April 30, 2018

Chairman Jay Clayton
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Strengthening the Private Equity Market Through Balanced Oversight

Dear Chairman Clayton,

The Institutional Limited Partners Association ("ILPA") would like to share our views on a number of rulemaking proposals under consideration by the Securities and Exchange Commission ("SEC" or "Commission"). Specifically, we are responding in regard to a variety of issues under discussion, including the SEC Advertising Rule, Form PF, broker-dealer registration for private equity fund advisers, and the SEC Custody Rule. Our comments to you are in support of continued growth and investor confidence in the private equity asset class, and with the assertion that the strength of the sector is directly correlated to continued and effective SEC oversight of the industry.

ILPA is the voice of institutional investors in the private equity asset class, known as Limited Partners ("LPs"). Our 450+ member institutions represent over $2 trillion in PE assets under management and include U.S. and global public and private pension funds, insurance companies, university endowments, charitable foundations, family offices and sovereign wealth funds, all of which invest in the U.S. private equity market.[1] LPs 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 so that they can enjoy financial security and comfort. Limited partner beneficiaries include teachers, first responders, students receiving university scholarships, charitable recipients, and insurance policyholders, among others. ILPA is based in Washington, D.C. with additional offices in Toronto and Boston.

[1] The ILPA Board includes representatives from: Guardian Life Insurance Company, Teacher 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/

ILPA and our membership are supportive of your agenda to increase capital formation and protect "the long-term interests of Mr. and Ms. 401(k)."[2] Many of the beneficiaries *on whose behalf* our members invest rely on the investment returns from that pension just as Mr. and Ms. 401(k) depend on their portfolios to fund their own retirement. And, by extension, the ultimate beneficiaries of private equity fund returns are counting on SEC regulatory oversight of private equity fund advisers ("Advisers" or "GPs) to ensure that GPs are adhering to the terms of the limited partnership agreement. Any regulatory changes contemplated should be considered in this light: what impact will there be on LP confidence in the asset class, and in turn, the continued health of this sector?

While we are supportive of SEC oversight, we recognize that some SEC rules and regulations under the Investment Advisers Act of 1940 ("IAA") may not be appropriately tailored to our industry nor accretive to the SEC in carrying out its oversight of private equity managers. For example, we are currently engaging with the SEC staff in its effort to update the SEC Advertising Rule, which we agree should be modernized.

While some of these rulemaking modernizations may make sense in terms of improving the marketplace for investing for all participants, others stand to harm capital formation. For example, the proposal to remove the requirement that private equity fund advisers complete Section 4 of Form PF would eliminate a critical information flow without an adequate benefit to the industry. Any cost/benefit analysis of these regulations should always consider that LPs ultimately pay the cost of the Advisers' compliance with SEC rules, and that LPs are often pleased to do so for the protection (benefit) such regulations provide. Such proposals were introduced through legislation in the 114th Congress and ultimately rejected.[3] The lack of support for these proposals is borne out by the fact that this legislation has not yet been re-introduced in the 115th Congress.

On March 27, 2018, ILPA and our members met with Commissioners Jackson and Peirce, as well as the staff in the Division of Investment Management, to share our concerns with some of these rulemaking efforts, as well as to discuss areas where targeted modernization of the IAA could deliver real value to the asset class. Our comments below provide an overview of these issues.

1. Advertising Rule (IAA Rule 206(4)-1)

Last amended in 1961, the SEC Rule 206(4)-1 ("Advertising Rule") is primarily geared to the marketing and advertising of securities to retail clients. Given that GPs were not required to be registered with the SEC until 2012, we agree that modernization should occur within this rule, ideally in a way that streamlines the requirements for GPs, while providing more transparency, disclosure and alignment in the overall relationship. ILPA recently met with both Director Dalia Blass and the Division of Investment Management ("IM") staff to share our perspectives on modernization of this rule.

---

[2] SEC Chairman Jay Clayton, *Remarks at the Economic Club of New York,* July 12, 2017, *available at:* https://www.sec.gov/news/speech/remarks-economic-club-new-york

[3] *See* Investment Advisers Modernization Act (H.R. 5424), 114th Congress, https://www.congress.gov/bill/114th-congress/house-bill/5424

The private equity market continues to face a lack of transparency around the true cost of a private equity investment. The bespoke nature of the limited partnership agreement and the lack of standardization regarding how fees and expenses are presented particularly on the front end of the investment, in advance of an LP's commitment to the fund, has resulted in an opaqueness that does not serve LP's nor their beneficiaries well. What might be understood to be a low initial cost is later magnified by various fees and expenses incurred and charged to the LP during the life of the investment, including fees and expenses charged to the portfolio companies in the fund. While SEC oversight has helped increase disclosure about fees and expenses that *may be charged*, it fails to require that GPs accurately present what the true and complete fee and expense load will look like over the life of the fund.

