April 25, 2022

Submitted via electronic filing: rule-comments@sec.gov

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: File Number S7-03-22 – Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews

Dear Ms. Countryman:

The Ohio Public Employees Retirement System (OPERS) is pleased to respond to the Securities and Exchange Commission’s (SEC or Commission) request for comment on its proposed reforms for private fund advisers (Proposal or Proposal).1 OPERS is generally supportive of the Commission’s efforts to improve transparency and integrity within the private markets; however, we are also concerned that some of the Commission’s proposed reforms could have unintended consequences that could ultimately harm the investors (e.g., public retirement systems and their members) the Commission is trying to protect.2

OPERS is the largest public retirement system in Ohio, with more than 1.1 million active, inactive, and retired members. Nearly one out of every 10 Ohioans has some connection to our System, and for many of them, OPERS represents the only retirement income they will ever receive. As such, we make every reasonable and prudent effort to maximize the value of our members’ retirement contributions and improve their retirement security.

We view the Commission’s Proposal as being among the most consequential it has released in recent years. The private markets have moved into the mainstream for institutional investors, attracting immense amounts of capital, but at the same time avoiding many of the transparency and other investor protection requirements that apply to the public markets. Given the size and importance of the private markets to institutional investors, many, including OPERS, have argued that policymakers should act to address some of the practices that continue to be commonplace in private market structures, such as fee and expense shifting and waiver of fiduciary duties.

We appreciate that the SEC has sought to protect investors by proposing rules to address these practices. In fact, OPERS has supported some of the Commission’s proposed reforms in its own

2 Id. at 87 Fed. Reg. 16,887.
advocacy to members of Congress and their staff, as well as through organizations such as the Institutional Limited Partners Association (ILPA) and the Council of Institutional Investors.

The opacity associated with private market funds costs investors time and money as they seek to protect themselves by painstakingly negotiating the terms of their legal agreements with private equity managers. It is difficult to anticipate self-interested behavior and even more so to fully mitigate the risks associated with that behavior. With the relatively recent influx of capital into the private markets, investors often find themselves competing for the same opportunities, which can erode their negotiating leverage and limit the universe of potential high-quality, top-performing managers. To the extent the Commission acts to require basic improvements in the integrity of the private markets, it can take some of this burden off investors whose only recourse is often to abandon a deal if they cannot negotiate the terms or transparency that they need.

However, we cannot consider these reforms in a vacuum. The private markets have thrived – in spite of the self-interested practices described in the Commission’s Proposal – because in many instances, investors have been well-compensated for their risks. The Commission’s Proposal is far-reaching and significant and while we, as investors, may welcome the additional protections, we cannot ignore the impact these reforms may have on the development of the private markets or the returns we receive from our participation therein.

Over the past 10 years, private equity has consistently been one of OPERS’ top performing asset classes, with net time-weighted returns of 16.8%. In 2021, net returns from investments in private equity were 44.8%, compared to the 15.3% returns of the total defined benefit plan. Further, private equity currently represents more than 12.5% of OPERS’ total assets. It is difficult to overstate the contribution that private equity has made to our ability to sustainably provide secure retirement benefits for our members.

The Commission’s Proposal requires us to consider how this could change moving forward. As noted above, we believe that some of the Commission’s proposed reforms could have unintended consequences for investors. It remains to be seen whether general partners (GPs) will simply bear the additional costs and risks associated with the Commission’s proposed reforms or try to shift some of that burden to investors. For example, OPERS is very concerned that GPs will use the Commission’s proposed reforms regarding preferential treatment in side letters as an excuse to deny certain investors the individual terms they need because they are unwilling to disclose those concessions to all investors. While the SEC may not have intended these results, the nature of the asset class and our own experience compel us to consider what we may have to pay or forgo for the protections the Commission has proposed.

