



July 28, 2017

The Honorable Steven Mnuchin
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20549

Re: Presidential Executive Order on Core Principles for Regulating the United States Financial System (February 3, 2017)

Dear Secretary Mnuchin:

The Institutional Limited Partners Association (“ILPA”), appreciates the opportunity to provide input to the U.S. Department of Treasury (“Treasury”) as it develops its report (the “Report”) in response to President Trump’s Executive Order on Core Principles for Regulating the United States Financial System (the “Executive Order”).¹

The ILPA is the only organization exclusively representing the interests of institutional investors in private equity, otherwise known as limited partners (“LPs”). Our 400+ member institutions, representing over \$1 trillion in assets under management, include public pensions, corporate pensions, insurance companies, university endowments, charitable foundations, family offices and sovereign wealth funds, all which are the primary investors in the US private equity market.² The ILPA’s members provide the capital that fuels private equity and venture capital investment, generating economic growth and job creation, across America and around the world.

In addition to providing this critical capital for economic growth, LPs are the trusted financial stewards investing the assets of average Americans across the country. Limited Partner beneficiaries include retirees, teachers, first responders, universities, charitable recipients, insurance policyholders and others. These private equity investments are essential to the sustainability of pensions, and ultimately provide for the retirement security of millions of Americans.

¹ Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017).

² As an example, members of the ILPA Board include: Ontario Teachers’ Pension Plan (OTPP), Guardian Life Insurance, Teachers Retirement System of Texas, D.C. Retirement Board, Washington State Investment Board, California State Teachers Retirement System (CalSTRS), Tufts University Investment Office, and the Alaska Permanent Fund Corporation, among others:
<https://ilpa.org/who-we-are/board-of-directors/>

I. Many of the Executive Order’s core principles align with ILPA’s efforts to promote a vibrant private equity marketplace

The Executive Order highlights “Core Principles” that focus on improvements to the regulatory framework with the goal of encouraging more investment, tailoring regulation, and fostering “economic growth and vibrant financial markets.” The “Core Principles” also highlight the importance of empowering Americans to, among other things, make informed choices in the marketplace and save for retirement. The current private equity regulatory structure aligns with these “Core Principles.” The light touch regulation and examination of private equity managers, in place since 2012, has fostered investor confidence to direct funds into the asset class, thereby supporting economic growth, as well as a vibrant private equity marketplace. Moreover, the current regulatory landscape for private equity advisers also enables average Americans, including many of the first responders, teachers, government workers and others that are invested through our members, to access the private equity market, something that many of them would be unable to do as individual investors. Given the above, it is the ILPA position that the current regulatory environment for private equity advisers is appropriately tailored to achieve the objectives in the Executive Order, while also satisfying the requirements in the Executive Order that regulation be “efficient, effective, and appropriately tailored.”³

II. Continued, effective SEC oversight is also critical to the health of private equity marketplace

The ILPA’s members are sophisticated investors and supporters of free market principles. They are strong believers in the private equity asset class, and its ability to generate the strong returns upon which their beneficiaries rely. Our members also assert that the current regulatory structure governing the private equity industry has engendered much needed confidence in the marketplace, and ultimately increased capital formation. The continued functioning of the efficient framework that exists today is critical to ensuring the health and growth of the private equity marketplace in the future.

The requirement that private equity fund advisers register with the SEC, and are subject to targeted examinations and enforcement, has resulted in an improved culture of transparency and disclosure in the private equity industry. In the few years since its inception, SEC registration of private fund advisers coupled with a strong examination program have uncovered and rectified a variety of opaque, questionable and, in some cases, unlawful practices that would have continued to harm the beneficiaries of Limited Partners if not discovered through regulatory oversight. These practices include inadequate policies and procedures related to the allocation and disclosure of the fees

³ Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017).

and expenses charged to investors, the existence of hidden fees not disclosed to investors, the lack of effective compliance programs, and the failure to disclose conflicts of interest. Furthermore, many of these practices were ultimately in violation of the Limited Partnership Agreements (LPAs), the investment contracts that managers negotiated with their investors, but were not able to be identified by outside parties. Only the SEC has jurisdiction and power to examine and enforce these elements.

A 2014 speech by Andrew Bowden, then the head of the SEC's Office of Compliance Inspections and Examinations (OCIE), highlighted these harmful practices, and stated that when the SEC had examined how fees and expenses were handled by private equity fund advisers, they identified "violations of law or material weaknesses in controls over 50% of the time," during their examination of over 150 private equity fund advisers.⁴ It is our concern that such lack of controls and fee disclosures, if left unmonitored, will undermine the confidence of LP investors and their governing bodies.

