SUBMITTED ELECTRONICALLY

May 31, 2011

Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090
Attention: Elizabeth M. Murphy

RE: Proposed Rules on Incentive-Based Compensation Arrangements Release No. 34-64140; File No. S7-12-11

Dear Ms. Murphy:

The Private Equity Growth Capital Council (the "PEGCC") is submitting this letter in response to Release No. 34-64140, in which the Securities and Exchange Commission (the "Commission") has requested comments on proposed rules (the "Proposed Rules") implementing Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"). Section 956 of the Dodd-Frank Act requires the Commission, as well as the OCC, Board of Governors of the Federal Reserve System, FDIC, OTS, NCUA and FHFA (collectively, the "Agencies") to jointly prescribe regulations or guidelines with respect to incentive-based compensation practices at covered financial institutions. Our comments focus on the application of the Proposed Rules for the investment advisers ("private equity firms") to private equity and growth capital funds ("private equity funds").

The PEGCC is an advocacy, communications and research organization and resource center established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are 35 of the world's leading private equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.[1]

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[1] The members of the PEGCC are: American Securities; Apax Partners; Apollo Global Management LLC; ArcLight Capital Partners; Avista Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; Crestview Partners; Francisco Partners; Genstar Capital; Global Environment Fund; GTCR; Hellman & Friedman LLC; Irving Place Capital; The Jordan Company; Kelso & Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners; MidOcean Partners; New Mountain Capital; Permira; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital

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The PEGCC understands that Section 956 of the Dodd-Frank Act was adopted in large part to address perceived abuses and conflicts of interest in the area of executive compensation, including the perception that certain covered financial institutions maintain compensation practices that encourage inappropriate risk-taking. The PEGCC acknowledges the importance of rules that address and prevent practices that promote (*i*) inappropriate risk-taking behaviors and (*ii*) systemic risk that could cause failures of the financial sector, such as those experienced in the U.S. markets in 2008. However, the PEGCC believes that the compensation practices at private equity firms and funds do not encourage inappropriate risk-taking behaviors or pose any systemic risk concerns that would warrant the same disclosure and regulation of their compensation structures as is applicable to other financial institutions.[2] The PEGCC believes that the structure of compensation and earnings opportunities in place at private equity firms, derived from the nature of the private equity firm business model itself, already provides all the protection against the inappropriate risk-taking and compensation abuses that Section 956 of the Dodd-Frank Act strives to prevent. Other regulators have recognized this difference in risk and compensation profile in the treatment of private equity firms under their financial institution compensation regimes.[3] The PEGCC respectfully requests that the rules be modified accordingly, as discussed below.

I. Background.

General. The PEGCC's comments in this letter are informed by the nature of the private equity industry's investment and compensation model. To provide important context for our discussion to follow, we provide here a brief overview of the structure and operations of private equity firms and private equity funds. For a more detailed description of the business and operations of private equity, please see Annex A.

Private equity firms sponsor, manage and advise private equity funds. Private equity firms (or their owners) typically own and control their funds' general partners ("GPs"), which make investment decisions for each fund. Private equity firms frequently are privately owned and controlled by their senior investment professionals. Subject to limited exceptions (for certain non-U.S. firms, certain private fund advisers and venture

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Partners; TA Associates; Thoma Bravo; Thomas H. Lee Partners; TPG Capital (formerly Texas Pacific Group); Vector Capital; and Welsh, Carson, Anderson & Stowe.

2 See letters submitted by the PEGCC to the Financial Stability Oversight Council on November 5, 2010 and February 25, 2011 concerning private equity and systemic risk (available upon request).

3 See, *e.g.,* Directive EU 2010/76/EU.

capital firms), private equity firms are registered, or will be required to be registered early next year,[4] as investment advisers under the Investment Advisers Act of 1940.

Typical Structure. A typical private equity fund is structured as a closed-end pooled investment vehicle, most frequently organized as a limited partnership that acquires stakes in operating businesses called portfolio companies. The fund typically is controlled by a GP and managed and advised by an affiliated private equity firm. The GP makes a significant capital commitment to the fund, *i.e.*, a contractual agreement to contribute capital from time to time over the term of the fund as and when needed by the fund to make investments and pay expenses. The private equity fund also obtains capital commitments, at the beginning of its term, from sophisticated third-party investors who generally agree to become limited partners of the fund ("LPs"). The LPs, like the GP, contribute capital to the fund over its term. The LPs are not involved in the management or control of the business of the fund except in very limited circumstances (*e.g.,* to vote on conflicts of interest or to remove the GP). LPs of private equity funds are sophisticated investors; typical investors include corporate pension plans, public retirement plans, foundations, endowments, sovereign wealth funds, insurance companies and (historically) banks, and, to a lesser extent, very high net worth individuals and family offices. The typical structure (including fund terms, fees, governance, limitations on conflicts of interest and reporting) is negotiated with the LPs to ensure an alignment of interest between LPs and GPs. Under this structure, the GP's wealth creation is derived primarily from a substantial equity investment in the fund and through receipt of an allocation of a percentage of the private equity fund's profits (a "carried interest") after the LPs have received a return of invested capital and expenses (including management fees) plus a preferred return.

Long-term Investment Strategies; Limited Borrowing; No Cross-Collateralization. Private equity funds pursue a variety of investment strategies (*e.g.,* venture capital, growth capital, buyout, real estate, distressed and mezzanine investing) and invest in a broad range of industries and geographies. Capital is contributed to a private equity fund by its GP and its LPs over the fund's term as and when needed by the fund to make investments and pay its expenses. The term of a private equity fund is typically 10 years (subject to extension for up to two or three years if needed by the fund to dispose of any investments then remaining in the portfolio). Regardless of the type of portfolio investment made, the objective of a private equity fund is the same: increase the value of the portfolio company during the period that it is owned by the fund.

Private equity firms and funds are not interconnected with other financial system participants. The investment strategies of private equity funds are mostly long-term "buy

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[4] While the exemption that many private equity firms rely upon will be rescinded effective July 21, 2011, the Commission has indicated that the implementation date for registration will be extended until the first quarter of 2012.

and hold" strategies, not trading strategies. Private equity funds typically purchase highly illiquid securities, and hold each of these investments for between three and seven years. With the exception of certain real estate funds, private equity funds almost never borrow, and frequently are prohibited from borrowing by their partnership agreements or other governing documents. Instead, they use long-term capital commitments from their LPs to make long-term investments. They do not rely on (or for that matter provide) short-term credit, are not a material source of credit to businesses, and are not a source of credit at all to consumers or governments. Because of the long-term, illiquid nature of their investments and because private equity funds typically do not borrow, private equity funds do not offer (and are not able to offer) redemption rights to their investors. Thus, investors cannot force private equity funds to sell securities into the markets in times of panic or financial distress.

