No. 23-60471

IN THE
United States Court of Appeals for the Fifth Circuit

NATIONAL ASSOCIATION OF PRIVATE FUND MANAGERS, *et al.*,
Petitioners,
v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

On Petition for Review of an Order of
the Securities and Exchange Commission

BRIEF FOR *AMICI CURIAE* INSTITUTIONAL LIMITED PARTNERS ASSOCIATION, COUNCIL OF INSTITUTIONAL INVESTORS, CHARTERED ALTERNATIVE INVESTMENT ANALYST ASSOCIATION, AND 11 PUBLIC PENSION FUNDS IN SUPPORT OF RESPONDENT

SEAN MAROTTA
HOGAN LOVELLS US LLP
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-4881
sean.marotta@hoganlovells.com

Counsel for Amici Curiae

December 22, 2023

(Additional counsel listed in signature block)

SUPPLEMENTAL CERTIFICATE OF INTERESTED PERSONS

1. Number and style of case: *National Association of Private Fund Managers v. SEC*, No. 23-60471

2. The undersigned counsel of record certifies that, in addition to the persons and entities listed in the briefs filed to date, the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

Amici Curiae

Institutional Limited Partners Association
California State Teachers' Retirement System
Council of Institutional Investors
Chartered Alternative Investment Analyst Association
Public School Teachers' Pension and Retirement Fund of Chicago
District of Columbia Retirement Board
Fire and Police Pension Association of Colorado
Fort Worth Employees' Retirement Fund
Los Angeles City Employees' Retirement System
Los Angeles Fire and Police Pension System
Louisiana Municipal Police Employees' Retirement System
Missouri Department of Transportation and Highway Patrol Employees' Retirement System
State Board of Administration of Florida on behalf of the Florida Retirement System Trust Fund
Washington State Investment Board

Attorneys for Amici Curiae

Sean Marotta
Hogan Lovells US LLP

Jeffrey P. Mahoney
Council of Institutional Investors

Daniel J. Hurtado
Public School Teachers' Pension and Retirement Fund of Chicago

Emily Baver Bowie
District of Columbia Retirement Board

Adam Franklin
Fire and Police Pension Association of Colorado

Maureen M. Hazen
State Board of Administration of Florida on behalf of the Florida Retirement System Trust Fund

Mary Chang
Fort Worth Employees' Retirement Fund

Joshua Geller
Los Angeles City Employees' Retirement System and Los Angeles Fire and Police Pension System

Benjamin A. Huxen II
Louisiana Municipal Police Employees' Retirement System

Greta Bassett-Seymour
Missouri Department of Transportation and Highway Patrol Employees' Retirement System

Callan Barrett
Washington State Investment Board

Steve Hamilton
California State Teachers' Retirement System

/s/ Sean Marotta
Sean Marotta

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INTEREST OF *AMICI CURIAE*

The Institutional Limited Partners Association, Council of Institutional Investors, Chartered Alternative Investment Analyst Association, and 11 public pension funds submit this brief as *amici curiae* in support of the Securities and Exchange Commission.[1]

The **Institutional Limited Partners Association** (ILPA) is the only global membership organization dedicated to advancing the interests of institutional investors into private markets, known as limited partners or LPs, through executive education, standards, best practices and advocacy. Institutional investors are trusted financial stewards who allocate the capital that fuels the private fund ecosystem. They do this to pay pension benefits, support operating budgets of colleges and other educational institutions, further charitable giving, pay insurance claims, and advance their organizations' missions. ILPA's membership comprises over 600 institutions, who collectively represent over $3 trillion allocated to global institutional private markets. ILPA members represent all investor categories of small and large institutions including public pensions, corporate pensions, endowments, foundations, family offices, insurance companies, investment companies, development financial institutions, and sovereign wealth funds.

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[1] The parties have consented to the filing of this brief. No party's counsel authored this brief in whole or in part and no party or person other than *amici curiae* or its counsel contributed money toward the preparation or filing of this brief.

The **Council of Institutional Investors** (CII) is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $5 trillion. CII's members have a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants—true "Main Street" investors through their pension funds. CII is a leading voice for effective corporate governance, strong shareowner rights, and sensible financial regulations that foster fair, vibrant capital markets.

The **Chartered Alternative Investment Analyst Association** (CAIA) seeks to serve investors by educating industry stakeholders on the most current knowledge and best practices across the ever-changing landscape of alternative investments. Through credentialing of investment professionals, advocating with regulators and senior leaders, and developing world class thought leadership, CAIA aims to raise the standards of the industry.

The **California State Teachers' Retirement System**, **Public School Teachers' Pension and Retirement Fund of Chicago**, **District of Columbia Retirement Board**, **Fire and Police Pension Association of Colorado**, **Fort Worth Employees' Retirement Fund**, **Los Angeles City Employees'**

Retirement System, **Los Angeles Fire and Police Pension System**, **Louisiana Municipal Police Employees Retirement System**, **Missouri Department of Transportation and Highway Employees' Retirement System**, **State Board of Administration on behalf of the Florida Retirement System Trust Fund**, and **Washington State Investment Board** are public pension funds. Committed to meeting their financial obligations to their members and retirees—police officers, fire fighters, paramedics, teachers, and other civil servants—these funds invest in private funds to diversify their portfolios, enhance long term returns, and strengthen their ability to meet long term obligations to retirees and active workers.

