



NEBF INVESTMENTS

National Electrical Benefit Fund

900 SEVENTH STREET N.W. • 9TH FLOOR. • WASHINGTON, D.C. 20001

April 25, 2022

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F. Street NE
Washington, DC 20549-1090

Re: File No. S7-03-22

Dear Ms. Countryman:

On February 4, 2022, the Securities and Exchange Commission (“SEC”) solicited public comments on proposed rules that address several practices in the private fund industry. In response, NEBF Investments offers the following comments to Private Fund Advisors File No. S7-03-22. We find that these proposed rules are carefully considered, well designed, practical, and highly beneficial to institutional investors. These rules will increase transparency and accountability in the industry, thereby contributing to more efficient operation of capital markets. The proposed rules also will provide significant benefits to pension funds such as ours that regularly commit to private funds by reducing the costs of negotiating the terms of our commitments and improving our ability to monitor their performance. We commend the SEC for the thoroughness of its review and strongly support the SEC’s proposals.

The National Electrical Benefit Fund (“NEBF”) is a “Taft-Hartley” multi-employer defined benefit pension plan that was established in 1946. The NEBF, jointly sponsored by the International Brotherhood of Electrical Workers and the National Electrical Contractors Association, Inc., provides pension benefits to over 500,000 participants and beneficiaries in the union electrical industry. The NEBF is qualified plan under Section 401(a) of the Internal Revenue Code and is subject to the Employee Retirement Income and Security Act of 1974, as amended (“ERISA”).

NEBF Investments’ professional staff, along with the fund’s independent fiduciary advisors, assist the NEBF’s Board of Trustees in overseeing the NEBF’s investment activities, including the plan’s extensive investments in private equity, real estate, infrastructure, and hedge fund of funds. As of December 31, 2021, NEBF had total assets of approximately \$18 billion, which include commitments to private equity and infrastructure funds of \$1.1 billion and to hedge funds of \$805 million. The NEBF’s investment program therefore is directly affected by the SEC’s regulations with respect to these investment funds.



The NEBF’s fiduciaries are subject to ERISA’s heightened “prudent expert” fiduciary standard of care when allocating capital, and, as such, they are charged with ensuring that the terms of the fund’s investments, including fees, are prudent and reasonable. To meet these fiduciary duties, the NEBF frequently incurs significant costs when negotiating relationships with the sponsors, advisors, and general partners (collectively “GPs”) of the private asset fund vehicles in which the NEBF invests (collectively “Private Funds”). These costs include the allocation of significant time and attention on the part of NEBF Investments staff and the NEBF’s fiduciary advisors, along with hundreds of hours of work by legal counsel.

Overall, we believe the SEC’s proposed rules are practical, reasonable, and contain effective requirements that will serve to reduce costs and improve NEBF Investments’ ability to evaluate investment opportunities and monitor the NEBF’s existing Private Fund investments. The adoption of these rules will improve transparency in the industry, better align GPs with their investors, and result in more efficient capital allocation by investors.

Quarterly Statement Rule (Proposed Rule 211(h)(1))

Required quarterly fee and expense reporting

Under current practices, most investors must negotiate the extent and contours of the reporting they receive from GPs. The best managed firms have learned that their investors require regular detailed disclosure of fees and expenses. However, that is not the case across the entire industry, and we find it necessary to incur substantial time and effort to reach agreement with some GPs on these issues. Further, the ways in which this information is reported varies widely and it can be difficult to compare between funds and GPs. We support use of the Institutional Limited Partner Association’s (“ILPA’s”) Fee Reporting Template because we find it to be an effective and efficient format for this critical data. Promulgation of an industry standard akin to this template would save investors significant time and effort on a continuing basis when monitoring GPs and their Private Funds. Rather than impose undue burdens on GPs, as the private equity industry tends to argue, requiring standardized fee and expense reporting would reduce the GP’s need to provide reporting in varying ways to investors with different needs – thereby reducing GP costs and effort – and would also improve transparency in the industry, providing investors greater confidence when allocating capital to private equity.