We believe that revising the Advertising Rule provides an opportunity for the SEC to dramatically improve fee and expense transparency in the private equity asset class. For example, the SEC could require that when projected performance in a private equity fund investment is presented to prospective LPs, the actual fees and expenses to be charged are factored into that prospective performance calculation. Requiring that data would make it clearer to all parties what the true, total cost of the investment would be. This number is often elusive today. Another option would be to have the SEC set forth specific definitions for what should be covered in a management fee or a partnership expense under the Advertising Rule, to ensure that all the fees and expenses are encapsulated in these two areas. These changes should be considered in order to modernize these regulations to reflect the transparency challenges in the private equity marketplace.

As sophisticated investors, LPs benefit less from protections that are primarily tailored to the retail customer under the Advertising Rule, e.g., language about past performance not mirroring future expectations. LPs are able to sift through marketing materials and the data provided by GPs to access the information they seek to make an informed investment decision. The primary goal of our members in modernizing this Rule is to ensure that LPs are able to access and be provided as much accurate information as possible by the GP under the Advertising Rule. We look forward to continuing our work with the IM staff to ensure that a final rule is put into place that promotes transparency, disclosure and increased alignment between GPs and LPs.

2. Form PF (IAA Rule 205(b)-1)

ILPA supports the requirement that GPs complete the information in Form PF applicable to private equity fund advisers. In particular, we believe that the information in Section 4, which large private equity fund advisers are required to complete, 1) remains statutorily required under Section 404 of the Dodd Frank Act[4], 2) provides important useful information to the Financial Stability Oversight Council ("FSOC") and SEC about potential risk in the private equity asset class, and 3) is an important component of the Commission's private fund examination program. We would support a requirement that Form PF be shared with the LPs investing with GPs, as our members are almost never provided the form by the GPs they invest with, despite requesting it.

[4] Section 404 stipulates amendments to Section 204(b), Investment Advisers Act of 1940.

Confidential Nature of Form PF Creates Unnecessary Doubt

As a regulatory reporting document, Form PF is unique given its confidential nature. Only the SEC and FSOC have guaranteed access to this information, with no access available to the general public. And while GPs are permitted to provide this information to their investors, such access is a negotiated right, and investors are seldom granted access to the form. Unfortunately, the consequence of this confidentiality is that the opponents of the form can claim it is not useful. We assert that this data would be useful to LPs, as well as the regulator, for on-going due diligence and oversight. Making Form PF available to investors would provide additional information to investors that they cannot currently receive in the publicly available Form ADV or Form ADV brochure.

Eliminating Completion of Section 4 would violate the IAA

Section 4 of Form PF collects important information about the portfolio companies of large private equity fund advisers (> $2 billion in assets under management). This information includes the leverage at the individual portfolio company level, and whether those companies are involved in the financial industry or not.[5] This information is required to be collected by the SEC under Section 204(b)(3), which includes information about the "use of leverage, including off-balance-sheet leverage"[6] by each private fund advised by the Adviser. In the private equity industry, funds primarily use leverage at the portfolio company level, which is the exact information required to be collected in the statute. Therefore, eliminating the requirement to complete Section 4 would be in direct conflict with the IAA.

Section 4 and Form PF Provides Significant Value for PE Examinations

The SEC staff use Form PF frequently in the examination process of GPs, and also to provide crucial data to the Office of Risk Analysis in the Division of Economic and Risk Analysis ("DERA"). The information in Section 1 provides critical demographic information, such as the makeup of the investors participating in a GP's funds, including whether individual investors participate. DERA further provides information generated from Form PF to help the SEC staff target their examinations effectively.

Section 4 provides necessary intelligence, particularly during a financial shock, about which GPs may be under stress due to the leverage of their portfolio companies. Fund managers under stress may be more inclined to engage in questionable behavior, including erring on the side of self-interest where the LPA is silent or vague, resulting in potential violations of the federal securities laws, or the terms of their LPAs. These actions could involve the shifting of fees and expenses so that the GP might gain financial advantage. The data in Section 4 provides important information for the SEC exam staff to focus the scope and content of exams, particularly in cases where the GP is subject to market stress and may be more prone to actions that could harm their LPs.