Together, *amici curiae* are some of the largest—and smallest—institutional players in the private fund space. *Amici* do not necessarily agree with every aspect of the Private Fund Adviser Rules, but they write to emphasize the structural issues they face, the tangible investor-protection benefits provided by the Private Fund Adviser Rules, and to confirm that this private fund rulemaking lies precisely within the SEC's three-pronged statutory mandate that includes investor protection, the maintenance of fair and efficient markets, and facilitation of capital formation. Minimum standards of disclosure are necessary for investors to make informed capital allocation decisions and to perform ongoing monitoring of their investments in private funds, which are typically long-term and illiquid. The Private Fund Adviser Rules' requirement that advisers provide transparency around conflicts of interest and fees charged to investors is wholly aligned with principles of informed choice and does not limit freedom of contract as Petitioners contend.

ARGUMENT

I. THE PRIVATE FUND ADVISER RULES HAVE IMPLICATIONS FOR REAL PEOPLE AND SEEK TO MITIGATE THE CONFLICTS OF INTEREST THAT CAN ARISE FROM THE SYSTEMIC IMBALANCE BETWEEN ADVISERS AND INVESTORS.

A. The Private Fund Adviser Rules Protect Real People.

Many LPs are institutions, including some of the largest pension plans in the United States, with a mandate to serve real people who rely on the returns generated through private fund investments. Indeed, these returns can make the difference between institutions meeting—or not meeting—their financial obligations to their beneficiaries. The Private Fund Adviser Rules seek to address the systemic imbalance between advisers and investors, allowing institutions to better carry out their missions and ultimately benefit their members—teachers, police officers, fire fighters, students, judges, and others.

1. The private fund sector can seem like a morass of technical financial jargon. So we start with some industry background. “Private funds” refers to entities created to pool money from investors but are exempt from registration and regulation under the Investment Company Act. Alternative Investment

Management Association Ltd., *SEC Registration*, *available at* https://tinyurl.com/373wpe3x (last visited Dec. 21, 2023).

Most relevant here are two categories of private funds: private equity and hedge funds. Private equity funds tend to invest in controlling stakes of illiquid, private investments, like in growing private companies, private companies seeking to eventually go public, or public companies that the fund views as undervalued or that the company's management team decides would be better off privately held. Bloomberg Law, Practical Guidance, *Private Funds, Overview — Hedge Funds & Other Investment Funds*, *available at* https://tinyurl.com/txe5ks24 (last visited Dec. 21, 2023). Because private equity funds are invested in illiquid assets, investments are generally tied up for a set period of years—typically 10 years or longer—or until a triggering event occurs, such as a public market listing or a sale to a strategic buyer. Hedge funds, meanwhile, tend to invest in liquid assets and allow redemption by investors at regular intervals. *Id.* Private funds are a big part of the investment economy, with over $25 trillion in assets under management at the end of 2022, eclipsing the U.S. commercial banking sector. Paul Kiernan, *Private Equity, Hedge Funds Brace for Coming SEC Overhaul*, Wall St. J. (Aug. 2, 2023), *available at* https://tinyurl.com/4spc64pt.

Private funds entail a tripartite relationship between the fund, the general partner, and the limited partners. The "fund" is the legal entity—usually a limited partnership—that formally receives capital from investors, invests the capital, and returns any gains to the investors, less fees and expenses. *See* Hamilton Lane, *Alternative Investment Dictionary* 5 (Oct. 23, 2023), *available at* https://tinyurl.com/35snwaat. The "general partner" is an adviser—usually a firm—that solicits capital from investors, selects investments for the fund to make, and typically both invests in and manages the fund. *See* Bloomberg Law, Practical Guidance, *Private Funds, Overview — General Partner*, *available at* https://tinyurl.com/3n6n3vwj (last visited Dec. 21, 2023). The fund is a blind pool formed to seek investor capital and is controlled by the adviser, so it is not an independent party to fund formation negotiations. "Limited partners" are the investors who contribute the capital used to make the fund's investments but do not participate in fund management. *See Alternative Investment Dictionary*, *supra*, at 7.

The partners' and the fund's legal obligations are governed by a "limited partnership agreement," or LPA, that "sets out the general terms and conditions applicable to all participants in a . . . fund." Claudia Zeisberger, Michael Prahl, & Bowen White, *Mastering Private Equity — Transformation via Venture Capital, Minority Investments & Buyouts* 208 (2017). The LPA "establishes the rights and responsibilities of a fund's [adviser] and [investors] related to fundraising, capital calls and distributions, expenses and profit sharing, fund governance and reporting, and fund termination." *Id.*

Frequently, investors will seek to negotiate "side letters" to the LPA to add or expand upon contractual protections not offered directly in the LPA. William W. Clayton, *High-End Bargaining Problems*, 75 Vanderbilt L. Rev. 703, 722 (2022). Common side letter terms include an investor's right to be excused from participating in certain kinds of investments, generally due to regulatory or other internal constraints; enhanced reporting and information rights; and redemption rights. Dechert LLP, *Private Fund Side Letters: Common Terms, Themes and Practical Considerations* (Oct. 28, 2018), *available at* https://tinyurl.com/4yscnxc4.