Unfortunately, this is the perspective from which we must consider the Commission’s Proposal. We are not offering a defense of the status quo, so much as we are urging the Commission to consider the tradeoffs that might result from its proposed changes. It is worth remembering that although the current system is flawed, it has produced consistently strong returns that we use to build and sustain retirement security for our members.
With that said, we believe there is tremendous value in the Commission’s efforts to identify, challenge, and deter self-interest and opacity. The SEC has laid a strong foundation with its Proposal, and we are supportive of its intent, if not all of its proposed reforms. Our comments regarding the SEC’s Proposal are provided below, divided into three sections based on our support, requests for clarification, or opposition to each of the SEC’s proposed reforms.

1. **Areas of General Support**

A. **Quarterly Fee, Expense, and Performance Disclosures**

OPERS generally supports the Commission’s decision to require quarterly disclosures regarding the fees, expenses, and performance associated with private funds. In the past, we have joined with other investors and advocacy organizations, such as ILPA, to request similar disclosures and we continue to believe they will allow private fund investors of all sizes to better monitor and evaluate their investments and ensure that the GP is adhering to the terms included in the limited partnership agreement (LPA).

OPERS was an early adopter of the ILPA reporting template and has required its GPs to complete some version of that form for more than five years. As a tool for gathering and standardizing data regarding private fund fees and expenses, OPERS’ implementation of the ILPA template has been incredibly helpful. However, tools are only as good as our ability to use them, and despite our best efforts to require disclosure, not all GPs complete our reporting template with the same level of specificity or detail. We believe the remaining impediment to effective disclosure is the lack of a mandate; voluntary participation has taken us as far as it can.

The SEC’s Proposal will allow investors to gather, aggregate, and use data to monitor their investments and fulfill their duties to their members and sponsors. As importantly, the SEC’s Proposal will remove the provision of fee, expense, and performance data from the list of items that need to be negotiated upon entry to a new private fund, thereby allowing investors to reallocate their time and energy to other more pressing items.

While we view the proposed disclosures as a positive development, we would clarify that our support is based on an understanding that the rule will require an appropriate level of granularity in the disclosed data. For example, the Proposing Release states that the Proposed Rule “would require a detailed accounting of each category of fund expense,” and also that a GP “would be required to list each specific category of expense … and the corresponding dollar amount, separately.”\(^3\) This is important because GPs should not be permitted to hide or obscure specific expenses by combining them together under broad categories. Investors should be able to compare and understand the provided information, as well as determine exactly what expenses they are paying and for what.

Additionally, we would echo the concern raised by ILPA and others that the Proposed Rule requires only fund-level reporting of fees, expenses, and performance, rather than the individual

\(^3\) *Id.* at 87 Fed. Reg. 16,894.
limited partner (LP)-level reports that many investors, including OPERS, have been able to receive under the ILPA reporting template. While the SEC offers that the Proposed Rule does not “prevent [a GP] from providing, or an investor from negotiating, personalized reporting,” there is at least a question as to whether the Commission’s Proposal will act as a ceiling on the level of disclosure that investors can expect moving forward. As such, we encourage the SEC to require LP-level disclosures in its proposed quarterly statements.

B. **Miscellaneous**

OPERS generally supports the Commission’s decision to require annual private fund adviser audits and views this reform as introducing a degree of consistency regarding the provision of a tool that investors can use to monitor their investments. Similarly, OPERS is generally supportive of the Commission’s decision to prohibit GPs from (1) charging compliance or other regulatory costs to private funds, (2) withholding taxes from clawback distributions to LPs, (3) charging private funds for services that have not been performed, and (4) borrowing from private funds.

We view each of these proposed reforms as improvements to the current system and consistent with the Commission’s goal of increasing investor protection. Further, each of these proposals addresses an item that is usually subject to the negotiation process between GPs and investors and as such, will provide investors with a more consistent set of protections and allow them to use their limited leverage to negotiate other more pressing terms.

