

A COMPETITIVE ANALYSIS OF THE U.S. PRIVATE EQUITY FUND MARKET



APRIL 2023

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**A Competitive Analysis
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Introduction

In February 2022 the SEC issued a proposed rulemaking that would create new disclosure, reporting, audit, and conduct requirements for the investment advisers to private funds (the “Proposed Rule”).¹ In doing so, the Proposed Rule expresses concern with respect to a purported lack of competition in the U.S. private fund market and claims that it would benefit investors by increasing competition in this market.² Furthermore, SEC Chair Gensler has frequently noted the need for greater competition in the U.S. private fund market, including in private equity, and repeatedly stated that increasing competition in the private fund market is one of the primary objectives of the Proposed Rule. He has further asserted that enhancing competition is a basis for the SEC’s authority to regulate private markets including the U.S. private funds industry.³

This report by the Committee on Capital Markets Regulation (the “Committee”) therefore evaluates whether the U.S. private equity fund market is competitive and if the Proposed Rule would enhance competition in the private equity fund market.

Chair Gensler’s focus on competition with respect to the Proposed Rule has been extensive. For example, in a November 2021 speech, Chair Gensler stated, “I think it’s time we . . . bring more sunshine and competition to the private funds space” to address, among other things, an “uneven playing field” among investors.⁴ He later explained that he asked the SEC staff to consider additional regulation of private funds because “[m]ore competition and transparency could potentially bring greater efficiencies to this important part of the capital markets.”⁵ In a January 2022 interview regarding the Proposed Rule he presented it as an effort to “driv[e] greater competition and efficiency in the private funds space.”⁶ He then introduced the Proposed Rule in February 2022 as an effort to “improve the efficiency, competition, and transparency of the activities of private funds’ advisers.”⁷ Following the release of the Proposed Rule he has made additional statements to this effect. In a speech in October 2022, he stated “[g]iven that these [private] funds touch so much of our economy, efficiency and competition among these intermediaries is important. More competition and transparency could potentially bring greater efficiencies to this important part of the capital markets.”⁸ In the same speech he also noted that “[f]inancial intermediaries, like . . . asset managers, sit at the neck of [an] hourglass, collecting a few grains in each transaction. With trillions of grains flowing through daily, a few grains of sand

¹ SECURITIES & EXCHANGE COMMISSION [“SEC”], *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, 87 FED. REG. 16,866 (Mar. 24, 2022), <https://www.federalregister.gov/documents/2022/03/24/2022-03212/private-fundadvisers-documentation-of-registered-investment-adviser-compliance-reviews> [the “Proposed Rule”].

² *Id.* at 16,940, 16,956.

³ Chair Gary Gensler, SEC, “*Competition and the Two SECs*” – Remarks Before the SIFMA Annual Meeting (Oct. 24, 2022), <https://www.sec.gov/news/speech/gensler-sifma-speech-102422>.

⁴ Chair Gary Gensler, SEC, *Prepared Remarks at the Institutional Limited Partners Association Summit* (Nov. 10, 2021), <https://www.sec.gov/news/speech/gensler-ilpa-20211110>.

⁵ *Id.*

⁶ Thomas Franck, *Gensler Says SEC Is Weighing New Rules, Greater Disclosure from Private Funds*, CNBC (Jan. 10, 2022), <https://www.cnbc.com/2022/01/10/gensler-says-sec-weighs-new-rules-more-disclosure-from-private-capital-funds.html>.

⁷ Chair Gary Gensler, *supra* note 3.

⁸ *Id.*

can really add up. Those grains may potentially become excess profits above what robust market competition would provide — also known as economic rents.”⁹ More recently, he has explicitly suggested that investors will “benefit from that greater transparency and, in essence, [from] helping the competition amongst asset managers for this literally growing, and one might say burgeoning asset class.”¹⁰ He has also stated that “[i]f we can drive greater competition and efficiency through transparency . . . then the investors — the limited partners — who are representing state pension funds, endowments, universities and various investors benefit.”¹¹ With respect to the SEC’s legal authority, Chair Gensler added that Congress “didn’t leave out so-called sophisticated investors” from its “various mandates” to the SEC to “consider competition and efficiency” and described the Proposed Rule as an effort to increase the efficiency of the private fund market by increasing “competition and transparency.”¹²

Part I and Part II of the Committee’s report examine the competitiveness of the U.S. private equity fund market. Part I finds that the concentration in the U.S. private equity fund market is very low, far lower than that of industries in public markets and registered funds, and that the number of private equity fund advisers and funds is steadily growing. Both are signs of a highly competitive market and one that is growing increasingly competitive. Part I also evaluates the range of investment strategies available in U.S. private equity fund markets, because one of the ways in which firms compete is by innovating and offering more differentiated products. Part I finds that the range of investment strategies available to investors in the U.S. private equity fund market is increasing at a significant rate. Finally, Part I evaluates barriers to entry in the U.S. private equity fund market finding that barriers to entry are low.

Part II specifically analyzes price and quality competition in the U.S. private equity fund market with a focus on the gross fees charged by private equity fund advisers and net-of-fee performance. It finds that the Proposed Rule misrepresents or omits key findings of empirical studies of private equity gross fees, which, contrary to Chair Gensler’s suggestion that the “2 and 20” fee model has remained static for decades,¹³ shows that effective management fees have declined to below 2% on average due in part to the prevalence of investor-specific discounts, and that effective carry is frequently less than 20% due to reduced or carry-free co-investment opportunities as well as investor-specific discounts. Part II then reviews the extensive empirical evidence showing that private equity fund performance net of fees outmatches that of public markets, which is further evidence that the market for private equity fund advisory services is competitive both in terms of price and quality. Part II also reviews the evidence of increasing demand from investors for U.S.

⁹ *Id.* See also SEC, *SEC Proposes to Enhance Private Fund Investor Protection* Press Release No. 2022-19 (Feb. 9, 2022), <https://www.sec.gov/news/press-release/2022-19>; Chair Gary Gensler, SEC, *A Century with a Gold Standard* (May 6, 2022), <https://www.sec.gov/news/speech/gensler-acfmr-20220506>.

¹⁰ Capitol Account, *Pressure Mounts on Gensler to Tighten Rules for Private Markets - and Their Investors* (Mar. 7, 2023), <https://www.capitolaccountdc.com/p/pressure-mounts-on-gensler-to-tighten>.

¹¹ Sam Sutton, *Gensler Wants to Overhaul Private Equity. It’s Scaring Some Investors* POLITICOPRO (Apr. 10, 2023), <https://subscriber.politicopro.com/article/2023/04/gensler-wants-to-overhaul-private-equity-the-investors-hes-trying-to-protect-arent-so-sure-00090822>.

¹² *Id.*

¹³ Chair Gary Gensler, *supra* note 4.

private equity fund investment opportunities, which is further evidence of effective price competition and service quality in U.S. private equity fund markets.

Part I and Part II conclude that the U.S. private equity fund market is competitive and is growing increasingly competitive.

Part III analyzes the SEC's rationale for its expectation that the Proposed Rule will increase the competitiveness of the U.S. private equity fund market and finds that this rationale is severely flawed. We focus in particular on inaccurate claims of uneven bargaining power between investors and advisers and the erroneous claim that uneven bargaining power, even if it did exist, implies that the U.S. private equity fund market is not competitive. Part III then analyzes the potential effects of the Proposed Rule on the competitiveness of the U.S. private equity fund market. Part III finds that the Proposed Rule will reduce competition in the U.S. private equity fund market in several respects. Most importantly, the Proposed Rule risks reducing returns for private equity fund investors and reducing the variety of investment strategies available to investors. The Proposed Rule will also increase barriers to entry to the U.S. private equity fund market with a particularly negative impact on women and minority-led private equity fund advisers.

The Committee therefore concludes that the Proposed Rule operates from the false premise that the U.S. private equity fund market lacks competition and, rather than further enhance competition is likely to reduce competition in the U.S. private equity fund market and consequently decrease the number and array of investment opportunities available to investors.

Overview of Methodology

We assess the competitiveness of the U.S. private equity fund market with reference to the various quantitative factors commonly used in the empirical literature and by U.S. government agencies to assess the competitiveness of a marketplace.¹⁴

1. Industry concentration among private equity funds and advisers, as measured by:
 - a. The Herfindahl-Hirschman Index for private equity funds and advisers, including as compared to other industries
 - b. The percentage of total private equity fund assets held by the advisers and funds with the largest assets under management

Industry concentration is a commonly used measure for the competitiveness of a marketplace because to the extent a market is dominated by relatively few firms – that is, the market is highly concentrated – firms may have fewer incentives to lower prices, increase production, improve efficiency, or innovate.¹⁵

2. The quantity of private equity fund advisory service providers, as measured by:
 - a. The number of private equity funds
 - b. The number of private equity fund advisers

The quantity of a service, including the number of service providers, is a measure of competitiveness because a greater number of providers gives more choices to consumers, increases the likelihood of competitive pricing, and reduces the likelihood of collusion and price fixing.¹⁶

3. The variety of private equity fund advisory services as measured by the range of investment strategies pursued by private equity funds

Service variety is used as a measure of competitiveness because one of the ways in which firms compete is by innovating and offering more differentiated products.¹⁷

4. Barriers to entry in the private equity fund industry, as measured by:
 - a. The number of new funds created each year
 - b. The number of advisers that establish new funds each year

The relative ease or difficulty with which new suppliers can enter an industry is one of the determinants of competition because it affects the potential for new providers to exert competitive pressure on existing suppliers through, for example, innovation or price competition.¹⁸

¹⁴ DEPARTMENT OF JUSTICE, FEDERAL TRADE COMMISSION, HORIZONTAL MERGER GUIDELINES (2010), <https://www.justice.gov/atr/horizontal-merger-guidelines-08192010> [“Agency Merger Guidelines”].

¹⁵ See, e.g., OECD, Market Concentration, <https://www.oecd.org/daf/competition/market-concentration.htm#:~:text=Market%20concentration%20measures%20the%20extent,for%20the%20intensity%20of%20competition> (last visited Jan. 3, 2023).

¹⁶ John C. Coates & Glenn Hubbard, *Competition in the Mutual Fund Industry: Evidence and Implications for Policy*, 33 J. CORP. L. 151 (2007), <https://hls.harvard.edu/bibliography/competition-in-the-mutual-fund-industry-evidence-and-implications-for-policy/>.

¹⁷ Agency Merger Guidelines.

¹⁸ *Id.* at 15.

5. Price and service quality competition

Lowering prices and increasing service quality are two of the primary mechanisms by which firms compete and a downward trend in prices or upward trend in service quality are strong indicators of competitiveness.¹⁹

We assess price and service quality competition in the private equity fund market with reference to private equity fund gross fees, net-of-fees fund performance, and investor demand as measured by assets under management.

In the context of investment management services, it is common to look to net-of-fee returns to determine the competitiveness of prices and service quality,²⁰ because an increase in nominal fees may be offset by higher gross returns and vice versa. In Part II we therefore also assess net-of-fee returns for private equity funds.

Increasing demand also suggests that advisers are offering high-quality services at competitive prices. We therefore measure demand for private equity advisory services by looking to assets under management by such advisers.

Data sources and existing literature

In order to assess each of the above factors, we rely primarily on publicly available SEC data. We have compiled and analyzed this raw SEC data and presented it in the charts displayed in this report. These data are supplemented with data from the private data service provider Preqin²¹ as well as academic studies and industry analyses.

Our focus is on changes to the above metrics over the 9-year period from 2013 through 2021, as this is the most recent period for which our sources provide comprehensive data. In some cases, longer or shorter periods are considered where data for additional or more limited years are available.

The factors that we consider are consistent with the Horizontal Merger Guidelines (“the Guidelines”) that the Federal Trade Commission and Department of Justice (the “Agencies”) use to assess the effect of a proposed horizontal merger on the competitiveness of an industry under federal antitrust law. Although the Agencies caution that the evaluation of a merger is a “fact-specific process” using a “range of analytical tools” rather than a “uniform application of a single methodology,”²² the Guidelines identify the important principles relevant to their analysis. The Guidelines indicate that the Agencies consider whether the merger may result in “reduced product quality, reduced product variety, reduced service, or diminished innovation.”²³ They also indicate that the Agencies consider industry concentration, as measured by the Herfindahl-Hirschman

¹⁹ *Id.* Coates, *supra* note 16 at 7.

²⁰ *See, e.g.*, Coates, *supra* note 16 at 7.

²¹ PREQIN, <https://www.preqin.com/> [“Preqin Data”]. For purposes of our analysis, Preqin data were generated applying two filters on the relevant sample: (1) FIRMTYPE = “Private Equity Firm” and (2) FIRMSMAINCURRENCY = “USD.”

²² Agency Merger Guidelines.

²³ *Id.*

Index (“HHI”) and barriers to entry, as indicated by the ease and frequency with which new firms enter the market.²⁴

The HHI is equal to the sum of the squares of firms’ market shares. The resulting number can be stated as a corresponding percentage that expresses the weighted average market share among firms.²⁵ The closer the number is to 10,000, the more concentrated is the marketplace. For example, if a single firm possesses a 100% market share, the HHI for that market is 10,000 (100^2), indicating that the weighted average market share of firms in that industry is 100%. If 10 firms each possess 10% of the market, the HHI is 1,000 ($10^2 * 10$), indicating that the weighted average market share is 10%. If two firms possess 25% market shares and a single firm possesses the remaining 50%, the HHI is 3750 ($25^2 + 25^2 + 50^2$), indicating a weighted average market share of 37.5%.

The Agencies generally consider an HHI of less than 1,500 (15%) to indicate an “unconcentrated” marketplace, an HHI of 1,500 to 2,500 (15%-25%) to be a “moderately concentrated” marketplace, and an HHI of 2,500 (25%) or greater to be a “highly concentrated” marketplace.²⁶

Our framework is also consistent with the factors considered in the empirical literature examining competition in the public investment fund industry, including Khorana and Servaes (2004)²⁷ (measuring competition with reference to growth of total assets under management, variety of funds offered, average adviser market share), Coates and Hubbard (2007)²⁸ (measuring competition with reference to net fund performance, industry concentration, rate of entrance of new funds), and Khorana and Servaes (2011)²⁹ (linking increased adviser market share to higher performance, lower fees, wider variety of offerings, and frequency of new fund offerings).

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ Ajay Khorana & Henri Servaes, *Conflicts of Interest and Competition in the Mutual Fund Industry* (2004), <https://ssrn.com/abstract=240596>.

²⁸ Coates & Hubbard, *supra* note 16.

²⁹ Ajay Khorana & Henri Servaes, *What Drives Market Share in the Mutual Fund Industry?* 16(1) REVIEW OF FINANCE 81 (2011), <https://academic.oup.com/rof/article/16/1/81/1594066>.

Part I: Competitiveness in the Private Equity Fund Advisory Industry

1. Private equity fund and private equity fund adviser industry concentration

Data on industry concentration indicate that the private equity fund advisory market exhibits a very low degree of concentration. More specifically, the HHIs for private equity funds and private equity fund advisers, in each case measured by assets under management, are and have been for the past decade well below the threshold that the Agencies consider to be concentrated marketplaces and very low in comparison to other industries: As illustrated in Figure 1, over the nine-year period from 2013 through 2021 the HHIs for private equity funds and advisers averaged 250, eight times less than the Agency threshold of 1500 for an *unconcentrated* marketplace, and less than one tenth of the average HHI for public companies in U.S markets. This would place the private equity fund industry within the lowest decile of HHIs for public companies organized by standard industrial classification codes.³⁰

The dramatically higher concentrations of the industries of public companies suggests that the SEC’s focus on competition in private equity fund advisory markets is misplaced. For example, approximately 90% of the market for sellers of personal computers is held by just six providers, with two providers accounting for over 50% of the market,³¹ and 80% of the beef packing industry is controlled by four firms.³²

In addition, SEC data indicate that the average HHI for public mutual funds across the same 2013-2021 period was 1000, four times the figure for private equity funds.³³

Preqin data corroborate the strong indicators of low concentration in private equity fund markets: Figure 2 shows that for each year from 2013 through 2021 the capital raised by new funds created by the five largest private equity advisers as a percentage of the total capital raised by all new private equity funds never exceeded 15% and shows no trend of increasing.

