PRIVATE EQUITY GROWTH CAPITAL COUNCIL

SUBMITTED ELECTRONICALLY

April 12, 2011

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090
Attention: Elizabeth M. Murphy, Secretary

Re: Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Release No. IA-3145, File No. S7-05-11

Dear Ms. Murphy:

We are submitting this letter in response to Release No. IA-3145 (the "Proposing Release"), in which the Securities and Exchange Commission (the "Commission") has requested comment on a proposed rule to require investment advisers registered under the Investment Advisers Act of 1940, as amended (the "Advisers Act"), to file a new Form PF. Form PF is intended for use by the Financial Stability Oversight Council (the "FSOC") in monitoring risk to the U.S. financial system. Our comments focus specifically on the effect of the new Form PF filing requirements on private equity and growth capital funds ("private equity funds") and their affiliated private equity firms, which are sometimes also referred to as advisers, managers or sponsors (hereinafter, "private equity sponsors").

The Private Equity Growth Capital Council (the "PEGCC") is an advocacy, communications and research organization and resource center established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are 33 of the world's leading private equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.[1]

[1] The members of the PEGCC are: American Securities; Apax Partners; Apollo Global Management LLC; Avista Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; Crestview Partners; Francisco Partners; Genstar Capital; Global Environment Fund; GTCR; Hellman & Friedman LLC; The Jordan Company; Kelso & Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners;

As discussed in Section I below, the PEGCC respectfully requests that the Commission not require private equity sponsors to file Form PF. As discussed in our prior comment letters to the FSOC,[2] private equity funds and private equity sponsors do not present systemic risk concerns, because, among other things: (*i*) private equity funds and private equity sponsors are not meaningfully interconnected with other financial system participants, with very limited counterparty exposure; (*ii*) there is no meaningful financial interconnection between a private equity sponsor, the funds that it manages or the companies in which those funds invest ("portfolio companies"), and therefore the distress or failure of one portfolio company would not adversely impact the private equity fund, its sponsor, or any of its other portfolio companies;[3] (*iii*) private equity funds typically engage in little or no borrowing; (*iv*) private equity funds and private equity sponsors are too small in size to present systemic risk concerns; (*v*) private equity funds pursue long-term investing strategies focused on acquiring primarily illiquid securities; and (*vi*) investors in private equity funds typically are prohibited from redeeming their interests for the life of the fund, making a "run" on the fund impossible.[4]

The Proposing Release does not demonstrate that private equity sponsors or private equity funds are particularly interconnected with the financial system in ways that "make them too interconnected to fail."[5] Instead, the Proposing Release focuses on borrowing by portfolio companies. While the failure of a portfolio company would be extremely unfortunate for the company and its creditors and other stakeholders (including employees and shareholders), such a failure would not have any spillover effect on the private equity fund that had invested in the portfolio company, the sponsor of the private

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MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thoma Bravo; Thomas H. Lee Partners; TPG Capital (formerly Texas Pacific Group); Vector Capital; and Welsh, Carson, Anderson & Stowe.

2 Copies of the PEGCC's prior letters to the FSOC of November 5, 2010 and February 25, 2011 are attached.

3 Private equity funds and their sponsors do not guarantee or pledge assets to secure each others' obligations, nor is their debt (if any) cross-collateralized. The same is true between portfolio companies owned by a private equity fund.

4 Investors in private equity funds commit to invest in the fund for a period that could extend for ten years or more without any opportunity to redeem their interests. Therefore, unlike other types of financial firms, a private equity fund cannot be subject to a "run" by its investors seeking to redeem their interests that could have a cascading effect on the financial system (*e.g.*, by contributing to volatility in the securities markets that might result if a fund was required to dispose of its investment portfolio to meet redemption requests by its investors).

5 *See* Proposing Release, n. 54 (discussing issues related to Long-Term Capital Management, a hedge fund that was rescued through Federal Reserve intervention in 1998 because of concerns that it was "too-interconnected-to-fail.").

equity fund, other portfolio companies owned by the private equity fund or other funds managed by the sponsor. Thus, the expressed concerns in the Proposing Release fundamentally relate to the risks that a portfolio company may not repay a loan.

In the case of portfolio companies that are themselves financial institutions, the PEGCC believes that if the Commission or another regulator is concerned about borrowing by a financial institution, then the information concerning that company and its leverage should be obtained from the company or its regulator rather than from the company's shareholders (which in this case happen to include a private equity fund). There is nothing unique about private equity funds that would justify the imposition of a reporting requirement on them that is not applicable to other types of shareholders.

In the case of portfolio companies that are not financial institutions, the PEGCC believes, as an initial matter, that the risks posed by such companies do not fall within the jurisdiction of the FSOC. However, if the Commission is concerned (as the Proposing Release seems to suggest) that leveraged lending practices raise systemic risk concerns, the PEGCC respectfully requests that the Commission instead work with the FSOC and other regulators to collect information on these lending practices from the lending institutions (which do fall within the FSOC's jurisdiction). The PEGCC believes that lending institutions are the best source for this information because, among other reasons, (*i*) they will have information on the borrowing practices of all leveraged businesses, and not only the portfolio companies of private equity funds, and (*ii*) they will have information on all types of loans. As noted above, the PEGCC does not believe that a shareholder that happens to be a private equity fund should be treated differently than other shareholders. Furthermore, the PEGCC does not believe that there is any evidence to suggest that the financing arrangements entered into by portfolio companies of private equity funds are significantly different from the wide range of other types of financings entered into by other businesses, including loans to highly leveraged companies that are not owned by private equity funds.

More broadly, the PEGCC wishes to point out that the concepts of systemic risk and economic dislocation are distinctly different and should not be conflated. The former falls directly within the objectives of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). The latter does not. Businesses across the United States are leveraged. Indeed, most businesses must depend on debt financing for capital because they cannot access equity markets. The intent of the Dodd-Frank Act is not to regulate how businesses use leverage in their capital structures but rather to regulate the extent to which an entity may, under certain adverse economic conditions, create cascading effects that imperil the financial markets or create risk to taxpayers. There is no justification for singling out private equity sponsors, alone among all shareholders of businesses in the United States, to be subject to a discriminatory and onerous reporting regime designed to monitor how their portfolio companies use leverage.

As discussed in Sections II, III and IV below, if—notwithstanding the lack of systemic risk, the lack of jurisdiction over portfolio companies that are not financial institutions and the limitations and inefficiencies of obtaining borrowing information from portfolio companies—the Commission concludes that private equity sponsors should be required to file Form PF, the PEGCC respectfully requests that private equity sponsors should not be required to file the Form more frequently than annually and that the Form should be substantially revised to take into account the structures, operations (*e.g.*, valuation procedures), and lower relative risks of private equity funds and private equity sponsors.

The PEGCC also respectfully requests that the Commission adopt the compliance date, amendment and certification changes outlined in Section V below.

I. Private Equity Funds and Their Sponsors Do Not Present Systemic Risk Concerns that Justify the Amount of Reporting Required by Proposed Form PF

As the Commission has noted, the PEGCC has previously addressed in great detail why private equity funds and their sponsors do not present systemic risk concerns.[6] While we do not repeat those arguments here, we do wish to respond to the reasons provided by the Commission in Section II.A.3 of the Proposing Release for its initial conclusion that the activities of private equity sponsors (or, more precisely, borrowing by portfolio companies) may be important to the assessment of systemic risk to the U.S. financial system. The Commission seems to put forward four overlapping concerns that lead it to its initial conclusion. We do not believe that any of these four concerns (discussed in paragraphs A, B, C, and D below) is valid or demonstrates that private equity sponsors (or private equity funds or their portfolio companies) pose any systemic risk concerns. Further, these concerns do not provide a basis for the onerous reporting regime that the proposed Form PF would impose on private equity sponsors.

A. *Bridge Financings Do Not Present Systemic Risks*

The first concern set forth in the Proposing Release is that the bridge loans that are employed in certain private equity acquisition transactions may raise systemic risk concerns. The Commission points out that leveraged private equity transactions often rely on banks to provide bridge financing until the permanent debt financing for the transaction is completed. The Commission goes on to state that "[w]hen market conditions suddenly turn, these institutions can be left holding this potentially risky

6 *See* Proposing Release, n. 77 (citing Comment Letter of the Private Equity Growth Capital Council (Nov. 5, 2010) responding to the Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, Financial Stability Oversight Council Release (Oct. 1, 2010), 75 FR 61653 (Oct. 6, 2010)). *See also* the PEGCC's letters, *supra* note 2.

bridge financing (or committed to provide the final bank financing, but no longer able to syndicate or securitize it and thus forced to hold it) at precisely the time when credit market conditions, and therefore the institutions' own general exposure to private equity transactions and other committed financings, have worsened."[7]

Bridge financing is but one of many techniques used by operating companies and management buy-out teams as well as private equity funds to finance an acquisition of a company. Bridge financings serve to make the sale process of a company more competitive. In a typical buyout transaction involving possible bridge financing, a private equity fund, on behalf of a portfolio company (or an acquisition vehicle), arranges a bridge commitment from one or more lenders to provide "back up" financing to the portfolio company (or the acquisition vehicle) that will be available if a public bond financing, or other form of more permanent financing, cannot be completed before an acquisition transaction closes. This back-up financing provides greater certainty that the underlying transaction will close, thereby benefiting the seller (*i.e.*, the company's owners, who may include public shareholders), particularly where the seller is in need of liquidity. Bridge loans, therefore, help support the financial stability and liquidity of the seller.

As a general matter, the PEGCC believes that focusing on bridge loans places a disproportionate emphasis on a small segment of leveraged buyout financings.[8] The PEGCC further believes that the terms of "bridge loans" have evolved dramatically over time (and continue to evolve) depending on various market forces. To the extent that the FSOC is concerned about lending practices relating to portfolio companies, the PEGCC believes that bridge loans should not be analyzed separately from other lending to portfolio companies (discussed below)—or to other leveraged businesses, for that matter. For example, the risks relating to the inability to syndicate bridge loans do not present fundamentally different issues than the inability to syndicate other types of debt incurred by any type of borrower as part of any type of financing.[9]

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7 Proposing Release, p. 24 – 25.

8 For the period from 1999 to 2010, bridge loans were generally less than 2% (and never exceeded 5%) of the total source of proceeds for leveraged buyouts. Standard & Poor's, LCD's Leveraged Buyout Review – 1Q11 (2011). The Commission only cited one article to support the importance of bridge loans to leveraged private equity transactions. *See* Proposing Release, n. 71 (citing Steven M. Davidoff, *The Failure of Private Equity*, 82 S. Cal. L. Rev. 481, 494 (2009)). The Davidoff article provides little data on the amount of bridge financing actually used by private equity funds.

9 We note that the reports referenced in n. 72 of the Proposing Release discuss the risks relating to undistributed bridge loans in the context of a wide variety of other types of loans, such as securitized loans and other debt instruments. *See* Senior Supervisors Group, Observations on Risk Management Practices during the Recent Market Turbulence, at 2 (Mar. 6, 2008) (not mentioning private equity, bridge loans or leveraged buyouts specifically but rather referencing the general issue of "leveraged loans to corporate borrowers"); Private Equity and Leveraged Finance Markets, Bank for International

Furthermore, the PEGCC believes that the Proposing Release mischaracterizes bridge loans as a risky form of financing. Bridge financing is relatively expensive compared to public bonds, so borrowers generally prefer not to draw on bridge commitments if a public bond offering can be completed on a timely basis. In addition, bridge loans may or may not be secured by the assets of the borrowing portfolio company. These factors, or the absence of a financing alternative at any point in time, also do not necessarily mean that the bridge financing, as such, is unduly risky relative to other forms of financing. The PEGCC also submits that, if this perception of risk is based on a view that bridge financing is short-term financing that must be refinanced within a short period of time or a default will result, that perception is incorrect. Any bridge financing which is not repaid or subsequently refinanced within a relatively short period of time is, by its terms, converted to long-term debt.

Finally, the PEGCC believes that any perceived systemic risk resulting from bridge financings is best dealt with by the prudential regulators of the lending institutions, either through reporting or regulation. There is no reason to impose reporting burdens on private equity sponsors. If in fact there is a problem with bridge commitments and loans (and the PEGCC is not aware of any history of serious problems with the repayment of bridge loans by portfolio companies), it exists primarily if lenders are not adequately capitalized, or if they otherwise fail to mitigate the risk (for example, by not syndicating their funding obligations before signing the commitment letter, or by not taking other risk mitigation steps such as reducing the number of the types of lending arrangements that they enter into).

These issues are presented in other lending contexts as well (including bridge loans where the underlying transaction does not involve any private equity fund).[10] To the extent a problem exists, it is with lending practices generally, not one created by one particular class of borrowers or a particular type of loan. This concern, if valid, is best addressed through prudential regulation of the lending institution—not by imposing reporting burdens on private equity funds and their sponsors and portfolio companies.[11] Reporting by lenders on their lending in a variety of contexts (including bridge loans)

Settlements Committee on the Global Financial System Working Paper No. 30 (Jul. 2008) at 1-2, available at http://www.bis.org/publ/cgfs30.pdf (discussing leveraged buyout activity in the context of the larger leveraged loan market); Bank of England, Financial Stability Report, at 19 (Oct. 2007), available at http://www.bankofengland.co.uk/publications/fsr/2007/fsrfull0710.pdf (discussing the issues of bridge loans along with asset-backed securities and commercial paper).

[10] *See* Michelle Sierra, AT&T $20b bridge loan draws pricing of 75bp, Reuters (Mar 29, 2011) (describing bridge loan in the proposed purchase of T-Mobile USA by AT&T). We note that according to this source, the largest two bridge loans in the U.S. have not involved private equity funds.

[11] The PEGCC also believes that the total outstanding amount of bridge financing at any time is relatively small and, therefore, highly unlikely to pose a risk to the financial system.

seems to us to be more likely to address the Commission's concerns and uncover potential systemic risks, as compared to requiring reporting only with respect to certain types of shareholders (*i.e.*, private equity funds) of certain borrowers (*i.e.*, portfolio companies).

B. *Portfolio Company Leverage Does Not Present Systemic Risk*

The second concern put forward in the Proposing Release is that "the leveraged buyout investment model of imposing significant amounts of leverage on [a private equity fund's] portfolio companies in an effort to meet investment return objectives subjects those portfolio companies to greater risk in the event of economic stress."[12] Although the Commission appears to be particularly concerned about the prospect of a private equity fund effecting a leveraged buyout of "an entity that could be systemically important"—a concern that we address in section I.D. below—the Proposing Release suggests that the Commission may be concerned about leverage of portfolio companies generally.

As the PEGCC has discussed at length in letters to the FSOC,[13] private equity sponsors and private equity funds generally are not leveraged, and, while some portfolio companies are leveraged, the amount of leverage is relatively modest.[14] Defaults related to the debt of private equity portfolio companies after the latest recession were below average.[15] In any event, the failure of a private equity portfolio company that is not itself

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12 Proposing Release, p. 26.

13 *See* the PEGCC's letters, *supra* note 2.

14 The average gross leverage ratio of private equity deals is historically approximately 2.85:1, although some portfolio companies may be materially more or less leveraged. Standard & Poor's Q4 2010 Leveraged Buyout Review. By comparison, Lehman Brothers was leveraged at approximately 32:1 at the end of February 2008, a gross leverage ratio relatively common among large broker-dealers at that time. See Lehman Brothers Holdings Inc., Quarterly Report on Form 10-Q, for the quarterly period ended February 29, 2008, at pages 5-6 (available at http://www.sec.gov/Archives/edgar/data/806085/000110465908023292/a08-10156_110q.htm). See also Tobias Adrian and Hyun Song Shin, "Liquidity and Leverage, *Journal of Financial Intermediation* (2010), at page 433, Figure 16.

