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AMERICA'S UNIONS

**American Federation
of Labor and
Congress of Industrial
Organizations**

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April 25, 2022

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

**Re: Private Fund Advisers; Documentation of Registered Investment
Adviser Compliance Reviews [Release Nos. IA-5955; File No. S7-03-22]**

Dear Ms. Countryman:

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), I am writing to provide comments to the U.S. Securities and Exchange Commission in response to the notice of proposed rulemaking on Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews [Release Nos. IA-5955; File No. S7-03-22]. The AFL-CIO is a federation of 57 national and international labor unions that represent 12.5 million working people. Union members participate in the capital markets as individual investors as well as participants in pension and employee benefit plans. We strongly support the Commission's proposed new rules and rule amendments to enhance the regulation of private fund investment advisers.

Private funds are an increasingly large part of many pension plan asset allocations. For example, U.S. public pension plan allocations to private equity rose from 6.35% in 2011 to 8.94% in 2021.¹ As noted by proposed rulemaking, today there are more than 5,000 registered investment advisers of private funds with over \$18 trillion in private fund assets under management. Historically, these private funds have not been subject to SEC oversight under the theory that institutional investors and high-net-worth individuals are financially sophisticated. However, the lack of clear rules for private fund disclosure has led to a market failure due to a lack of transparency regarding private fund fees and performance. The Commission's proposed rules will correct this information asymmetry between private fund investment advisers and private fund investors that include the pension plans of millions of working people.

The Commission's proposed quarterly statement rule for registered private fund advisers will provide uniform and standardized disclosure of fees and expenses. Pension plans have long struggled to comprehend the byzantine fee structure and

¹ Heather Gillers, "Retirement Funds Bet Bigger on Private Equity," Wall Street Journal, January 10, 2022.

opaque costs that are often associated with investing in private funds. In addition to private fund management fees and carried interest performance fees, pension plans also bear the cost of monitoring fees, transaction fees, directors fees and other expenses that are charged to their portfolio companies.² According to a recent Bloomberg study, even the largest U.S. public pension plans have difficulty tracking private fund fees and expenses.³ As a result of this imperfect information, it is not surprising that private fund fees have not faced the same competitive market pressures that have reduced the cost of investing in other asset classes. For these reasons, we strongly support the Commission's proposal to require quarterly reporting of all fees and expenses including all amounts paid by the private fund's portfolio investments.

We strongly favor the Commission's proposed rules to prohibit abusive fee practices that harm investors including pension plans. These include charging "accelerated" monitoring fees for services that may not be performed, non-pro rata fee allocations that result in some private fund investors paying higher fees than others, and regulatory compliance fees that are more appropriately paid for by the registered investment adviser. We find it particularly objectionable that private fund investment advisers have sought indemnification from their clients for breaches of fiduciary duty and other misconduct. These contractual clauses effectively require victims to reimburse perpetrators for their wrongdoing. We also support prohibiting investment advisers from borrowing from their private fund clients and support banning reduced fee clawbacks to cover the private fund adviser's taxes. Such private fund practices are contrary to the public interest and create conflicts of interest that the Commission's proposed rules will rightly prohibit.

The Commission's proposed rules will also provide needed transparency for investors regarding private fund performance. The valuation of illiquid private fund portfolios has long been a challenge for pension plans.⁴ The traditional performance metric for illiquid private funds — internal rate of return — is widely considered to be potentially misleading.⁵ For this reason, we strongly support the Commission's proposed requirement for quarterly disclosure of a multiple of invested capital performance metric in addition to the internal rate of return. We also favor the disclosure of performance information on a gross and net basis, as well as on a realized and unrealized basis. We urge the Commission to also require disclosure of a public market equivalent metric to help investors better evaluate illiquid private fund performance. Finally, we strongly favor requiring that private funds obtain annual audits as well as fairness opinions for adviser-led secondary transactions to verify the valuation of private fund assets.

We also support the Commission's proposed restrictions on private funds providing favorable treatment to certain investors that can have a negative impact on other investors. Granting preferential redemption rights to certain private fund investors is inherently unfair for the

² Eileen Appelbaum and Rosemary Batt, "Fees, Fees and More Fees: How Private Equity Abuses Its Limited Partners and U.S. Taxpayers," Center for Economic and Policy Research, May 2016.

³ Sabrina Willmer, "Private Equity's Opaque Costs Mystify the Pensions That Pay Them," Bloomberg, March 29, 2022.

⁴ Barbara Bovbjerg, "Plans Face Valuation and Other Challenges When Investing in Hedge Funds and Private Equity," U.S. Government Accountability Office, July 20, 2010.

⁵ Luis Garcia, "As Regulators Scrutinize Private-Equity Performance Reporting, Researchers See Value in Alternative Metrics," Wall Street Journal, April 14, 2022; Michelle Celarier, "Is Private Equity Overrated?," New York Times, December 4, 2021, Benjamin Robertson, "Private Equity's Biggest Critic Sounds Off With His Final Warning," Bloomberg, July 23, 2020, Jonathan Ford, "Private equity returns are not all they seem," Financial Times, September 15, 2019; Arleen Jacobius, "IRR may overstate PE returns," Pensions & Investments, July 11, 2011.

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remaining investors who may be left with a less liquid pool of assets. We also believe that investors in private funds should have equal access to information about their investment. The selective disclosure of public company information to favored investors is prohibited by Regulation FD, and the same rules should apply for private funds. We agree that other forms of preferential treatment such as lower fees that are negotiated through side letters should be required to be disclosed to all investors in a private fund. While such fee discounts may be appropriate for a larger private fund investor, all investors in a private fund should at least be made aware of such preferential arrangements through written disclosure.

For these reasons, we are pleased to support the Commission's proposed rulemaking on private fund advisers. The Commission's proposed rules for private fund disclosure will go a long way to correct the power imbalance and information asymmetries that currently exist between private fund investment advisers and their limited partner clients, many of which include working people's pension plans. The transparency provided by these proposed rules will greatly reduce pension plan costs associated with the selection and monitoring of private funds, and will likely result in increased competition between private fund investment advisers to reduce fees and other expenses. We commend the Commission's proposed private fund regulation as an important and necessary part of the Commission's investor protection, capital formation and market integrity mandate. Thank you for the opportunity to share our views. If the AFL-CIO can be of further assistance, please contact me at [REDACTED].

Sincerely,

A handwritten signature in black ink, appearing to read 'B. J. Rees', written in a cursive style.

Brandon J. Rees
Deputy Director, Corporations and Capital Markets