Further, it is our understanding that ILPA intends to recommend that the SEC require GPs to report expenses at both the total fund level and the individual limited partner investor level as well. We agree that such reporting at both levels would be beneficial to Limited Partners and encourage the SEC to implement the ILPA recommendation.



Fund level disclosure of advisor compensation

Investors often face difficulties in tracking the compensation, fees, and other amounts paid to GPs and their principals, staff, affiliates, and closely related or controlled consultants and operating partners, including how these payments may serve to offset the GPs' management fee. Over the last decade, some GPs have slowly and steadily shifted costs from their books to those of the Private Funds they manage, effectively boosting the GPs' profitability at the expense of their fund investors. In many cases, a lack of transparency on the part of GPs has left investors unable to observe these cost shifts until after the fact. Further, when such shifts occur, investors often have no recourse and must wait until the GP markets a successor fund to raise the issue.

NEBF Investments has had direct experience with these difficulties. With certain of the NEBF's early vintage investments in Private Funds, staff and legal counsel spent significant time and effort engaging with the GPs to obtain more meaningful reporting concerning which of its employees (or consultants) were paid by the GP, by a portfolio company, or by the fund itself. These efforts cost the NEBF thousands of dollars in staff and counsel time, which in effect represented an unanticipated indirect cost of committing to these Private Funds.

To improve its ability to monitor GP compensation, NEBF Investments spends considerable time with legal counsel negotiating reporting and disclosure rights at the outset when considering commitments to Private Funds. In most cases, the GPs' legal costs for these negotiations are charged to the Private Fund as organizational or partnership expenses, meaning investors are forced to pay not just their own direct legal costs, but perversely they also indirectly must bear the expense of the GP's advisors who are negotiating against investors. Having uniform reporting of advisor compensation would not only improve the ability of investors to monitor GPs, but it would also limit the need for negotiation on these issues, thereby significantly reducing investors' direct and indirect costs.

The disclosure proposed by the SEC is not merely helpful information for investors. It can serve as an early warning of financial and operational problems within the GP's firm and their Private Funds. The sooner investors know that a GP or fund is struggling, the sooner they can intervene to preserve enterprise value in the portfolio companies owned by the fund. The disclosure proposed by the SEC will better enable investors to manage the operational risks of their GPs.

Fund expenses

In addition to GP compensation, when negotiating Private Fund documents and side letters, we have found it increasingly necessary to demarcate which expenses should be borne by the funds and which by the GP. Over time, we have seen GPs gradually shift an increasing amount of expenses to their funds (and hence to their investors). We have responded to this shift by adding to a growing list of specific expenses that must be borne solely by the GP. This effort is inefficient, costly to investors, and often not fully addressed until the GP seeks commitments to a follow-on fund. Investors would benefit by clear and unambiguous regulations about what



expenses should be borne by the GP and expenses should be charged to the fund. Although the SEC is proposing only to require disclosure of expenses, we note that regulation to clearly separate the costs to be borne by GPs from the costs to be borne by their funds would save investors time and money when negotiating their commitments to Private Funds. Further, it would save investors significant cost and effort when monitoring the on-going operation of GPs and their Private Funds. It would allow investors to better compare costs across GPs and Private Funds, leading to more efficient allocation of capital. Finally, it would free investors to devote time and energy to the search for other high value investments, which has the potential to generate millions of dollars in additional investment returns to our plans. We support the SEC's proposed regulations with respect to disclosure of fund expenses.

Disclosure of Investment Performance

The SEC has proposed clear, effective, and reasonable rules with respect to how GPs report on their investment performance of their funds. We agree that these rules would be beneficial to investors and we support the SEC's proposals with respect to disclosure of investment performance.