15 The PEGCC is not aware of any evidence that private equity-owned businesses default on their debt obligations at a rate greater than other businesses. In fact, there is evidence that the default rate for private equity fund portfolio companies is lower than the average default rate for all U.S. corporate bond issuers. *See* Kaplan, Steven N. and Per Stromberg, "Leveraged Buyouts and Private Equity," *Journal of Economic Perspectives*, Volume 23, Number 1 (Winter 2009) (analyzing data on 17,171 worldwide private equity acquisitions announced between 1970 and 2002 and finding that the annualized default rate as of 2007 for private equity portfolio companies was 1.2%, compared to the average default rate of 1.6% reported by Moody's for all U.S. corporate bond issuers); Thomas, Jason, "The Credit Performance of Private Equity-Backed Companies in the 'Great Recession' of 2008–2009," *Entrepreneurship & Finance,* Vol. 5, No. 30 (April 12, 2010), supported by the PEGCC, available at SSR: http://ssrn.com/abstract=1582666 (analyzing private equity-backed companies

systemically significant does not present systemic risk concerns because of the way that private equity sponsors, funds and portfolio companies are structured (*e.g.*, no cross-collateralization, as discussed above).

Similar to the situation with respect to bridge loans, there is nothing unique about a lender's loans to private equity portfolio companies that would make them more risky than a wide range of other types of loans made by the lender to other companies owned by public shareholders, public companies or other institutional investors.

Therefore, the PEGCC submits that the most direct manner to obtain information concerning these types of systemic risks, if any, is to collect the information from the lenders who face such risks and not from the borrowers. The PEGCC believes that banks and other lending institutions are in the best position to collect and compare information across all types of borrowers (*e.g.*, a bank's exposure to all highly leveraged companies, whether the owner is a private equity fund or another type of owner), and to provide information that will allow regulators to assess the systemic risks (if any) that such lending practices present. Requiring private equity sponsors to provide reports on these loans would be duplicative of information provided by the lending institutions to their regulators. For these reasons, we do not believe that the reporting burden described in the Proposing Release should be placed on private equity sponsors or funds, when the necessary information is more readily available from banks and other lending institutions.[16]

C. *Favorable Financing Terms Do Not Create Systemic Risk*

In support of its conclusions regarding the risks relating to bridge loans, specifically, and portfolio company leverage, more generally, the Commission noted that "prior to the recent financial crisis, a trend in private equity transactions was for private equity sponsors to enter into buyout transactions with seller-favorable financing conditions and terms that placed much of the risk of market deterioration after the transaction agreement was signed on the financing institutions and the private equity adviser."[17]

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acquired in a buyout or similar transaction between 2000 and 2009 and held through 2008-2009 and finding that private equity-backed businesses defaulted at less than one-half of the rate of comparable companies during 2008-2009).

[16] To the extent that a bank or other lending institution is not within the jurisdiction of the FSOC, we believe that the underlying loans are unlikely to present a systemic risk to the U.S. financial system. Under these circumstances, any increased risk exposure would be to institutions that are outside of the U.S. financial system. As discussed, the borrower (such as a private equity fund's portfolio company) does not itself present systemic risks to the U.S. financial system.

[17] Proposing Release, p. 25.

Rather than creating systemic risks, the PEGCC believes that the "covenant-lite" and other favorable terms negotiated by some borrowers with some lenders are actually a source of stability to portfolio companies during periods of economic stress. These terms reduce the number of defaults by portfolio companies that would ordinarily be tripped by covenants and encourage negotiations between a lender and its borrower during times of stress (rather than incentivizing the lender to immediately exercise its default remedies).[18]

The PEGCC believes that it would be a serious mistake to conclude that the ability of private equity portfolio companies (and other borrowers) to obtain financing on favorable terms creates systemic risk.[19] It certainly should not provide a basis for imposing a burdensome reporting regime on private equity sponsors.

D. *Investments in Financial Companies by Private Equity Funds Do Not Provide a Basis for Discriminatory Treatment*

The Proposing Release states that if a private equity sponsor or fund "conducts a leveraged buyout of an entity that could be systemically important, information about that investment could be important in the FSOC monitoring and assessing financial risk."[20] It is not clear (and it is not discussed in the Proposing Release) what additional risks a private equity fund investment in a systemically important bank or nonbank financial institution places on the bank or nonbank financial institution, as compared to an investment by any other type of investor. Furthermore, it is not clear why a private equity fund should be required to provide the information of interest to the FSOC, and not the financial institution itself.

If the FSOC wishes to obtain information about the leverage levels of banks and nonbank financial institutions that could be systemically important, the PEGCC believes that it should obtain that information from those institutions, not from their securityholders. If the FSOC wishes to obtain information on equity holders of systemically important financial institutions, it is likely that banking regulators will receive from a systemically important lending financial institution more than sufficient

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18 *See* Michael N. Reczek, An Examination of the Value of Covenant Lite Debt to Issuing Companies (April 1, 2010), available at http://w4.stern.nyu.edu/glucksman/docs/Reczek2010.pdf (discussing "the ability to delay bankruptcy and the associated restructuring costs" among the values of covenant-lite debt).

19 Despite the talk about private equity borrowers, the Commission's discussion of "seller-favorable financing conditions and terms" seems to focus on the failure of lending institutions either to adequately understand or manage the increased risks relating to changes in the conditions and terms of loans. *See* Proposing Release, p. 25. We believe that this supports our conclusion that the best method to obtain information concerning the systemic risks relating to leveraged loans and bridge loans is from the lenders.

20 Proposing Release, p. 26.

information on any shareholder (including any private equity fund) that is a significant investor in that institution.

II. Recommended Modifications to the Obligation to File Form PF and Related Definitions

As noted above, the PEGCC does not believe that private equity funds present the types of systemic risk concerns that justify requiring private equity sponsors to report on Form PF, and that there are more efficient and effective ways to obtain information about leveraged lending practices and exposures (*i.e.*, by obtaining such information from lenders). As discussed below, the PEGCC believes that the Commission has the discretion not to require private equity sponsors to file Form PF. The PEGCC believes that the Commission should use its discretion accordingly to exclude private equity sponsors from the Form PF filing requirements or, at least, to tailor the reporting requirements to address those concerns that the Commission has identified.

A. *The Form PF Reporting Obligation Need Not Apply to All Registered Private Fund Advisers*

The Commission appears to interpret new Section 204(b)(5) of the Advisers Act to mean that it must require all registered investment advisers with private fund clients to file Form PF.[21] As the Commission has recognized, however, the literal language of the statute is not clear on whether the rulemaking and reporting is mandatory.[22] We believe that Congress provided the Commission with sufficient flexibility to decide which investment advisers should be required to provide reports about private funds as well as what information those investment advisers should be required to report. This Congressional intent is shown generally in the repeated use of the clause as "necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk by the Financial Stability Oversight Council" in various provisions of Section 204(b).[23] Specifically, Congress applied this standard to Section 204(b)(1)(A), which provides the Commission with the discretion to determine which advisers must file these reports. Section 204(b)(5) provides the Commission with the discretion to determine which information should be contained in the reports; there is no reason to believe, however, that this provision limits the discretion of the Commission to determine that certain classes of private fund advisers should not be required to file the reports. Therefore, we do not believe that it would be appropriate to read Section

[21] *See* Proposing Release, n. 101.

[22] *See* Proposing Release, n. 12 (stating that Section 204(b)(1) should not be read in isolation).

[23] *See* Sections 204(b)(1)(A), 204(b)(3)(H), 204(b)(4) and 204(b)(5).

204(b)(5) in isolation as limiting the discretion of the Commission to impose reporting obligations on some classes of private fund advisers but not on others.

Furthermore, the Commission has broad discretion to impose different requirements on different classes of investment advisers. For example, Section 211(a) provides the Commission with the power to "classify persons and matters within its jurisdiction and prescribe different requirements for different classes of persons or matters." Congress affirmed this discretion with regard to private fund advisers in the new Section 203(n).[24] Section 203(n) specifically directs the Commission to "take into account the size, governance, and investment strategy" of the private funds advised by a newly registered investment adviser and to tailor the Advisers Act requirements to "reflect the level of systemic risk posed by such funds."

Thus, the Commission has the discretion <u>not</u> to impose the new reporting regime on private equity sponsors if the Commission concludes (as it can) that such a filing is not necessary and appropriate for the assessment of systemic risk.

B. *The Definitions of Various Types of Private Funds Are Fundamentally Flawed and Should Be Modified*

Proposed Form PF defines the term "private equity fund" by what it is not—that is, a private equity fund would be a "private fund that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund or venture capital fund and does not provide investors with redemption rights in the ordinary course." Because the proposed definition of "private equity fund" depends on the scope of the definition of "hedge fund" and because of the extensive reporting required by advisers to "hedge funds," it is critical that the Commission ensure that funds that are intended to be classified as "private equity funds" are not mistakenly classified as "hedge funds."[25]

As noted below in Section II.B.2, the PEGCC believes that, if the Commission concludes that private equity sponsors should file Form PF, the Commission should only require reporting with respect to those funds that present systemic risk concerns based on the nature of their portfolio companies. We believe that this may be done either by

24 *See also* Proposing Release, n. 41.

25 While not without their issues, we do not comment in this letter on the definitions of liquidity fund, real estate fund, securitized asset fund or venture capital fund, since they do not appear to encompass funds that would ordinarily be considered private equity funds for these purposes. We note that many private equity funds share many of the characteristics of venture capital funds and, like venture capital funds, do not present systemic risks. Similarly, we note that many real estate funds may have characteristics similar to hedge funds (*e.g.*, making portfolio investments that incorporate a significant amount of leverage). The fact that Form PF does not impose onerous reporting burdens on sponsors of large real estate funds suggests that such burdens should not be imposed on private equity sponsors or their funds.

tailoring the definition of "private equity fund" or defining sub-categories of private equity funds.

If the Commission decides to include a definition of "private equity fund," the PEGCC believes that it would be more straightforward and more accurate to define a private equity fund affirmatively based on the structural characteristics of the typical private equity fund: (*i*) the fund does not provide investors with redemption rights in the ordinary course; (*ii*) the fund calculates incentive allocations (carried interest allocations) based *primarily* on gains realized from sales or other dispositions of portfolio companies, and not based *primarily* on unrealized appreciation in the fund's portfolio;[26] and (*iii*) the fund has not borrowed an amount in excess of one-half of its net asset value (including any committed capital) and does not have a gross notional exposure in excess of twice its net asset value (including any committed capital).[27] We believe that these elements capture the essence of the structure of a private equity fund and would not reflect the characteristics of the typical hedge fund.

1. Definition of "Hedge Fund"

If the Commission decides to maintain the definition of "private equity fund" currently in the Proposing Release, the PEGCC believes that the definition of "hedge fund" must be modified to ensure that it does not result in "private equity funds" being mistakenly classified as "hedge funds."

Form PF defines the term "hedge fund" as a private fund that: (*i*) has a performance fee or allocation calculated by taking into account unrealized gains; (*ii*) may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or (*iii*) may sell securities and other assets short.

We believe that the definition of "hedge fund" is overly broad and could catch many private equity funds that are not, and were not intended to be, included in the hedge fund reporting regime. The definition should be modified, as discussed below.

First, the use of the term "may" in reference to borrowing and short selling is problematic. Private equity fund documents are often worded to give the sponsor the

[26] The use of the term "primarily" in this element of the definition is important. As discussed below, we believe that this element of the hedge fund definition may present technical issues for certain private equity funds.

[27] Under this approach, the Commission should add an exclusion from the definition of "hedge fund" for any fund that is a private equity fund. We assume that the Commission would also maintain its existing exclusions from the definition of private equity fund for liquidity funds, real estate funds, securitized asset funds and venture capital funds.

ability to pursue the investment objectives of the fund, even if, as a practical matter, it is unlikely or there is no expectation that the sponsor would undertake a particular activity.[28] The fact that a fund has the authority to ("may") incur debt or sell short, even if does not actually do so, should not cause the fund to be characterized as a hedge fund. If these activities do present the types of risk that warrant the type of reporting that is appropriate for hedge fund sponsors, a private equity sponsor should not be required to comply with those requirements until a fund that it manages actually engages in such activities. The PEGCC urges the Commission to modify the definition of hedge fund to this effect.

Second, the absence of any materiality or other similar threshold concept with respect to short selling is problematic. We understand why the Commission would focus on short selling in an effort to describe the activities of a hedge fund. In doing so, however, the Commission should not create a definition so broad that it includes private equity funds. As a general rule, private equity funds do not sell securities short, but exceptions exist.[29] Even if a fund engages in short selling, the fund should not be considered a hedge fund if such activities are not a material part of its investment strategy and are not engaged in to any material extent or are not engaged in for speculative purposes. The PEGCC urges the Commission to modify the definition of hedge fund to this effect.

Third, the Commission's inclusion of a bright-line performance fee test as part of the definition of hedge fund could lead to unintended results. This test appears to be based on the fact that, in general, hedge funds calculate performance fees (often referred to as incentive allocations) based on unrealized gains and that private equity funds calculate performance fees or allocations (typically referred to as carried interest) based

[28] The PEGCC believes that using a potential standard ("may") as opposed to an active standard ("does") leads to more difficult interpretative questions and less clarity. We note that most private equity funds do not borrow or engage in short selling. Many private equity funds are prohibited by the terms of their governing documents from borrowing or engaging in short selling. Some private equity funds simply do not borrow or engage in short selling, but the fund documents are silent on the issue. Furthermore, some private equity fund documents give the fund broad latitude to pursue its investment objectives and do not expressly prohibit the fund from borrowing, so technically the fund "may" borrow—even if the fund is effectively restricted from borrowing (*i*) by statements made in the private placement memorandum prepared when interests in the fund are marketed to investors, or (*ii*) because the fund is required by its governing documents to use reasonable best efforts (or some variation thereof) to avoid the receipt of "unrelated business taxable income" (a type of income that can arise from the incurrence by a fund of acquisition indebtedness) in the hands of the fund's partners.

[29] Some private equity funds may be permitted to sell short "but not for speculative purposes." Some private equity funds may engage in limited hedging activity to protect against currency fluctuations or, under certain circumstances, engage in limited short selling for specific risk management purposes.

on realized gains.[30] We note that hedge fund and private equity fund performance fee calculations can be distinguished in other respects: (*i*) private equity funds generally include general partner clawback clauses,[31] while hedge funds generally do not; (*ii*) private equity funds generally calculate and receive their performance fees at or after the time of an event, not periodically, whereas hedge funds generally calculate their performance fees on a periodic basis generally not exceeding one year; and (*iii*) the performance fees of private equity funds are only paid out of realized gains (even if the allocation of the gains may be in part based on unrealized gains and losses). The PEGCC urges the Commission to modify the performance fee element of the definition of hedge fund so that it reflects that hedge funds calculate performance fees based *primarily* on unrealized gain.

Finally, the PEGCC believes that the Commission should define a "hedge fund" to be any fund meeting three out of the following four characteristics: the three current factors discussed above (short selling, borrowing, and performance fee) and the presence of periodic redemption rights for investors, subject to limitations such as lock-up periods.[32] We believe that such an approach would encompass all of the hedge funds, while minimizing the unintended risk that a private equity fund would be improperly categorized as a "hedge fund."