Some private equity funds, such as buyout funds, purchase companies using equity and borrowed money. The borrowings or other obligations of a portfolio company, however, are not guaranteed by, or secured by pledges of the assets of, the fund or any other portfolio company. So, the failure of one portfolio company should not impact the fund's other portfolio companies. The fund and its investors may lose their investment in the failed portfolio company, but not in other investments held by the fund. Similarly, the obligations of a private equity fund are not guaranteed by, or secured by pledges of the assets of, another private equity fund; and no private equity fund advised by a private equity firm guarantees or pledges its assets to secure the obligations of the private equity firm, or vice-versa. So, the failure of one private equity fund advised by a private equity firm should have no impact on the other funds advised by that firm.

Economic Returns. When an investment is sold by a private equity fund, the sale proceeds are typically distributed by the fund to its investors so that: first the investors receive a return of their invested capital and fund expenses; next, the investors receive a preferred return (typically 8% per annum) on that capital and those expenses; and then the profits are allocated among LPs and the GP so that over the life of the fund the GP receives, a share of the profits, typically 20%, referred to as the GP's "carried interest" and discussed in more detail below.

GP Investment. Additionally, GPs and their principals are required to invest their own money side-by-side with LPs, either directly in the private equity fund or through a co-investment vehicle. This aspect of the private equity model ensures a strong alignment between the interests of the private equity fund and its managers and its LP investors. Because the private equity firm principals invest side-by-side with the LP investors, to the extent that any risks are taken on behalf of the LPs, the private equity principals are also taking the same risk with their own capital.

Private Equity Compensation Practices. As discussed, a private equity fund is typically controlled by its GP, and managed and advised by an affiliated private equity firm. Normally, neither the fund nor its GP has any employees. Rather, the investment

professionals and staff who source and monitor investments made by a private equity fund are employed by the private equity firm. Those employees typically receive salaries and bonuses from the private equity firm. As noted above, the senior investment professionals (sometimes called "principals") typically also invest in the fund through the GP and additionally have the opportunity to share in carried interest distributions made by the fund to the GP. The management fees payable to, equity commitment required from and carried interest opportunities made available to the principals are negotiated with the LPs and contractually determined before the term of the private equity fund begins.[5] Because of this, the principals' compensation and carried interest opportunity in the aggregate are not discretionary or subject to fluctuation over the life of the fund.

Management Fees. In most cases a private equity firm receives a management fee from the private equity funds that it manages and advises. The amount of the management fee is negotiated prior to the commencement of the term of a private equity fund between the private equity firm and the GP (and their counsel and advisers), on the one hand, and the LPs (and their counsel and advisers), on the other. Typically the management fee is between 1.5% to 2% per annum of the fund's committed capital during the fund's investment period, and thereafter through the end of the fund's term the same percentage (or less) of the amount of invested capital that remains in the fund's portfolio (so that the fee is reduced as investments are disposed of). The fee does not increase based on the timing or value of fund investments. The private equity firm uses the management fee to pay the firm's expenses and the salaries and other annual compensation (including bonuses) of the firm's principals and other personnel.

Carried Interest. Carried interest is a return on the realized gains of an investment given to a private equity fund's GP, typically structured as a partnership allocation of profits. A GP's carried interest is equal to a specified percentage (typically 20%) of the cumulative net profits from the private equity fund's investment program, meaning that (*i*) a GP only receives any payment in respect of its carried interest if the fund is profitable, and (*ii*) the size of the payment is directly proportional to the cumulative net profits achieved. The carried interest percentage, and the timing and calculation of carried interest distributions, are heavily negotiated at the beginning of the term of a private equity fund between the private equity firm and the GP (and their counsel and advisers), on the one hand, and the LPs (and their counsel and advisers), on the other. These carried interest distributions, derived directly from realized investment profits (typically, after investors achieve a return of their investment amount and fund expenses and after offsetting any losses), are distributed by the fund to the GP, and then

[5] LPs are sophisticated investors and are generally represented by counsel when negotiating these terms. Many institutional LPs are members of the Institutional Limited Partners Association (ILPA), an association for institutional investors in the private equity sector. ILPA is a forum for the private exchange of information, networking and relationship-building specifically designed to assist LPs and protect their rights.

by the GP to the principals according to their participation percentages in the GP.[6] In this way the principals (through the GP), along with the LPs, share in the fund's success or failure. If the fund is successful, a principal typically receives a greater percentage of earnings through carried interest distributions than through base salary and bonus. Since carried interest distributions are calculated based on realized gains (net of any prior realized—and sometimes unrealized—losses), all distributions to the GP (and by extension to the principals) are automatically adjusted to correspond with actual investment and fund portfolio-wide performance.

Clawbacks. Clawback covenants are universally used to ensure that payments from realized gains to the GP (and by extension to the principals) over the life of a private equity fund correspond with fund performance over the same period. These clawbacks require that carried interest recipients return any over-distributions of carried interest to the GP that might arise if, for example, carried interest distributions are made on a deal-by-deal basis (*i.e.,* where carried interest distributions are made as individual investments are sold) and the last investment sold is sold at a loss. Thus, if a GP underperforms in later-realized investments, it (and its principals) has to pay back the investors. These clawbacks are typically backed by personal guarantees from each principal who has a right to a percentage of carried interest distributions. Some firms (and/or their LP investors) require that a portion of the realized carry be placed in escrow pending final realization of all of a fund's investments to secure the clawback obligations. In all cases, a mechanism exists to enforce any clawback right that should arise. Clawbacks backed by personal guarantees or escrows are a unique feature of the private equity business model. Because of this clawback feature, backed by personal guarantees, GPs (and their principals) have longer-term and greater exposure to losses than any exposure from a 3-year compensation deferral feature.

II. The Proposed Rules should be tailored to reflect covered financial services firms' risk profiles and compensation practices. Private equity firms and funds do not raise systemic risk concerns, and their compensation packages are linked to long-term investment performance.

