To: Gary Gensler
Chair, Securities and Exchange Commission, Re S7-03-22

U.S. Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549

March 17, 2022

Dear Chair Gensler:

We are fully supportive of the SEC's proposals to shine an intense light on the private equity industry's investment performance, fees and the nature and objectives of individual funds. For too long the SEC, and other actors that have a role in overseeing private equity, have coddled the business, enabling it to grow into a juggernaut that is now vacuuming up wide swaths of American business, commercial real estate, individual homes and apartments, infrastructure, private company debt, and business development corporations, all under the demonstrably false rubric of "higher returns, and lower risk" than the equivalent public market indexes of same.

We applaud the SEC's proposals to create transparency for funds' limited partner (LP) investors. The current lack of transparency means LPs are unable to know for certain what they pay in fees and expenses – unless they expressly ask General Partners (GPs) -- what monitoring fees the PE firm is charging the fund's portfolio companies, and what returns the LPs have earned under different measurement criteria. LPs often do not have enough unambiguous data to know if their investments are performing as the fund advisor – the GP – claims. We welcome the SEC's improvements in performance metrics, including among others that the IRR be reported with and without subscription line loans and that management fees paid by LPs be reported with and without offsets from monitoring fees shared with them. A better metric for measuring PE fund performance, as the SEC acknowledges, is the public market equivalent. Requiring PE funds to report the K-S public market equivalent would eliminate opportunities to (legally) manipulate the IRR and would greatly improve the accuracy of reported returns vis a vis the public markets. We do not believe that this calculation would be too costly for PE funds to undertake. There are already individuals that do this calculation for publications like Prequin and PitchBook, suggesting this is financially feasible. We are also pleased to see the SEC proposing to ban accelerated monitoring fees, which reduce the sale price of the portfolio company being exited to the benefit of the PE firm and at the expense of the fund's LPs.

However, the fundamental problem with the current proposal is obvious: the SEC and the general public will not have direct and ready access to the enhanced information from the new reporting requirements. This is not right. We believe this information should be filed on a timely basis by each private equity fund with the SEC and made publicly to preserve the SEC's mission of efficient capital markets and protection for the investing public. The proposal asks for such suggestions in the proposal's final pages. Furthermore, to advance the compilation of data and to improve private equity fund analysis, the private equity fund advisor should (i) "code" each fund; and (ii) designate the fund's comparable public benchmark. The SEC's database should enable outsiders to download private equity information by these codes, so investors – including potential investors in a PE's new fund – are not burdened by having to sort through hundreds of filings manually. Similar coding is now conducted by prominent private equity data services.

We have concerns about whether the SEC is the appropriate agency to carry out the mission of supervising the private equity industry. Despite its jurisdiction for the past fifteen years, the agency has given PE free rein, even as PE has reaped tens of billions in fees with less than stellar returns. Perhaps a new federal agency with higher salaries, a bonus system for catching violators, and a different culture might be more effective. Alternatively, a system where private law firms or consultants can step in the SEC's shoes to catch violators for a percent of the fine.

Issues with the SEC regulation to date include:

- SEC employees fear "taking on" the big private equity funds for fear that they can't win a case against the funds and their giant Wall Street law firms.
- SEC employees fear "being tough" on big private equity funds and their law firms because they think they jeopardize their post-SEC careers (although we think a few $100 million fines against private equity funds would enhance post-SEC employment opportunities). The former SEC Chair is now the non-executive chair of the largest PE fund complex.
- The SEC culture whereby "losing one case" hurts one's SEC career. This doesn't help an SEC employee "hunting big game," such as a sizable private equity fund breaking the rules, whereby cases may be lost from time to time.
- The SEC lacks the budget and resources to administer thousands of private equity funds effectively.
- During the 2009 financial crisis, the stock market fell 37%, yet the LBO funds claimed just a 30% loss, despite the underlying LBO portfolio companies being more leveraged than their public counterparts. The LBO funds should have shown a loss of 60% or more, a disclosure that would have stopped the buyout private equity industry in its tracks. A whistleblower represented by a former SEC attorney alerted the SEC to this fact, but the SEC ignored the complaint. The SEC's acquiescence to the private equity buyout industry's "return smoothing" has facilitated the private equity industry's remarkable growth, but it has left an indelible stain on the agency's purported mission to foster efficient markets, capital formation and fairness.
- We also note that the buyout PE funds have a TVPI on average of 1.5x over a 10-12-year life. This hardly indicates investment genius. Yet, PE funds often claim IRRs of 20% or 25%, which does not square with the TVPI in any common sense way. Can the agency overcome such issues?
- The SEC has a substantial amount of "backfilling" work to do by examining the historical and misleading return claims of many private equity fund families. Such claims may have violated securities laws, prompting Justice Department referrals. .