2. The Definition of "Private Equity Fund" Should Be More Focused on Perceived Risks

Assuming that the Commission concludes that certain types of private equity funds may present systemic risks, the PEGCC believes that the definition of "private equity fund" is overbroad considering the limited systemic risks identified in the Proposing Release. The systemic risk discussion appears to focus only on two types of

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30 In certain circumstances the calculation of carried interest may take into account unrealized gains and losses—although, not in a manner that increases the carried interest amount, above the amount that would be distributed were unrealized gains and losses not taken into account. For example, in certain private equity funds, when a realization (*e.g.*, sale) of a portfolio investment occurs, the general partner is entitled to a percentage of the gains realized on the sale, reduced by any unreimbursed losses from previous realizations and, often, further reduced by unrealized losses in the portfolio—or reduced by unrealized losses net of unrealized gains in the portfolio.

31 A general partner clawback requires the return of a certain portion of any performance fee received by the general partner from a fund where the amount previously distributed to the general partner exceeds the amount it should have received based on the subsequent realization of the fund's investments.

32 As implicitly noted in the current definition of "private equity fund," another key factor that distinguishes private equity funds from hedge funds is that private equity funds typically do not offer their investors redemption rights in the ordinary course, whereas hedge funds typically do following an initial lock-up period and are subject to "gates" and other limitations.

private equity funds: (*i*) leveraged buyout funds and (*ii*) funds that invest in financial institutions. The term "private equity fund," however, is defined as a "catch all" bucket into which the Commission sweeps most private funds that are not hedge funds, liquidity funds, real estate funds, securitized asset funds or venture capital funds.[33] As noted above, the Commission's concerns about leveraged buyout funds seem unwarranted. If the Commission has concerns about private equity funds that invest primarily in financial institutions, and concludes that Form PF is the most efficient means to collect data about such risks (as noted above, we do not believe that it is), then the obligation to file Form PF should be modified (either by changing the definition of private equity fund, or modifying the rule elsewhere) so that it is limited to investment advisers that manage private equity funds that invest primarily in such financial institutions.

3. Definition of "Large Private Fund Adviser"; Annual Calculation

Form PF will impose particularly onerous reporting requirements on private equity sponsors that fall within the term "Large Private Fund Adviser" as defined in proposed Form PF. The Commission acknowledges that private equity funds "present less potential risk to U.S. financial stability" than hedge funds and liquidity funds,[34] yet the Commission uses the same threshold of $1 billion in assets under management for each type of private fund adviser. The PEGCC urges the Commission to eliminate the concept of Large Private Fund Adviser with respect to private equity sponsors in recognition of the very low systemic risk concerns that private equity sponsors and private equity funds present.

If the Commission is unwilling to take this approach, the PEGCC urges the Commission to increase significantly the threshold categorizing a private fund sponsor as a Large Private Fund Adviser in recognition of these lower risks. In addition, the Commission should base the reporting requirement on a metric other than assets under management. Specifically, the PEGCC recommends that the Commission measure a private equity sponsor's size based on the proprietary assets of the private equity sponsor, inclusive of the private equity sponsor's own investments in the funds (and portfolio companies) that the sponsor manages. The assets that the private equity sponsor manages for third-party investors (whether pursuant to separate managed account arrangements or through private equity funds managed by the sponsor) should not be counted.

[33] The definition also excludes private funds where the fund does not provide investors with redemption rights in the ordinary course.

[34] Proposing Release, p. 19. For its part, as discussed above and in the letters referred to in footnote 2 above, the PEGCC believes that the size of a particular private equity sponsor or fund is not particularly relevant to a systemic risk analysis in the absence of cross-collateralization with another private equity fund or sponsor and in view of the limited interconnectedness with other financial system participants.

In addition, we believe that the calculation of whatever metric is used to determine if a private equity sponsor is a Large Private Fund Adviser should only be required to be made annually. Given that private equity funds typically make long-term investments in operating businesses, the value of their assets under management is less likely to fluctuate, or be relevant, in the short term. Also, given that their investments typically are illiquid, those assets are difficult to value. In view of these two facts, we do not see the utility to regulators (and we do see the burden on private equity sponsors) of requiring mid-year changes in Form PF reporting. The PEGCC therefore respectfully recommends that, to reduce the administrative burden on private equity sponsors and the Commission, the Large Private Fund Adviser determination (if any) be made only at the time of a private equity sponsors' annual filing.

4. Definition of "Fund of Funds"

The PEGCC believes that the definition of "fund of funds" is too narrow, in that it is limited to private funds that invest exclusively in other private funds. We believe that, at a minimum, a fund of funds should be permitted to invest in cash and other similar short-term investments pending long-term investment. Furthermore, we believe that a fund of funds should be allowed to engage in a *de minimis* amount of direct investing (for example, by permitting a fund of funds to invest up to 30% of its capital commitments in direct, non-fund investments).[35] The PEGCC urges the Commission to modify the definition in these respects.

5. Definition of "Controlled Portfolio Company"

A private equity sponsor would be required to provide more detailed information with respect to the portfolio companies that it "controls." However, the definition of "control" imported from Form ADV (where there is a presumption that a person has "control" of a company if it holds more than 25% of the company's voting securities) is too broad. First, private equity funds with minority stakes may not be in a position to cause the portfolio company to take on the leverage the Commission has identified as presenting systemic risks. Second, these funds may also not be in a position to cause the portfolio company to provide the necessary information for the required reporting. The PEGCC believes that, for purposes of Form PF, the definition of "control" should only cover situations where the private equity fund owns a majority of the portfolio company's voting securities.

[35] The threshold should be expressed as a percentage of total capital commitments rather than a percentage of invested assets to provide greater assurance that the timing of an investment or disposition does not impact the fund's categorization.

III. Recommended Modifications to the Information Required to Be Provided on Form PF

With regard to the information required on Form PF, the PEGCC believes that, as a general matter, the form should focus less on the reporting of specific detailed data. As the Commission has noted, where Form PF indicates that a specific fund presents a systemic risk, the Office of Financial Research may make more targeted requests for information.[36]

Furthermore, as noted above, we believe that (*i*) lenders, and not portfolio companies (borrowers) or their private equity fund owners (or the funds' sponsors), are the best source for information regarding lending (*e.g.*, bridge loans), and (*ii*) the definitions of hedge fund and private equity fund have not yet been tailored sufficiently to the point where the funds that will be required to provide this detailed information will be of the type the Commission has identified as presenting systemic risks.

We have identified several specific Form PF reporting requirements that should be modified or eliminated.

A. *Performance Reporting*

The Commission should not require quarterly or monthly performance calculations by private equity sponsors.[37] The PEGCC is not aware of any private equity funds that calculate their performance on a monthly basis. The Commission appeared to acknowledge this fact in connection with its comparison of certain types of private fund managers in discussing the reporting requirements imposed on Large Private Fund Advisers.[38] Nor is there any practical need for private equity sponsors to value their assets monthly. As discussed below, such a requirement, whether monthly or quarterly, would impose significant burdens on private equity sponsors. The value of such reports in assessing systemic risk is dubious.

B. *Creditor Identification*

The Commission should not require that every private fund (no matter its investment strategy or size) identify each creditor with respect to borrowings equal to at least 5% of the fund's net asset value.[39] It is unclear how this information will benefit

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[36] *See* Proposing Release, pp. 16, 18.

[37] Form PF, Section 1b, Item C, Number 14.

[38] *See* Proposing Release, p. 32.

[39] Form PF, Section 1b, Item B, Number 10.

financial service regulators and it is likely duplicative given that much of this information could be provided by the lending financial institutions. Furthermore, providing this information would be very burdensome on private equity sponsors.

In addition, if the Commission decides to require this information on Form PF, the PEGCC believes that the Commission should not require that the creditor be identified if a borrowing that exceeds the 5% limit has been securitized or syndicated. Under these circumstances, the portfolio company may not know who the "creditor" is and there may be no practical way to find out.

C. *Portfolio Company Information*

The PEGCC does not see any reason why Form PF should require a private fund sponsor to provide any portfolio company data with respect to a portfolio company that has issued public securities (debt or equity) and files reports with the Commission under the Securities Exchange Act of 1934. These portfolio companies already make extensive, publicly available filings that can be a source of data for the Commission and other regulators.

In addition, the Commission should not require reporting of information on the indebtedness of portfolio companies, either on an aggregate or individual basis.[40] As discussed above, there is no evidence that borrowing by portfolio companies raises systemic risk concerns, or that the borrowings by these companies are any different than any other company's indebtedness from a systemic risk perspective.

We also believe that obtaining, standardizing and reporting that information will be more burdensome than the Commission anticipates. For example, as discussed above, a private equity fund might be deemed to "control" a portfolio company for Form PF purposes, but not have sufficient influence to receive the detailed information necessary to break down the portfolio company's indebtedness by maturity. In addition, debt-to-equity ratios are highly dependent on the accounting methodologies of the underlying portfolio company, making, for example, a calculation of a weighted average unreliable. This unreliability may be increased in times of economic stress when accounting values differ most markedly from actual market value, meaning that these items would be least reliable when they are most necessary.

D. *PIK and Zero-Coupon Debt*

The Commission should not require information on pay-in-kind (PIK) or zero-coupon debt. The Commission has not identified any systemic risk associated with these financial instruments that would warrant such granular reporting.

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[40] Form PF, Section 4, Item B, Numbers 59 – 62.

E. *Breakdown of the Fund's Investments by Industry and Geography.*

Form PF would require private fund advisers to provide breakdowns of each reporting fund's investments by industry, plus a geographical breakdown of the reporting fund's investments by percentage of gross asset value.[41] Such granular reporting should not be required. The Proposing Release does not identify the purpose that disclosure of this data would serve. For example, does the fact that a private equity fund has invested a substantial amount of assets in Brazil have any bearing on systemic risk? If it does, the Proposing Release does not explain what that might be.

IV. Quarterly Filing Requirements Impose Disproportionate Burdens on Private Equity Sponsors that Are Large Private Fund Advisers

Large Private Fund Advisers would be required to file Form PF on a quarterly basis within 15 calendar days after the end of each calendar quarter. While we disagree that a private equity sponsor should be required to file quarterly reports on Form PF, a 15-day deadline would be utterly impractical, given the level of detail and specificity that would be required. The Commission dramatically underestimates the amount of time that would be required to collect and generate the required information, as well as the amount of time and costs that would be required to develop the systems required to support these reports. The PEGCC believes that many of its members do not have portfolio accounting and risk systems presently designed to produce the information the proposed Form PF would require, particularly on a quarterly basis.

For example, a private equity sponsor would be required to determine its regulatory assets under management as well as performance-related information (which we discuss below). While we believe that this might be a challenge even for a fund that invests primarily in publicly-traded securities, it would be a totally inadequate period of time for a sponsor that manages a portfolio of illiquid assets. The valuation process of most private equity funds involves a detailed review of the financial and business affairs of each portfolio company (based on a number of assumptions and estimates) and multiple layers of review and approval including, generally, the sponsor's audit committee and, in certain circumstances, the fund's investor advisory committee. In addition, this process generally cannot begin until each portfolio company provides the necessary financial statements, which may not be for 60 days after the end of the quarter. Furthermore, the PEGCC believes that additional legal review would be required with respect to any filing with the Commission.[42]

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41 Form PF, Section 4, Item B, Numbers 67 and 68.

42 We also question the requirement that the annual Form PF be filed on or before the date on which the private fund sponsor's annual Form ADV update is due. The firm's compliance, financial, legal and administrative personnel would be focused on preparing two extremely important, fact intensive and

Requiring private fund sponsors to file quarterly reports suggests that the Commission believes that the portfolios of private equity funds can fluctuate dramatically in the short term. As a general matter, they do not. A private fund generally has an "investment period" of approximately 5 to 6 years to invest commitments. Depending on the transaction environment, these investments and realizations of investment may be made more or less rapidly. However, unlike many types of funds (including mutual funds), private equity fund portfolios are not subject to rapid turnover, and it is difficult to see the value to regulators focusing on systemic stress or risk the benefits that would be gained from such frequent reporting.

Finally, it is unlikely that quarterly filings will reveal trends that would provide meaningful information that could be used to identify systemic risk. Since all of the returns to investors are derived from realized gains, the interim performance data is essentially economically immaterial.

Taken together, the PEGCC believes that (*i*) the increased burden of requiring quarterly reporting of performance-related information outweighs any marginal benefit to the Commission or the FSOC; and (*ii*) to the extent that any quarterly reporting is required, the Commission must provide a time period of at least 90 days for a private equity sponsor to execute its rigorous valuation process.

V. Procedural Issues

A. *Recommended Modifications to the Form PF Compliance Date*

If it does not exempt private equity sponsors from the obligation to report on From PF, the Commission should, at a minimum, delay the effective date of the reporting requirements for a year. Form PF requests quite complex information and prospective filers should have an opportunity to develop the reporting systems necessary to produce accurate and timely information. This is particularly important given the potential liability for reporting inaccurate information or not updating the form on a timely basis.

B. *Amendment to the Filing*

The PEGCC believes that, given the hasty filing schedule, investment advisers should be given flexibility to amend their filings to correct inaccuracies promptly upon discovery. For example, if a private equity sponsor who is a Large Private Fund Adviser receives new data regarding a portfolio company after the 15-day quarterly filing window, the sponsor should be allowed to amend its Form PF to provide the updated information without the risk of adverse consequences. For purposes of clarity, any such

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sensitive filings that would be due at the same time. We suggest that the annual filing date for Form PF be at least 60 days after the deadline for Form ADV annual filings.

amendment should not be viewed as violating the certification of Form PF (discussed below).

C. *Certification Requirement*

The PEGCC does not believe that the certification requirement of Form PF is appropriate in view of the nature of the information to be reported (*e.g.*, valuation of illiquid assets) and the filing schedule proposed by the Commission. As we have noted, the filing schedule envisioned by the Commission will necessarily curtail the ordinary valuation processes of private equity sponsors and, therefore, will make certification more difficult. At a minimum, the PEGCC believes that the Commission should allow an adviser to base the certification on knowledge and materiality qualifiers and should only require the certification at most annually.

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The PEGCC appreciates the opportunity to comment on the proposed rule and would be pleased to answer any questions you might have regarding our comments, or regarding the private equity and growth capital industry more generally.

Respectfully submitted,

Douglas Lowenstein
President
Private Equity Growth Capital Council

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner

Eileen Rominger, Director, Division of Investment Management
Robert Plaze, Associate Director, Division of Investment Management
David Vaughan, Attorney Fellow, Division of Investment Management

SUBMITTED ELECTRONICALLY

November 5, 2010

The Honorable Timothy F. Geithner
Secretary, United States Department of the Treasury
Chairman, Financial Stability Oversight Council
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Financial Stability Oversight Council (the "FSOC") Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (the "ANPR") – FSOC-2010-0001

Dear Secretary Geithner:

These comments are submitted by the Private Equity Growth Capital Council (the "PEGCC"). The PEGCC is an advocacy, communications and research organization and resource center established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are 32 of the world's best-known and most respected private equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.[1]

The PEGCC has supported and continues to support efforts to identify potential systemic risks before they arise and, where appropriate, to require enhanced regulation of systemically significant, nonbank financial companies (*i.e.*, those whose material financial distress or failure, or ongoing activities, could pose a threat to the financial

[1] The members of the PEGCC are: American Securities; Apax Partners; Apollo Global Management LLC; Avista Capital Partners; Bain Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; Crestview Partners; Genstar Capital; Global Environment Fund; GTCR; Hellman & Friedman LLC; The Jordan Company; Kelso & Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners; MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thomas H. Lee Partners; TPG Capital (formerly Texas Pacific Group); Vector Capital; and Welsh, Carson, Anderson & Stowe.

