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Private Equity and Capital Markets Policy

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SUMMARY

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Eva Su
Analyst in Financial Economics

Private Equity and Capital Markets Policy

Private equity (PE) is a type of *private* fund, meaning a fund that generally pools money from institutional and individual investors that meet certain criteria indicating they are more sophisticated and able to invest in companies that are often not publicly traded. PE investors could include pension funds, other private funds, foreign institutions, high-net-worth individuals, insurance companies, and nonprofits.

The term *private equity* can be used to describe a variety of funds. For example, some observers use the term to describe all types of private funds. Others discuss PE as one type of fund within the broader categorization of private funds that also include hedge funds, venture capital, liquidity funds, and family offices. This report uses the terminology set forth by the asset management industry's primary regulator, the Securities and Exchange Commission (SEC), which separates PE from other private fund types. Under this definition, PEs typically take a controlling interest in an operating business, also known as a *portfolio company*, and engage in financial and operational activities with the hope of increasing the company's value. PEs are known for active ownership, longer investment time horizons, and financial leverage through the use of debt, but other PE investment and operational styles also exist.

The PE industry grew in size in recent years, including during the COVID-19 pandemic. According to the SEC, between 2016 and 2021 (first quarter), the total number of PE funds increased by more than half to nearly 16,000. The aggregate gross fund assets more than doubled to almost $5 trillion during that period.

Many research papers suggest that PE plays a role in enhancing competition, enabling capital formation, assisting distressed company resolution, and transforming financially underperforming companies. The PE industry has also increased in importance because of the significant growth of the private securities and private funds markets.

Some observers have raised financial stability concerns in light of the industry's growth in size, importance, and complexity. The PE industry also faces additional policy debates regarding its performance records, operational practices, and industry-specific issues, including the compatibility of PE's profit maximization practices with certain public-service-oriented industries. Many aspects of PE's operating and financing model, which focuses on value creation for investors, attract policymakers' attention. Below are some examples:

- **Capital restructuring.** PE sometimes restructures portfolio companies' debt and equity to manage the total cost of capital, draw down capital not yet invested, or negotiate with lenders to gain more flexibility for loans. Some observers view the process as a way to extract wealth from portfolio companies while transferring the risk from equity investors to debt investors. Other observers view excessive leverage (e.g., debt borrowing) as a financial stability concern because it could reduce the portfolio companies' ability to absorb risks during adverse market conditions.
- **Operational changes.** PE sometimes increases productivity through cutting jobs, selling non-core assets, or making adjustments to the portfolio companies' business strategies. Some observers view cost savings through job cuts as a way to enrich the investors while bringing harm to affected individuals and communities.
- **Incentive allocation.** PE provides equity and other incentives for portfolio company managers and investment advisers managing the funds. Some observers view certain investment fund manager incentives and fees as potentially excessive, non-transparent, and rife with conflict of interest concerns.
- **Exit strategy.** PE seeks to find the opportunistic timing to sell the portfolio companies through mergers and acquisitions, initial public offerings, or secondary offerings to other PE firms, or they may seek a partial exit through dividend recapitalization, among other methods. Some observers are concerned about certain exit strategies, such as dividend recapitalization, which allows portfolio companies to borrow more debt to pay dividends to equity investors.

The SEC has proposed reforms to bring increased transparency and risk oversight to this capital market segment. Many observers predict that these agency actions would transform the PE regulatory philosophy and practice.

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This report examines the private equity (PE) industry's terminology, size, performance, and operational and regulatory structures. It also discusses selected policy issues relating to PE business practices and industry-specific debates. Following the general discussion of policy issues, the report presents three real-world examples to demonstrate policy observations in the context of actual events. In the first quarter of 2022, the industry's primary regulator, the Securities and Exchange Commission (SEC), proposed multiple PE reform initiatives. The report concludes with a discussion of two SEC proposed rules and their policy implications.

Terminology

PE funds are pooled investment vehicles that gather money from investors and invest in companies that are often not publicly traded. PEs typically take a controlling interest in an operating business, also known as a *portfolio company*, and engage in financial and operational activities with the hope of increasing the company's value.[1] PEs are known for active ownership, longer investment time horizons, and financial leverage, but other PE investment and operational styles also exist.[2]

The term *private equity* in this report refers to a type of *private* fund that pools money only from *accredited investors* and *qualified clients* (e.g., institutional and individual investors that meet certain criteria indicating their relatively high net worth or professional knowledge) and invests the money on behalf of the fund.[3] PE investors could include pension funds, other private funds, high-net-worth individuals, foreign institutions, nonprofits, and insurance companies (**Figure 2**). Private funds stand in contrast to *public* funds, such as mutual funds, in which the general public can invest.[4]

Some observers use the term *private equity* to describe all types of private funds.[5] Others discuss PE as a categorization of private funds that also includes hedge funds, venture capital, liquidity funds, and family offices. In general discussions, these private fund types are sometimes not mutually exclusive. This report uses the terminology set forth by the asset management industry's primary regulator, the SEC, which separates PE from other private fund types.[6]

[1] SEC, *Private Equity Funds*, https://www.investor.gov/introduction-investing/investing-basics/investment-products/private-investment-funds/private-equity.

[2] *Financial leverage* generally refers to the use of debt to buy more assets or fund existing operations. Other forms of leverage measures also exist. For more information, see Adam Hayes, "Leverage," *Investopedia*, March 19, 2021, https://www.investopedia.com/terms/l/leverage.asp.

[3] For more on accredited investors, see CRS In Focus IF11278, *Accredited Investor Definition and Private Securities Markets*, by Eva Su. *Qualified client* means a person or a company that has at least $1 million under the management with an investment adviser or has a net worth of more than $2.1 million. For more details, see 17 C.F.R. §275.205-3(d)(1) and SEC, *Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205-3 under the Investment Advisers Act of 1940*, https://www.sec.gov/rules/other/2016/ia-4421.pdf.

[4] For more discussion on public and private funds, see CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su.

[5] For example, some experts define *private equity* as an alternative asset class that includes all assets beyond the three primary asset classes—stocks, bonds, and cash. For more details, see Benoit Leleux, Hans van Swaay, and Esmeralda Megally, *Private Equity 4.0: Reinventing Value Creation* (The Wiley Finance Series, 2015).

[6] SEC, Form PF – Reporting Form for Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors, https://www.sec.gov/files/formpf.pdf.

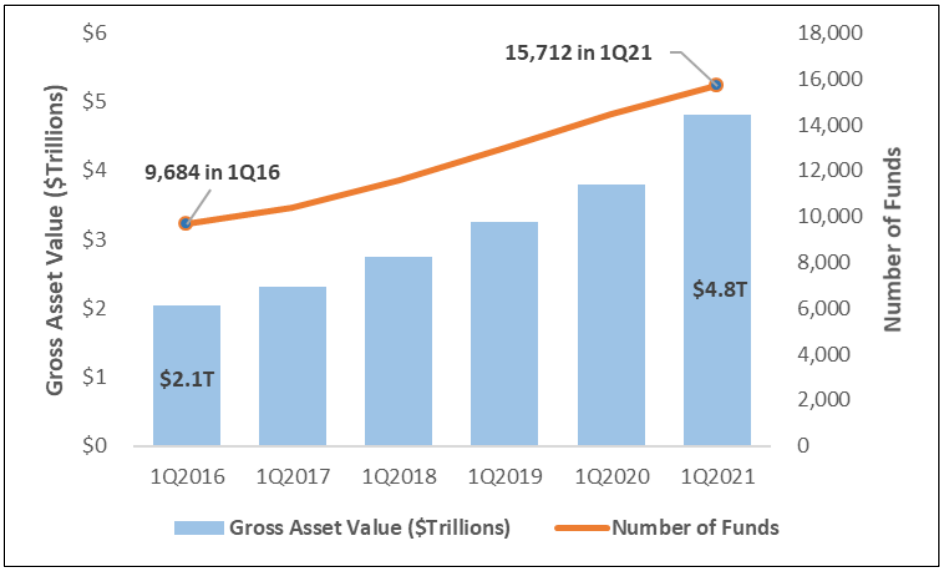
Industry Size, Investors, and Performance

Size

The PE industry grew in size in recent years, including during the COVID-19 pandemic. According to the SEC, between the first quarter of 2016 and the first quarter of 2021, the total number of PE funds increased by more than half to reach almost 16,000, and the aggregate gross fund assets more than doubled to reach $4.8 trillion (**Figure 1**).[7]

Figure 1. Private Equity Growth Trend

Gross Asset Value and Number of Funds



Source: CRS based on data from SEC private funds statistics, https://www.sec.gov/divisions/investment/private-funds-statistics.shtml.

