

United States Senate

WASHINGTON, DC 20510

May 15, 2023

The Honorable Gary Gensler
Chair
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Chair Gensler:

As the Securities and Exchange Commission (SEC or Commission) works to complete the significant rulemaking titled “Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews” (the Private Funds Proposal),¹ we write to underscore the importance of the Proposal and to urge the Commission to finalize the rule as soon as practicable.

The Commission’s recent finalization of “Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers”,² marks an important step in increasing oversight by requiring current reports from large hedge fund and large private equity fund advisers upon the occurrence of certain sharp losses, demands for margin or capital, operational disruptions, and significant withdrawals or redemptions. The new Form PF amendments will alert regulators during episodes of market volatility and disruption, such as the March 2020 COVID-19 turmoil, the January 2021 market volatility in so-called “meme stocks”,³ and last March’s dramatic volatility in the fixed-income markets, each of which caused sizeable losses at hedge funds with wrong-way bets and even led to fund closures.⁴

The Private Funds Proposal would provide additional transparency and come at a critical time given the continued growth in private funds. As of June 30, 2022, private funds managed nearly \$14 trillion in net assets.⁵ In particular, private credit has grown dramatically, reaching over \$1.4 trillion of assets under management globally at the end of 2022, up from about \$631 billion

¹ Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews, Rel. No. IA-5955, 87 FR 16886 (Mar. 24, 2022), <https://www.govinfo.gov/content/pkg/FR-2022-03-24/pdf/2022-03212.pdf>.

² Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers, Rel. No. IA-6297, File No. S7-01-22 (May 3, 2023), <https://www.sec.gov/rules/final/2023/ia-6297.pdf>.

³ Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers, Rel. No. IA-5950, 87 FR 9106, 9107 (Feb. 17, 2022), <https://www.govinfo.gov/content/pkg/FR-2022-02-17/pdf/2022-01976.pdf>.

⁴ Nishant Kumar, Star-Led Hedge Funds Hit by Steep Losses, Stunting Their Comeback, *Bloomberg*, Mar. 24, 2023, <https://www.bloomberg.com/news/articles/2023-03-24/hedge-fund-behemoths-show-boring-is-best-in-march-market-tumult>; Nishant Kumar & Bei Hu, Haidar, Macro Hedge Fund Plunges 32% in Wild Bond Market Moves, *Bloomberg*, Mar. 21, 2023, <https://www.bloomberg.com/news/articles/2023-03-21/haidar-macro-hedge-fund-plunges-32-in-wild-bond-market-moves>; Ortenca Aliaj & Eric Platt, Hedge fund Melvin sustains 53% loss after Reddit onslaught, *Financial Times*, Jan. 31, 2021, <https://www.ft.com/content/fa74a7c6-bcb0-469e-8b76-c5dfc04b9564>; Matthew Goldstein & Kate Kelly, Melvin Capital, hedge fund torpedoed by the GameStop frenzy, is shutting down, *The New York Times*, May 18, 2022, <https://www.nytimes.com/2022/05/18/business/melvin-capital-gamestop-short.html>.

in 2017. Market estimates project private credit to grow to \$2.3 trillion by 2027.⁶ Private credit funds have become direct competitors to banks, but are not subject to the same oversight and supervision. Last year, private debt comprised approximately one-third of the overall financing market for private equity transactions.⁷

In the months since the SEC issued the Private Funds Proposal, we have been troubled by several trends in the private markets. The largest direct loans on record have been under consideration by groups of private fund managers⁸ and one of the biggest private credit investors has just launched a \$1.5 billion fund that will be marketed primarily to high-net worth individuals.⁹ The investor bases for these deals, and of these funds, are increasingly retail investors who deserve the protections under the securities laws contained in the Private Funds Proposal.¹⁰ Troublingly, there is limited data on fund size and fund activities, and almost no data on the fees assessed by those funds. Investors need increased transparency, more informative and useful data, and prohibitions on abusive and conflicted practices. In turn, that will help them hold private fund managers accountable for violations of their fiduciary duties. That will also help limit fraud enabled by the opacity and weak rulebook that characterize our private markets.

