ACG®
Association for Corporate Growth

September 6, 2016

VIA ELECTRONIC SUBMISSION

Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Comments on Proposed Rule Regarding Investment Adviser Business Continuity and Transition Plans – File Number S7-13-16

Dear Mr. Fields:

The Association for Corporate Growth ("ACG") welcomes the opportunity to comment on the proposed rule (the "Proposed Rule") issued by the Securities and Exchange Commission ("SEC") that would require SEC-registered investment advisers to adopt and implement written business continuity and transition plans ("BCP") reasonably designed to address operational and other risks related to a significant disruption in the investment adviser's operations. ACG's comments will focus on how the Proposed Rule would negatively impact middle-market private equity firms.[1]

Middle-market private equity firms raise and advise private funds, which directly invest in small and medium-sized privately-held businesses throughout the United States, providing these businesses ("Portfolio Companies") with a vital source of funding and liquidity. Private equity investments are long-term, typically involving a three-to-five-year hold period during which time the firm helps the Portfolio Companies grow and create jobs. Each private equity fund makes only a handful of investments each year.

Portfolio Company securities held by the private equity firm during the "hold period" are not traded, and are transferred only upon a sale or disposition of the Portfolio Company. Valuation of Portfolio Company securities is generally done quarterly on an unaudited basis, and audited annually. Middle-market private equity funds do not trade securities generally, nor do they employ leverage at the firm or fund level. Portfolio Company securities generally are not complex instruments, nor do they require the use of third parties, pricing services or technology to value.

Most of the concerns identified by the SEC in the Proposed Rule simply are not applicable to middle-market private equity firms. Moreover, all SEC-registered investment

[1] ACG refers to middle-market private equity firms as those that invest primarily in privately-held operating companies which have a total enterprise value of $400 million or less or annual revenues of $400 million or less.

advisers are already required to adopt business continuity and transition planning procedures under Rule 206(4)-7 of the Investment Advisers Act of 1940 (the "Compliance Program Rule").

Given the unnecessary burden the Proposed Rule would place on middle-market private equity firms, we believe that the Proposed Rule should not be adopted. If the SEC does decide to adopt the Proposed Rule, we believe that middle-market private equity firms should be exempted from the BCP requirement. In addition, we believe that any BCP requirement should be in the form of informal guidance rather than a formal rule.

Background on the Association for Corporate Growth

Founded in 1954, the Association for Corporate Growth has 59 chapters and 14,500 members around the world. ACG serves 90,000 investors, owners, executives, lenders and advisers to growing middle-market companies. This includes professionals from private equity firms, corporations, banks and other lenders to middle market companies, as well as professionals from law firms, accounting firms, investment banks and other advisors to deal making.

The purpose of ACG is to help facilitate growth by bringing together middle-market dealmakers and business leaders who invest in growth and build value in companies. ACG accomplishes this by hosting hundreds of chapter events every year, providing online tools for its members, structuring networking opportunities and providing leading-edge market intelligence.

Middle Market Private Equity

A particular focus of ACG is middle-market private equity. ACG's members include more than 1,000 private equity firms that focus on the middle-market, the segment that accounts for 80% of private equity transactions. Three years ago, ACG conducted ground-breaking research using independent databases to better understand the relationship of private capital investment on corporate growth and job creation. The research found that between 1998 and 2015:

- Private equity-backed companies grew jobs by 27.6% while all the companies in the U.S. economy grew jobs by 21%;
- Private equity-backed companies grew sales by 56.3% while all the companies in the U.S. economy grew sales by 15%;
- Middle-market private equity-backed companies created more than 70% of new jobs (455,000), more than the small and large segments combined; and
- In every year except one over the fifteen-year period, private capital-backed companies had more relative growth compared to the general U.S. economy

According to Pitchbook, private equity firms invested more than $600 billion in more than 3,602 deals in 2015 alone. Two-thirds of private equity funds come from pension funds and university endowments, but for smaller or younger funds accredited investors are a vital source of capital as well. Overall, these investors have realized a 10-year return in excess of 14% - superior to all other asset classes.

Middle-market private equity firms differ from the types of companies described in the Proposed Rule in that they make long-term investments in privately held companies and then add value to these companies through improving efficiencies, setting performance benchmarks, imposing fiscal discipline, improving corporate governance, facilitating add-on acquisitions and myriad other ways. Private equity firms are not engaged in short-term trades and do not employ leverage at the fund level.

The Private Equity Business Model Does Not Require a Separate Rule on BCPs

As noted above, the private equity business model differs radically from the types of investment adviser activities identified in the Proposed Rule. The Proposed Rule focuses on the 2008 financial crisis, zeroing in on financial distress experienced by banks, investment banks, broker-dealers, government-sponsored entities (such as Fannie Mae and Freddie Mac) and insurance companies.

Private equity firms employ a very different business model than these businesses. Private equity firms played no part in the 2008 financial crisis, nor could private equity firms contribute in any significant way to a future financial crisis, given their business model. Middle-market private equity funds invest directly in privately-held Portfolio Companies, and then hold on to that investment for several years before eventually selling the company. During this time, Portfolio Company securities are not traded and are transferred only upon a sale or disposition of the Portfolio Company.

Valuation of Portfolio Company securities is generally done quarterly on an unaudited basis, and on an audited basis annually. Portfolio Company securities involved generally are not complex, nor do they require the use of third parties, pricing services or technology to value. Middle-market private equity funds do not trade securities.

Middle-market private equity firms generally do not employ leverage at either the firm or the fund level. They generally do not enter into derivative or swap transactions, and neither face nor generate the counterparty risk and/or interconnectedness that plagued the financial crisis. Moreover, investors in private equity funds generally do not have the right to redeem their investment.