2. **Requests for Additional Information, Clarification, or Possible Expansion**

A. **Prohibition on Limiting or Eliminating Liability for Adviser Misconduct**

On its face, the SEC’s decision to prohibit GPs from seeking “reimbursement, indemnification, exculpation, or limitation of [their] liability by the private fund or its investors for a breach of fiduciary duty, willful misfeasance, bad faith, negligence, or recklessness in providing services to [a] private fund” is a welcome and necessary reform. OPERS has advocated for similar relief in the past and continues to believe that strong standards of care and limitations on GPs’ ability to be indemnified and exculpated for their bad acts should be mandated.

OPERS frequently encounters contractual terms asking LPs to waive their rights to hold GPs accountable for bad acts in relation to the fund, or to make GPs whole for losses sustained in connection with those bad acts. As noted in the Proposing Release, these terms are “permissible under certain state laws” and many GPs take advantage of these grants of authority. LPAs also almost universally pare back fiduciary standards of care with respect to GPs as otherwise permitted under law.

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4 *Id.* at 87 Fed. Reg. 16,891.
5 It is our understanding that this prohibition includes the various disclosure and other regulatory requirements included in the SEC’s Proposed Rule.
7 *Id.* at 87 Fed. Reg. 16,951.
OPERS spends significant amounts of time and money trying to shield itself and the other LPs from broad indemnification and exculpation provisions, or waivers of fiduciary duties, often at the expense of negotiating other important terms. If we are not able to negotiate acceptable standard of care, indemnification, and exculpation provisions, our only recourse is often to walk away from the fund investment, which could affect our ability to secure strong risk-adjusted returns.

Based on our reading of the SEC’s Proposal, it is unclear to us whether it will preempt state laws that allow parties to contract away certain fiduciary elements. If the protections may only be read to affect what is currently permissible under the Investment Advisers Act of 1940 (Advisers Act), then LPs will continue to face the obstacles they currently experience because they lack a private right of action to enforce the Advisers Act protections. To the extent the SEC’s Proposal will preempt state law provisions governing waivers of duties and limitations of liability, we support its efforts; however, if that is not the case, we respectfully request that the SEC provides additional information and guidance regarding the intended scope, impact, and potential consequences of this proposed prohibition.

Beyond that, we encourage the SEC to consider establishing its own universally applicable standard of care and perhaps even a private right of action for investors to enforce the duties required by the Advisers Act. Additionally, to the extent that GPs feel they must purchase large insurance policies to protect themselves in response to the SEC’s rules, it may be worthwhile for the SEC to consider whether the premiums associated with those policies might most appropriately be described as a manager, rather than a fund, expense.

B. GP-led Secondary Transactions

At the outset, it is important to note that OPERS is very pleased that the SEC has identified GP-led secondary transactions as an area of concern and has taken steps to address what has become a serious and increasingly frequent issue for many LPs. OPERS’ primary concern is with the adequacy of the SEC’s proposed relief; namely, we question whether the decision to require the procurement of a fairness opinion will be sufficient to confront the investor protection issues that arise in certain GP-led secondary transactions.

While the SEC’s Proposed Rule speaks to GP-led secondary transactions more broadly, we are focusing our comments on GP-led continuation funds and their impact on LPs. Continuation funds are often structured in ways that favor GPs, and it is not uncommon to encounter fee increases, changes in negotiated terms, suspect valuations, and other inequitable behaviors in these types of transactions. In considering whether to proceed with its proposed fairness opinion requirement, we respectfully request that the SEC take meaningful steps to address these other investor protection concerns associated with GP-led continuation funds.

As background, in a continuation fund, a GP will establish a new fund under its management for the purpose of acquiring portfolio investments from its existing fund. A new LPA is drafted, which necessitates additional underwriting and legal document review. Usually, existing side letter protections do not carry over to the new fund, and often fee rates are reset. A valuation
process, which sometimes involves a fairness opinion, is conducted and presented to the LPs, who are then given an opportunity to sell their interests in the selected portfolio companies or roll their interest into the new fund.

