April 12, 2022

Vanessa A. Countryman
Securities and Exchange Commission
100 F St NE
Washington, DC 20549

Re: Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (File No: S7-03-22)

Secretary Countryman,

We appreciate this opportunity to comment on the Securities and Exchange Commission's ("the Commission") proposed rules that would provide investors with necessary details on the fees, expenses, returns, and compliance records of private funds they are invested in or are considering investing in. We support these proposals as these disclosures provide a significant step towards investors having the insight they need into private funds.

The fact that this basic information, which is generally already clear to fund advisers, is not disclosed to investors, represents a profound market failure. Currently, even the most sophisticated investors in these funds frequently cannot form a clear picture of:

- what fees they are being charged and how they are being charged
- accurate information on returns
- if the fund adviser has been engaged in misconduct
- whether other fund investors are receiving preferential treatment that puts them at a disadvantage

With this proposal, the Commission addresses the imbalance of power that favors the fund advisers, stemming from the current information asymmetry, by requiring the advisers to provide investors on a quarterly basis:

- a table detailing all the different fees and expenses charged
- a standardized, reliable set of returns for investors to evaluate alongside more detailed assumptions used to calculate returns
- disclosures on special arrangements it may have with certain investors, often referred to as "side letters"

The proposal would also prohibit certain hidden conflicts and fees that unduly enrich the fund adviser at the expense of investors and require annual independent audits to address the systematic compliance deficiencies and ensure private investments are valued properly.

We strongly support these proposals which will provide investors in private funds with the information necessary to determine if the fees, returns, and investment terms are suitable for them and make it easier to make sure their advisers are acting in their best interest.

Such proposals will also ensure that private fund investors are properly able to steward the savings of millions of Americans. Investors in these funds include public pension funds responsible for the retirement savings of workers and retirees, along with other important public serving institutions, including universities and foundations. The absence of clear standards for basic information, and of protections against dangerous conflicts of interest, puts both these investors and the integrity of capital markets at serious risk, channeling trillions of dollars of investment in ways that are untethered from accurate reporting of fees and returns.

The lack of transparency which further erodes accountability has enabled a transfer of wealth from workers and retirees to Wall Street executives. This dynamic has been described by a leading academic expert as one of the "largest [wealth transfers] in the history of modern finance" from several hundred million retirees to the private equity industry.[1] Further, this lack of transparency and conflicts of interest create misaligned incentives that increase the likelihood of extractive management practices by private equity that benefit executives and at the expense of other stakeholders, including in various ways investors, workers, and consumers/patients.

At United for Respect, we have spent years supporting workers at multiple retail companies owned by private equity firms, who have fallen victim to their predatory tactics. If this SEC rule is finalized, it will make it harder for Wall Street executives to raise funds to get rich at the expense of workers and communities by looting companies, cutting jobs, and gouging customers. For example:

- Private equity firms, Bain Capital and KKR, siphoned off $464 million in fees and interest from Toys "R" Us as they drove the company into bankruptcy.[2] Because private equity firms do not fully disclose the fees they charge their portfolio companies to investors, it took pension funds longer to realize the extent of the problem and speak out than it should have.

- Art Van was a successful midwestern family-owned furniture chain with 117 stores and 3,500 employees until Thomas H. Lee Partners purchased it in 2017.[3] The private equity

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[1] Flood, Chris. Financial Times. Private equity barons grow rich on $230bn of performance fees. https://www.ft.com/content/803cff77-42f7-4859-aff1-afa5c149023c

[2] Private Equity Stakeholder Project. KKR, Bain Capital, Vornado repeatedly rewarded themselves for adding debt to Toys "R" Us. https://pestakeholder.org/kkr-bain-capital-vornado-repeatedly-rewarded-themselves-for-adding-debt-to-toys-r-us/

[3] Engel, Clint. Furniture Today. Art Van to be sold to private equity. January 25, 2017.

firm saddled the company with unsustainable debt and rent payments to purchase it when they partially financed the deal by selling the firm's real estate and forcing Art Van to lease those same locations back at a much higher cost.[4] It only took three years for private equity to bankrupt this 61-year-old company, cutting workers off from their primary source of income and health insurance in the middle of the COVID-19 pandemic.