These factors make private equity firms fundamentally different from the types of entities that were forced to wind down or cease operations during the financial crisis. Due to their differing business model, private equity funds are not susceptible to a run on liquidity or the type of crisis of confidence that resulted in firms winding down or ceasing operations on short notice.

It is unlikely a middle-market private equity firm would be required to immediately wind down or cease operations in a time of great financial stress – systemic or otherwise. Even if this were to occur, each fund makes only a handful of transactions per year, the reconciliation, liquidation, and transfer of investor accounts on a timely basis would not carry the same risks to clients as it would with other types of asset managers. Moreover, a temporary suspension or disruption of a private equity firm's operations is unlikely to result in client harm the way such suspension or disruption would impact, say, a hedge fund, mutual fund, bank, investment bank, or any of the other types of firms put out of business by the financial crisis.

Due to their long-term investment focus, private equity firms enter into long-term agreements ("Limited Partnership Agreements" or "LPAs") with the investors in their funds that address many of the disaster scenarios described in the Proposed Rule, including the winding down or ceasing operations during a time of stress. The role the LPA plays in resolving many of the scenarios described in the Proposed Rule is described in detail below.

This is not to say that middle-market private equity firms should not take precautions to protect themselves against a disruption in their business operations. To the contrary, as noted in the Proposed Rule, all SEC-registered investment advisers are *already required to do so* under Rule 206(4)-7.[2] The SEC *already* requires registered investment advisers to review these policies and procedurally annually. *Less than a year ago* the SEC's Office of Compliance Inspections and Examinations ("OCIE") released a Risk Alert that identified six areas of focus regarding cybersecurity and included a detailed sample diligence questionnaire.[3]

For all of these reasons mandating onerous BCP requirements as described in the Proposed Rule is unnecessary and unwarranted.

<u>Many of the Issues Identified in the Proposed Rule are Addressed in a Fund's Limited Partnership Agreement</u>

Unlike hedge funds, registered investment companies (mutual funds) and other investment advisers, the primary (exclusive) investment purpose of private equity funds is make long-term investments in privately held businesses. As a result, the Limited Partnership Agreements between the firm and investors in its funds are detailed, comprehensive agreements that take into account many of the issues identified in the Proposed Rule.

The Proposed Rule focuses significantly on transition planning. Nearly all private equity LPAs contain so-called "Key Person" clauses that prescribe what is to be done if one or more key members of the firm or fund cease to devote sufficient time to the business

[2] In the release adopting Rule 206(4)-7, the Commission stated that "an adviser's compliance policies and procedures should address BCPs "to the extent that they are relevant to an adviser."
[3] OCIE's 2015 Cybersecurity Examination Initiative, September 15, 2015; https://www.sec.gov/ocie/announcement/ocie-2015-cybersecurity-examination-initiative.pdf.

due to death, incapacitation or for any other reason. Remedies available through the LPA upon the triggering of a key person clause may include:

- prohibiting the fund from making additional investments;
- removal or replacement of the general partner; and/or
- an orderly winding-down of the fund.

In addition, unlike hedge funds, private equity funds do not receive all of an investor's capital up front; rather, committed capital is called from investors on an as-needed basis and then immediately used to make Portfolio Company investments. This significantly reduces the risk faced by investors in private equity funds. For this reason, as well as its long-term investment horizon, private equity LPAs generally do not provide redemption rights to investors. Thus, the SEC's concern regarding the processing of fund redemption transactions does not exist in the context of private equity firms.

Many of the Requirements in the Proposed Rule are Duplicative, Onerous and Unnecessary for Private Equity Firms

It is also worth noting that many of the potentially required elements of a BCP described in the Proposed Rule are duplicative with other regulations, onerous, and/or unnecessary for private equity firms. Requiring that a BCP contain information such as the corporate governance structure of the adviser, material financial resources available to the adviser, an assessment of the applicable law and contractual obligations is unnecessary.

Less than a year ago the SEC's Office of Compliance Inspections and Examinations released a Risk Alert ("September 2015 Cybersecurity Risk Alert") that identified six areas of focus regarding cybersecurity and included a detailed Appendix discussing these six key areas of focus.[4] Little efforts seems to have been made to ensure that the discussion of cybersecurity in the Proposed Rule (including obligations regarding third-party vendors) is consistent with the guidance already provided by the SEC in the September 2015 Cybersecurity Risk Alert.

Finally, it should be noted that in its descriptions of the estimated costs of implementing the Proposed Rule in Footnotes 124 and 127, the Proposed Rule includes an estimated *minimum* cost of $5,000 for a relocation place. Reading Footnote 127, it does not appear that the Proposed Rule, if implemented, would *require* an adviser to maintain an alternative location at all times – i.e. rent office space at all times. However, to avoid confusion, any final rule should clarify that an adviser is not required to maintain alternative office space at all times and, as noted in the Proposed Rule, smaller advisers with minimal employees may be able to function by enabling its employees to telework and access the adviser's systems remotely instead of requiring formal meeting space.

[4] OCIE's 2015 Cybersecurity Examination Initiative, September 15, 2015; https://www.sec.gov/ocie/announcement/ocie-2015-cybersecurity-examination-initiative.pdf.

ACG appreciates the opportunity to comment on the Proposed Rule and welcomes the opportunity to discuss further any of the issues addressed in this letter. If you have any questions, or if we can provide any additional information, please feel free to contact Amber Landis, vice president of public policy, at alandis@acg.org or (312) 957-4272.

Sincerely,

Gary A. LaBranche, FASAE, CAE
President & CEO
Association for Corporate Growth (ACG)