Reporting in Form PF is Essential to Ensure Health of Private Equity Marketplace

[5] Form PF, https://www.sec.gov/rules/final/2011/ia-3308-formpf.pdf
[6] Section 204(b)(3)(A), Investment Advisers Act of 1940.

Information about leverage of private equity portfolio companies is important to the SEC's ability to ensure that the private equity marketplace is healthy. Private-equity backed companies are now a significant player in the American economy. According to Bain Consulting, in 2013 private-equity backed companies accounted for 23% of America's midsized companies and 11% of its large companies.[7] From 2008 to 2016, the number of private equity-backed companies in the United States grew from 5,005 to 7,580.[8] This does not include the additional companies that are receiving credit financing from private funds. The increased indebtedness of private equity owned companies makes them more susceptible to default, particularly in a financial crisis if they are unable to refinance the debt. A 2013 paper published by the Bank of England highlighted that:

> [H]igh leverage deals that were undertaken in periods of loose credit conditions potentially present a significant risk to the financial system. This risk comes through the leveraged loan exposure of UK banks, as well as through the effects of leveraged buyouts on corporate indebtedness. It will be important to monitor this risk from previous acquisitions from private equity funds. And from a macroprudential policy perspective, there is also a need to remain alert to any return to the debt levels used on acquisitions in the run-up to the 2007-08 financial crisis.[9]

In sum, section 4 of Form PF gives FSOC and the SEC the ability to review the potential risks to the American economy presented by levered portfolio companies. We encourage the SEC to continue to require this data to be provided to ensure the U.S. regulatory agencies have sufficient information to monitor the marketplace.

3. Broker-Dealer Registration for Private Equity Fund Advisers

ILPA supports the SEC providing more clarity around broker-dealer registration in regard to private equity fund advisers. SEC statements in a 2013 speech, and the 2016 settlement in the *Blackstreet Capital Management, LLC* case, have created a grey area around this issue. While we do not believe GPs should be required to register as broker-dealers, we strongly believe that any no-action relief granted by the SEC should be *contingent* on transaction, deal or success fees charged in connection with the purchase or sale of a portfolio company being 100% offset against the management fee. We do not believe that no-action relief should enable GPs to develop another fee generation opportunity which does not benefit the LPs invested in the fund that provided the capital.

4. Custody Rule (Rule 206(4)-2)

---

[7] "According to Bain & Company, a management consultancy, in 2013, private-equity-backed companies accounted for 23% of America's midsized companies, and 11% of its large companies." *See the Barbarian Establishment,* THE ECONOMIST, October 22, 2016, *available at:* https://www.economist.com/news/briefing/21709007-private-equity-has-prospered-while-almost-every-other-approach-business-has-stumbled

[8] Pitchbook News & Analysis, *These 15 Charts Illustrate the Current Private Equity Landscape,* July 19, 2016, *available at:* https://pitchbook.com/news/articles/these-15-charts-illustrate-the-current-us-private-equity-landscape

[9] David Gregory, *Private Equity and Financial Stability,* Bank of England Quarterly Bulletin, 2013 Q1, Vol. 53 No.1., p. 45, *available at:* http://www.eachccp.eu/wp-content/uploads/2015/12/qb1301.pdf

The Custody Rule is a critical component of verifying that an Adviser is actually holding the assets that they claim to hold, whether those assets are privately-held securities or public securities. ILPA members believe that the 2013 SEC guidance from the Division of Investment Management was positive in that it provided relief from the costly requirement to retain a qualified custodian to hold illiquid securities.[10] The guidance also retained the requirement of an annual audit of the fund's financial statements, or an annual surprise examination. These requirements are critical to ensure the assets of the investors in the fund are protected from fraud and malfeasance. "Friends and family" funds should have equal protection to other funds, given they are subject to the same risks as other investors, perhaps more so given their status as individual investors. We therefore would not support additional changes to the Custody Rule – either through additional guidance or rulemaking.

We appreciate the opportunity share our views on these important issues with you and your fellow Commissioners. We look forward to continuing to be a resource to you as we work together to continually strengthen the private equity industry.

Sincerely,

Steve Nelson
Chief Executive Officer
Institutional Limited Partners Association

cc: Commissioner Kara Stein
Commissioner Michael Piwowar
Commissioner Hester Peirce
Commissioner Robert Jackson
Director Dalia Blass, Division of Investment Management
Director Brett Redfearn, Division of Trading & Markets

---

[10] Privately Offered Securities under the Investment Advisers Act Custody Rule, IM Guidance Update 2013-4 (August 2013).