- BC Partners saddled PetSmart with risky debt when they bought it in 2015[5] and again when they purchased the online pet retailer Chewy in 2017.[6] Those bets paid off massively during the pandemic because so many people bought pets, but BC Partners has prioritized paying themselves handsomely while they continue to cut corners. In the first year of the pandemic, Chewy's stock price almost quadrupled,[7] and a recent rumored deal to buy PetSmart valued the company at $14 billion, almost double what BC Partners purchased it for in 2015.[8] A recent VICE exposé details terrifying conditions such as how understaffing is leading to freezers overflowing with dead animals.[9] Meanwhile, many workers are still making $12.50/hr without healthcare as business booms.

Because of our experience supporting retail workers to fight private equity's greed, we encourage the SEC to adopt the proposed rules as written.

Current rules unfairly benefit private fund advisers at the expense of investors

The proposed rule is particularly crucial as the size of private funds have grown exponentially. In the last decade, these funds have grown by 383%, from $3 trillion in 2007 to around $11.5 trillion at the end of 2021.[10] However, the rules have not kept pace with this growth. The

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https://www.furnituretoday.com/business-news/art-van-sold-private-equity/

[4] Rubin, Neal and Dickson, James David. Art Van files for bankruptcy; stores reopen after closing for safety concerns. March, 9, 2020. https://www.detroitnews.com/story/news/local/macomb-county/2020/03/09/art-van-files-bankruptcy-delaware/4998571002/

[5] Unglesbee, Ben. Retail Dive. Retail's Largest Private Equity Buyouts and How They've Panned Out. November 9, 2018. https://www.retaildive.com/news/the-biggest-buyouts/541078/

[6] Chewy Investors. PetSmart Completes Acquisition of Chewy. May 31, 2017. https://investor.chewy.com/news-and-events/news/news-details/2017/PetSmart-Completes-Acquisition-of-Chewy/default.aspx

[7] Ash, Jordan. Private Equity Stakeholder Project. BC Partners Feasts on Chewy's Riches, Leaves Table Scraps for Petsmart Workers. April 15, 2021. https://pestakeholder.org/bc-partners-feasts-on-chewys-riches-leaves-table-scraps-for-petsmart-workers/

[8] Natarajan, Sridhar and Tse, Crystal. Bloomberg. KKR SPAC Said to Mull Deal for PetSmart at $14 Billion Value. January 20, 2022. https://www.bloomberg.com/news/articles/2022-01-21/kkr-spac-is-said-to-weigh-deal-for-petsmart-at-14-billion-value?sref=AuDcg4ag

[9] Gurley, Lauren Kaori. Some Understaffed PetSmarts Are Dealing With Freezers Overflowing With Dead Pets. March 9, 2022. https://www.vice.com/en/article/3ab4ek/some-understaffed-petsmarts-are-dealing-with-freezers-overfilled-with-dead-pets

[10] Pitchbook. Total private assets. Mar 31, 2021.

outdated rules mean that investors frequently have very little insight into their private fund investments.[11]

A significant reason for the growth in private funds has been investments from pension funds, non-profit foundations, endowments, and insurance companies driven to seek higher returns than those in the public markets in the context of record low interest rates.[12] These investors have increasingly turned to investing in private funds managed by hedge funds or private equity firms to try and meet return targets, but they have faced a lack of transparency and basic accountability that seriously interfere with their ability to accurately determine risks and returns, and to appropriately make critical allocation decisions.[13]

Public pension funds, for example, have now allocated about 9% of their portfolios to private equity investments, totaling $480 billion in 2021, compared to $300 billion in 2018.[14]

The SEC's proposal to require detailed accounting of fees would greatly benefit fund investors

We strongly support the Commission's proposal requiring private fund managers to provide detailed reporting on a quarterly basis on Form ADV, breaking down all the compensation, fees, and expenses paid to the adviser. Fund advisers are not currently providing that baseline level of information and have largely ignored investors requests to do so.[15] This rule will help ensure that investors know what fees and expenses they are being charged and determine whether they are appropriate.

