February 10, 2020

Vanessa Countryman
Secretary
U.S. Securities & Exchange Commission
100 F Street NE
Washington, D.C. 20549-0609

Re: Comments on the Investment Adviser Advertisements; Compensation for Solicitations, SEC Release No. IA-5407, File No. S7-21-19 (November 4, 2019)

Dear Ms. Countryman:

This letter is submitted on behalf of the Institutional Limited Partners Association ("ILPA")[1] in response to the request of the U.S. Securities and Exchange Commission (the "Commission") for comments to the Investment Advisers Act Release No. 5407 (November 4, 2019) (the "Proposal" or "Release"),[2] in which the Commission proposes to amend the rules under the Investment Advisers Act of 1940 (the "Advisers Act") addressing investment adviser advertisements[3] and payments to investment adviser solicitors,[4] respectively. The Commission has stated that these proposed amendments are intended to reflect changes in technology, the expectations of investors seeking advisory services and the evolution of industry practices.[5] With respect to the advertising rule, the proposed amendments are intended to replace the current rule's broad prescriptive prohibitions with more flexible principles-based rules. ILPA appreciates the Commission's efforts to modernize these rules, neither of which has been materially amended or supplemented since their adoption, except through guidance and interpretations provided by the Commission staff (the "Staff"), and encourages the Commission to adopt them, while incorporating our suggested revisions and requests for additional guidance.

For purposes of this letter, we will confine our comments to the proposed advertising rule and its application to private funds, and in particular private equity funds and their advisers (a

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[1]ILPA is the voice of the institutional investors invested in private equity, colloquially known as "Limited Partners" or "LPs." Our 550+ member institutions represent over $2 trillion in private equity assets under management globally and include 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. alternative investment market. 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 millions of Americans. Limited partner beneficiaries include teachers, first responders, students receiving university scholarships, charity recipients, and insurance policyholders, among others. ILPA is headquartered in Washington, D.C. with additional offices in Toronto, Ontario. For more information on ILPA's members, please visit: http://www.ilpa.org/members.

[2] Investment Adviser Advertisements; Compensation for Solicitations, SEC Release No. IA-5407 (November 4, 2019), *available at* https://www.sec.gov/rules/proposed/2019/ia-5407.pdf.

[3] Rule 206(4)-1.

[4] Rule 206(4)-3.

[5] *See* Proposal, Summary.

"private equity fund adviser").[6] ILPA commends the Commission's proposed expansion of the advertising rule to expressly cover promotional communications disseminated by advisers seeking to "obtain or retain" investors in pooled investment vehicles.[7] We, however, have significant concerns about the application (or, in some cases, exclusion) of the proposed rules to certain types of communications and information, as well as the absence of specific requirements or guidance, with respect to private equity funds. Some of the changes proposed by the Commission may have a chilling effect on existing investment and operational due diligence efforts of existing and prospective investors, while others may be used as a "shield" by private fund advisers seeking to limit, or misleadingly standardize, the information disseminated, even in response to specific or tailored requests.

Additionally, several assumptions underlying the application of the proposed rules to private funds (e.g., the bifurcation of investors into "Retail" and "Non-Retail Persons") understate the difficulty of obtaining complete and accurate information regarding fees, expenses, performance data, material conflicts of interest or other information necessary to analyze investments private equity funds, and overstate the effectiveness of the resources and relationships of institutional investors with private fund advisers. The availability of resources varies widely among Non-Retail Persons, and in the current environment, even the largest and most sophisticated investors, including ILPA members, find negotiating for information exceedingly difficult.[8] The proposed rules must therefore recognize that, while a Non-Retail Person may be in a better position than the average investor to appreciate the risks associated with investments in private funds, complete and accurate information must still be provided by private fund advisers to allow such investors to properly evaluate such risk.[9] If resources and relationships were sufficient, then there be no need for the guidance provided by the Staff over the years with respect to communications concerning private funds,[10] and there would be no enforcement actions against some of the largest and most reputable private fund advisers with respect to inadequate disclosure and transparency.[11]

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[6] The term "private equity fund" can be used to describe several types of private funds, each of which may focus on a different asset class (e.g., equity in private companies, credit, real asset, infrastructure) and engage in one or more of a variety of investment strategies (e.g., venture, leveraged buyout, direct lending, etc.). Common factors include private securities offerings of fund interests, active management, primarily non-publicly traded securities or asset investments, a finite term (e.g., ten to fifteen years), general illiquidity, limited partnership or similar structure, extensive use of debt, and capital contributions made over the life of the fund. Often, "private equity fund" is colloquially used to refer only to leveraged buyout funds, however, in this letter we use the term to refer to the broader set described above.

[7] *See* Proposal, Section II.A.2.b.

[8] *See* Sonali Basak and David Carey, "Private Equity's Biggest Backers are Tired of the Fees," Bloomberg, Oct. 26, 2017, *available at* https://www.bloomberg.com/news/features/2017-10-26/private-equity-s-biggest-backers-are-tired-of-the-fees; *see also* Emma Cusworth, "Private Equity: A Two-Speed Market," Investments & Pensions Europe, January 2017, *available at* https://www.ipe.com/reports/special-reports/fees-and-costs/private-equity-a-two-speed-market/10016975.article.

[9] *See* Davide Scigliuzzo, Kelsey Butler, and Sally Bakewell, *How Private Equity Works, and Took Over Everything*, Bloomberg Businessweek, October 3, 2019, *available at* https://www.bloomberg.com/news/features/2019-10-03/how-private-equity-works-and-took-over-everything.

[10] See Proposal, Section II.A.2.b.iv., note 69, at 36.

[11] *See, e.g., In re* BlackRock Advisors, LLC, et al., Release No. IA-4065 (Apr. 20, 2015); *In re* First Reserve Management, L.P., Release No. IA-4529 (Sept. 14, 2016); *In re* Kohlberg Kravis Roberts & Co. L.P., Release No. IA-4131 (June 29, 2015); *see also* SEC, NATIONAL EXAMINATION PROGRAM, EXAMINATION PRIORITIES FOR 2015 (Jan. 13, 2015); SEC, Division of Enforcement 2019 Annual Report (Nov. 6, 2019), *available at* https://www.sec.gov/enforcement-annual-report-2019.pdf.

ILPA believes that requirements addressing the presentation of gross or net performance, fee transparency and disclosure of other factors affecting advertised performance results, as well as the disclosure of material conflicts of interest, should be based equally upon the complexity of an investment product (i.e., private equity funds) as well as the sophistication of the targeted investor. This approach is in keeping with the principles set forth in the Commission's final interpretation regarding the standard of conduct for advisers, in which the Commission stated that disclosures of conflicts of interest must be clear and detailed enough for the client to make an informed decision, regardless of the nature of the client.[12] ILPA sees no reason to treat advertising communications differently. We are therefore recommending the Commission amend the text of the Proposal, substantially revising the requirements and guidance provided therein to address specific applications of the proposed rule to communications by advisers promoting private equity funds.