Advisor-led Secondaries Rule (Proposed Rule 211(h)(2)-2)

Addressing conflicts of interest in GP-led secondary transactions

As private equity funds increase the number of companies they own and the amount of assets they control, it is likely that the need of secondary transactions initiated by GPs will increase. For a variety of reasons related to the life span of a Private Fund, the time needed to fully develop a portfolio company, the amount of LP capital commitments available for investment, and the desire of GPs to access carried interest accrued in their funds, we anticipate that GPs will see secondary transactions as an attractive means of realizing fund investments. But investors would benefit from greater scrutiny and transparency applied to GP-led secondaries. A fairness opinion helps mitigate any appearance of conflict of interest on the part of the GP and gives investors greater confidence that the transaction is in their best interests.

We recognize that requiring a fairness opinion will introduce additional expense into the operation of funds when a GP seeks to undertake a secondary transaction. In this situation, we believe the additional expense to be justified. If a GP is required to involve an external third party in review of a secondary transaction, we are confident that the GP will exercise greater care and diligence in structuring the terms of the transaction. Given the potential for conflicts in any such secondary transaction, greater scrutiny is justified and appropriate.

The SEC's proposal to require a fairness opinion is reasonable, beneficial, and not likely to add material costs to the transaction. As the case with other securities deals and corporate actions that



routinely call for a fairness opinion, these secondary transactions should be held to a similar standard. We support the SEC proposal with respect to this rule.

Prohibited Activities Rule (Proposed Rule 211(h)(2)-1)

Accelerated payments and fees for services not performed

It is difficult for investors to track all services provided and expenses charged to the Private Funds in which they invest. Application of an industry-wide standard with respect to accelerated payments and fees for services not performed by GPs would enable investors to better manage the costs they bear and would free investors to direct time and attention to more productive and profitable work. We support the SEC's proposed rules with respect to these payments and fees.

Prohibition on charging compliance costs to a fund or its investors

GPs should be expected to meet the requirements of regulation and SEC compliance, including SEC registration of the GP-affiliated advisor. The associated expenses are a routine cost of doing business and it is reasonable to expect GPs to establish the necessary internal procedures to do so efficiently and effectively. However, if GPs are allowed to pass these costs off to their investors, GPs have less incentive to manage these costs in an economically efficient manner. To the extent that such inefficiencies drive up fund costs and reduce investor returns, they impose a burden on investors and the beneficiaries of our pension plans. Further, it is inappropriate for GPs to shift any costs associated with an SEC enforcement action to their investors. We support the SEC's proposal with respect to compliance costs.

Non-pro rata fee and expense allocations

As described in earlier sections of these comments, it is difficult for investors to observe, track and evaluate the costs and expenses that GPs shift to the Private Funds they manage. It is even more difficult to monitor how these expenses are allocated among the Private Funds' investors. Some GPs elect to waive routine fees for the commitments made by friends, family, and other affiliated parties. This represents an indirect (and often invisible) subsidy to these favored parties. These affiliated or favored investors should be required to bear their fair share of fund expenses and the most practical way to accomplish this is to require GPs to allocate such fees and expenses on a pro rata basis among all investors in a fund. Doing so would reduce the expenses charged to most investors and would improve the investment returns achieved by unaffiliated limited partners, which, in the case of the NEBF, improves its financial strength and the ability to provide benefits to its participants and beneficiaries. NEBF Investments therefore support the SEC's proposed rule with respect to the pro rata allocation of fees and expenses.



Fiduciary waivers and payment of SEC fines or penalties

In our experience, the standard of care, limits of liability, and indemnification provisions in Private Fund documentation are skewed entirely in favor of protecting GPs at the expense of the investors who entrust them with their capital. NEBF Investments' experience has been that, except in rare cases, GPs refuse to accept any express fiduciary obligations. Further, they often insist on exculpation and indemnification provisions that provide for blanket protection to GPs except where their conduct is actually found by a court in a final determination to be so egregious as to rise to the level of gross negligence, willful misconduct, or fraud. When pressed to include more investor friendly terms, counsel for GPs routinely invoke the defense that such terms are “not market”, resulting in a take-it-or-leave-it proposition for investors, notwithstanding that counsel for GPs have aggressively made the market for their advisor clients.