In 2022, as public market valuations declined, private fund managers begrudgingly reduced the value of their holdings,¹¹ and those markdowns continued into 2023.¹² Because private fund advisers' fees are calculated based on fund asset valuations, the accuracy and transparency of fund asset valuation practices is crucial to prevent overcharging of investors and to mitigate conflicts for private fund advisers. As a large institutional investor warned in late 2022, "[i]n fact, the more private assets an investor had in its portfolio in FY22, the stronger their performance. This is somewhat counterintuitive and may indicate that private managers have not

⁵ U.S. Sec. & Exch. Comm'n, Div. of Inv. Mgmt., Private Funds Statistics, Second Calendar Quarter 2022, at 5, <https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2022-q2.pdf>.

⁶ Davide Scigliuzzo, Private Credit Muscles Out Banks, With Worrisome Consequences, *Bloomberg Businessweek*, Jan. 13, 2023, <https://www.bloomberg.com/news/articles/2023-01-13/what-is-private-credit-industry-poses-regulatory-risks>; S&P Global, Private Markets: Still Waters Run Deep, Apr. 18, 2023, <https://www.spglobal.com/en/research-insights/featured/special-editorial/look-forward/private-markets-still-waters-run-deep>.

⁷ EY Global Private Equity, Private Equity Pulse: Five takeaways from 4Q 2022, Jan. 24, 2023, https://www.ey.com/en_us/private-equity/pulse.

⁸ Lisa Lee, Oak Hill, KKR in Talks with Vista for Record Private Debt Deal, *Bloomberg*, Apr. 24, 2023, <https://www.bloomberg.com/news/articles/2023-04-24/vista-seeks-record-6-billion-private-credit-deal-for-finastra>; Eric Platt, Private credit edges out banks to offer Carlyle largest direct loan of its kind, *Financial Times*, Mar. 7, 2023, <https://www.ft.com/content/0d65e8d0-5354-40ed-9cb8-8c3fd1b0a31e>.

⁹ Allison McNeely, Ares Launches Private Credit Fund for Wealthy Clients, *Bloomberg*, Apr. 24, 2023, <https://www.bloomberg.com/news/articles/2023-04-24/ares-launches-private-credit-fund-for-high-net-worth-clients>.

¹⁰ Jonathan Kandell, Ares Faces Its Biggest Decision Yet, *Institutional Investor*, Mar. 23, 2023, <https://www.institutionalinvestor.com/article/b8xvz8lz7v60c2/Ares-Faces-Its-Biggest-Decision-Yet-Stick-With-Private-Credit-or-Become-an-Alts-Supermarket>.

¹¹ Dawn Lim, SEC Ramps Up Scrutiny of Private Equity Firms' Writedowns, *Bloomberg*, Sept. 23, 2022, <https://www.bloomberg.com/news/articles/2022-09-23/private-equity-writedowns-spur-mounting-scrutiny-from-the-sec>; Antoine Gara, Harvard predicts looming markdowns to private fund holdings, *Financial Times*, Oct. 13, 2022, <https://www.ft.com/content/e00fd280-3863-4a12-8dc5-017058590ebe>.

¹² Juliet Chung & Eliot Brown, Tiger Global Writes Down Venture Funds' Bets by 33% in 2022, *The Wall Street Journal*, Mar. 16, 2023, <https://www.wsj.com/articles/tiger-global-writes-down-venture-funds-bets-by-33-in-2022-3f9f6ade>.

yet marked their portfolios to reflect general market conditions.”¹³ Because current rules do not provide guidelines for private fund valuation and performance reporting, fund results often lack sufficient detail for investors to fully understand fund valuation practices and the performance of individual investments or to compare returns among private market investments.

The Private Funds Proposal would require registered private fund advisers to obtain an audit of the financial statements for each private fund it manages at least annually and distribute quarterly statements with information regarding fees, expenses, and performance for each fund.¹⁴ We agree with the SEC that together, these requirements would help protect investors from an adviser’s loss, misappropriation or misuse of fund assets and serve as a check on inflated fees paid to the adviser.

Improved performance reporting, particularly for unrealized portions of a fund’s portfolio, and increased disclosure of private fund valuation and accounting details would help investors unpack an adviser’s policies in the absence of readily available market values. Greater transparency and increased attentiveness to valuation practices would have provided critical details in the case of private funds’ investments in FTX, many of which we now understand were made with little analysis or rigor.¹⁵ While the performance reporting provisions in the Private Funds Proposal would not have addressed the widespread fraud at FTX, investors in private funds invested in FTX as its valuation skyrocketed would have had access to detailed, periodic performance results that should have been a starting place to question those values.