There's no question that many private fund investors do not have the information they need to have insight into the additional fees they are being charged on top of their standard 2% management fee and 20% performance fee.[16]

For example, the Commission fined private equity firm Lightyear Capital in 2018 for charging its investors legal, compliance, and consulting expenses without disclosing that funds primarily owned by its own employees in the same investments would not be charged the same

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[11] Greene, Sophia. Financial Times. Private equity: the definition of an opaque asset class. Jan 24, 2015. https://www.ft.com/content/7d5fda20-a182-11e4-8d19-00144feab7de

[12] Jeng, Leslie and Lerner, Josh. American Economic Review. Making Private Data Accessible in an Opaque Industry: The Experience of the Private Capital Research Institute. 2016. https://www.aeaweb.org/articles?id=10.1257/aer.p20161059

[13] Sonti, Samir. American Federation of Teachers. Lifting the Curtain on Private Equity: A Guide for Institutional Investors and Policymakers. March 2021. https://www.aft.org/sites/default/files/private-equity-report-2021.pdf

[14] Gillers, Heather. Wall Street Journal. Retirement Funds Bet Bigger on Private Equity. Jan 10, 2022. https://www.wsj.com/articles/retirement-funds-bet-bigger-on-private-equity-11641810604

[15] Cumming, Chris. Wall Street Journal. New Rules Aim to Prevent Private-Equity Firms From Passing Legal Costs to Investors. Mar 9, 2022. https://www.wsj.com/articles/new-rules-aim-to-prevent-private-equity-firms-from-passing-legal-costs-to-investors-11646823601

[16] Simon, Emma. Morningstar. Why are Fund Fees So Confusing? Mar 17, 2021. https://www.morningstar.co.uk/uk/news/210529/why-are-fund-fees-so-confusing.aspx

expenses. Additionally, because they did not have adequate information about the private funds' expenses, the investors were deprived of the management fee rebates they were eligible for. "The Limited Partners of the Flagship Funds had no way of knowing that the Flagship Funds did not receive the management fee offset," the Commission stated in its cease-and-desist order.[17]

The lack of transparency has even enabled some private fund advisers to pass the costs of private jet flights[18] and personal expenses[19] onto fund investors. [20]

The SEC proposal protect investors by prohibiting private funds from charging investors or their portfolio companies' fees related to wrongdoing or for services not provided

In conjunction with the Commission's proposal to specifically list the various fees and expenses investors are being charged on their Form ADV, we strongly support the Commission's new proposed rules to explicitly prohibit the following fees and expenses from being passed on to investors.

- Accelerated monitoring fees
- Costs related to governmental or regulatory investigations
- Compliance expenses
- Costs related to obtaining external financing

These fees and expenses are not related to services provided to investors but rather as the Commission correctly characterizes them "compensation schemes that are contrary to the public interest and the protection of investors" and should therefore be covered by the fund, not the investors.

Requiring a standardized set of returns and disclosure of assumptions used in calculating returns and requiring more accurate metrics would help investors verify they are getting accurate return information

We strongly support the Commissions propose to require private equity funds who would be considered "illiquid funds" to include the assumptions and calculations that go into their return figure, which the industry currently shows using an Internal Rate of Return (IRR). Given the historical unreliability of IRR, we also strongly support Commissions proposal to require that