Investor Composition

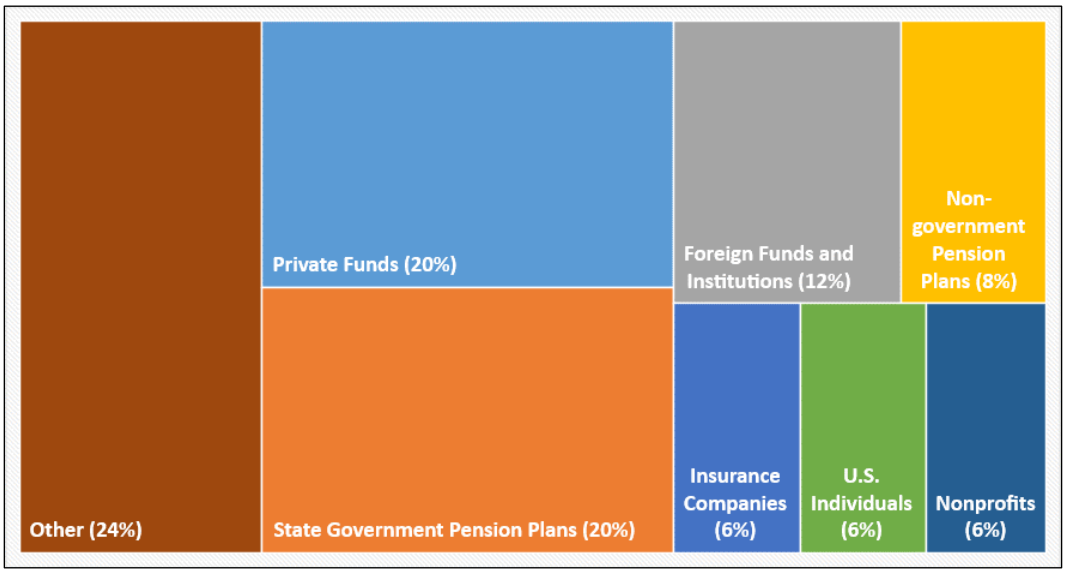
The largest PE investor types are pension plans, other private funds, foreign institutional investors, insurance companies, U.S. individuals, and nonprofit organizations. These investors, in aggregate, held around 76% of the PE industry total assets as of first quarter 2021, according to the SEC's private funds statistics (**Figure 2**).[8]

[7] SEC, Division of Investment Management, *Private Funds Statistics*, https://www.sec.gov/divisions/investment/private-funds-statistics.shtml.

[8] SEC, Division of Investment Management Analytics Office, *Private Funds Statistics First Calendar Quarter 2021*, November 1, 2021, https://www.sec.gov/divisions/investment/private-funds-statistics/private-funds-statistics-2021-q1-accessible.pdf.

Figure 2. Private Equity Investor Composition

Beneficial Ownership for Private Equity Funds as a Percentage of Aggregate Net Asset Value



Source: CRS based on data from SEC private funds statistics, https://www.sec.gov/divisions/investment/private-funds-statistics.shtml.

Note: As reported on Form PF for first quarter 2021.

Investment Returns

Because PE information availability and disclosure requirements are not the same as for public funds, measuring its investment return involves challenges, and how well PEs perform relative to public funds is an area of debate. Certain academic research suggests that PEs have not outperformed public equity since at least 2006,[9] while other studies suggest that PE funds significantly outperformed public equity.[10] Divergent findings in different studies may be related to their use of different (1) definitions for PE, (2) PE performance data sources, (3) public equity benchmarks, and (4) measurement time periods.[11]

According to a calculation by an investment management firm published in June 2021 and using data from an academic study, since the mid-1990s, PE investment returns have ranged between approximately 1.3 times and 2.0 times the invested capital (i.e., multiples of invested capital over the life of the PE investments from the initial investments in portfolio assets to the final exit) and 5% to 25% in internal rate of return (**Figure 3**).[12] As a point of reference, the S&P 500 index (an

[9] Ludovic Phalippou, *An Inconvenient Fact: Private Equity Returns and the Billionaire Factory*, June 20, 2020, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3623820.

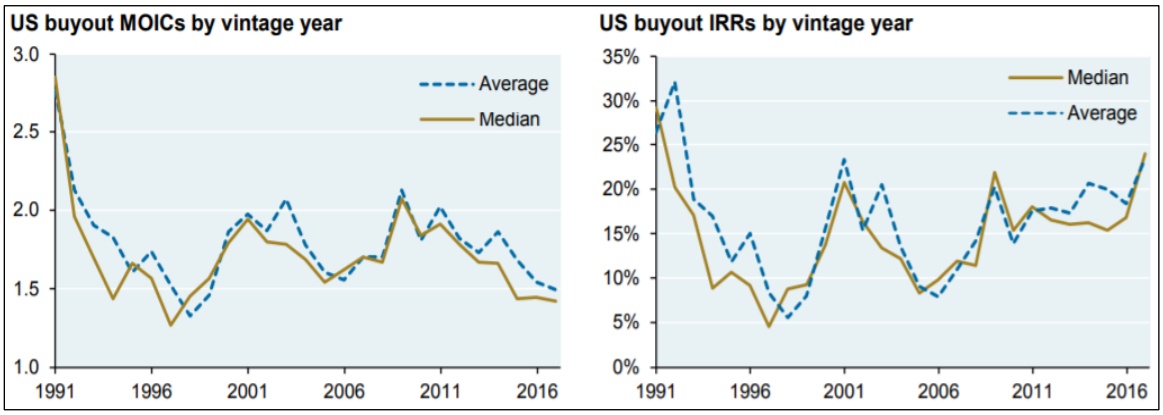
[10] Robert S. Harris, Tim Jenkinson, and Steven Kaplan, *Private Equity Performance: What Do We Know?*, February 2021, https://www.nber.org/system/files/working_papers/w17874/w17874.pdf.

[11] For examples of key arguments and rebuttals, see Michael Cembalest, *Food Fight: An Update on Private Equity Performance vs Public Equity Markets*, June 28, 2021, https://privatebank.jpmorgan.com/content/dam/jpm-wm-aem/global/pb/en/insights/eye-on-the-market/private-equity-food-fight.pdf.

[12] Cembalest, *Food Fight*.

index including 500 large U.S. publicly traded companies) has an annualized average return of around 11% between its inception in 1957 and 2021.[13]

Figure 3. U.S. Private Equity Buyout Performance



Sources: J. P. Morgan Asset Management, Steve Kaplan (Chicago Booth), and Burgiss.

Notes: MOIC = multiples of invested capital; IRR = internal rate of return. MOIC measures cash in versus cash out, while IRR is a time-weighted measure of return.

