

Strengthening the Partnership in Private Equity



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Policymakers Must Act to Restore Trust, Promote Cost Transparency, and Ensure Open Lines of Communication in the Private Equity Industry.

The Institutional Limited Partners Association (“ILPA”) has worked at the forefront of efforts to improve governance, transparency and alignment in the private equity industry. ILPA has set forth guidelines for our industry, including both best practices as well as reporting standards, notably the ILPA reporting template, to effectively and efficiently disclose fees and expenses to investors.

While practices in the industry have improved as a result, we believe more can be done to strengthen the partnership between private equity advisers that manage funds (“GPs”) and their investors (“LPs”). As such, ILPA is engaging with policymakers in the U.S. Congress and the U.S. Securities & Exchange Commission to support legislative and regulatory advances that ensure adequate standards of trust and transparency are upheld in our industry.

We call for the following changes to the Investment Advisers Act of 1940 (“Advisers Act”) to raise the bar for business practices in the private equity industry.

1. Restoring Trust in Private Equity: Eliminating the Fiduciary Duty Loophole

- ▶ **Why Fiduciary Duty is Important:** Strong fiduciary duties are the foundation of the relationship between LPs and GPs. These duties of care, loyalty, and good faith foster the necessary trust that gives investors the confidence to invest with fund managers, particularly in the private markets, which is less transparent by its private nature.
- ▶ **The Fiduciary Duty Loophole:** GPs are increasingly reducing their fiduciary obligations to their LPs through a legal loophole under Delaware and Cayman law that permits the GP to act in their “sole discretion”, i.e. putting their own financial interest ahead of that of the fund or its investors.
- ▶ **Trust is Critical to Our Industry:** The use of this loophole goes against the spirit of the Advisers Act, which requires investment managers to act in the best interest of the fund. It also runs counter to a fundamental principle of investing, that you should be able to trust the individual or organization that is managing your assets. This trust is even more important due to the illiquid and long investment commitment horizon (10-15 years) of private equity.

Policy Action Required: ILPA and its members believe that GPs should not be able to contract to a lower fiduciary standard than that required under the Advisers Act. We encourage Congress to address this harmful loophole in the Advisers Act that erodes trust in our industry.

2. Cost Transparency in Private Equity: Bringing Fees & Expenses into the Light

- ▶ **Voluntary Standards Provide a Path but are Not the Complete Solution:** Since 2014, the SEC brought to light several cases where fees and expenses had been improperly charged or insufficiently disclosed. While many GPs have since embraced reporting standardization, such as the ILPA fee template, to demonstrate to their LPs that they were allocating costs appropriately, many more have yet to offer their LPs the same level of transparency and consistency. Full transparency around costs is essential for GPs to show they are accurately and fairly accounting for their fees.

- ▶ **A Uniform, Federal Fee Reporting Requirement is Needed:** A number of states, most prominently California, are considering or have passed legislation requiring public pensions to report private equity fees and expenses paid. While greater transparency is welcome, state-level mandated disclosure rules can create a patchwork of compliance requirements and disadvantage certain LPs who invest in different states. A federal requirement that GPs report any and all fees charged, would prevent arbitrage between states, which drives up costs and reduces returns for beneficiaries.

Policy Action Required: The SEC and/or Congress should act to ensure that all SEC-registered PE Advisers (GPs) report all fees and expenses. A disclosure baseline is critical to LPs' knowledge of the true cost of investing in the asset class and to ensuring that all LPs, regardless of their own reporting requirements, are negotiating from a level playing field with respect to transparency.

3. Ensuring Information Access: Opening Lines of Communication Between Partners

- ▶ **LP-to-LP Communication is Essential for Good Governance:** One of the benefits of a partnership is the ability to communicate and share information with one another. Many private equity investment contracts include confidentiality provisions limiting the ability of LPs in the same partnership to communicate with each other about the fund or the GP. LPs are often unaware of the identity of other LPs in the fund, a potential impediment to exercising contractual rights related to governance matters that require investor consent or a vote within the partnership.

Policy Action Required: The SEC and/or Congress should take action to limit the restrictions on communications among LPs in the fund and require investor names be shared with other LPs. These changes will foster healthy governance within the private equity investment relationship.

- ▶ **Partners Should Be Able to Discuss SEC Compliance Issues:** Since GPs first became registered with the SEC in 2012, a significant portion of the industry has been examined. While the majority of GPs follow the terms of their investment contracts with LPs, some do not, as brought to light through SEC examinations and enforcement actions.
- ▶ **LPs Should Be Made Aware of Compliance Issues Uncovered with Taxpayer Dollars:** When a GP has been examined by the Commission, LPs are generally not privy to any of the compliance or other issues that the SEC may have uncovered—not because this information is protected but because many GPs refuse to share it with their own investors. ILPA believes that GPs should be required to share these communications with their partners upon request, including SEC deficiency letters, to ensure LPs are aware of any potential regulator concerns and any remedial steps taken. LPs are sophisticated investors and can have a healthy dialogue with their GPs about these compliance issues and how to address them. Requiring this information to be provided will drive better alignment and trust in the industry between GPs and LPs.

Policy Action Required: The SEC should take action to require that LPs invested in an examined fund be provided by the GP the deficiency letters issued in the course of said examination. Increasingly, LPs pay for SEC registration and compliance costs as a partnership expense. Thus, it is reasonable that LPs should have access to the results to ensure the GP is abiding by the letter of the law. Such transparency is even more important in an illiquid asset class where the partners cannot easily exit the investment when bad behavior that falls short of breach of contract is uncovered.

About ILPA: *With more than 500 member institutions representing over \$2 trillion USD of private equity assets under management, the Institutional Limited Partners Association (ILPA) is the only global organization dedicated exclusively to advancing the interests of LPs and their beneficiaries. Our members include public and private pensions, insurers, endowments and foundations, family offices, developmental finance institutions, and sovereign wealth funds. Our policy agenda is focused on strengthening the private equity asset class through strong governance, alignment of interests, and transparency. For more information, please visit ILPA.org.*