Bowden also highlighted the challenges that even the most sophisticated investors, including the ILPA's members, have in uncovering these violations. Bowden stated that these challenges were due to the "structure of the industry, the opaqueness of the private equity model, the broadness of limited partnership agreements and the limited information rights of investors."⁵ In this type of environment, Bowden stated that violations were occurring despite the best efforts of Limited Partners to monitor their investments, and in many cases, violations could likely not have been detected by Limited Partners due to insufficient disclosures or the lack of transparency.⁶ Certain issues are only discoverable by virtue of the SEC's visibility into the entire operations of private equity advisers that manage multiple funds across a large platform. For example, where there may be impropriety or insufficient disclosure of fee or expense allocations across multiple funds or multiple groups of investors, knowledge of such practices would fall beyond the purview of any Limited Partner's investment in a single fund, and the negotiated information rights pertaining to that fund. Without the SEC's active oversight and attention to such issues, Limited Partners' ability to discern questionable practices would understandably be limited. As the SEC has stated, "even experienced investors can be defrauded if they lack transparency into the various fees, expenses and practices."⁷

As a result of increased SEC oversight and through the efforts of the SEC's Private Fund Examination Unit, our members have seen increased transparency and disclosure of fees and expenses by fund managers, improved fund manager compliance with the terms in the contracted investment agreements and a significantly improved culture of compliance

⁴ Andrew Bowden, Director, Office of Compliance Inspections & Examinations, U.S. Securities & Exchange Commission, "*Spreading Sunshine in Private Equity*", Private Equity International (PEI) Private Fund Compliance Forum 2014, New York (May 6, 2014).

⁵ *Id.*

⁶ *Id.*

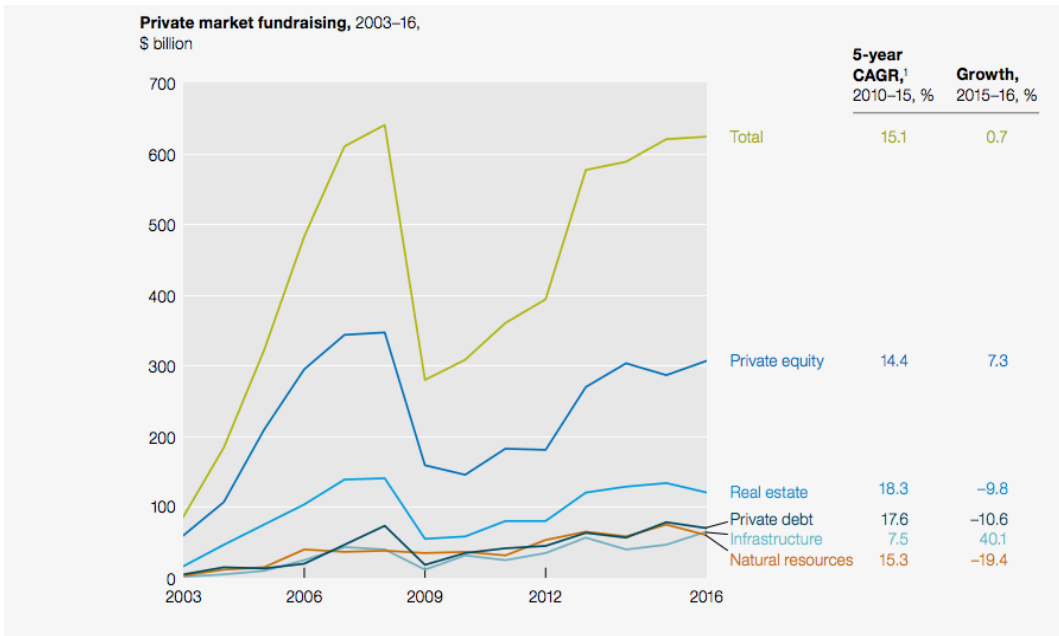
⁷ Andrew Ceresney, Director, Division of Enforcement, U.S. Securities & Exchange Commission, "*Private Equity Enforcement*", Securities Enforcement Forum West 2016, San Francisco, (May 12, 2016).

and voluntary disclosure from fund managers. A strong SEC enforcement regime, which could not effectively operate without registration, is evidenced by the 10 significant settlements reached with major private equity fund advisers since 2014. This enforcement effort has demonstrated that the SEC has the power needed to ensure a level and fair playing field for all parties, and has increased the confidence of those currently participating in the industry as well as those wishing to do so.

III. The SEC registration requirement has not harmed capital formation and has, in fact, improved it with private equity fundraising at an all-time high.

The registration requirements on the private equity industry have given investors more confidence to invest in the asset class, thereby strengthening capital formation in America. Market indicators from a variety of sources illustrating the industry’s growth following the implementation of SEC registration give no evidence of a detrimental impact on the growth in private equity fundraising or overall invested assets. According to the McKinsey Global Private Markets Review⁸ (the “Review”), explained in Chart A below, fundraising has continued to improve dramatically since the 2008 financial crisis and associated economic downturn. There is a particularly significant increase in capital formation in the asset class after 2012, when SEC registration was implemented.