³⁰ Preqin Data.

³¹ Gartner, *Gartner Says Worldwide PC Shipments Declined 28.5% in Fourth Quarter of 2022 and 16.2% for the Year* (Jan. 11, 2023), <https://www.gartner.com/en/newsroom/press-releases/2023-01-11-gartner-says-worldwide-pc-shipments-declined-28-percent-in-fourth-quarter-of-2022-and-16-percent-for-the-year>.

³² The White House, *The Importance of Competition for the American Economy* (July 9, 2021), <https://www.whitehouse.gov/cea/written-materials/2021/07/09/the-importance-of-competition-for-the-american-economy/>.

³³ SEC, PRIVATE FUNDS STATISTICS 2022 Q1, <https://www.sec.gov/divisions/investment/private-funds-statistics> [“SEC Private Funds Statistics”].

Figure 1: HHI for Private Equity Funds and Advisers vs. Public Companies³⁴

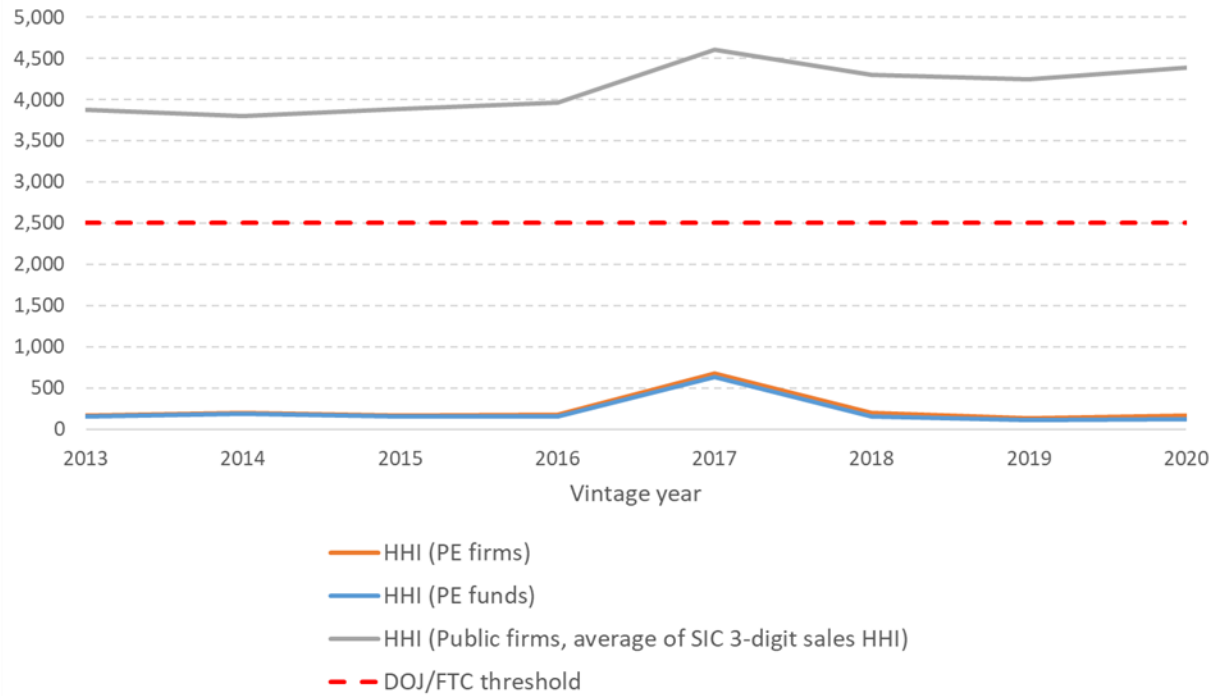
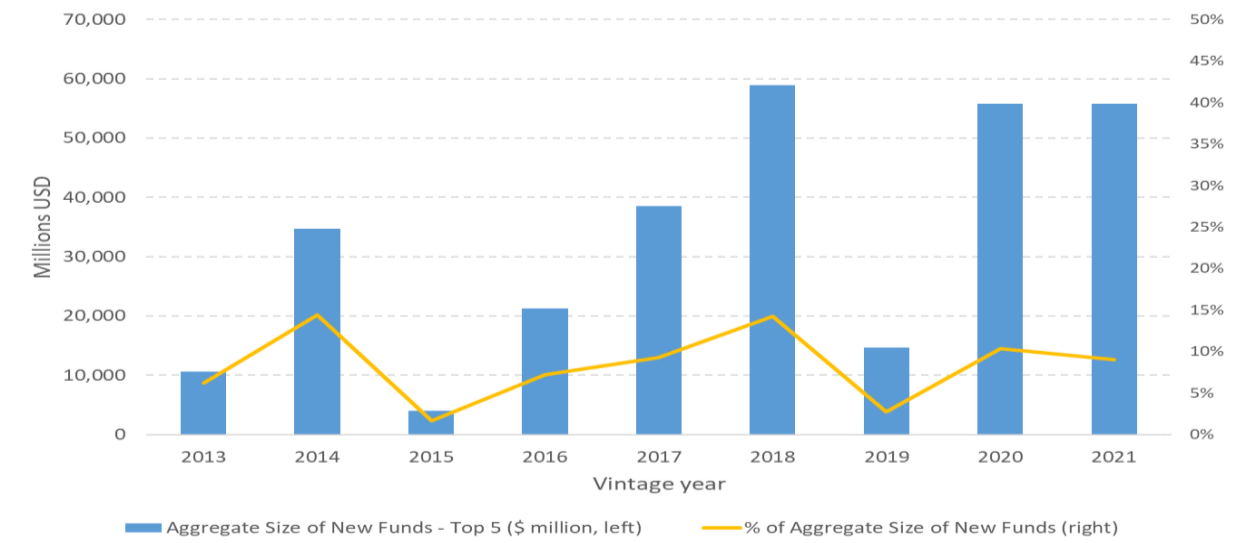


Figure 2: Total Capital Raised by New Funds Established by the Five Largest Private Equity Fund Advisers, Including as Percentage of Total Capital Raised by New Private Equity Funds³⁵



³⁴ Preqin Data.

³⁵ *Id.*

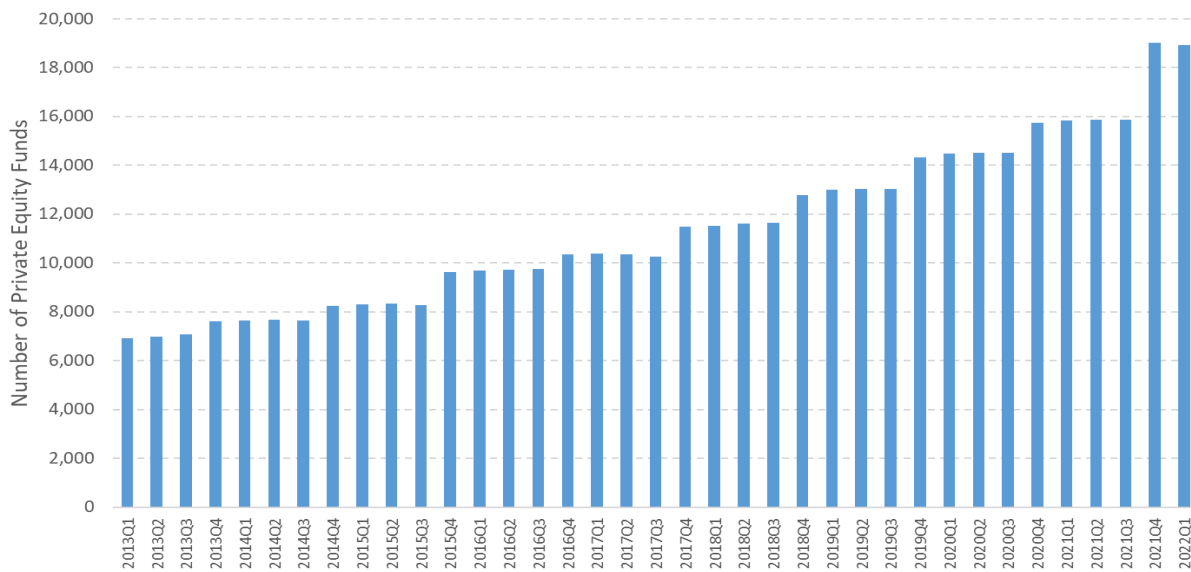
2. Quantity of private equity fund advisory services

SEC data show that the number of private equity funds and private equity fund advisers in U.S. markets has increased steadily over the past 10 years. These trends indicate that private equity fund investors are able to select from an increasingly greater number of advisers and funds. A greater aggregate quantity of service and greater quantity of service providers are indicators of an increasingly competitive market.

a. *Number of private equity funds*

As shown in Figure 3, the total number of private equity funds more than doubled over the 2013-2022 period increasing from 6,910 in Q1 2013 to 18,925 in Q1 2022.

Figure 3: Number of Private Equity Funds³⁶

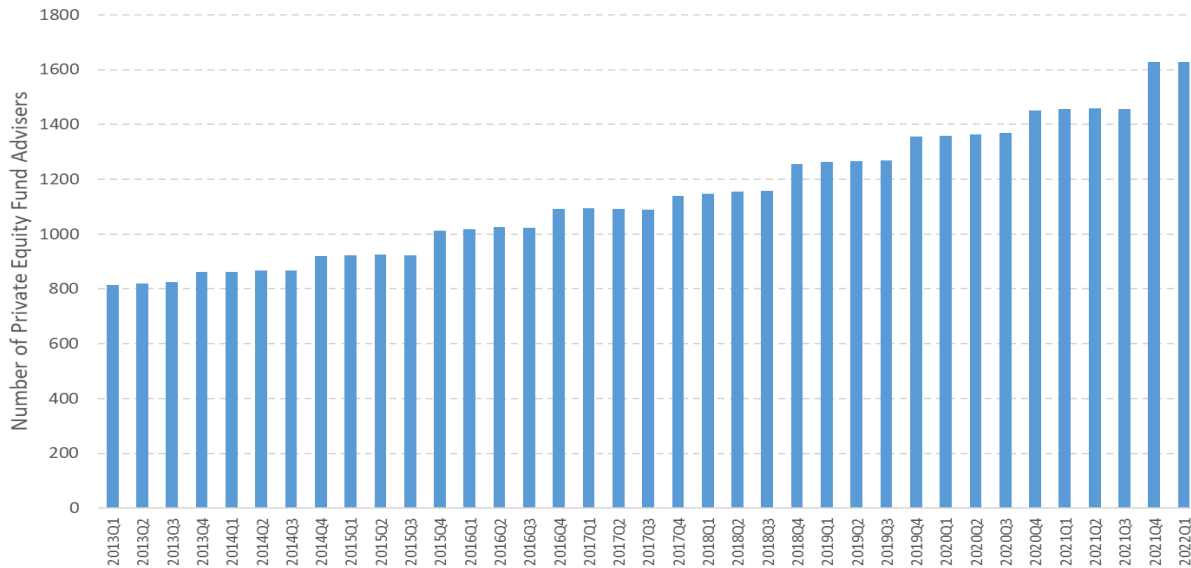


b. *Number of private equity fund advisers*

As shown in Figure 4, the number of private equity fund advisers doubled from 815 in Q1 2013 to 1,628 in Q1 2022.

³⁶ SEC Private Funds Statistics.

Figure 4: Number of Private Equity Fund Advisers³⁷



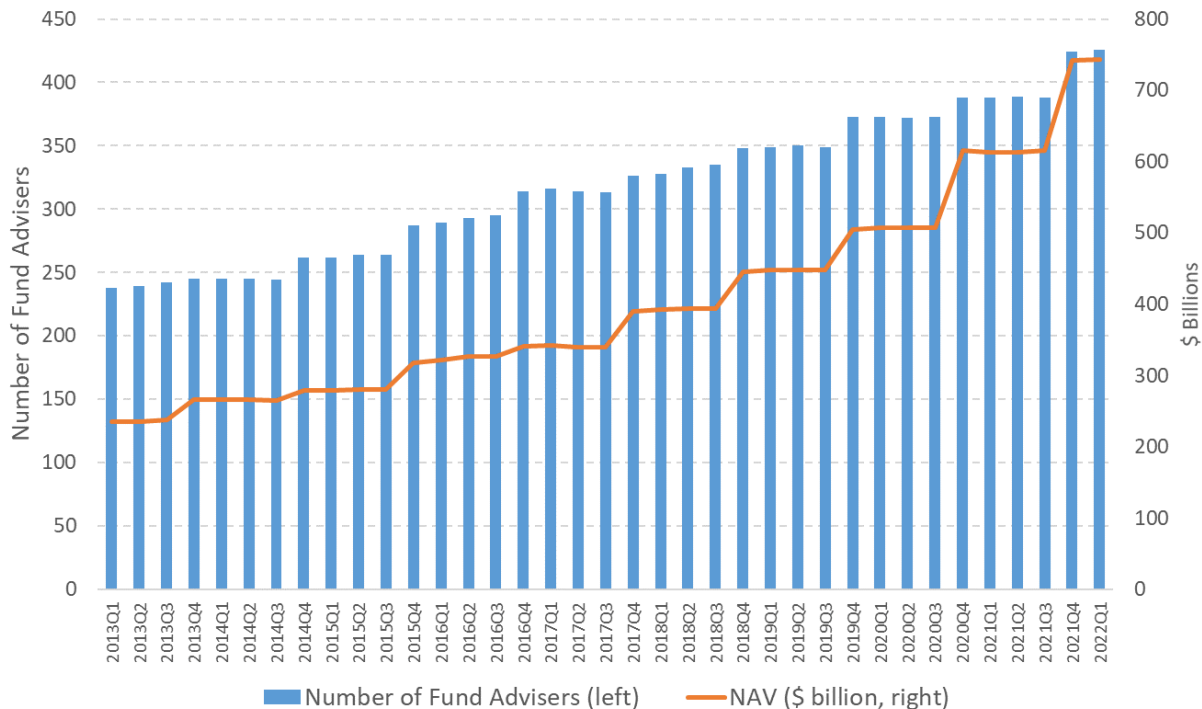
Dividing the number of funds shown in Figure 3 by the number of advisers shown in Figure 4 shows that the average number of funds per adviser grew from 8.5 in Q1 2013 to 11.6 in Q1 2022. However, this growth in the average number of funds per adviser is not driven by the largest advisers. If that were the case, one would observe increasing industry concentration as measured by HHI, and stagnation or decline in the number of advisers that create new funds each year. Instead, Figure 1 showed that the HHI of private equity funds and advisers did not increase over the 2013-2020 period, and Figure 2 demonstrated that the market share of new funds established by the largest five advisers has not increased. Moreover, Figure 9 on page 14 shows that the number of private equity fund advisers that created at least one new fund each year doubled over the 2013-2021 period. The increasing average number of funds per adviser is thus the result of increasing fund creation across advisers of varying sizes.

c. Quantity of private real estate funds

The private real estate fund sector, which the SEC data categorize separately from private equity funds, has exhibited particularly strong growth over the past decade, and we therefore highlight data demonstrating its growth. As illustrated in Figure 5, over a nine-year period the number of private real estate fund advisers nearly doubled, from 238 as of Q1 2013 to 428 as of Q1 2022. Assets under management increased over the same period by a factor of nearly six, from \$235 billion to \$743 billion.

³⁷ *Id.*

Figure 5: Private Real Estate Funds; Assets under Management and Total Advisers³⁸



3. Variety of private equity fund advisory services

SEC and Preqin data show that private equity fund investors have also gained access to an increasingly broad variety of investment strategies over the prior decade. Moreover, private equity funds have continued to invest in portfolio companies in a wide array of industries, such that investors are able to gain access to a variety of industry sectors through such funds. A variety of differentiated services is another indicator of a competitive market.

