Small Business Capital Formation Advisory Committee

Expanding Retail Access to Private Markets

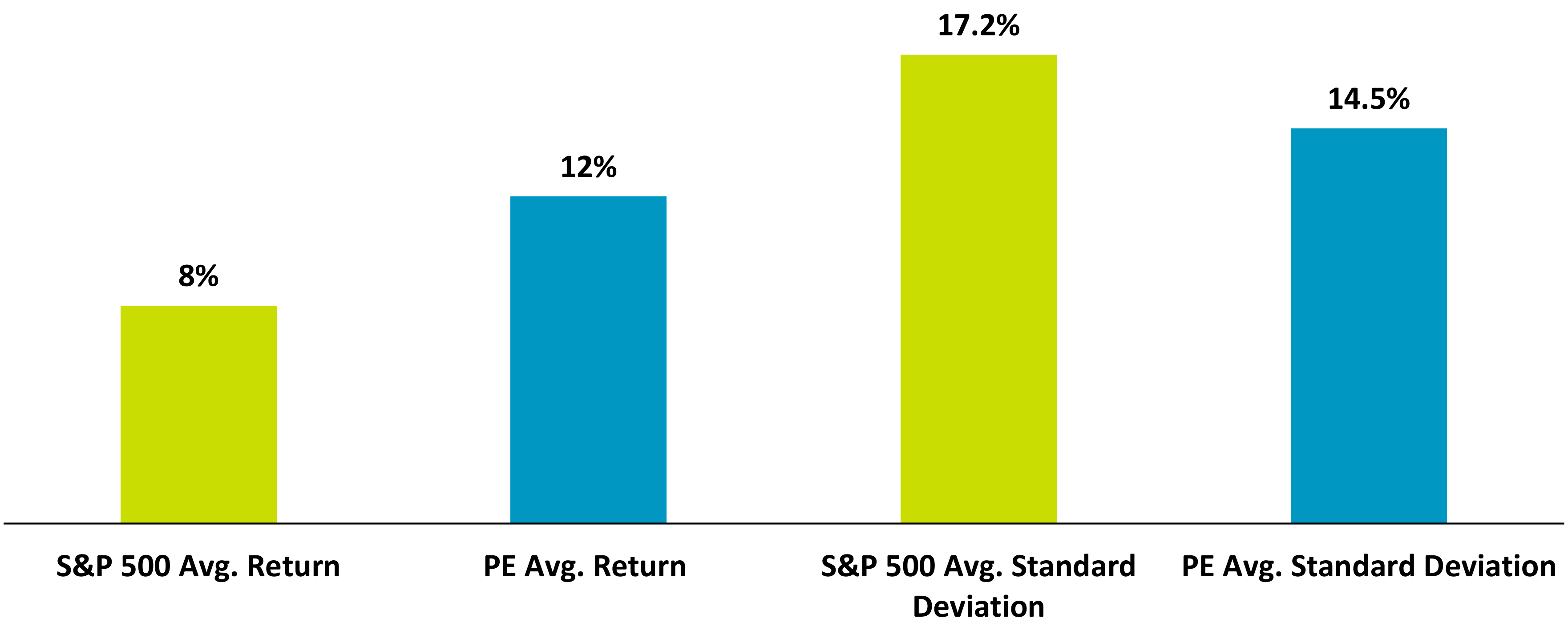
November 2019

Presented by:
John Finley, Senior Managing Director & Chief Legal Officer, Blackstone

PE Performance vs. S&P 500

Private Equity has higher returns and lower volatility than Public Markets over past two decades