950 F Street NW, Suite 550 ■ Washington, DC 20004 ■ PH 202.465.7700 ■ FX 202.639.0209 ■ www.pegcc.org

stability of the United States).[2] The FSOC was created to take on this challenge by the recently enacted Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").

The PEGCC appreciates the opportunity to submit these comments, for consideration by you and your fellow FSOC members, concerning (*1*) the criteria that should inform the FSOC's possible designation of nonbank financial companies under Section 113 of the Dodd-Frank Act and (*2)* the application of systemic risk criteria to private equity and growth capital firms ("private equity firms") and to the private equity and growth capital funds ("private equity funds") advised by those firms.[3]

Private Equity Firms and Funds Do Not Present Systemic Risk Concerns

The PEGCC believes that private equity firms and private equity funds, as a class and individually, do not present systemic risk concerns under any criteria for assessing such risk of which we are aware.

We discuss systemic risk criteria and their application to private equity firms and funds in detail in our response below to question 2 of the ANPR. However, the most important considerations that lead the PEGCC to this conclusion are the following:

(1) Private equity firms and private equity funds ***are not deeply interconnected*** with banks or with other nonbank financial companies, including by virtue of: derivatives positions; counterparty exposure relating to, for example, swaps or securities lending; reliance on short-term credit for their operations; or the provision of credit to financial system participants. Furthermore, such firms and funds are not interconnected with each other, because they neither pledge their assets as security for, nor do they guarantee, each others' obligations. Therefore, the failure of a private equity firm or private equity fund could not create cascading negative effects on other parts of the financial system.

(2) Private equity firms and private equity funds ***do not present substitutability concerns*** because—although they play an important role in our economy and help grow

2 See the testimony of Douglas Lowenstein, President of the PEGCC, to the House Financial Services Committee on July 17, 2009 (available at http://www.financialservices.house.gov/Hearings/hearingDetails.aspx?NewsID=1150). See also Mr. Lowenstein's additional testimony to the Committee on October 6, 2009 (available at http://www.financialservices.house.gov/Hearings/hearingDetails.aspx?NewsID=1126).

3 For the avoidance of doubt, for purposes of this letter we do not include in the definition of private equity funds the following: private investment funds sponsored by banks or insurance companies, even if some of those funds make private equity-type investments; any private investment fund that is open-ended; funds of funds (funds that invest in private equity funds or other private investment funds); or hedge funds.

and strengthen the businesses in which they invest—such firms and funds do not provide the kinds of products, services or infrastructure that are necessary for the functioning of the financial system (such as consumer credit, clearance and settlement services, or legally required insurance products) and that other institutions cannot provide.

(3) Private equity firms and private equity funds do not rely on short-term financing that could dry up in times of financial stress. In addition, the investors in such firms and funds do not have redemption or withdrawal rights that would enable those investors to force a fire sale of assets were those investors to attempt to make a "run on the bank." Private equity firms and private equity funds, therefore, ***do not face liquidity concerns*** that could result in forced massive asset sales to meet investor (or other) claims—and which in turn could drive down investment values, thereby adversely affecting other financial system participants.

(4) A highly leveraged financial firm, such as a bank, that is interconnected with other financial firms is less likely than an unleveraged firm to be able to absorb spillover effects if another financial system participant fails. However, private equity funds are not interconnected with other financial firms (as mentioned above) and typically ***are not leveraged***. Even the degree of leverage at the portfolio company level is significantly less than that of most large banks and broker-dealers.

(5) Very large financial firms, such as banks, that are interconnected with other financial firms are likely to have larger spillover effects should they fail than would smaller firms. However, private equity firms and private equity funds are not interconnected with other financial firms (as mentioned above) and ***are relatively small in size*** (whether measured by assets available for investment, risk capital, liabilities or transaction volume) compared to large banks, insurance companies, broker-dealers and advisors to registered investment companies.

Structure and Operations of Private Equity Firms and Funds

To provide important context for the more detailed discussion below in our responses to questions posed by the ANPR, here we provide a description of the structure and operations of private equity firms and private equity funds:

Private Equity Firms. Private equity firms sponsor, manage and advise private equity funds (which are described below). Private equity firms, or the owners of private equity firms, typically own and control their funds' general partners (or, in the case of a fund that has a non-partnership structure, the equivalent controlling entity), which make investment decisions for the fund ("GPs"). Private equity firms most frequently are privately owned and controlled by their senior investment professionals. Subject to limited exceptions (for small firms, certain non-U.S. firms and venture capital firms), private equity firms are, or after July 21, 2011 will be required to be, registered as investment advisers under the Investment Advisers Act of 1940.

Private equity firms may have one or several lines of business. Many private equity firms organize and advise a private equity fund to pursue a particular private equity investment strategy and, once that fund is largely invested, the private equity firm will organize a successor fund to continue that investment strategy. Other private equity firms may pursue two or more distinct private equity investment strategies, organizing a fund (and then successor funds) to pursue each of those strategies. Other private equity firms may organize different private equity funds (and, eventually, successor funds) to invest in different geographies.

In addition, some private equity firms—although primarily in the business of advising private equity funds—also have ancillary (non-private equity) businesses, such as hedge funds or fund of funds businesses, among others. These ancillary businesses are small relative to large asset management businesses and, critically, are not cross-collateralized or otherwise interconnected with the private equity firm or any of the private equity funds advised by the firm. Thus, these diversified private equity firms do not raise systemic risk concerns. To the extent that the regulators review these non-private equity businesses for systemic risk purposes, the PEGCC believes that these other ancillary businesses should be assessed separately from the firm's private equity business. Federal Reserve Board Chairman Bernanke has expressed his view that no individual hedge fund or private equity fund would become a systemically critical firm individually:

> "[M]y view at this point is that I would not think that any hedge fund or private equity fund would become a systemically critical firm individually. However, it would be important for the systemic risk council to pay attention to the industry as a whole and make sure that it understood what was going on so there wouldn't be kind of a broad-based problem that might cut across a lot of firms."[4]

Private Equity Funds: Typical Structure. Private equity funds are closed-end pooled investment vehicles, most frequently organized as limited partnerships, that invest in operating businesses ("portfolio companies"). As described above, a private equity fund is sponsored, managed and advised by an affiliated private equity firm. The fund is controlled by its GP, which makes investment decisions for the fund and, as noted above, typically also is affiliated with the private equity firm that advises the fund. The GP makes a significant capital commitment to the fund, *i.e.*, a contractual agreement to contribute capital from time to time over the term of the fund as and when needed by the fund to make investments and pay expenses. The private equity fund also obtains capital commitments, at the beginning of its term in private placement transactions, from sophisticated third party investors who agree to become the limited partners (or members or shareholders in a non-partnership structure) of the fund ("LPs"). The LPs, like the GP, contribute capital to the fund over its term. The LPs are not involved in the management

4 Testimony of Ben Bernanke, Chairman of the Federal Reserve Board, to the House Committee on Financial Services (October 1, 2009).

or control of the business of the fund except in very limited circumstances (*e.g.*, to vote on conflicts of interest or to remove the GP). LPs of private equity funds include corporate pension plans, public retirement plans, foundations, endowments, sovereign wealth funds, insurance companies and (historically) banks, and to a lesser extent very high net worth individuals and family offices.

Private Equity Funds: Investment Strategies and Diversification. Private equity funds pursue a variety of investment strategies (*e.g.*, venture capital, growth capital, buyout, real estate, distressed and mezzanine investing) and invest in a broad range of industries and geographies.[5] While an individual private equity fund may hold a limited number of investments, and while some private equity firms and/or private equity funds have a geographic or industry focus, private equity funds in the aggregate are diversified across multiple geographies and industries and thus lack concentrated exposure in any single region or sector.[6]

Private Equity Funds: Long-Term Funding, Long-Term Illiquid Investments. As noted above, capital is contributed to a private equity fund by its GP and its LPs over the fund's term as and when needed by the fund to make investments and pay its expenses. The term of a private equity fund is typically 10 years (subject to extension for up to two or three years if needed by the fund to dispose of any investments then remaining in the portfolio). Most often new investments are made by a fund only during the first three to six years of the fund's term. Whatever the investment strategy or focus

5 Private equity investing can take many forms. For example, a private equity fund may acquire common or preferred stock of a promising start-up or early stage company with the intent of providing its founders with the capital necessary to commercialize the company's product (*i.e.*, a venture capital investment). Or, the fund may inject equity into, or buy debt of, a struggling company in an effort to turn around its operations (*i.e.*, a distressed investment). Or, the fund may invest in a promising or strong company that needs capital to expand into new markets or develop new products (*i.e.*, a growth capital investment). Or, the fund may make equity investments in more mature businesses, where the purchase price is a combination of the fund's equity investment and proceeds from new senior and subordinated debt that is borrowed (and eventually is to be repaid) by the business being acquired (*i.e.*, a buyout transaction). These private equity transactions could involve purchases of: unwanted, non-core (and often undermanaged) divisions of large conglomerates; family businesses where the founders are seeking to transition beyond family ownership; public companies that are taken private in an effort to increase value long-term without the short-term earnings pressures of the public markets; and underperforming businesses where not only capital but also operating and financial expertise can be brought to bear to turn around the business.

6 From 2000 to 2007, for example, buyout investment in a sector as a percentage of total buyout investment was as follows: for industrial companies, 21.2%; for consumer-related companies, 14.7%; for communications businesses, 12.1%; for computer firms (software and hardware), 9.6%; for health care concerns, 9.5%; for Internet-specific companies, 7.8%; for business and financial consulting and other services firms, 7.3%; and for other types of businesses, 17.9%. Source: Robert J. Shapiro and Nam D. Pham, *The Role of Private Equity in U.S. Capital Markets*, supported by the PEGCC (October 2008), at page 14.

of a private equity fund, that fund typically invests capital in highly illiquid securities (*i.e.*, securities not tradable on a securities exchange)—common equity and, to a lesser extent, preferred equity or debt securities such as mezzanine debt—of operating businesses. A private equity fund typically holds each of its investments for between three and seven years. In each case the fund works to improve the value of the business in which it has invested so that, eventually, that investment may be sold by the fund at a profit based on the value created during the period that the fund owned a stake in that investment.[7] When an investment is sold by a fund, the sale proceeds typically are distributed by the fund to its investors so that: first, the investors receive a return of their capital; next, the investors frequently (but not always) receive a preferred return (typically 8% per annum) on that capital; and then the profits are shared between the LPs and the GP so that over the life of the fund the GP receives, in addition to the return on its capital investment, a share of the profits, typically 20%, referred to as the GP's "carried interest." With very limited exceptions, a private equity fund is not permitted to reinvest (recycle) the proceeds from the sale of a portfolio investment. So, when the fund has invested (or reserved to cover fund expenses or liabilities) all of its capital commitments, the fund can make no further investments; and the private equity firm must raise a new, successor fund to continue that private equity fund's investment strategy.

Private Equity Funds: Strictly Limited Hedging and Trading. As discussed above, the investment strategies of private equity funds are mostly long-term "buy and hold" strategies, not trading strategies. Private equity funds typically purchase highly illiquid securities. Not surprisingly, therefore, virtually all private equity funds are prohibited by the terms of their partnership agreements or other governing documents from hedging for speculative purposes, from purchasing commodities or derivatives, and from investing in hedge funds or publicly traded securities (except in connection with a going private transaction).

Private Equity Funds: Limited Lending, Limited Borrowing. Most private equity funds purchase equity securities, although a relatively small number of funds purchase privately-issued mezzanine or other debt of operating businesses. Even these debt funds rarely originate debt or otherwise provide credit. Accordingly, private equity

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7 Regardless of the type of portfolio investment made, the objective of a private equity fund is the same: increase the value of the portfolio company during the time that it is owned by the private equity fund. Private equity funds accomplish this by, for example: strengthening and adding to the management team; assisting the company in achieving an optimal capital structure; requiring the implementation of management and employee equity stock ownership and/or revised performance based bonus plans; professionalizing financial management of the portfolio company; providing operational assistance; sitting on a revitalized board of directors; working with management to develop and implement a new or revised business plan; and/or causing the company, as appropriate, to make capital and R&D expenditures, to cut corporate waste and inefficiencies, to expand into new markets and develop new products, and/or to make strategic acquisition to create the scale required to compete and become market leaders.

funds (including these debt funds) are not a material source of credit to businesses, and they are not a source of credit at all to consumers or governments.

With the exception of certain real estate funds, private equity funds almost never borrow, and frequently they are prohibited by their partnership agreements or other governing documents from borrowing. To our knowledge none are reliant on short-term credit markets or regularly roll-over debt as part of their operations. Private equity funds rarely borrow because of the particular tax concerns of tax-exempt LPs concerning "unrelated business taxable income." [8]

Private Equity Funds: No Redemption, Withdrawal or Unlimited Transfer Rights. Because of the long-term, illiquid nature of their investments and because they typically do not borrow, private equity funds do not offer (and are not able to offer) redemption rights to their investors. Indeed, a private investment fund is not considered a private equity fund if its investors are permitted to redeem their interests in the fund. Private equity funds typically do not allow their investors to withdraw from the fund, except in extremely limited circumstances (such as a change in law that makes it illegal for such investor to continue to hold its interest in the fund), and in any event the fund is not forced to sell assets to effect such withdrawal. For tax and business reasons, private equity funds do not allow LPs to transfer their interests in the fund without the consent of the GP.

Private Equity Funds: No Cross-Collateralization, No Cross-Guarantees. Except perhaps for a pledge by a private equity fund of the shares of a portfolio company that it owns as security for that portfolio company's borrowings, the borrowings or other obligations of that portfolio company are not guaranteed by, or secured by pledges of the assets of, the fund or any other portfolio company. So, the failure of one portfolio company should not impact the fund's other portfolio companies. The fund and its

[8] It is true that some private equity funds, such as buyout funds, purchase companies using equity and borrowed money—but the funds themselves do not borrow or guarantee that debt. In a leveraged buyout transaction, a buyout fund may, for example, incorporate an acquisition vehicle and make an equity investment; the acquisition vehicle then uses the capital that the fund invested, together with cash that it borrows from a bank or other lender, to purchase the target company from the seller of that business, with repayment of the debt being secured by a lien on the assets of that company and by a pledge by the fund of its shares in the portfolio company. There are many variations on this simplified buyout structure, but all leveraged acquisitions have this in common: when the acquisition is complete, the fund owns an equity stake in an operating business that, like almost all operating businesses in this country, has some degree of leverage on its books that the company (not the fund) is obligated to repay from its earnings; and if the business fails, the lenders and other creditors of the company will be repaid before the fund or other equityholders are entitled to any additional return on their equity investments. In any event the lenders have no recourse to the assets of the private equity fund (except for any shares of the failed portfolio company that were pledged by the fund to secure the borrowing), of any other portfolio company, or of the private equity firm.

investors may lose their investment in the failed portfolio company, but not in other investments held by the fund.

Similarly, the obligations of a private equity fund are not guaranteed by, or secured by pledges of the assets of, another private equity fund; and no private equity fund advised by a private equity firm guarantees or pledges its assets to secure the obligations of the private equity firm, or vice-versa. So, the failure of one private equity fund advised by a private equity firm should have no impact on the other funds advised by that firm.

