

## Proposed SEC reforms would tackle fundamental disconnects between industry LPs and GPs, says ILPA

**New ILPA analysis shows private markets industry needs to level the playing field on the bargaining process, fee transparency and other key areas**

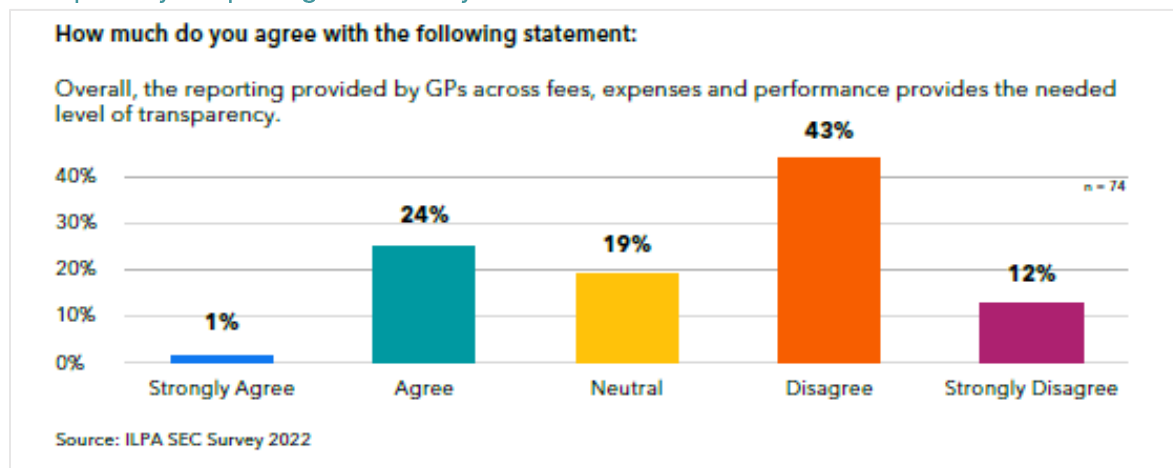
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March 6, 2023 (Washington, D.C.) Limited Partners (LPs) and General Partners (GPs) are aligned on the importance of private equity to the success of investment programs. However, the SEC’s proposed Private Fund Advisers (PFA) rule highlights opportunities for stronger alignment, according to the Institutional Limited Partners Association (ILPA).

A new report from ILPA, [The Future of Private Equity Regulation: Insight into the Limited Partner Experience & the SEC’s Proposed Private Fund Advisers Rule](#), features data and insights gathered from its member LPs to clarify and supplement its comprehensive [comment letter](#) submitted to the SEC last April.

According to the report, the industry lacks a level playing field when it comes to the bargaining process, and the SEC’s proposed reforms could help achieve better balance by removing common-sense legal terms from the negotiating table. Creating a minimum standard for fee and expense reporting and enhanced fiduciary duties and preserving the use of side letters through requiring a “best-in-class” process could help elevate the baseline for how LPs and GPs engage.

### Transparency - Reporting Provided by GPs



“Private equity has made great strides in transparency, governance and alignment since ILPA’s founding 20 years ago, but as an asset class, it’s clear LPs and GPs must work together to strengthen certain industry dynamics,” said Jennifer Choi, ILPA CEO. “This analysis demonstrates that the proposed SEC reforms have the potential to enhance the ability of ILPA’s members, as fiduciaries, to meet their obligations to beneficiaries by strengthening both disclosures and alignment of interest.”

## Private Fund Advisers Rule: An Opportunity to Address Persistent Challenges

PROPOSAL	ILPA'S STANCE
<p><b>Required Quarterly Fee &amp; Expense Reporting</b> GPs would provide quarterly fee and expense reporting at the fund-level to all LPs in their funds.</p>	<p>The SEC should require GPs to provide LP-level reporting upon request and fund-level reporting to all investors with LPs reasonably expected to bear a pro rata portion of costs for this reporting.</p>
<p><b>Addressing Fiduciary Duty</b> GPs would be prohibited from seeking indemnification or exculpation for a breach of fiduciary duty, misfeasance, bad faith, negligence or recklessness.</p>	<p>ILPA supports a strong fiduciary standard and substituting "negligence" with "gross negligence" provided that ordinary negligence applies to LPA or side letter breaches.</p>
<p><b>Disclosure of Preferential Treatment</b> GPs would be required to disclose, on a rolling basis and annually, to all current or prospective LPs any preferential treatment provided to an LP.</p>	<p>The SEC should reaffirm that side letters are essential to investors. ILPA's recommended "best-in-class" MFN process is designed to achieve desired policy goals without imposing additional cost or time burdens.</p>
<p><b>Reducing Clawbacks for Taxes</b> GPs would be prohibited from reducing the clawback by taxes applicable to the advisor.</p>	<p>ILPA supports the intent of this proposal but believes a hypothetical but reasonable rate would prevent leakage and address unintended consequences.</p>
<p><b>Non-Pro Rata Fee and Expenses</b> GPs would be prohibited from charging fees related to a portfolio investment on a non-pro rata basis.</p>	<p>ILPA supports this provision but recommends the SEC should include an exception for co-investments from the rule.</p>
<p><b>Grandfathering</b> Open question on the status of rulemaking applying towards current funds.</p>	<p>Except for required quarterly statements and annual fund audits, ILPA recommends the rules should be solely applied to new funds formed after the implementation date.</p>

In addition to addressing key aspects of the rule (*above*) and providing new and clarifying data, the ILPA analysis offers measured recommendations that could improve transparency, governance and alignment of interest in the industry, including:

- ILPA's support for the PFA's intent to create a minimum standard of fee and expense transparency to ensure all LPs are aware of the costs they are charged, without needing to negotiate to receive this critical information.
- To determine which costs should be covered by the management fee, ILPA recommends a principles-based approach—rather than an item-by-item framework—and express prohibitions on charging certain egregious costs to the partnership outside of the management fee.

"Where we have pushed for adjustments in key areas or made recommendations, a major effort was taken to create a minimum standard such that the baseline engagement between LPs and GPs rises to the level that ILPA and our LP members think would move the industry forward," says the report.

"We sincerely appreciate the opportunity to engage so closely with our members and other industry stakeholders on these issues and the openness with which the SEC has approached the follow-on conversations we've had with them about the PFA rule over the last year," said Neal Prunier, ILPA Senior Director of Industry Affairs. "We look forward to a final rule that will strengthen the dynamics of our industry, particularly for LPs and the millions they serve. At the same time, we'll be looking for expanded opportunities to bring the industry together to work on the many interconnected challenges we've identified."

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### **About ILPA**

With nearly 600 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, development 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.