Gmail

SEC has authority to prohibit indemnification - it is just common sense - look at Berkshire

1 message

Fri, Dec 2, 2022 at 9:21 AM

Hi Mr. Scott and Mr. Pitt:
CC PE Lobby/SEC

I am just going to write this the way an investor sees it.

It is crucial that the PE world can't indemnify themselves. They need to be on the hook if they are taking risks with other people's money.

1) The Blackstone wholesalers who deal every day with the 5 million + crowd know that those investors have no idea how IRR works. You have seen my recorded conversations with Blackstone. Let's not pretend that accredited or QP investors don't need protection, they do. PE is charging full strength to retail and it is just common sense that the indemnification rule is there to protect them. Let's not pretend the accredited and QP level doesn't have to be adjusted way up. I believe they should raise the levels 3-4x. PE is tricky and FINRA 2210(D) requires that it be explained according to the audience. You can't use footnotes. The industry is simply flouting that rule in retail.

2) You are minimizing the "conflicts of interest" language which is actually an elephant. The LP's can't say no to PE because if they do, they are out of a job. I have dozens of examples but I am not trying to win a legal battle with you, I am trying to get you to admit the reality of the situation. The PE business model is based on the fact that excess returns accrue to the beneficiaries and therefore it is worth the expense and risk and complexity.

It is simply not true. Again, if you think I am wrong. Publish the returns without any IRR tricks. You can't even have a discussion when the returns are hidden. We could simply send out a simple zoom survey to the beneficiaries asking if they want PE to be indemnified. Nothing is so complicated. Yes, the LP's are sophisticated and have legal prowess. However, they don't have the best bargaining chip- the ability to walk away and tell the PE industry to get lost and just put it in an index fund. Conflicts are THE MOST IMPORTANT thing for an investor.

3) An indemnification provision is CERTAINLY a sales practice. Just like Buffet, you want your managers to take personal risk. It keeps them honest. Who wants to go into a deal where the promoter has almost no risk. It lets these guys sell, sell, sell, with no downside. Heads I win, tails you lose is a bad trade for the fireman and if they had the facts, they would agree.

4) An indemnification clause is CERTAINLY a compensation scheme. These guys are able to take huge risks, and take huge compensation with no down side. They would have a totally different view if they were taking personal risk. <u>See Buffet below- if they mess up with your money, they lose money as well- if that isn't compensation, what is?</u>

5) An indemnification clause is CERTAINLY a conflict of interest. See Buffet again. A teacher thinks the folks running the funds are acting like owners. They aren't and that is a conflict.

6) You say the SEC can't make a rule "prohibiting terms between sophisticated parties." You are leaving out the obvious fact that the LP's are conflicted. Jeff Hooke writes about this in "The Myth of Private Equity.". Anyone who follows PE has heard about it. Howard Marks mentions it

in his recent memo- attached. Michelle Celeriar wrote a PE article for the NYT. She called the ILPA, CALPERS and the PE lobby. No one would talk to her about how they report performance with IRR. The ILPA has a stance that PE is worth it. OF COURSE THEY DO!- They have no way to make that kind of income unless they are managing a complicated portfolio. Richard Ennis talks about this. He suggests indexing the entire thing.

https://www.nytimes.com/2021/12/04/business/is-private-equity-overrated.html

7) Look at wealth management. Who at MS/ML/UBS/ICapital has funds that beat the S&P. 95% don't. The 5% are usually sector funds like SilverLake-however, for every sector fund that does better, there is one that does worse. Let's say a teacher has $100 and $12 are allocated to Private Equity. That $12 is spread around 100 funds. Each fund only has $.10 (10 cents) of a teacher's money. If the S&P and a regular PE fund turn that 10 cents into 15 cents, a Silver Lake MAY turn it into 20 cents... but it could also turn it into 11 cents. But, for the teacher, it just doesn't matter. There are only so many Silver Lakes. It helps the managers as they compete to say they got a small allocation to a great fund. Then when they jumble everything together, it makes them look good. It just doesn't move the needle for the teachers. You learn this in the first 3 months in Wealth Management. Why don't the sophisticated LP's act this way? They are conflicted.

Again, if you think I am wrong, show the teachers and let them decide. Stop being paternalistic.

It is a joke.

ILPA "works" for the beneficiaries and they won't talk to the NYT. The PE lobby "works" for the beneficiaries and claims high returns and won't talk to the NYT? CALPERS is arguably the most "sophisticated" investor on the planet and "works for the beneficiaries" and they won't talk to the NYT about how they report performance?

We have a situation where the people who need the protection the most are being taken advantage of by their "agents". The SEC's mandate is to protect investors. They have to go a step further and make the returns public-without any IRR tricks or combining funds for window dressing.

Granted, an insurance company or a SWF is a battle of equals. However, you can't write rules for them. They have to be written for the beneficiaries. If PE is so good, they shouldn't care about not being indemnified. The Berkshire directors are taking that risk. What are the PE guys scared of?

The entire industry should first be pounding the table on transparency of returns (and fees.) Then you can have a discussion. I believe if this is tested in court, a Jury will agree with me.

Buffet does not provide liability insurance:

Buffett believes that corporate culture matters. At Berkshire, directors are expected to act like owners.

They are not treated like rock stars. They do not get fancy Wall Street-like perks. ***And if they screw up, they must bear the consequences without insurance protection.*** *Buffett explains:*

"They receive token compensation: no options, no restricted stock and, for that matter, virtually no cash.

We do not provide them directors and officers liability insurance, a given at almost every other large public company. If they mess up with your money, they will lose their money as well.