

Private Investments Sub-Committee Update

SEC Asset Management Advisory Committee –
19th March 2021

Agenda

- Discuss returns from other asset classes
 - Private Debt
 - Real Estate
- Discuss Design Principles
 - Some initial feedback
 - Emerging “main” issues for rest of Committee to consider
- Discuss comments / suggestions that have been received by the SEC relevant to the issue

What we decided to not look at

- Real Assets (other than Real Estate)
 - Lack of public market comparisons
- Structured Products
 - Very large market (\$7tn approx.)
 - Used largely by insurance companies and very large investors with long term investment horizons
- Hedge Funds
 - Also a very large market (\$3.5tn approx.)
 - Variety of asset classes and strategies which make any comparison to public markets impossible
- We did not ultimately seek to compare some perceived risky retail products such as levered ETFs / ETNs and options with private investments

Comments / Suggestions from public comment letters to Harmonization Concept Release

What restrictions should there be, if any, on the ability of closed-end funds, including BDCs, to invest in private funds, including private equity funds and hedge funds, and to offer their shares to retail investors?¹

- Use of the registered investment company regime to allow retail investors to invest in private funds
- Removal of the 15% limit on closed end funds (“CEFs”) investing in private funds
- Allowing CEFs that invest in private funds to list and create a secondary market
- Increasing flexibility of interval funds and tender offer funds to make them more suitable for private investments
- Allowing advisers of RICs to be affiliated with underlying sponsors
- Allow target date funds to have greater % of investment in private investments that decrease as target date gets closer

1. Question #115 on Pg 188 of the Commission’s [Concept Release on Harmonization of Securities Offering Exemptions](#) (“Harmonization Concept Release”). See also Questions #116, 117, 121, 122, 128, and 129 on Pgs 188 – 193 of the Harmonization Concept Release.

Sources:

[Harmonization Concept Release](#)

[Public Comment Letters to the Harmonization Concept Release](#)

APOLLO GLOBAL MANAGEMENT

Private Debt Landscape

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SEC Asset Management Advisory Committee*

March 19, 2021

Private Debt Can Take Many Forms

What is the definition of private debt?