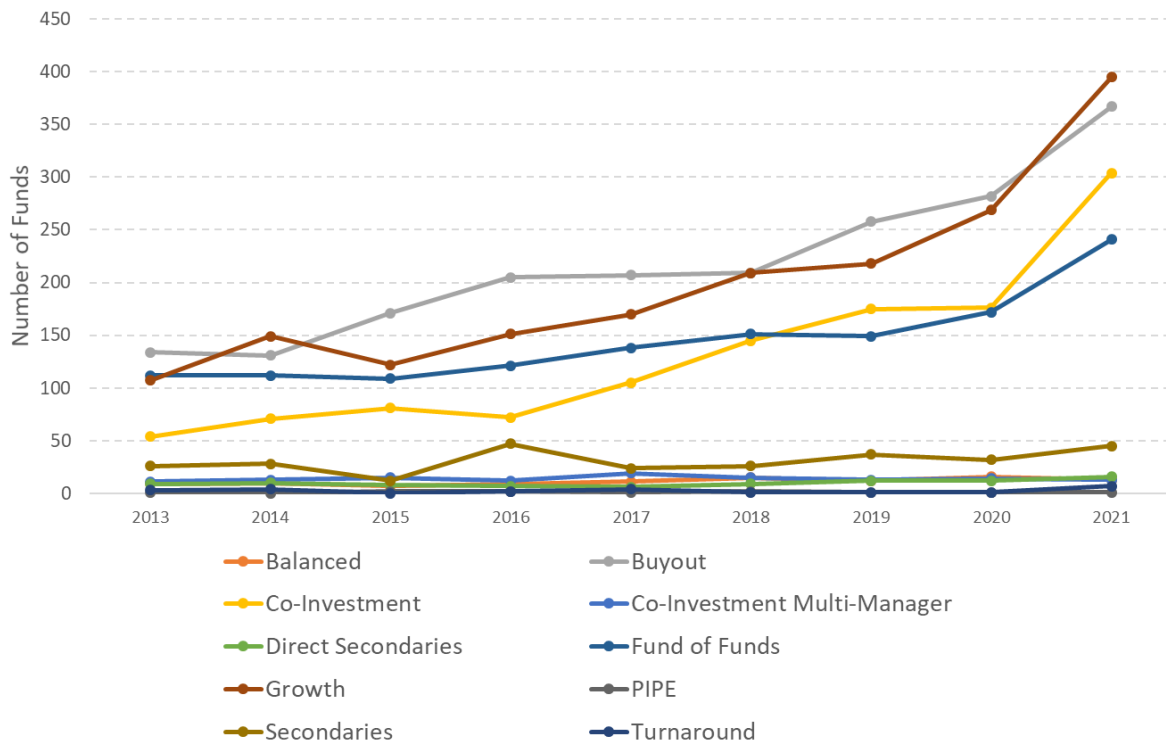
a. *Variety of private equity fund investment strategies*

SEC and Preqin data indicate that private equity fund advisers have either maintained or increased the range of investment strategies that their funds offer to investors.

As shown in Figure 6, over the nine-year period from 2013 through 2021, there was no significant decline, quarter-to-quarter or year-over-year, in the number of private equity funds within any of the ten principal strategy types tracked by Preqin, and the number of funds offered in four of those categories increased significantly. For example, the number of growth funds increased from 107 in 2013 to 395 in 2021.

³⁸ *Id.*

Figure 6: Number of Private Equity Funds by Strategy Group³⁹

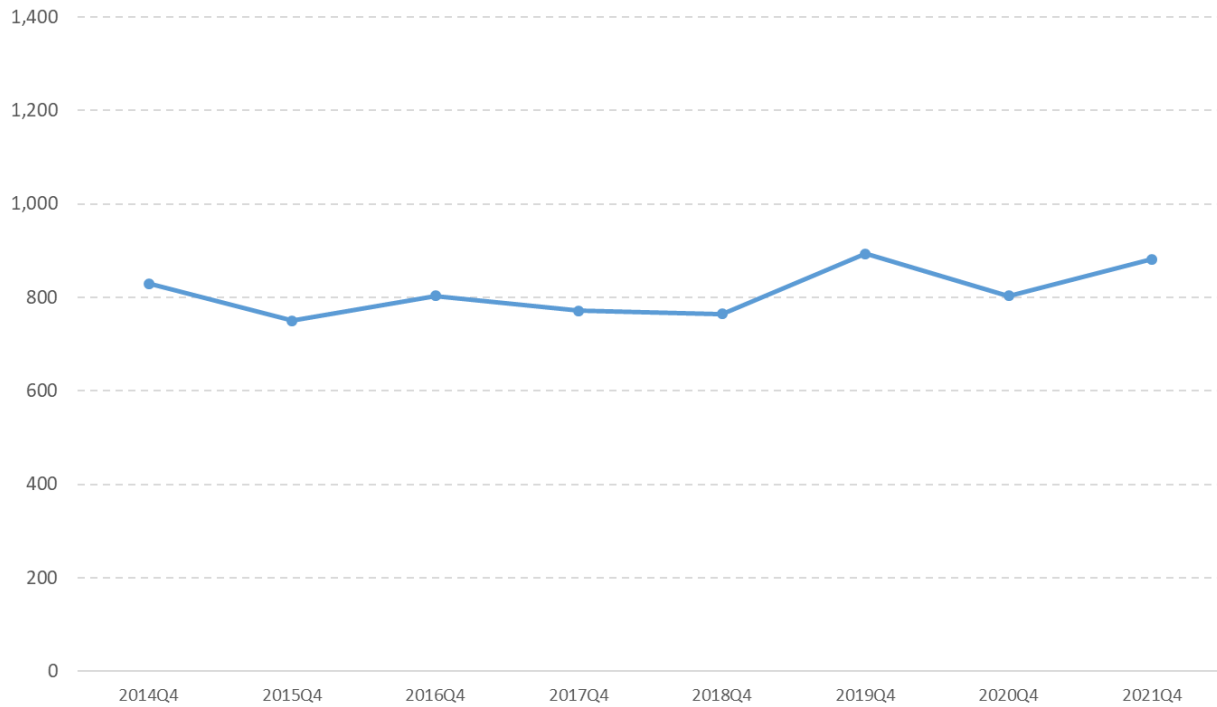


b. Private Equity Portfolio Company Industry Diversity

Private equity funds offer service variety to investors not only through variation in investment strategy, but also by providing investment exposure to a wide array of industries. For example, as demonstrated by Figure 7, from Q4 2014 to Q4 2021, HHI for the asset allocation of private equity funds across portfolio companies never exceeded 900, meaning that in aggregate, private equity funds allocated on average less than 10% of their assets to portfolio companies in any given industry.

³⁹ Preqin Data.

Figure 7: HHI for Private Equity Gross Assets Among Portfolio Company Industries⁴⁰



4. Barriers to entry to the private equity fund industry

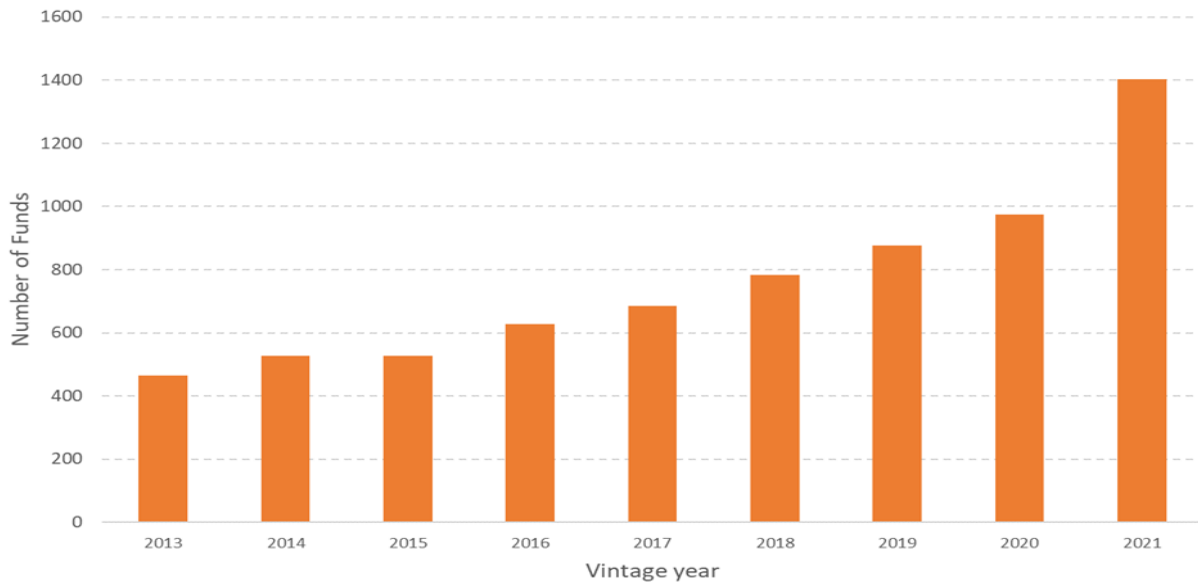
The rate of entry of new private equity fund advisers and the rate at which new and existing advisers have created new funds have both increased over the prior decade, suggesting that the private equity fund market has low barriers to entry and that those barriers are becoming lower, which is a characteristic of an increasingly competitive market.

a. Number of new private equity funds

Figure 8 shows that the number of new private equity funds established each year has increased for all but one of the nine years from 2013 through 2021 and has grown, by a factor of over three, from 466 funds established in 2013 to 1,402 funds established in 2021.

⁴⁰ SEC Private Funds Statistics. In the case of this Figure 7, the calculation covers only “controlled portfolio companies” as defined in SEC Form PF and Form ADV – that is, portfolio companies for which the fund or its affiliates directly or indirectly have the power to direct the management or policies of that portfolio company through ownership of securities, contract, or otherwise.

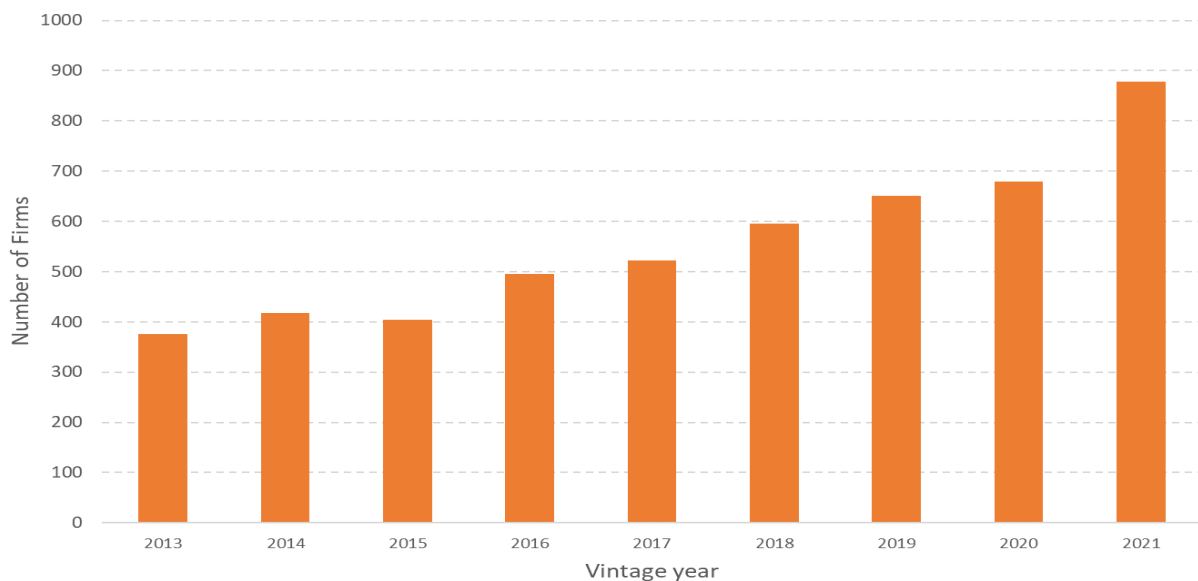
Figure 8: Number of Newly Created Private Equity Funds⁴¹



b. Number of private equity advisers creating new funds

Over the past ten years an increasing number of private equity fund advisers have engaged in the creation of new funds. As shown in Figure 9 below, the number of private equity fund advisers that established at least one new fund in 2013 was 376. As of 2021 that number had increased to 878.

Figure 9: Number of Private Equity Fund Advisers Establishing New Funds⁴²



⁴¹ Preqin Data.

⁴² *Id.*

Part II: Price and Quality Competition in the Private Equity Fund Advisory Industry

Two of the primary means by which service providers compete are by reducing the price for a given quality of service (“price competition”) and by increasing the quality of service for a given price (“quality competition”).

The Proposed Rule bases its assessment of the competitiveness of private equity fund advisory markets almost entirely on its characterization of gross fees and fee-related practices, as we further explain in Subpart 1 of Part II. The Proposed Rule suggests that such fees and fee-related practices indicate that advisers may be charging uncompetitive prices relative to the quality of service they provide, and that Proposed Rule’s restrictions will remedy this issue by introducing greater price and quality competition.

This argument fails for three overarching reasons.

First, and most generally, rising prices do not necessarily reflect a lack of competition, but may instead indicate increased demand.⁴³ Thus even if there were evidence that private equity fund fees were increasing, this evidence would be insufficient on its own to demonstrate that prices are inefficient.

Second, there is meaningful evidence that private equity fund gross fees have in fact decreased over time and commonly vary in response to competitive pressures.

Third, gross fees are an inferior measure of price and quality competition compared to net-of-fee performance. This is because the competitiveness of a price or fee in any marketplace can only be meaningfully assessed relative to the quality or amount of the good or service provided, and vice versa.⁴⁴ The market for investment advisory services is distinguished by the relative ease with which service value can be precisely quantified, via investment performance, compared to other service markets where value is more difficult to quantify.⁴⁵

For example, investors would reasonably prefer an investment adviser that charges a 2% fee and achieves a gross return of 10%, thus providing a net return of 8%, over an adviser that charges a 1% fee and achieves a gross return of 5%, thus providing a net return of 4%, since an investor’s wealth is enhanced to a greater extent by the first adviser, notwithstanding the higher gross fee.

That net-of-fee performance is the more relevant metric for competition in the market for investment management services than gross fees is well established in the empirical literature examining actively managed mutual fund performance, including for example Coates & Hubbard

⁴³ See, e.g., MCKINSEY & COMPANY, *Five Trends Shaping Tomorrow’s Luxury-car Market* (July 8, 2022), <https://www.mckinsey.com/industries/automotive-and-assembly/our-insights/five-trends-shaping-tomorrows-luxury-car-market>.

⁴⁴ Aviv Nevo, *Measuring Market Power in the Ready-to-Eat Cereal Industry* NBER Working Paper No. 6387 (1998), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=226135; Maurice E. Stucke & Ariel Ezrachi, *The Curious Case of Competition and Quality* JOURNAL OF ANTITRUST ENFORCEMENT (2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2494656.

⁴⁵ Valerie A. Zeithaml, *Service Quality, Profitability, and the Economic Worth of Customers: What We Know and What We Need to Learn*, 28(1) JOURNAL OF THE ACADEMY OF MARKETING SCIENCE 67 (2000), <https://link.springer.com/article/10.1177/0092070300281007>.

(2007),⁴⁶ Khorana & Servaes (2011),⁴⁷ Berk & Green (2002),⁴⁸ Adams et al. (2012),⁴⁹ and Densmore (2022).⁵⁰

We address these issues in greater detail in Subparts 1, 2, and 3.

Subpart 1 first addresses the data on private equity fund gross fees. We show that the Proposed Rule’s assessment of gross private equity advisory fees and fee-related market practices is based on fragmented and anecdotal data and an incomplete description of the relevant research. Indeed, empirical evidence that the Proposed Rule ignores shows that gross fees and fee-related practices for private equity funds reflect a competitive marketplace. In particular, recent market data show that management fees have been declining and that management fees and carry are frequently below the levels cited in the Proposed Rule and by Chair Gensler.