Concerns about valuation have affected other types of funds. Beginning in late 2022, several large funds that invest in private real estate, which were sold to retail and institutional investors in private and public offerings, restricted withdrawals in the face of elevated investor demands for return of their funds. Although those restrictions may have been in accordance with the funds’ contractual terms, the withdrawal requests focused attention on those funds’ elevated valuations and positive reported performance results at a time of broad declines among public real estate funds.¹⁶ The experience of those funds again centers attention on the importance of consistent valuation practices. It also argues in favor of increasing the stringency of regulation to keep pace with increased retail investment in private funds.

In addition to increased reporting and transparency, the Private Funds Proposal would also impose important prohibitions on liability waivers by fund advisers for misconduct, inequitable treatment among fund investors, including opaque arrangements that afford preferential treatment to certain investors, and fees for unperformed services. Each of those prohibitions

¹³ Harvard Management Company, Message from the CEO, Oct. 2022, at 13, https://finance.harvard.edu/files/fad/files/fy22_hmc_letter.pdf.

¹⁴ Private Funds Proposal at 16890, 16911.

¹⁵ Hema Parmar & Gillian Tan, FTX Fiasco Hits Investors From Tiger Global to Tom Brady, *Bloomberg*, Nov. 9, 2022, <https://www.bloomberg.com/news/articles/2022-11-09/tom-brady-tiger-global-among-investors-hurt-by-ftx-fiasco>.

¹⁶ Miriam Gottfried, Blackstone Limits Redemptions From Real Estate Vehicle, Stock Sinks, *The Wall Street Journal*, Dec. 1, 2022, <https://www.wsj.com/articles/blackstone-limits-redemptions-from-real-estate-vehicle-stock-sinks-11669920880>; Andrew Bary, Starwood, KKR Retail Real Estate Funds Limit Investor Withdrawals, *Barron’s*, Jan. 19, 2023, <https://www.barrons.com/articles/kkr-reit-starwood-withdrawal-limits-51674142589>.

would address the information imbalance that exists between private fund advisers and investors and prevent advisers from entering into contractual provisions that are detrimental to their investors.

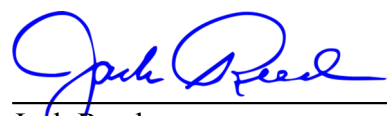
Such prohibitions are important because a fund adviser's position creates the potential for a variety of conflicts. Recent settlements based on violations of existing Investment Advisers Act prohibitions against an adviser engaging in principal trades with its private fund advisory clients without obtaining investors' consent and against an adviser effecting cross trades between private fund clients without disclosure show the importance of being able to enforce strong, well-defined regulations in order to prevent fraud.¹⁷ Additionally, fund managers often exert significant influence on the companies they invest in. We saw this influence in action when private fund managers called on portfolio company executives to move deposits from Silicon Valley Bank, contributing to the bank's failure. That episode, in part, demonstrates why the SEC should take clear and affirmative steps to improve governance in the private funds industry.

Ultimately, the Private Funds Proposal addresses the critical need for greater transparency in private fund investments. The specific circumstances described above serve as examples of the ways in which disclosures relating to private funds can be improved. If investments in private markets are expected to provide outsized returns, additional information to allow for better analysis and comparisons should support the private funds market. More generally, as investment in private funds continues to grow as record sums are allocated to subsectors such as private credit funds, it is becoming increasingly important for the Commission to ensure that investors in these funds receive adequate disclosure. In conclusion, the Commission should finalize the Private Funds Proposal and continue to carry out its important work to promote transparency and protect investors in private funds.

Sincerely,



Sherrod Brown
United States Senator



Jack Reed
United States Senator

¹⁷ Legal & General Investment Management America, Inc., Inv. Advisers Act of 1940 Rel. No. 6188, Inv. Company Act of 1940 Rel No. 34756, Administrative Proceeding File No. 3-21244 (Nov. 21, 2022), <https://www.sec.gov/litigation/admin/2022/ia-6188.pdf>.



Tina Smith
United States Senator



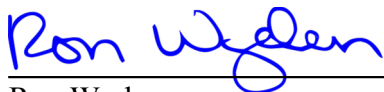
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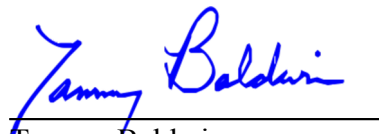
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