April 15, 2022

Chair Gary Gensler
Honorable Commissioners
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549–1090
Via email: rule-comments@sec.gov

Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews
File No. S7–03–22

Dear Commissioners,

On behalf of more than 500,000 members and supporters of Public Citizen, we provide the following comment in response to the Securities and Exchange Commission's (SEC) proposal regarding private fund advisors. Many Public Citizen members are investors; some are beneficiaries of pension funds that may invest in private equity. Therefore, we have an immediate interest in disclosures now proposed by the SEC.

There are currently 5,037 registered private fund advisers who manage more than $18 trillion in private fund assets.[1] These fund advisors play a major role in the economy, through mergers, acquisitions, bankruptcies, lending and more.[2] Many private funds engage in venture capital where they provide essential support for new companies. Meanwhile, some of the nation's most important savings plans are invested in these private funds, including state, municipal, university and labor pension plans.

Private equity advisors also impact the economy, sometimes in damaging ways. In the 1980s, leveraged buyout funds bought once stable companies, then saddled them with debt. This in turn forced layoffs, plant closures, and a reduction in research among other cutbacks.[3] Congress explored these problems in

[1] Securities and Exchange Commission, *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Review,* FEDERAL REGISTER (March 24, 2022) https://www.govinfo.gov/content/pkg/FR-2022-03-24/pdf/2022-03212.pdf
[2] Division of Investment Management, Analytics Office, *Private Funds Statistics Report: First Calendar Quarter 2021,* SECURITIES AND EXCHANGE COMMISSION (Nov. 1, 2021) https:// www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2021-q1.pdf
[3] See, for example, Bryan Burrough, *Barbarians at the Gate*, HARPERCOLLINS (1989) https://www.amazon.com/Barbarians-Gate-Fall-RJR-Nabisco-ebook/dp/B000FC10QG

several congressional hearings.[4] In the last decade, private equity has led to 1.3 million job losses in the retail sector alone, through such bankruptcies as Toys R Us and at other large employers. In fact, job reduction appears to be a business model for this sector, as employment has been found to shrink in the two years after a private equity firm takes over a public company. Other services falter as well. When private funds take over a nursing home, mortality rates jump by 10% while bills for patients also rise more than 10%.[5] Private fund investment in housing leads to rising rents, higher rates of eviction, and worse quality. Buyouts of private colleges lead to higher tuition and student debt, lower graduation rates and graduate earnings, and more law enforcement actions for fraud.[6] As Public Citizen has shown in recent research, when lawmakers have attempted to seek reform, private funds flooded key lawmakers campaign coffers to try and halt the oversight.[7]

Private equity has contributed to climate change. Since 2010, private equity has invested more than $1.1 trillion into fossil fuel companies, according to one report. This is more than the market value of the three largest oil companies combined.[8]

Despite the fact that private funds, by definition, are aimed at privileged investors, Public Citizen and our partners found that $5.3 billion in relief funds from the CARES Act meant for cash-strapped enterprises were diverted to 611 portfolio companies backed by 113 private equity funds.[9]

Because of the use of leverage, private funds represent a systemic risk to the financial system and the broader economy. Between 2015-2019, nearly two-thirds of retail companies that went into bankruptcy were owned through private funds. Bankruptcy rates among companies purchased in leveraged buyouts are 10 times higher than those in other firms.[10]

An immediate problem for investors is the high level of fees charged by private equity advisors. As the commission notes, it has pursued enforcement actions where advisors caused private funds to pay inflated fees and expenses.[11] One SEC official noted that an examination of fees and expenses uncovered "violations of law or material weaknesses in controls over 50% of the time."[12] A recent Risk Alert issued by the SEC found numerous failures, including track records that failed to reflect fees and expenses;

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[4] See Senate Banking Committee, *Legislative Calendar,* UNITED STATES SENATE (1987-1988) https://www.banking.senate.gov/imo/media/doc/Legislativecalendar100th.pdf

[5] Sen. Elizabeth Warren, *Private Equity: By the Numbers*, OFFICE OF SENATOR WARREN (website visited March 7, 2022) https://www.warren.senate.gov/imo/media/doc/PE%20Stats%20Final.pdf

[6] Sen. Elizabeth Warren, *Private Equity: By the Numbers*, OFFICE OF SENATOR WARREN (website visited March 7, 2022) https://www.warren.senate.gov/imo/media/doc/PE%20Stats%20Final.pdf

[7] Mike Tanglis, Private Equity's Investment, Public Citizen (March 11, 2020) https://www.citizen.org/article/private-equitys-investment/

[8] Alyssa Giachino, *Private Equity Propels the Climate Crisis*, PRIVATE EQUITY STAKEHOLDER PROJECT (October 2021) https://pestakeholder.org/report/climate-crisis/