ILPA and its members look forward to engaging with the Staff as the Commission reviews the comments submitted in response to the Proposal and develops the final version of the advertising rule.

I. Definition of Advertisement.

ILPA supports expanding the scope of the definition of "advertisements" to expressly include communications disseminated to "obtain or retain one or more advisory clients or investors in any pooled investment vehicle advised by the adviser."[13] We agree with the Commission that applying the advertising rule to such communications is an appropriate extension of the rule's protections to such investors,[14] especially given the growth of private equity as an asset class over the last two decades.[15] We are unconcerned with any overlap between the proposed rule and the general anti-fraud prohibition in Rule 206(4)-8, and view the proposed rule as a clarification of the application of Rule 206(4)-8 with respect to private fund advertisements.[16] Accordingly, we see no need to specifically address the requirements found in the proposed rule through an amendment to Rule 206(4)-8. However, the Commission should make clear that the prohibitions in both the proposed rule and Rule 206(4)-8 apply to all such communications disseminated by private fund advisers.

II. Application to Other Private Fund Advisers, Including Exempt Reporting Advisers

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[12] *See* Commission Interpretation Regarding Standard of Conduct for Investment Advisers, SEC Release No IA-5248 (June 5, 2019), *available at* https://www.sec.gov/rules/interp/2019/ia-5248.pdf, Section II.C., at 25.

[13] Proposal, Section II.A.2.b.iv.

[14] *See id.,* at 36.

[15] See Private Markets Come of Age, McKinsey Global Private Markets Review 2019, McKinsey & Company, available at *https://www.mckinsey.com/~/media/McKinsey/Industries/Private%20Equity%20and%20Principal%20Investors/Our%20Insights/Private%20markets%20come%20of%20age/Private-markets-come-of-age-McKinsey-Global-Private-Markets-Review-2019-vF.ashx*; *see also* Global Private Equity Report 2019, Bain & Company (Feb. 15, 2019), available at https://www.bain.com/contentassets/2792a2cbcdcf4e94acfddc077a85c5ea/bain_report_private_equity_report_2019.pdf.

[16] *See* Proposal, Section II.A.2., note 69, at 37. ILPA echoes the sentiment in the Comment Letter of the Investment Company Institute on the Concept Release on Harmonization of Securities Offerings, SEC Release Nos. 33-10649; IA-5256; IC-33512 (Sept. 24, 2019), cited here by the Commission.

In the Proposal, the Commission requested comment on whether the advertising rule should apply to communications with respect to private funds other than those that fall within the definition of a "pooled investment vehicle" in Rule 206(4)-8 (i.e., 3(c)(1) Funds or 3(c)(7) Funds).[17] ILPA has no doubt that the proposed rule should apply to communications disseminated with respect pooled investment vehicles exempt from registration under the Investment Company Act by Sections other than 3(c)(1) or 3(c)(7). Specifically, communications promoting private funds excluded from the definition of "investment company" by reason of Sections 3(c)(5) and 3(c)(11) of the Investment Company Act should also be subject to the proposed rule.

Of equal concern, however, is the absence of any application of the proposed rule, including the general prohibitions, to private fund advisers exempt from registration pursuant to Sections 203(b)(3) (i.e., foreign private advisers), 203(l) (adviser to venture funds) and 203(m)(1) (advisers to small private funds, i.e., less than $150 million in assets under management) under the Advisers Act.[18] These advisers were exempted from registration with the Commission by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank")[19] and the rules adopted by the Commission pursuant thereto, primarily for the policy reasons stated in the adopted Rule.[20]

While these Exempt Reporting Advisers ("ERAs") and foreign private advisers remain subject to the general anti-fraud prohibitions of Section 206 of the Advisers Act and Rule 206(4)-8, many of the rules adopted by the Commission apply only to advisers registered or required to be registered with the Commission - including the advertising rule. Yet, ERAs and foreign private advisers regularly seek capital from investors in the United States, including Retail and Non-Retail Persons, disseminating substantially the same type of communications used by registered private fund advisers. According to data made available by the Commission,[21] as of January 2020, there are over four thousand private fund advisers registered with the Commission as ERAs pursuant to Sections 203(l) and 203(m) alone. It is ILPA's view that the proposed rule <u>should apply</u> to communications disseminated to obtain or retain clients or investors in private funds managed by these advisers in the same manner it applies to communications by registered private fund advisers. The requirements of the proposed rule, being primarily principle-based, will not create an undue compliance burden for such private fund advisers. In keeping with the public policy purposes for exempting ERAs and private foreign advisers from registration, the Commission could relieve such advisers of certain compliance and filing requirements in the Proposal where it determines such requirements to be too burdensome (e.g., Form ADV disclosures).

III. Exclusions from the Definition of Advertisement.

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[17] *See id.*, note 63, at 35.

[18] An "exempt reporting adviser" is an investment adviser that relies on the exemption from investment adviser registration under the Advisers Act provided in either Section 203(l) (an adviser solely to one or more venture capital funds), Section 203(m)(1) (an adviser solely to private funds and has assets under management in the United States of less than $150 million) of the Act. *See also*, Rules 203(l)-1 and 203(m)-1.

[19] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[20] *See* Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, SEC Release No. IA-3222 (June 22, 2011), Section I.

[21] *See* Investment Adviser Information Reports, Exempt Reporting Advisers, January 2020, *available at* https://www.sec.gov/help/foiadocsinvafoiahtm.html.

The proposed rule would exclude from the definition of "advertisement" any (i) live oral communications that are not broadcast on radio, television, the internet or any other similar medium; (ii) responses to certain unsolicited requests for information, specified in such request, about the adviser or its services; (iii) certain communications related to registered investment companies and business development companies that are within the scope of Rule 482 or Rule 156 under the Securities Act of 1933 ("Securities Act"), and (iv) information required in a statutory or regulatory notices, filings or other communications.[22] While we appreciate the Commission's efforts to provide bright line criteria for the exclusions included in the Proposal, we believe that, in certain circumstances the character of a communication (i.e., promotional versus factual) should render an otherwise excluded communication subject to the proposed rule.

A. Non-Broadcast Live Communications.

The exclusion of non-broadcast live oral communications is consistent with the approach under the current rule, which excludes oral communications that are not "on radio or television." We understand that the proposed exclusion is intended to merely update the means by which such communications can be broadcast, i.e., the internet, podcasts, etc., while remaining flexible enough to accommodate new broadcast media. The exclusion is limited to "live" broadcasts, ensuring that previously recorded oral communications are included in the proposed definition of "advertisement" and subject to the proposed rule's requirements.