If one or more private equity funds advised by a private equity firm fail(s) to generate satisfactory returns for their LPs, it may be difficult if not impossible for the private equity firm to raise new private equity funds. If the private equity firm fails to raise new funds, it will continue to advise its existing funds (which existing funds, in turn, will manage and eventually wind down their portfolios over the terms of those funds), and then the private equity firm will quietly go out of business.

Answers to Selected ANPR Questions

1. What metrics should the Council use to measure the factors it is required to consider when making determinations under Section 113 of DFA?

[Text of a. deleted.]

b. Are there some factors that should be weighted more heavily by the Council than other factors in the designation process?

The PEGCC believes that it would be ideal if the FSOC (*1*) could develop objective "screens" that could be used effectively and predictably to eliminate from review nonbank financial companies that clearly do not present systemic risk, and (*2*) then apply additional precise but more subjective criteria to assess the potential for systemic risk presented by the financial firms that remain under review. However, in this letter we limit our comments to the list of factors that are required to be considered by the FSOC and are set forth in Section 113(a)(2) of the Dodd-Frank Act.

Of the Section 113(a)(2) factors, the PEGCC believes that interconnectedness and substitutability considerations, and to a lesser extent liquidity, leverage and size considerations, are among the more important factors that the FSOC should consider when assessing whether (and to what extent) different types of financial system participants are potentially systemically significant.[9] Specifically:

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[9] We note that, in discussing systemic risk in his written testimony on financial services reform to the House Financial Services Committee on September 29, 2009, Treasury Secretary Geithner referred to size, leverage and interconnectedness: "Addressing the threats to financial stability posed by large,

(1) ***Interconnectedness*** refers to linkages that exist between and among financial institutions. Examples of these linkages are swaps, securities lending arrangements, derivative positions, and interbank lending and borrowing. Interconnectedness creates the risk of "spillover" or "contagion", *i.e.*, that the failure of one bank or nonbank financial company will have cascading negative effects on other banks or nonbank financial companies. Interconnectedness is a key consideration (perhaps the most important consideration) in assessing systemic risk. If the material financial distress, failure or ongoing operations of a bank or nonbank financial company would not materially impact other banks or nonbank financial companies, then it seems unlikely that such bank or nonbank financial company presents material systemic risk concerns.

(2) ***Substitutability*** concerns exist when a bank or nonbank financial company provides a product, service or infrastructure that is of critical importance to the functioning of the financial system *and* that product, service or infrastructure cannot be replaced if such bank or nonbank financial company fails. Examples of products, services and infrastructure that might be considered to be of critical importance to the financial system include: financial products and services that are critical to consumers (such as savings and checking accounts and consumer credit); financial products that are legally required to be purchased by consumers (such as medical, motor vehicle and certain other insurance products); and infrastructure that is necessary for the functioning of the financial system (such as clearance and settlement activities). If a provider of such vital products, services or infrastructure fails and cannot be replaced by another provider, material systemic risk concerns are raised.

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leveraged, and interconnected financial firms is central to the Administration's financial regulatory reforms." *The Administration's Proposals for Financial Regulatory Reform: Hearing Before the Committee On Financial Services*, 111th Congress 54–61 (2009) (written testimony of Treasury Secretary Timothy F. Geithner).

The Financial Stability Board lists interconnectedness, size and substitutability as the key systemic risk factors in its *Report to the G-20 Finance Ministers and Central Bank Governors, Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations* (October 2009). The International Monetary Fund discusses interconnectedness in its *Global Financial Stability Report: Responding to the Financial Crisis and Measuring Systemic Risk* (April 2009).

Publications that contain helpful and accessible discussions of systemic risk include the following: SIFMA and Deloitte, *Systemic Risk Information Study* (June 2010); Robert J. Shapiro and Nam D. Pham, *The Role of Private Equity in U.S. Capital Markets*, supported by the PEGCC (October 2008); Property Casualty Insurers Association of America, *Why "Too Big to Fail" is Too Short-Sighted to Succeed* (January 18, 2010); Committee on Capital Markets Regulation, *The Global Financial Crisis: A Plan for Regulatory Reform* (May 2009); and Mary A. Weiss, Center for Insurance Policy and Research, National Association of Insurance Commissioners, *Systemic Risk and the U.S. Insurance Sector* (February 23, 2010).

(3) In times of financial stress, short-term credit could become unavailable, and financial firms that rely on short-term credit for their operations could be forced to sell assets to fund those operations. Similarly, uncertainty in times of financial stress could lead investors to seek to move out of existing debt and equity investments into cash, either by liquidating those investments or, if the investors hold their investments through investment vehicles, by redeeming their interests in such vehicles, which in turn could force those investment vehicles to sell assets to fund those redemption demands. Systemic risk can exist if the ***liquidity concerns*** described above place significant stress on the affected institution and result in forced assets sales that depress investment values, and thereby negatively affect not only the selling institution but also other financial firms.

(4) If a bank or nonbank financial company is deeply interconnected with other financial firms, then ***leverage*** makes that bank or nonbank financial company less likely than an unleveraged company to be able to withstand a financial crisis and absorb spillover effects from one or more other failing financial firms.

(5) If a bank or nonbank financial company is deeply interconnected with other financial firms, then the greater the ***size*** of the bank or nonbank financial company, the more the systemic risk that is made possible by interconnectedness is magnified.

2. What types of nonbank financial companies should the Council review for designation under DFA? Should the analytical framework, considerations, and measures used by the Council vary across industries? Across time? If so, how?

Private equity funds do not present systemic risk concerns under any criteria of which we are aware for assessing systemic risk. The PEGCC believes strongly, therefore, that private equity firms and private equity funds should not, as a class or individually, be required by the FSOC under Section 113 of the Dodd-Frank Act to be designated for supervision and regulation by the Federal Reserve Board,

Specifically, here we review the key systemic risk factors listed in our response above to question 1 of the ANPR and the other factors that the FSOC is required to consider under Section 113(a)(2) of the Dodd-Frank Act, and we apply those factors to private equity firms and private equity funds:

- ***Interconnectedness with other financial companies.*** Private equity firms and private equity funds are not deeply interconnected with banks or other nonbank financial firms because typically: they do not hold derivatives positions; they do not have counterparty exposure arising from, for example, swaps or securities lending activities; they do not rely on short-term credit for their operations; they do not lend to financial system participants; and they neither rely on prime brokers nor are they otherwise operationally linked to other financial institutions.

Similarly, private equity firms and the private equity funds that they advise are not interconnected with each other (except, of course, that a private equity fund is operationally linked to the private equity firm that advises and manages such fund), because such firms and funds neither pledge their assets as security for, nor do they guarantee, each others' obligations. (A private equity firm typically does not go out of business because the failure of a portfolio company or fund causes another portfolio company or fund to fail, but because the poor performance of one or more of the funds advised and managed by the private equity firm makes it impossible for the firm to organize successor funds.)

Because of this lack of interconnectedness, the material financial distress, failure or ongoing operations of private equity firms and private equity funds could not create cascading negative effects on other parts of the financial system.[10]

- ***Substitutability concerns.*** While private equity firms and private equity funds are important to the U.S. economy and help grow and strengthen the businesses in which they invest, they do not provide the kinds of products, services or infrastructure that are of critical importance to the functioning of the financial system, such as (*1*) financial products and services that are vital to consumers (*e.g.*, savings and checking accounts or consumer credit), (*2*) financial products that are legally required to be purchased by consumers (*e.g.*, medical, motor vehicle and certain other insurance products) or (*3*) infrastructure that is necessary for the financial system to operate (*e.g.*, clearance and settlement activities), *and* that could not be replaced by other firms.

- ***Liquidity.*** Private equity funds invest in highly illiquid assets and rely on long-term, stable financing in the form of capital commitments from their investors. They do not incur long-term borrowings to make short-term investments or vice-versa (indeed, as discussed elsewhere in this letter, typically they do not borrow at all). They do not rely on short-term financing that could dry up. Typically they do not invest in liquid securities that could be dumped rapidly into the markets if the firm needs capital; and in any event their investors generally do not have redemption or withdrawal rights that would enable those investors to force a fire sale of assets were those investors to attempt to make a "run on the bank". Therefore, private equity firms and private equity funds cannot be forced to rapidly unwind their portfolios and dump assets to satisfy investor or

[10] The PEGCC is not aware of any failure of a private equity firm or fund that has had any negative impact on the broader financial system.

other claims, thereby driving down investment values and potentially adversely affecting other financial firms. Private equity firms and private equity funds are structured and operated such that liquidity shortages will not have systemic impacts.[11]

- ***Extent of private equity fund and firm leverage.*** Although debt may be incurred at the portfolio company level in buyout transactions, private equity funds themselves almost never borrow, whether to purchase securities on margin or otherwise. Private equity funds typically do not borrow because of the particular tax concerns of tax-exempt LPs, and frequently are prohibited by the terms of their governing documents from incurring leverage. As for private equity firms, while they may have revolving lines of credit or other borrowings to fund ordinary business operations, most private equity firms are only modestly leveraged, if at all. So, private equity firms and private equity funds generally are not subject to unsustainable debt or creditor margin calls.

- ***Extent of portfolio company leverage.*** Many portfolio companies, like other U.S. operating businesses, are leveraged. The portfolio companies of some private equity funds, such as those of buyout funds, may be more (or less) leveraged than other U.S. operating businesses, but the failure of a single portfolio company will not cause the failure of another portfolio company. The average gross leverage ratio of private equity deals is historically approximately 3:1, although of course some portfolio companies may be materially more or less leveraged.[12] In comparison,

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[11] See, for example, *Globalization of Alternative Investments, Working Papers Volume 3: The Global Economic Impact of Private Equity Report 2010* (World Economic Forum), at page 5: "[T]he structural differences between PE funds and other financial institutions may make them less susceptible to industry shocks. A major source of concern for financial institutions is the so-called 'run on the bank' phenomenon. Runs occur when holders of short-term liabilities, for example, depositors or repo counterparties, simultaneously refuse to provide additional financing and demand their money back. Other versions of this phenomenon arise when companies simultaneously draw down lines of credit, hedge fund investors simultaneously ask for redemptions of their investments, or a freeze in the market for commercial paper prevents structured investment vehicles (SIVs) from rolling over short-term commercial paper. It is unlikely that PE investments create dangers through this mechanism. Private equity funds are typically prevented from borrowing, and the funds' only claimants are their limited partners (LPs), which are typically bound by 10-year lock-up agreements. Hence, the funds have no short-term creditors that can run. By way of contrast, extensive loans are provided to the individual portfolio companies. However, these loans are typically made by a concentrated set of lenders, and are without recourse to other portfolio companies or the fund generally. Hence, an individual creditor's ability to be repaid is largely unaffected by the actions of other creditors, mitigating an incentive to run."

[12] Source: Standard & Poor's Q4 2009 Leveraged Buyout Review, at page 46.

for example, Lehman Brothers was leveraged at approximately 32:1 at the end of February 2008,[13] a gross leverage ratio relatively common among large broker-dealers at that time.[14] The PEGCC does not believe that portfolio company leverage, in the absence of interconnectedness or cross-collateralization concerns (as discussed elsewhere in this letter), is relevant to an assessment of systemic risk; but even if portfolio company leverage is seen as relevant, the PEGCC submits that such leverage is modest in comparison to large bank holding companies and broker-dealers.

- ***Size.*** Private equity firms and private equity funds are important to the U.S. economy and help grow and strengthen the businesses in which they invest. In size terms, however, private equity firms and private equity funds are relatively small participants in the overall U.S. financial system (whether measured by assets available for investment by those firms, or by their risk capital, or by trading volume, or by liabilities), as compared to large banks, insurance companies, broker-dealers and advisors to registered investment companies.

  - To put this discussion in context, please note (for example) that the 50 largest U.S. bank holding companies had average total assets of over $280 billion, and the six largest U.S. bank holding companies had average total assets of over $1.5 trillion, as of June 30, 2010.[15]

  - Individual private equity funds, on the other hand, are quite small relative to the institutions described above. The largest private equity fund known to us has capital commitments from its investors of less than $21 billion, and most private equity funds are significantly smaller. A fund's capital commitments are the total assets that investors are required to contribute to the fund for investment and to pay its expenses, and, therefore, typically are the maximum amount available to be invested by the fund and the maximum amount subject to loss by the fund and its investors.

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13 Source: Lehman Brothers Holdings Inc., Quarterly Report on Form 10-Q, for the quarterly period ended February 29, 2008, at pages 5-6 (available at http://www.sec.gov/Archives/edgar/data/806085/000110465908023292/a08-10156_110q.htm).

14 Source: Tobias Adrian and Hyun Song Shin, *Liquidity and Leverage*, Journal of Financial Intermediation (2010), at page 433, Figure 16.

15 Source: National Information Center's list of Top 50 bank holding companies, available at http://www.ffiec.gov/nicpubweb/nicweb/nichome.aspx (as of November 4, 2010).

- Similarly, individual private equity firms are quite small relative to the institutions described above. The largest private equity firm known to us has risk assets of less than $6 billion.

  To the extent that size is relevant,[16] the PEGCC does not believe that it is appropriate for systemic risk analysis purposes to look at the assets of a private equity firm and the private equity funds that it advises on a consolidated basis. Private equity firms and their sponsored funds are not cross-collateralized (as discussed in "Interrelationships with and among a private equity firm, the private equity funds that it advises, and the portfolio companies of such funds" below). Furthermore, portfolio investments are (indirectly) managed, and not owned, by the private equity firm. The $6 billion figure above represents the maximum amount that the private equity firm would lose were it and all the funds that it advises to fail.

- In addition to measuring the size of a private equity firm or fund by reference to its assets, one can also measure size in terms of transaction volume. Private equity firms typically do not invest at all (except in the GPs of their funds). Private equity funds generally invest in illiquid securities, and do not actively trade their portfolios. A typical private equity fund will make between two and eight investments each year (perhaps a few more in the case of venture funds). As compared to other financial institutions, some of which place hundreds or thousands of trades every day, the amount of trading activity of a private equity firm or fund barely registers.

- Another way to measure size is by looking at the liabilities of a financial institution. Again, as compared to other financial system participants, whose liabilities can be enormous, the liabilities of private equity firms and private equity funds barely register because, as discussed above, they do not have significant counterparty exposure and they typically do not borrow (in the case of private equity funds) or are only modestly leveraged, if at all (in the case of private equity firms).

• ***Importance as a source of credit.*** Private equity firms and private equity funds are not a source of credit to households, governments or (except to a

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16 The PEGCC does not believe that size is a good proxy for systemic risk in the absence of interconnectedness. See also Mary A. Weiss, Center for Insurance Policy and Research, National Association of Insurance Commissioners, *Systemic Risk and the U.S. Insurance Sector* (February 23, 2010), at pages 20-21.

very limited extent) businesses, nor do they act as a material source of liquidity for the financial system. Therefore the failure of such firms and funds would not deprive the financial system, or consumers of credit, of an important source of credit.