To fight these proposals, the private equity industry will unleash its army of Wall Street lawyers, Washington D.C. "swamp" lobbyists, ex-SEC staffers, and paid-by-the-hour economists. We foresee two principal objections from these actors, who often lack an ethical compass or a sense of civic responsibility.

The first argument will be cost. The added calculations, valuations, and data compilations will be too costly they will say; however, we note the private equity data services such as Preqin and Pitchbook already make such determinations for many funds without going bankrupt. The SEC might consider a minimum asset threshold, such as a $200 million for a reporting fund.

Second, these actors will echo the position, in many different and repeated iterations, of SEC Commissioner Caroline Crenshaw's contention (February 9, 2022), "that these well-heeled, well-represented investors (i.e., sophisticated institutions like massive public pensions plans and big university endowments) are able to fend for themselves;" and, thus the proposed private equity disclosures and SEC monitorings are unnecessary. In a narrow way, her statement is true; the investment managers at these institutions probably have the knowledge and experience to conduct due diligence on private equity funds and to negotiate terms. The problem with her assertion is that the managers are irrevocably compromised. If they were to 60-40 index their portfolios, instead of stuffing them full of private equity, hedge, private real estate, and other alternatives, the in-house managers would make more money for their institutions—this is a proven fact—but less for themselves. These same managers would hinder their own compensation and careers by eliminating alternatives from their portfolios. What institution is going to pay a manager $2 million per year to index, when a computer can do the indexing?

The other institutional problem lies within the skillset and curiosity of such institutions' board members, who are supposed to provide oversight of these career-seeking managers. The Boards, in the case of public pension plans (private equity's largest customers), are typically comprised of a mix of politicians, political appointees, and state and municipal union leaders. All have little financial expertise, and they tend to "rubber stamp" in-house manager initiatives. As a result, Commissioner Crawford's position is only defensible in a model corporate governance environment, but this ideal situation is not the "real-life" case with private equity's largest customers, who represent the retirement savings of millions of "little people." Such people know the swamp and Wall Street in only an abstract, powerless way. These people are the inevitable targets of the private equity industry and its paid army of apologists.

In addition to SEC inaction, other members of private equity's "protective ecosphere" have enabled the private equity industry's rise to prominence. Consider the following:

- Accounting Profession: The FASB and GASB do not require disclosure of carried interest fees in institutions' financial statements. The FASB allows the Net Asset Value Expedient convention, which treats illiquid LP interests as if they are liquid, publicly traded stocks.
- Business Media: It has only begun to address the private equity industry's mediocre performance, mark-to-market issues, and misleading information. For two decades, the media has touted many private equity fund titans as "geniuses," highlighting portfolio company successes and slighting the many bankruptcies.

- State Governments: Allow public pension plans to hide private equity fees and performance.
- Federal Government (besides SEC): The Department of Labor ignores high private equity fees and mediocre results of retirement plans that invest in private equity; the U.S Congress permits interest tax deductions for preferred-stock-like debt. The IRS allows many non-profits to operate like hedge funds and pay fees that may approach one-third of their annual charitable donations while claiming tax-exempt status, and the IRS allows many nonprofit hospitals, notably academic medical centers, to operate venture capital subsidiaries without paying taxes on the profits generated.
- Investment Consultants: Despite being classified as "sophisticated investors," many large public plans hire investment consultants to provide advice and to provide "air cover" to inside managers and trustees if investment performance "goes south." Ignoring documented historical evidence to the contrary (e.g., studies at Harvard, Oxford, Johns Hopkins, Bain Consulting, McKinsey, CEM Studies, et al.), the consultants insist on telling public plans that private equity will provide the highest investment returns in the future, eclipsing the stock market by several points per annum in their words.
- The PE Customers Themselves: As noted, the investment executives of the public plans and non-profits often have career concerns that trumpet fiduciary obligations.