According to the Proposal, this exclusion is designed to address situations where advisers are communicating directly with investors and where a compliance review and other requirements in the proposed rule cannot be practically applied. We note that, although live oral communications are excluded from the definition of advertisement, the written materials prepared in advance for use during a live oral communication (e.g., scripts , storyboards, PowerPoint slides or other written material) would be subject to the proposed rule if they otherwise within the definition. In the context of private funds, however, this exclusion should not apply to certain live oral communications made by private fund advisers for promotional purposes.

Most private equity funds seeking capital rely heavily on the exemption for private securities offerings in Section 4(a)(2) of the Securities Act and the safe harbor provided under Rule 506(b) of Regulation D,[23] adopted thereunder. An issuer making private offering in reliance on Rule 506(b) is prohibited under Regulation D from engaging in any form of general solicitation or advertising.[24] "General solicitation" and "general advertising" has been interpreted by the Commission and the courts to include mass communications, broadcasts or any seminar, conference or meeting whose attendees have been invited through a general solicitation or advertising. The prohibition on general solicitation applies to all communications regarding issuer and its securities offering. An exception is made only for communications to persons with whom the issuer or its agents have a substantive, pre-existing relationship, which must be

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[22] *See* Proposal, Section II.A.2.c.

[23] 17 C.F. R. §§ 230.501 *et seq.*

[24] *See* 17 C.F.R. § 230.502(c).

established prior to the offering.[25] Establishing a substantive, pre-existing relationship, is not terribly difficult and can be accomplished by either the issuer or its agents.

Due to the limitations on general solicitation for private offerings, most private fund advisers avoid "broadcast" and "live non-broadcast" communications that could result in a violation of the restrictions under Rule 506(b). However, a common method of marketing by private fund advisers that has been interpreted by the Staff not to constitute general solicitations or advertising under Regulation D, but which would meeting the definition of a "non-broadcast live communication," is the "invitation only" seminar, demo day or venture fair.[26] Presentations delivered at these events are pre-planned and intended to promote the private fund and obtain or retain clients and investors therein. Under the proposed rule, such communications would fall within the scope of the "non-broadcast live" exclusion, however ILPA believes that they should be considered "advertisements" regardless of whether they are non-broadcast, live or use written materials to accompany the presentations. The proposed rule should be amended to consider the promotional character of such communications, *prohibiting* reliance on the non-broadcast live exclusion where the intent of the adviser is to obtain or retain investors in private funds. We also believe that taking into account the promotional character and intent of the communications at such promotional event would not conflict with the Commission's concerns regarding oral communications made by advisers at other non-broadcast live appearances, such as unscripted talks at luncheons or conferences.[27] Where such unscripted talks take place and the event is not organized for the primary purpose of promoting advisory services or investment in the private funds managed by the adviser, the exclusion would apply.

B. Responses to Unsolicited Requests.

In keeping with prior Staff guidance,[28] the Proposal excludes from the definition of "advertisements" any communications that do "no more than" respond to an unsolicited request for specific information from clients or prospective clients. The Proposal states that the investor must seek the specified information for that requester's own purpose, rather than in response to any communication disseminated by an adviser for the purpose of offering or promoting its services or soliciting the request. If the adviser includes additional information beyond what was specifically requested, the communication will not qualify for the exclusion, unless such information was necessary to make the requested specified information not misleading. If a communication that initially qualifies for this exclusion is subsequently disseminated by the adviser to one or more additional persons who do not make their own unsolicited requests, that same communication would not meet the exclusion's requirements with respect to those other persons. [29]

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[25] *See id. See also,* Interpretive Release on Regulation D, SEC Release No. 33-6455 (Mar. 3, 1983), E.F. Hutton & Company, SEC No-Action Letter (Dec. 3, 1985).

[26] *See* SEC Division of Corporation Finance Compliance and Disclosure Interpretations, Securities Act Rules (last update: November 6, 2017), at Question 256.33 (an issuer's presentation may not constitute general solicitation if attendance at the demo day or venture fair is limited to persons with whom the issuer or the organizer has pre-existing, substantive relationships or who have been contacted through a personal network of individuals with experience investing in private offerings).

[27] *See* Proposal, Section II.A.2.c, at 43.

[28] *See* Investment Counsel Association of America, Inc., SEC No-Action Letter (Mar. 1, 2004).

[29] *See* Proposal, Section II.A.2.c., at 47-48.

The proposed exclusion is intended to recognize the goal of the communication and is designed to permit private fund advisers to respond to due diligence questionnaires ("DDQs") and any such additional due diligence, audit or similar requests for information.[30] The Proposal indicates, however, that such communications must be disseminated in response to no more than one client or investor, and only where the client or investor makes such a request without prompt from the adviser. These restrictions could create practical problems for private fund advisers who use form DDQ responses to provide factual data to all investors in anticipation of common due diligence requests. For example, a private fund adviser may provide access to a data room to potential LPs for review of certain non-promotional information in connection with a contemplated capital raise. Unless the Commission clarifies that such non-promotional information would not meet the definition of an advertisement, all such communications, regardless of their character, would be included in the definition. ILPA and our members fear that subjecting these communications to the requirements and restrictions of the proposed rule may have a chilling effect on the efforts of private fund advisers to provide useful information in an efficient manner. Additionally, if an LP or its consultant requests follow-up information, it is unclear whether an adviser can respond to such requests relying on this exclusion. Does inviting potential investors to a data room and sharing certain information constitute an affirmative effort to solicit requests for follow-up information based on the materials provided? On the other hand, promotional information and communications, such as private placement memoranda, case studies or a presentation of an adviser's strategy or investment philosophy, should qualify as an advertisement regardless of whether they were disseminated in response to an unsolicited request due to its promotional purpose.

The proposed exclusion assumes that the basis for the request determines whether the response is promotional (and therefore advertising) as opposed to factual. ILPA is concerned that this basis is problematic in the context of private equity funds and that its applications could have a chilling effect on the efforts by private fund advisers to provide investors essential information in an efficient and comprehensive manner. We believe that the Commission should clarify the exclusion, particularly the meaning of "solicit" in this context and, at least in some cases, revise the exclusion to be based on the content and purpose of the communication, rather than the character of the request or response.[31]

IV. General Prohibitions and Past Recommendations.

ILPA applauds the Commission's Proposal to apply the general prohibitions provided in the proposed rule as a means reasonably designed to prevent dissemination of fraudulent, deceptive, or manipulative communications.[32] Private equity funds pose unique difficulties – for both private fund advisers and investors alike – when it comes to disseminating accurate and comprehensive information about the fund and its underlying investments. This is largely because private equity funds use active management strategies with respect to (primarily) non-publicly traded securities or assets, and information about such underlying investments and their management is generally unavailable from independent sources – even for Non-Retail Persons. This lack of transparency makes private equity investments substantially more difficult to due

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[30] *See* Proposal, Section II.A.2.c., note 95, at 46.

[31] ILPA also believes that this approach would be in keeping with the guidance provided in the Proposal with respect to whether communications are disseminated to "offer or promote" advisory services. *See* Proposal, Section II.A.2.b.iii.