2. Institutional investors that invest in private funds do so to enhance long term investment returns for their beneficiaries. They are public and private pension plans, universities, endowments, foundations and other charitable organizations. ILPA, Private Equity Glossary, *Institutional Investor*, *available at* http://tinyurl.com/3rm2tmxu (last visited Dec. 21, 2023). Insurance companies, too, frequently invest in private funds. National Association of Insurance Commissioners, Center for Insurance Policy & Research, *Private Equity* (June 28, 2023), https://content.naic.org/cipr-topics/private-equity.

Institutional investors are increasingly investing in private markets to meet their portfolio-return goals. *See* Letter from Steve Nelson, CEO, ILPA, to Vanessa A. Countryman, Secretary, U.S. Sec. & Exch. Comm'n (Apr. 25, 2022), *available at* http://tinyurl.com/3pynwd23. One ILPA survey, for instance, found that 60% of respondents did not think their organizations could meet their performance requirements without investing in private equity. ILPA, *The Future of Private Equity Regulation: Insight into the Limited Partner Experience & the SEC's Proposed Private Fund Advisers Rule* 5 (2023), *available at* https://tinyurl.com/yuwefjnw.

Institutional investors allocate capital to private funds for rational reasons. For one, institutional investors are expected to earn a positive return to preserve and enhance the institution's ability to meet the financial needs of individual beneficiaries in bull and bear markets alike. A pension fund, for instance, must pay retirees both when the economy is booming and when it is in recession. Insurance companies must cover loss claims regardless of public market conditions. Private funds have unique potential for uncorrelated returns—returns unconnected from broader market trends—that make them an indispensable part of many institutional investors' portfolios. *See* Laura Matthews, *Investors Seek Uncorrelated Assets On Worries Volatility Will Return*, Reuters, Feb. 10, 2023, *available at* https://tinyurl.com/ytxbtj57 (noting how private funds allow investors to diversify in ways that traditional 60/40 stock-bond portfolios do not). For another, with the number of public companies halved since a 1996 peak, institutional investors need to allocate capital to private funds to obtain a portfolio that is diversified across the full spectrum of the U.S. economy. *See* Nicole Goodkind, *America Has Lost Half Of Its Public Companies Since the 1990s. Here's Why*, CNN, (June 9, 2023), *available at* https://tinyurl.com/bdduncka; *see also* Center for Research in Security Prices, *CRSP Count, Q2 2023 Update* (2023), *available at* https://tinyurl.com/yc5752zv. For many institutional investors, this diversification is required because they are fiduciaries with an obligation to "diversif[y] plan investments in order to minimize the risk of loss." Seyfarth Shaw LLP, *Fiduciary Governance & Institutional Investing* (2023), *available at* http://tinyurl.com/4xvz323u.

3. Contrary to Petitioners' claims, institutional investors are not exclusively "the world's wealthiest, most sophisticated, and experienced investors." Pet. Br. 1; *see also* Pet. Br. 5 (calling institutional investors "some of the world's most sophisticated investors"); *id.* at 7 (referring to "sophisticated investors"); *id.* at 10 (same); *id.* at 22 (referring to "highly sophisticated investors"); *id.* at 36 (back to "sophisticated investors"); *id.* at 47 (same); *id.* at 62 (now referring to "sophisticated counterparties"); *id.* at 72 (referring to "the world's most sophisticated investors"). Sovereign wealth funds, large public pension funds, and

large university endowments are institutional investors in private funds, but so are children's hospitals with modest endowments and small private and municipal pension funds. Institutional investors both large and small—including many state and local governmental entities—simply do not have the resources to match those of the advisers with which they invest. Due to structural challenges in private markets and the resulting bargaining inefficiencies discussed below, *infra* pp. 15-21, even the largest and most "sophisticated" investors often spend significant resources to attain alignment of interests around key governance and disclosure terms in the contracts that govern the relationship between the fund, the adviser, and the investors. Advisers hold outsized control of information and influence over the fund formation process. As a result, despite their sophistication and best efforts, investors often face headwinds in negotiating for common, but critical governance terms, including consents and disclosures. *See The Future of Private Equity Regulation*, *supra*, at 8.

Petitioners are therefore wrong when they intimate that this litigation is merely about wealthy institutional investors looking to claim a bigger share of the investment pie. The institutional investors allocating capital to private funds do so in furtherance of their missions and consistent with their obligations to satisfy the contractual or fiduciary obligations they have to their beneficiaries, be they retirees, policy holders, or charitable organizations. Moreover, Petitioners' focus on institutional investors' sophistication is a deliberate attempt to deflect from the fundamental issue. The Private Fund Adviser Rules seek to rectify the structural imbalance of power between advisers and investors. The Private Fund Adviser Rules, at their core, are about protecting those benefiting by institutions' investments in private funds—and doing so in accordance with the SEC's statutory mandate. Everyday people are ultimately harmed when the institutions investing for their benefit are indirectly exposed to risk as a result of the imbalance of power between advisers and institutional investors and the information asymmetry around conflicts that can result.

B. The Private Fund Adviser Rules Seek to Mitigate Against Adviser Conflicts Of Interests Borne Of The Structural Inequalities In The Adviser-Institutional Investor Relationship.

The Private Fund Adviser Rules address a significant structural imbalance between advisers and institutional investors, large and small. Due to information asymmetry in both the fund negotiation process and the decision-making control contractually granted to advisers over the life of the fund, minimum disclosures are essential to mitigating conflicts of interest. The fee structure prevalent among private funds compounds this problem. Adviser income drawn from fixed management fees—which are indirectly charged to investors in the form of lower returns—have grown in absolute terms as fund sizes have dramatically increased, resulting in advisers' greater reliance on management fees instead of performance-based compensation, creating the potential for incentive misalignments.