[9] Miriam Li, Taylor Lincoln, Mike Tanglis, et al *Public Money for Private Equity,* PUBLIC CITIZEN, AMERICANS FOR FINANCIAL REFORM, ANTI-CORRUPTION DATA COLLECTIVE (Sept 15, 2021) https://www.citizen.org/article/public-money-for-private-equity/

[10] Sen. Elizabeth Warren, *Private Equity: By the Numbers*, OFFICE OF SENATOR WARREN (website visited March 7, 2022) https://www.warren.senate.gov/imo/media/doc/PE%20Stats%20Final.pdf

[11] Securities and Exchange Commission, *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Review,* FEDERAL REGISTER (March 24, 2022) https://www.govinfo.gov/content/pkg/FR-2022-03-24/pdf/2022-03212.pdf

[12] Andrew J. Bowden, Remarks, SECURITIES AND EXCHANGE COMMISSION (May 6, 2014)_ https://www.sec.gov/news/speech/2014--spch05062014ab.html.

failure to reduce the cost basis of an investment when calculating their management fee after selling, writing off, writing down or otherwise disposing of a portion of an investment, which could result in charging investors excess management fees; presenting stale performance information; and cherry-picking track records. [13]

In some cases, it is difficult for investors to understand fee inflation because firms are not required to detail their nature. The number of fees abound, from management fees, performance-based compensation, consulting fees, monitoring fees, servicing fees, transaction fees, director fees, and expenses charged directly to the funds. At the time of the initial investment and as fund operations continue, many investors do not have sufficient information regarding the fee streams that flow to the adviser or its related persons and reduce the return on their investment. As for results, funds describe them in a variety of ways that may include different assumptions and benchmarks and are not standardized between funds. In addition, fund advisors may have conflicts that are unknown to investors. For example, a fund advisor may apply returns to is preferred customers. Certain venture advisors may obtain control of the new enterprise and force the company to use the advisor for other services.

Currently, private funds disclose information to the SEC through Form ADV. It requires only minimal information. This includes information about the investment adviser's business, ownership, clients, employees, business practices, affiliations, and any disciplinary events of the adviser or its employees. The format consists of check-the-box and fill-in-the-blank items. It also requires a narrative brochure that is provided to clients that include plain English disclosures of the adviser's business practices, fees, conflicts of interest, and disciplinary information. Finally, Form ADV requires a "relationship summary," which is brief summary about the types of services the adviser offers, the fees and costs clients will have to pay for those services, the conflicts of interest the adviser may have, the required standard of conduct, any legal and disciplinary history, key questions to ask the adviser, and references to where clients can find more detailed information about the adviser and the services they offer.[14] To address problems with fees and other disclosure deficiencies in private equity, the SEC is proposing a number of improvements to allow investors to understand what fees they are being charged and how they are being charged; accurate information on returns; whether the fund advisor engaged in misconduct, and whether other fund investors are receiving preferential treatment.

On a quarterly basis, the SEC proposes that fund advisors disclose a table detailing all the different fees and expenses charged; a standardized report comparing returns to other benchmarks; disclosure of special arrangements with certain investors; a prohibition of certain conflicts. We support these proposals.

The SEC also proposes to require that every private fund be audited annually by an independent public accounting firm registered with the Public Company Accounting Oversight Board (PCAOB). These audits will provide important scrutiny over how the fund is estimating valuations of complicated property such as real estate that is not sold routinely. We strongly support these required disclosures.

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[13] *Observations from Examinations of Private Fund Advisers*, SECURITIES AND EXCHANGE COMMISSION (Jan. 27, 2022) https://www.sec.gov/files/private-fund-risk-alert-pt-2.pdf

[14] *Form ADV,* SECURITIES AND EXCHANGE COMMISSION (website viewed March 30, 2022) https://www.investor.gov/introduction-investing/investing-basics/glossary/form-adv

We also support the commission's proposal to prohibit the selective disclosure of information to some investors. In the stock market, it is illegal for firms to make selective disclosures to some investors while not to all investors.[15] It should also be illegal in the private markets.

The new disclosures will be confidential, reported to the SEC and private fund investors. It will not be made public. We believe the SEC should anonymize this data and make it public. This will be important for researchers, policy makers and the public, especially those investors who might consider the fund. This will also help accountability.

As climate change alters the planet including investment decisions, we urge the SEC to expand requirements by PE advisors to report on how their management addresses these concerns. The SEC recently proposed expanded disclosures for publicly traded firms. We believe investors private equity should be afforded similar information.

Again, we applaud the commission for proposing this rule as an important step in helping investors understand fees and conflicts with private equity.

For questions, please contact Bartlett Naylor at [redacted].

Sincerely,

Public Citizen

[15] *Selective Disclosure and Insider Trading,* SECURITIES AND EXCHANGE COMMISSION (website visited April 6, 2022) https://www.sec.gov/rules/final/33-7881.htm