[32] *See* Proposal, Section II.A.3.

diligence, analyze and monitor than direct or indirect investments in the public securities markets. The general prohibition provisions, therefore, are even more important in the context of communications disseminated by private fund advisers, who are often the only source of information available to an investor.

We believe that the Commission should further clarify the application of these general prohibitions – either in the rule or through guidance in the Proposal – for private fund advisers disseminating advertisements. Specifically, further guidance should be provided with respect to the application of following general prohibitions to advertisements by private equity funds:

- Making any material claim or statement that is unsubstantiated;
- Making untrue or misleading implications about, or that would be reasonably likely to cause an untrue or misleading inference to be drawn concerning, a material fact relating to the adviser (e.g., a series of separate true and accurate statements that, taken together, have an overall misleading effect);
- Discussing or implying any potential benefits connected with the adviser's services or methods of operation without clear and prominent discussion of associated material risks or other limitations associated with the potential benefits; and
- Referring to specific investment advice and including or excluding performance results, or presenting time periods for performance, in a manner that is not "fair and balanced," taking into account the facts and circumstances of the advertisement, including the nature and sophistication of the audience (i.e., anti-cherry picking provisions).[33]

Over the years, ILPA has asserted that certain guiding principles form what we believe to be essence of an effective private equity partnership (alignment of interest, governance, and transparency) and has published ILPA Principles, currently in its third generation, intending to establish this relationship between private fund advisers and their prospective and current investors. We encourage the Commission to review our ILPA Principles 3.0 as it revises the proposed rule and develops further guidance as to how the general prohibitions should apply to advertisements disseminated by private equity fund advisers.[34]

A. Misleading Implications.

Most private fund advisers interpret the current definition of "advertisement" broadly to include, without limitation, private placement memoranda, flip books, marketing presentations, letters to investors, certain responses to due diligence questionnaires, web content, press releases and written materials for public and private appearances. These communications often include information about the operations of the private adviser and its affiliates, the private equity fund, parallel funds or co-investments, current and targeted portfolio investments, targeted returns, as well as market conditions and other factors affecting the investment strategy and/or specific portfolio investments. Written materials used for capital raises are loosely patterned

[33] *See* Proposal, Section II.A.3.c. through e.

[34] *See* ILPA Principles 3.0: Fostering Transparency, Governance and Alignment of Interests for General and Limited Partners (2019), *available at* https://ilpa.org/wp-content/uploads/2019/06/ILPA-Principles-3.0_2019.pdf.

after public securities prospectuses and include numerous disclosures of risk factors and conflicts of interest, as well as legends with standard language warning investors of the high risks of investment.

The Commission should state specifically in the proposed rule that each of these communications must avoid making unsubstantiated material claims and statements or untrue or misleading implications about, or that would be reasonably likely to cause an untrue or misleading inference to be drawn concerning, a material fact relating to the adviser and its affiliates, the private equity fund and the portfolio investments and provide examples of those statements that would violate these principles. For example, such statements would include (a) unsubstantiated claims that fees charged by affiliated service providers are "at market or lower" or "arms-length," when no effort has been made to determine third-party pricing on an ongoing basis;[35] (b) any discussions or implications regarding the benefits of the adviser's or private equity fund's operations, including the use of affiliated or in-house professional service providers, without including a clear and prominent discussion of associated material risks or other limitations of such operations; and (c) allocation of operational expenses, time commitments and other resources among the various private funds, separately managed accounts and personal investments without discussion of the material risks to the operations of and management by the adviser with respect to the private equity fund at issue.

Additionally, since private equity funds operate over a period of ten years or more – continually calling capital, making portfolio investments and follow-on investments, obtaining investment realization, and making distributions to investors – material changes can occur over time with respect to the adviser, the private equity fund and the portfolio investments. Unlike other types of investments, it is extremely difficult for investors to withdraw their capital from a private equity fund should any issues arise. It is crucially important that private funds advisers, when disseminating advertisements, disclose all material information to investor from the time the adviser is seeking to obtain or retain investors for the private fund to the final communications disseminated after liquidation.[36] The Commission should make clear in the final rule that dissemination of such communications are subject to the general prohibitions over the entire life-cycle of a private fund. In the recent past, the Commission has brought several enforcement actions against private fund advisers who failed to fully inform the investors of changes in their operations, investment management strategy or use of third-party service providers.[37]

The proposed rule provides an opportunity for the Commission to definitively state the expectation that dissemination of communications that qualify as advertisements are required to include clear and accurate presentation of all material facts related to the adviser, the private

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[35] *See* Marc Wyatt, Acting Director of OCIE, "Private Equity: A Look Back and a Glimpse Ahead," May 13, 2015, *available at* https://www.sec.gov/news/speech/private-equity-look-back-and-glimpse-ahead.html.

[36] *See* Andrew Ceresney, Director of the Division of Enforcement, "Private Equity Enforcement," Securities Enforcement Forum West 2016 Keynote Address (May 12, 2016) ("I think it is fair to say that the investment structure of private equity and the nature of private equity investments can lend themselves to some of the misconduct that we've observed. As you'll see in some of the enforcement actions I reference, investors in certain circumstances do not have sufficient transparency into how fees and expenses are charged to portfolio companies or the funds. Sometimes fees are not properly disclosed, conflicts are not aired, expenses are misallocated, and investors are defrauded. Private equity advisers are fiduciaries and need to fully satisfy the duties of a fiduciary in all of their actions.")

[37] *See e.g., In re* Apollo Management V, L.P., et al., Release No. IA-4493 (Aug. 23, 2016); *In re* Blackstone Management Partners, L.L.C., et al., Release No. IA-4219 (Oct. 7, 2015).

fund and the portfolio investments, for the duration of the term of the private fund (and any extensions thereof). The application of the general prohibitions in the proposed rules to such communications would accomplish much to protect investors – both Retail and Non-Retail – from the type of issues identified by the Staff six years ago.[38] ILPA encourages the Commission to seize the opportunity and provide clear requirements and guidance on this issue in the final rule.

B. Past Recommendations.

The Proposal would relax the current prescriptive prohibition on past specific recommendations in advertisements, provided such presentations are made in a manner that is "fair and balanced," taking into account the facts and circumstances of the advertisement, including the nature and sophistication of the audience. We note that, in the past, the Staff has provided limited relief with respect to the prohibition, where a partial list of recommendations was permitted, subject to several conditions.[39] The new principle-based criteria, requiring presentation in a "fair and balanced" manner, will require further clarification with respect to its application to private equity funds, especially if the Commission intends to withdraw man of the no-action letters that address presentation of past recommendations in the context of private equity funds.