Investors have reported that advisers also increasingly attempt to withhold or obfuscate basic information on fees and costs charged to investors and even attempt to erode their fiduciary duties. *The Future of Private Equity Regulation*, *supra*, at 15. The adviser controls the negotiating process and whether comments from individual investors are ultimately reflected in the LPA. From a structural standpoint, the adviser and their external counsel write the initial LPA, which serves as the contractual starting point before negotiations even begin and is increasingly slanted towards the adviser's favor—97% of institutional investors surveyed in an ILPA survey observed the *starting point* of LPA terms have moved in the favor of the adviser and 87% of institutional investors reported the *final* LPA terms have shifted in the favor of the adviser. *The Future of Private Equity Regulation*, *supra*, at 9. Investors must therefore decide how to allocate their finite negotiating leverage to obtain the necessary level of financial transparency and fiduciary obligations, terms that should be inherent in any fund.

The Private Fund Adviser Rules make these obligations default expectations, allowing parties to orient negotiations to the commercial terms that should be the subject of case-by-case considerations. This reorientation towards the issues that are truly specific to the investment strategy, economic model, and governance of the fund represents a more fair and efficient fund formation process, which is achievable only if a higher minimum standard of information rights and investor protections are extended to all investors.

1. Advisers are generally paid a fixed management fee and variable performance-based compensation related to the fund's investment performance. Reuters, *Hedge Funds Move Away From Unpopular 'Two and 20' Fee Model* (July 11, 2019), *available at* http://tinyurl.com/2ru2yane; Barry Steinman, *Private Equity Fund Fees*, Duane Morris LLP (Aug. 2014), *available at* https://tinyurl.com/msvtduen. This model gives advisers an incentive to focus on earning additional compensation by increasing the amount of assets under management and by tacking on new, and additional, fees rather than pursuing superior market returns. Stephen Fraidin & Meredith Foster, *The Evolution of Private Equity & the Change in General Partner Compensation Terms in the 1980s*, 24 Fordham J. Corp. & Fin. L. 321, 354 (2019). That, in turn, harms institutional investors because "more than half of the fees are non-performance related," meaning that "incremental performance under existing fee structures may not materially contribute to GPs' compensation and hence may not provide sufficient incentive for GPs to perform." Wayne Lim, *Accessing Private Markets: What Does It Cost?* 19 (June 15, 2023), *available at* http://tinyurl.com/3j67xedj.

These misaligned incentives are particularly troublesome in private fund investments because the usual mechanisms of resolving them—transparency and fiduciary duties—do not function consistently across private funds. Additionally, the fact that investments are typically tied up for 10 years or longer with limited ability to exit the investment (without investors typically taking a loss) make investor protection even more important. Unlike traditional corporations, private funds do not have a board of directors with the power to control the adviser. Doris Toyou, *Protection of Private Equity Investors Under the Dodd-Frank Act*, 37 J. L. & Comm. 115, 127 (2019). Moreover, Delaware limited partnerships—which most private funds are—do not have any mandatory fiduciary duties imposed by statute other than an implied covenant of good faith and fair dealing in the contractual relationship. *Id.*; *see also* 6 Del. Code § 17-1101(d) (stating that "[t]o the extent that, at law or in equity, a partner or other person has duties (including fiduciary duties) to a limited partnership or to another partner . . . the partner's or other person's duties may be expanded or restricted or eliminated by provisions in the partnership agreement," but "the partnership agreement may not eliminate the implied contractual covenant of good faith and fair dealing").

In the absence of a statutorily mandated fiduciary duty at the state level for most private funds, advisers therefore routinely attempt to excuse themselves from fiduciary duties in their LPAs. *See* Letter from Steve Nelson, CEO, ILPA, to Brent

Fields, Secretary, U.S. Sec. & Exch. Comm'n, at 3 (Nov. 21, 2018), https://tinyurl.com/ye25er88. One ILPA poll found that 69% of institutional investors had been faced with reduced fiduciary duties in the LPAs they were required to sign to invest, and 54% of institutional investors reported an increased frequency of reduced fiduciary duties in LPAs. *Id.*

2. Without independent control or binding fiduciary duties as a check against potentially unfair adviser practices, institutional investors must try to take on a monitoring role themselves. Petitioners contend that a "market-oriented, contract-based approach has worked remarkably well," and that the "competitive" environment for private funds will resolve institutional investors' concerns. Pet. Br. 1. If investors want more protections, Petitioners seem to argue, they should negotiate for them. But investors are hampered by structural aspects of the fund formation process that makes it difficult for even the most sophisticated institutional investors to secure the appropriate level of disclosures to police advisers' conflicts of interests.