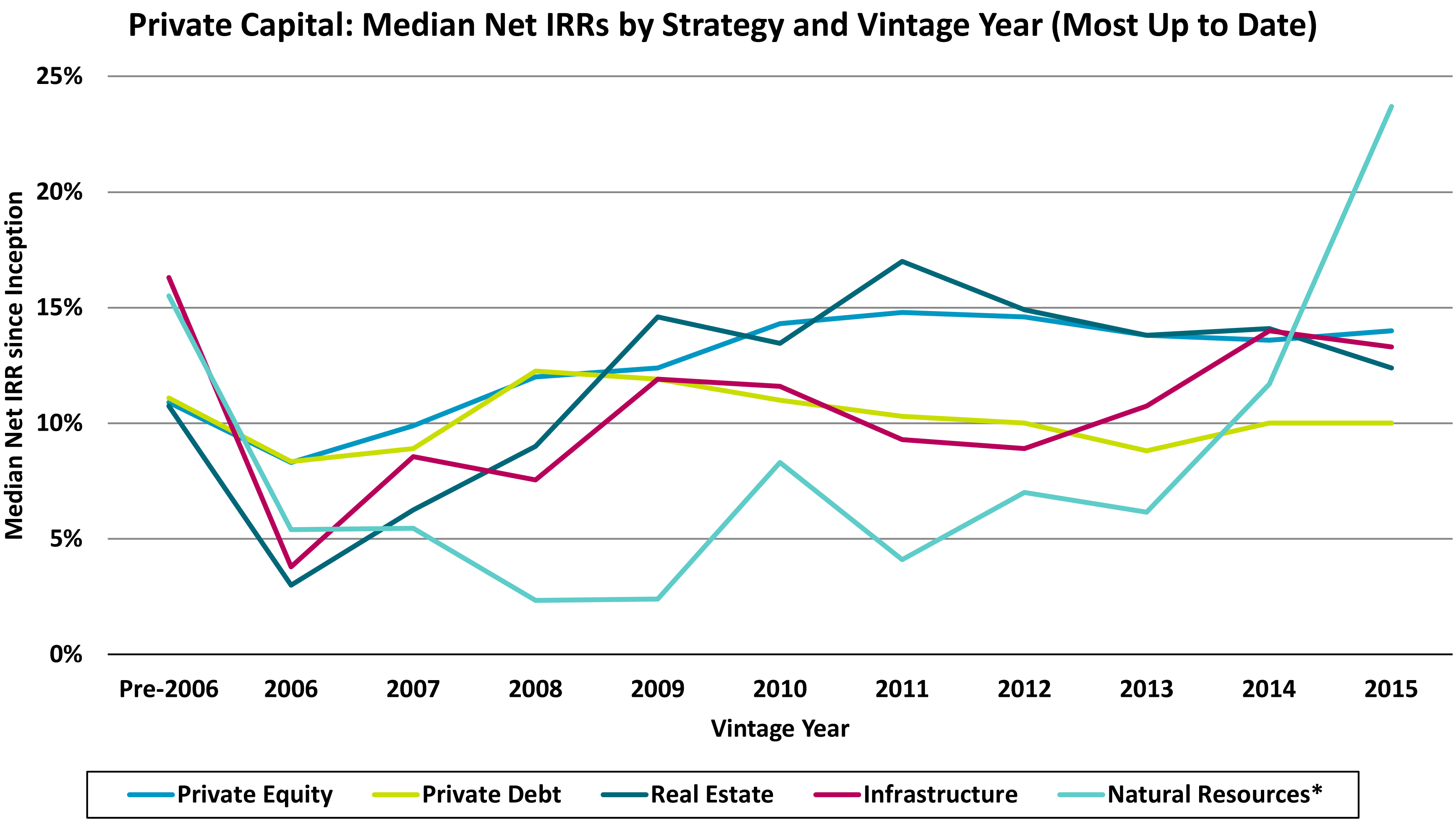
PE Performance vs. S&P 500 (1996-2016)



Source: Committee on Capital Markets Regulation and Voya Investment Management (October 2017).

Private Capital Net IRRs

Private Capital median net IRRs have, on average, exceeded 10% (Excluding Natural Resources)



Source: Preqin, "The Future of Alternatives Report" (October 2018). *Natural Resources includes Natural Resources and Timberland funds only to avoid double counting.

Retail Access to Private Markets – Why Now?