- ***Extent to which assets are managed rather than owned.*** From the perspective of a private equity firm, the holdings of a private equity fund are managed, not owned, assets. As discussed elsewhere in this letter, the holdings of private equity funds are not cross-collateralized, and private equity funds and firms do not guarantee each others' obligations. The risk of loss of a particular portfolio investment made by a particular private equity fund is a risk borne by that fund and its investors, and not by the private equity firm (except to the extent of its investment through the GP of that fund). While the failure of a large financial firm that owns significant financial assets might have a systemic impact, the failure of an asset manager such as a private equity firm is much less likely (indeed, is extremely unlikely) to have a systemic impact. The private equity firm's ability to acquire, hold and dispose of a private equity fund's assets is strictly limited by contract, regulation or other legal arrangements. The private equity firm cannot use the assets of a private equity fund to gain access to liquidity or to settle its debt. Moreover, the private equity firm is not directly or implicitly obligated to repay any debt incurred by a private equity fund or its portfolio companies, nor does the firm serve as the guarantor of their debt. This is in stark contrast to consolidated, on-balance sheet assets, which are owned by the private equity firm and can be acquired, sold, otherwise financed or disposed of in any manner the management of the firm sees fit. Conflating these two very different metrics would unduly penalize private equity firms that act as advisors to private equity funds relative to other kinds of financial institutions that actually have large amounts of proprietary capital at risk.

- ***Concentration.*** An individual private equity fund may hold a limited number of investments, and some private equity firms and/or private equity funds have a particular geographic or sector focus. But private equity funds in the aggregate are diversified geographically and across multiple industries, and thus lack concentrated exposure in any single region or sector.[17] If investment in a particular region or industry becomes unattractive or problematic, only a portion of the private equity sector (and certainly not other financial system participants) will be adversely affected, because (*1*) private equity investments are not concentrated in any one region or industry and (*2*) as discussed elsewhere in this letter, private

[17] See the discussion at footnote 5 above.

equity firms and private equity funds are not interconnected either with each other or with other financial system participants.

- ***Degree of regulation.*** Subject to limited exceptions for small firms, certain non-U.S. firms and venture capital firms, private equity firms are registered, or after July 21, 2011 will be required to be registered, with the Securities and Exchange Commission (the "SEC") as investment advisers and thus subject to SEC regulation, reporting and inspection. Regulators also now have the authority to require all private equity firms and private equity funds to provide any additional data needed to assess systemic risk. Interests in private equity funds are offered to sophisticated investors in private placement transactions subject to the antifraud provisions of U.S. federal and state and non-U.S. securities laws. The PEGCC believes that, in view of the nature of the private equity industry (and particularly its lack of interconnectedness with other financial system participants and the sophistication of the investors in private equity funds), this degree of regulation is appropriate from a systemic risk perspective, from a safety and soundness perspective, and from an investor protection perspective.

- ***Amount and nature of financial assets.*** Private equity funds generally invest in long-term, highly illiquid assets that most often are significant stakes in operating businesses. As discussed above, private equity funds generally do not invest to any meaningful degree in short-term tradable securities, like derivatives, swaps or publicly-traded equities, and so the volume of trading activity is insignificant and should have little or no market impact. Private equity funds are extremely unlikely to trigger a systemic crisis in the financial system because they invest in individual companies rather than financial instruments.

- ***Reliance on short-term funding.*** Private equity funds do not rely on short-term funding. Rather, private equity funds rely on long-term capital commitments from their LPs, who commit their capital for 10–12 years (or more) with no redemption or withdrawal rights that would force private equity funds to sell assets into down markets to fund payments to investors.

- ***Interrelationships with and among a private equity firm, the private equity funds that it advises, and the portfolio companies of such funds.***

    - Private equity firms do not guarantee the performance or obligations of, or provide credit support to, the private equity funds that they advise.

    - Private equity funds do not guarantee the obligations of, or provide credit support to, their affiliated private equity firms. Typically covenants in a private equity fund's governing document (*e.g.*, its partnership agreement) and fiduciary duties of the GP would prohibit such an arrangement.

- Private equity firms and private equity funds are not legally or contractually obligated to "bail out" or otherwise provide credit support to each other.

- Investors in private equity firms and private equity funds have no expectation that such firms or funds will "bail out" or otherwise provide credit support to each other.

- A private equity fund's portfolio companies are not cross-collateralized and do not guarantee each others' obligations, nor do they guarantee the obligations of the fund. This means that neither investors in, nor debt holders of, a portfolio company have a claim on, nor can they force the fund to sell, another portfolio company (for example, to repay a debt).

- For the reasons outlined above, private equity funds and their portfolio investments are, in effect, "firewalled" from one another. Between funds, a nonperforming fund does not negatively affect the performance of another fund. Within any one fund, a nonperforming portfolio investment does not negatively affect the other companies held in the portfolio; should a portfolio company fail, the fund's losses are limited to the value of that investment.

- ***Other risk-related factors.***

  - ***Investment in the firm and its funds.*** Either individual senior investment professionals of a private equity firm, or the private equity firm itself, typically control and make substantial investments in the private equity funds advised by the firm. These substantial investments incentivize such persons not to take inappropriate operational or investment risks that could lead to the failure of the firm or the fund in which they have invested.

  - ***Sophisticated investors.*** The provisions of the Securities Act of 1933 and the Investment Company Act of 1940, and regulations promulgated thereunder, limit the offer and sale of interests in private equity funds to sophisticated investors. The agreements governing private equity funds tend to be heavily negotiated with these investors and their counsel. These investors negotiate forcefully for limits on the GP's discretion, for limits on indebtedness and for other investor protections.

- ***Transparency.*** Private equity funds' ongoing reporting to their investors is extensive and detailed. For many years private equity funds have provided, and been required to provide, to LPs extensive quarterly, annual and other financial, tax and non-financial reporting. When investors lack information in times of financial uncertainty, they may wish to liquidate their investments. While this is not directly relevant to private equity funds because the LPs of those funds do not in any event have redemption or withdrawal rights, transparency is nevertheless a factor that mitigates uncertainty and thus risk.

While the criteria discussed above, as applied to other nonbank financial institutions, may or may not lead the FSOC to conclude that certain of these nonbank financial institutions present systemic risk concerns, the PEGCC believes that an application of those same criteria to private equity firms and private equity funds clearly demonstrates that private equity firms and private equity funds do not present systemic risk concerns.

5. How should the Council measure and assess the scope, size, and scale of nonbank financial companies?

Please see our discussion of size in our response above to question 2 of the ANPR.

[Text of a., b. and c. deleted]

d. During the financial crisis, some firms provided financial support to investment vehicles sponsored or managed by their firm despite having no legal obligation to do so. How should the Council take account of such implicit support?

The PEGCC has seen no evidence of an "implicit" guarantee by any private equity firm or GP to "bail out" or otherwise provide financial support to a failing fund, in the absence of any legal obligation to do so. No such suggestion is contained in any fund marketing materials or fund governing agreements of which we are aware, nor to our knowledge is this a topic of discussion when private equity funds are being organized and negotiated. The PEGCC is not aware of any expectation on the part of the LPs (or any basis for any such expectation on the part of LPs) that a private equity firm or a GP (let alone any government or governmental agency) will provide credit support to a private equity fund beyond the firm's or the GP's capital commitment to the fund. We see no evidence of "moral hazard" in the private equity context.

6. How should the Council measure and assess the nature, concentration, and mix of activities of a nonbank financial firm?

Please see our response above to question 2 of the ANPR.

a. **Section 113 of DFA requires the Council to consider the importance of the company as a source of credit for households, businesses, and State and local governments, and as a source of liquidity for the United States financial system. Given this requirement, are there measures of market concentration that can be used to inform the application of this criterion? How should these markets be defined? What other measures might be used to assess a nonbank financial firm's importance under this criterion?**

b. **Section 113 of DFA requires the Council to consider the importance of the company as a source of credit for low-income, minority, and underserved communities. Given this requirement, are there measures of market concentration that can be used to inform the application of this criterion? How should these markets be defined? What other measures might be used to assess a nonbank financial firm's importance under this criterion?**

Private equity firms and private equity funds are not a source of credit to households or governments or (except to a very limited extent) businesses.

7. How should the Council measure and assess the interconnectedness of a nonbank financial firm?

a. **What measures of exposure should be considered (e.g., counterparty credit exposures, operational linkages, potential future exposures under derivative contracts, concentration in revenues, direct and contingent liquidity or credit lines, cross-holding of debt and equity)? What role should models of interconnectedness (e.g., correlation of returns or equity values across firms, stress tests) play in the Council's determinations?**

b. **Should the Council give special consideration to the relationships (including exposures and dependencies) between a nonbank financial company and other important financial firms or markets? If so, what metrics and thresholds should be used to identify what financial firms or markets should be considered significant for these purposes? What metrics and thresholds should be used in assessing the importance of a nonbank financial company's relationships with these other firms and markets?**

Please see our discussion of interconnectedness in our response above to question 2 of the ANPR.

8. How should the Council measure and assess the leverage of a nonbank financial firm? How should measures of leverage address liabilities, off-balance sheet exposures, and non financial business lines? Should standards for leverage differ by types of financial activities or by industry? Should acceptable leverage standards recognize differences in regulation? Are there existing standards (e.g., the Basel III leverage ratio) for measuring leverage that could be used in assessing the leverage of nonbank financial companies?

Private equity funds generally are not leveraged. Private equity firms have modest leverage in comparison to large banks, insurance companies and broker-dealers. Please see our discussion of leverage in our response above to question 2 of the ANPR.

9. How should the Council measure and assess the amount and types of liabilities, including the degree of reliance on short-term funding of a nonbank financial firm?

Please see our discussion of liquidity, leverage, size (last sub-bullet point) and reliance on short-term funding in our response above to question 2 of the ANPR.

a. What factors should the Council consider in developing thresholds for identifying excessive reliance on short-term funding?

Private equity firms and private equity funds do not rely on short-term financing to any meaningful extent. Private equity funds rely on and provide long-term funding to their portfolio companies that is well matched to the length of portfolio company holding periods.

[Text of b., c. and d. deleted]

12. During the financial crisis, the U.S. Government instituted a variety of programs that served to strengthen the resiliency of the financial system. Nonbank financial companies participated in several of these programs. How should the Council consider the Government's extension of financial assistance to nonbank financial companies in designating companies?

The organization and operations of private equity firms and private equity funds, and the nature and scale of private equity investments, are fundamentally different from the kinds of organizations and investments that produced the current financial crisis and that received financial assistance from the U.S. government.

To our knowledge no private equity firm or private equity fund received or requested, or was even considered as a possible recipient of, TARP funds or other government support during the recent financial crisis. Furthermore, to our knowledge no venture capital or other private equity firm or fund received or requested, or was even considered as a possible recipient of, government support when the value of many technology investments made by those funds collapsed after the Internet "bubble" burst in 2000.

While history cannot predict the future, these facts strongly suggest that the private equity industry—most likely because it is less interconnected, less vital to the functioning of the financial system, less subject to liquidity crunches, less leveraged, smaller, less important as a source of credit, and less concentrated than other financial institutions—is much less systemically significant (indeed, as discussed above, private equity firms and funds are not systemically significant) than institutions that did receive TARP funds or other government support.

Conclusion

For the reasons outlined above, the PEGCC believes that private equity firms and private equity funds do not present systemic risk. Accordingly, the PEGCC respectfully recommends that private equity firms and private equity funds not be designated by the FSOC under Section 113 of the Dodd-Frank Act for supervision or regulation by the Federal Reserve Board.

The PEGCC appreciates the FSOC's consideration of our views, and is ready and available to respond to any questions that the FSOC may have concerning this letter or that otherwise may develop concerning the private equity industry.

Respectfully submitted,

Douglas Lowenstein
President
Private Equity Growth Capital Council

cc: Mr. Alastair Fitzpayne
Deputy Chief of Staff and Executive Secretary
United States Department of the Treasury

SUBMITTED ELECTRONICALLY

February 25, 2011

The Honorable Timothy F. Geithner
Secretary, United States Department of the Treasury
Chairman, Financial Stability Oversight Council
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Re: Financial Stability Oversight Council (the "FSOC") Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies (the "NPR") – FSOC-2011-0001

Dear Secretary Geithner:

These comments are submitted by the Private Equity Growth Capital Council (the "PEGCC"). The PEGCC is an advocacy, communications and research organization established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are 33 of the world's leading private equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.[1]

The PEGCC has supported and continues to support efforts to identify potential systemic risks before they arise and, where appropriate, to require enhanced regulation of systemically significant, nonbank financial companies. On November 5, 2010, the PEGCC submitted comments in response to the FSOC Advance Notice of Proposed Rulemaking Regarding Authority to Require Supervision and Regulation of

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1 The members of the PEGCC are: American Securities; Apax Partners; Apollo Global Management LLC; Avista Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; Crestview Partners; Francisco Partners; Genstar Capital; Global Environment Fund; GTCR; Hellman & Friedman LLC; The Jordan Company; Kelso & Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners; MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thoma Bravo; Thomas H. Lee Partners; TPG Capital (formerly Texas Pacific Group); Vector Capital; and Welsh, Carson, Anderson & Stowe.

Certain Nonbank Financial Companies. The PEGCC reviewed each of the statutory factors that the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") requires the FSOC to consider in determining whether a nonbank financial company should be designated for enhanced supervision (the "statutory considerations"), as such considerations apply to private equity and growth capital firms ("private equity firms") and the private equity and growth capital funds managed by those firms ("private equity funds").[2]

The PEGCC concluded in its November 5 letter that private equity firms and private equity funds, as a class and individually, do not present systemic risk concerns under any or all of the statutory considerations. Federal Reserve Board Chairman Bernanke has expressed his view that no individual hedge fund or private equity fund would become a systemically critical firm:

> [M]y view at this point is that I would not think that any hedge fund or private equity fund would become a systemically critical firm individually. However, it would be important for the systemic risk council to pay attention to the industry as a whole and make sure that it understood what was going on so there wouldn't be kind of a broad-based problem that might cut across a lot of firms. [3]

The PEGCC believes that that the NPR correctly identifies the appropriate criteria for designating nonbank financial firms, and continues to believe that application of those criteria demonstrates that private equity firms and private equity funds, individually or as a class, do not present systemic risk concerns.

The PEGCC appreciates the opportunity to submit these comments, for consideration by you and your fellow FSOC members, concerning (*A*) the structure and operations of private equity firms and funds, (*B)* the application of systemic risk criteria to private equity firms and to private equity funds and (*C*) the notice, information collection and hearings process set forth in the NPR.

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[2] For the avoidance of doubt, for purposes of this letter we do not include in the definition of private equity funds the following: private investment funds sponsored by banks or insurance companies, even if some of those funds make private equity-type investments; any private investment fund that is open-ended; funds of funds (funds that invest in private equity funds or other private investment funds); and hedge funds.

[3] Testimony of Ben Bernanke, Chairman of the Federal Reserve Board, to the House Committee on Financial Services (October 1, 2009).

A. Structure and Operations of Private Equity Firms and Funds.

To provide important context for the discussion below, here we provide a description of the structure and operations of private equity firms and private equity funds:

1. Private Equity Firms.

Private equity firms sponsor, manage and advise private equity funds (which are described below). Private equity firms, or the owners of private equity firms, typically own and control their funds' general partners (or, in the case of a fund that has a non-partnership structure, the equivalent controlling entity), which make investment decisions for the fund ("GPs"). Private equity firms most frequently are privately owned and controlled by their senior investment professionals. Subject to limited exceptions (for small firms, certain non-U.S. firms and venture capital firms), private equity firms are, or after July 21, 2011 will be required to be, registered as investment advisers under the Investment Advisers Act of 1940.