The PEGCC believes that the approach taken by the Commission and the other Agencies in the Proposed Rules does not adequately address the differences in risk profiles and compensation practices at the numerous types of covered financial institutions regulated by the Agencies. We believe and respectfully request that the Proposed Rules be revised to tailor their application to covered financial institutions, and in particular to private equity firms, to more appropriately reflect these differences, as discussed in this Section II and in the remainder of this letter. In particular, the PEGCC also respectfully requests that the final rules recognize that (*i*) private equity firms and

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[6] Principals (and the LPs) typically receive tax distributions to cover taxes payable on allocations of profit from the underlying partnership that are not otherwise accompanied by distributions.

funds do not raise systemic risk concerns and (*ii*) the primary source of earnings for GPs and their principals (carried interest arrangements) are linked to actual, long-term investment performance, and generally do not raise the types of concerns that the Proposed Rules were intended to address, as further discussed below, and modify the application of the Proposed Rules to private equity firms accordingly. This modification would be in keeping with the regulatory practices adopted in other countries, which have exempted private equity firms from certain compensation regimes (similar to those of the Proposed Rules), because the private equity model does not pose the excessive compensation dangers and systemic risks associated with other financial institutions.

Systemic Risk Background. The Dodd-Frank Act was implemented to respond to systemic risk and as a means of identifying and regulating large, interconnected institutions whose failure could affect the entire financial system.[7] One of the Senate's concerns when debating the Dodd-Frank Act was the lack of transparency in unregulated investment pools, particularly funds whose trades "can move markets," with systemic consequences.[8] Notably, the Senate Banking Committee report issued in connection with the Dodd-Frank Act hearings stated that "private equity funds characterized by long-term equity investments in operating businesses do not present the same risks as [other] large private funds."[9] We believe that private equity firms and private equity funds, as a class and individually, do not present systemic risk concerns.

Private Equity Firms Do Not Present Systemic Risk Concerns. The core business structures of private equity firms are significantly different from those of other financial firms in that: (*i*) private equity funds have limited or no leverage at the fund level, and therefore are not subject to unsustainable debt or creditor margin calls; (*ii*) rather than relying on short-term funding, private equity funds obtain long-term capital commitments, with that capital being locked up for their entire terms (typically 10 – 12 years); (*iii*) private equity funds do not offer investors redemption rights; (*iv*) private equity firms and funds are not deeply interconnected with other financial market participants through derivatives positions, counterparty exposures or prime brokerage relationships; (*v*) private equity investments ("portfolio investments" or "portfolio companies"), firms and funds are not cross-collateralized, so neither investors nor debt holders can force a fund to sell unrelated assets to pay a debt, and the failure of one portfolio investment or fund will not have cascading effects on other portfolio companies or funds; (*vi*) private equity funds typically invest in and hold illiquid securities of operating companies, and do not trade or invest in liquid, listed equity or intangible

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7 Private equity firms do not have the magnitude necessary to pose systemic risk concerns—the total value of all private equity holdings is equivalent to just 2.6% to 4.3% of corporate stocks and 3.1% to 5.3% of GDP. S. Rep. No. 111-176, pt. I at 2 (2010).

8 S. Rep. No. 111-176, pt. V at 38 (2010).

9 *Id.* at 75 (2010).

financial assets (such as derivatives or swaps); and (*vi*) borrowing by companies owned by private equity funds is still a small portion of the overall credit market, representing under five percent of all U.S. credit market obligations outstanding.[10]

Purpose of Incentive Compensation Regulation Does Not Apply to Private Equity Firm Compensation Practices. Subtitle E (Investor Protection) of the Dodd-Frank Act was enacted to prevent executive compensation practices that promote excessive risk taking, particularly by systemically important financial institutions.[11] Private equity firm compensation arrangements do not promote the excessive risk-taking that the Proposed Rules are intended to address because: (*i*) in private equity firms, stakeholders (*i.e.,* the sophisticated third-party investors in private equity funds) monitor, negotiate and control distributions (management fees and carried interest paid and distributed to the private equity firm and the GP, respectively); (*ii*) private equity firm employees make significant direct investments in the fund, aligning the interests and incentives of employees with investors; (*iii*) private equity firm compensation practices are structured so as to not affect their risk profile or impact the firm's capital base; and (*iv*) the distribution arrangements at private equity firms inherently include risk adjustment, deferral of incentive payments until realization of risks, long-term performance-based payouts and claw-back mechanisms for return of over-distributions.

Negotiated by Stakeholders. The Proposed Rules state that supervision and regulation of executive compensation by the Agencies is necessary because it is difficult for shareholders of a financial institution to monitor effectively and control incentive-based compensation arrangements throughout an institution; and such arrangements may materially affect the institution's risk profile. Unlike compensation arrangements at banks and many other financial institutions—arrangements that traditionally have been put into place with no input from shareholders—private equity management fees and other compensation and carried interest arrangements are the result of direct and detailed negotiations with sophisticated third-party stakeholders (*i.e.*, a private equity fund's LPs), many of which are represented by separate counsel.[12] These negotiations allow private equity investors effectively to monitor and control compensation and carried interest allocations, ensuring that the size of the variable compensation pool is not excessive, and

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[10] See *Regulating Hedge Funds and Other Private Investment Pools, Hearing on the Private Fund Transparency Act Before the Subcomm. on Securities, Insurance and Investing of the S. Comm. on Banking, House and Urban Affairs,* 111th Cong. 1-2 (July 15, 2009) (statement of Mark Tresnowski, Managing Dir. and Gen. Counsel of Madison Dearborn Partners, LLC) at 5-6. For a further discussion of why private equity firms do not pose systemic risk concerns, please see the letter submitted by the PEGCC to the Financial Stability Oversight Council on November 5, 2010.

[11] S. Rep. No. 111 176, pt. II at 35 (2010).

[12] *See supra* note 5.

providing protective features for investors, namely (*i*) realization-based payments and (*ii*) clawbacks.

Carried Interest. As described in Section I, carried interest distributions are inherently success-based because they are earned based on a percentage of the fund's overall return on investment, meaning that both (*i*) the absolute size of the payment is directly proportionate to the actual gains and losses achieved and (*ii*) payment is not made until the actual results of the investment are known. Further, the payments are structured such that they cannot threaten a firm's liquidity or ability to make future investments, since the source of carried interest distributions is net profits from investments. Furthermore, clawbacks, backed by personal guarantees of the principals and/or escrow arrangements, ensure that the principals entitled to carried interest allocations will receive no more value than the carried interest is intended to provide.