It is impossible to know a GP’s motivation in using a continuation fund, but many in the LP community suspect such practices are often used to benefit the GP by crystallizing carried interest on the portfolio company when it is sold from one fund to the other, resetting economic terms with an intent to increase fees, or changing other fund terms to shift risk away from the GP. What is clear, however, is that GPs attempt to reclaim any negotiating leverage they may have shared in the original fund by providing tight timeframes for review, disallowing LP negotiation of continuation fund governing documents, and presenting a “take-it-or-leave-it” approach to LPs in their decision to roll into the new fund or cash out.

Depending on the terms of the new fund, LPs may or may not be able to roll their interest into it. As noted above, LPs are not generally given the chance to transfer their negotiated economic terms and side letter protections if they elect to roll their interest. Moreover, even though GPs often know well in advance that they plan to establish a continuation fund, they often do not communicate that information to the LPs until shortly before the new fund is created. LPs sometimes have as few as 10 business days to decide whether they will sell their interest or roll it. This means that LPs often do not have sufficient time to adequately evaluate the transaction, get necessary approvals, or conduct appropriate legal reviews.

When faced with the choice of cashing out and losing the potential for future returns or retaining the potential for returns and losing all of their protection and economic terms, many LPs feel compelled to sell their interest. The fact that many investors do not believe they have a true choice whether to participate in a continuation fund because they cannot accommodate or accept uneven terms written to favor GPs presents significant concerns regarding investor protection and is worthy of further consideration by the SEC.

As noted above, the SEC’s proposed fairness opinion requirement is a welcome first step, but it is not well suited to address many of the inequities associated with GP-led continuation funds. For example, OPERS experienced one situation in which an independent fairness opinion was provided as proof that LPs were being offered a fair price for their interests, but almost immediately after the rollover documents were signed, a sale of the rollover’s largest asset was announced at a much higher valuation than was presented to the LPs at the rollover election. The provided fairness opinion did not take into account the subsequent liquidity event because it was meant only to assess whether the price offered to LPs was fair at that moment and could not have contemplated that the GP intended to undertake a liquidity event in the immediate aftermath, because the GP was not required to share that information.

OPERS believes GP-led continuation funds currently present serious investor protection concerns that merit further regulatory action. We respectfully request that the Commission considers whether it can provide additional relief beyond the proposed fairness opinion requirement. For example, investors in a GP-led continuation fund would ideally be offered an option to participate based on the same terms that applied in the initial fund or elect a “status quo
option” by maintaining the original pro rata investment through the initial fund, allowing those negotiated terms to remain in place.

Additionally, ILPA has discussed a number of other principles-based reforms to address the most egregious behaviors associated with GP-led continuation funds, including requiring an independent fairness opinion/third-party valuation, providing the LPAC with additional time, transparency, and opportunities to discuss so that it can make an informed conflict of interest waiver vote; and supplying LPs with a clear justification for why the continuation fund, rather than an alternative option, was chosen. OPERS generally supports each of these reforms.

3. Areas of Concern

A. Prohibition on Certain Non-Pro Rata Fee and Expense Allocations

OPERS is concerned that the SEC’s proposed prohibition on certain non-pro rata fee and expense allocations could inequitably impact co-investors that invest alongside another fund managed by the same GP. To the extent the SEC believes it must address non-pro rata allocations of fees and expenses, we respectfully request that it considers a more nuanced solution than a blanket prohibition, including allowing flexibility in co-invest situations where such allocations may make sense for the fund and its investors.

For example, consider a fund structure in which a commingled fund identifies, performs diligence on, and negotiates the purchase of a portfolio company, and a co-investment vehicle becomes involved only in the very final stages of the transaction to provide additional capital, if needed. Under the Proposed Rule, LPs in those commingled vehicles could be required to pay broken deal expenses for transactions in which they had no involvement prior to those expenses being incurred. Contrary to what was proposed by the Commission, we believe it is inequitable to shift a pro-rata portion of these expenses to a co-investment fund that had no role in identifying or negotiating these transactions. Further, co-investment funds often do not have management fee offsets to reduce the burden of these expenses as the commingled fund would.