Subpart 2 then evaluates private equity fund net-of-fee performance. The data on net performance are more extensive and rigorously analyzed than those on gross fees and recent analyses of net performance data show that private equity fund advisers have significantly outperformed public market benchmarks. If the market for private equity fund advisory services were not competitive, one would instead expect gross fees to increase to offset improved gross performance, such that net-of-fee performance would not exceed public market benchmarks. Instead, such funds outperformance of public market indices indicates that private equity fund advisers are charging prices that are low relative to the value that they are providing to investors, which evidences the existence of a highly competitive marketplace. The Proposed Rule entirely ignores this evidence and its implications for the competitiveness of private equity fund markets.

Subpart 3 then introduces further evidence of price and quality competition in the private equity fund market in the form of increasingly high demand for private equity fund advisory services.

1. Private equity fund adviser gross fees

As the Proposed Rule itself acknowledges, in private fund markets “[m]anagement fee compensation figures and performance-based compensation figures are not widely disclosed or reported.”⁵¹ Consequently even if gross fees were relevant to the assessment of price competition, there are insufficient data to draw the general conclusion that reforms are necessary to increase price competition.

The Proposed Rule nonetheless suggests that estimates of the aggregate quantity of fees and performance compensation, as well as the mere existence in the marketplace of portfolio company-level and investor-specific fee structures, substantiate a “need for reform” of private equity

⁴⁶ Coates & Hubbard, *supra* note 16.

⁴⁷ Khorana & Servaes, *supra* note 29.

⁴⁸ Richard C. Green & Jonathan Berk, *Mutual Fund Flows and Performance in Rational Markets* NBER Working Paper No. w9275 (2002), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=338881&rec=1&srcabs=1005426&pos=2.

⁴⁹ John C. Adams et al., *Are Mutual Fund Fees Excessive* 36(8) JOURNAL OF BANKING AND FINANCE 2245 (2012), <https://www.sciencedirect.com/science/article/abs/pii/S0378426612001008>.

⁵⁰ Michael Densmore, *The Growth of Passive Indexing and Smart-Best: Competitive Effects on Actively Managed Funds* (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3823328.

⁵¹ Proposal at 16,940.

advisory markets aimed at increasing price competition.⁵² Each of these arguments is conceptually flawed, is based on insufficient evidence, and fails to consider relevant countervailing evidence.

Aggregate fee quantities

The Proposed Rule asserts that “private fund adviser fees may currently total in the hundreds of billions of dollars per year.”⁵³ The Proposed Rule offers two other data points on the scale of private equity fund fees. First, the Proposed Rule cites an academic paper (Phalippou (2020)) estimating that “from 2006–2015, performance-based compensation alone for private equity funds averaged \$23 billion per year.”⁵⁴ Second, the Proposed Rule references a 2020 Callan report that “[p]rivate equity management fees are currently estimated to typically be 1.76 percent and performance-based compensation is currently estimated to typically be 20.3 percent of private equity fund profits.”⁵⁵ At least with respect to management fees and despite being cited by the SEC, the Callan report ironically belies Chair Gensler’s speculation that the “2 and 20” fee model is “not that different from when I was on Wall Street” and “might be even higher” among “the largest private equity firms.”⁵⁶

The estimates that the Proposed Rule and Chair Gensler cite on fee percentages are insufficiently rigorous to warrant any conclusions about the private equity fund market. The 2020 Callan report is based on a survey of private equity and venture capital funds but does not specify whether the survey only relates to funds of U.S. advisers or includes funds of non-U.S. advisers. Moreover, the survey’s sample consists of only 90 funds over two years: 2018 and 2019. The survey does not specify how that sample of funds was selected or whether these funds constitute a representative sample of the private equity fund industry, nor is the survey sensitive to fee levels before and after this two-year period. Moreover, the Proposed Rule fails to note that the survey found that average management fees dropped to 1.5% for periods after which funds acquire their portfolio investments.⁵⁷ Chair Gensler’s assertion that average fee levels have remained constant is thus not supported with any empirical data.

Moreover, neither the Proposed Rule nor Chair Gensler present systematic evidence to show that gross fees reflect a lack of price competition. Estimates of the aggregate dollar amount of fees show only that the private fund market is large, and merely stating the nominal percentages at which certain fees are charged permits no inference about the competitiveness of those fees. Similarly, an observation that such fee percentages have remained roughly constant over time, even if true, is insufficient to infer that they do not reflect competitive levels, because the observation does not consider changes in the value provided in exchange for those fees. In subpart

⁵² *Id.* at 16,887.

⁵³ *Id.* at 16,956.

⁵⁴ *Id.* at 16,939.

⁵⁵ *Id.* at Note 263, citing CALLAN’S RESEARCH CAFÉ, HOW TO NAVIGATE PRIVATE EQUITY FEE AND TERMS (2020), <https://www.callan.com/uploads/2020/12/2841fa9a3ea9dd4ddd6f4daefe1cec4/callan-institute-private-equity-fees-terms-study-webinar.pdf>.

⁵⁶ Chair Gary Gensler, *supra* note 4.

⁵⁷ CALLAN’S RESEARCH CAFÉ, *supra* note 55 at 6.

2 we show that the value provided by private equity advisory services in the form of returns has climbed steadily over the last decade.

The Proposed Rule also presents two anecdotal reports of rising fees: a 2020 WSJ news article⁵⁸ and a one-page summary report from 2021 by the Institutional Limited Partners Association (“ILPA”).⁵⁹ However, these reports only observe in isolation the levels of certain subcategories of fees, such as those charged for organizational expenses. The reports do not consider overall fee levels, so they are not indicators of what investors are paying for private equity advisory services. Moreover, increases in subcategories of fees are often offset by reductions in other fees, such as the overall management fee. This is a standard practice in the investment management industry.⁶⁰ Furthermore, although these sources do report that these subcategories of fees are rising, they do not find that they are rising out of proportion to the actual costs to which they relate or that those costs are inflated by lack of competition. Indeed, the 2020 WSJ article reports that such fee provisions are heavily negotiated and closely monitored by investors and that the perception of rising fees may be attributable to “greater transparency in fund reporting” and more detailed fee itemization.⁶¹ The ILPA report similarly finds that clear and transparent reporting of fees and expenses “has seen real progress” through increasing availability of the ILPA Fee Template, which is yet another indicator that fees are competitively determined.⁶² The ILPA Fee Template is a template form designed to provide investors with comprehensive and clear information about fees that they bear at both the fund and portfolio company level.⁶³ The Proposed Rule ignores these findings.

The Proposed Rule also fails to consider the evidence available on the scale of gross private equity fees, which suggests that gross private equity fund fees as well as the contractual structure of fee provisions reflect a competitive equilibrium and that management fees and carry have in fact declined over time such that their effective levels are below the “2 and 20” figures that Chair Gensler asserts have remained static for decades.⁶⁴ Indeed, during Chair Gensler’s tenure, the SEC’s Asset Management Advisory Committee itself acknowledged that “management fees vary from 1.2% to 2%.”⁶⁵

⁵⁸ Proposal at 16,894, citing Preeti Singh, *Coming to Terms: Private-Equity Investors Face Rising Costs, Extra Fees*, THE WALL STREET JOURNAL (Dec. 20, 2021), <https://www.wsj.com/articles/coming-to-terms-private-equity-investors-face-rising-costs-extra-fees-11640001604#:~:text=Coming%20to%20Terms%3A%20Private-Equity%20Investors%20Face%20Rising%20Costs%2C,and%20some%20expenses%20are%20excluded%20from%20annual%20fees>

⁵⁹ Proposal at 16,894, citing ILPA, KEY FINDINGS ILPA INDUSTRY INTELLIGENCE REPORT “WHAT IS MARKET IN FUND TERMS?” (2021), <https://ilpa.org/wp-content/uploads/2021/10/Key-Findings-Industry-Intelligence-Report-Fund-Terms.pdf>.

⁶⁰ Begenu & Sirwardane, *infra* note 79 at 9.

⁶¹ Singh, *supra* note 58.

⁶² ILPA, *supra* note 59.

⁶³ ILPA, Reporting Template, <https://ilpa.org/reporting-template/> (last visited Feb. 24, 2023).

⁶⁴ Chair Gary Gensler, *supra* note 4.

⁶⁵ SEC, ASSET MANAGEMENT ADVISORY COMMITTEE, FINAL REPORT & RECOMMENDATIONS FOR PRIVATE INVESTMENT (2021), <https://www.sec.gov/files/final-recommendations-and-report-private-investments-subcommittee-092721.pdf>.

Preqin’s 2022 survey indicates that the average management fee for institutional investors in private funds has remained below 2% over the past decade, and has in fact declined below that level to a current level of approximately 1.5%.⁶⁶ The average management fee among private equity buyout funds specifically is 1.36%.⁶⁷ Moreover, effective carry rates are often reduced below the commonly cited 20% level on an investor-specific basis by way of side letters and co-investment opportunities that are subject to discounted carry rates or are carry-free.⁶⁸

Robinson & Sensoy (2013)⁶⁹ analyze a private 26-year dataset of private equity buyout fund and venture capital fund investment contract terms, including management fees and carried interest terms obtained “from a large, institutional limited partner.”⁷⁰ The authors conclude that their findings on gross private equity fund fees are “most consistent with an equilibrium in which . . . managers with higher compensation earn back their pay by delivering higher gross performance” and that investors are sophisticated parties who understand private equity fund fees and have bargaining power over those fees.⁷¹

Portfolio company fees

The Proposed Rule expresses a concern with the practice of private equity fund advisers charging certain fees to their funds’ portfolio companies in addition to the management fees they charge at the fund level. It relies on a single study, Phalippou et al. (2018),⁷² which analyzed “leveraged buyout transactions from 1990–2012” to assert that “accelerated monitoring fees” (i.e., up-front fees advisers charged directly to portfolio companies with respect to future periods) had been charged in 28 percent of leveraged buyout transactions examined and represented “15 percent of total fees charged in those transactions.”⁷³

Presumably, high portfolio company fees could reduce the value of portfolio companies and the returns to investors in private equity funds when such portfolio companies are sold, and returns are realized. However, the findings of Phalippou et al. (2018) do not address this proposition. Analyzing portfolio company fees in isolation fails to reflect the extent to which those fees are added to or offset by lower fees charged at the fund level and thus to reflect the totality of what investors are paying. Moreover, the Proposed Rule fails to note a central conclusion of the Phalippou et al. (2018) study, which is that advisers charging lower portfolio company fees raised more capital and that investors “penalized” those charging higher fees by providing them with less

⁶⁶ Paul O’Shea, COLMORE, *Fee Universe* in PREQIN INSIGHTS, THE 2022 PREQIN PRIVATE CAPITAL FUND TERMS ADVISOR (2022), at Figure 10.4, <https://www.preqin.com/insights/research/reports/the-2022-preqin-private-capital-fund-terms-advisor>.

⁶⁷ *Id.* at 60.

⁶⁸ *Id.* at 50, 70.

⁶⁹ David T. Robinson & Berk A. Sensoy, *Do Private Equity Managers Earn Their Fees? Compensation, Ownership, and Cash Flow Performance* 26(11) REVIEW OF FINANCIAL STUDIES 2760 (2013), <https://www.jstor.org/stable/24464777>.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² Ludovic Phalippou, Christian Rauch et al., *Private Equity Company Portfolio Company Fees* (2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2703354.

⁷³ Proposal at 16,937.

capital.⁷⁴ These findings suggest the existence of a competitive marketplace where advisers that charge lower portfolio company fees are rewarded with more investment capital and those who charge higher fees lose investment capital. Another critical flaw of Phalippou et al. (2018) is that the work is stale, in that the study focuses on fund vintages that are 10-30 years old. More recent data indicate that portfolio company fees are typically offset against management fees.⁷⁵ Similarly, a 2022 Preqin survey found that most funds in most private capital asset classes, and 71% of all private funds, rebated 100% of portfolio company fees, including transaction, directors' fees, and monitoring fees, to fund investors.⁷⁶ A 2020 report by Troutman Pepper also finds that there has been "a marked decline" in the number of advisers that employ such practices, including monitoring fees.⁷⁷

Investor-specific fee terms

The Proposed Rule also expresses a concern that "[t]here can be substantial variation in the fees private fund advisers charge for similar services and performances."⁷⁸ It cites the finding of a single study, Begenau & Siriwardane (2020),⁷⁹ to the effect that "a sample of public pension funds investing in a sample of private equity funds would have received an average of an additional \$8.50 per \$100 invested had they received the best observed fees in the sample," to imply that negotiations between private equity fund investors and advisers often fail to produce competitive gross fees for many investors.⁸⁰ Once again, the evidence the Proposed Rule presents for this conclusion is insufficient, because the Proposed Rule fails to grapple with the context of these findings.

The study by Begenau & Siriwardane concludes that investor-specific fee provisions are more common among advisers "who face low demand" and that such provisions may therefore be a way that advisers "attract more capital commitments (e.g., via signaling effects)."⁸¹ The conclusion is thus not that investor-specific fee structures are a sign of adviser bargaining power or uncompetitive pricing, but instead that advisers use such structures to compete to offer better pricing terms and to offer discounts to investors when the adviser would otherwise be unable to raise enough capital.

Begenau & Siriwardane (2020) also find that the investors who are most likely to receive the best fee terms are those who commit more capital to the fund.⁸² This finding, which the Proposed Rule ignores, suggests that unique fee provisions reflect bargained-for compensation for the cost to the large investor of committing more capital to an investment.

⁷⁴ Phalippou et al, *supra* note 72 at 4.

⁷⁵ Begenau & Siriwardane, *infra* note 79 at 9.

⁷⁶ PREQIN INSIGHTS, *supra* note 66.

⁷⁷ TROUTMAN PEPPER, PRIVATE FUNDS CFO: FEES AND EXPENSES SURVEY 2020 (2020), <https://www.troutman.com/insights/private-funds-cfo-fees-and-expenses-survey-2020.html>.

⁷⁸ Proposal at 16,940.

⁷⁹ Juliane Begenau & Emil Siriwardane, *How Do Private Equity Fees Vary Across Public Pensions* (2020), <https://www.hbs.edu/faculty/Pages/item.aspx?num=57534>.

⁸⁰ Proposal at Note 268.

⁸¹ Begenau & Siriwardane, *supra* note 79 at 4.

⁸² *Id.* at 31.

Accordingly, the Proposed Rule inaccurately presents the study’s finding that pension fund investors would have “received an average of an additional \$8.50 per \$100 invested had they received the best observed fees in the sample” as representing value forgone by smaller investors that could be restored to them with greater price competition.⁸³ Instead, the study’s findings indicate that the \$8.50 difference between investors who received the best terms and other investors represents discounts offered by advisers who cannot otherwise raise sufficient capital and/or value forgone by advisers for the purpose of attracting larger investors with larger capital commitments or first-close investors (i.e., investors who commit capital to a fund at the time of initial fundraising). Preqin’s 2022 survey corroborates this finding, estimating that over 50% of large investors and over 70% of first-close investors received management fee discounts.⁸⁴ Even then, Preqin’s 2022 survey adds that “in recent years, this divergence in fee rates across commitment size has eroded from roughly 43 bps to 20 bps, less than half of the original difference.”⁸⁵

In addition, Begenau & Siriwardane (2020) find that patterns of fee dispersion among investors in the same fund are consistent with the competitive dynamics observed in a wide variety of other competitive markets and are moreover consistent with dispersions observed in publicly offered investment funds. Specifically, the authors note that “[O]ur estimates of within-fund dispersion in management fees [for private equity funds] are comparable to Hortaçsu and Syverson (2004), who show that management fees for S&P 500 index funds range from 10 to 268 basis points.”⁸⁶

Moreover, the findings of Begenau & Siriwardane (2020) are consistent with ILPA’s comments on the Proposed Rule’s restrictions on certain investor-specific provisions. ILPA embraces the “accepted market practice consistent with contract negotiations in all domains” that advisers often provide better fee provisions to certain investors to incentivize larger or earlier capital commitments.⁸⁷ Such provisions thus do not evidence the exploitation of smaller investors by advisers. ILPA is an industry group that represents the interests of the private fund investors that the SEC purports to protect with the Proposed Rule.⁸⁸ Preqin’s 2022 survey corroborates this view, finding that investors who are charged lower management fees tend to contribute more capital.⁸⁹

Variable fee provisions can also reflect the mere fact that investors’ fee preferences differ and that advisers compete to offer better service to investors by offering more choices. As Professor S.P. Kothari, the former SEC Chief Economist and Director of the Division of Economic and Risk Analysis from 2019 to 2021, observes in his report appended to the American Investment Council’s comment letter on the Proposed Rule, certain advisers offer investors the option to choose from different fee structures according to their risk preferences: for example, as highlighted

⁸³ Proposed Rule at Note 268.