Management Fees. As described in Section I, a fund's committed capital (the amount of money available to make investments and pay fund expenses) is determined at the inception of the fund. Management fees typically are based on a fixed percentage of that committed capital and do not vary based on investment. Therefore, they do not create or incentivize risk. Further, because the amount is a fixed percentage of the committed capital by contractual arrangement, as negotiated with sophisticated investors, the management fee is structurally prevented from becoming distorted by risk-taking activities. Accordingly, the absolute size of management fee-based bonus pools cannot be excessive.

No Compensation-Related Risk of Material Loss. The structure of a private equity firm insulates it from risks that may lead to a material loss to the firm. As discussed in Annex A, private equity firms typically have limited or no leverage at the fund level, so private equity funds are not subject to unsustainable debt or creditor margin calls. Further, private equity firms are not deeply interconnected with other financial market participants through derivatives positions, counterparty exposures or prime brokerage relationships. A private equity firm's liability is limited primarily to its capital commitment to the funds that it advises and manages, and nothing that happens at the underlying fund can cause a failure of the firm or any cross-default between related entities. Compensation typically is paid by the firm from management fees received from the funds that the firm manages and advises, and carried interest distributions are made from the realized investment profits of those funds; neither is paid from the private equity firm's own capital.

III. The definition of "incentive-based compensation" should be clarified.

Incentive-Based Compensation. The Commission has requested comments on the proposed definition of "incentive-based compensation," including whether there are any forms of compensation that the Agencies should clarify are not incentive-based

compensation. "Incentive-based compensation" is defined in the Proposed Rules as "any variable compensation that serves as an incentive for performance."

The focus on regulating *incentive-based* compensation is premised on the belief that flawed incentive compensation practices in the financial industry—notably, arrangements that rewarded employees for short-term profits or revenue without regard to long-term risks or actual results—contributed to the financial crisis by incentivizing employees to expose firms to inappropriate risks.[13]

Proposed Clarification of "Incentive-Based Compensation" Exclusions. According to the Proposed Rules, compensation arrangements based solely on continued employment, or which "provide rewards solely for activities or behaviors that do not involve risk-taking," would not be considered incentive-based compensation. This excluded category includes salary, payments for achieving or maintaining professional certification, company 401(k) contributions, and dividends paid and appreciation realized on stock or other equity instruments that are owned outright by a covered person and not subject to any vesting or deferral arrangement (irrespective of whether such deferral is mandatory). We believe that these exclusions are appropriate, as such activities do not involve the dangers that regulation of incentive compensation is meant to address.

For clarity, the PEGCC respectfully requests that the final rules explicitly list additional types of payments that are excluded from the scope of the "incentive-based compensation" definition. As noted in footnote 6 above, periodic tax distributions related to equity in the form of partnership interests are made to covered persons to allow tax payments as they become due; these distributions do not create or incentivize risk-taking behavior and thus should be excluded. Similarly, compensation payments sourced from management fees should be excluded as they are based on a fixed percentage of committed capital and do not increase based on the investment or return of capital, and therefore do not incentivize risk.

Additional Categories of Excluded Compensation. In addition, the PEGCC respectfully requests that the final rules exclude from the definition of incentive-based compensation additional categories of equity interests that provide inherent protection against excessive risk taking, whether or not subject to vesting, such as general partner interests and other interests with unlimited liability. This treatment would be consistent with the underlying policy of the Proposed Rules. Accordingly, the PEGCC further respectfully requests that carried interest arrangements at private equity firms and funds also be explicitly excluded from the definition of incentive-based compensation, as carried interest (*i*) is structured to pay out in such a way that it does not encourage excessive risk-taking behavior, (*ii*) is always calculated and earned with respect to the

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[13] See, Financial Stability Board Principles for Sound Compensation Practices, April 2, 2009; Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395 (June 21, 2010).

performance of the underlying investments of the private equity firm over a period of years, (*iii*) does not involve vesting conditions that could encourage excessive risk and (*iv*) cannot lead to a material loss at the private equity firm because it is paid only from profits earned on a successful investment by the fund. Carried interest should not be considered "incentive-based compensation" under the Proposed Rules because its inclusion would not serve the rules' objective and would impose an undue burden on private equity firms.[14]

IV. The method for determining the $1 billion and $50 billion asset thresholds should be modified.

The Commission has requested comments on the proposed method of determining asset size for investment advisers, including specifically on whether the determination of total assets should be further tailored for certain types of investment advisers, including private equity firms. We believe the rules regarding asset size determination should be modified to ensure that asset size thresholds are appropriately and fairly applied to investment advisers.

Purpose of Asset Size Thresholds. We understand that there are three primary reasons for implementing rules based on asset size: (*i*) flawed incentive compensation approaches at larger organizations are more likely to have adverse effects on the broader financial system; (*ii*) larger institutions are more significant users of incentive compensation; and (*iii*) to avoid imposing an undue burden on smaller institutions.[15]

Testing Using Total Consolidated Assets As Reported in the Firm's Most Recent Year-End Audited Consolidated Statement of Financial Condition Is Not Appropriate For Determining Private Equity Firms' Asset Size. Under the Proposed Rules, total assets shown on the investment adviser's balance sheet for the most recent fiscal year would determine whether a private equity firm met the thresholds for covered financial institution ("CFI") or larger CFI status. The PEGCC believes that the Commission should modify its definition of "total assets" as applied to private equity firms, so that "total assets" includes only the proprietary assets of a private equity firm, inclusive of the private equity firm's own investments in the funds (and portfolio companies) that the firm manages. Assets that the private equity firm manages for third-party investors (whether pursuant to separate account arrangements or through private equity funds managed by the firm) should not be counted. Such third-party managed assets should not

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[14] We also believe that, to the extent that equity subject to vesting is treated as "incentive-based compensation," the rules should be clarified to make clear that distributions on and appreciation of such equity between grant and vesting would not be considered additional "incentive-based compensation," because it is the grant-date value that is considered when compensation decisions are made.