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[17] Securities and Exchange Commission. Order Instituting Cease-and-Desist Proceedings Pursuant to 203(k) of the Investment Advisers Act of 1940. Dec 26, 2018. https://www.sec.gov/litigation/admin/2018/ia-5096.pdf
[18] Flood, Chris. Financial Times. Investors take aim at private equity's use of private jets. Nov 8, 2021. https://www.ft.com/content/1212b266-8760-4766-a03e-9e7db203b5d2
[19] Indap, Sujeet and Vandevelde, Mark. Financial Times. Apollo rebuked in trial over bogus expenses. Dec 4, 2020. https://www.ft.com/content/f2b79a28-889c-4ff1-86cf-53dc96454d76
[20] Fross, Stuart et al. Foley & Lardner LLP. SESC Enforcement Actions Impacting Private Fund Advisers for Fiscal Year 2020. https://www.foley.com/en/insights/publications/2020/11/sec-actions-private-fund-advisers-fy-20

advisers provide investors with return figures that show how many multiples of capital have actually been returned to investors.

Investors in what the Commission defines as "illiquid funds" currently have very little insight into how returns from their fund's investments are calculated, which in turn means they have little information about the accuracy of the return figures they are presented with, or about what more accurately or comparably presented returns might be. Since those private investments have no publicly available market price, investors have no independent way to verify those returns are being calculated accurately. Investors pay performance fees based on returns, and they consider making investments based on prior performance figures; this information is crucially important.

One return metric very frequently used by PE firms, the Internal Rate of Return (IRR), has been found repeatedly to be an unreliable measure of performance,[21] especially given that borrowed money can be used to further inflate the IRR.[22]

IRR is heavily distorted by a fund's early returns as evidenced by how consistent a fund's IRR tends to stay over most of the life of a fund.[23] A look into Yale University's endowment investments into a KKR fund for example shows a since-inception IRR of around 26% in every SEC filing since 2006 while the same goes for its investments in Apollo's private equity funds where the since-inception IRR stay around 39%.[24]

Assuming those figures were accurate total returns, $100 million invested in one Apollo fund in 1990 and growing annually at that rate would be worth over $2.3 trillion today, a mathematical absurdity given that the entire private fund industry itself is estimated to manage around $11.5 trillion.

Workers and retirees are harmed when inflated returns do not come to fruition. A 2013 investigation into six private equity funds the Florida State Board of Administration invested in found that the funds collectively gained $351.5 million from 1988 to 2011. However, if those same funds had instead been invested in the Russell 3000 index of small cap stocks, those investments would have yielded $1.38 billion; Florida retirees were deprived of $1 billion in

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[21] Phalippou, Ludovic. Oxford Said Business School. The Hazards of Using IRR to Measure Performance. Sep 29, 2009. https://ssrn.com/abstract=1111796

[22] Albertus, James and Denes, Matthew. Carnegie Mellon Tepper School of Business. Distorting Private Equity Performance: The Rise of Fund Debt. June 2019. https://uncipc.org/wp-content/uploads/2019/07/DistortingPrivateEquityPerformance_07192019.pdf

[23] Phalippou, Ludovic. Oxford Said Business School. The Hazards of Using IRR to Measure Performance. Sep 29, 2009. https://ssrn.com/abstract=1111796

[24] Phalippou, Ludovic. Oxford Said Business School. An Inconvenient Fact: Private Equity Returns & The Billionaire Factory. December 2020. https://doi.org/10.3905/joi.2020.1.153

returns as a result of this investment choice.[25] Inaccurate return figures guiding investment decisions on a large scale also distort the capital markets.

We therefore strongly support the Commission's proposal to require private fund advisers to disclose on their Form ADV the criteria and assumptions used to determine their performance calculations, and to require additional performance figures based on multiples of capital committed to show how much cash has actually been distributed back to investors.[26] Such additions would greatly help investors compare the returns of funds to each other, and to lower-fee alternatives in the public market.

Annual audits of every private fund should be mandatory

We also support the SEC proposal to require that every private fund be audited annually by an independent public accounting firm registered with the Public Company Accounting Oversight Board (PCAOB).

Such independent audits would provide an additional level of scrutiny over whether the fund advisers' estimated valuations on its illiquid investments, that otherwise have few public price points, are consistent with Generally Accepted Accounting Principles (GAAP).