Risk Measures

PE's volatility of returns relative to public equity have also been subject to debate. Some data show that the PE index has lower volatility than do public equity benchmarks. Other observers argue that that measurement is the result of PE portfolio companies typically being valued quarterly instead of daily like public equity markets. In addition, they believe certain valuation measures could have "smoothed" the pricing, because companies that are not publicly traded lack trading-based pricing, and the valuations are largely dependent on external appraisals.[14] As such, some believe that if PE firms valued their portfolio companies more frequently using different valuation methods, their volatility could be higher.

PE investors often expect higher returns to compensate for the funds' inherent risk. For example, PE funds could invest in high-risk assets with limited information disclosure, including small private companies and distressed companies that face high possibilities of default. PE fund investors also face higher liquidity risk than public equity holders do and thus expect a liquidity premium. *Liquidity* refers to how easy it is to buy and sell securities without affecting the price. Public funds (e.g., mutual funds and exchange-traded funds) are considered liquid for investors because of their daily redemption or exchange trading features, whereas PE funds are considered illiquid because their holding periods could be as long as five to 10 years.[15] Thus, PE investors may not be able to sell their investments when sudden cash needs arise.

[13] S&P Dow Jones Indices, *S&P 500*, https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview; and J. B. Maverick, "What Is the Average Annual Return for the S&P 500?," *Investopedia*, January 13, 2022, https://www.investopedia.com/ask/answers/042415/what-average-annual-return-sp-500.asp#.

[14] Nicolas Rabener, "Private Equity: The Emperor Has No Clothes," *CFA Institute*, December 3, 2018, https://blogs.cfainstitute.org/investor/2018/12/03/private-equity-the-emperor-has-no-clothes.

[15] There are also publicly traded PE funds. Such funds could gain liquidity by trading on national securities exchanges after going through an additional public securities offerings regulatory compliance process.

Regulatory Framework

Because PE funds are private, as previously noted, they are exempt from certain laws and regulations that generally govern public funds. For example, PE funds are exempt from the Investment Company Act of 1940 (P.L. 76-768) and are not required to register with the SEC and provide related public disclosure and other compliance at the fund level.[16] Much of the regulation of PE applies to PE advisers. Section 202(a)(11) of the Investment Advisers Act of 1940 (IAA; P.L. 76-768) defines *adviser* as any person or firm that, for compensation, is engaged in providing advice to others or issuing reports or analyses regarding securities. PE fund managers, for example, would usually qualify as advisers.

PE fund advisers could be subject to SEC or state registration and oversight if they have more than $150 million in assets under management. The IAA provisions and related agency rules specify many PE adviser obligations.[17]

Reporting Requirements

PE advisers use Form ADV to register with the SEC and state securities authorities. Form ADV disclosures are publicly available and include information about the adviser's business, ownership, employees, affiliations, fees, potential conflicts of interest, and past disciplinary events, among other information.[18] A PE adviser may also be required to submit Form PF with information about the fund's beneficial ownership, size, leverage, industry concentration, and other matters, though this information is not subject to public disclosure.[19]

Other Operational Compliance

SEC-registered PE investment advisers face other compliance requirements, including, for example (1) fiduciary requirements that obligate advisers to act in the best interests of their clients, (2) a code of ethics that governs insider trading, (3) requirements to seek best price and execution for their clients' securities transactions, (4) potential SEC examinations, (5) custody of client assets, and (6) requirements governing how advisers can advertise their services or pay others to solicit new clients.[20]

Operating and Financing Structure

PE firms are typically managed through partnerships that consist of two types of partners. The *general partners* are responsible for the operations of the fund, including raising capital and setting up the fund. The *limited partners* are capital investors who are not involved with the daily operations. While general partners typically have unlimited personal liability of the partnership's

[16] See Sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940.

[17] Staff of the SEC's Division of Investment Management and Office of Compliance Inspections and Examinations, *Information for Newly-Registered Investment Advisers*, November 23, 2010, https://www.sec.gov/divisions/investment/advoverview.htm.

[18] SEC, Form ADV, https://www.investor.gov/introduction-investing/investing-basics/glossary/form-adv.

[19] SEC, Form PF, https://www.sec.gov/files/formpf.pdf.

[20] SEC, Division of Investment Management, Staff of the Investment Adviser Regulation Office, *Regulation of Investment Advisers by the U.S. Securities and Exchange Commission*, March 2013, https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

debts, limited partners' liabilities are limited to the money they put in. One PE firm may create multiple PE funds, and the general partners could hire professional fund managers to manage the investments.[21]

Private Equity versus Other Funds

PE investments differ from other public and private funds through their types of investments, levels of operational control, and restricted investor access.[22] PE funds typically place long-term investments in *mature* companies, whereas venture capital invests in early stage companies. PE funds often maintain some level of operational control over the portfolio companies, which is not the general practice at public funds such as mutual funds and exchange-traded funds.

Leveraged Buyout

PE investments normally focus on obtaining a controlling stake in private companies, purchasing business units from public or private companies, or taking entire public companies private. To finance such transactions, the PE firms often reconfigure their portfolio companies' capital structure to expand on the debt offerings and use the proceeds from new debt to reduce the amount of money the PE firms themselves would have to put in. This use of debt, or "leverage," for asset purchases is referred to as a leveraged buyout (LBO). Because LBOs are a common practice for PE, some industry observers use the terms *PE fund* and *LBO fund* interchangeably.[23]

Dividend Recapitalization

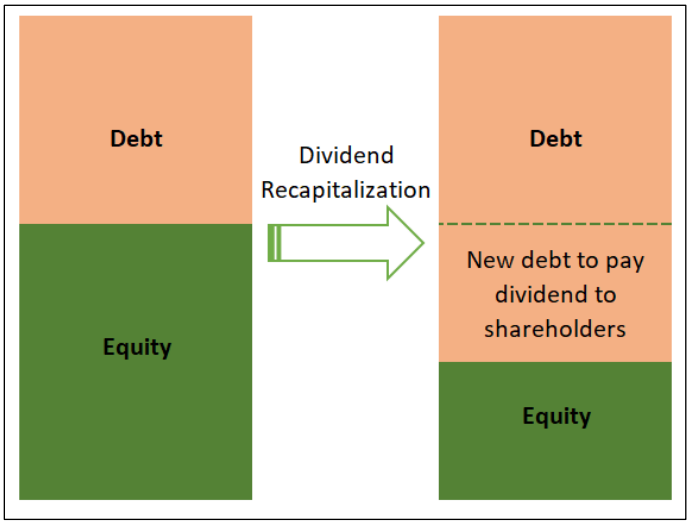
Dividend recapitalization refers to the issuance of new debt to pay shareholders (e.g., PE equity investors). PE firms could deploy dividend recapitalization as a strategy to reconfigure their portfolio companies' financing structure and debt and equity composition. As **Figure 4** illustrates, this practice increases the debt for portfolio companies but transfers the cash proceeds to equity investors.

[21] Sean Gill, *CFA Institute Investment Foundations, Third Edition, Chapter 12 Alternative Investments*, https://www.cfainstitute.org/-/media/documents/support/programs/investment-foundations/12-alternative-investments.ashx.

[22] SEC, *Private Equity Funds*, https://www.investor.gov/introduction-investing/investing-basics/investment-products/private-investment-funds/private-equity.

[23] Steven Kaplan and Per Strömberg, *Leveraged Buyouts and Private Equity*, July 2008, https://www.nber.org/system/files/working_papers/w14207/w14207.pdf.

Figure 4. Dividend Recapitalization



Source: CRS.

Value Creation Process

PE funds' active involvement in the operations of portfolio companies they acquire and their financing methods are undertaken with the goal of making their investors' stakes in those companies more valuable. This section explains PE value creation from mathematical calculation and attribution analysis perspectives. The "Calculation Methods" section provides simplified ways to conceptualize value drivers. The "Attribution Analysis" section provides examples of specific actions that lead to higher valuations.