[15] Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395 (June 21, 2010), at 36406.

be included in a private equity firm's calculations even if current Generally Accepted Accounting Principles ("GAAP") require some of these assets to be consolidated with those of the private equity firm.[16]

Using a private equity firm's total consolidated assets, which in some cases would include third-party managed assets, rather than assets that are owned by the private equity firm, would provide a misleading view of the size and interconnectedness of the private equity firm. Indeed, a private equity firm's ability to acquire, hold and dispose of third-party managed assets is strictly limited by contract, regulation and other legal arrangements. Neither the private equity firm nor any creditor of the firm can use third-party managed assets to gain access to liquidity or to settle a debt of the firm. In addition, because holdings of private equity funds that are sponsored by the same private equity firm are not cross-collateralized or cross-guaranteed, a counterparty or investor's exposure to one private equity fund managed by a particular private equity firm does not lead to exposure to other funds managed by that same firm. (See Annex A, hereto, at Section 8.) For these reasons, the PEGCC strongly believes that the proper metric for measuring the size and interconnectedness of a private equity firm is the amount of the firm's own assets that are at risk.

Conflating assets that are owned by the private equity firm with assets managed by the firm for third parties in defining "total assets" would obfuscate the amount of the true assets of a private equity firm, reports that may be misleading to regulators and result in potentially varying treatment for otherwise similarly situated asset managers. This would inappropriately subject very small firms with small operations and few actual assets to burdensome reporting and other obligations under the Proposed Rules and subject larger private equity firms, which do not raise systemic risk concerns, to the provisions of the Proposed Rules applicable only to larger CFIs.

For these reasons, the PEGCC recommends that the Commission modify the concept of "total assets." The definition should start with the consolidated assets concept, but, as relevant to private equity firms, should allow for any necessary deductions for managed or other non-proprietary assets. This would produce a figure that includes only the consolidated assets of the private equity firm that are at risk regardless of the private equity firm's accounting treatment of managed assets.

V. Required deferral of executive officer incentive compensation should not apply to private equity firms.

Private Equity Firms Should Not Be Subject To Any Deferral Requirements. The Proposed Rules require larger covered financial institutions to defer 50% of annual

[16] The Financial Accounting Standards Board is currently reconsidering the accounting rules used to determine total assets as shown on a private equity firm's balance sheet, and it is not currently known when final guidance regarding consolidation will be implemented.

incentive compensation payments over a multi-year period to allow employers to adjust the amount received by an employee in the event of poor performance. The Commission has asked for comments on several aspects of the deferral requirements, including whether deferral should not be required for certain categories of institutions (*e.g.,* investment advisers) based on the business risks inherent in that business or other relevant factors. We believe that deferral should not be required for private equity firms because: (*i*) unlike other financial firms, private equity firms do not give rise to systemic risk concerns; (*ii*) earnings opportunities for private equity firm covered persons are already substantially deferred through carried interest arrangements; (*iii*) the principal components from which compensation may be paid, and from which wealth creation is derived, are negotiated by sophisticated outside investors; (*iv*) the carried interest structure combined with the clawback features already provide for deferral and risk-adjustment of rewards; and (*v*) requiring deferral would put U.S. private equity firms at a substantial economic disadvantage compared with their peers at other financial institutions and at private equity firms in other countries. As discussed, private equity carried interest arrangements, combined with clawback features, are already an ideal implementation of what the Proposed Rules hope to achieve. We discuss this last point below.

Other financial services institutions reward their employees primarily through salaries and large annual incentive bonus payments. In contrast, a significant portion of the earnings opportunity made available to private equity firm covered persons is typically in the form of carried interest, which are long-term profits arrangements based on realized returns, as opposed to annual awards based on short-term results. Covered persons are also required to make significant equity commitments to the funds that they manage. In return for the opportunity to participate in carried interest distributions realized over the long-term life of a fund, private equity firm covered persons accept significantly smaller ordinary compensation packages (*i.e.*, salaries and annual bonuses) than they would receive if they worked in other financial services industries. They typically rely on these salaries and annual incentive payments to cover their normal expenses, as well as help to fund the up-front capital commitments of the GPs to each investment fund, pending realization, if any, of their carried interests. Because such a large portion of a private equity firm employee's earnings opportunity is already deferred through carried interest opportunities, requiring covered persons to defer annual incentive compensation on top of those substantial deferrals would negatively impact private equity firms' ability to attract and retain the talented professionals necessary for their businesses.

In recognition of the risk and compensation profile of private equity firms, some European regulators have exempted private equity firms from deferral requirements similar to the Proposed Rules. In applying a proportionate approach to firms by reference to their size, internal organization and the nature, scope and complexity of their activities, the UK Financial Services Authority's Remuneration Code (the "Code") requires firms

regulated by the Financial Services Authority ("FSA") to have remuneration policies that promote sound and effective risk management. The Code has addressed proportionality by dividing firms covered by the Code into four tiers, with the Code applying most rigorously to tier one firms and least rigorously to tier four firms. The Code fully exempts from its application many FSA regulated entities whose activities are limited to providing investment advice, including such entities that are owned by non-UK based private equity groups. Generally, private equity firms fall into tier four and, accordingly, are exempt from the Code's requirement to defer at least 40% of variable remuneration for a period of at least 3 – 5 years, among other obligations. [17] The UK Rules were implemented pursuant to Directive EU 2010/76/EU, which makes clear that the rules should be applied proportionately to investment firms. Thus, it is anticipated that similar rules will be established in the other EU countries. Requiring deferral at U.S. private equity firms would put U.S. entities at a competitive disadvantage compared to private equity firms not subject to the U.S. rules.

Carried Interest Should Not Be Subject to Deferral. If the Commission does not exempt large private equity firms from the deferral requirements and classifies carried interest as incentive-based compensation, the PEGCC urges the Commission to confirm expressly that carried interest is not "annual compensation," and, accordingly, is not subject to the deferral requirements applicable to annual incentive compensation at larger covered financial institutions. As discussed, carried interest is calculated and earned with respect to performance of underlying investments over a period of years, and is therefore inherently deferred from the grant date over a period of time that allows the risk associated with the firm's investments to be fully realized. A further deferral of, or application of a rigid vesting schedule to, carried interest payments would serve no purpose.[18]

If, however, the Commission declines to clarify that carried interest payments are not annual incentive compensation, the PEGCC believes that the Proposed Rules should (*i*) be clarified to provide that such interests are valued and treated as incentive compensation at grant for purposes of calculating deferral and that any required deferral

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[17] Firms in tier four are generally exempt from the following requirements of the Code: (*i*) that a substantial portion, which is at least 50%, of any variable remuneration (*e.g.*, bonuses) should consist of shares other than financial instruments; (*ii*) that at least 40% of variable remuneration must be deferred over a period which is not less than 3-5 years; (*iii*) that any variable remuneration, including a deferred portion, is paid or vests only if it is sustainable in light of the financial position of the firm as a whole and justified by the performance of the firm, the relevant business unit or the individual concerned; (*iv*) that the firm sets appropriate ratios between fixed and variable rate remuneration; and (*v*) that the governing body of the firm may carry out the function of the remuneration committee, where this is appropriate.