Private equity firms may have one or several lines of business. Many private equity firms organize and advise a private equity fund to pursue a particular private equity investment strategy and, once that fund is largely invested, the private equity firm will organize a successor fund to continue that investment strategy. Other private equity firms may pursue two or more distinct private equity investment strategies, organizing a fund (and then successor funds) to pursue each of those strategies. Other private equity firms may organize different private equity funds to invest in different geographies.

In addition, some private equity firms—although primarily in the business of advising private equity funds—also have ancillary (non-private equity) businesses, such as hedge funds or fund of funds businesses, among others. These ancillary businesses are small relative to large asset management businesses and, critically, are not cross-collateralized or otherwise interconnected with the private equity firm or any of the private equity funds advised by the firm. Thus, these diversified private equity firms do not raise systemic risk concerns. To the extent that regulators review these non-private equity businesses for systemic risk purposes, the PEGCC believes that these other ancillary businesses should be assessed separately from a firm's private equity business.

2. Private Equity Funds: Typical Structure.

Private equity funds are closed-end pooled investment vehicles, most frequently organized as limited partnerships, that invest in operating businesses ("portfolio companies"). A private equity fund typically is controlled by its GP, which makes investment decisions for the fund and is affiliated with the private equity firm that advises the fund. The GP makes a significant capital commitment to the fund, *i.e.*, a contractual agreement to contribute capital from time to time over the term of the fund as and when needed by the fund to make investments and pay expenses. The private equity fund also obtains capital commitments, at the beginning of its term in private placement transactions, from sophisticated third party investors who agree to become limited partners (or members or shareholders in a non-partnership structure) of the fund ("LPs"). The LPs, like the GP, contribute capital to the fund over its term. The LPs are not involved in the management or control of the business of the fund except in very limited circumstances (e.g., to vote on conflicts of interest or to remove the GP). LPs of private equity funds include corporate pension plans, public retirement plans, foundations, endowments, sovereign wealth funds, insurance companies and (historically) banks, and to a lesser extent very high net worth individuals and family offices.

3. Private Equity Funds: Investment Strategies and Diversification.

Private equity funds pursue a variety of investment strategies (*e.g.*, venture capital, growth capital, buyout, real estate, distressed and mezzanine investing) and invest in a broad range of industries and geographies.[4] While an individual private equity fund may hold a limited number of investments, and while some private equity firms and/or private equity funds have a geographic or industry focus, private equity funds in the aggregate are diversified across multiple geographies and industries and thus lack concentrated exposure in any single region or sector.[5]

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[4] Private equity investing can take many forms. For example, a private equity fund may acquire common or preferred stock of a promising start-up or early stage company with the intent of providing its founders with the capital necessary to commercialize the company's product (*i.e.*, a venture capital investment). Or, the fund may inject equity into, or buy debt of, a struggling company in an effort to turn around its operations (*i.e.*, a distressed investment). Or, the fund may invest in a promising or strong company that needs capital to expand into new markets or develop new products (*i.e.*, a growth capital investment). Or, the fund may make equity investments in more mature businesses, where the purchase price is a combination of the fund's equity investment and proceeds from new senior and subordinated debt that is borrowed (and eventually is to be repaid) by the business being acquired (*i.e.*, a buyout transaction). These private equity transactions could involve purchases of: unwanted, non-core (and often undermanaged) divisions of large conglomerates; family businesses where the founders are seeking to transition beyond family ownership; public companies that are taken private in an effort to increase value long-term without the short-term earnings pressures of the public markets; and underperforming businesses where not only capital but also operating and financial expertise can be brought to bear to turn around the business.

[5] From 2000 to 2007, for example, buyout investment in a sector as a percentage of total buyout investment was as follows: for industrial companies, 21.2%; for consumer-related companies, 14.7%; for communications businesses, 12.1%; for computer firms (software and hardware), 9.6%; for health care concerns, 9.5%; for Internet-specific companies, 7.8%; for business and financial consulting and other services firms, 7.3%; and for other types of businesses, 17.9%.

4. Private Equity Funds: Long-Term Funding, Long-Term Illiquid Investments.

As noted above, capital is contributed to a private equity fund by its GP and its LPs over the fund's term as and when needed by the fund to make investments and pay its expenses. The term of a private equity fund is typically 10 years (subject to extension for up to two or three years if needed by the fund to dispose of any investments then remaining in the portfolio). Most often new investments are made by a fund only during the first three to six years of the fund's term. Whatever the investment strategy or focus of a private equity fund, that fund typically invests capital in highly illiquid securities (*i.e.*, securities not tradable on a securities exchange)—common equity and, to a lesser extent, preferred equity or debt securities such as mezzanine debt—of operating businesses. A private equity fund typically holds each of its investments for between three and seven years. In each case the fund works to improve the value of the business in which it has invested so that, eventually, that investment may be sold by the fund at a profit based on the value created during the period that the fund owned a stake in that investment.[6]

When an investment is sold by a fund, the sale proceeds typically are distributed by the fund to its investors so that: first, the investors receive a return of their capital; next, the investors receive a preferred return (typically 8% per annum) on that capital; and then the profits are shared between the LPs and the GP so that over the life of the fund the GP receives, in addition to the return on its capital investment, a share of the profits, typically 20%, referred to as the GP's "carried interest." With very limited exceptions, a private equity fund is not permitted to reinvest (recycle) the proceeds from the sale of a portfolio investment. So, when the fund has invested (or reserved to cover fund expenses or liabilities) all of its capital commitments, the fund can make no further investments; and the private equity firm must raise a new, successor fund to continue that private equity fund's investment strategy.

Source: Robert J. Shapiro and Nam D. Pham, *The Role of Private Equity in U.S. Capital Markets*, supported by the PEGCC (October 2008), at page 14.

6 Regardless of the type of portfolio investment made, the objective of a private equity fund is the same: increase the value of the portfolio company during the time that it is owned by the private equity fund. Private equity funds accomplish this by, for example: strengthening and adding to the management team; assisting the company in achieving an optimal capital structure; requiring the implementation of management and employee equity stock ownership and/or revised performance based bonus plans; professionalizing financial management of the portfolio company; providing operational assistance; sitting on a revitalized board of directors; working with management to develop and implement a new or revised business plan; and/or causing the company, as appropriate, to make capital and R&D expenditures, to cut corporate waste and inefficiencies, to expand into new markets and develop new products, and/or to make strategic acquisitions to create the scale required to compete more effectively and become market leaders.

5. Private Equity Funds: Strictly Limited Hedging and Trading.

As discussed above, the investment strategies of private equity funds are mostly long-term "buy and hold" strategies, not trading strategies. Private equity funds typically purchase highly illiquid securities. Not surprisingly, therefore, private equity funds typically are prohibited by the terms of their partnership agreements or other governing documents from hedging for speculative purposes, from purchasing commodities or derivatives, and from investing in hedge funds or publicly traded securities (except in connection with a going private transaction).

6. Private Equity Funds: Limited Lending, Limited Borrowing.

Most private equity funds purchase equity securities, although a relatively small number of funds purchase privately-issued mezzanine or other debt of operating businesses. Even these debt funds rarely originate debt or otherwise provide credit. Accordingly, private equity funds (including these debt funds) are not a material source of credit to businesses, and they are not a source of credit at all to consumers or governments.

With the exception of certain real estate funds, private equity funds almost never borrow, and frequently they are prohibited by their partnership agreements or other governing documents from borrowing. To our knowledge none are reliant on short-term credit markets or regularly roll-over debt as part of their operations. Private equity funds rarely borrow because of the particular tax concerns of tax-exempt LPs concerning "unrelated business taxable income."[7]

[7] It is true that some private equity funds, such as buyout funds, purchase companies using equity and borrowed money—but the funds themselves do not borrow or guarantee that debt. In a leveraged buyout transaction, a buyout fund may, for example, incorporate an acquisition vehicle and make an equity investment; the acquisition vehicle then uses the capital that the fund invested, together with cash that it borrows from a bank or other lender, to purchase the target company from the seller of that business, with repayment of the debt being secured by a lien on the assets of that company and by a pledge by the fund of its shares in the portfolio company. There are many variations on this simplified buyout structure, but all leveraged acquisitions have this in common: when the acquisition is complete, the fund owns an equity stake in an operating business that, like almost all operating businesses in this country, has some degree of leverage on its books that the company (not the fund) is obligated to repay from its earnings; and if the business fails, the lenders and other creditors of the company will be repaid before the fund or other equityholders are entitled to any additional return on their equity investments. In any event the lenders have no recourse to the assets of the private equity fund (except for any shares of the failed portfolio company that were pledged by the fund to secure the borrowing), of any other portfolio company, or of the private equity firm.

7. Private Equity Funds: No Redemption, Withdrawal or Unlimited Transfer Rights.

Because of the long-term, illiquid nature of their investments and because they typically do not borrow, private equity funds do not offer (and are not able to offer) redemption rights to their investors. Indeed, a private investment fund is not considered a private equity fund if its investors are permitted to redeem their interests in the fund. Private equity funds typically do not allow their investors to withdraw from the fund, and in any event the fund is not forced to sell assets to effect such withdrawal. For tax and business reasons, private equity funds do not allow LPs to transfer their interests in the fund without the consent of the GP.

8. Private Equity Funds: No Cross-Collateralization, No Cross-Guarantees.

Except perhaps for a pledge by a private equity fund of the shares of a portfolio company that it owns as security for that portfolio company's borrowings, the borrowings or other obligations of that portfolio company are not guaranteed by, or secured by pledges of the assets of, the fund or any other portfolio company. So, the failure of one portfolio company should not impact the fund's other portfolio companies. The fund and its investors may lose their investment in the failed portfolio company, but not in other investments held by the fund.

Similarly, the obligations of a private equity fund are not guaranteed by, or secured by pledges of the assets of, another private equity fund; and no private equity fund advised by a private equity firm guarantees or pledges its assets to secure the obligations of the private equity firm, or vice-versa. So, the failure of one private equity fund advised by a private equity firm should have no impact on the other funds advised by that firm.

If one or more private equity funds advised by a private equity firm fail(s) to generate satisfactory returns for their LPs, it may be difficult if not impossible for the private equity firm to raise new private equity funds. If the private equity firm fails to raise new funds, it will continue to advise its existing funds (which existing funds, in turn, will manage and eventually wind down their portfolios over the terms of those funds), and then the private equity firm will quietly go out of business.

B. The Six-Part Framework Described in the NPR is an Appropriate Framework for Analyzing the Potential for Systemic Risk. Application of this Framework to Private Equity Firms and Private Equity Funds Demonstrates that Such Firms and Funds Do Not Present Systemic Risk Concerns.

In its November 5, 2010 comment letter, the PEGCC discussed the six factors—size, substitutability, interconnectedness, leverage, liquidity risk and existing regulatory scrutiny—that the NPR describes as making up the framework that the FSOC will use to assess the risk that the material distress of a financial institution would adversely impact the financial stability of the United States or threaten the stability of the United States financial system. The PEGCC agrees that the FSOC should analyze these factors and believes that no private equity firms or funds present systemic risk under the proposed framework. We discuss each of the six factors below.

1. **Size: Private equity firms and funds are too small in size to present systemic risk concerns.**

Private equity firms and private equity funds are quite small in size relative to large banks, insurance companies, broker-dealers and advisers to registered investment companies. To put this discussion in context, the 50 largest U.S. bank holding companies had average total assets of nearly $300 billion, and the six largest U.S. bank holding companies had average total assets of over $1.5 trillion, as of December 31, 2010.[8]

The PEGCC believes that, for purposes of analyzing potential systemic risk, the proper metric for measuring the size of a private equity *firm* is risk assets, which is the total amount that a firm would lose in the extraordinarily unlikely (indeed, unprecedented) event that the firm and all of the funds it advises were to fail. The largest private equity firm known to us has risk assets of less than $6 billion.

The PEGCC believes that the proper metric for measuring the size of a private equity *fund* is its assets available for investment, *i.e.* capital commitments. The largest private equity fund known to us has capital commitments of less than $21 billion, and most private equity funds are significantly smaller.

Although private equity firms are also relatively small when measured by assets under management, the PEGCC does not believe that it is appropriate for systemic risk analysis purposes to calculate the size of a private equity firm based on its assets under management. As discussed at paragraph A.8 above, private equity firms and their sponsored funds are not cross-collateralized and portfolio investments are (indirectly) managed, and not owned, by the private equity firm. The risk of loss of a particular portfolio investment made by a particular private equity fund is a risk borne by that fund and its investors, and not by the private equity firm (except to the extent of its investment through the GP of that fund). The private equity firm cannot use the assets of a private equity fund to gain access to liquidity or to settle its debt.

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8 Source: National Information Center's list of Top 50 bank holding companies, available at http://www.ffiec.gov/nicpubweb/nicweb/Top50Form.aspx.

Private equity firms and funds are also quite small when measured by liabilities. As compared to other financial system participants, whose liabilities can be enormous, the liabilities of private equity firms and private equity funds barely register because (as discussed below) they do not have significant counterparty exposure and they typically are not leveraged.

Another way to measure size is by measuring transaction volume. Private equity funds generally invest in illiquid securities, and do not actively trade their portfolios. A typical private equity fund will make between two and eight investments each year (perhaps a few more in the case of venture funds). Therefore, as compared to other financial institutions, some of which place hundreds or thousands of trades every day, the amount of trading activity of a private equity firm or fund is insignificant.

Given the material differences between private equity firms and other nonbank financial companies, the PEGCC believes that the FSOC should not take a "one size fits all" approach to designating nonbank financial companies based on size. Size should be considered together with the other factors discussed herein and no arbitrary thresholds should be established based solely on size, given that the failure of even the largest private equity funds would not have a negative impact on the broader financial system in the absence of interconnectedness and substitutability concerns.

2. Substitutability: Private equity firms and funds do not provide financial products or services that cannot be replaced.

Substitutability concerns exist when a bank or nonbank financial company provides a product, service or infrastructure that is of critical importance to the functioning of the financial system *and* that product, service or infrastructure cannot be replaced if such bank or nonbank financial company fails. Examples of products, services and infrastructure that might be considered to be of critical importance to the financial system include: (*a*) financial products and services that are critical to consumers (such as savings and checking accounts and consumer credit); (*b*) financial products that are legally required to be purchased by consumers (such as medical, motor vehicle and certain other insurance products); and (*c*) infrastructure that is necessary for the functioning of the financial system (such as clearance and settlement activities). If a provider of such vital products, services or infrastructure fails and cannot be quickly replaced by another provider, material systemic risk concerns are raised.

The PEGCC believes that private equity firms and funds over the years have made, and continue to make, important positive contributions to job growth, innovation, economic growth, and productivity by improving the operations of the businesses in which they invest. Private equity firms and private equity funds themselves do not present substitutability concerns, however, because such firms and funds do not provide the kinds of products, services or infrastructure (*a*) that are necessary for the functioning of the financial system *and* (*b*) that could not quickly be replaced by other firms. There is intense competition in the marketplace to raise capital from the sophisticated investors that invest in private equity. If a private equity firm decides to not raise or is unable to raise a new fund, there are large numbers of investment professionals and new and existing investment firms ready and able to step in and compete for that capital and the available investment opportunities. Indeed, a number of private equity firms have ceased operations in the past decade (including some of the largest such firms) with no negative impact on the functioning of the U.S. financial system.

We note that private equity firms and private equity funds are not a source of credit to households, governments or (except to a very limited extent) businesses, nor do they act as a material source of liquidity for the financial system. Therefore the failure of such firms and funds would not deprive the financial system, or consumers of credit, of an important source of credit.

