materials, monthly performance reporting, quarterly and annual letters, annual investor meeting presentations and in response to specific requests.

[39] Fiduciary Interpretation at 25-26.

[40] *Id.* at 15-16. ("However, for example, when advising a financially sophisticated client, such as a fund or other sophisticated client that has an appropriate risk tolerance, it may be in the best interest of the client to invest in such derivatives or in securities on margin, or to invest in other complex instruments or other products that may have limited liquidity".)

[41] Proposing Release at 34.

provided in the annual audited financial statements of the fund. Greater specificity in breaking down those annual expenses would provide more information to investors without the skewed impressions that would result from quarterly expense reporting.[42]

Average Annual Net Returns Over Certain Periods. The Quarterly Statement Rule would also require advisers to provide for liquid funds the average annual net total returns over one-, five- and ten- calendar year periods. The recent amendments to Advisers Act rule 206(4)-1 (the "Marketing Rule"), however, specifically exempted all private funds from performance reporting over the same periods.[43] While the proposed rule distinguishes between liquid and illiquid funds for the purpose of this reporting, we agree with the Commission's rationale in the adopting release for the Marketing Rule that excepting all private funds from performance reporting over one-, five-, and ten- calendar year periods is appropriate because doing so may present performance information for certain types of funds that is misleading and introduces unnecessary complexity.[44] Consistent with that rationale, we believe that liquid funds should not be required to report annual net total returns over one-, five-, and ten- calendar year periods.

Reporting Since Inception. The Commission's proposal to include reporting since inception is overbroad and conflicts with requirements under other Commission rules. The Commission specifically asks: "Is it common practice for older funds (*e.g.*, hedge fund incepted 30 years ago) to retain records to support that performance?"[45] If the adviser is not marketing the performance of the funds going back many years, then it is not required to maintain records of that performance. Thus, many advisers do not have the records going back to inception. Instead, to make this feasible and harmonize this requirement with the recently-adopted Marketing Rule, the Quarterly Statement Rule should instead tie the reporting requirement to the period for which the adviser is marketing the fund's performance (and is therefore required to maintain records of that performance). Further, many funds have been in existence for many years, some for decades. The Commission asks "Should the proposed rule include a maximum period of time that funds that are in existence as of the compliance date must look back in order to report performance, fees, and

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[42] For example, research vendor expenses are often pre-paid on an annual basis when a contract is signed or renewed. Presenting annual fund research expenses would provide an investor a more meaningful way to compare research expenses year to year. Even service providers that invoice more frequently, such as monthly or quarterly, often have billing that lags behind when expenses are incurred or may have delays in issuing an invoice in any given billing cycle but tend to "catch up" and reconcile annually at the end of their fiscal year.

[43] *See* Rule 206(4)-1(d)(2) ("An investment adviser may not include in any advertisement … Any performance results, of any portfolio or any composite aggregation of related portfolios, *in each case other than any private fund*, unless the advertisement includes performance results of the same portfolio or composite aggregation *for one-, five-, and ten-year periods*, each presented with equal prominence and ending on a date that is no less recent than the most recent calendar year-end; except that if the relevant portfolio did not exist for a particular prescribed period, then the life of the portfolio must be substituted for that period.") (emphasis added).

[44] *Investment Adviser Marketing*, Release No. IA-5653; File No. S7-21-19 at 182 ("An adviser may rely on this exception when displaying performance advertising of any type of private fund, rather than only when displaying performance advertising of private equity funds or other closed-end private funds. We believe that it is appropriate to except any private fund because there may be additional types of private funds than those identified by commenters for which displaying this information could be misleading. We decline to allow only certain defined types of private funds to rely on this exception, given the varied limitations that private funds may place on redemptions now and in the future. We also do not believe the benefit of having advisers parse the rule's requirements based on specific fund types would justify the complexity.").

[45] Proposing Release at 184.

expenses?"[46] Limiting required reporting to the period for which performance is being used to market the funds would address this issue.

