Institutional Limited Partners Association
700 12th Street NW Suite 700 Washington, DC 20005

September 6, 2016

The Honorable Maxine Waters
2221 Rayburn House Office Building
Washington, DC 20515

Subject: H.R.5424, the "Investment Advisers Modernization Act of 2016"

Dear Ms. Waters,

On behalf of the membership of the Institutional Limited Partners Association (ILPA), I am writing to express our opposition to H.R.5424, the "Investment Advisers Modernization Act of 2016."

The ILPA is a global organization comprising more than 3,000 investment professionals across more than 370 institutions that represent the Limited Partner interests in private equity funds. The ILPA's membership includes public and private pension funds, insurance companies, foundations, endowments and family offices, collectively representing more than US$1 trillion in private equity assets under management. The ILPA advocates globally in the interest of institutional Limited Partners who aspire to a more aligned, transparent and well-governed private equity industry.

Private equity is a meaningful component to our members' investment portfolios. Over the last 20 years, Limited Partner interests in private equity funds have generated net returns that exceed the S&P 500 by 4.97%.[1] While private equity delivers attractive returns, these are complex, long-term relationships that require careful stewardship. Institutional investors' ability to govern these relationships has been markedly improved by the SEC's oversight of private equity and the additional investor disclosures made possible by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Since the enactment of Dodd-Frank, in its examinations of private equity fund advisers, the SEC has uncovered insufficient fee disclosures and inappropriate allocations of expenses charged to Limited Partners, practices that investors had previously little visibility into. Disclosures are often negotiated within individual governing contracts, i.e., Limited Partnership Agreements or LPAs, which means that investor access to information will vary fund to fund and investor to investor. Additionally, certain issues are only discoverable by virtue of the SEC's visibility into the operations of entire private equity firms that manage multiple funds at once. Where there may be impropriety or insufficient disclosure of fee or expense allocations across multiple funds or multiple groups of investors, knowledge of such practices would fall beyond the purview of any

[1] Source: ILPA Private Markets Benchmark (U.S./Canada Private Equity) in association with Cambridge Associates. Data indicates pooled horizon return, net of fees, expenses and carried interest as of December 31, 2015. Comparison based on Cambridge Associates Modified Public Market Equivalent (mPME), which replicates private investment performance under public market conditions.

Limited Partner's investment in a single fund. Without the SEC's active oversight and attention to such issues, Limited Partners' ability to discern questionable practices would understandably be limited. As the SEC has stated, "even experienced investors can be defrauded if they lack transparency into the various fees, expenses and practices."[2]

The ILPA is not suggesting that the 1940 Investment Advisers Act is perfectly calibrated to private equity funds. In principle, our members are supportive of thoughtful modifications that may better align the law's requirements with private equity's commercial realities, but that do not compromise investor protections or access to information. *However, we believe this bill marks a step in the wrong direction for institutional investors, for their millions of beneficiaries, and for the private equity industry.*

To the extent that H.R.5424 will diminish the flow of information between managers and investors, or weaken the SEC's ability to provide oversight of private equity managers, the ILPA opposes this legislation.

The bill as originally drafted contained several provisions that the ILPA considered detrimental to investors' access to information. Some of those worrying provisions, enumerated below, have been addressed by the amendment proposed by Mr. Foster. While we are encouraged that the concerns of our members and other investors have been heard, we feel it useful to articulate our views here to contextualize our members' views on disclosure more broadly.

- *(Addressed in Rep. Foster's amendment)* **Form ADV 2A** contains a plain English summary of fees, expenses and carried interest as well as investment strategies, risk of loss and other financial information. While much of this information may be provided to Limited Partners through other documents, the content of those documents is not standardized and therefore such disclosures are uneven. Additionally, advisers are required to update Form ADV 2A to reflect any material changes, such as disclosure of an existing fee or expense practice, sometimes in response to an SEC examination finding regarding the quality of such disclosures. Because the Limited Partners Agreement may not obligate the adviser to make such subsequent disclosures to all Limited Partners in a fund, Form ADV 2A is presumed to be a more comprehensive record of information material to all investors. The mandate to require that advisers file ADV 2A should not be removed without careful consideration.
- *(Addressed in part by Rep. Foster's amendment)* Under the custody rule, **proposed exemptions from the annual fund audit and surprise examination requirement for so-called "friends and family" co-investment vehicles,** the funds whose investors are comprised solely of the adviser's employees or affiliates that invest alongside the primary fund vehicle. Without the SEC's ability to review the financial information for such vehicles, investors would face considerable difficulty in ensuring that these side vehicles operate, if not in the best interest of all investors, at least not in conflict with them by shifting broken deal and other expenses onto the primary fund's investors.

[2] Securities Enforcement Forum West 2016 Keynote Address: Private Equity Enforcement, Andrew Ceresney, Director, Division of Enforcement, May 12, 2016. https://www.sec.gov/news/speech/private-equity-enforcement.html

While the revisions proposed by Mr. Foster are welcomed, the ILPA remains concerned with select provisions that remain in the amended version of the bill, specifically:

- **The removal of the requirement to notify investors of transfers** in Section 2 of the bill due to a revised definition of "assignment" that would exclude sales and transfers of minority interest, and the assumption of investor approval of any and all such transfers at the outset of the Partnership. Institutional investors view any transfer of interests, up to a change of control in the Partnership, as significant and potentially impactful, particularly in their consideration of conflicts of interest or of the impact of such transfers on compensation for remaining partners and their incentives to act in the best interests of fund investors. Where possible, investors seek to negotiate the ability to approve such transfers within the Limited Partners Advisory Committees, a subset of Limited Partners tasked with identifying and ruling on conflicts of interest, however not all investors are successful in negotiating such rights. Therefore the removal of the requirement to document and disclose such transfers could strip certain investors of potentially vital information on the operations of the fund's management company.

- **The removal of the overriding requirement that privately issued securities exempted from the custody rule must be held by limited partnerships that are audited** and for which audited financial statements are distributed. At a time when institutional investors are compelled, either due to state-level mandated reporting requirements, revised GASB guidance or their own organizational policies, to seek more comprehensive verification of the value of their portfolio holdings and investment costs via fund-level audits, not less. To the extent that this provision would result in fund audits not covering 100% of a fund's assets, including coinvestment or other special purpose vehicles for single assets, this measure would relax audit requirements that are already deemed to be insufficient, both in the audit's scope and in the amount of information available to investors.

The ILPA believes that the changes to mandatory disclosures and other requirements as proposed in H.R.5424 would be counterproductive to providing institutional Limited Partners with the transparency they need to ensure alignment of interest in their private equity fund investments, and to carry out their duty to protect the interests of millions of beneficiaries of these investments – retirees, policyholders, non-profit and educational institutions.

Thank you for your consideration of our views. The ILPA welcomes inquiries regarding how to enhance the environment for private equity investment while safeguarding the needs of investors.

Kind regards,

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