Presentations of past specific recommendations have always raised difficulties for private equity fund advisers. As stated above, private equity firms use complex investment strategies, often involving active management of non-publicly traded companies or assets over a period of years. For example, many private fund advisers managing leveraged-buyout funds execute a "buy-and-build" or "platform" strategy, in which the initial investment in a private company is augmented by follow-on investments in horizontal or vertical companies. These additional acquisitions are merged with, or contracted to provide goods and services to, the initial portfolio company, creating a, hopefully, more efficient and profitable operation. Additional capital investments in existing portfolio companies can be made for growth purposes or to buttress flagging operations. Generally speaking, other than the term of the private equity fund, there is no limitation on how long a portfolio investment may be held, and private fund advisers regularly request extensions for a fund term (with some fund terms running 15 to 18 years) while managing poorly performing portfolio investments that remain unrealized.

Due to this complexity, private fund advisers often favor the use of "case studies" in communications that would qualify as advertisements under the proposed rule. Neither the Commission nor the Staff has ever definitively addressed the use of case studies in private fund advertisements and how they may relate to the current prohibition on past specific recommendations. However, the general prohibitions in the proposed rule afford an ample opportunity for the Commission to provide such guidance. The Commission should make clear that any presentation of such "case studies" is subject to general prohibitions provided in the rule

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[38] *See* Andrew J. Bowden, Director of OCIE, "Spreading Sunshine in Private Equity," May 4, 2014, *available at* https://www.sec.gov/news/speech/2014--spch05062014ab.html; *see also* Marc Wyatt, Acting Director of OCIE, "Private Equity: A Look Back and a Glimpse Ahead," *supra* note 35.

[39] *See* Franklin Management, Inc., SEC No-Action Letter (Dec. 10, 1998); TCW Group, Inc., SEC No-Action Letter (Nov. 7, 2008) (the list of recommendations must (a) be chosen based on objective, non-performance-based criteria; (b) not be accompanied by a discuss profitability of the recommendations; (c) must be accompanied by cautionary language concerning the list; and (d) be included in the records as to the chosen recommendations; advisers are also permitted to provide a list of at least ten best and worst performers for past recommendations)

and the requirements for extracted performance,[40] and should be made in the context of the performance of the entire private equity fund, if it is to be "fair and balanced." The Commission should require private fund advisers to include all information material to the performance of a portfolio company used for a case study, including without limitation, (a) whether follow-investments were made and the reason for making them, (b)whether any co-investments were made and why (e.g., strategic co-investment, shortfall in purchase capital, etc.), (c) the importance and effects of any platform building with respect to the portfolio company, (d) market conditions at the time purchase and sale, (e) the use (and importance) of affiliated service providers or other portfolio companies to provide goods or services and whether such goods and services were provided at market rates, and (f) the use of debt for the purchase and/or any further capital investments in the portfolio company and the effects on performance (at both the portfolio company and fund level).

V. Performance Advertising: Gross Performance vs. Net Performance.

The Proposal would define "gross performance" as "the performance results of a portfolio before the deduction of all fees and expenses that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio."[41] "Net performance" is defined to mean "the performance results of a portfolio after the deduction of all fees and expenses, that a client or investor has paid or would have paid in connection with the investment adviser's investment advisory services to the relevant portfolio."[42]

- The definition of "net performance" includes a non-exhaustive list of the types of fees and expenses to be considered in preparing net performance. This list includes, if applicable, advisory fees, advisory fees paid to underlying investment vehicles, and payments by the investment adviser for which the client or investor reimburses the adviser, and is meant to illustrate fees and expenses that clients or investors bear in connection with the services they receive.[43]

- Both "gross performance" and "net performance" would be defined by reference to a "portfolio," which would be further defined as "an individually managed group of investments" and can include "an account or pooled investment vehicle."[44]

- The definition of "net performance" permits three possible modifications when deducting relevant fees and expenses: (A) deduction of a model fee that would result in performance figures no higher than if an actual fee had been deducted; (B) deduction of a model fee that is equal to the highest fee charged to the relevant audience of the advertisement; and (C) exclusion of custodian fees paid to a bank or other third-party organization for safekeeping funds and securities (unless such fees are included in wrap fees).[45]

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[40] *See* Proposal, at Section II.A.5.b.iii., at 55.

[41] *See* Proposal, Section II.A.5.b.ii., at 126.

[42] *See id.*

[43] *Id.*

[44] *Id.* at 127.

[45] *Id.* at 127-128.

- Gross performance may not be presented in any advertisement unless the advertisement provides or offers to provide promptly a schedule of the specific fees and expenses deducted to calculate net performance, which schedule must itemize the specific fees and expenses incurred in generating the performance of the portfolio being advertised.[46] If net performance is presented, the schedule must show the fees and expenses actually applied in calculating the net performance presented. If net performance is not otherwise presented or calculated, the schedule must show the fees and expenses that the adviser would apply in calculating net performance as though the adviser were presenting net performance. In the schedule, fees and expenses are required to be shown "in percentage terms," as a percentage of assets under management. No other specific restrictions or requirements on how fees and expenses are categorized or determined, is provided.[47]

While ILPA is supportive of the Commission's efforts to update the advertising rule with respect the presentation of gross and net performance, our observation is that the proposed rules summarized above are more appropriate for the presentation of performance information with respect to separately managed accounts and private funds invested in the public markets. For example, both "gross performance" and "net performance" are defined by reference to fees and expenses paid (or that would have been paid) in connection with an adviser's services to a "relevant portfolio." A "portfolio" is defined as an "individually managed group of investments" which can include "an account or pooled investment vehicle."[48] In a footnote of the Proposal, the Commission acknowledges that this definition is identical to the definition used in the Global Investment Performance Standards ("GIPS") adopted by the CFA Institute. It is widely recognized that GIPS, which was originally developed for investment advisers managing strategies through separate accounts, employs concepts that are not suitable for the private equity asset class, including the definitions of a "portfolio" and a "composite," an aggregate of one or more portfolios managed through a particular strategy.[49] A private equity fund is neither a portfolio nor a composite, so the definition proposed by the Commission will create confusion. The CFA Institute has recently acknowledged the awkward application of GIPS to the private equity asset class, which is why the proposed 2020 GIPS standards include changes from prior versions to better apply the standard to the private equity industry.[50] It is not clear that the 2020 GIPS Standards will be widely adopted by private equity fund advisers or required by institutional investors. Until such time, given both the growth and the importance of private equity as an asset class,[51] the Commission would better serve private equity fund investors by revising the proposed rule to adopt performance reporting requirements specific to, and appropriate for, this unique and complex asset class. ILPA is not supportive of withdrawing the guidance provided

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[46] *Id.* at 129.

[47] *Id.* at 130.

[48] *See id.*, at 127.

[49] *See* Luis Garcia, "New Performance Standards Crafted to Win Over Private-Equity Firms," The Wall Street Journal, March 28, 2019, ***available at*** https://www.wsj.com/articles/new-performance-standards-crafted-to-win-over-private-equity-firms-11553770803; ***see also*** Marine Cole, "GIPS 2020: The CFA Institute's guidelines will include private equity, but will there be uptake?" Private Funds CFO, June 3, 2019, ***available at*** https://www.privatefundscfo.com/print-editions/june-2019-issue/gips-2020-cfa-institutes-guidelines-will-include-private-equity-will-uptake/.