At a minimum, we believe that non-pro rata allocations should be preserved as a term that can be negotiated depending on the economics and circumstances of a particular co-investment strategy. Co-investments are an important contributor to OPERS’ investment strategy and are often used by other similarly situated public sector institutional investors. The SEC’s Proposed Rule would materially change the economics of these investments, potentially making it more difficult to find co-investors and in turn, creating concentration risk from a few larger investments in the main fund and thereby changing the risk profile of the fund.

OPERS also seeks to clarify whether the SEC intends this proposed prohibition of certain non-pro rata fees to apply to situations in which a GP absorbs certain expenses of an individual LP, so long as the cost of that coverage is not passed on to other investors. For example, as a public entity, OPERS must consider reputation and headline risks involved with the payment of private air travel for GPs as a fund expense. In instances where the GP is unwilling to carve this out as a fund expense, they will often choose to absorb our pro-rata share of that expense instead of
shifting that to the other LPs in the fund. Presumably, this situation would be unaffected by the SEC’s Proposed Rule, but we wish to confirm this interpretation. Conversely, if the Proposed Rule would require all LPs to share in this cost, we are interested in the SEC’s thoughts regarding how that would impact the LPs that have these types of individual restrictions in place.

B. Preferential Treatment

OPERS has significant concerns regarding the possible consequences of the Commission’s proposed prohibitions and mandated disclosures relating to certain terms negotiated between LPs and GPs. In particular, we worry that the SEC’s Proposal is insufficiently clear regarding the definition of certain affected terms leading to questions about the appropriateness of terms that are currently acceptable and necessary. Additionally, we fear that the mandated disclosure of certain side letter terms as required by the Proposal could discourage GPs from agreeing to certain terms in future negotiations.

We appreciate that the SEC is seeking to protect investors by providing a uniform level of transparency, but it is important to remember that these negotiated terms are an important component of how we, as investors, protect ourselves. Investors like OPERS utilize the side letter process to negotiate individual terms and different treatment – including statutory requirements (e.g., mandatory forum selection clauses) and OPERS Board-approved policies (e.g., external manager insurance) – that help tailor and mitigate its risks. If OPERS is unable to protect itself by negotiating these necessary terms, it could be forced to walk away from a fund, which carries its own risks, including missing out on increasingly limited opportunities to deploy capital. As a result, the Commission’s Proposal could end up harming some of the investors it was intended to protect (e.g., the public retirement systems that depend on private market returns to fund pensions for retired public employees).8

Further, it is also important to note the extent to which LPs with smaller commitments and less negotiating leverage (small LPs) can benefit from LPs with larger commitments and greater leverage (large LPs) negotiating terms that apply to all investors. For example, OPERS routinely attempts to negotiate the inclusion of certain investor protections in the LPA because doing so is more efficient or administratively effective for the fund. These include (1) allowing LPs to vote on proposed fund extensions, (2) strengthening investor protections in the event a key person associated with the GP leaves or is replaced, (3) limiting the ability of GPs to put their own interests ahead of the fund’s when acting in their sole discretion, (4) adding limitations on the ability of the fund to recycle capital, and (5) broadening the circumstances in which the LPs may terminate the fund or remove the GP. Each of these terms represent a meaningful benefit to all LPs and is directly attributable to OPERS’s efforts and position as a large LP. If, as a result of the SEC’s Proposal, LPs making large commitments like OPERS are unable to invest in a fund, the entire LP base could lose out on these beneficial changes in negotiation.