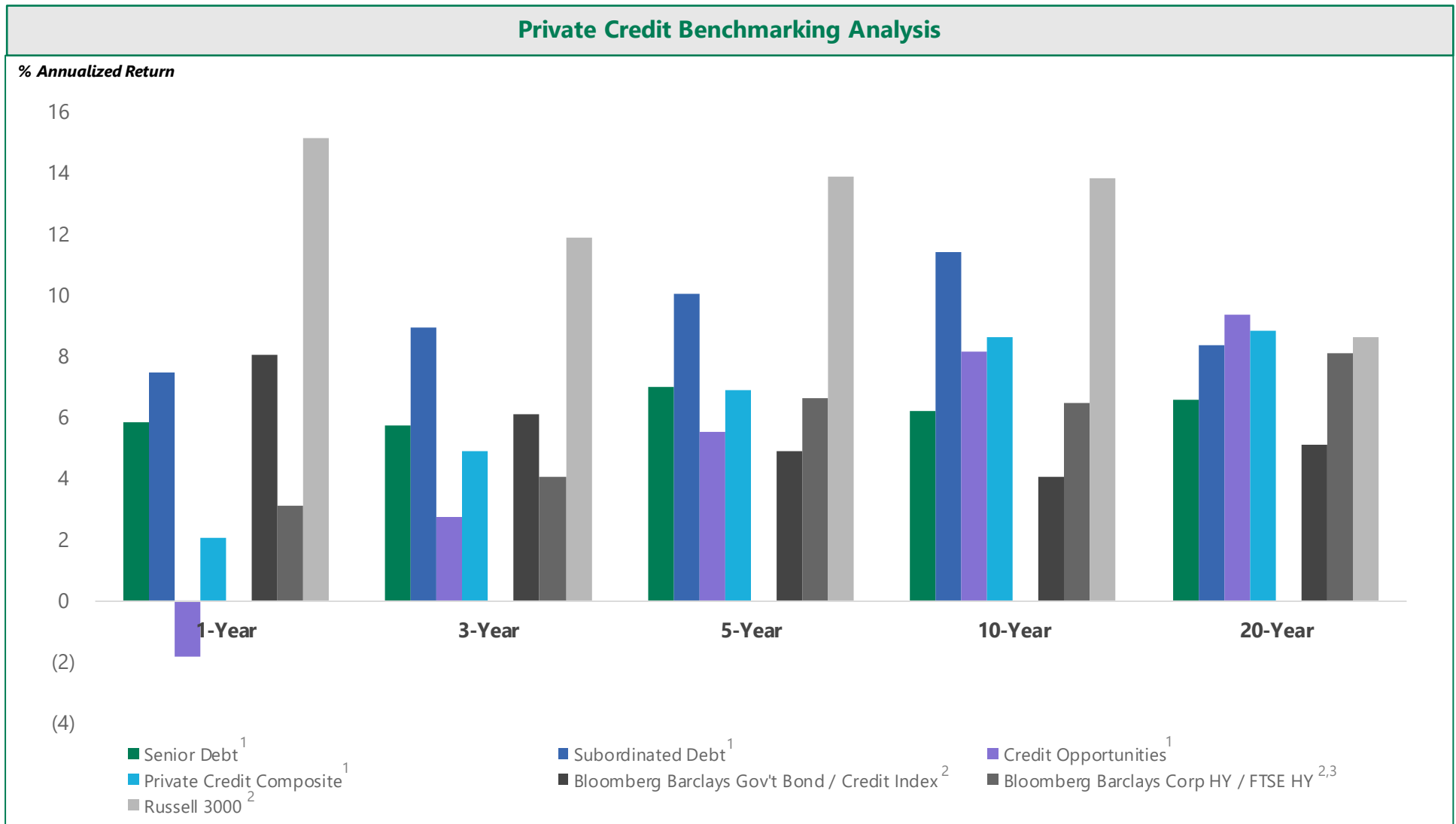
- The definition of private debt can vary widely, but generally private debt refers to debt held by, or loans made to, private companies
 - It is also helpful to contextualize what private debt **is not**: broadly syndicated, CUSIP'd loans widely available for liquid trading in the secondary market
- Key categories of differentiation in private debt include security type, asset class and the lender's source of capital
- Private debt investment vehicles may isolate specific variables below or could involve mandates with broad flexibility across the private credit investing spectrum



(1) These views reflect the views and opinions of Apollo Global Management.

Private Debt Benchmarking

- Given the nuance within private credit strategies and risks associated with each individual investment, it is challenging to measure private credit against an appropriate public market benchmark
 - Many industry participants compare private credit to a corporate HY benchmark as well as public equities across a variety of time periods
- Private credit tends to lag public market alternatives over shorter time periods, but outperforms over the longer-term



Source: Large, well-known global consulting firm. As of September 30, 2020. Data compiled from 512 private credit funds, including fully liquidated partnerships, formed between 1986 and 2020. (1) Pooled horizon return, net of fees, expenses, and carried interest. (2) Large, well-known global investment firm's adjusted modified public market equivalent replicates private investment performance under public market conditions. The public index's shares are purchased and sold according to the private fund cash flow schedule, with distributions calculated in the same proportion as the private fund, and NAV is a function of public market cash flows and public index returns. (3) Bloomberg Barclays US Corporate High Yield/FTSE High Yield Market. Data from 1/1/1986 to 1/31/1989 represented by Bloomberg Barclays US Corporate HY index. Data from 2/1/1989 to present represented by FTSE HY Market.

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Real Estate

Real Estate

Categories of domestic real estate investments

- Core
 - Core properties require very little asset management and are typically occupied with credit tenants on a long term basis.
- Core Plus
 - Core plus properties have the ability to increase cash flows through light property improvements, management efficiencies or by increasing the quality of tenants. Similar to core properties, these properties tend to be of high-quality and well occupied.

Real Estate

Categories of domestic real estate investments

- Value Add
 - Value add properties often have little to no cash flow at acquisition but have the potential to produce cash flow once the value has been added.
 - These buildings may have occupancy issues, management problems or deferred maintenance.
 - Investments require deep knowledge of real estate, strategic planning, and oversight by owners.
- Opportunistic
 - Opportunistic investments take on the complicated projects and may not see a return on their investment for three or more years.
 - These investments require deep knowledge and experience.
 - Ground up developments, acquiring an empty building, land development and repositioning a building from one use to another are examples of opportunistic investments.
 - Little or now cash flow at acquisition but have the potential for significant cash flow once the value has been added.