This construct poses a dilemma for pension fund investors like the NEBF that must make investment decisions consistent with ERISA's strict fiduciary requirements. ERISA investors acknowledge that is appropriate in most cases for GPs to draft their governing documents to ensure that their Private Funds are not subject to ERISA's fiduciary standards and its intricate prohibited transaction rules. However, as noted above, most GPs go much further and refuse to accept any fiduciary obligations and are protected from liability in a variety of situations where they have acted inappropriately. As a result, ERISA investors typically must accept a lower standard of care and loyalty with respect to Private Funds than they would for any other type of investment relationship. The SEC's proposal would serve to ease these concerns for ERISA investors.

Although GPs argue that their efforts to avoid fiduciary requirements allow them to operate more efficiently and with less cost, these provisions serve primarily to limit GP liability rather than to offer concrete benefits to investors. As GP push to gain access to individual or “retail” investors as well as institutional ones, the need for strict fiduciary standards becomes more necessary and critical to the efficient and effective operation of capital markets.

On rare occasion, the SEC levies penalties or fines on GPs that have acted improperly. Some GPs will in these instances categorize such fines and penalties as fund expenses and seek reimbursement from the fund, rather than treat the penalties as costs that should be borne exclusively by the GPs. Further, Private Fund contract documents typically provide for indemnification of the GP for a wide range of costs, leaving open the possibility that a GP might treat an SEC fine or penalty as an expense that it can charge to the Private Fund (and hence the investors). This practice raises concerns about equity between the GP and the investors and may serve to relieve the GP of financial responsibility for actions that resulted in the SEC's actions. This practice also may impose significant costs on investors. GPs should be solely responsible for any fines or penalties levied by the SEC and should be prohibited from passing these costs on to a fund and its investors.



For the reasons set forth above, NEBF Investments strongly supports the SEC’s proposal to preclude an adviser from seeking direct or indirect reimbursement, indemnification, exculpation, or limitation of its liability for a breach of fiduciary duty, willful misfeasance, bad faith, negligence (as opposed to gross negligence), or recklessness in providing services to a Private Fund. Specifically, we support the SEC’s proposed rule that would prohibit General Partners from seeking indemnification for breach of the GPs’ fiduciary duty, regardless of whether state or other law permits an advisor to contractually waive its fiduciary duty. Such waivers and overly GP-favorable exculpatory and indemnification provisions may have the effect of shifting significant costs from the GPs to investors. Absent a regulatory prohibition, investors will be compelled to continue to expend significant time, effort, and cost to negotiate appropriate protections when investing in Private Funds (which we estimate to involve thousands of dollars every time we negotiate a new private equity commitment). As noted above, this is particularly the case for ERISA investors like the NEBF.

Preferential Treatment Rule (Proposed Rule 211(h)(2)-3(a)(1) and (2))

GPs frequently treat their investors differently, provide differing terms and provisions in agreements, and disclose differing degrees of detail in information related to portfolio holdings. In some cases, these differences have material consequences to both those investors who receive such treatment and those who do not. All investors should have a right to know the nature of such preferential treatment and how it might affect the investors’ rights and investment returns. Specifically, all investors should be treated equally with respect to liquidity, distributions, exits from a fund, and access to secondary transactions, except in cases where regulatory or other concerns may exist that require otherwise. Investors are required to commit capital typically for more than decade and to grant the GP the discretion about when to acquire assets, when to sell holdings, and when and how much to distribute to investors over the life of the fund. Absent the ability to exit at their own discretion, investors need to be able to count on equal treatment by the GPs during the life of a Private Fund. They also deserve disclosure of any other preferential treatment granted to some favored investors. Without such transparency, investors are unable to appropriately evaluate the GP and its funds. We therefore support the SEC proposed rules with respect to preferential treatment of investors.

NEBF Investments appreciates the opportunity to provide these comments.

Sincerely,

NEBF Investments

By: 

Monte Tarbox
Executive Director of Investments