[18] The practice at many private equity firms is to require that a portion of realized carry be placed in an escrow account. The requirement to escrow a portion of the cash carry ensures that cash is available to meet any clawback required.

period applicable to carried interest begins when the carried interest is granted (usually at the outset of the fund), or, at the latest, at the fund's first investment, and not at realization of the underlying investments, (*ii*) permit tax distributions and distributions upon realization of investments, even if during the vesting period, and (*iii*) apply a less rigid deferral schedule, rather than the fixed three-year schedule, that better matches the fund's underlying investment risk. To require an additional deferral period upon realization of the investment, or to require holdback of payments after realization, would serve no policy purpose (as there are no "tail" risks to a private equity firm associated with a portfolio investment after its disposition).

Bonuses Based on Management Fees Should Not Be Subject to Deferral. The rule that 50% of annual incentive compensation be deferred is premised on a compensation system where most of a covered person's incentive compensation is paid in the form of an annual bonus. For private equity firm covered persons, however, most of their variable earnings opportunity (typically, well over 50%) is in the form of carried interest payments. Thus, because (*i*) there is no risk-taking associated with or incentivized by compensation sourced from management fees (as discussed above, the management fees from which bonuses are paid are fixed in amount and not based on the results of risk activities) and (*ii*) so much of a private equity employee's financial opportunity is already deferred through carried interest arrangements, a requirement to defer bonuses paid from management fees serves no further purpose.

Additional Considerations Relating to Tax Liability Distributions. The Commission requested comments on whether there are additional considerations, such as tax considerations, which may affect the ability of larger covered financial institutions to comply with deferral, or that the Agencies should consider in designing the deferral provisions. Most private equity firm employees hold partnership interests, implicating very different tax rules than ordinary compensation. Partners are taxed when an allocation of income occurs (whether or not distributed). In contrast, ordinary income is generally not taxable until cash or property is actually paid to the employee. Partners may be required to pay taxes on income from management and other fees and profit allocations from their carried interests at the time of allocation, even if deferral of payment is required under the rules. Thus, the PEGCC respectfully requests that the final rules provide that any deferral in such circumstances should be on an after-tax basis in order to allow payment of taxes as they become due and that the tax distributions themselves should be exempt from deferral requirements.

VI. Clarification should be provided as to how affiliated entities are to comply with the reporting requirements.

The Agencies have asked for comments on all aspects of the reporting provisions in the Proposed Rules. Where there are several entities in a consolidated group, each of which may be considered a CFI (*e.g.*, a parent or holding company with more than one investment adviser or subsidiary) or where groups of CFIs are otherwise affiliated,

further guidance is needed to determine which entities would be required to report and how such reports would be structured. Is each entity looked at separately and required to file a separate report, based on its size? Are consolidated groups considered a single entity for size and reporting purposes? Are affiliated entities considered separate entities or a single entity? We suggest that in such situations, consolidated and affiliated CFIs should be allowed either to consider and report each CFI separately, or to report on a combined basis. Such flexibility would allow each CFI to determine the method of reporting that made the most sense based on the size, structure and complexity of its business, while still meeting the policy goals of the Proposed Rules.

VII. Factors for determining if compensation is excessive should be clarified.

The Commission has asked for comments on the factors that the Agencies will consider to determine if compensation is excessive, including whether additional factors should be considered. CFIs need further guidance to gauge whether their compensation could be considered "excessive" and how the Commission will apply the standards. Particularly, we believe that the Proposed Rules should clarify that compensation will be deemed "excessive" based on its promotion of inappropriate risk-taking or its ability to lead to a material financial loss to the covered financial institution, rather than based on the dollar amount of the awards. Additional guidance should be provided to describe:

(1) How the factors noted by the Commission will be weighted in determining whether compensation is excessive.

(2) How important industry standards are to the determination that compensation is excessive. In the private equity industry, there is a customary practice for employee compensation that, as discussed above, already incorporates the risk-reducing features that the Proposed Rules are intended to encourage. Private equity firms would consider industry standards the most important factor in determining if compensation practices are appropriate. We believe that the fact that compensation practices fall within the range of compensation practices at comparable private equity institutions strongly suggests that such compensation practices are not excessive, and therefore respectfully recommend that this factor should be given considerable weight. For the reasons mentioned below, however, we also believe that compensation practices that differ from those of comparable covered financial institutions should not be presumed to be excessive.

(3) What other factors the Agencies consider to be relevant. In order to assess how the factors will impact private equity firms, it is important to know what additional factors, or what type of factors, will be considered.

Private equity firms and other financial institutions face intense competition for talent, both within the private equity industry and from numerous other types of financial institutions that are regulated by the Agencies, as well as from unregulated industries and global firms, including businesses that are not "comparable financial institutions." We

believe that this competition must be factored into any analysis of a covered financial institution's incentive compensation arrangements and whether they are considered "excessive." A covered financial institution may appropriately put in place incentive compensation arrangements that differ from those of comparable covered financial institutions because it believes that such differing arrangements are necessary to attract and retain the best talent in a competitive environment. It should not be presumed that these differing compensation arrangements are excessive. Accordingly, this competition for talent must be factored into any determination as to whether compensation is "excessive." In this regard, the PEGCC recommends that the factors to be considered in determining whether incentive compensation is "excessive" should also include:

(1) Comparable compensation practices at other kinds of financial and other institutions that compete for the same employee talent pool; and

(2) The compensation history of a covered person with a prior employer (needed to attract new hires).

We also believe, and request that the final rules provide, that the size of the overall compensation pool and how it is determined should be a factor in determining "excessive" compensation, and that the total incentive compensation pool should be determinative of "excessiveness," not how the pool is allocated among individuals. (If a total pool is reasonable and not excessive, its distribution to and among individual managers should not be considered excessive.)