Investment Returns

We looked at investment returns from Cambridge Associates and Hamilton Lane through 9/30/20.

Cambridge Associates utilized FTSE NAREIT All Equity Index and Hamilton Lane utilized the Dow Jones Equity REIT Total Return Index.

- Both contain certain tax qualified REITs that also meet minimum size and liquidity criteria.

Both Cambridge Associates and Hamilton Lane employ a methodology to convert the private investment real estate IRR returns to a public market equivalent using certain assumptions.

In looking at the return information, generally over a 3, 5 and 10 year period the private investments out performed the public REIT between 100 to 300 basis points.

In looking at the 1 year return through 9/30/20 there was significant over performance from private real estate. This could be explained by the difference of share based total return in public REITs compared to asset based valuation for a private fund during the COVID environment.

There were periods (over 15 years) where public equity REITs outperformed private real estate which incorporates the 2009 Global Financial Crisis.



Private Investment Design Principles



Design Principles Criteria

- **Liquidity of Investments**
- **Diversification**
- **Institutional Investor Participation**
- **Disclosure of Fees, Risks and Conflicts**
- **Avoiding Excessive Risks and Fees**
- **Aligning Adviser Compensation with Investor Interests**
- **Chaperoned Access**
- **Investor Choice**

Potential Private Investment Access Options for Retail Investors

- **Registered Exchange-Traded Closed-End Funds**
- **Tender Offer or Interval Funds**
- **Target-Date Funds**
- **Registered Funds of Private Funds**
 - **Managing Conflicts of Interest**
- **Chaperoned Access**

Registered Exchange-Traded Closed-End Funds

- Should retail non-accredited investors be allowed to purchase shares of a registered closed-end fund that holds more than 15% of its portfolio assets in private investment companies?
- Should there be a cap (above 15%) on portfolio investments in private investment companies?
- Should securities exchanges be allowed to list such closed-end funds for trading?

Registered Exchange-Traded Closed-End Fund	
Frequency of Calculating NAV	NAV usually calculated daily on voluntary basis; Share prices are determined in secondary market trading
Continuously offered	No; shares trade on exchange after IPO
Redemptions	N/A; Market demand on secondary market
Repurchase Frequency	N/A
Repurchase Amount	N/A
Timing of Payment of Repurchase Proceeds	N/A
Illiquid Assets allowed	Up to 100%, however private investment companies limited to 15% of net assets (unless sales limited to accredited investors and fund not traded on an exchange)
Repurchase Fees	N/A
Performance Fee	No performance fee permitted based on capital appreciation. Adviser may be paid based on "fulcrum fee" arrangement or performance fee based only on dividend/interest income.

Tender Offer or Interval Funds

An interval fund is a type of registered closed-end fund that continuously offers its shares, but also makes periodic repurchase offers of outstanding shares at net asset value, subject to specified requirements under SEC rules.

Tender offer funds are registered closed-end funds that also continuously offer their shares, but have greater flexibility with respect to the timing and amount of repurchase offers as compared to interval funds. However, tender offer funds must comply with specified Exchange Act tender offer rules that are less streamlined than the rules that apply to interval funds.

	Tender Offer Fund	Interval Fund
Frequency of Calculating NAV	Varies	Weekly, except daily during five business days preceding a repurchase request deadline; each day investors purchase/redeem shares
Continuously offered	Typically	Typically
Redemptions	At the discretion of the board	Periodic
Repurchase Frequency	At the discretion of the board	Intervals of 3, 6 or 12 months; monthly with exemptive relief
Repurchase Amount	At the discretion of the board	Between 5% and 25%
Timing of Payment of Repurchase Proceeds	Paid "promptly"	Paid within 7 days of repurchase pricing date
Illiquid Assets allowed	No liquidity requirements, but must be able to fulfill tenders "promptly"	Liquidity restrictions apply during period between notice of redemption and redemption pricing date
Repurchase Fees	Maximum 2% for early withdrawal	Maximum 2% of proceeds for repurchase expenses
Performance Fee	No performance fee based on capital gains unless sales limited to "qualified clients." Fund with retail investors may charge "fulcrum fee" or performance fee based only on dividend/interest income.	No performance fee based on capital gains unless sales limited to "qualified clients." Fund with retail investors may charge "fulcrum fee" or performance fee based only on dividend/interest income.