Calculation Methods

PE's financial value creation is generally measured by the difference in a portfolio company's valuation between the entry and exit points of the PE investments and adjusted for changes in net debt.[24] Among many different securities valuation methods that could calculate a company's worth, the industry typically applies *multiples analysis* (in conjunction with other methods) that estimates company values using the company's earnings before interest, taxes, depreciation, and amortization (EBITDA), which represents a firm's financial performance and earnings capacity.

In a simplified analysis, the investors would calculate a "multiple" using the transaction history of comparable companies, including how much these companies were sold at how many times their EBITDA.[25] The estimated company value would equal EBITDA times the multiple.

[24] Net debt is total debt minus cash and cash equivalents. For simplicity, this section selectively explains factors with more policy relevance, thus not discussing all factors in depth.

[25] For more on multiples analysis, see Corporate Finance Institute, *Multiples Analysis*, https://corporatefinanceinstitute.com/resources/knowledge/valuation/multiples-analysis; and CFA Institute, *Market-Based Valuation: Price and Enterprise Value Multiples*, https://www.cfainstitute.org/en/membership/professional-development/refresher-readings/market-based-valuation-price-enterprise-value-multiples.

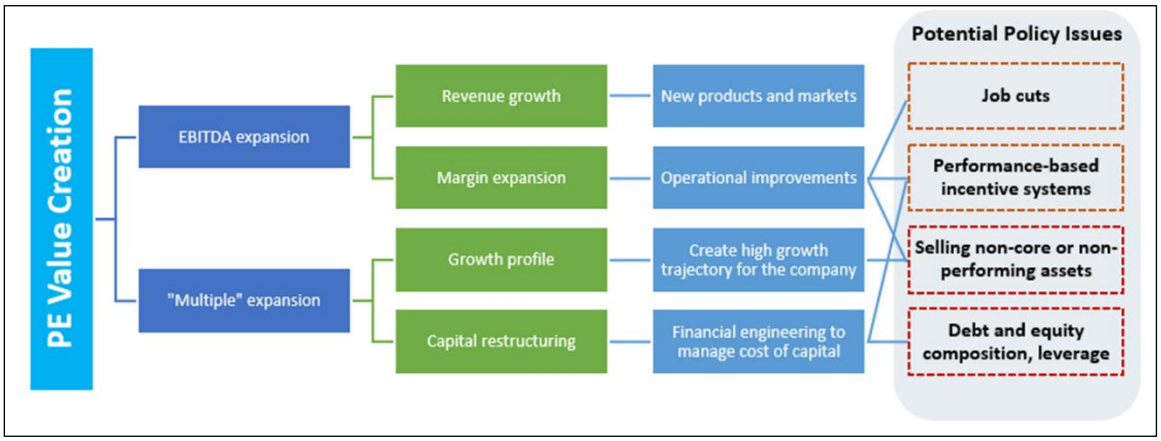
Portfolio company value = EBITDA x Multiple (M)

For example, if a company's EBITDA is $12 million, at a 10 times multiple (which should be comparable to similar companies' previous sales prices and valuations), $120 million is the portfolio company's estimated worth.[26] This formula shows that increasing EBITDA or the "multiple" would increase company valuation.

Attribution Analysis

Attribution analysis is an evaluation tool that identifies and explains drivers of a fund's performance. **Figure 5** illustrates the ways PE could expand EBITDA and multiples. PE's standard methods for expanding EBITDA include assisting portfolio companies to generate revenue growth or profit margin expansion. Improving a company's operations through cost savings and operational efficiencies, for example, could realize profit margin expansion. Offering new products and distributing products to new geographic locations, for example, could boost sales and realize revenue growth.

Figure 5. Examples of PE Value Creation Attribution and Policy Issues



Source: CRS.

Notes: PE = private equity; EBITDA = earnings before interest, taxes, depreciation, and amortization; Multiple = enterprise value calculation multiples. The chart does not provide an inclusive list of all examples. The examples may not be mutually exclusive in relation to value creation factors.

Methods to expand *multiples* include modifying a company's business strategy to increase the likelihood of future growth. This could mean developing higher quality assets (such as those with better cash flow) in market segments with more growth potential. Adjusting the cost of capital for financing the company could also expand multiples. Sometimes external market conditions that are usually outside the control of the PE fund (e.g., macroeconomic conditions) could also expand or decrease multiples and affect company valuation.

Figure 5 shows how PE creates value for its investors (though not necessarily for, and in some cases at the expense of, other stakeholders) through methods that may elicit a variety of policy concerns:

- Capital restructuring—for example, changing the ratio and types of a company's debt and equity in an effort to manage the total cost of capital or for other

[26] Of course, investors may apply several valuation methods concurrently in actual PE transactions, and the factors influencing assumptions and adjustments could be much more nuanced.

purposes, drawing down capital not yet invested, or negotiating with lenders to gain more flexibility for loans;

- Operational changes—for example, increasing productivity through cutting jobs, selling non-core assets, or making adjustments to the company's business strategy;
- Incentive allocation—for example, using new performance-based incentive structures and equity ownership retention bonuses for managing the company.

PE investors complete their investment lifecycle after cashing out from the portfolio company asset holdings. The exit strategies—for example, finding the opportunistic timing to sell the portfolio companies through mergers and acquisitions, initial public offerings, secondary offerings to other PE firms, or partial exit through dividend recapitalization, among other methods—are also important factors for creating value for investors.

Policy Issues

This section discusses PE-related policy issues from the perspectives of benefits, challenges, and industry-specific debates.

Potential Benefits

Many research papers suggest that PE plays a role in enhancing competition, enabling capital formation, assisting distressed company resolution, and transforming financially underperforming companies. The PE industry has also taken on increased importance because of a significant increase in the size of the private securities and private funds markets.[27] Because PE funds purchase large volumes of private securities, this shift has led the industry to occupy an increasing role in U.S. capital markets. (The reasons for the changing public versus private markets landscape is another policy debate beyond the scope of this report.)[28]

- **Capital formation.** PE channels money from investors to companies in need, thus facilitating capital flow for economic activities.
- **Performance and productivity gain.** Some argue that PE's active ownership at portfolio companies could add value by increasing operational efficiency, including creating worker productivity gains and other performance enhancements. One research study showed that labor productivity increased by

[27] Companies turn to capital markets to raise funding from investors. This process is referred to as a *securities offering*. Similar to public and private funds, *public* securities offerings are open to a wide range of investors and must meet comprehensive registration requirements imposed by the SEC, whereas *private* securities offerings are exempt from certain SEC registration requirements and face investor access restrictions. For more on public and private securities offerings and funds, see CRS Report R45957, *Capital Markets: Asset Management and Related Policy Issues*, by Eva Su; and CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su.

[28] Two points of view are presented by Steven Davidoff and Paul Rose, "The Disappearing Small IPO and the Lifecycle of the Small Firm," July 1, 2014, https://ssrn.com/abstract=2400488; and Michael Ewens and Joan Farre-Mensa, "The Deregulation of the Private Equity Markets and the Decline in IPOs," February 7, 2020, https://ssrn.com/abstract=3017610. For more background, see CRS Report R45221, *Capital Markets, Securities Offerings, and Related Policy Issues*, by Eva Su.