With regard to specific items in the lengthy proposal, we make the following comments about what we think should happen in roughly chronological order:

- Wider dissemination of information is needed, as set forth earlier in this letter.
- Private equity funds should "self-clarify" themselves as buyout or growth, for example, and indicate what the relevant common stock benchmarks are in the summary performance table, which should appear on page 1 of their quarterly report. The index's performance is then matched against the private equity fund on a "net basis" on page 1.
- The PME will be used with the benchmark, along with the other measurements.
- The proposal performance table will also include the modified IRR with a reinvestment rate of 10%. Investors will not be confused (page 76) by the multiple measurements.
- The private equity fund can only charge performance fees to the extent it "beats" the benchmark, rather beating a fixed percent like 8% annualized. (same with hedge funds).
- Charge fees on invested assets only.
- Standardization is good. If the SEC uses a "principles-based" disclosure regimen, the private equity funds will find ways to avoid truth telling.
- Due to the 'independent accounting firms' acquiescence in private equity fund "return smoothing," the SEC should require a rotation of audit firms every 3-5 years for private equity funds, so objectivity is enhanced, in addition to formal audits for funds over $200 million.
- We also think the large private equity funds should be required to hire, at random, for 30% of their portfolios, SEC-approved independent valuation consultants to "double-check" the private equity funds portfolio company valuations and the audit firm "sign-off" of these values.

- For PE advisor-led secondaries, the LPs, not the GPs, should pay for the fairness opinion on a pro-rata basis to enhance objectivity. The selection process for the opinion provider should be random from an approved SEC list.
- The SEC also has to watch secondary fund IRR inflation, whereby the secondary fund buys an LP's PE interest at 85% of NAV, and then turns around in six months and writes up the 85% to 100%, using NAVE.
- Both closed deal and "broken-deal" legal fees, financing fees, and due diligence expenses should be for the private equity fund advisor's account, paid for out of the advisor's management fee. The same goes for a fund formation's expenses. Under the current system, the pre-tax PE advisor profit margins are at 30% to 40% or higher, indicating that the expenses are easily affordable and, in equitableness, should be for the advisor's account.
- Regarding fairness opinions on public LBOs, we note the 2014 $590 million settlement of a class-action lawsuit alleging multiple LBO funds conspiring to fix prices on multiple transactions totaling tens of billions in value. Each of those deals had fairness opinions. We also reference the $24 billion 2013 Dell buyout where a Delaware Supreme Court judge indicated in 2016 that the deal was underpriced by $5 billion and where that 2013 deal had fairness opinions from prominent investment banks.
- Fund advisors should have more "skin in the game,.", not 3% but 10% of the equity in a PE fund.

In closing, there is a place for private equity in the American capital markets. However, in the last fifteen years, the private equity industry's growth has rested on a foundation of sand, supported by secrecy, misinformation, hype, and poor institutional governance. The private equity industry, controlling trillions of dollars in assets, sorely needs adult supervision, independent verification, and public information dissemination.

With their vast management fees and the wealth that comes with it, private equity fund managers have gained an entrance ticket to the highest levels of American business, political and cultural establishments. Derailing their growth will be an uphill battle at the very least.

Thank you for your consideration of our comments.

Best regards,

Eileen Appelbaum Jeffy Hooke

Eileen Appelbaum and Jeffrey Hooke

Dr. Eileen Appelbaum is the Co-Director of the Center for Economic and Policy Research. She was formerly a Distinguished Professor in the School of Management and Labor Relations at Rutgers University. She is the coauthor of Private Equity at Work: When Wall Street Manages Main Street. The book was selected by the Academy of Management as a finalist for the prestigious George R. Terry Book Award.

Jeffrey Hooke is a senior finance lecturer at the Johns Hopkins Carey Business School. He was formerly an investment banker and a private investment executive for many years, and he is an author of books, policy papers, and academic reports. His most recent book is, "The Myth of Private Equity," (September 2021, published by Columbia University Business School Press).