



August 2, 2016

The Honorable Mary Jo White  
Chair  
Securities and Exchange Commission  
100 F Street N.E.  
Washington, D.C. 20549

Dear Chair White:

We are writing to urge the Securities and Exchange Commission to vigorously investigate what appear to be ongoing, widespread violations of securities law by private equity advisers. While we applaud one such recent enforcement action, the first-ever enforcement case against a private equity adviser for broker-dealer violations,<sup>1</sup> we remain concerned that such violations continue at many U.S. buyout firms, and we believe that unregistered broker-dealer activity directly harms investors.

More broadly, we are troubled by what appear to be other continuing violations of securities law by private equity advisers and the slow and selective nature of investigation by the Commission.

### **Broker-Dealer Violations**

Numerous large U.S. buyout firms have no registered broker-dealer affiliate yet charge transaction fees on a regular basis in connection with the purchase and sale of portfolio company securities on behalf of the funds they manage and for advising portfolio companies on securities issuances. For example, TH Lee, the large Boston-based buyout firm, discloses in one of its adviser's ADV Part 2 that it receives fees for "transaction-related" services "in connection with structuring investments [for the funds it manages] in such portfolio companies":

As our investors are aware, the Adviser performs transaction-related, financial advisory and other services for, and receives fees from, actual or prospective portfolio companies or other investment vehicles of the Clients, including fees in connection with structuring investments in such portfolio companies, as well as mergers, acquisitions, add-on acquisitions, refinancings, public offerings, sales or other dispositions and similar transactions with respect to such portfolio companies ("Transaction Fees") pursuant to monitoring agreements with portfolio companies of the Clients.<sup>2</sup>

These activities appear identical to the activities in the recent case that were determined to constitute unregistered broker-dealer activity. The SEC order in that case noted that Blackstreet Capital Management, LLC ("BCM") earned transaction fees in a manner similar to TH Lee:

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<sup>1</sup> In the matter of Blackstreet Capital Management, LLC and Murry N. Gunty, Respondents

<sup>2</sup> THL Managers VII, LLC Form ADV Part 2, dated March 30, 2016

Rather than employing investment banks or broker-dealers to provide brokerage services with respect to the acquisition and disposition of portfolio companies, some of which involved the purchase or sale of securities, BCM performed these services in-house, including soliciting deals, identifying buyers or sellers, negotiating and structuring transactions, arranging financing, and executing the transactions.

Despite these apparent broker activities, TH Lee's Form ADV Part 1 (item six) claims that the firm is not engaged in the business of a broker-dealer, which suggest that it has no registered broker-dealer affiliate. Moreover, in item five of Part 1, TH Lee states that it employs no employees who are registered representatives of a broker-dealer.<sup>3</sup>

Looking at many other large private equity firms, one finds the same pattern. For example, Silver Lake, a large west coast buyout firm, makes a disclosure in its ADV Part 2 that is almost identical to TH Lee's regarding the provision of transaction-related services for Silver Lake's funds and their portfolio companies and the receipt of associated fees:

#### Transaction Fees

As our investors are aware, the Adviser and its affiliates perform transaction-related, financial advisory and other services for, and in many instances will receive fees from, actual or prospective portfolio companies or other investment vehicles of the Funds, including fees in connection with structuring investments in portfolio companies and similar transactions with respect to such portfolio companies (such fees, "Transaction Fees").<sup>4</sup>

Also like TH Lee, Silver Lake states in Part 1 of its ADV that it has no broker-dealer affiliate and that it employs no employees who are registered representatives of a broker-dealer.<sup>5</sup>

Failing to register as a broker-dealer is more than a mere technical violation. If they registered, private equity firms would be required to receive approval for any fee amounts that they or their affiliates might receive for transacting on behalf of their funds. As a result, the amounts of such fees would be reflected in fund books and records, which investors would generally have a contractual right to access. By contrast, in the current situation where these payments are not treated as broker-dealer fees, investors must depend on the willingness of private equity fund managers to provide such information, which they frequently decline to offer.

#### Undisclosed Fees

The last several years have seen many important revelations regarding private equity manager fee practices that were never disclosed to fund investors at the time of their investment. These revelations are troubling and have led to some enforcement activities by the Commission but,

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<sup>3</sup> THL Managers VII, LLC Form ADV Part 1, dated March 30, 2016

<sup>4</sup> Silver Lake Technology Management, L.L.C. ADV Part 2, dated March 30, 2016

<sup>5</sup> Silver Lake Technology Management, L.L.C. ADV Part 1, dated March 30, 2016

despite widespread apparent violations, the Commission's enforcement activities have been extremely selective and slow.

### *Termination-of-Monitoring Payments*

In its enforcement action against Blackstone, the SEC found that the firm had collected so-called "termination-of-monitoring" fees from portfolio companies that were not disclosed to investors at the time they committed to Blackstone funds. This practice involved Blackstone charging a fee to portfolio companies that it was in the process of selling for work that would never be performed. To date, no other private equity firms have been subject to enforcement actions for undisclosed termination-of-monitoring fees, even though the practice of charging termination of monitoring fees is extremely common and was rarely disclosed to investors at the time before they committed capital to the sponsored funds.