8% over two years at PE portfolio companies after the buyout.[29] Other research has also shown enhanced performance and operating gains.[30]

- **Distressed company resolution.** PE tends to place investments in underperforming companies. Some research states that certain PE's acquisition of underperforming businesses positively affected the local economy and helped to stabilize the financial system during crisis.[31] Other research states that PE-backed companies restructure more quickly and that PE involvements could help avoid defaults or resolve financial distress in a manner that better preserves firm value when defaults do occur.[32]
- **Enhancements to competition.** Some research states that PE transactions have a positive spillover effect for competing firms in the same industry.[33]

Example: Hilton Hotels

As discussed in the "investment returns" section of this report, the PE industry typically generates positive returns. As such, operational failures and investment losses may not represent the industry norm. One of the most well-known PE "success stories" is Blackstone's investment in Hilton Hotels. Blackstone took Hilton Hotels private in 2007 and made it public again in 2013, booking a gain of $10 billion. In Hilton Hotel's 2013 initial public offering SEC filings, the hotel disclosed that it employed 147,000 workers and increased the number of open rooms by 34%, or 170,000 rooms, between 2007 and 2013, which represented the highest growth rate of any major lodging company for the period.[34] As a point of reference, the number of workers Hilton Hotels employed before the take-private transaction was 105,000 workers as of December 31, 2006.[35]

Potential Challenges and Concerns

The PE industry also faces mounting criticisms and challenges.[36] PE practices have drawn criticism for a number of reasons. Some challenges are related to the value creation process for PE investors, while other challenges are linked to broad financial stability concerns.

- **From a capital restructuring perspective.** Some observers view the LBO process as a way to extract wealth from portfolio companies while transferring

[29] Steven J. Davis et al., *The Economic Effects of Private Equity Buyouts*, October 7, 2019, https://www.hbs.edu/ris/Publication%20Files/20-046_ceb00b98-e62a-45db-8d5f-9793ffd0226e.pdf.

[30] Shourun Guo et al., "Do Buyouts (Still) Create Value?," *Journal of Finance*, vol. 66, no. 2 (April 2011), https://www.jstor.org/stable/29789787.

[31] Emily Ross, Song Ma, and Manju Puri, *Private Equity and Financial Stability: Evidence from Failed Bank Resolution in the Crisis*, April 17, 2021, https://ssrn.com/abstract=3828789.

[32] Edith Hotchkiss, Per Stromberg, and David Smith, *Private Equity and the Resolution of Financial Distress*, July 7, 2021, https://ssrn.com/abstract=1787446.

[33] Serdar Aldatmaz and Gregory Brown, *Private Equity in the Global Economy: Evidence on Industry Spillovers*, July 29, 2019, https://ssrn.com/abstract=2189707.

[34] SEC, *Hilton Worldwide Holdings Inc. Form S-1*, September 12, 2013, https://www.sec.gov/Archives/edgar/data/1585689/000119312513364703/d593452ds1.htm.

[35] SEC, *Form 10-K Hilton Hotels Corp*, February 28, 2007, https://sec.report/Document/0001104659-07-014553.

[36] For example, Sen. Elizabeth Warren, "Warren, Baldwin, Brown, Pocan, Jayapal, Colleagues Reintroduce Bold Legislation to Fundamentally Reform the Private Equity Industry," press release, October 20, 2021, https://www.warren.senate.gov/newsroom/press-releases/warren-baldwin-brown-pocan-jayapal-colleagues-reintroduce-bold-legislation-to-fundamentally-reform-the-private-equity-industry.

the risk from equity investors to debt investors. Other observers view excessive leverage (e.g., debt borrowing) as a financial stability concern because it could reduce the portfolio companies' ability to absorb risks during adverse market conditions.

- **From an operational changes perspective.** Some observers view cost savings through job cuts as a way to enrich the investors while bringing harm to affected individuals and communities.[37] Although many aspects of operational improvements through job cuts are intended to improve financial profit and operational efficiency, concerns exist regarding employment,[38] social welfare, and the importance of stakeholder capitalism (as oppose to shareholder capitalism).[39]
- **From an incentive allocation perspective.** While some employees face job cuts and pay reductions following buyouts, portfolio company managers may receive retention bonuses and performance-based incentives as a result of productivity increases.[40] In addition, some observers (including the SEC's Office of Compliance Inspections and Examinations) view certain investment fund manager incentives and fees as potentially excessive, non-transparent, and rife with conflict of interest concerns.[41] Furthermore, some PE fund managers may have provided misleading disclosures to investors in order to gain incentives and fees.[42]
- **From an exit strategy perspective.** Some observers are concerned about certain exit strategies, such as dividend recapitalization, which allows portfolio companies to borrow more debt to pay dividends to equity investors.[43] Some observers view dividend recapitalization as a tool to help PE funds book short-term profits without making substantive improvements for the portfolio companies.[44] While the proceeds from dividend recapitalization could provide an early partial exit for PE investors, it could increase the risk and debt burden at the portfolio companies and may harm the companies' ability to borrow new money for operations or growth.[45]

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[37] U.S. Congress, House Committee on Financial Services, *America for Sale? An Examination of the Practices of Private Funds*, hearing, 116th Cong., 1st sess., November 19, 2019, https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404650.

[38] Davis et al., *The Economic Effects of Private Equity Buyouts*.

[39] Stakeholder capitalism versus shareholder capitalism is an area of intense policy debate. For more on stakeholder capitalism, see McKinsey and Company, *The Case for Stakeholder Capitalism*, November 12, 2020, https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-case-for-stakeholder-capitalism.

[40] Phillip Leslie and Paul Oyer, *Managerial Incentives and Value Creation: Evidence from Private Equity*, National Bureau of Economic Research, Working Paper no. 14331, September 2008, https://www.nber.org/papers/w14331.

[41] SEC Risk Alert, *Observations from Examinations of Investment Advisers Managing Private Funds*, June 23, 2020, https://www.sec.gov/files/Private%20Fund%20Risk%20Alert_0.pdf.

[42] SEC Risk Alert, *Observations from Examinations of Private Fund Advisers*, January 27, 2022, https://www.sec.gov/files/private-fund-risk-alert-pt-2.pdf.

[43] See "Dividend Recapitalization" section of this report for more background.

[44] Eileen O'Grady, *Dividend Recapitalizations in Health Care*, October 2020, https://pestakeholder.org/wp-content/uploads/2020/10/PESP-HC-dividends-10-2020.pdf.

[45] Matthew Goldstein, "Private Equity Firms Are Piling On Debt to Pay Dividends," *New York Times*, February 19, 2021, https://www.nytimes.com/2021/02/19/business/private-equity-dividend-loans.html. Other observers argue that

- **From a financial stability perspective.** In light of the PE industry's growing size, importance, and complexity, some observers have voiced financial stability concerns regarding risk monitoring and information transparency. The "Form PF Reform" section of the report discusses these financial stability concerns (and the SEC proposed regulatory changes to address them) in more detail.

Example: Toys"R"Us

Toys"R"Us is one example that appears to capture multiple categories of policy concerns listed above. PE companies Bain and KKR and real estate investment trust Vornado acquired Toys"R"Us in 2005 through an LBO. The firm's valuation at the time was approximately $7.5 billion with $1 billion in debt—a capital structure of 87% equity and 13% debt.[46] The consortium purchased the firm for $6.6 billion—paid for using $1.3 billion in equity from the investors and the rest in new debt. Combined with the existing debt, Toys"R"Us's capital structure post-acquisition reached 17% in equity and 83% in debt. To service the debt, Toys"R"Us had to contribute the vast majority (97%) of its operating profit, which some observers believe accelerated the firm's underperformance and eventual bankruptcy.[47] When Toys"R"Us filed for Chapter 11 bankruptcy in 2018, it owed creditors $5.3 billion in debt. During the liquidation, around 33,000 employees lost their jobs and were not paid the $75 million they claimed the firm owed, because other more senior creditors were paid before them during the bankruptcy process.[48] On the PE investor side, Bain, KKR, and Vornado lost $1.3 billion of their equity investments, but the loss was partially offset by $470 million in fees and other payments they previously collected.[49]

Many policymakers raised concerns about the fairness of the outcome for Toys"R"Us's 33,000 employees who lost their jobs and the affected communities, among other issues.[50] Critics and advocates of PE reportedly generally agree that "you don't want to stand in the way of economic innovation, but you would hope that people who get run over are helped."[51]

Example: Trident USA

Trident USA, a provider of mobile diagnostic equipment to nursing homes and elder care facilities, reportedly conducted multiple rounds of dividend recapitalization (see the "Dividend

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dividend recapitalization is often conducted at the request of PE limited partners, such as pension funds, to fulfill these investors' scheduled pension obligations to retirees. American Investment Council, *Private Investment Explained: Dividend Recapitalization*, February 19, 2021, https://www.investmentcouncil.org/private-investment-explained-dividend-recapitalization.