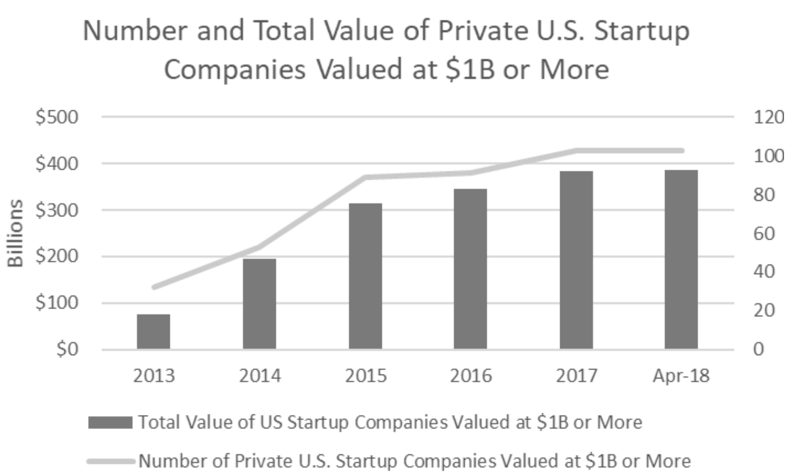
- The SEC is exploring how to increase access for retail investors to private companies
  - Currently, retail investors have a limited ability to access the complete U.S. equity market
  - The SEC's recent concept release recognizes the key role that pooled investment vehicles, including private and regulated funds, can play in providing a more level playing field for retail investors

- Retail investors remain under-allocated to alternative asset classes
  - Private markets provide opportunities for excess or uncorrelated returns
  - Given the decline in the number of public companies, achieving true diversification without an allocation to private markets is difficult

The SEC's Focus on Retail Investor Access to Private Companies

"When retail investors participate in our markets, how broad a spectrum of investments do they have? I think that spectrum has been getting relatively smaller. Because we have fewer public companies, companies are waiting much longer in their life cycle to go public, which by definition means that **retail investors have less access to the market** as a whole. And I fear, **less access to companies that are well-established,** but still growing."