Institutional investors, for instance, can attempt to negotiate additional transparency and reimpose fiduciary duties in the LPA. This negotiation takes place against default terms that have increasingly shifted in advisers' favor—especially with respect to fiduciary duties. *The Future of Private Equity Regulation*, *supra*, at 4. Starting terms in LPAs also tend to be exceedingly and increasingly opaque as to the fees that advisers will charge portfolio companies, "permit[ting] [advisers] to charge them in a general sense but otherwise provid[ing] little specific about the timing and nature of these fees." William W. Clayton, *The Private Equity Negotiation Myth*, 37 Yale J. on Reg. 67, 80 (2020). Default terms in LPAs also fail to "require that [advisers] provide sufficiently robust information disclosures" and "giv[e] investors only 'barebones' information about the fund . . . conditions that benefit [advisers] and keep investors in the dark." *Id.*

Dynamics in the LPA negotiation process make it difficult for institutional investors to revise these terms in their favor. Advisers use a limited pool of external counsel, who tend to use standard LPA templates in negotiating with institutional investors, regardless of the adviser they represent. *The Future of Private Equity Regulation*, *supra*, at 4. These concentrated adviser counsel aggressively attempt to move LPA templates in favor of advisers, "pick[ing] a few terms each year and insisting that they are [the] market," insisting on those terms in most of the LPAs they negotiate. Will Louch, *Kirkland & Ellis: Is It Party Over For the World's Most Profitable Law Firm?*, Financial Times (Dec. 11, 2023), *available at* http://tinyurl.com/4upkupc8 (second brackets in original). Institutional investors have seen these adviser-favorable terms reflected in their LPAs. *The Future of Private Equity Regulation*, *supra*, at 9.

The historical success that adviser counsel have had in moving fund terms in favor of advisers is the result of market concentration, informational asymmetries, and misaligned incentives, not market forces. Major adviser counsel can compile significant amounts of data about the LPAs they negotiate, giving them superior knowledge of "market" terms. *Kirkland & Ellis*, *supra*. Institutional investors, by contrast, are bound by clauses to not publicly disclose LPAs and to not share with other investors in a fund—other than certain investors with most favored nation clauses—their side letters with the adviser. *High-End Bargaining Problems*, *supra*, at 738, 751. These limitations make it more difficult for investors to know the "market" terms for private funds, *id.* at 738, and investor attempts to band together to get better terms or share information is often met with charges of "collusion" from adviser counsel, *Kirkland & Ellis*, *supra*. ILPA tries to fill the gap with surveys, "but these self-reported surveys can only provide investors with limited confidence and limited detail about where market terms actually stand." *High-End Bargaining Problems*, *supra*, at 739. Without information on actual terms negotiated in other funds, the adviser's counsel leverages the information asymmetry to dictate what is "market." Further, secrecy around standard LPA and side letter clauses "hampers the diffusion of contracting innovations and improvements across the market-wide network of investors," making negotiations less effective. *High-End Bargaining Problems*, *supra*, at 739.

Negotiating LPAs and side letters is "extremely labor intensive and costly," compounding these concerns. *Id.* at 753. Even worse, investors effectively pay for both their own and the adviser's counsel, up to a negotiated maximum that the adviser is permitted to pass along as part of the fund's formation expenses. *Id.* at 737. These capped fund formation expenses have grown significantly, rising 123% between 2011 and 2020. *Future of Private Equity Regulation*, *supra*, at 18. Advisers "are likely to be relatively insensitive to the legal costs that are incurred during the bargaining process because they are not paying their attorneys' legal bills" up to an agreed cap, while "investors . . . are paying two sets of legal fees for every hour that they negotiate the fund contract, making them even *more* sensitive to legal costs." *High-End Bargaining Problems, supra*, at 738. There are therefore misaligned incentives between investors and adviser's counsel to negotiate efficiently, which can result in certain investors being "less likely to raise issues than they otherwise would be" if negotiations have gone multiple rounds with limited progress. *Id.*

When investors are successful in negotiating improved outcomes, it is typically only through their individual side letters, meaning the improved terms only benefits the particular investor and not all investors in the fund. Although investors prefer to have these negotiated terms placed in the LPA itself, those efforts are met with strong resistance from adviser counsel because of the impact any changes to the LPA will have on the adviser's counsel's "brand." Elisabeth de Fontenay & Yaron Nili, *Side Letter Governance*, 100 Wash. U. L. Rev. 907, 916 (2023).

For example, only 8% of institutional investors observed that advisers would commit in the LPA to provide the ILPA Reporting Template. *Future of Private Equity Regulation*, *supra*, at 17. Similarly, only 19% of investors were able to consistently secure enhancements to fiduciary duty in the LPA compared to 37% that needed to resort to securing a more limited set of enhancements through their side letter. *Id.* at 20. Each investor having to negotiate individually to achieve outcomes that improve upon the slanted starting point of LPA terms in an environment with structurally misaligned incentives is inefficient approach and will benefit greatly from the higher minimum standards in the Private Fund Adviser Rules.

During negotiations, institutional investors focus their efforts on "must haves"—generally fee-and-expense transparency and restoring fiduciary duties. *Future of Private Equity Regulation*, *supra*, at 11-15. Although there may be many private funds, only a few may meet an institutional investor's particular portfolio needs at a given time. *Id.* at 13. Additionally, there is a broad spread between top- and bottom-performing advisers, and not all advisers can absorb the size of investments being made by the largest institutional investors. *Id.* Pushing too hard for changes can get an institutional investor potentially cut off from future funds formed by the adviser; 84% of institutional investors ILPA surveyed accepted suboptimal terms in at least some funds out of fear of losing access to an adviser's funds or receiving smaller allocations in future funds. *Id.* at 11.