[46] Testimony of Eileen Appelbaum, in the U.S. Congress, House Committee on Financial Services, *America for Sale? An Examination of the Practices of Private Funds*, hearings, 116th Cong., 1st sess., November 19, 2019, https://financialservices.house.gov/uploadedfiles/hhrg-116-ba00-wstate-appelbaume-20191119.pdf.

[47] Tara Lachapelle, "Lessons Learned from the Downfall of Toys 'R' Us," *Bloomberg*, March 9, 2018, https://www.bloomberg.com/news/articles/2018-03-09/toys-r-us-downfall-is-ominous-reminder-about-debt-laden-deals.

[48] Steven Church, "Toys 'R' Us Bankruptcy Plan Ties Payouts to Manager Lawsuits," *Bloomberg*, November 13, 2018, https://www.bloomberg.com/news/articles/2018-11-13/toys-r-us-bankruptcy-plan-ties-payouts-to-manager-lawsuits.

[49] David Carey, "Bain, KKR, Vornado Suffer Wipeout in Toys 'R' Us Bankruptcy," *Bloomberg*, September 19, 2017, https://www.bloomberg.com/news/articles/2017-09-19/bain-kkr-vornado-suffer-wipeout-in-toys-r-us-bankruptcy.

[50] House Financial Services Committee, *America for Sale?*

[51] Katia Dmitrieva, "Everything Is Private Equity Now," *Bloomberg*, October 3, 2019, https://www.bloomberg.com/news/features/2019-10-03/how-private-equity-works-and-took-over-everything.

Recapitalization" section of the report for more background) while under investigation for illegal kickback schemes. The company filed for bankruptcy in 2019 after paying out $380 million to several PE firms.[52]

Industry-Specific Debates

Some observers believe that PE's business model, which seeks to maximize profits, could appear incompatible with certain public-service-oriented industries, such as health care and education, which should, PE critics argue, prioritize quality of care, societal impact, or long-term well-being. But PE firms are increasingly involved in some of these industry sectors. For example, one research paper estimates that the PE transaction value in the health care sector had reached $120 billion in 2019 from $42 billion in 2010.[53] Some observers argue that the PE involvement could put the health care system at risk, citing studies that show PE firms have adversely affected health outcomes and prices.[54]

Some industry practitioners believe that PE could help improve systems that involve the public good. For example, one report from a consulting firm argues that private funding fills a void where public education systems are overburdened and lack the resources to deal with rapid increases in demand. This consulting firm states that PE's societal impact challenges and invites policymakers to "adopt transparent, robust and consistent regulatory frameworks [to] track and report relevant data; and provide incentives to encourage private sector participation to address unmet needs."[55]

SEC Proposed Rules

As the primary regulator for the PE industry, the SEC could implement certain regulatory changes at the agency level without additional congressional legislative mandates. The SEC published two proposed rules in the first quarter of 2022 to reform the PE industry through regulatory changes aimed at private fund advisers and Form PF disclosure processes. These proposed amendments would generally affect all private funds, including PE. Many observers predict that these agency actions would transform PE regulatory philosophy and practice.

The SEC's private fund reform focuses more on investor protection issues, and the Form PF reform emphasizes systemic risk mitigation and financial stability concerns.

Private Fund Reform

On February 9, 2022, the SEC issued a proposed rule pursuant to its authorities under the Investment Advisers Act of 1940 (IAA; P.L. 76-768).[56] If the proposal goes into effect, PE fund

[52] Eileen O'Grady, *Dividend Recapitalizations in Health Care*, Private Equity Stakeholder Project, October 2020, https://pestakeholder.org/wp-content/uploads/2020/10/PESP-HC-dividends-10-2020.pdf.

[53] Richard Scheffler, Laura Alexander, and James Godwin, *Soaring Private Equity Investment in the Healthcare Sector: Consolidation Accelerated, Competition Undermined, and Patients at Risk*, American Antitrust Institute and Petris Center, University of California, Berkeley, May 18, 2021, https://publichealth.berkeley.edu/wp-content/uploads/2021/05/Private-Equity-I-Healthcare-Report-FINAL.pdf.

[54] Scheffler, Alexander, and Godwin, *Soaring Private Equity Investment in the Healthcare Sector*.

[55] Ashwin Assomull, Maryanna Abdo, and Roisin Pelley, *Driving Grades, Driving Growth: How Private Capital in Education Is Increasing Access, Inspiring Innovation and Improving Outcomes*, https://cdn.ey.com/parthenon/pdf/perspectives/Parthenon-EY_WISE_Research_Report.pdf.

[56] SEC, "Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews," proposed

managers would start providing quarterly statements on fund performance and fees to their investors for the first time. The funds would also have to undergo annual audits and face some new prohibitions, among other requirements. In proposing the amendments, the SEC emphasized the changes in size and importance of the private fund markets and aimed to enhance the related regulation for "increasing transparency, competition, and efficiency" in private funds markets.[57]

Traditional Regulatory Philosophy

Private funds traditionally face less regulation and disclosure than public funds do. The SEC follows a disclosure-based regulatory philosophy that is consistent with Supreme Court Justice Louis Brandeis's famous quote that "sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[58] In practice, for *public* securities offerings and *public* funds, transparency through disclosure seeks to inform investors and policymakers and enables market mechanisms to price risk and deter fraud. The expectations for market participants are that if the securities issuers or funds elect to opt into *public* markets for fundraising, they would generally have to provide extensive disclosure to all investors.

The funds could also elect to be private, meaning they could provide less disclosure than public funds do but confine their activities to a smaller investor pool that consists mainly of more sophisticated institutional investors and individuals with higher income and net worth (e.g., PE investors in **Figure 2**). These sophisticated investors are perceived as better able to fend for themselves through (1) their existing financial cushions to absorb potential investment losses and (2) their professional knowledge and expertise enabling them to comprehend and manage risks absent the standardized disclosure.

By increasing the disclosure and compliance requirements at *private* securities markets, which some observers referred to as "spreading sunshine" in PE (following the metaphor created by Brandeis),[59] some argue the SEC would be blurring the line between public and private funds and markets from a regulatory perspective.[60]

Proposed Amendments to the IAA

The SEC proposed changes to the IAA that aim to enhance protection for private fund investors, including PE investors. The proposal would impose new requirements on SEC-registered private fund advisers and other advisers. The following are the new proposed rules and other amendments under the IAA:[61]

- **Quarterly Statement Rule.** The proposal would require SEC-registered PE fund advisers to provide quarterly statements on the funds' performance, fees, and

rule, https://www.sec.gov/rules/proposed/2022/ia-5955.pdf.

[57] SEC, "SEC Proposes to Enhance Private Fund Investor Protection," press release, February 9, 2022, https://www.sec.gov/news/press-release/2022-19.

[58] Louis Brandeis, "What Publicity Can Do," Chapter 5 in *Other People's Money* (1932). First published in *Harper's Weekly*, December 20, 1913.

[59] Andrew Bowden, SEC Director for Office of Compliance Inspections and Examinations, *Spreading Sunshine in Private Equity*, May 6, 2014, https://www.sec.gov/news/speech/2014—spch05062014ab.html.