– Jay Clayton, Chairman of the SEC

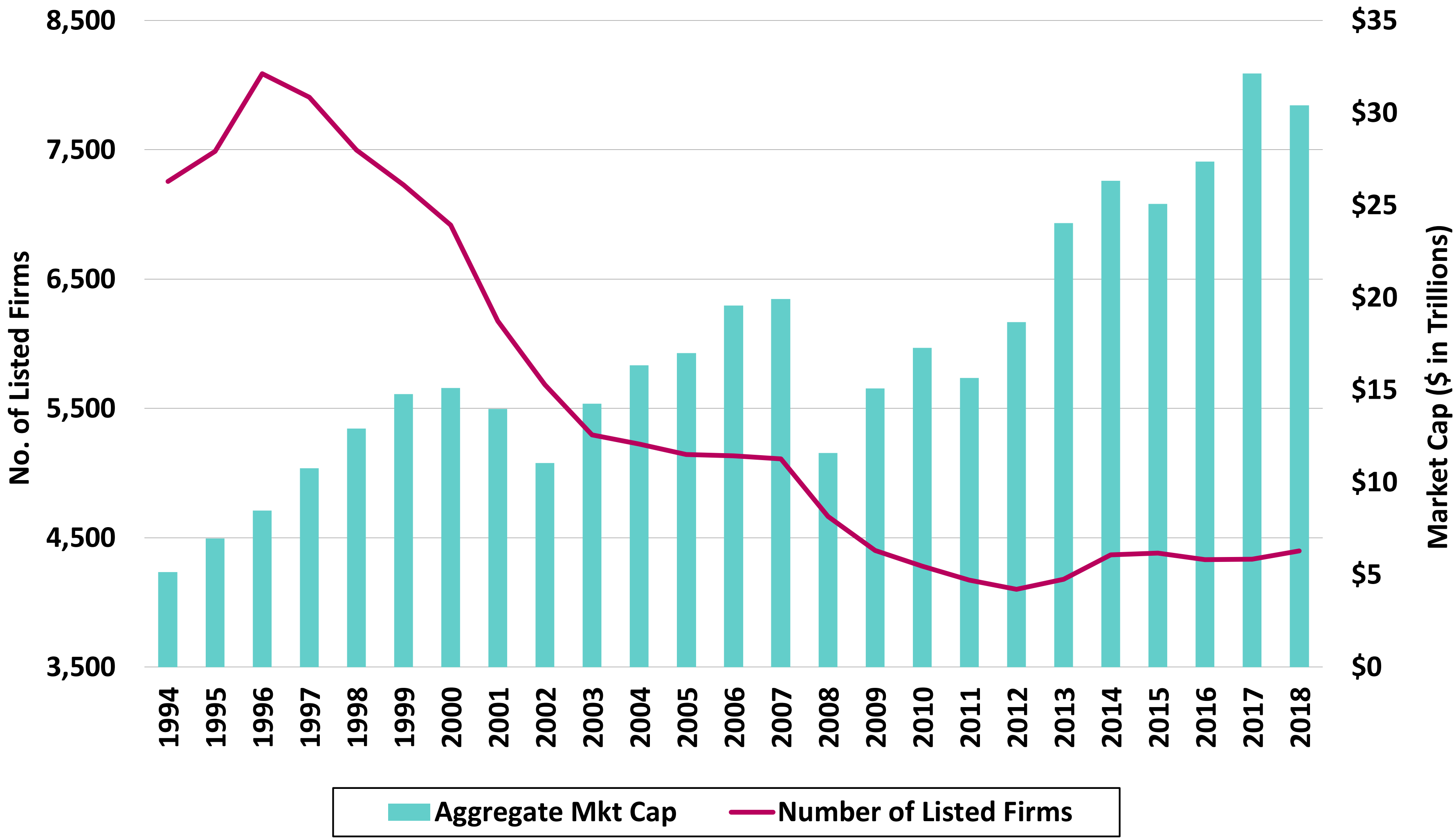


- As of April 2018 there were 103 privately held U.S. start-ups with valuations of over $1 billion and a total value of $385 billion
- Less access to private companies means retail investors are missing out on the opportunity for excess or uncorrelated returns

Source: Dow Jones Venture Source and the Wall Street Journal, https://www.wsj.com/graphics/billion-dollar-club/, as of April 2018.

U.S. Listed Companies and Market Capitalization

Number of Listed Companies decreased -39% in past 25 years, while Market Cap increased by 492%

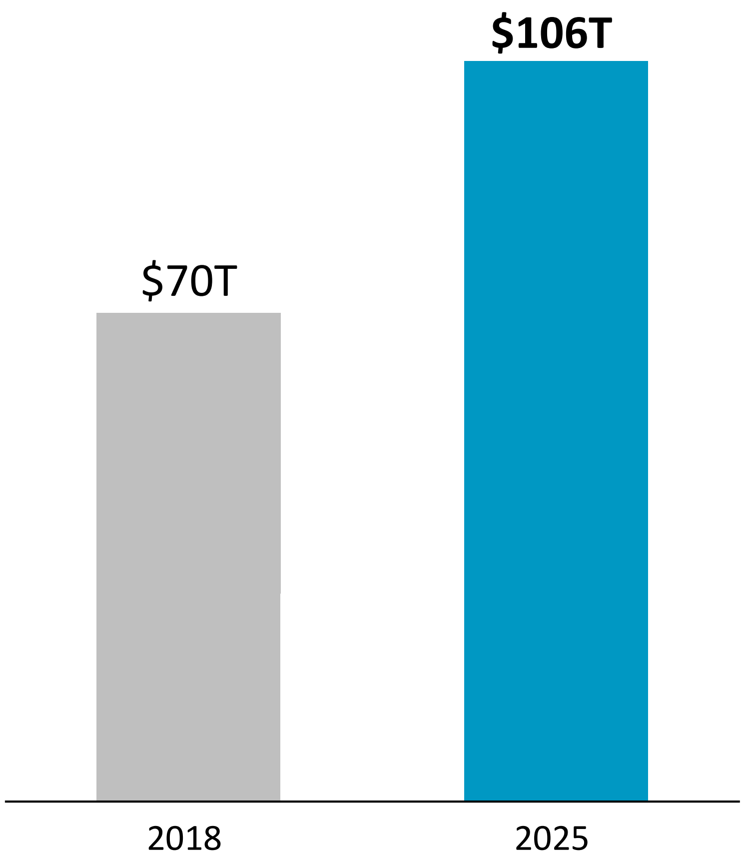


Source: World Bank, as of December 31, 2018. Market capitalization and number of listed companies are for listed domestic companies. Listed domestic companies, including foreign companies which are exclusively listed, are those which have shares listed on an exchange at the end of the year. Investment funds, unit trusts, and companies whose only business goal is to hold shares of other listed companies, such as holding companies and investment companies, regardless of their legal status, are excluded. A company with several classes of shares is counted once. Only companies admitted to listing on the exchange are included.