[50] *See* 2020 GIPS Standards, CFA Institute, *available at* https://www.gipsstandards.org/standards/2020/Pages/index.aspx.

[51] *See* Melissa Karsh and Benjamin Robertson, "Private Equity Begins 2020 with More Cash than Ever Before," Bloomberg, Jan. 2, 2020, *available at* https://www.bloomberg.com/news/articles/2020-01-02/private-equity-is-starting-2020-with-more-cash-than-ever-before.

by the Staff in the *Clover Capital Management* no-action letter,[52] or other no-action letters addressing advertising by private funds,[53] without including more private equity-specific guidance in the proposed rule and the Proposal.

As stated above, the presentation of gross or net performance for private equity funds, raises unique challenges. The performance of any private equity fund depends on several factors beyond the operations, methods and strategies implemented by private funds advisers. For example, the following are some of the fees, expenses, performance allocations and methodologies which can affect private equity fund performance, and which need to be addressed specifically in the proposed rule:

- ***Management Fees***. Most private fund advisers charge a management fee between 1.0% and 2.0% on the assets under management held in the fund. For private equity funds, management fees are typically expressed as a percentage of basis which can change over the course of fund term (e.g., capital commitments, unfunded capital, invested capital). Management fees can also be waived or reduced by the adviser for various reasons, including for the size of an investor's commitment, participation in co-investments or in exchange for an increase in performance allocation. The private equity fund adviser typically has an internal schedule of expected management fees, and the Commission should consider requiring advisers to disclose these expectations with respect to performance performing, to properly calculate the management fees over the life of the fund.

  Management Fees are often offset by transaction fees (described below) specifically identified in the organizational documents of the private equity fund and received by the adviser or its affiliates. Consequently, the actual management fee paid by investors may be much lower than the fee initially stated in the fund offering documents. Any presentation of net performance by a private fund adviser to a private equity fund should require disclosure of these material facts, and include disclosure with respect to the fee stated in the offering documents versus the actual management fee paid after fee waivers, offsets and other deductions are taken into account.

- ***Organizational Expenses***. Organizational expenses relate to establishing and organizing the private equity fund, any parallel funds and their infrastructure. Fees and expenses include the fees of various service providers (e.g., attorneys, consultants, custodians, administrators, placement agents and accountants) and the expenses of forming the entities, printing and distributing offering materials, establishing custodial accounts and other administrative costs and expenses. Over the past decade, organizational fees for private equity funds have increased dramatically.

- ***Professional Fees***. Professional fees typically include auditor, tax and legal professional service fees charged to the private equity fund. Auditor and tax expenses can be impacted by the internal operations of the adviser and the

[52] *See* Clover Capital Management, Inc., SEC No-Action Letter (Oct. 28, 1986).

[53] *See e.g.,* Franklin Management, Inc., SEC No-Action Letter (Dec. 10, 1998; Investment Counsel Association of America, Inc., SEC No-Action Letter (Mar. 1, 2004); TCW Group, Inc. SEC No Action Letter (Nov. 7, 2008).

investment strategy, with fees increasing for higher risk strategies. These expenses are typically allocated among the private equity funds managed by the adviser, as determined in its sole discretion. Legal fees are primarily outsourced expenses related to portfolio investments. Such fees may be allocated among several private equity funds and accounts managed by the adviser that have co-invested in the same portfolio investment. In some cases, legal fees are allocated to a co-investor that did not ultimately contribute to the portfolio investment or that was not allocated a portion of the investment by the adviser.

In recent years, professional fees have included material expenses for fund administrator services, which may be allocated to the private equity fund or retained by the adviser and covered by the management fee. Any presentation of performance should require disclosure of who is paying this administrator cost and the basis for allocation.

- ***Travel & Entertainment Expenses***. These expenses are typically allocations of the adviser's travel costs related to supporting the investments. In recent years the trend is to move more cost to the fund and the investors would only be aware when they examine the supporting documents to find reimbursements to the investment professionals of the adviser.

- ***Transaction Fees***. Other fees and expenses charged both at the fund and portfolio investment level, and often paid to the private fund adviser or its affiliates, affect performance. Examples of such fees and expenses include, but are not limited to, developer fees, property management fees, monitoring fees, broken-deal fees, consulting fees, director fees, loan origination fees, placement fees, fees for legal and accounting services provided to portfolio companies, as well as numerous other fees and expenses. Guidance from the Staff has repeatedly indicated that the presentation of such fees falls within the general anti-fraud provisions of Section 206 and Rule 206(4)-8 and presentation of such performance results must be accompanied by certain disclosures.[54] However, ILPA believes that Commission should take this opportunity to provide specific guidance in the proposed rule with respect to the presentation of such transaction fees and how they affect performance of the portfolio investments and the fund as a whole.

- ***Performance Allocations (i.e., Carried Interest).*** Most private equity fund advisers receive the vast majority of their compensation when portfolio investments are liquidated, receiving a performance allocation as part of the distributions to the investors.[55] Several factors may affect if and when performance allocations are made to advisers, including (a) the rate of the preferred return promised to investors prior to receipt of any performance allocation, (b) whether the calculation of the distribution waterfall is made on a "deal-by-deal," "realized investments" or "whole-

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[54] *See* Investment Co. Institute, SEC No-Action Letter (Aug. 24, 1987).

[55] The performance allocation is referred to by different names depending on the asset class in which the private equity fund invests (e.g., real estate, private companies, private lending, venture, etc.). For example, buy-out funds typically refer to the performance allocation as "carried interest," while real estate funds may refer to the allocation as the "promote." All such allocations, however, are made as part of the distributions to the partners of the fund (as opposed to a fee for services) and are given capital gains tax treatment if distributed in accordance with the requirements set forth by the Internal Revenue Service.

fund" basis, and (c) whether any prior distributions must be clawed back and returned to the fund (and then re-distributed to the investors).

Reporting on the performance of a private equity fund can be easily misleading if such factors affecting the performance allocation are not fully disclosed. This is especially true if a fund has reached the end of its term (or extensions of such term has been granted) and one or more portfolio investments remains unrealized. For this reason, the Commission should clarify that any presentation of performance for a private equity fund should include information as to (i) the preferred return for the fund, and how it is calculated, (ii) which of the three distribution waterfall methods described above is used for determining the preferred return and making distributions, (iii) whether the private equity fund has reached the end of its standard term; (iv) whether any portfolio investments remain unrealized, with estimated valuation for such portfolio investments, and how immediate realization would affect the performance of fund as whole, and (v) whether any performance allocations have been clawed back or, if the term of the fund has not expired or has been extended, are reasonably expected to be clawed back.