For private equity investments in particular, an institutional investor will see its capital tied up for 10-plus years; getting comfortable with being in business with an adviser for a decade or more "can take years of relationship-building from the . . . investment team" and requires the "investment team [to] carr[y] out deep evaluations across the operational and investment capabilities of the" adviser. *Id.* at 13. An institutional investor cannot simply drop one adviser if it does not like the LPA or side letter terms and pick up another without wasting potentially months or even years of relationship building and due diligence efforts. *Id.* at 13-14. Even if an investor was willing to walk away, consolidation in adviser counsel means that the investor will likely face substantially similar terms in the next LPA with a different adviser. *Id.* at 14. It is therefore no surprise that 71% of institutional investors that ILPA surveyed disagreed that they have "substantial flexibility to switch" advisers "if they are dissatisfied with the terms being offered by a particular" adviser, *id.* at 12, and 65% of respondents disagreed that they have been able "to use their expertise and negotiating leverage to achieve favorable changes in common contractual terms." *Future of Private Equity Regulation*, *supra*, at 8.

All of this means that investors must judiciously direct what bargaining leverage they do have, for example choosing between whether to press for fee disclosures or fiduciary duties potentially at the expense of other fund governance issues that are important to investors. Those include strong "key person" and "no-fault" removal clauses, which, respectively, allow investors to prevent new investments if key executives depart or cannot devote sufficient time to the fund and allow investors to replace the adviser or terminate the partnership after the final closing date. *See id.*; *see also* ILPA, Private Equity Glossary, *Key Person Clause*, *available at* http://tinyurl.com/bdhuktj4 (last visited Dec. 21, 2023); *id.* at *No-Fault Divorce*, *available at* http://tinyurl.com/yunkkypj (last visited Dec. 21, 2023). For many institutional investors, this choice of what to negotiate for is no choice at all. For example, pensions operating under federal and state statutorily mandated fiduciary duty requirements must often negotiate for the restoration of fiduciary duties from advisers in their side letter in order to be lawfully able to invest in the fund at all.

3. Even with institutional investors focusing their efforts on must-have terms like financial and fee disclosures, they may still lack the information necessary to enforce LPAs' restrictions on adviser conduct. Despite LPA terms

meant to limit the allocation of fees and expenses to funds—and passed along to investors—the SEC has regularly settled enforcement actions against advisers that the Commission has concluded overcharged funds or failed to disclose conflicts to investors.[2]

The Private Fund Adviser Rules address these structural issues and protect institutional investors by taking basic financial transparency and fiduciary issues off the table as subjects for negotiation. The Private Fund Adviser Rules require advisers to provide investors with quarterly statements about private funds' fees, expenses, and performance. *Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews*, 88 Fed. Reg. 63,206, 63,211 (Sept. 14, 2023). The statements must include "all compensation, fees, and other amounts allocated or paid to the investment adviser or any of its related persons by the private fund during the reporting period" and "all fees and expenses allocated or

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[2] *See*, *e.g.*, U.S. Sec. & Exch. Comm'n, *SEC Charges Private Equity Fund Adviser for Overcharging Fees and Failing to Disclosure Fee Calculation Conflict*, Release No. 2023-112 (June 20, 2023), *available at* http://tinyurl.com/2dbfej54(adviser charged excess management fees and failed to disclose a conflict of interest to investors relating to its fee calculations); U.S. Sec. & Exch. Comm'n, *SEC Charges Private Equity Adviser for Failing to Disclose Disproportionate Expense Allocations to Fund*, Release No. 2022-107 (June 14, 2022), *available at* http://tinyurl.com/ye3xukfs (adviser allocated undisclosed, disproportionate expenses to fund); U.S. Sec. & Exch. Comm'n, *SEC Charges KKR With Misallocating Broken Deal Expenses*, Release No. 2015-131 (June 29, 2015), *available at* http://tinyurl.com/bddre7se (adviser misallocated over $17 million in broken-deal expenses to funds); *see also* SEC Br. 36-38 (discussing enforcement actions).

paid by the private fund during the reporting period," with separate line items for "organizational, accounting, legal, administration, audit, tax, due diligence, and travel fees and expenses." *Id.* at 63,388. The quarterly statement must additionally include particular performance information, which differs for liquid and illiquid funds. *Id.* As the Commission explained, the quarterly statement will allow investors to identify potential adviser conflicts of interest and to understand how fees impact their return on investment. *Id.* at 63,211. The standardized statement will also allow investors to understand how fund performance is calculated and compare performance across funds. *Id.*

The Private Fund Adviser Rules also address investors' concerns about advisers attempting to contract away their fiduciary duties. The Commission in adopting the Private Fund Adviser Rules declined to forbid advisers from seeking reimbursement, indemnification, exculpation, or limitation of its liability to the fund or investors for the adviser's breach of its fiduciary duties. *Id.* at 63,276. That is because, as the SEC explained in adopting the Private Fund Adviser Rules, an adviser seeking reimbursement, indemnification, exculpation, or limitation of its liability to the fund or investors for the adviser's breach of its *federal* fiduciary duties are effectively waivers of those duties, which the Investment Advisers Act already forbids. *Id.*

The Private Fund Adviser Rules make fund formation more fair and efficient because advisers and institutional investors will not need to spend time—or drive up legal fees—by haggling over terms that are basic common sense investor protections. Stripping out that inefficiency in the process benefits markets, institutional investors, and ultimately the ordinary people on whose behalf institutional investors deploy capital.