⁸⁴ PREQIN INSIGHTS, *supra* note 66, Figure 6.12.

⁸⁵ *Id.* at 67.

⁸⁶ Begenau & Siriwardane, *supra* note 79 at 6.

⁸⁷ ILPA, Comment Letter to the Proposed Rule at 5 (Apr. 25, 2022), <https://www.sec.gov/comments/s7-03-22/s70322-20126586-287243.pdf>.

⁸⁸ Proposed Rule at 16,887.

⁸⁹ Preqin, *supra* note 66, at 67.

in Begenau & Siriwardane (2020),⁹⁰ Bain funds offer investors a choice between a 1% management fee with a 30% carry or 2% management fee with a 20% carry.⁹¹

2. Private equity fund net performance

Empirical studies are nearly unanimous in demonstrating that private equity funds have on average out-performed equivalent public market indices net of fees over the past 20 years. Preqin data also confirms that private equity fund performance as measured by average net internal rate of return has been strong and increased significantly over the past 20 years. However, the Proposed Rule ignores this evidence completely.

Preqin Data on Net IRR

Preqin data measuring the average net internal rate of return (“IRR”) as of 2022 of private equity funds founded in each year from 2000 through 2018 shows substantial improvement over time.

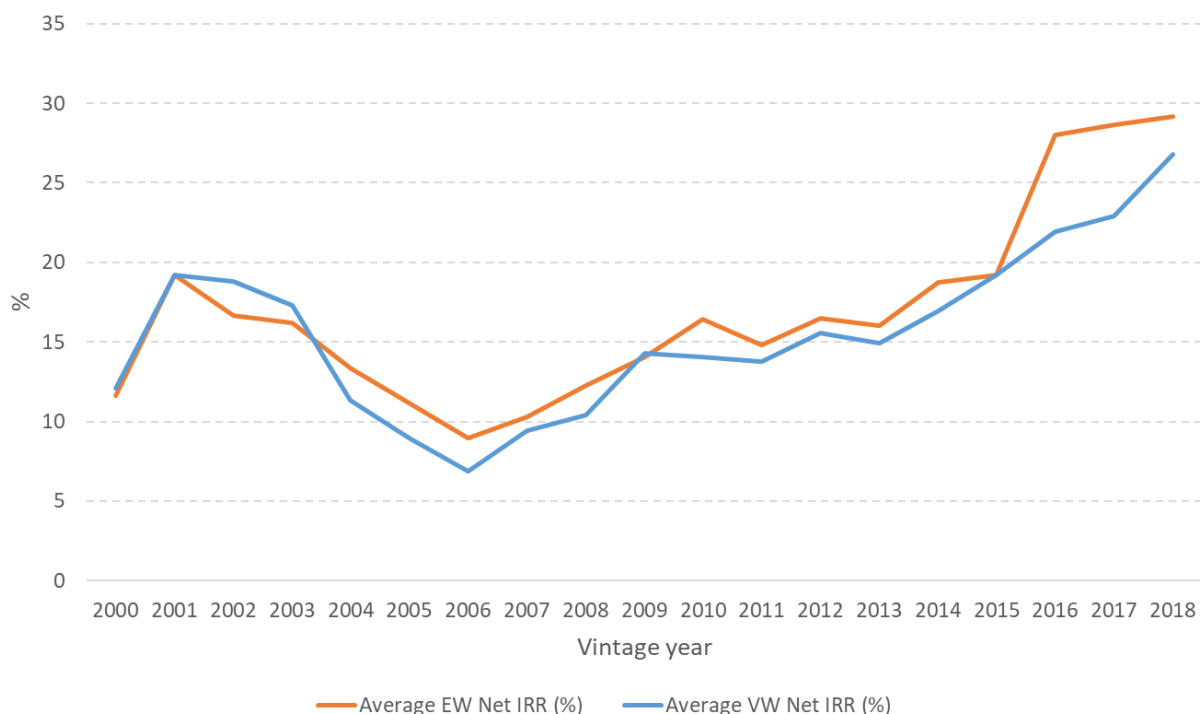
Net IRR is a measure of investment performance that expresses the average annual rate of return of an investment minus expenses across a time period.⁹² Net IRR thus takes account of the performance of a fund investment relative to the fees that the investor must pay. The Preqin data indicate that the average net IRR across private equity funds has increased over the past 20 years by a factor of nearly three, on both an equal-weighted and value-weighted basis. Specifically, Figure 10 shows an increase in the average IRR, using both measurements, from approximately 12% in 2000 to 27% and 29% in 2018 on equal-weighted and value-weighted bases, respectively. More recent vintage years are not analyzed, because such funds do not yet have sufficient performance history.

⁹⁰ Begenau & Siriwardane *supra* note 79 at 9.

⁹¹ AMERICAN INVESTMENT COUNCIL, Letter Re. Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews (SEC Release No. IA-5955; File No. S7-03-22) (Feb. 9, 2022), Appendix I: Report of Professor S.P. Kothari, para. 38 <https://www.sec.gov/comments/s7-03-22/s70322-20126669-287340.pdf>., citing Isabel Markham, *Bain keeps two investor class structure for Fund XII* PRIVATE FUNDS CFO (June 22, 2017), <https://www.privatefundscfo.com/bain-keeps-two-investor-class-structure-for-fund-xii/>.

⁹² More specifically, net internal rate of return is a time-weighted annual return expressed as a percentage derived from the present sum of investor cash contributed to the fund, the discounted present value of expected future distributions from the fund to the investor, and the current value of unrealized investments. The calculation excludes any carry or performance fees earned by the adviser or general partner. PREQIN, Measuring Private Equity Performance, https://docs.preqin.com/misc/Performance_Ratios_and_Example.pdf (last visited Feb. 16, 2023).

Figure 10: Net Annual IRR⁹³



These metrics suggest that even if gross fees had remained relatively constant over the past 15 years, they would have been more than offset by higher gross performance. If the market for private equity fund advisory services were uncompetitive, one would instead expect fees to increase to offset better gross performance, such that net IRR decreases or remains constant. These dynamics are generally substantiated in the empirical literature. For example, Döpfer et al. (2021)⁹⁴ finds that higher competition makes it more difficult for suppliers to raise prices. Because the market for private equity fund advisory services is highly competitive, it is likely difficult for individual advisers to raise fees even when they are successful, and advisers are driven to compete for investors’ capital by generating higher returns without raising their fee percentages in newer funds, which is consistent with the increase in net IRR over time.

Other recent analyses of private equity fund performance corroborate the conclusion that the performance of private equity funds across all vintages has been very strong over recent years. According to one such report, private equity funds returned a 27.1% pooled average IRR in the first three quarters of 2021 and 33% in 2020.⁹⁵

⁹³ Preqin Data.

⁹⁴ Hendrik Döpfer et al., *Rising Markups and the Role of Consumer Preferences* (2021), <https://economics.indiana.edu/documents/rising-markups-and-the-role-of-consumer-preferences1.pdf>.

⁹⁵ MCKINSEY & COMPANY, PRIVATE MARKETS RALLY TO NEW HIGHEST, MCKINSEY GLOBAL PRIVATE MARKETS REVIEW 2022 (2022), <https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/mckinseys-private-markets-annual-review>.

Evidence of outperformance of public markets

The vast majority of analyses of net performance data indicate that private equity fund advisers continue to provide value to investors in the form of gross returns that outperform equivalent public markets, and that such outperformance persist even when subtracting the cost of the gross fees they charge, indicating that competitive pressures continue to keep such fees low.

In a 2018 report, the Committee reviewed and analyzed the evidence regarding private equity fund net performance and concluded that empirical studies have consistently shown that average private equity buyout fund performance has outperformed public markets on a net basis.⁹⁶ For example, Harris et al. (2016),⁹⁷ Robinson & Sensoy (2016),⁹⁸ Harris et al. (2014),⁹⁹ and Higson & Stucke (2014),¹⁰⁰ Phalippou (2014),¹⁰¹ all determine that the average private equity buyout fund has outperformed the S&P 500 over time after netting out fees.

A review of more recent studies analyzing the performance of private equity funds finds that private equity funds continue to outperform public markets. For example, in a 2020 analysis, Professor Steve Kaplan presents data on private equity performance from the private equity analytics company Burgiss, which is sourced from a wide variety of limited partners.¹⁰² The analysis employs a measure known as “public market equivalent” (“PME”), which measures performance net of fees relative to a comparable market index. A PME of greater than one indicates that an investment outperformed the relevant index. Kaplan’s analysis shows that both the pooled average and median U.S. buyout fund PMEs (using the S&P 500 as a benchmark) by vintage year from 1991-2015 was greater than 1 for all except three years and was in several years as high as 1.6. Even using small cap indices, such as the Russell 2000 and the Russell 2000 Value (both of which have historically outperformed the S&P 500), the average PME is above 1 for the same periods.¹⁰³ The SEC has itself acknowledged this evidence of outperformance: In a 2021 report, the SEC’s Asset Management Advisory Committee found “support for [private equity] returns being *at least slightly better to somewhat better* than those for public markets.”¹⁰⁴

Kaplan (2020) also refutes the conclusion of Phalippou (2020), which is the only study that the Proposed Rule cites that concludes that private equity funds have not offered superior net performance relative to public markets.¹⁰⁵

⁹⁶ COMMITTEE ON CAPITAL MARKETS REGULATION, EXPANDING OPPORTUNITIES FOR INVESTORS AND RETIREES: PRIVATE EQUITY (2018), <https://capmksreg.org/wp-content/uploads/2022/11/Private-Equity-Report-FINAL-1-1.pdf>

⁹⁷ Robert S. Harris, Tim Jenkinson and Steven N. Kaplan, *How Do Private Equity Investments Perform Compared to Public Equity*, 14 JOURNAL OF INVESTMENT MANAGEMENT 14 (2016).

⁹⁸ David Robinson & Berk Sensoy, *Cyclical, Performance Measurement, and Cash Flow Liquidity in Private Equity*, 122 JOURNAL OF FINANCIAL ECONOMICS 251 (2016).

⁹⁹ Robert Harris et al., *Private Equity Performance: What Do We Know?* 69 JOURNAL OF FINANCE 1851 (2014).

¹⁰⁰ Chris Higson & Rüdiger Stucke, *The Performance of Private Equity* (2012), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2009067.

¹⁰¹ Ludovic Phalippou, *Performance of Buyout Funds Revisited?*, 18 REVIEW OF FINANCE 189 (2014).

¹⁰² Steve Kaplan, *What Do We Know About Private Equity Performance?* (Aug. 2020).

¹⁰³ *Id.* at 17, 19.

¹⁰⁴ SEC *supra* note 65.

¹⁰⁵ Ludovic Phalippou, *An Inconvenient Fact: Private Equity Returns & The Billionaire Factor* (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3623820.

Professor Phalippou’s inconsistent findings can be attributed to several methodological flaws. Specifically, Professor Phalippou’s analysis:

- Includes the performance of private real estate, natural resources, and infrastructure funds with private equity buyout funds whereas other studies focus on buyout funds. Phalippou then compares the performance of these other types of private funds aggregated with private equity buyout funds against an index of equities (the S&P 500), which is a distinct asset class and thus not a fitting benchmark for the performance of other types of private funds.¹⁰⁶ The performance of natural resources funds, for example, should instead be compared against an index of natural resource assets, such as the S&P Global Natural Resources Index.¹⁰⁷
- Cherry-picks the 2006-2015 vintage range, which is one of the lowest performing in recent history, and yields a PME of 0.99 relative to the S&P 500. For any other vintage period between 1996 and 2015, PME relative to the S&P 500 is greater than 1. For example, the 2009-2015 vintage range yields a PME of 1.04.¹⁰⁸
- Uses the S&P 500, a large-cap index, as a benchmark, which fails to reflect that buyout funds also invest in small- and mid-cap portfolio companies. Adopting the Russell 2000 or S&P 600, each of which includes a greater proportion of small- and mid-cap companies, increases the PME for the 2006 to 2015 vintage to 1.11 and 1.03, respectively.¹⁰⁹
- Ignores the fact that investors increasingly co-invest in private equity deals with discounted fees or no fees, and thus underestimates net performance.¹¹⁰
- Disregards the diversification benefits of private equity investments, including the author’s own conclusion in Gourier & Phalippou (2018) that “large buyout and VC funds have provided substantial diversification benefits to investors; most real asset funds, overall, have not.”¹¹¹ The 2021 report of the SEC’s Asset Management Advisory Committee also attests to these diversification benefits, noting that “in addition to higher returns, [private equity] funds offer a benefit to traditional equity investors in the form of enhanced diversification.”¹¹²

Several other recent studies of private equity fund performance also find that private equity funds outperform public markets. Harris et al. (2020)¹¹³ finds that the average PME through 2019 across

¹⁰⁶ Kaplan, *supra* note 102, at 8.

¹⁰⁷ S&P Dow Jones Indices, S&P Global Natural Resources Index, <https://www.spglobal.com/spdji/en/indices/equity/sp-global-natural-resources-index/#overview> (last visited Mar. 15, 2023).

¹⁰⁸ Steven Kaplan, COLLIER RESEARCH INSTITUTE, *A Winning Strategy*, 17 PRIVATE EQUITY FINDINGS 24 (2021), https://www.collercapital.com/sites/default/files/Private%20Equity%20Findings%20Issue%2017_0.pdf.

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² SEC, *supra* note 65 at 9.

¹¹³ Robert S. Harris et al., *Has Persistence Persisted in Private Equity? Evidence from Buyout and Venture Capital Funds*, Working Paper No. 2020-167 (2020), https://bfi.uchicago.edu/wp-content/uploads/2020/11/BFI_WP_2020167.pdf.

all funds established from 1994 through 2014¹¹⁴ was 1.2, and that the PME for funds established in each individual vintage year was greater than 1. Brown & Kaplan (2019)¹¹⁵ draw a consistent conclusion using the MSCI ACWI index (a global equity index) for the PME comparison. They found that, based on performance data through September 2018, private equity funds maintained PMEs greater than 1 for each vintage year from 1988 through 2014.

Private sector research further corroborates these findings. A 2021 Cambridge Associates analysis found that private equity funds outperformed the S&P 500 over each of the past 5-, 15-, and 25-year periods.¹¹⁶ And a 2021 McKinsey report found that over the years 1978-2017, private equity funds achieved a 9.9% annualized return over the trailing 20-year period, compared to a 6.4% annualized return for the S&P 500.¹¹⁷

The outperformance of private equity funds also inures to the benefit of institutional investors. The 2021 Cambridge Associates analysis found that for the 10-year period ending June 30, 2020, the median return of institutional investors that allocated at least 30% of their portfolios to private equity funds was 2% higher than the median return earned by institutional investors that allocated less than 10% of their portfolios to such funds.¹¹⁸ A 2022 Cliffwater report finds that over the years 2000-2021, pension funds investing in private equity earned an annualized net-of-fee return of 11%, 4.1% higher than the 6.9% annualized return they would have earned had they invested the same amount in public equities over that period.¹¹⁹

The analyses of net performance are thus one of the strongest indicators of the competitiveness of private equity fund advisory markets. The conclusions of these analyses demonstrate that private equity fund advisers do not raise fees to capture the value of the superior gross investment performance that they achieve, as one would expect in an uncompetitive marketplace. Strong competitive dynamics compel private equity fund advisers to keep prices low, thus resulting in continued strong net investment performance for investors.