Given the Commission's findings that 10% of private funds are still not being audited, mandatory audits should be required of all private funds so that investors are provided with the necessary safeguards against inflated fund valuations and other compliance breaches.

The SEC should collect and share appropriately aggregated and anonymized information about fees and returns with researchers, policy makers, and the public

While the additional detail surrounding fees, expenses, and returns provided to private fund investors will be useful for investors in private funds, we also urge the Commission to share information in appropriately aggregated and anonymized formats with researchers, policy makers, and the public.

These public disclosures would add another layer of accountability for all actors in the system and would also provide private fund investors with additional insights into what they are being charged relative to others' and into the performance of PE investments.

All side letters need to be disclosed to all other investors; side letters that put some investors at a material disadvantage should not be permitted.

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[25] Edwards, Gina. Watchdog City. Opting for risky and secretive private equity investments cost Florida pension fund an estimated $1 billion on six deals. Apr 2, 2013. http://www.watchdogcity.com/storyinfo/216-Opting-for-risky-and-secretive-private-equity-investments-cost-Florida-Pension-fund-an-estimated-1-billion-on-six-deals-.htm

[26] Robertson, Gary. Callan. Private Equity Performance Measurement Requires Unique Calculations. Oct 22, 2019. https://www.callan.com/blog-archive/pe-measurement/

We support the Commission's proposal to require that all special arrangements or terms offered to a certain set of fund investors, often referred to as "side letters," be disclosed to all other investors in the fund to ensure there are no violations of fiduciary duties to other investors.[27] Investors need to be able to see what side agreements funds have with other investors to ensure that they are not being unduly harmed by agreements they have no visibility into. Allowing preferential treatment enables private fund advisers to actively discriminate between different classes of investors.

The side letters with the greatest potential to harm other fund investors are those that include the ability to redeem their holdings first, which leaves remaining investors invested in a materially different portfolio that may be far riskier and/or less liquid.[28] We therefore support the Commission's proposal to prohibit preferential terms regarding redemption to select investors.

Preferential information sharing that is illegal in the public markets should be prohibited in private markets

We support the Commission's proposal to prohibit the selective disclosure of information to some investors. In the public markets, under Regulation FD, it is illegal for a public company to disclose information to a certain set of investors, but not others. [29] Yet, private funds have been engaging in the practice of providing only certain investors, often large funds who actively invest with the manager or initial seed investors, with additional details into their portfolio investments.

Such selective disclosures to certain investors may also be a violation of the private funds fiduciary duty to its other investors who may be negatively harmed as a result.

The Commission should therefore ban any such side arrangements that allow the selective sharing of material, non-public information.

Additional reporting requirements are not an unfair burden on smaller funds

Contrary to the arguments that are being made about the additional costs associated with these reporting requirements, it is worth noting that all the information the Commission is requesting is already available to the funds themselves; it is simply not being disclosed. Any properly operated private fund is already tracking all this information in the ordinary course of its daily

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[27] Dechert LLP. Private fund side letters: common terms, themes, and practical considerations. Oct 28, 2018. https://www.dechert.com/knowledge/onpoint/2018/9/private-fund-side-letters--common-terms--themes-and-practical-co.html

[28] Davie, Alexander. Strictly Business. Using Side Letters in Private Funds. Nov 29, 2017. https://www.strictlybusinesslawblog.com/2017/11/29/using-side-letters-in-private-funds/

[29] Morrison & Foster. Frequently Asked Questions About Regulation FD. Oct 2, 2017. https://media2.mofo.com/documents/faqs-regulation-fd.pdf

business. The Commission is simply proposing to mandate that this information be made available to investors.

Thank you again for the opportunity to comment. For more information please contact Jess Newman, Political Manager, [redacted], 248-763-4506 or Ben Wolcott, Senior Research Coordinator: Wall Street Accountability Campaigns, [redacted], 301-704-2886.