Offering Memoranda Disclosures. The Commission asks whether advisers should be required to restate in quarterly statements the relevant disclosures from offering memoranda.[47] Summarizing highly technical provisions runs a risk of creating inconsistencies with offering documents and potentially misleading investors. If, to avoid such inconsistencies, the detailed PPM disclosures are incorporated into the quarterly statement, they will undermine any benefit to investors of such statements because they will be difficult to follow. Instead, providing cross-references by page and section number, as provided for in the proposed Quarterly Statement Rule, would provide clearer and more effective disclosure to investors

Time Period for Reporting. Further, we believe that requiring reporting 45 days after a reporting period ends is too short of a window. The operational burdens presented by such a rapid timeframe could result in a decline in the quality of reporting. In the alternative, if the Commission decides to adopt a version of the Quarterly Statement Rule, we believe that requiring that the statements proposed by the Commission only be distributed on an annual basis, 90 days after a fund's fiscal year end, would better align reporting with annual audits conducted in connection with the Custody Rule (and potentially the proposed Private Fund Audit Rule), provide investors a more accurate picture of the expenses they are bearing and can expect to bear over time, and will give advisers the additional time needed to prepare accurate reporting.

VIII. The Private Fund Audit Rule Should Be Omitted, or in the Alternative, Should Be Harmonized with the Custody Rule and Exempt Non-U.S. Advisers with Respect to Non-U.S. Clients.

The proposed Private Fund Audit Rule should not be adopted by the Commission because it is duplicative of the Custody Rule's existing requirements and would have effects that were not addressed by the Commission in the Proposing Release.

As the Commission notes, greater than 90 percent of hedge funds and private equity funds receive an annual audit,[48] and therefore the vast majority of private fund investors receive the benefits of an annual audit. Further, the Commission has not cited any enforcement actions relating to conduct that would have been avoided if there was a universal requirement that private funds undergo annual audits. In our experience, the audit requirement of the Custody Rule is very comprehensive – in many cases advisers are required to spend time and money for audits, in particular for funds in wind-down or liquidation, when investors have expressed a specific preference for the discontinuation of audits.

If the Commission adopts a version of the proposed Private Fund Audit Rule, it should consider two key changes. First, the Private Fund Audit Rule should be modified to make clear that satisfaction of the requirements under either the Custody Rule or the Private Fund Audit Rule

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[46] *Id.*

[47] *Id.* at 54.

[48] Proposing Release at 104, n. 118.

satisfies an adviser's obligations. Second, the Private Fund Audit Rule should be revised to specify that advisers with their principal office and place of business outside the United States should be exempt from the Private Fund Audit Rule's requirements with respect to their non-U.S. private fund clients. This approach is consistent with the Commission's "long-held view that non-U.S. activities of non-U.S. advisers are less likely to implicate U.S. regulatory interests"[49] and with the approach to the Custody Rule for non-U.S. advisers.[50]

IX. Private Fund Advisers Should Be Grandfathered with Respect to Existing Private Fund Clients from the Proposed Rules.

Certain of the Proposed Rules impose restrictions on certain activities between advisers and their private fund clients, in particular the Prohibited Activities Rule and the Preferential Treatment Rule. The application of these rules would radically alter existing contractual arrangements in a number of ways discussed above, many of which were the result of extensive review and negotiation between private fund advisers and the investors in their funds.

Although we object to the adoption of the Proposed Rules, to the extent that the Commission adopts the Proposed Rules, especially the Prohibited Activities Rule and the Preferential Treatment Rule, exempting (colloquially, "grandfathering")[51] private funds in existence as of the effective date of such rules would substantially reduce the negative impacts resulting from the disturbance of existing contractual arrangements. The Commission should also establish a substantial transition period, similar to its approach under the Marketing Rule.

* * *

We would be pleased to respond to any inquiries you may have regarding our letter or our views on the Proposed Rules more generally. Please feel free to direct any inquiries to Marc Elovitz, Kelly Koscuiszka or Christopher Avellaneda at (212) 756-2000.

Respectfully submitted,

SCHULTE ROTH & ZABEL LLP

cc: The Honorable Gary Gensler
The Honorable Caroline Crenshaw
The Honorable Allison Herren Lee
The Honorable Hester Peirce
William Birdthistle, Director, Division of Investment Management

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[49] Exemptions Release at 77.

[50] Division of Investment Management, U.S. Sec. & Exch. Comm'n, Staff Responses to Questions About the Custody Rule, VI.5, https://www.sec.gov/divisions/investment/custody_faq_030510.htm ("offshore advisers registered with the SEC are not subject to the custody rule, with respect to offshore funds").

[51] Grandfathering would be consistent with the Commission's historical approach to rules that disrupt existing contractual arrangements, including Advisers Act Rule 205-3, which permits newly registered investment advisers to continue charging performance fees to non-"qualified clients" and Advisers Act Rule 203(l), which permitted advisers to existing venture capital funds that did not meet the definition of "venture capital fund" to rely on the exemption from registration provided by that rule.