3. Demand for private equity fund advisory services

The degree of price competition and the quality of private equity fund advisory markets can also be inferred from the extent of investor demand for such services. If service quality were uncompetitive relative to price or vice versa, investors would likely withdraw capital from private equity funds over time in favor of more competitive alternatives. To the contrary however, investors have committed increasingly greater amounts of capital to private equity funds over the

¹¹⁴ As in the case of the net IRR data above, funds of more recent vintages would not yet have generated sufficient relevant performance history to be analyzed.

¹¹⁵ Gregory W. Brown & Steven N. Kaplan, *Have Private Equity Returns Really Declined?* (2019), https://uncipc.org/wp-content/uploads/2019/05/HavePrivateEquityReturnsDeclined_05022019.pdf.

¹¹⁶ Maureen Austin & David Thurston, Cambridge Associates, *Building Winning Portfolios Through Private Investment* (Aug. 11, 2021).

¹¹⁷ McKinsey & Company, *McKinsey Global Private Markets Review 2021*, at 20-21 (April 2021), <https://mck.co/3jUcfyQ>.

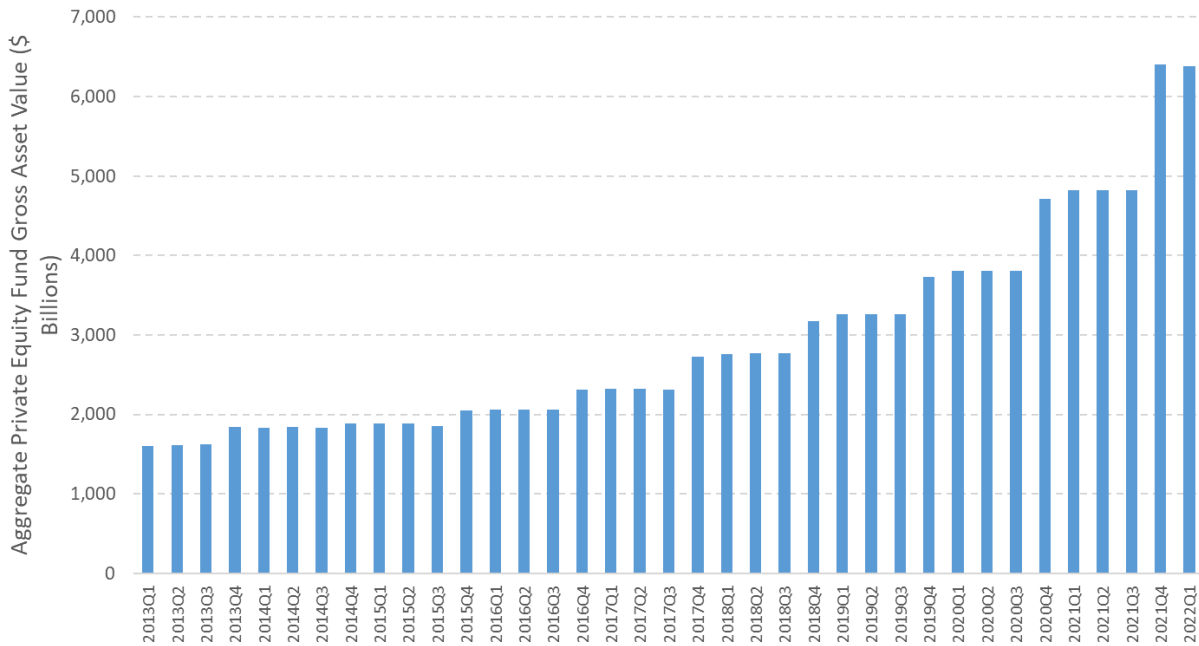
¹¹⁸ *Id.*

¹¹⁹ Cliffwater, *Long-Term Private Equity Performance: 2000 to 2021* (June 2022), <https://www.cliffwater.com/Resources>.

past decade, indicating that demand for private equity fund advisory services continues to be high, and in turn that price competition and service quality remain high.

Both aggregate gross and net assets under management for private equity funds have increased steadily over the past decade. Gross assets measures fund assets without subtracting fund liabilities and net assets measures fund assets reduced by fund liabilities.¹²⁰ Figure 11 shows that private equity fund aggregate gross assets increased from \$1.60 trillion in Q1 2013 to \$6.38 trillion in Q1 2022. Figure 12 on the following page shows that private equity fund net assets increased from \$1.47 trillion in Q1 2013 to \$5.73 trillion in Q1 2022.

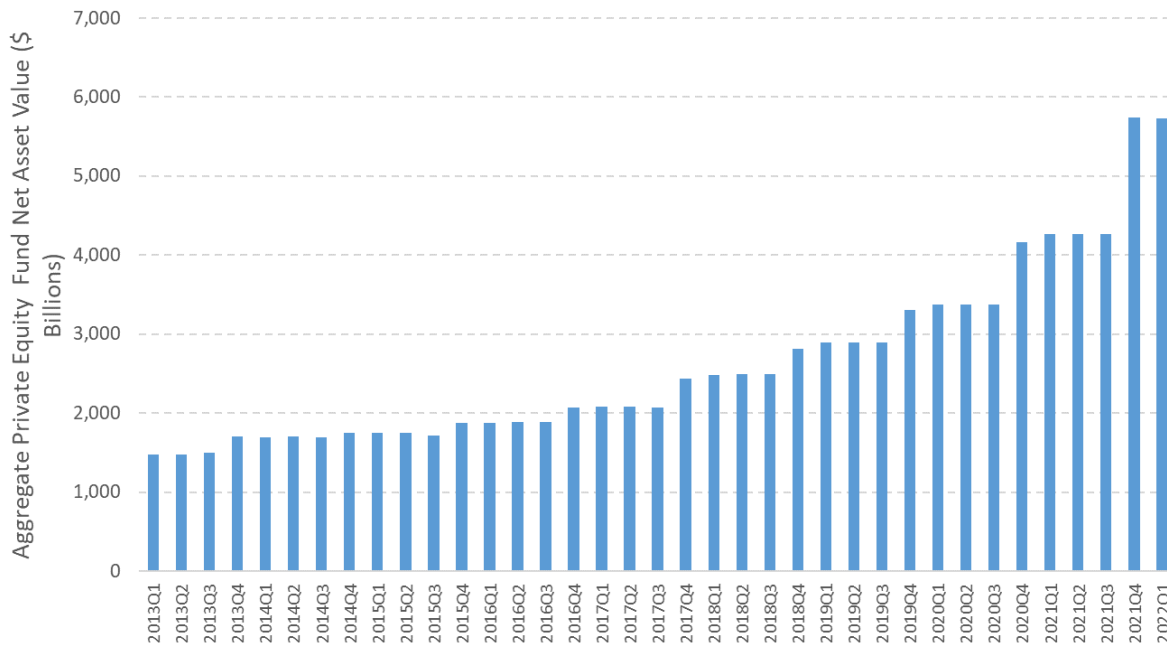
Figure 11: Aggregate Private Equity Fund Gross Asset Value¹²¹



¹²⁰ PREQIN, GLOSSARY OF TERMS, <https://docs.preqin.com/pro/Preqin-Glossary.pdf> (last visited Feb. 24, 2023).

¹²¹ *Id.*

Figure 12: Aggregate Private Equity Fund Net Asset Value¹²²



Despite the clear evidence of increasing aggregate supply and demand for private equity fund investments, both the Proposed Rule and Chair Gensler’s public statements have suggested that public pension funds are uniquely disadvantaged by a lack of competition and “uneven playing field” in private fund markets.¹²³ If this were the case, one would expect such funds, which are managed by investment professionals who owe fiduciary duties to their funds, to move away from private equity investments. On the contrary, public pension funds have allocated increasingly greater amounts of capital to private equity investments. According to one survey, the median allocation of public pension funds to private equity investments increased by a factor of 9, from under 1% in 2001 to approximately 9% (equivalent to approximately \$480 billion) in 2020.¹²⁴ Moreover, major pension fund investors indicated in 2022 that they intend to continue to increase their allocations to private equity fund investments.¹²⁵

¹²² *Id.*

¹²³ Chair Gary Gensler, *supra* note 4.

¹²⁴ Center for Retirement Research at Boston College, MissionSquare Research Institute, National Association of State Retirement Administrators, and Government Finance Officers Association, Public Plans Data 2001-2020.

¹²⁵ Jessica Hanlin, *Will Public Pensions Stick to Their PE Targets in 2023* PITCHBOOK (Dec. 13, 2022), <https://pitchbook.com/news/articles/pensions-allocations-private-equity-2023>; PRIVATE EQUITY WIRE, *Rise in Private Equity Allocations Looks Unstoppable, For Now* (Mar. 15, 2022), <https://www.privateequitywire.co.uk/2022/03/15/312892/rise-private-equity-allocations-looks-unstoppable-now>; PREQIN, *86% of Investors Plan to Invest the Same or More in Private Capital Over Next 12 Months* (Mar. 16, 2022), <https://www.preqin.com/LinkClick.aspx?fileticket=Jd7u8FD7Ibo%3D&portalid=0>.

Part III: The Effect of the Proposed Rule on Competitiveness in the Private Equity Fund Advisory Industry

Part III analyzes the likely effects of three of the Proposed Rule’s provisions on competitiveness in the U.S. private equity fund market: (1) the prohibition on preferential redemption terms (the “Preferential Redemption Prohibition”),¹²⁶ (2) the prohibition on certain exculpation and indemnification terms (the “Indemnification Prohibition”),¹²⁷ and (3) the prohibition on charging certain compliance expenses to funds (the “Expense Prohibition”).¹²⁸ A full description of these prohibitions is in the Committee’s comment letter on the Proposed Rule and they are briefly summarized below.¹²⁹

- The Preferential Redemption Prohibition would prohibit a private equity fund adviser from granting an investor in the private equity fund or in a substantially similar pool of assets the ability to redeem its interest on terms that the adviser reasonably expects to have a material, negative effect on other investors in that fund.
- The Indemnification Prohibition would prohibit a private equity fund adviser from seeking reimbursement, indemnification, exculpation, or limitation of its 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 the private equity fund.
- The Expense Prohibition would prohibit a private equity fund adviser from charging fees or expenses associated with an examination or investigation of the adviser or its related persons by any governmental or regulatory authority, as well as regulatory and compliance fees and expenses of the adviser or its related persons.

Section A of Part III provides an assessment of the SEC’s policy rationale for each of the three proposed prohibitions, particularly in light of our prior analysis of competition in the private equity fund market. In Section B, we then identify the likely consequences of the three prohibitions, finding that they will *reduce* competition in the private equity fund market. Although estimating the quantitative effects of the Proposed Rule (e.g., estimating the extent of changes to HHI) is not feasible, we identify qualitative effects, including for example the likely directional changes to industry concentration and the overall quantities of funds and advisers. **We identify 10 negative effects on competition from the Proposed Rule.**

A. An Assessment of the Proposed Rule’s Competition Rationale

The Proposed Rule contends that it will improve the competitiveness of the U.S. market for private fund advisory services by mitigating a purported systemic bargaining power imbalance between investors and fund advisers¹³⁰ that forces investors to invest on terms that the adviser dictates, and

¹²⁶ Proposed Rule § 275.211(h)(2)–3(a)(1).

¹²⁷ *Id.* § 275.211(h)(2)–1(a)(5).

¹²⁸ *Id.* § 275.211(h)(2)–1(a)(2)–(3).

¹²⁹ COMMITTEE ON CAPITAL MARKETS REGULATION, Comment Letter Re. the Proposed Rule (Apr. 25, 2022), <https://www.sec.gov/comments/s7-03-22/s70322-20126557-287195.pdf>.

¹³⁰ *See, e.g.*, Proposed Rule at 16,951 (“We associate these practices with a tendency towards opportunistic hold-up of investors by advisers, involving the exploitation of an informational or bargaining advantage by the adviser or advantaged investor.”).

which competitive market forces do not remediate.¹³¹ The Preferential Redemption Prohibition, Indemnification Prohibition, and Expense Prohibition are intended to address this purported lack of competition by establishing certain mandatory contractual provisions that are intended to be favorable to investors.

However, Part I and Part II have shown that the Proposed Rule’s characterization of the competitive dynamics of the private fund market is inaccurate. On the contrary, the extensive and expanding quantity and variety of private fund investment opportunities, high net-of-fee returns, low barriers to entry, and low industry concentration each evidence the existence of a highly competitive market. The Proposed Rule presents no empirical evidence of an uncompetitive marketplace beyond that which we describe in Part II, which, as discussed, is unpersuasive. Indeed, the evidence presented in Part I indicates that far from having no choice, investors have a wide array of funds and advisers to choose from, and many have significant knowledge of fund negotiation terms from prior deals across various private fund advisers. Despite having no obligation to invest in private equity funds and the existence of various alternatives, including publicly offered mutual funds and direct investment in public equities, institutional investors have continued to allocate significant capital to private equity funds and intend to allocate more.

The empirical literature extensively demonstrates that introducing restrictions in a competitive market (which the literature refers to as “frictions” or “distortions”) negatively impacts competition. Therefore, by restricting the negotiations of sophisticated and informed counterparties, the Proposed Rule’s Preferential Redemption Prohibition, Indemnification Prohibition and Expense Prohibition would reduce competition.

For example, Singham et al. (2018) detail various examples of regulatory interventions in competitive marketplaces and their anti-competitive effects and resulting negative impacts on consumer welfare, such as artificially raising the cost of production.¹³² Moreover, the Proposed Rule’s Preferential Redemption Prohibition would reduce what the economic literature refers to as “price discrimination,” where different consumers of private fund advisory services are provided differential treatment. However, Levine (2001)¹³³ concludes that price discrimination is consistent with and often an element of a competitive marketplace and not an indicator of uncompetitive market power. In fact, he concludes that regulatory attempts to eliminate price discrimination in competitive markets “almost always produce outcomes less efficient than the ones that they were designed to change.”¹³⁴ The Proposed Rule however does not consider this body of literature.

¹³¹ See, e.g., Proposed Rule at 16,925 (“We believe that such contractual provisions are neither in the public interest nor consistent with the protection of investors . . . particularly where . . . investors with less bargaining power are forced to bear the brunt of such arrangements.”); *id.* at 16,943 (“Advisers may not have sufficient incentives and abilities to commit to a solution to these problems with existing governance mechanisms.”).

¹³² Shanker A. Singham & U. Srinivasa Rangan, *Anti-Competitive Market Distortions: A Typology* 38(3) ECONOMIC AFFAIRS 339 (2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3269426.

¹³³ Michael E. Levine, *Price Discrimination Without Market Power* (2001), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=224947.

¹³⁴ *Id.* at 3.

Bargaining Power and Competition

The Proposed Rule asserts that private equity fund advisers possess superior bargaining power over investors, so advisers are able to charge high fees or impose onerous terms on investors and therefore the private equity fund market is not competitive. For example, the Proposed Rule asserts that “opportunistic” exploitation by advisers of “informational advantage or bargaining power” over investors is an “inherent” problem in the adviser-investor relationship.¹³⁵

In March 2023, ILPA submitted a report to the comment file on the Proposed Rule (the “**ILPA Report**”) that makes additional claims about a purported bargaining power imbalance between private equity advisers and fund investors that justifies the Proposed Rule’s interventions.¹³⁶ The report asserts that, because “there are more LPs looking to get access to the top-performing GPs,” the “fear of losing allocation” to the highest performers “inhibit[s] LPs’ ability to switch GPs if they are dissatisfied with terms[,]”¹³⁷ such that investors commonly accept “sub-optimal” legal terms.¹³⁸ Investors are also purportedly constrained in the bargaining process by “vital portfolio construction considerations.”¹³⁹ The report states that “dispersion between top-performing GPs and bottom performing GPs is significant” and that “once LPs get access to a high-performing GP, they are less inclined to walk away for performance reasons.”¹⁴⁰ It contests the view that the private equity fund advisory market is unconcentrated by stating that 71% of the investors that ILPA surveyed disagreed with the view that the private industry is unconcentrated.¹⁴¹

The Proposed Rule and the ILPA Report present these claims as evidence of a lack of competition that the Proposed Rule’s restrictions will remedy by increasing the competitiveness of the private equity fund advisory market.¹⁴² However, this argument fails because the existence of a balance of bargaining power between buyers and sellers is not a precondition for or a necessary result of a competitive marketplace. Indeed, whereas the empirical literature and the Agency Merger Guidelines look to all of the factors that we consider in our Part I and Part II analysis as indicia of competitiveness, neither treats the existence of bargaining power as being relevant to competitiveness. Lack of bargaining power may not lie with antitrust law but, rather, with the laws of supply and demand.