The SEC’s decision to prohibit certain terms altogether and others that are not properly disclosed to current and prospective investors seemingly ignores both the ways that all investors – large

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8 See Proposed Rule, supra note 2.
and small – can benefit as a result of the side letter process, and also the possible consequences of regulating the side letter content. We urge the Commission to preserve the ability of investors to negotiate the terms they need through the side letter process.

i. *Prohibited Preferential Redemptions*

OPERS is concerned that the SEC’s prohibition on preferential redemptions could cause issues for investors in certain situations. For example, a public retirement system may need to negotiate individual liquidity options from a fund should its sponsoring state legislature require it to divest its holdings in private market investments. Understanding that the public retirement system’s exit from the fund could be interpreted to materially and negatively impact other investors, would such a negotiated liquidity option constitute a preferential liquidity term prohibited by the rule? In this example, the public retirement system could be caught between a legislative mandate on one side and a GP’s determination that an exit from the fund would have a “material negative impact” on the other.

To be clear, we view this situation as being distinct from GPs granting preferential liquidity terms to certain LPs as a negotiated business item, on which we agree with the SEC’s position. However, we urge the Commission to consider exemptions to its proposed ban on preferential redemptions to allow flexibility in situations such as the example described above. We also respectfully request that the SEC provide additional clarity regarding the definition of “material negative impact” so that investors can adequately consider and check GP decisions to exclude terms.

ii. *Other Preferential Treatment*

OPERS is also concerned that the SEC’s proposed prohibition on other “preferential” treatment (unless it is disclosed to all current and prospective investors in the private fund) suffers from a lack of clarity and consistency regarding the terms that could be considered “preferential” and thus, subject to the rule. The decision to define “preferential” terms by considering the facts and circumstances surrounding their inclusion in a side letter could encourage GPs to become overinclusive in determining whether a term is “preferential” and subject to disclosure so that it has additional leverage in arguing whether a disputed term should be included in a side letter.

This could become problematic for investors if a GP believes – reasonably or not – that denying terms to smaller investors is not worth the trouble or the risk and takes the posture that it will no longer grant certain individualized terms to more significant investors with larger commitments. As discussed above, this refusal could harm every investor in the fund. Larger LPs who generally have the leverage to negotiate these types of terms will be forced to abandon the fund, putting pressure on their ability to achieve the returns they need. Smaller LPs that generally lack the size and leverage to engage in arm’s length negotiations with GPs will be forced to fend for themselves.

We ask the Commission to consider the possible unintended consequences that might follow its decision to require the description or disclosure of “preferential” treatment; specifically, the
possibility that GPs could use this mandate as a shield against investors because they do not want to disclose certain negotiated terms or deal with the pressure of negotiating similar terms with other investors in the fund. As discussed above, we also respectfully request that the Commission provide additional guidance regarding the process by which it will confirm GP decisions that particular terms were indeed “preferential” and thus, subject to disclosure.

Conclusion

OPERS is grateful for the opportunity to submit comments in response to the Commission’s proposed private fund reforms. As discussed above, we view this Proposal as having an enormous and potentially transformative impact on the private markets. As an institutional investor with significant exposure to private funds, we are generally supportive of certain parts of the Commission’s Proposal, including the quarterly reporting and annual audit requirements, as well as the prohibitions on fees for unperformed services and reducing adviser clawbacks for taxes. We are also cautiously optimistic that other parts of the Proposal (e.g., the prohibition on limiting or eliminating liability for adviser misconduct) will provide significant value to investors if they can be further clarified and expanded upon. However, there are still other reforms in the Commission’s Proposal that give us cause for great concern. In particular, we fear that the Commission’s proposed limitations on preferential treatment does not adequately consider current private market realities regarding how investors protect themselves and their investments and could disrupt the side letter process to the point of harming investors. On reforms such as these, we are respectfully requesting that the Commission revisit and revise its Proposal with an eye to comments submitted by OPERS and other large LPs. We appreciate your consideration of our comments and welcome any questions you may have.

Sincerely,

Karen Carraher
Executive Director
Ohio Public Employees Retirement System