[60] Hannah Zhang, "The SEC Thinks the Lack of Transparency in Private Markets Is a Risk to Investors. The Commission Wants That to Change," *Institutional Investor*, November 8, 2021, https://www.institutionalinvestor.com/article/b1vcmt40y4rq4b/The-SEC-Thinks-the-Lack-of-Transparency-in-Private-Markets-Is-a-Risk-to-Investors-The-Commission-Wants-That-to-Change.

[61] SEC, *Private Fund Proposed Reforms Fact Sheet*, https://www.sec.gov/files/ia-5955-fact-sheet.pdf; SEC, "Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews.".

expenses to their investors. For illiquid funds such as PE funds, the proposed rule would require reporting of IRR and multiples of invested capital adhering to specific definitions for standardized performance measures. See the "Industry Size, Investors, and Performance" section for more background on the PE performance measures.

- **Private Fund Audit Rule.** The proposal would require financial statement audits to be distributed to investors annually and at a fund's liquidation.
- **Adviser-Led Secondaries Rule.** The proposal would require the PE fund advisers to obtain a *fairness opinion* at an adviser-led secondary transaction. The adviser-led secondary transaction refers to, for example, the buying opportunities for existing fund investors of other assets being advised by the same PE adviser. A "fairness opinion" is a valuation analysis that opines on whether the terms and prices of the transactions are fair. The proposal would also require the advisers to provide to investors a written summary of business relationships that could lead to potential conflict of interest concerns between the fairness opinion providers and the advisers.
- **Prohibited Activities Rule.** The proposal would prohibit all private fund advisers (including unregistered advisers) from certain activities that would harm public interest and investor protection, such as wrongfully charging fees and expenses for unperformed services or assigning fees on a non-pro-rata basis, among other things.
- **Preferential Treatment Rule.** The proposal would prohibit all private fund advisers from providing preferential treatment to investors regarding redemption terms or information about fund holdings. It would also prohibit other types of preferential treatment unless such activities are disclosed to current and prospective investors.
- **Books and Records Rule amendments.** The proposal would amend the Books and Records Rule under the IAA to require advisers to retain records in relation to the new provisions in the proposed rule.
- **Compliance Rule amendments.** The proposal would amend the Compliance Rule under the IAA to require advisers to document their annual review of compliance policies and procedures in writing.

Policy Debates About Private Fund Reform

This section explains the SEC's private fund reform policy intention and the views from proponents and opponents of the proposal.

The SEC's Policy Intention and Proponents' Views

SEC Chair Gary Gensler explained the proposal's policy intention, stating that "private fund advisers, through the funds they manage, touch so much of our economy. Thus, it's worth asking whether we can promote more efficiency, competition, and transparency in this field." Gensler said the proposal "would help investors in private funds on the one hand, and companies raising capital from these funds on the other."[62] Regarding specific provisions, the SEC concluded that the information disclosure would allow private fund investors to better assess, monitor, and compare their investments. The audits, fairness opinions, and prohibitions could provide checks

[62] SEC, "SEC Proposes to Enhance Private Fund Investor Protection."

and balances to protect private fund investors against fraud, conflict of interest, or misappropriations of assets and fees. The additional compliance amendments to the existing rules would increase the SEC's ability to monitor the advisers' compliance with the proposed rules.[63]

Some consultants and investor groups support the SEC's plan to increase fee transparency. These proponents argue that the reform could help private fund managers, including pension funds and others, to track private fund performance and negotiate costs. Some proponents argue that the regulatory actions to bring PE regulation more in line with public markets are overdue. One consultant stated that "the SEC is trying to play catch-up. They want more information as private equity gets more pervasive as an investment option."[64] Regarding other actions to address fees, expenses, and conflict of interest concerns, the proponents argue that the regulatory actions provide answers to some of the previously identified industry misconduct, including numerous issues addressed in the SEC's risk alerts.[65]

Opponents' Views

Some observers view the proposal as a significant departure from the traditional private fund regulation paradigm. As previously discussed, the traditional regulatory philosophy suggests that more sophisticated investors are adequately protected with a less intensive disclosure framework. As such, the SEC investor protection regulation has been more focused on retail investors, which are perceived to be less sophisticated. One of the SEC's commissioners, who cast the dissenting vote, stated that the proposal "embodies a belief that many sophisticated institutions and high-net-worth individuals are not competent or assertive enough to obtain and analyze the information they need to make good investment decisions or to structure appropriately their relationships with private funds."[66] She stated that the SEC should allocate resources toward retail investor protection instead of private fund investor protection. Some private fund industry groups state that "we are concerned that these new regulations are unnecessary and will not strengthen pension returns or help companies innovate and compete in a global marketplace."[67] Some argue that the SEC's proposed rules would "harm the most sophisticated investors."[68]

Other observers explain that the business terms between PE investors and PE funds are often commercially negotiated.[69] Some state that private fund investors already negotiate and receive information relevant to investment decisionmaking absent the SEC's proposed mandates. Because the existing fiduciary requirements already obligate the PE advisers and some of their institutional clients to act in the best interest of their clients, some observers argue that certain

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[63] SEC, "Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews."

[64] Chris Flood and Antoine Gara, "Investment Industry Welcomes SEC Efforts to Reform Private Equity Fees," *Financial Times*, February 17, 2022, https://www.ft.com/content/ec661f96-4c71-4361-a823-00bb69ba0fc0.

[65] For example, SEC, Division of Examinations, *Risk Alert: Observations from Examinations of Private Fund Advisers*, January 27, 2022, https://www.sec.gov/files/private-fund-risk-alert-pt-2.pdf.

[66] SEC Commissioner Hester Peirce, *Statement on Proposed Private Fund Advisers; Documentation of Investment Adviser Compliance Reviews Rulemaking*, February 9, 2022, https://www.sec.gov/news/statement/peirce-statement-proposed-private-fund-advisers-020922.

[67] Paul Kiernan and Sebastian Pellejero, "SEC Proposes Broad Disclosure Rules for Private Investment Funds," *Wall Street Journal*, February 9, 2022, https://www.wsj.com/articles/sec-to-propose-broad-disclosure-rules-for-private-investment-funds-11644418801.

[68] Kiernan and Pellejero, "SEC Proposes Broad Disclosure Rules for Private Investment Funds."

[69] Robin Painter et al., "SEC Proposes Advisers Act Reforms Focusing on Private Fund Investor Protections," *National Law Review*, February 16, 2022, https://www.natlawreview.com/article/sec-proposes-advisers-act-reforms-focusing-private-fund-investor-protections.

provisions in the proposal may not generate meaningful additional impact.[70] In addition, some PE fund lawyers anticipate litigation challenges at the SEC. They question the SEC's authority to impose prohibitions and whether the SEC's economic analysis provided sufficient justifications or rested solely "on generalized assumptions that the rules will simply enhance market efficiency."[71]

Form PF Reform

One other important action the SEC took to initiate reform in the PE market is its proposed amendments to Form PF.[72] Form PF controls the content and process for collecting PE data. The reporting includes information about the PE's size, leverage, beneficial ownership, industry concentration, and other matters.

Form PF generally applies to all private funds, including PE, hedge funds, venture capital, and liquidity funds. Depending on the fund type, the required Form PF reporting fields could be different. The information collected is not subject to public disclosure except for industry-wide statistics, which are shared with the public at the aggregate level.[73] The confidentiality of Form PF reporting protects private funds' sensitive proprietary information, which could adversely affect the funds' competitiveness when made public. This section describes the importance of Form PF, the proposed changes, and their policy debates.

Why Is Form PF Important?

The creation of Form PF was part of the regulatory reforms following the 2007-2009 financial crisis to address financial stability concerns. As previously discussed, unlike public securities and public funds, private funds generally do not have the same level of information disclosure and transparency.[74] Form PF aims to introduce more visibility into a large capital market segment that was otherwise viewed as non-transparent.