In addition, incentive pools that are determined in consultation with institutional investors, such as in the case where a private equity firm negotiates management fees and carried interest arrangements with institutional investors, should be a significant factor in making any determination that the compensation arrangements are not considered excessive. The PEGCC respectfully requests that the final rules so provide.

Covered financial institutions need certainty in designing and analyzing their compensation practices. Accordingly, the PEGCC respectfully requests that the final rules further clarify how compensation is valued and, in particular, how unvested and deferred awards are to be treated, in determining whether compensation is deemed "excessive." Because compensation decisions are made, and compensation expenses determined, at the time of grant, we believe that, to the extent that equity subject to vesting is treated as "incentive-based compensation," the final rules should provide (*i*) that for "incentive-based compensation purposes," any deferral period required under the Proposed Rules would begin at grant and not at the realization date of such equity, and (*ii*) that earnings on and appreciation of such equity between grant and vesting would not cause an initial determination that a grant was not "excessive" to be reevaluated.

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The PEGCC appreciates the opportunity to comment on the Proposed Rules and would be pleased to answer any questions you might have regarding our comments, or regarding the private equity and growth capital industry more generally.

Respectfully submitted,

Douglas Lowenstein
President
Private Equity Growth Capital Council

cc: The Honorable Mary L. Schapiro, Chairman
The Honorable Kathleen L. Casey, Commissioner
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner

Annex A

Structure and Operations of Private Equity Firms and Funds

This summary was prepared by the Private Equity Growth Capital Council (the "PEGCC"). The PEGCC is an advocacy, communications and research organization and resource center established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are 35 of the world's leading private equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.

1. Private Equity Firms

Private equity firms sponsor, manage and advise private equity funds (which are described below). Private equity firms, or the owners of private equity firms, typically own and control their funds' general partners (or, in the case of a fund that has a non-partnership structure, the equivalent controlling entity), which make investment decisions for the fund ("GPs"). Private equity firms most frequently are privately owned and controlled by their senior investment professionals. Subject to limited exceptions (for non-U.S. firms, certain private fund advisers and venture capital firms), private equity firms are registered, or will be required to be registered early next year, as investment advisers under the Investment Advisers Act of 1940.[1]

Private equity firms may have one or several lines of business. Many private equity firms organize and advise a private equity fund to pursue a particular private equity investment strategy and, once that fund is largely invested, the private equity firm will organize a successor fund to continue that investment strategy. Other private equity firms may pursue two or more distinct private equity investment strategies, organizing a fund (and then successor funds) to pursue each of those strategies. Other private equity firms may organize different private equity funds to invest in different geographies.

In addition, some private equity firms—although primarily in the business of advising private equity funds—also have ancillary (non-private equity) businesses, such as hedge funds or fund of funds businesses, among others. These ancillary businesses are small relative to large asset management businesses and, critically, are not cross-collateralized or otherwise interconnected with the private equity firm or any of the private equity funds advised by the firm.

[1] While the exemption that many private equity firms rely upon will be rescinded effective July 21, 2011, the Commission has indicated that the implementation date for registration will be extended until the first quarter of 2012.

2. Private Equity Funds: Typical Structure

Private equity funds are closed-end pooled investment vehicles, most frequently organized as limited partnerships, that invest in operating businesses ("portfolio companies"). A private equity fund typically is controlled by its GP, which makes investment decisions for the fund and is affiliated with the private equity firm that advises the fund. The GP makes a significant capital commitment to the fund, *i.e.*, a contractual agreement to contribute capital from time to time over the term of the fund as and when needed by the fund to make investments and pay expenses. The private equity fund also obtains capital commitments, at the beginning of its term in private placement transactions, from sophisticated third-party investors who agree to become limited partners (or members or shareholders in a non-partnership structure) of the fund ("LPs"). The LPs, like the GP, contribute capital to the fund over its term. The LPs are not involved in the management or control of the business of the fund except in very limited circumstances (*e.g.,* to vote on conflicts of interest or to remove the GP). LPs of private equity funds include corporate pension plans, public retirement plans, foundations, endowments, sovereign wealth funds, insurance companies and (historically) banks, and to a lesser extent very high net worth individuals and family offices.

3. Private Equity Funds: Investment Strategies and Diversification

Private equity funds pursue a variety of investment strategies (*e.g.,* venture capital, growth capital, buyout, real estate, distressed and mezzanine investing) and invest in a broad range of industries and geographies.[2] While an individual private equity fund may hold a limited number of investments, and while some private equity firms and/or private equity funds have a geographic or industry focus, private equity funds in the

[2] Private equity investing can take many forms. For example, a private equity fund may acquire common or preferred stock of a promising start-up or early-stage company with the intent of providing its founders with the capital necessary to commercialize the company's product (*i.e.,* a venture capital investment). Or, the fund may inject equity into, or buy debt of, a struggling company in an effort to turn around its operations (*i.e.,* a distressed investment). Or, the fund may invest in a promising or strong company that needs capital to expand into new markets or develop new products (*i.e.,* a growth capital investment). Or, the fund may make equity investments in more mature businesses, where the purchase price is a combination of the fund's equity investment and proceeds from new senior and subordinated debt that is borrowed (and eventually is to be repaid) by the business being acquired (*i.e.,* a buyout transaction). These private equity transactions could involve purchases of: unwanted, non-core (and often undermanaged) divisions of large conglomerates; family businesses where the founders are seeking to transition beyond family ownership; public companies that are taken private in an effort to increase value long-term without the short-term earnings pressures of the public markets; and underperforming businesses where not only capital but also operating and financial expertise can be brought to bear to turn around the business.

aggregate are diversified across multiple geographies and industries and thus lack concentrated exposure in any single region or sector.[3]

4. Private Equity Funds: Long-Term Funding, Long-Term Illiquid Investments

As noted above, capital is contributed to a private equity fund by its GP and its LPs over the fund's term as and when needed by the fund to make investments and pay its expenses. The term of a private equity fund is typically 10 years (subject to extension for up to two or three years if needed by the fund to dispose of any investments then remaining in the portfolio). Most often new investments are made by a fund only during the first three to six years of the fund's term. Whatever the investment strategy or focus of a private equity fund, that fund typically invests capital in highly illiquid securities (*i.e.,* securities not tradable on a securities exchange)—common equity and, to a lesser extent, preferred equity or debt securities such as mezzanine debt—of operating businesses. A private equity fund typically holds each of its investments for between three and seven years. In each case the fund works to improve the value of the business in which it has invested so that, eventually, that investment may be sold by the fund at a profit based on the value created during the period that the fund owned a stake in that investment.