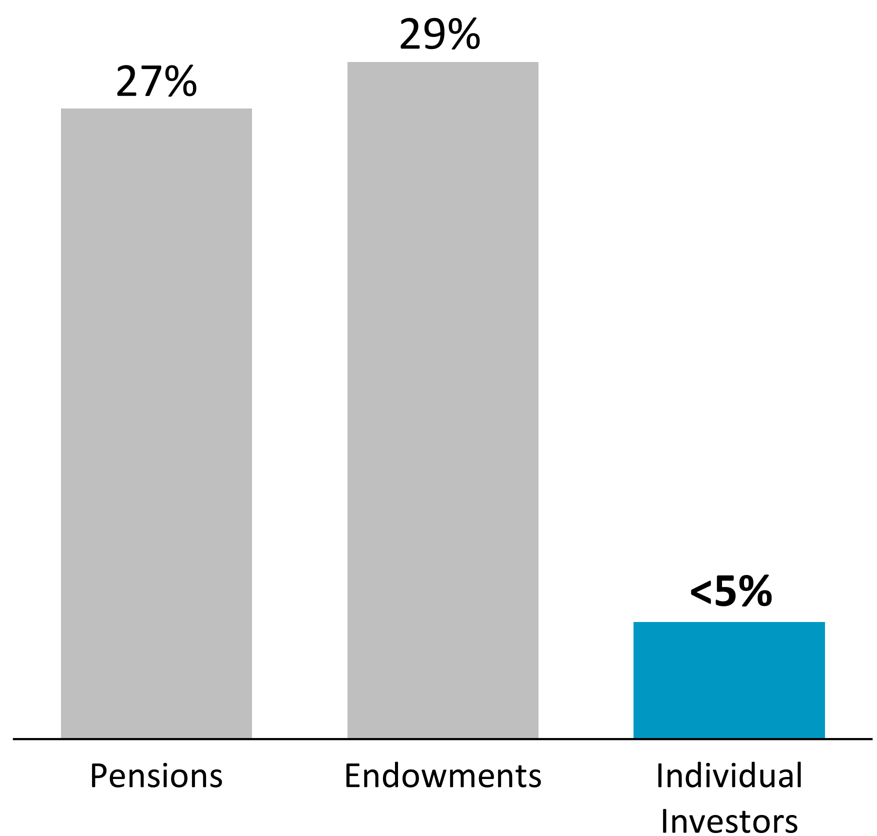
Global Individual Wealth

Global individual investable wealth is growing, remains under-allocated to alternatives

Global Individual Investable Assets



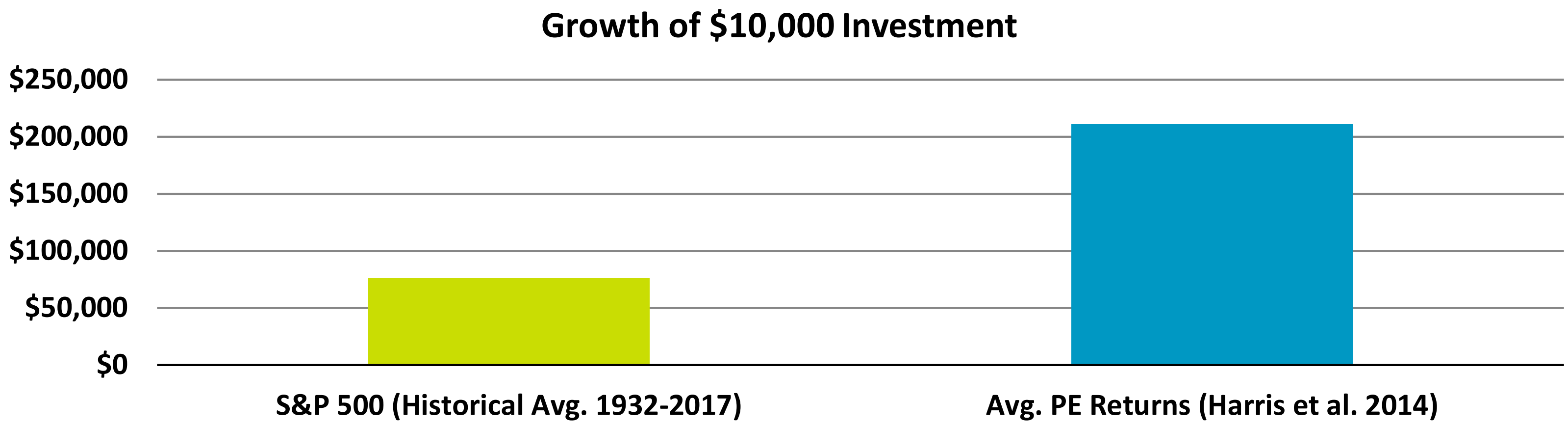
Average Allocation to Alternatives



Sources: For investable assets, 2018 CapGemini World Wealth Report. For allocations: 2016 Willis Towers Watson Global Pension Assets Study; 2016 National Association of College and University Business Officers; Money Management Institute, "Distribution of Alternative Investments through Wirehouses." Allocations shown are for U.S. Pensions and U.S. University Endowments.