Tender Offer or Interval Funds

- Would interval funds or tender offer funds be a good means for retail investors to access private investments given their limited liquidity?
- Do interval funds and tender offer funds offer the right mix of liquidity and access?
- Are there other limits or investor protections that the SEC should adopt for this structure?

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Target-Date Funds

Fund companies generally have generally not invested in private investments because of portfolio liquidity concerns, and because investments in private equity funds can increase a fund's expense ratio, which may be inconsistent with a retirement plan sponsor's fiduciary duty under ERISA.

- Should the SEC alter its rules limiting investments in illiquid investments to permit target-date funds to hold more than 15% of their portfolio net assets in illiquid investments?
- Is the potentially higher cost structure that may result from greater private investments justified given the access to a new investment class?

Open-end Target Date Fund	
Frequency of Calculating NAV	Daily
Continuously offered	Yes
Redemptions	Daily
Repurchase Frequency	Required to meet all daily requirements
Repurchase Amount	Required to meet all daily redemption requests
Timing of Payment of Repurchase Proceeds	Paid within 7 days of request
Illiquid Assets allowed	Up to 15% of net assets
Repurchase Fees	Permissible under SEC Rule 22c-2 and as stated in prospectus
Performance Fee	No performance fee based on capital gains unless sales limited to "qualified clients." Fund with retail investors may charge "fulcrum fee" or performance fee based only on dividend/interest income.

Registered Funds of Private Funds

Some industry commenters have argued that the SEC should permit registered investment companies to invest more than 15% of its assets in one or more underlying private funds, that themselves hold investments in private issuers, without limiting their investors to accredited investors.

- Should the SEC consider revising its affiliated transaction rules to allow registered funds to invest in affiliated private funds, and if so under what conditions?
- Should the SEC require a registered fund of private funds to invest only in funds that have substantial institutional investor participation?
- Should the SEC adopt other investor protection rules?

Chaperoned Access

Some industry commenters have argued retail investors should be allowed to invest in private equity funds, but only if access is provided by an investment professional with a duty to act in the best interest of the retail investor.

Do you believe this structure would be beneficial to the retail investor?

Should the SEC prohibit the investment professional from receiving sales compensation from the issuer?

Summary Attributes of Common Fund Offerings

	Registered Exchange-Traded Closed-End Fund	Tender Offer Fund	Interval Fund	Open-end Target Date Fund
Frequency of Calculating NAV	NAV usually calculated daily on voluntary basis; Share prices are determined in secondary market trading	Varies	Weekly, except daily during five business days preceding a repurchase request deadline; each day investors purchase/redeem shares	Daily
Continuously offered	No; shares trade on exchange after IPO	Typically	Typically	Yes
Redemptions	N/A; Market demand on secondary market	At the discretion of the board	Periodic	Daily
Repurchase Frequency	N/A	At the discretion of the board	Intervals of 3, 6 or 12 months; monthly with exemptive relief	Required to meet all daily requirements
Repurchase Amount	N/A	At the discretion of the board	Between 5% and 25%	Required to meet all daily redemption requests
Timing of Payment of Repurchase Proceeds	N/A	Paid "promptly"	Paid within 7 days of repurchase pricing date	Paid within 7 days of request
Illiquid Assets allowed	Up to 100%, however private investment companies limited to 15% of net assets (unless sales limited to accredited investors and fund not traded on an exchange)	No liquidity requirements, but must be able to fulfill tenders "promptly"	Liquidity restrictions apply during period between notice of redemption and redemption pricing date	Up to 15% of net assets
Repurchase Fees	N/A	Maximum 2% for early withdrawal	Maximum 2% of proceeds for repurchase expenses	Permissible under SEC Rule 22c-2 and as stated in prospectus
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