

September 10, 2019

The Honorable Carolyn Maloney
Chairman
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Bill Huizenga
Ranking Member
Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
U.S. House of Representatives
Washington, D.C. 20515

Re: September 11, 2019 Hearing Entitled “Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment”¹

Dear Madam Chair and Ranking Member Huizenga:

I am writing on behalf of the Institutional Limited Partners Association (ILPA) to express our appreciation for holding the above referenced hearing and to provide you with our views on increased retail investor access to private fund investments, as well as the legislation we understand will be discussed at the hearing. We would respectfully request that this letter be made a part of the hearing record.

ILPA is the voice of institutional investors invested in the private equity (“PE”) asset class, known as Limited Partners (“LPs”). Our 520+ 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. PE market.² 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 in a class of

¹ Hearings, United States House of Representatives, Subcommittee on Investor Protection, Entrepreneurship and Capital Markets (September 11, 2019), <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404232>

²For a public list of ILPA members, please see: <https://ilpa.org/member-list/>

investments consistently providing high investment returns so that they may enjoy financial security and comfort.

ILPA's View on Retail Access to Private Fund Investments

ILPA's members are strong believers in the benefit to investors of all types of investing in the private markets. Our members have continued to increase their allocations to private equity because they are seeking returns that cannot be attained in the public markets.³ Private equity has outperformed the private market over the long-term. According to Cambridge Associates, a respected investment consultant, private equity investments on average returned 13.69% over 15 years, net of fees, and 12.44% over 20 years net of fees. In comparison, the S&P 500 returned 8.57% over 15 years and 6.04% over 20 years. These time horizons are the right comparison given the long-term nature of these investments and the strong bull market over the past 10 years.⁴ Given the strong returns in the private equity market, as well as shrinking opportunities for high growth investments in the public market, we believe retail investors should have additional opportunities to access this market.

However, we again encourage members of this Subcommittee to consider efforts to improve transparency and governance for *all investors* in the private equity market. Raising the bar for transparency, governance and disclosure is extremely valuable for institutional investors in the asset class, but also critical for retail investors. ILPA believes that certain targeted reforms can achieve bipartisan support and greatly improve the asset class for investors.

These reforms include those set forth in **ILPA's May 2019 Position Paper on Improvements to Fund Governance**⁵, which encouraged policymakers in Congress to take action to: (1) eliminate the fiduciary duty loophole which permits private equity advisers to dilute their fiduciary duties under the Advisers Act; (2) require quarterly fee and expense reporting to all investors in private equity funds; (3) safeguard the ability for LPs to learn who their fellow LPs are, and safeguard their ability to communicate with one another; and, (4) permit access for investors to SEC deficiency letters issued by the Commission to private fund advisers. Each of these reforms would make a significant difference to all current or potential investors in the private equity marketplace, while also improving the asset class for the long term.

In addition to making the reforms suggested above, we suggest if Congress or the Securities & Exchange Commission (SEC) wish to permit additional access for retail

³ See Kate Rooney, "Investors, 'starved for returns,' flood private markets in search of high-growth opportunities", CNBC, August 12, 2019, available at: https://www.cnbc.com/2019/08/12/investors-starved-for-returns-flood-private-markets.html?_source=sharebar|twitter&par=sharebar

⁴ Cambridge Associates, Q1 2019 Final Report on Global Private Equity, available at: <https://www.cambridgeassociates.com/private-investment-benchmarks/>

⁵ ILPA, *Strengthening the Partnership in Private Equity*, May 2019, available at: <https://ilpa.org/wp-content/uploads/2019/05/ILPA-Position-Paper-on-Improvements-to-Fund-Governance.pdf>

investors to private market investments, they do so in the following ways. First, the best option to provide additional access to private equity or private market investment would be through existing or new vehicles registered under the Investment Company Act of 1940. Existing vehicles that fit within the registered fund framework, such as Business Development Companies (BDCs), add additional protections necessary for retail investment in private markets, while still providing access to returns from private companies. By being registered funds under the Investment Company Act, they also have the added protection of fiduciary obligations, independent boards, and conflicts of interest protections, protections that either don't exist or must be negotiated in private 3(c)(1) or 3(c)(7) funds. Second, if direct access to private funds is permitted for retail investors, it should only be upon successful completion of a rigorous examination that tests the sophistication of the investor. This test for sophistication should place a heavy emphasis on evaluating the risk of illiquid investments, sourcing and evaluation of fund managers, and the importance and meaning of negotiated legal terms in the investment contract. These elements are critical components in ILPA's recently released Principles 3.0⁶ and have been well learned by our members while investing successfully in private funds.