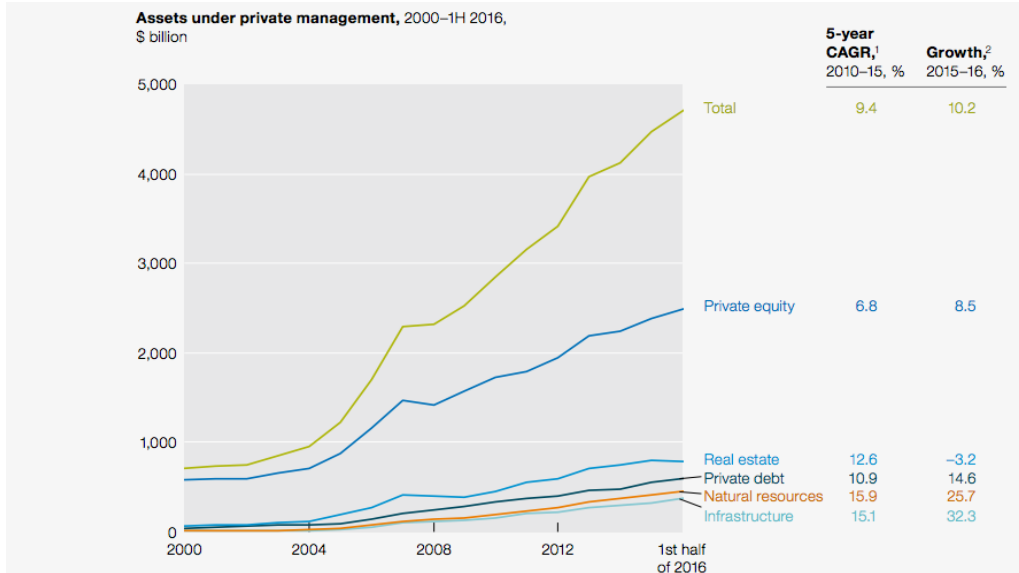
CHART A



⁸ McKinsey Global Private Markets Review, *A routinely exceptional year*, February 2017, available at: [http://www.mckinsey.com/~media/mckinsey/industries/private equity and principal investors/our insights/a routinely exceptional year for private equity/mckinsey-global-private-markets-review-february-2017.ashx](http://www.mckinsey.com/~media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/a%20routinely%20exceptional%20year%20for%20private%20equity/mckinsey-global-private-markets-review-february-2017.ashx)

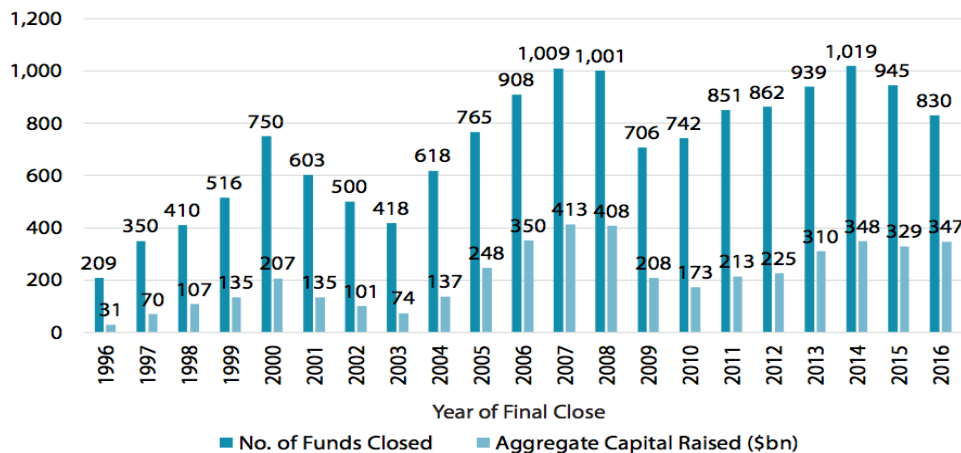
Likewise, the assets invested in private equity also continue to grow dramatically as evidenced in Chart B below (also from the Review), demonstrating the capital that is attracted from investors who have confidence in the asset class.

CHART B



According to the 2017 Preqin Global Private Equity & Venture Capital Report,⁹ represented in Chart C below, fund formation in terms of both LP capital raised, and the number of funds formed, has also continued to rebound since the 2008 financial crisis and after the SEC registration requirement for private funds was introduced. This contrasts with claims that capital formation was harmed due to private equity registration, and supports the argument that registration has improved investor confidence.

CHART C



⁹ 2017 Preqin Global Private Equity & Venture Capital Report, 2017, available at: https://www.preqin.com/docs/samples/2017-Preqin-Global-Private_Equity-and-Venture-Capital-Report-Sample-Pages.pdf

Capital formation—both private and public—is the bedrock of a healthy and growing economy. It is in our collective best interest to maintain effective and appropriate monitoring mechanisms that will encourage investor appetite for private equity investments. We encourage the Treasury to recommend in the Report that the SEC continue to promote transparency and disclosure in the private equity industry, without significant rulemaking changes, as the current oversight aligns with the goals of the Executive Order. In making this recommendation, Treasury should acknowledge that the data has shown that strong regulatory oversight by the SEC has resulted in further increases in capital formation, strong returns to average Americans through their pensions, and a strong private equity industry overall.

Sincerely,



Jennifer Choi
Managing Director
Institutional Limited Partners Association (ILPA)