II. THE PRIVATE FUND ADVISER RULES PROVIDE INVESTORS WITH THE INFORMATION THEY NEED TO MAKE INFORMED INVESTMENT DECISIONS, A CORE PURPOSE OF THE SECURITIES LAWS.

Petitioners paint the Private Fund Adviser Rules as a radical expansion of the Commission's authority over private funds, running roughshod over Congressional intent. Not so. The Commission explains how the Private Fund Adviser Rules fit squarely within the anti-fraud and other provisions of the Dodd Frank Act. SEC Br. 16-33. More broadly, the Private Fund Adviser Rules further the federal securities laws' interest in making sure that investors make informed decisions about where to allocate their capital, furthering the Commission's mission of maintaining fair and efficient markets, protecting investors, and facilitating capital formation.

1. The broad congressional purpose of the securities laws is to "protect investors." *A. C. Frost & Co. v. Coeur D'Alene Mines Corp.*, 312 U.S. 38, 40 (1941); *Smallwood v. Pearl Brewing Co.*, 489 F.2d 579, 592 (5th Cir. 1974). By

prohibiting fraud and mandating disclosure, securities regulations seek "to insure honest securities markets and thereby promote investor confidence." *United States v. O'Hagan,* 521 U.S. 642, 658 (1997); *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953) (securities laws protect investors by "promoting full disclosure of information thought necessary to inform investment decisions"). As this Court has explained, "[t]he federal securities laws were enacted primarily to serve two distinct goals: 1) to promote or require sufficient disclosure of information to allow those in securities markets to make intelligent investment decisions, and 2) to control fraud and manipulation in the trading of securities." *SEC v. Southwest Coal & Energy Co.*, 624 F.2d 1312, 1318 (5th Cir. 1980).

That same basic principle runs throughout the securities laws. For example, the Securities Act of 1933 was enacted "to provide investors with full disclosure of material information concerning public offerings of securities in commerce, to protect investors against fraud and, through the imposition of specified civil liabilities, to promote ethical standards of honesty and fair dealing." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 195 (1976). The Securities Exchange Act of 1934 similarly sought "to achieve a high standard of business ethics in the securities industry" by "substitut[ing] a philosophy of full disclosure for the philosophy of *caveat emptor*." *Affiliated Ute Citizens of Utah v. United States,* 406 U.S. 128, 151 (1972) (citation omitted).

2. To be sure, private funds do not have the same disclosure requirements as publicly traded companies. But the Supreme Court's decision in *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963), emphasizes the importance of disclosure and fiduciary duty in the investment adviser context.

In *Capital Gains Research Bureau*, the Supreme Court held that the Investment Advisers Act of 1940 imposes on investment advisers "an affirmative duty of utmost good faith, and full and fair disclosure of all material facts." *Id.* at 194 (citation and internal quotation marks omitted). The Court explained that those duties are consistent with the Advisers Act's legislative purpose of "substitut[ing] a philosophy of full disclosure for the philosophy of *caveat emptor* and . . . achiev[ing] a high standard of business ethics in the securities industry." *Id.* at 186. The Act thus reflects "a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which [is] not disinterested." *Id*. at 191-192. The Act is designed to "protect[ ] investors through the prophylaxis of disclosure" by eliminating "the darkness and ignorance of commercial secrecy"—"conditions upon which predatory practices best thrive." *Id*. at 200.

The nature of the relationship between investors and investment advisers makes the investment adviser context especially ripe for a disclosure requirement. The Court emphasized, for example, the "trust and confidence" that clients place with advisers and the status of the client vis-à-vis an adviser. *Id.* at 190 (citing Hearings on S. 3580 before S. Comm. of the Sen. Comm. on Banking and Currency, 76th Cong., 3d Sess.) (leading investment advisers emphasized their relationship of "trust and confidence" with their clients). It also relied on "Committee Reports [that] indicate[d] a desire to preserve 'the personalized character of the services of investment advisers,' and to eliminate conflicts of interest between the investment adviser and the clients." *Id.* at 191. SEC reports likewise reflected "the attitude—shared by investment advisers and the Commission—that investment advisers could not 'completely perform their basic function—furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments—unless all conflicts of interest between the investment counsel and the client were removed.' " *Id.* at 187 (quoting *Investment Trusts and Investment Companies, Report of the Securities and Exchange Commission, Pursuant to Section 30 of the Public Utility Holding Company Act of 1935, on Investment Counsel, Investment Management, Investment Supervisory, and Investment Advisory Services*, H.R. Doc. No. 477, 76th Cong., 2d Sess., 28).

In the Court's view, investment advisers' status as fiduciaries obligates them to disclose all material facts to their clients and, as such, an adviser's clients should be given the opportunity "to evaluate such overlapping motivations, through appropriate disclosure, in deciding whether an adviser is serving 'two masters' or only one, 'especially . . . if one of the masters happens to be economic self-interest.' " *Id.* at 196 (quoting *United States v. Mississippi Valley Generating Co.*, 364 U.S. 520, 549 (1961)).