Even markets where consumers have little to no ability to modify the terms on which they receive a good or service from a particular provider can be highly competitive. For example, in the market for retail footwear the average purchaser typically has no bargaining power to change the price of a particular shoe or compel a producer to modify its characteristics. The footwear market is

¹³⁵ Proposing Release at 16,943.

¹³⁶ ILPA, THE FUTURE OF PRIVATE EQUITY REGULATION 4 (2023), <https://www.sec.gov/comments/s7-03-22/s70322-20158927-326926.pdf> [the “ILPA Report”].

¹³⁷ *Id.* at 4.

¹³⁸ *Id.* at 11.

¹³⁹ *Id.* at 7.

¹⁴⁰ *Id.* at 13.

¹⁴¹ *Id.* at 13.

¹⁴² *Id.* at 14. Proposing Release at 16,956.

nonetheless characterized by intense price competition as well as quality competition in the form of the introduction of new models and existing product upgrades and the entrance of new producers to the marketplace who compete with the existing major producers.¹⁴³ In such cases, competition among providers keeps prices close to marginal cost and the existence of multiple providers gives consumers choices about what they purchase and how much they pay. We demonstrated in Part I and Part II that those same characteristics exist in the private equity fund market and therefore the private equity fund market is highly competitive.

Moreover, presenting an opinion survey of buyers of a service as evidence of a lack of competitiveness, as the ILPA Report does, is a fatally flawed methodology. The wish for buyers to obtain better service at lower prices is neither revealing nor surprising. Demonstrating this desire by means of a survey provides no reliable evidence of a competitive market failure and is not an indication that prices or service quality competition can be improved by a regulatory intervention.

Below we further address in turn the conceptual flaws in the argument that a bargaining power imbalance entails an uncompetitive marketplace and the factual inaccuracies in the claims about such an imbalance between investors and advisers.

a. Claims of uneven bargaining power do not evidence an uncompetitive marketplace

The ILPA Report emphasizes the fact that investors must often accept compromise positions in negotiating fund terms because they want to retain investment opportunities with the best advisers, which obtain significantly better investment performance for their investors. It presents this phenomenon as a sign of an uncompetitive market necessitating regulatory intervention. But this is not a sign of an uncompetitive market. In this context, particularly with respect to the best performers, lack of bargaining power is an inevitable consequence of certain basic facts, including that: valuable services are often finite, service providers tend to have differing skill levels, and consumers prefer, and are thus reasonably willing to pay more for skilled providers. Aaron Judge's ability to command a \$360 million deal does not mean the market for baseball players is not competitive.¹⁴⁴

The scenario that the ILPA Report describes does not justify a regulatory intervention in the name of increasing competition. Indeed the Proposed Rule's restrictions cannot alter these basic features of competitive marketplaces. Advisers would continue to achieve differing levels of success, and access to the funds of the best performing advisers would remain finite. The Proposed Rule would simply limit the various contractual compromises that advisers *and investors* have devised under conditions of intense competition.

¹⁴³ Ashwin Jospeh, *Competitive Analysis of Running Shoe Brands From Amazon* DATAHUT (Nov. 4, 2022), <https://www.blog.datahut.co/post/running-shoe-brands-competitive-analysis-amazon>; YAHOO REPORTLINKER, *Global Footwear Market to Reach \$427.4 Billion by 2027* (Oct. 10, 2022), <https://www.yahoo.com/now/global-footwear-market-reach-427-115000297.html>.

¹⁴⁴ Aaron Judge, *Yankees Finalize \$360 Million, 9-Year Contract* ESPN (Dec. 20, 2022), https://www.espn.com/mlb/story/_/id/35293005/aaron-judge-yankees-finalize-360-million-9-year-contract.

As another example of this flawed reasoning, the report claims that investors must commonly accept “sub-optimal” legal terms.¹⁴⁵ However the report does not clarify what “optimal” means in this context, and gives no indication that it means anything other than the ideal terms from the perspective of the investor. To suggest that in a competitive marketplace, consumers must be able to obtain their preferred terms from the best providers without compromise is clearly unrealistic.

The ILPA Report implies that investors are unable to exercise bargaining power because of “vital portfolio construction considerations” and “switching costs” that make them unable to forgo access to the best performing advisers.¹⁴⁶ But this is merely an attempt to present the common desire to obtain the best possible service at the lowest possible price as an “inability” to accept anything less. Once again, the fact that ideal service terms cannot always be obtained from one’s preferred provider is a basic feature of any marketplace that a regulatory intervention cannot and should not attempt to change. The inability for the average consumer to purchase a Ferrari at a lower price does not mean the market for luxury sports cars is uncompetitive.

b. Claims of uneven bargaining power are unfounded or exaggerated

In addition to the flawed reasoning that equates a purported bargaining power imbalance with an uncompetitive market, several of the factual premises used to substantiate the existence of a systemic bargaining power advantage in favor of advisers and against investors are unfounded or exaggerated.

First, the ILPA Report questions the level of concentration in the private equity fund advisory industry by noting that 71% of surveyed investors do not believe that the industry is “unconcentrated.”¹⁴⁷ However, the report offers no definition of “unconcentrated,” nor does it clarify if any definition was offered to survey respondents. The statistic is thus nothing more than a vague statement about the subjective perceptions of a subset of private fund investors ungrounded in any quantitative or objective criteria. It is thus clearly inadequate to cast any doubt on the extensive quantitative evidence, detailed in Part I above, that the private equity fund advisory industry is in fact highly unconcentrated.

Second, the ILPA Report claims that the “GP and its counsel have complete information on all issues being raised by all potential LPs” whereas investors often lack “an awareness of the issues being raised by other LPs in that particular transaction.”¹⁴⁸ Investors do not, however, “lack awareness” of what terms other investors are likely negotiating for with the adviser. The task of advising private equity fund investors has become increasingly concentrated in the hands of a small group of sophisticated counsel. The more prominent counsel see nearly every significant private equity fund that is raised, and as such have access to an “enormous collection” of precedent agreements that provide detailed insight into market practices.¹⁴⁹ Indeed, the ILPA Report reveals that just 26% of its respondents noted “insufficient information on ‘What’s Market’ in Fund

¹⁴⁵ ILPA Report at 11.

¹⁴⁶ *Id.* at 7.

¹⁴⁷ ILPA Report at 13.

¹⁴⁸ *Id.* at 9.

¹⁴⁹ Casey Sullivan, *Inside the Legal War Between Private-Equity Firms and Their Investors* BUSINESS INSIDER (Sept. 20, 2021), <https://www.businessinsider.com/private-equity-lawyers-investors-legal-war-2021-9>.

Terms” as a top explanation for why investors accept, from their perspective, sub-optimal investment terms.¹⁵⁰

Moreover, even if one accepts the claim at its most literal (i.e., that an investor does not know with certainty what specific terms other investors have obtained) the report completely omits the corollary that an investor that negotiates with multiple advisers has “complete information” on the issues being raised by the different advisers to those funds, while each individual adviser “lacks awareness” of the issues being raised by other advisers. The ILPA Report thus fails to substantiate an informational advantage on the part of advisers.

Third, the ILPA Report contains several indications that relative bargaining power has been moving in favor of investors and that the ability of investors to negotiate exclusive terms with advisers is not harmful to other investors. For example, the report notes that “[p]rivate equity has made great strides in transparency, governance and alignment of interests” over the past 20 years.¹⁵¹ It also indicates that 72% of surveyed investors agreed or strongly agreed that side letter terms that provide investors “with critical governance, statutory or regulatory protections” do not have a material negative impact on other investors in the same fund.¹⁵² Moreover, the ILPA Report notes that during the 2020-2022 period there have been declines in the frequency with which a number of cost categories are included in management fees, including travel and costs related to deal-sourcing, regulatory filings and compliance costs, and overhead.¹⁵³ More generally, the balance of bargaining power between investors and advisers is sensitive to overall market conditions. During periods of strong market performance, advisers may have relatively more power, but these dynamics naturally shift over time with changing market conditions.¹⁵⁴

B. The Proposed Rule Would Reduce Competition in the Private Equity Fund Market

Each of the Preferential Redemption, Indemnification, and Expense Prohibition would produce numerous negative consequences for the competitiveness of the U.S. private equity fund market.

1. Increasing compliance costs

The empirical literature documents the potential for a direct compliance obligation to produce substantial collateral costs. For example, Franks et al. (1997)¹⁵⁵ found that indirect regulatory compliance costs for firms in the investment management industry outweighed direct costs at a ratio of 3.2 to 1. Buchan et al. (2012)¹⁵⁶ found that a tax rate increase required firms to incur costs

¹⁵⁰ ILPA Report at 13.

¹⁵¹ *Id.* at 5.

¹⁵² ILPA, PRIVATE FUND ADVISERS DATA PACKET 46 (2023), <https://ilpa.org/wp-content/uploads/2023/03/ILPA-Private-Fund-Advisers-Data-Packet-March-2023-Final.pdf>.

¹⁵³ *Id.* at 34.

¹⁵⁴ *See, e.g.*, TROUTMAN PEPPER *supra* note 77.

¹⁵⁵ Julian R. Franks, *The direct and compliance costs of financial regulation* 21 JOURNAL OF BANKING & FINANCE 1547 (1997), <https://www.sciencedirect.com/science/article/abs/pii/S0378426697000459>.

¹⁵⁶ Heather Buchan et al., *Compliance costs: The impact of the increased GST rate on two New Zealand businesses* 10(2) NEW ZEALAND JOURNAL OF APPLIED BUSINESS RESEARCH 49 (2012), <https://search.informit.org/doi/abs/10.3316/informit.195723286111009>.

beyond their higher tax liabilities, including costs from software development, legal research, audits, employee training, and customer communication.

The Preferential Redemption, Indemnification, and Expense Prohibitions would each increase adviser compliance costs in this manner. For example, advisers would be required to engage outside counsel or task in-house counsel with a legal analysis of investor-specific redemption provisions to determine if they were materially negative to other investors and thus conflict with the Preferential Redemption Prohibition. Advisers would need to do the same with fee provisions to determine if they conflict with the Expense Prohibition. In the case of the Indemnification Prohibition, advisers may be required to carry additional liability insurance, to the extent available, against suits that cannot be indemnified.¹⁵⁷ In doing so, these provisions would have the following negative effects on competition in the private equity fund market.

a. *Reduction in supply (service quantity)*

Economic theory is axiomatic to the effect that an exogenous increase in costs causes suppliers in a competitive market to reduce the quantity of a good or service they supply.¹⁵⁸ This theoretical principle has been empirically verified. For example, Quigley et al. (2005)¹⁵⁹ found that local land-use regulations restricting urban growth reduce the supply of housing and reduce the responsiveness of the housing supply to increases in demand, thus raising housing prices.

In the private funds industry, increasing adviser compliance costs would mean that advisers are likely to scale back their fund offerings or exit the marketplace.

b. *Lower net returns (service quality)*

An exogenous increase to costs also reduces the extent to which suppliers in a competitive market can compete by lowering their prices while still earning a profit, such that some portion of the increased cost is passed on to customers in the form of higher prices. These dynamics have been empirically verified. For example, in their cross-industry analysis of the economic effect of regulatory burdens on consumer prices, Chambers, et al. (2019)¹⁶⁰ found that a 10 percent increase in total regulations leads to a 0.687 percent increase in consumer prices.

Empirical studies have demonstrated that when an exogenous cost increase occurs, the proportion of those costs that will be passed on to consumers is likely to be greater when the industry is highly competitive. For example, a study by the UK Office of Fair Trading (2014) found that in competitive markets, when there is an exogenous increase in production costs, the price at which

¹⁵⁷ Kothari, *supra* note 91.

¹⁵⁸ See, e.g., RICHARD V. EASTIN & GARY L. ARBOGAST, DEMAND AND SUPPLY ANALYSIS: INTRODUCTION (2011), <https://www.cfainstitute.org/-/media/documents/support/programs/cfa/prerequisite-economics-material-demand-and-supply-analysis-intro.pdf> (the cost of production is one of the main determinants of aggregate supply); Douglas A. Ruby, Exogenous Supply Side Shocks (2003), <http://www.digitaleconomist.org/supply.html> (exogenous increase in production costs reduces production).

¹⁵⁹ John M. Quigley et al., *Regulation and the High Cost of Housing in California* 95(2) AMERICAN ECONOMIC REVIEW 323 (2005), https://urbanpolicy.berkeley.edu/pdf/QR_RegAER0406.pdf.

¹⁶⁰ Dustin Chambers et al., *How do federal regulations affect consumer prices? An analysis of the regressive effects of regulation* 180 PUBLIC CHOICE 57 (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3191409.

firms supply a given quantity increases and that the extent of this increase is positively correlated with the degree of competition in the industry.¹⁶¹

Because the market for private fund advisers is highly competitive, one should expect a significant portion of the costs associated with greater compliance burdens to be passed on to investors through fees or lower fund performance, thus negatively impacting investor returns. ILPA’s comment letter to the Proposed Rule corroborates these concerns. For example, the letter notes that in prohibiting the pass-through of compliance costs, the Expense Prohibition could “yield unintended consequences, chiefly increased management fees.”¹⁶²

c. Increased barriers to entry

New firms entering a marketplace are typically smaller than incumbent firms and thus benefit from fewer economies of scale in absorbing the impact of an exogenous increase in compliance costs. As a result, one can expect higher compliance costs to increase barriers to entry. Empirical studies anticipate this consequence. For example, Huffman (2000)¹⁶³ concludes that the creation of additional regulatory compliance burdens for new entrants to an industry more severely affects smaller firms. Fisman & Sarria-Allende (2004)¹⁶⁴ conducted a cross-industry comparison of start-up costs and barriers to entry and found that increasing regulatory start-up costs leads to lower rates of entry of new firms. Klapper et al. (2006)¹⁶⁵ conducted a similar study and reached similar findings. Becht et al. (2008)¹⁶⁶ found that relatively small increases in general minimum capital requirements for incorporation of firms had a significant negative effect on the rate of firm creation.

d. Increased industry concentration

As increased costs cause existing advisers to scale back offerings or exit the marketplace and reduce the rate of entry of new advisers, the extent of industry concentration in the private equity fund market can be expected to increase. Once again, the empirical literature anticipates this consequence. For example, in their cross-industry analysis, Bustamente & Donangelo (2017)¹⁶⁷ found that industries with higher barriers to entry tend toward higher industry concentration and less competition. Carree & Thurik (2005) review the substantial economic literature indicating that facilitating the entry of new firms increases both the quantity and variety of service and the rate of

¹⁶¹ RBB ECONOMICS, COST PASS-THROUGH: THEORY, MEASUREMENT, AND POTENTIAL POLICY IMPLICATIONS (2014), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/320912/Cost_Pass-Through_Report.pdf.

¹⁶² ILPA, *supra* note 87, at 16.

¹⁶³ James L. Huffman, *The Impact of Regulation on Small and Emerging Businesses*, 4 JOURNAL OF SMALL & EMERGING BUSINESS LAW 307 (2000), <https://heinonline.org/HOL/LandingPage?handle=hein.journals/jsebl4&div=17&id=&page=>.

¹⁶⁴ Raymond Fisman & Virginia Sarria-Allende, *Regulation of Entry and the Distortion of Industrial Organization*, NBER Working Paper No. 10929

¹⁶⁵ Leora Klapper et al., *Entry regulation as a barrier to entrepreneurship* 82(3) JOURNAL OF FINANCIAL ECONOMICS 591 (2006), https://www.nber.org/system/files/working_papers/w10380/w10380.pdf.