- ***Expense Shifting***. Traditionally, a management fee paid to a private fund adviser is expected to cover, among other things, the costs of the adviser's operations, implementation of the overall investment strategy, and the employment of highly skilled professionals. Over time, many private fund advisers have allocated some of these expenses away from the advisor's bottom line and onto the fund or the portfolio companies. This is accomplished in various ways, including (a) establishing paid independent contractor relationships between individual professionals who would otherwise be employed and compensated by the adviser and the fund or portfolio companies (e.g., officers and directors fees); (b) charging the fund or portfolio companies for certain services (e.g., administrative, legal, accounting, etc.) that would otherwise be provided by third parties or performed as part of the management of the fund; and (c) establishing affiliated service providers, including property managers, consulting firms, loan monitoring services, etc. and contracting such affiliates to provide services to the fund or the portfolio companies.

  Over the past decade, expenses paid by the private equity fund or the portfolio companies, as opposed to the adviser and its affiliates, have increased year over year. Expense ratios for private equity funds of substantially the same size have doubled, and efforts by advisers to shift more expenses from the adviser to the fund or portfolio companies continues unabated. If an investor becomes aware of blatant shifts in expenses, it can attempt negotiate either a return of such expenses to the advisor's bottom line or an offset against the management fee. The Commission has an opportunity to require private fund advisers to disseminate more transparent presentations of the fees and expenses that directly and indirectly affect the performance of private equity funds, including those shifted over time from the adviser to the fund or portfolio companies. By revising the proposed rule to specifically require comprehensive fee and expense disclosure, the Commission would provide investors with the information necessary to appropriately analyze the performance of private equity funds and conduct reasonable negotiations with respect to their investments in such funds going forward.

- ***Subscription Credit Lines and Other Forms of Borrowing***. Recently, many private equity funds have begun to change their use of certain fund-level credit lines that are collateralized by a pledge of the investors' capital commitments to the private fund ("subscription credit lines). Historically, debt is used by private equity funds (especially leveraged-buyout funds) to purchase portfolio investments. Such financing was supported by pledging the assets of portfolio investment as collateral and backing such pledge with a guaranty of the loan by the private equity fund. The private equity fund would also borrow funds at the fund level, but primarily for purposes of paying expenses, providing bridge financing with respect to a target investment, or making distributions. The aggregate amount of borrowing by the fund, when combined with the guarantees, that is permitted to be outstanding at any time is limited to a percentage of the total capital commitments made to the fund (e.g., 20-30% of commitments).

  Often, a private equity fund also establishes a subscription credit line for the purpose of meeting short term cash needs (e.g., 60 – 180 days). Draws on such credit line are traditionally used for "smoothing out" capital calls – i.e., providing temporary funds while a capital call process is completed, and would be paid off upon receipt of capital from the investors. Recently, many private fund advisers have begun to use subscription credit line draws for making portfolio investments and allowing draws to remain outstanding for longer periods of time before calling capital from the investors (e.g., 1 – 2 years).[56] Using subscription credit lines in this manner (a) temporarily shifts (at least in part) the primary risk of borrowing from the portfolio company directly to the private investment fund (i.e., the lender is no required to enforce its loan at the portfolio company level before looking to the guarantees), and (b) affects the performance of both the portfolio company and the fund.[57]

  The Commission should make clear that any presentation of performance results for a private equity fund should require disclosure of (a) the use of subscription credit lines for periods exceeding 180 days, and (b) the effects of the subscription credit lines on net performance.

In the experience of ILPA's members, the information typically provided prospective investors with respect to the fees and expenses needed to calculate the net performance of a private equity fund includes the management fees, professional fees, organizational costs, travel and related expenses and other expenses highlighted above. During due diligence of the data, these expenses may be abbreviated by the adviser to a few categories, e.g., management fees, partnership expenses and organizational cost. Typically, the other fees and expenses listed above are not expressly disclosed and performance allocation must be calculated using the terms from the private placement memorandum or organizational documents. Performance

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[56] *See* Howard Marks, "Lines in the Sand," April 18, 2017, ***available at*** https://www.oaktreecapital.com/docs/default-source/memos/linesin-the-sand.pdf.

[57] *See* Amy Whyte, "Private Equity Returns Are Being 'Distorted' by Loans, Research Finds," Institutional Investor, July 3, 2019, *available at* https://www.institutionalinvestor.com/article/b1g3c42spkmyc0/Private-Equity-Returns-Are-Being-Distorted-by-Loans-Research-Finds; *see also* Subscription Lines of Credit and Alignment of Interests, Institutional Limited Partnership Association (June 2017), *available at* https://ilpa.org/wp-ontent/uploads/2017/06/ILPA-Subscription-Lines-of-Credit-and-Alignment-of-Interests-June-2017.pdf.

reporting typically does not provide expense information for amounts paid to an affiliate of the adviser, which should be included in net performance calculations.

A. Disclosures.

Previously, the Staff has discussed several disclosures that advisers may consider including in a presentation of performance information and the Staff would not recommend enforcement action under the current rule.[58] In the Proposal, however, the Commission states that it understands that requiring disclosures in all performance advertising may be of limited utility to investors, and that lists of disclosures that may not be properly tailored to the relevant services being offered or the performance being presented could result in a prospective investor receiving irrelevant information or being unable to determine which information is most relevant.[59] The proposed rule, therefore, does not require specific standardized disclosures or any legend containing specific disclosures in advertising presenting performance results. ILPA believes, however, that the factors affecting private equity fund performance, as summarized above, demonstrate the necessity for specific requirements and guidance regarding the use disclosures in the context of presenting performance for private equity funds. We strongly encourage the Commission to reconsider its decisions to rely solely on the principle-based approach and amend the proposed rule to include more specific disclosure requirements and guidance.

Investors' growing needs for improved disclosures around fees, expenses and carried interest in were given greater focus after the enforcement actions brought by the Commission against several private funds' advisers between 2014 and 2015. A 2015 survey of ILPA members revealed that 52% of institutions had created custom templates to capture fee and expense information beyond what was being provided in standard private fund performance reporting packages. In response, ILPA convened an ongoing working group of investors and interested stakeholders in the spring of 2015, the ILPA Transparency Initiative. The goals of this broad-based effort were to address shared performance reporting and compliance challenges by establishing more robust standards for fee and expense reporting as well as compliance disclosures among investors, fund managers and their advisors. We encourage the Commission to review the ongoing work of the ILPA Transparency Initiative, especially with respect to the fee and expense template developed by the members through such initiative, as it revises the proposed rule and provides the guidance necessary for private equity fund advisers and investors in private equity funds to receive accurate and reasonably comprehensive performance presentations in advertisements.

B. Schedule of Fees.

The proposed rule would prohibit in any advertisement any presentation of gross performance unless the advertisement provides or offers to promptly provide a schedule of specific fees and expenses deducted to calculate net performance. Where the adviser presents net performance, the schedule should show the fees and expenses actually applied in calculating the net performance that is presented.[60] The Proposal requires such fees and

[58] *See* Proposal, Section II.A.5.a.