3. The Private Fund Adviser Rules are in line with these principles. The Private Fund Adviser Rules focus primarily on disclosures rather than substantive prohibitions, particularly with respect to the all-important fee and performance disclosures. *See supra* pp. 22-23. The Private Fund Adviser Rules explain that the Commission adopted the quarterly statement requirement "because we see [a] lack of transparency in many areas, including investment advisers' disclosure regarding private fund fees, expenses, and performance." 88 Fed. Reg. at 63,211. In particular, "some private fund investors do not have sufficient information regarding private fund fees and expenses because those fees and expenses have varied labels across private funds and are subject to complicated calculation methodologies." *Id.* Likewise, standardized performance reporting will "improve investors' ability to interpret complex performance reporting and assess the relationship between the fees paid in connection with an investment and the return on that investment as they monitor their investment and consider future investments." *Id.* Throughout, the focus is on informed choice, not limiting freedom of contract.

In fact, the Commission in the Private Fund Adviser Rules ultimately rejected its initial proposal to outright prohibit certain activities—such as charging or allocating to the fund fees or expenses associated with a government investigation of the adviser—so long as the adviser instead provides appropriate disclosures and, in some instances, obtains investor consent. *See id.* at 63,212. That shift is fully in line with the Commission's—and, more importantly, Congress's—longstanding view that the SEC "is not a merit regulator." Elad L. Roisman, Commissioner, U.S. Sec. & Exch. Comm'n., *Statement on Proposed Changes to Asset Managers' Proxy Voting Disclosures* (Sept. 29, 2021), *available at* http://tinyurl.com/4pphm8bf. The Commission, instead, has a "limited role as a disclosure regulator." Hester M. Peirce, Commissioner, U.S. Sec. & Exch. Comm'n., *Paper, Plastic, Peer-to-Peer* (Mar. 15, 2021), *available at* http://tinyurl.com/5f2r2cs3. That the Commission has applied its longstanding disclosure-and-consent approach to private funds, using the regulatory power that Congress gave it over the industry in Dodd Frank, is no reason to view the Private Fund Adviser Rules any differently from the many disclosure-based regulations courts have upheld in the past.

CONCLUSION

For the foregoing reasons, and those in the SEC's brief, the petition for review should be denied.

Respectfully submitted,

/s/ Sean Marotta
SEAN MAROTTA
HOGAN LOVELLS US LLP
555 Thirteenth Street, N.W.
Washington, D.C. 20004
(202) 637-4881
sean.marotta@hoganlovells.com

Counsel for Amici Curiae

JEFFREY P. MAHONEY
COUNCIL OF INSTITUTIONAL INVESTORS
1717 Pennsylvania Avenue, N.W.
Suite 350
Washington, D.C. 20006

Counsel for Council of Institutional Investors

DANIEL J. HURTADO
PUBLIC SCHOOL TEACHERS' PENSION AND RETIREMENT FUND OF CHICAGO
425 South Financial Street
Suite 1400
Chicago, IL 60605

Counsel for Public School Teachers' Pension and Retirement Fund of Chicago

ADAM FRANKLIN
FIRE AND POLICE PENSION ASSOCIATION OF COLORADO
7979 East Tufts Avenue, Suite 900
Denver, CO 80237

Counsel for Fire and Police Pension Association of Colorado

EMILY BRAVER BOWIE
DISTRICT OF COLUMBIA RETIREMENT BOARD
900 7th Street, N.W.
Washington, D.C. 20001

Counsel for District of Columbia Retirement Board

Maureen M. Hazen
STATE BOARD OF ADMINISTRATION OF FLORIDA ON BEHALF OF THE FLORIDA RETIREMENT SYSTEM TRUST FUND
1801 Hermitage Boulevard, Suite 100
Tallahassee, FL 32308

Counsel for State Board of Administration of Florida on behalf of the Florida Retirement System Trust Fund

MARY CHANG
FORT WORTH EMPLOYEES'
RETIREMENT FUND
3801 Hulen Street, Suite 101
Fort Worth, TX 76107

Counsel for Fort Worth Employees' Retirement Fund

JOSHUA GELLER
LOS ANGELES CITY EMPLOYEES'
RETIREMENT SYSTEM
977 North Broadway Avenue
Los Angeles, CA 90012

Counsel for Los Angeles City Employees' Retirement System and Los Angeles Fire and Police Pension System

CALLAN BARRETT
Assistant Attorney General
WASHINGTON STATE INVESTMENT
BOARD
2100 Evergreen Park Drive, S.W.
Olympia, WA 98502

Counsel for Washington State Investment Board

BENJAMIN A. HUXEN II
LOUISIANA MUNICIPAL POLICE
EMPLOYEES' RETIREMENT SYSTEM
7722 Office Park Boulevard, Suite 200
Baton Rouge, LA 70809

Counsel for Louisiana Municipal Employees' Retirement System

GRETA BASSETT-SEYMOUR
MISSOURI DEPARTMENT OF
TRANSPORTATION AND HIGHWAY
PATROL EMPLOYEES' RETIREMENT
SYSTEM
1913 William Street
Jefferson City, MO 65109

Counsel for Missouri Department of Transportation and Highway Patrol Employees' Retirement System

STEVE HAMILTON
CALIFORNIA STATE TEACHERS'
RETIREMENT SYSTEM
100 Waterfront Place
West Sacramento, CA 95605

Counsel for California State Teachers' Retirement System

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CERTIFICATE OF SERVICE

I hereby certify that the foregoing was filed with the Clerk using the appellate CM/ECF system on December 22, 2023. All counsel of record are registered CM/ECF users, and service will be accomplished by the CM/ECF system.

/s/ Sean Marotta
Sean Marotta

CERTIFICATE OF COMPLIANCE

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/s/ Sean Marotta
Sean Marotta