PE Funds Facilitate Access to Private Companies

- Private equity funds provide access to companies that are not public.
- Retail investors are increasingly looking for opportunities to outperform the public market, including through investment in private companies.
  - Studies of private equity performance consistently find that private equity funds outperform public market alternatives, while providing diversification, lower volatility and protection in times of market stress
- Studies by Harris et al. show that private equity buyout funds have generally outperformed public markets. This has major implications for the potential returns to retail investors and retirees from private equity funds.
  - For example, $10,000 in a retirement fund that earned 7% annually from the S&P 500 over 30 years would result in an ending balance of $76,123
  - Alternatively, if the $10,000 had been invested in an average private equity buyout fund, which earns 3.7% above the S&P 500 annually, then the ending balance would be $211,071



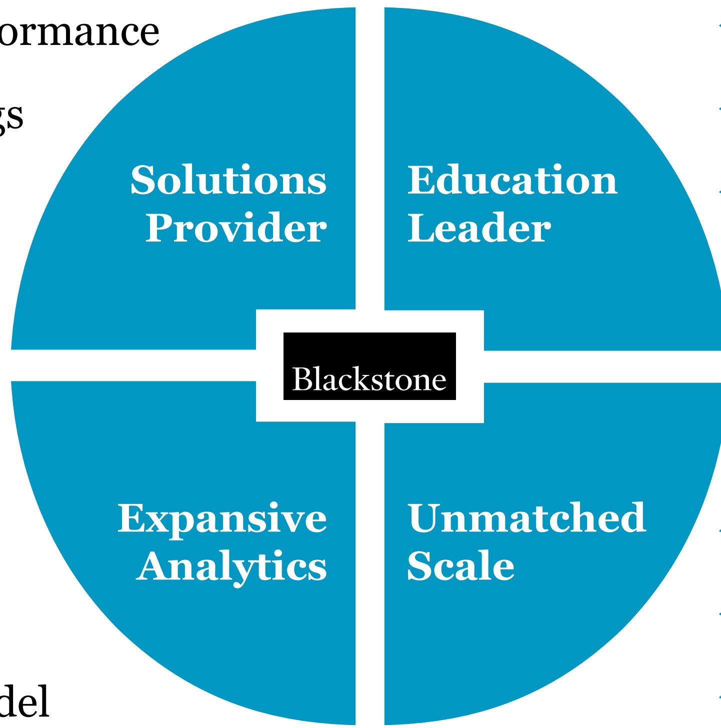
Source: Harris, Jenkinson & Kaplan, "Private Equity Performance: What Do We Know?," Journal of Finance (October 2014).

Blackstone's Platform for Retail

Invested heavily to build powerful platform advantage

- ✓ Institutional quality performance
- ✓ Bespoke product offerings
- ✓ Diversified alternatives

- ✓ Blackstone University
- ✓ Investing insights
- ✓ Scalable digital platform



- ✓ Proprietary system
- ✓ 250K+ advisor profiles
- ✓ Opportunity ranking model

- ✓ 130 employees globally
- ✓ Channelized sales
- ✓ Dedicated service platform

Democratizing Access to Private Markets – Proposed Regulatory Changes

Commenters on the SEC's concept release argued in favor of the following regulatory changes that would help expand retail investor access to private markets:

Eliminate Accredited Investor Threshold for Offering of Regulated Funds of Private Funds

- Currently, the SEC staff requires that offerings of registered closed-end funds that invest more than 15% of their assets in private funds be limited to Accredited Investors.
  - *A number of commenters encouraged the SEC staff to change its policy imposing the 15% limitation*[(1)]