SEC Rule 204(b)-1 implemented Title IV Sections 404 and 406 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) to create Form PF and require that SEC-registered investment advisers with at least $150 million in private fund assets under management file the form.[75] The SEC started using Form PF to collect data from private funds in July 2012.[76] The initial policy intention for Form PF was to provide empirical data that allow regulators to evaluate the private fund activities' systemic risk implications.[77] As such, Form PF's confidential

[70] SEC-registered investment advisers are *fiduciaries*, meaning they have a legal obligation to act in the best interest of their clients. For more on fiduciary requirements, see SEC, *Information for Newly-Registered Investment Advisers*, November 23, 2010, https://www.sec.gov/divisions/investment/advoverview.htm.

[71] David Blass, Michael Osnato, and Michael Wolitzer, "SEC Continues March Towards More Intrusive Regulation of Private Funds," *Harvard Law School Forum on Corporate Governance*, March 1, 2022, https://corpgov.law.harvard.edu/2022/03/01/sec-continues-march-towards-more-intrusive-regulation-of-private-funds.

[72] SEC, "SEC Proposes Amendments to Enhance Private Fund Reporting," press release, January 26, 2022, https://www.sec.gov/news/press-release/2022-9.

[73] SEC, Form PF, https://www.sec.gov/files/formpf.pdf.

[74] For more on SEC disclosure, see CRS In Focus IF11256, *SEC Securities Disclosure: Background and Policy Issues*, by Eva Su.

[75] 17 C.F.R. §275.204(b)-1.

[76] Pursuant to amendments to the IAA that were enacted in 2010.

[77] Commodity Futures Trading Commission and SEC, "Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF," 76 *Federal Register* 71127, November 16,

reporting is available primarily to the SEC and the Financial Stability Oversight Council.[78] Financial regulators have been using Form PF data to monitor market conditions and inform policy decisions.

Proposed Amendments to Form PF

The private fund markets have grown in size and complexity since the adoption of Form PF. In light of the industry's growth and the role some private funds played in recent market disruptions,[79] the SEC proposed amendments to Form PF on January 26, 2022.[80] The proposed rule would increase the scope and timeliness of large PE adviser reporting.

- **Lowering reporting threshold.** Form PF subjects large private fund advisers to additional reporting requirements. PE advisers with more than $2 billion in regulatory assets under management are "large private equity advisers."[81] The proposed rule would lower the threshold for large PE advisers to $1.5 billion, thus increasing the number of eligible PE advisers for additional reporting.[82]
- **Increasing reporting content.** The proposed rule would amend Section 4 of Form PF for large PE advisers to gather additional information on fund strategies, use of leverage and portfolio company financings, controlled portfolio companies (CPCs) and CPC borrowings, fund investments in different levels of a single portfolio company's capital structure, and portfolio company restructurings or recapitalizations.[83]
- **Raising reporting timeliness.** Form PF currently requires advisers to file the form quarterly or annually with some time lag. The proposal would require large PE advisers to file reports within one business day of the reporting events. The proposed rule identifies reporting events as those actions that could significantly harm investors or pose systemic risk concerns. Examples of reporting events include the execution of adviser-led secondary transactions, implementation of general partner or limited partner claw-backs, removal of a fund's general partner, termination of a fund's investment period, or termination of a fund.[84]

2011.

[78] The SEC makes Form PF data available to the Office of Financial Research and to the Federal Reserve Board, subject to certain use agreements and confidentiality protections. Staff of the SEC, *U.S. Securities and Exchange Commission Annual Staff Report Relating to the Use of Form PF Data*, December 3, 2021, https://www.sec.gov/files/2021-pf-report-to-congress.pdf.

[79] For example, the role that some hedge funds played during Treasury market disruptions. For more on Treasury market disruptions, see CRS In Focus IF12012, *Treasury Securities Market Disruptions and Policy Issues*, by Eva Su.

[80] SEC, "Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers," 87 *Federal Register* 9106, February 17, 2022.

[81] SEC, Form PF, https://www.sec.gov/files/formpf.pdf.

[82] 87 *Federal Register* 9106, p. 9119.

[83] 87 *Federal Register* 9106, p. 9120.

[84] 87 *Federal Register* 9106, p. 9108.

Policy Debates About Form PF Reform

The SEC's proposed rule did not receive uniform acceptance. Because previous sections already explained the proposal's background and merits, this section discusses some of the contrary views.

The SEC proposed the amendments to Form PF in a three-to-one vote. The SEC commissioner who cast the dissenting vote explained that the proposal "represents a fundamental shift in Form PF's scope and purpose" away from the original policy intention of systemic risk monitoring.[85] She also argued that, instead of reducing the reporting threshold for large PE advisers, the SEC should increase it to reduce filing costs for smaller private funds.

Some in the industry are concerned about data breaches that could compromise the funds' confidential and proprietary information.[86] Some industry practitioners also worry that the SEC could use the additional Form PF data for investigations. They argue that "nothing gets investors to run for the door faster than a government investigation. Those practical realities provide plenty of motivation for funds to push back here."[87]

The public comment period for the proposed rule is 30 days after the *Federal Register* publishes the proposed rule. The length of the comment period also attracted policy attention. Some observers requested the SEC to extend the comment period for its rulemaking process.[88] They argued that the relatively short comment period may not leave sufficient time for the industry to research, analyze, and provide quality comments on substantive changes. SEC Chair Gensler reportedly explained that it is important to "move to the next steps in the rulemaking process to determine whether the SEC should re-propose, modify, or adopt the proposed rules based upon the feedback."[89] The SEC has a fall 2021 regulatory agenda that consists of around 54 rules.[90] The comment period debate also exists for some other proposed rules. Some observers argue that the short and overlapping comment periods may place cumulative effects on the industry's capacities to respond.[91]

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[85] SEC Commissioner Hester Peirce, Statement on Proposed Amendments to Form PF to Require Current Reporting and Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Fund Advisers, January 26, 2022, https://www.sec.gov/news/statement/peirce-form-pf-20220122.

[86] Benjamin Bain and Robert Schmidt, "Hedge Funds Face New SEC Disclosures as Gensler Cracks Down," *Bloomberg*, January 26, 2022, https://www.bloomberg.com/news/articles/2022-01-26/hedge-funds-face-new-sec-disclosoures-as-gensler-cracks-down.

[87] Katanga Johnson, "U.S. SEC to Ramp Up Hedge Fund, Private Equity Fund Scrutiny," Reuters, January 26, 2022, https://www.reuters.com/business/finance/us-sec-aims-gather-more-details-fund-strategies-use-leverage-among-other-details-2022-01-26.

[88] Rep. Patrick McHenry and Sen. Pat Toomey, letter to the SEC, January 10, 2022, https://republicans-financialservices.house.gov/uploadedfiles/2022-01-10_pmc_toomey_letter-gensler_sec_comment_period.pdf.

[89] Quoted text is a summary by Soyoung Ho, "Gensler Defends 30, 45-Day Comment Period for SEC Rulemaking Proposals," Reuters, January 24, 2022, https://tax.thomsonreuters.com/news/gensler-defends-30-45-day-comment-period-for-sec-rulemaking-proposals.

[90] SEC, *Agency Rule List—Fall 2021*, https://www.reginfo.gov/public/do/eAgendaMain?operation=OPERATION_GET_AGENCY_RULE_LIST&currentPub=true&agencyCode=&showStage=active&agencyCd=3235&csrf_token=7CE97CC2D49C9B6B70868F7B2752E582C86F1945A4A46F34426C18AF1ABE101E611318F64B67159C3A36E7556BD0FB872C8F.

[91] Al Barbarino, "SEC Under Fire Over Shorter Rule Proposal Comment Periods," *Law360*, March 9, 2022, https://www.law360.com/banking/articles/1471291/sec-under-fire-over-shorter-rule-proposal-comment-periods.

Author Information

Eva Su
Analyst in Financial Economics

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