3. **Interconnectedness: Private equity firms and funds are not deeply interconnected with other financial institutions.**

Private equity firms and private equity funds are not deeply interconnected with non-affiliated banks or other nonbank financial companies, because typically: (*a*) they do not hold derivatives positions; (*b*) they do not have counterparty exposure arising from swaps or securities lending activities; (*c*) they do not rely on short-term credit for their operations; (*d*) they do not provide liquidity to financial system participants; (*e*) they do not borrow; and (*f*) they neither rely on prime brokers nor, typically, are they otherwise operationally linked to other financial institutions. Their structures and operations are such that their failure could not have "spillover" or "ripple" effects on other financial system participants.

Indeed, even *within a large private equity business*, where the private equity firm manages multiple private equity funds, the firm and the funds that it manages are not interconnected with each other, because such firms and funds neither pledge their assets as security for, nor do they guarantee, each others' obligations. A private equity firm typically does not go out of business because the failure of a portfolio company or fund causes another portfolio company or fund to fail, but because the poor performance of one or more of the funds advised and managed by the private equity firm makes it impossible for the firm to organize successor funds.

Drilling down even more, even *within a single fund*, the fund's portfolio companies are not interconnected with each other, or with the fund that owns them, because the fund does not pledge the equity of a portfolio company to secure indebtedness or other obligations of another portfolio company, and no portfolio company pledges assets in favor of, or guarantees the indebtedness or obligations of, another portfolio company or the fund.

Because of this lack of interconnectedness, the material financial distress, or even failure, of a private equity fund or a private equity firm would not create cascading negative effects on the broader financial system. Indeed, the PEGCC is not aware of any failure of a private equity firm or fund that has had a negative impact on the broader U.S. financial system.

4. **Leverage: Private equity firms and funds generally are not leveraged and portfolio company leverage does not present more risk than other operating company leverage.**

Private equity *funds* typically are not leveraged. Indeed, (*a*) many fund partnership agreements or other fund governing documents prohibit the private equity fund from borrowing; (*b*) most private equity funds have little or no current income that would enable them to service debt on a current basis even if they were permitted to borrow; and (*c*) investors in private equity funds generally do not expect or want those funds to borrow, either because (*i*) leverage (if it can be serviced by portfolio company cash flow) is incurred at the portfolio company level, or (*ii*) in the case of U.S. tax-exempt investors, borrowing by the fund would likely generate "unrelated business taxable income," which is taxable to those otherwise tax-exempt investors. The private equity business model simply does not rely on the use of fund-level borrowing to magnify returns or for any other purpose. As for private equity *firms*, while they may have revolving lines of credit or other borrowings to fund ordinary business operations, most private equity firms are only modestly leveraged, if at all. Therefore, private equity firms and private equity funds generally are not subject to unsustainable debt or creditor margin calls.

It is true, of course, that even though private equity funds typically do not borrow, many of the *portfolio companies* in which private equity funds invest are leveraged—as are other operating businesses. However, given the absence of cross-collateralization among a private equity fund's portfolio companies, which prevents the failure of one portfolio company from affecting the fund's other portfolio companies, the PEGCC submits that portfolio company leverage is not relevant to an assessment of the potential for systemic risk posed by private equity firms and funds. If a portfolio company faces financial distress and is unable to service its debt, there is no risk (beyond the potential loss of that particular investment) to the private fund that invested in the portfolio company.

Turning to the potential systemic risk that portfolio company leverage might pose to banks and other lenders to portfolio companies, the PEGCC wishes to make six points. First, if a portfolio company is neither a bank nor a nonbank financial company, we believe that the FSOC is not charged with assessing the risk that the material distress of such a company might pose to the U.S. economy or the U.S. financial system. The Dodd-Frank Act, to our knowledge, does not mandate the FSOC to examine the operations of non-financial businesses. The mere fact that a non-financial business is owned (in whole or in part) by a private equity fund rather than a strategic investor or public shareholders should not expand the FSOC's mandate.

Second, if the FSOC nevertheless determines that it is empowered and required to analyze the risk to the U.S. economy and financial system presented by the borrowing practices of non-financial businesses, there is no reason to limit that examination to operating companies owned by private equity firms. If operating company borrowing is risky, it should not make a difference to regulators if the company is owned by a strategic investor or public shareholders or is owned (in whole or in part) by a private equity fund.

Third, if the FSOC determines that it is empowered and required to analyze the risk to the U.S. economy and financial system presented by the amount of leverage at non-financial businesses, the PEGCC submits that a regulatory focus on sound *lending* practices applicable to all such businesses is more likely to uncover systemic risk concerns than a focus on borrowers.

Fourth, if regulators do focus on borrowing by operating companies, the PEGCC submits that there is no evidence that private equity-owned businesses default on debt at a rate greater than other businesses. In fact, there is evidence that the default rate for private equity portfolio companies is lower than the average default rate for all U.S. corporate bond issuers.[9]

Fifth, to the extent that the FSOC believes that leverage at the portfolio companies of private equity funds is relevant to systemic risk analysis, the PEGCC submits that such leverage is modest in comparison to that of large bank holding companies and broker-dealers. The average gross leverage ratio of private equity deals is historically approximately 2.85:1, although some portfolio companies may be

[9] Source: Kaplan, Steven N. and Per Stromberg. 2009. "Leveraged Buyouts and Private Equity," *Journal of Economic Perspectives*, Volume 23, Number 1 (Winter 2009) (Analyzing data on 17,171 worldwide private equity acquisitions announced between 1970 and 2002 and finding that the annualized default rate as of 2007 for private equity portfolio companies was 1.2%, compared to the average default rate of 1.6% reported by Moody's for all U.S. corporate bond issuers); Thomas, Jason, "The Credit Performance of Private Equity-Backed Companies in the 'Great Recession' of 2008–2009," *Entrepreneurship & Finance*, Vol. 5, No. 30 (April 12, 2010), supported by the PEGCC, available at SSR: http://ssrn.com/abstract=1582666 (Analyzing private equity-backed companies acquired in a buyout or similar transaction between 2000 and 2009 and held through 2008-2009 and finding that private equity-backed businesses defaulted at less than one-half of the rate of comparable companies during 2008-2009).

materially more or less leveraged.[10] By comparison, Lehman Brothers was leveraged at approximately 32:1 at the end of February 2008,[11] a gross leverage ratio relatively common among large broker-dealers at that time.[12]

Finally, the PEGCC agrees that if a portfolio company is itself a bank or nonbank financial company, that portfolio company should be analyzed for systemic risk purposes like any other similarly situated company. The mere fact that it is owned (in whole or in part) by a private equity fund should not change that analysis.

The PEGCC is aware that the Securities and Exchange Commission (the "SEC") and the Commodity Futures Trading Commission issued joint proposed rules on January 25, 2011 regarding Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF (the "Proposed Private Fund Reporting Rules"). Although the Proposed Private Fund Reporting Rules concern reporting by private fund advisors, they do suggest two (relatively limited) ways in which private equity transactions could have systemic risk implications. The PEGCC believes that these concerns are misplaced.

First, the Proposed Private Fund Reporting Rules suggest that the bridge financing that is sometimes provided by banks to portfolio companies in connection with their acquisition could have systemic risk implications for the banks that provide such bridge financing:

> Leveraged private equity transactions often rely on banks to provide bridge financing until the permanent debt financing for the transaction is completed, whether through a syndicated bank loan or issuance of high yield bonds by the portfolio company or both. When market conditions suddenly turn, these institutions can be left holding this potentially risky bridge financing (or committed to provide the final bank financing, but no longer able to syndicate or securitize it and thus forced to hold it) at precisely the time when credit market conditions, and therefore the institutions' own general exposure to private equity transactions and other committed financings, have worsened.[13]

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10 Source: Standard & Poor's Q4 2010 Leveraged Buyout Review.

11 Source: Lehman Brothers Holdings Inc., Quarterly Report on Form 10-Q, for the quarterly period ended February 29, 2008, at pages 5-6 (available at http://www.sec.gov/Archives/edgar/data/806085/000110465908023292/a08-10156_110q.htm).

12 Source: Tobias Adrian and Hyun Song Shin, *Liquidity and Leverage*, Journal of Financial Intermediation (2010), at page 433, Figure 16.

13 Source: Proposed Private Fund Reporting Rules, pp. 24–25.

The Proposed Private Fund Reporting Rules mischaracterize bridge financing as risky short-term financing. Bridge commitments, if they are ever drawn upon and not subsequently refinanced, convert to long-term debt—typically with a seven- to ten-year maturity. Bridge financing is relatively expensive compared to public bonds, so borrowers prefer public bonds, but bridge financing does not present inherently greater systemic risk than any other form of financing. The PEGCC strongly believes that the total outstanding amount of bridge financing at any time is highly unlikely to pose a risk to the financial system. But even assuming that a particular bank were to extend excessive bridge financing, designating a private equity firm or fund as systemically significant would have no impact on such bank. If there is systemic risk involved in bank lending, the regulatory focus should be on sound lending practices.

Second, the Proposed Private Fund Reporting Rules suggest that "if private equity funds conduct a leveraged buyout of an entity that could be systemically important, information about that investment could be important in FSOC monitoring and assessing potential systemic risk." As noted above, the PEGCC believes that any systemic risk that would arise from such an acquisition would be due to the nature of the portfolio company, not due to the identity of its owner. There is no evidence that a systemically important bank or nonbank financial company owned by a private equity fund poses a greater risk than a systemically important company owned by another type of shareholder. If the portfolio company itself meets the criteria for designation, it should be designated as presenting systemic risk without so designating the private equity fund that acquires it.

5. **Liquidity risk: Private equity firms and funds generally have long term assets and liabilities.**

Private equity funds invest in highly illiquid assets and rely on long-term, stable financing in the form of capital commitments from their investors. Once a private equity fund draws and invests all if its capital commitments in portfolio companies, it generally may not make additional investments. Private equity funds do not rely on short-term financing that could dry up (indeed, as discussed above, private equity funds typically do not borrow at all). Rather, long-term capital (in the form of capital commitments that are typically locked-up for 10 years) is used to make long-term investments.

Furthermore, private equity funds do not invest in liquid securities that could be dumped rapidly into the markets if the firm needs capital; and in any event their investors generally do not have redemption or withdrawal rights that would enable those investors to force a fire sale of assets were those investors to attempt to make a "run on the bank". Therefore, private equity firms and private equity funds cannot be forced to rapidly unwind their portfolios and dump assets to satisfy investor or other claims.

6. Existing regulatory scrutiny: Private equity firms are and will be subject to significant SEC scrutiny.

Subject to limited exceptions (for small firms, certain non-U.S. firms and venture capital firms), private equity firms are registered, or after July 21, 2011 will be required to be registered, with the SEC as investment advisers and thus subject to SEC regulation, reporting and inspection. Regulators also now have the authority to require all private equity firms and private equity funds to provide any additional data needed to assess systemic risk. Furthermore, interests in private equity funds are and always have been offered to sophisticated investors in private placement transactions subject to the antifraud provisions of U.S. federal and state and non-U.S. securities laws.[14] In addition, most private equity funds are organized as limited partnerships, with a general partner that under state law owes common law and statutory duties to the limited partners (investors).

C. The Proposed Notice, Information Collection and Hearings Process Should Allow Nonbank Financial Companies Adequate Time to Respond to Notices and an Opportunity to Present Oral and Written Arguments to the FSOC.

The designation of a nonbank financial company for enhanced supervision and prudential standards under the Dodd-Frank Act could have a material and adverse effect on such company. Companies that in fact are large and interconnected enough to present systemic risk are likely to be highly complex institutions. The PEGCC believes that companies being considered for determination must be given sufficient time to respond to FSOC notices and must have the opportunity to discuss the systemic risk analysis with regulators as early as practicable in the designation process. The PEGCC believes that the notice, information collection and hearing provisions in the Proposed Rule should be revised as follows:

1. Nonbank financial companies should receive detailed information in initial notices and have the opportunity to meet with FSOC staff.

Under Section 1310.21(a) of the Proposed Rule, the FSOC must provide a nonbank financial company written notice (a "1310.21(a) Notice") if the FSOC is considering whether to designate such company for supervision by the Board of

[14] In addition to being subject to U.S. federal and state and non-U.S. securities laws, private equity firms and funds are subject to significant contractual restrictions and oversight imposed by the sophisticated investors in those funds. Investors in private equity funds typically are large institutional investors and high net worth individuals, usually represented by counsel, who conduct extensive due diligence and heavily negotiate the terms and conditions, reporting, governance and other duties of the private equity fund and the private equity firm (or general partner) that manages and controls the fund.

Governors of the Federal Reserve System and prudential standards ("1310 Designation"). In order to assure that a nonbank financial company is able to adequately respond to a 1310.21(a) Notice, the PEGCC respectfully requests that Section 1310.21(a) be revised to provide that (*a*) the 1310.21(a) Notice shall include a reasonably detailed statement as to why the FSOC is considering a 1310 Designation with respect to such company, (*b*) the 1310.21(a) Notice shall state that representatives of such company shall have an opportunity to meet with senior staff having responsibility for recommending the 1310 Designation to the full FSOC in order to discuss the FSOC's concerns and the basis for such concerns, and (*c*) the FSOC shall provide for such meetings, within 30 days after the 1310.21(a) Notice is provided to such company.

2. **Nonbank financial companies should be allowed sufficient time to prepare written materials for the FSOC.**

Under Section 1310.21(a) of the Proposed Rule, the FSOC must fix a time for a nonbank financial company that has received a 1319.21(a) Notice to submit written materials, which date may not be later than 30 days after the 1310.21(a) Notice is provided. Given the complexity and number of factors that are to be considered by the FSOC under the Proposed Rule and the likely complexity of the company that may be proposed for designation, the PEGCC believes that such company will require significant time and resources to prepare written materials in response to a 1310.21(a) Notice. The PEGCC respectfully requests that Section 1310.21(a) be revised to provide that a nonbank financial company shall have *at least* 60 days to submit written materials.

3. **Written notice of proposed determination should include the data used by the FSOC.**

Under Section 1310.21(b) of the Proposed Rule, if the FSOC makes an initial determination that a nonbank financial company should be subject to a 1310 Designation, the FSOC must provide a written notice of such proposed designation to such company, including an explanation of the basis of the proposed determination (a "1310.21(b) Notice"). In order to ensure that a nonbank financial company is able to respond adequately to a 1310.21(b) Notice, the PEGCC respectfully requests that Section 1301.21(b) be revised to provide that a 1310.21(b) Notice shall include the data used by the FSOC in making the proposed determination (or that such data be made available upon request).

4. **Nonbank financial companies being considered for 1310 Designation should have the right to present oral and written arguments.**

Under Section 1310.21(c) of the Proposed Rule, a nonbank financial company being considered for a 1310 Designation may request an oral or written hearing before the FSOC. The FSOC has sole discretion to allow oral testimony or argument. Given the complexity and number of factors to be considered by the FSOC and the likely complexity of the company being considered for designation, the PEGCC believes that all companies that receive a 1310.21(b) Notice should have the opportunity to meet with the FSOC to submit oral and written testimony and argument and to discuss the appropriateness of a 1310 Designation.

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The PEGCC appreciates the FSOC's consideration of this letter and is available to discuss any questions that the FSOC may have concerning the private equity industry.

Respectfully submitted,

Douglas Lowenstein
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cc: Mr. Alastair Fitzpayne
Deputy Chief of Staff and Executive Secretary
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