Regardless of the type of portfolio investment made, the objective of a private equity fund is the same: increase the value of the portfolio company during the time that it is owned by the private equity fund. Private equity funds accomplish this by, for example: sitting on a revitalized board of directors; strengthening and adding to (and where necessary replacing members of) the management team; requiring the implementation of management and employee equity stock ownership plans, stock option plans and/or revised performance-based bonus plans; professionalizing financial management of the portfolio company; assisting the company in optimizing its capital structure; providing operational assistance; working with management to develop and implement a new or revised business plan; and/or causing the company, as appropriate, to make capital and R&D expenditures, to cut corporate waste and inefficiencies, to expand into new markets and develop new products, and/or to make strategic acquisitions to create the scale required to compete more effectively and become market leaders.

When an investment is sold by a fund, the sale proceeds typically are distributed by the fund to its investors so that: first, the investors receive a return of their capital;

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[3] From 2000 to 2007, for example, buyout investment in a sector as a percentage of total buyout investment was as follows: for industrial companies, 21.2%; for consumer-related companies, 14.7%; for communications businesses, 12.1%; for computer firms (software and hardware), 9.6%; for health care concerns, 9.5%; for Internet-specific companies, 7.8%; for business and financial consulting and other services firms, 7.3%; and for other types of businesses, 17.9%. Source: Robert J. Shapiro and Nam D. Pham, *The Role of Private Equity in U.S. Capital Markets*, supported by the PEGCC (October 2008), at page 14.

next, the investors receive a preferred return (typically 8% per annum) on that capital; and then the profits are shared between the LPs and the GP so that over the life of the fund the GP receives, in addition to the return on its capital investment, a share of the profits, typically 20%, referred to as the GP's "carried interest." With very limited exceptions, a private equity fund is not permitted to reinvest (recycle) the proceeds from the sale of a portfolio investment. So, when the fund has invested (or reserved to cover fund expenses or liabilities) all of its capital commitments, the fund can make no further investments; and the private equity firm must raise a new, successor fund to continue that private equity fund's investment strategy.

5. Private Equity Funds: Strictly Limited Hedging and Trading

As discussed above, the investment strategies of private equity funds are mostly long-term "buy and hold" strategies, not trading strategies. Private equity funds typically purchase highly illiquid securities. Not surprisingly, therefore, private equity funds typically are prohibited by the terms of their partnership agreements or other governing documents from hedging for speculative purposes, from purchasing commodities or derivatives, and from investing in hedge funds or publicly traded securities (except in connection with a going private transaction).

6. Private Equity Funds: Limited Lending, Limited Borrowing

Most private equity funds purchase equity securities, although a relatively small number of funds purchase privately-issued mezzanine or other debt of operating businesses. Even these debt funds rarely originate debt or otherwise provide credit. Accordingly, private equity funds (including these debt funds) are not a material source of credit to businesses, and they are not a source of credit at all to consumers or governments.

With the exception of certain real estate funds, private equity funds almost never borrow, and frequently they are prohibited by their partnership agreements or other governing documents from borrowing. To our knowledge none are reliant on short-term credit markets or regularly roll-over debt as part of their operations. Private equity funds rarely borrow because of the particular tax concerns of tax-exempt LPs concerning "unrelated business taxable income."[4]

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[4] It is true that some private equity funds, such as buyout funds, purchase companies using equity and borrowed money—but the funds themselves do not borrow or guarantee that debt. In a leveraged buyout transaction, a buyout fund may, for example, incorporate an acquisition vehicle and make an equity investment; the acquisition vehicle then uses the capital that the fund invested, together with cash that it borrows from a bank or other lender, to purchase the target company from the seller of that business, with repayment of the debt being secured by a lien on the assets of that company and by a pledge by the fund of its shares in the portfolio company. There are many variations on this simplified buyout structure, but all leveraged acquisitions have this in common: when the acquisition

7. Private Equity Funds: No Redemption, Withdrawal or Unlimited Transfer Rights

Because of the long-term, illiquid nature of their investments and because they typically do not borrow, private equity funds do not offer (and are not able to offer) redemption rights to their investors. Indeed, a private investment fund is not considered a private equity fund if its investors are permitted to redeem their interests in the fund. Private equity funds typically do not allow their investors to withdraw from the fund, and in any event, the fund is not forced to sell assets to effect such withdrawal. For tax and business reasons, private equity funds do not allow LPs to transfer their interests in the fund without the consent of the GP.

8. Private Equity Funds: No Cross-Collateralization, No Cross-Guarantees

Except perhaps for a pledge by a private equity fund of the shares of a portfolio company that it owns as security for that portfolio company's borrowings, the borrowings or other obligations of that portfolio company are not guaranteed by, or secured by pledges of the assets of, the fund or any other portfolio company. So, the failure of one portfolio company should not impact the fund's other portfolio companies. The fund and its investors may lose their investment in the failed portfolio company, but not in other investments held by the fund.

Similarly, the obligations of a private equity fund are not guaranteed by, or secured by pledges of the assets of, another private equity fund; and no private equity fund advised by a private equity firm guarantees or pledges its assets to secure the obligations of the private equity firm, or vice-versa. So, the failure of one private equity fund advised by a private equity firm should have no impact on the other funds advised by that firm.

If one or more private equity funds advised by a private equity firm fail(s) to generate satisfactory returns for their LPs, it may be difficult if not impossible for the private equity firm to raise new private equity funds. If the private equity firm fails to raise new funds, it will continue to advise its existing funds (which existing funds, in turn, will manage and eventually wind down their portfolios over the terms of those funds), and then the private equity firm will quietly go out of business.

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is complete, the fund owns an equity stake in an operating business that, like almost all operating businesses in this country, has some degree of leverage on its books that the company (not the fund) is obligated to repay from its earnings; and if the business fails, the lenders and other creditors of the company will be repaid before the fund or other equityholders are entitled to any additional return on their equity investments. In any event, the lenders have no recourse to the assets of the private equity fund (except for any shares of the failed portfolio company that were pledged by the fund to secure the borrowing), of any other portfolio company, or of the private equity firm.