[59] *See id.*, at 104.

[60] *See* Proposal, Section II.A.5.b.iv., at 129 – 130.

expenses be shown in terms of a percentage of the assets under management, but otherwise impose no specific restrictions on how fees and expenses are categorized or determined.

For reasons previously stated in this letter, ILPA believes that the requirements with respect to the schedule of fees are insufficient and inappropriate for presentation of performance information for private equity funds. As listed above, there are numerous fees, expenses and allocations that affect the private equity fund performance, which need to be specifically addressed by the Commission in the proposed rule. There will be very few private equity investors that will refrain from requesting the schedule of fees and expenses from the fund adviser, so the schedule required by the proposed rule should reflect complete and accurate disclosure of the fees and expenses that directly or indirectly affect performance.

Drawing on extensive consultations within the investor and private equity fund adviser communities, ILPA has developed and released the ILPA Reporting Template for fees, expenses, and carried interest. The aim of the template is to encourage uniformity in these disclosures, both to provide investors with an improved baseline of information to streamline analysis and drive decision making, and to reduce the compliance burden on private equity fund advisers being asked to report against a range of disparate formats from investors. Since its release, more than 140 organizations have endorsed the template, including more than 20 private equity fund advisers. The template has been widely adopted in the marketplace; ILPA estimates over 300 private equity managers provide the template to those LPs requesting it. The UK regulator, the Financial Conduct Authority (FCA), has recognized the value of the ILPA template, and has permitted it to be used by private equity fund advisers in lieu of the template created under the auspices of their own Cost Transparency Initiative.[61]

We encourage the Commission to revise the proposed rule to require private fund advisers to develop a schedule of fees and expenses using a template and formatting accepted in the industry for that specific asset class, and to provide an example for private equity funds by referring to the ILPA template. The proposed rule should provide that a schedule of fees and expenses be provided to investors, if a net performance calculation is not provided, modeled after the ILPA Reporting Template, that includes the following data points:

- Management Fees (expressed as % of basis)
    - Management Fees – Gross of Offsets, Waivers & Rebates
    - Management Fee Rebates
    - Total Offsets to Fees & Expenses (This may not be know during fund raising)
    - Fee Waivers
- Fund Expenses
    - Fund Expenses – Accounting, Administration & IT
    - Fund Expenses – Audit & Tax Preparatory
    - Fund Expenses – Bank Fees
    - Fund Expenses – Custody Fees
    - Fund Expenses – Due Diligence

[61] Pensions and Lifetime Savings Association (PLSA), Cost Transparency Initiative Overview, *available at:* https://www.plsa.co.uk/Policy-and-Research-Investment-Cost-Transparency-Initiative

- Fund Expenses – Legal
- Fund Expenses – Organizational Costs (may include syndication fees)
- Fund Expenses – Other Travel & Entertainment
- Fund Expenses – Other (May include interest expense, broken deal, etc.)

- Income (typically not provided due to materiality)
  - Interest Income
  - Dividend Income
  - Other Income

As discussed above, any schedule of fees and expenses should be accompanied by disclosures regarding fees paid to affiliates, allocations of fees and expenses among private equity funds managed by the adviser and its affiliates, recent shifting of fees and expenses from the adviser to the fund or portfolio companies, etc. ILPA encourages the Commission to take advantage of the work of its members and the ILPA template and adopt a standard for the required schedule of fees and expenses which comports with a template already widely accepted by private equity fund investors and advisers.

C. Retail vs. Non-Retail Persons.

The proposed rule would prohibit presenting gross performance in Retail Advertisements without also presenting net performance.[62] The Commission does not believe that Non-Retail Persons need this requirement because "they have access to analytical and other resources, and therefore the capacity to evaluate gross performance as advertised" and "Non-Retail Persons often do not find advisers' presentation of net performance useful and prefer to apply to gross performance their own assumptions and calculations of fees and expenses." As stated above, ILPA respectively disagrees.

ILPA members have indicated that they prefer marketing materials that include both gross and net performance, especially in the early stages of the due diligence process, which may be focused on comparing proposals and offering memoranda against each other and various benchmarks. While ILPA members analyze adviser-provided numbers and seek fee and expense data to assist with that analysis (in particular when negotiating fees), it is inaccurate to say that adviser-reported net performance is not useful for Non-Retail Persons. While ILPA members may be able to calculate the net performance number, it is helpful to have the net performance number to check that it is accurate based on their own calculations. For Non-Retail Persons, the Commission states that (a) the "general prohibitions" in the proposed rule and (b) resources and negotiating abilities of Non-Retail Persons, are sufficient to make sure that advisers provide the information necessary to effectively analyze complex products. As previously stated, these assumptions underestimate the difficulty of obtaining information regarding fees and expenses associated with such investment products, as well as the limited negotiating leverage of many Non-Retail Persons in the current market. The absence of specifically required information will likely result in the need for further guidance from the Staff in the form of no-action letters, FAQs and interpretations to force advisers to fill in any information gaps.

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[62] *See* Proposal, Section II.A.5.b.iv.

D. Hypothetical Performance.

The unsolicited request exception in the proposed Advertising Rule does not apply to communications that include hypothetical performance. Accordingly, those communications qualify as advertisements and must comport with the specialized requirements applicable to advertisements using such performance data. The question is whether these new requirements would result in managers not sharing information that they would currently share in response to the request of an institutional investor. Under the proposed rule, managers must have policies and procedures to ensure the relevance of hypothetical information to an investor.[63] Accordingly, institutional investors are likely to see an increase in requests for certifications, questionnaires, non-disclosure agreements, and other manager-protective documents early in the due diligence process. To limit this type of front-end documentation burden, the Commission should permit the unsolicited request exception to apply to hypothetical performance provided upon the specific request of a Non-Retail Person.

VI. Conclusion.

The proposed rule and the guidance provided in the Proposal present an opportunity for the Commission to address issues and problems in the private equity industry that have remained unresolved for over a decade. The proposed rule should require private equity advisers to disseminate advertisements that provide complete and accurate information regarding fund and portfolio investment performance (gross and net), conflicts of interest and adviser operations – all in a fair and balanced manner that is appropriate and useful for investors, regardless of their nature.

We look forward to continuing our dialogue with the Commission to ensure that the interests of LPs and private equity fund advisers are reasonably aligned and that each is aware of its rights and fiduciary obligations under the proposed rule.

Sincerely,

Steve Nelson
Chief Executive Officer
Institutional Limited Partners Association (ILPA)

cc. Honorable Jay Clayton, Chairman
Honorable Robert J. Jackson Jr., Commissioner
Honorable Hester M. Peirce, Commissioner
Honorable Elad L. Roisman, Commissioner
Honorable Allison Herren Lee, Commissioner

Dalia Blass, Director, Division of Investment Management

[63] *See* Proposal, Section II.A.5.c.iv., at 171-172.