¹⁶⁶ Marco Becht et al., *Where Do Firms Incorporate? Deregulation and the Cost of Entry* 14(3) JOURNAL OF CORPORATE FINANCE 241 (2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=906066.

¹⁶⁷ Maria C. Bustamente & Andres Donangelo, *Product Market Competition & Industry Returns* 30(12) THE REVIEW OF FINANCIAL STUDIES 4216 (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2173985.

innovation.¹⁶⁸ As one example thereof, Kirzner (1997)¹⁶⁹ concludes that participation by newer and smaller firms is associated with greater competition.

2. Constraining fund terms would reduce competition.

The Expense, Indemnification, and Preferential Redemption Prohibitions would each reduce the ability of well-informed and highly sophisticated investors to negotiate contractual provisions with fund advisers that efficiently allocate the burden of fees and risks of legal liability, and that consider differing investor priorities as to redemptions. In doing so, these restrictions would have the following negative effects on competition and service quality in the private equity fund market:

a. *Lower net returns due to fee aggregation (service quality)*

The effect of the Expense Prohibition would be that advisers and investors can no longer negotiate the sharing of these costs transparently and effectively. Instead, advisers would be required to roll such costs into generic management fees.¹⁷⁰

Empirical research indicates that the bundling of fees in the investment management context can often result in higher aggregate fees compared to when fees are individually itemized. For example, Jackson et al. (2020)¹⁷¹ found that the disaggregation of sell-side research charges from brokerage commissions under MiFID II improved European market efficiency. Monk & Sharma (2015)¹⁷² found that the unbundling of fees for financial services into separately itemized charges increased transparency, and alignment of investors' interests with those of external asset managers. By contrast, the Expense Prohibition would reverse the itemization process, the likely consequences of which will be less transparency and higher fees.

b. *Inferior fund redemption terms (service quality)*

In the current competitive marketplace, investors can bargain for unique redemption terms, thus potentially reducing illiquidity risk. Even in the case of private equity funds, which generally require a multi-year commitment of capital, investors commonly bargain for and receive bespoke withdrawal rights.¹⁷³ The Proposed Rule attempts to present this flexibility as detrimental to investors and private fund markets generally. Chair Gensler has done the same in public comments, stating that side letters that create preferred liquidity terms “can create an uneven playing field

¹⁶⁸ Martin Carree & Roy Thurik, *Understanding the role of entrepreneurship for economic growth* (2005), <https://www.econstor.eu/bitstream/10419/20001/1/2005-10.pdf>.

¹⁶⁹ Israel M. Kirzner, Entrepreneurial Discovery and the Competitive Market Process: An Austrian Approach, 35 JOURNAL OF ECONOMIC LITERATURE 60 (1997), <https://econfaculty.gmu.edu/pboettke/summer/summer%20docs/kirzner1997.pdf>.

¹⁷⁰ Proposed Rule at 16,943.

¹⁷¹ Howell E. Jackson & Jeffery Zhang, *The Economics of Soft Dollars: A Review of the Literature and New Evidence from the Implementation of MiFID II* REVIEW OF BANKING & FINANCIAL LAW (forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3673470.

¹⁷² ASHBY MONK & RAJIV SHARMA, RE-INTERMEDIATING INVESTMENT MANAGEMENT (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2625303.

¹⁷³ Elisabeth de Fontenay & Yaron Nili, *Side Letter Governance* (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4067905.

among limited partners.”¹⁷⁴ However as ILPA noted in its comment letter to the Proposed Rule, differential liquidity terms are often a legitimate reflection of the differing sizes of investors’ capital commitments and the differing timing of their entrance to the fund (i.e., investors may offer larger commitments and commit earlier to a fund in exchange for better redemption terms).¹⁷⁵ ILPA’s letter also notes that investors “do not deem such differentiated treatment to be damaging but rather an accepted market practice consistent with contract negotiations in all domains and not limited to private fund investments.”¹⁷⁶ Unique liquidity provisions also often address investors’ legal- or compliance-related imperatives – for example a pension fund may need to retain the right to withdraw from a fund if its investment ceases to comply with its ERISA obligations, a fact which ILPA also highlights in its comment letter.¹⁷⁷ Moreover, unique liquidity rights are not limited to larger investors. In fact, many advisers offer such rights to attract capital from smaller investors.¹⁷⁸

Under the Preferential Redemption Prohibition, advisers will not be able to offer such terms, reducing liquidity for certain constrained investors, which is an example of inferior service quality.

c. Fewer innovative, diversification enhancing strategies (service quality and variety)

The Indemnification Prohibition would prohibit advisers and investors from allocating the legal liability risks associated with the inherent uncertainty of investment strategies by prohibiting indemnification against both gross and ordinary negligence. Managing such liability risk is particularly important for new and innovative investment strategies, for which investment risks may be higher or less defined. Due to an inability to manage such liability risk, private equity fund advisers may avoid such strategies and pursue a more limited set of strategies that pose less legal risk. This would reduce the ability of investors to use private equity fund investments to achieve diversified portfolios and maximize returns. The likelihood of such consequences is documented in the empirical literature. For example, Guan et al. (2022)¹⁷⁹ found that allowing corporate managers to limit their legal liability by contract increased managers’ incentives to innovate.

Professor Kothari identifies the same concerns in his report on the Proposed Rule, noting that “[a] prohibition of limiting liability of advisers would result in higher ex ante fees for insurance premiums or lead to lower returns due to diminished investment risk-taking as advisers seek to avoid potential legal liabilities.”¹⁸⁰ ILPA’s comment letter corroborates these concerns. It indicates that barring indemnification for ordinary negligence could impose the “unintended consequence” that “advisers’ risk tolerance will be fundamentally impacted and potentially damage the returns produced by private funds.”¹⁸¹

¹⁷⁴ Chair Gary Gensler, *supra* note 4.

¹⁷⁵ ILPA, *supra* note 87 at 5.

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at 20.

¹⁷⁸ Committee on Capital Markets Regulation, *supra* note 129.

¹⁷⁹ Yuyan Guan et al., *Managerial Liability and Corporate Innovation: Evidence from a Legal Shock* 69 JOURNAL OF CORPORATE FINANCE (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3070160.

¹⁸⁰ Kothari, *supra* note 91 at para. 10.

¹⁸¹ ILPA *supra* note 87 at 2.

d. *Lower net returns from constrained liquidity (service quality and variety)*

Part of the return on an investment in a private equity fund is attributable to an “illiquidity premium,” – that is, a risk premium that compensates an investor for fact that a particular asset can be less readily sold.¹⁸² By prohibiting the provision of differential liquidity terms to investors, funds may in some cases be required to provide more frequent withdrawal rights to a broader set of investors and thus to hold more liquid assets as part of their investment strategies, thereby reducing such illiquidity premiums and in turn reducing service quality (i.e., net returns) for investors. For example, suppose one potential investor in a private equity fund demands as a condition of its investment short-term withdrawal rights, while another potential investor does not. If the adviser obtains the investment of the first investor by offering it short-term withdrawal rights, then the Preferential Redemption Prohibition could require the fund to provide the same rights to the second investor, since the first investor’s liquidity rights could be deemed to be preferential treatment that is materially negative to the second investor. As a result, the fund would be required to hold more liquid assets (to account for potential withdrawals of both investors) than if it could offer different liquidity terms to different investors, which may impose an additional restraint on funds’ investment strategies.

3. Constraining fund terms would increase barriers to entry and industry concentration.

The Preferential Redemption Prohibition and Indemnification Prohibition will disproportionately affect newer and smaller advisers, beyond increased compliance costs. For example, new advisers with shorter performance histories may rely more on offering unique redemption terms to attract investors. Smaller advisers may also rely more on indemnification and limitation of liability provisions, because a liability suit is more likely to threaten the continued operation of a smaller adviser. The result of these prohibitions will thus likely be to increase the proportion of the market share possessed by larger advisers, thereby increasing industry concentration.

These dynamics are again supported by the empirical literature. As discussed in Part II, Begenau & Siriwardane (2020) suggest that investor-specific terms are one of the methods by which advisers “who face low demand” attract larger capital commitments.¹⁸³ In a cross-jurisdictional analysis of new firm incorporation Klapper et al. (2006)¹⁸⁴ found that regulatory burdens hamper the creation of new firms, and force new entrants to be larger. And Carr & Mathewson (1988) conclude that regulatory prohibitions on freely negotiated limitation of liability provisions functions as barrier to entry for new firms.¹⁸⁵

4. Negative impact on women- and minority-led private equity advisers

¹⁸² Vincent Maurin et al., *A Theory of Liquidity in Private Equity* (2020), https://www.hec.edu/sites/default/files/documents/MRS_Liquidity_PE.pdf.

¹⁸³ Begenau & Siriwardane, *supra* note 79.

¹⁸⁴ Leora Klapper et al., *Entry regulation as a barrier to entrepreneurship* 82(3) JOURNAL OF FINANCIAL ECONOMICS 591 (2006), https://www.nber.org/system/files/working_papers/w10380/w10380.pdf.

¹⁸⁵ Jack Carr & Frank Mathewson, *Unlimited Liability as a Barrier to Entry* 96(4) JOURNAL OF POLITICAL ECONOMY 766 (1988), https://econpapers.repec.org/article/ucpjpolec/v_3a96_3ay_3a1988_3ai_3a4_3ap_3a766-84.htm.

As we have explained, newer and smaller advisers are likely to be disproportionately affected by the Proposed Rule. Our original empirical analysis (see Appendix A) indicates that private equity fund advisers owned by women and racial minorities are likely to be newer, at a 1% level of statistical significance. Women-owned private equity advisers are also more likely to be smaller, also at a 1% level of statistical significance. Minority-owned private equity advisers are also on average smaller.¹⁸⁶ One can also infer from the young ages of these advisers that the share of private equity fund advisers represented by women- and minority-owned firms has been growing over recent years. Thus, by disproportionately affecting newer and smaller advisers, the Proposed Rule may reduce participation by women- and minority-owned private equity fund advisers and thereby stall or reverse the recent trend of increased participation by such advisers.

Economic literature indicates that in doing so, the Proposed Rule will have negative effects on overall competition in the private funds industry, including service quantity and service variety. It is well established that increasing the diversity of new industry entrants enhances competition. As noted above, the empirical literature, including for example Carree & Thurik (2005)¹⁸⁷ and Kirzner (2007),¹⁸⁸ demonstrates that increased participation by newer and smaller firms in a marketplace is associated with greater competition. Indeed, various empirical studies indicate that increased participation rates of women and minorities in decision making capacities in industry can have competition-enhancing effects in the form of improved profitability and greater innovation.¹⁸⁹

The effect of the Proposed Rule on participation by women- and minority-led private equity advisers is particularly relevant in light of the Appropriations Committee Report associated with the Financial Services and General Government Appropriations Bill of 2023, which encourages the SEC to reconduct its economic analysis of the Proposed Rule to ensure that it “adequately considers the disparate impact on emerging minority and women-owned asset management firms, minority and women-owned businesses, and historically underinvested communities.”¹⁹⁰

¹⁸⁶ FAIRVIEW CAPITAL, WOMAN AND MINORITY-OWNED PRIVATE EQUITY AND VENTURE CAPITAL FIRMS (2021), https://fairview.cdn.prismic.io/fairview/397ab706-dc64-4c31-981b-9ded2e43c788_FairviewCapital_2021_MarketReview.pdf.

¹⁸⁷ Carree & Thurik *supra* note 168.

¹⁸⁸ Kirzner, *supra* note 169.

¹⁸⁹ See, e.g., Toyah Miller & Maria Del Carmen Triana, *Demographic Diversity in the Boardroom; Mediations of the Board Diversity-Firm Performance Relationship* 46(5) JOURNAL OF MANAGEMENT STUDIES 755 (2009), <https://onlinelibrary.wiley.com/doi/10.1111/j.1467-6486.2009.00839.x>; Orlando Richard et al., *The Impact of Racial Diversity on Intermediate and Long-Term Performance: the Moderating Role of Environmental Context* 28(12) STRATEGIC MANAGEMENT JOURNAL 1213 (2007), <https://onlinelibrary.wiley.com/doi/10.1002/smj.633>.

¹⁹⁰ Financial Services and General Government Appropriations Bill, 2023, Appropriations Committee Report, pg. 102 (Jun. 28, 2022), <https://www.congress.gov/117/crpt/hrpt393/CRPT-117hrpt393.pdf>.

Conclusion

This report has examined the Proposed Rule and Chair Gensler's claims that the U.S. private equity fund market is not competitive and that the Proposed Rule would enhance competition in the U.S. private equity fund market.

In Part I and Part II, our analysis of quantitative measures of each of the principal metrics by which industry competition is commonly assessed show that the U.S. private equity fund market is highly competitive and is growing increasingly competitive. We analyzed in particular depth the evidence of price competition in the U.S. private equity fund market with a focus on the gross fees charged by private equity fund advisers and private equity fund net-of-fee performance. Contrary to what the Proposed Rule suggests, private equity fund gross fees respond to competitive pressures and have in fact declined on average over recent year. There is even more extensive empirical evidence that U.S. private equity fund performance net of fees, which is the superior measure of price competition, outmatches that of public markets, which is further evidence that the U.S. market for private equity fund advisory services is highly competitive.

In Part III, we showed that the Proposed Rule's assessment of competition in the U.S. private equity fund market is based on the false premise that a bargaining power imbalance exists between investors and advisers. We then demonstrated that the Proposed Rule would reduce competition in the U.S. private equity fund market including by reducing net-of-fee investor returns and the variety of investment strategies available to investors. The Proposed Rule would also increase barriers to entry to the U.S. private equity fund market with a particularly negative impact on women and minority-led private equity fund advisers.

The Committee therefore concludes that the U.S. private equity fund market is highly competitive and, rather than further enhance competition, the Proposed Rule would reduce competition in the U.S. private equity fund market.

Appendix A

We constructed a sample of private equity fund advisers from the Preqin database by applying filters that select for private equity firms for the years 1980 through 2021 having the U.S. dollar as their principal currency. The filters were:

FIRMTYPE=="Private Equity Firm" YEAREST>=1980 & YEAREST<=2021

We sorted the advisers by years in operation, number of employees, assets under management, whether the adviser was woman-owned, and whether the adviser was minority-owned.

Table 1 shows that the average age of private equity fund advisers led by women in our sample is 3.06 years less than the average age of men-owned private equity fund advisers (8.57 years vs. 11.63). It also shows that women-owned advisers in our sample tend to be smaller, measured both by average number of employees (9.03 vs. 13.58) and average assets under management (\$971.9 million vs. \$4,558 million). Each of the age, employee, and assets under management differences are statistically significant at a 1% level. Our analysis thus shows that newer and smaller advisers are more likely to be women-owned than older and larger advisers.

Table 2 shows that the average age of minority-owned advisers in our sample is 3.97 years less than non-minority-owned advisers (7.6 years vs. 11.57 years). This difference is statistically significant at a 1% level. Our analysis thus shows that newer advisers are more likely to be minority-owned. Table 2 also shows minority-owned advisers in our sample tended to be smaller, measured both by average employees (11.38 vs. 13.33) and average assets under management (\$2,941.2 million vs. \$4,440.1). These differences were not statistically significant at a 1% level.

Table 1

	Women-owned	Men-owned	Difference	t-statistic
Age (years established)	8.57	11.63	3.06***	11.18
Number of employees (total)	9.03	13.58	4.55***	3.66
Assets Under Management (USD MN)	971.9	4,558.0	3,586.1***	3.30

Table 2

	Minority-owned	Non-minority-owned	Difference	t-statistic
Age (years established)	7.60	11.57	3.97***	13.08
Number of employees (total)	11.38	13.33	1.95	1.31
Assets Under Management (USD MN)	2,941.2	4,440.1	1,498.9	0.91

*** indicates significance at 1% level.

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