ILPA Supports the Family Office Technical Correction Act

ILPA's membership includes over fifty family offices that are investing in the private equity asset class. Congress, in section 409 of Dodd Frank, correctly recognized that single family offices advising family clients, did not require the investor protections of the Investment Advisers Act of 1940 and did not need to register with the SEC. The SEC implemented Section 409 through the "Family Office Rule"⁷ which exempted single family offices from the Investment Advisers Act.

Unfortunately, the family office rule does not apply beyond the Investment Advisers Act of 1940. ILPA and our members believe that the same public policy principles that supported the family office rule under the Advisers Act should also be extended to the Securities Act of 1933 and the Investment Company Act of 1940, as is intended under the Family Office Technical Correction Act, previously introduced by Representative Carolyn Maloney in the 115th Congress.

The Family Office Technical Correction Act would extend the same policy in Section 409 of Dodd Frank and the Family Office Rule to the Securities Act of 1933 and provide more flexibility for family clients of single-family offices to invest in private markets. This access to private investments would be conditioned on these family clients relying on the advice and sophistication of family offices. Many family clients do not technically meet the income or net worth thresholds under the accredited investor definition because their assets are structured within a trust vehicle rather than under the

⁶ The ILPA Principles are a best practices framework for investing in the private equity asset class. The most recent version, Principles 3.0, was released in June 2019. It is available here: https://ilpa.org/wp-content/uploads/2019/06/ILPA-Principles-3.0_2019.pdf

⁷ SEC Rule 202(a)(11)(G)-1, see also <https://www.sec.gov/rules/final/2011/ia-3220.pdf>

ownership of the individual family member. Therefore, they may not establish the individual net worth of the family client for the purposes of the accredited investor definition.

ILPA strongly supports introduction and passage of the Family Office Technical Correction Act given the alignment with existing public policy and the flexibility it provides for family offices in their private market investment activities.

ILPA Supports the Fair Investment Opportunities for Professional Experts Act.

Given our support for other ways to establish sophistication under the accredited investor definition, ILPA is supportive of the Fair Investment Opportunities for Professional Experts Act.

This bill would permit individuals who hold a securities license or are registered investment advisers to invest in private offerings and be considered “accredited investors” under the Securities Act of 1933. These individuals already have to take an examination to provide investment advice to others and establish their knowledge of private market investments. The bill would also permit the SEC to create regulations to allow certain sophisticated professionals, based on education or job experience, to access these investment opportunities. Given the targeted nature of the changes and the focus on ensuring there is sufficient knowledge and expertise in private markets among these professionals, ILPA supports allowing these investors to access investments in the private market without meeting the requisite income or net worth requirements.

ILPA Supports a Congressional Report Requirement Prior to Adopting Rule Changes for Private Securities Offerings but believes its scope should be expanded to include the Qualified Purchaser and Qualified Client Definitions.

As we’ve highlighted above, ILPA believes that while there are opportunities for strong returns in the private market, a level of sophistication is required to successfully achieve those returns. A report to Congress which evaluates the far-reaching impacts on expanding access should be conducted as has been suggested in the draft legislation for this hearing. However, we would ask that this report go further to include the impacts on investors in private funds, including the considered changes in the SEC’s recent concept release⁸ that impact the Qualified Purchaser definition under the Investment Company Act of 1940. The qualified purchaser definition is the threshold that is most relevant to access private funds, including private equity funds, as merely meeting the accredited investor threshold does not demonstrate sufficient net worth or income to meet the higher qualified purchaser threshold. Given that these other exemptions are under consideration in the SEC concept release, we believe the report

⁸ Concept Release on Harmonization of Securities Offering Exemptions, SEC Rel. IA-5256, File No. S7-08-19 (Jun. 18, 2019).

to Congress should also conduct research on the impacts to changes to these exemptions as well.

If ILPA can answer any questions or provide additional information that would be helpful to the Subcommittee, please do not hesitate to contact me at chayes@ilpa.org.

Sincerely,

A handwritten signature in black ink, appearing to read "Chris Hayes", with a long horizontal flourish extending to the right.

Christopher Hayes
Senior Policy Counsel
Institutional Limited Partners Association (ILPA)