Ease Liquidity Restraints for Target Date Funds

- A registered open-end fund may not invest more than 15% of its net assets in illiquid securities, which limits the extent to which a mutual fund may invest in private companies and private funds.
  - *Several commenters recommended that the SEC ease liquidity constraints for target date funds with longer investment horizons, to provide greater flexibility to invest in illiquid assets, including private funds*[(2)]

Allow Carry-like Compensation for Retail Funds

- Section 205(a)(1) of the Advisers Act prohibits registered investment advisers to a registered fund (other than a BDC) from receiving compensation on the basis of capital gains or capital appreciation unless the fund is limited to Qualified Clients.
  - *Several commenters suggested that the SEC expand the definition of Qualified Client to help facilitate the offering of regulated funds that make direct investments in private companies*[(3)]

(1) See, e.g., Letter from American Investment Council dated September 24, 2019; ("AIC Letter"); Letter from The Investment Adviser Association dated October 18, 2019; Letter from Federal Regulation of Securities Committee of the Business Law Section of the American Bar Association dated October 16, 2019 ("ABA Letter"); Letter from Institutional Limited Partners Association dated September 24, 2019 ("ILPA Letter"); Letter from Simpson Thacher & Bartlett LLP dated September 24, 2019 ("Simpson Letter"); Letter from Ropes & Gray LLP dated September 24, 2019 ("Ropes Letter"); Letter from Dechert LLP dated September 24, 2019 ("Dechert Letter").
(2) See, e.g., AIC Letter; ABA Letter; Ropes Letter.
(3) See, e.g., AIC Letter; Simpson Letter; Dechert Letter.

Mitigating Risks for Retail Investors

Commenters on the concept release also underscored the following ways to expand access to private markets while mitigating risks for retail investors:

- **Embrace Regulated Funds**(1)
  - The legal structure of a regulated fund provides core investor protections.
    - A regulated fund is managed by a registered investment adviser who owes a fiduciary duty to the fund, subject to the oversight of a majority independent board and distributed by intermediaries who must act in the best interest of investors
  - Holding an interest in a diversified portfolio reduces risk relative to individual investments.
    - A regulated fund holds a diversified portfolio designed to reduce the risk that losses at any single underlying company will outweigh successful investments
    - The adviser to a regulated fund has substantial resources and sophistication to review and diligence investments on behalf of the fund's investors
- **Provide Access to Experienced Managers**(2)
  - The SEC could enhance retail investors protection by requiring managers to meet "scale and experience" criteria.
  - The SEC should also consider limiting retail access to managers with an institutional investor base to help ensure that investors are exposed to experienced private markets managers only.
    - For example, the SEC could require that regulated funds of private funds only invest in private funds that accept more than a certain percentage (e.g. 50%) of their capital commitments from institutional investors
  - Retail investors benefit when the manager of a regulated fund has a strong institutional investor base.
    - Institutional investors negotiate favorable terms for their investments
    - Provides an opportunity for retail investors to achieve incentive alignment with institutional investors

(1) See, e.g., Letter from Committee on Capital Markets Regulation dated September 19, 2019 ("CCMR Letter"); AIC Letter; ILPA Letter.
(2) See e.g., CCMR Letter; AIC Letter; ABA Letter.

Speaker Biography

John G. Finley, a Senior Managing Director, is Blackstone's Chief Legal Officer.

Before joining Blackstone, Mr. Finley had been a partner with Simpson Thacher & Bartlett for 22 years where he was most recently a member of that law firm's Executive Committee and Co-Head of Global M&A.

Mr. Finley is an Adviser on the American Law Institute's Restatement of the Law, Corporate Governance Project and a member of the Dean's Advisory Board of Harvard Law School, the Board of Advisors of the Penn Institute for Law and Economics and the Advisory Board of the Penn Netter Center for Community Partnerships. He has served on the Board of Advisors of the Knight-Bagehot Fellowship in Economics and Business Journalism at Columbia University, the Lawyers Committee for Human Rights and the Jewish Board of Family and Children Services. He has also served as Chairman of the Annual International Mergers & Acquisitions Conference of the International Bar Association and on the Committee of Securities Regulation of the New York State Bar Association.

Mr. Finley has a BS in Economics, summa cum laude, from the Wharton School of the University of Pennsylvania (1978), a BA in History, summa cum laude, from the College of Arts and Sciences of the University of Pennsylvania (1978), and a JD, cum laude, from Harvard Law School (1981).

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