For example, Blackstone frequently received termination-of-monitoring fees alongside other private equity firms that received the same fees as co-investors in the same deals. In the Biomet transaction that was the subject of a New York Times article, KKR, TPG and Goldman Sachs, in addition to Blackstone, each received a share of the termination-of-monitoring payment. However, a review of KKR's and TPG's ADV Part 2 filings show that both firms first disclosed their practice of charging termination-of-monitoring fees only in 2013, seven years after the investors in KKR's fund first made their irrevocable commitment to that fund and fully ten years after investors in TPG's fund first committed to that fund.

Another example involves Freescale Semiconductor, which was held by Blackstone, TPG, Carlyle and Golden Gate and which paid \$68 million as a termination-of-monitoring fee to these private equity firms. While TPG first disclosed its termination-of-monitoring fee practices in 2013, neither Carlyle nor Golden Gate disclosed its termination-of-monitoring fee practice in its ADV until 2015, ten years after launching the Carlyle fund that invested in Freescale and 11 years after the launch of the relevant Golden Gate fund.

However, the SEC appears to have sanctioned only Blackstone for these practices, while private equity firms engaging in the same conduct in connection with the very same portfolio companies appear to have gotten away scot-free. This situation is just one glaring example of what appears to be a highly selective, limited, and ad hoc approach to enforcement activities with regard to termination-of-monitoring fee practices. These practices are pervasive and were, until very recently, completely undisclosed, yet only Blackstone has been sanctioned for them.

### *Senior Advisor/Operating Partner Abuses*

Many private equity advisers have historically held out their senior advisor/operating partner personnel as firm members and have either implied or explicitly stated that they were compensated from firm revenues. In recent years, the world has discovered that in many cases, these individuals were actually categorized as independent contractors of the portfolio companies and, that their compensation was billed to these companies, not to the private equity firm. The effect of these misrepresentations has been to falsely justify high management fees on the grounds that the fees were being used to pay for a large roster of firm personnel, when, in fact, a

meaningful fraction of firm compensation expense was actually being paid by the portfolio companies. In short, investors were being billed twice for the work of these individuals, once in the form of management fees and another in the form of fees paid by portfolio companies.

An easy way to spot this issue at particular firms is by comparing old versions of their websites with the current ones. For example, on a version of its website that was publicly displayed on February 9, 2012,<sup>6</sup> Silver Lake Partners listed its senior advisors under the heading of the “Silver Lake Team” alongside other individuals who worked at the firm in roles ranging from managing director to associate. By contrast, the current version of the Silver Lake website removes all the individuals who hold the title of “senior advisor” or “special advisor” from the firm’s “Team” page and, instead, lists them on a separate page with a lengthy disclaimer explaining that these individuals are “not employees, members, personnel or affiliates of Silver Lake.”

It is clear why Silver Lake switched from suggesting that its advisors are members of the firm to claiming that they are not. As the firm’s ADV Part 2 makes clear, payments received from portfolio companies by firm members (“affiliates”) are required to be shared with fund investors via management fee offsets, which reduce management fees owed by investors. However, by claiming that its advisors are independent, non-affiliated, third parties, Silver Lake evades this sharing obligation:

As our investors are aware, from time to time, the Adviser and its affiliates also engage and retain senior or special advisors, advisors, consultants, and other similar professionals who are independent industry executives and not employees or affiliates of the Adviser and who receive payments from the Funds and/or from, or allocations with respect to, portfolio companies and/or other entities. In such circumstances, such fees or other compensation earned by such persons will be retained by them and will not be deemed to be earned by the Adviser and its affiliates. Such amounts will not be subject to the sharing arrangements described above and will not benefit the Fund or its investors.<sup>7</sup>

It is worth noting that Silver Lake added the phrase “As our investors are aware...” to its ADV disclosure on this issue only in 2016.

### *Vendor Rebates/Discounts*

Private equity firms receive all manner of vendor rebates and discounts that are offered to them solely because of business opportunities they allocate to various vendors or because of the control they exercise over portfolio companies. The SEC has long recognized an adviser’s fiduciary responsibility to allocate the benefit of such discounts to the funds they manage, since the advisers effectively purchase the discounts using the funds’ capital. This principle was evident in the 2015 Blackstone enforcement action, where the SEC sanctioned Blackstone for receiving discounts from Simpson Thacher for legal work provided to Blackstone but where the benefit of such discounts was not shared with Blackstone funds.

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<sup>6</sup> Archived version of Silver Lake website, available at <https://web.archive.org/web/20120209235228/http://www.silverlake.com/content.php?page=team>

<sup>7</sup> Silver Lake Technology Management, L.L.C., ADV Part 2 p. 9, dated March 30, 2016

Attached to this letter is a table containing statements by more than 20 private equity advisers where the adviser appears to acknowledge in ADV Part 2 filings that they receive discounts from law firms or other similar vendors that are not shared with funds or investors. Also attached to this letter is a table listing approximately 20 private equity advisers that acknowledge in ADV Part 2 filings that they receive rebates or other similar benefits from group purchasing organizations that procure goods and services on behalf of portfolio companies.

As with termination-of-monitoring fee practices, this conduct is pervasive within the private equity firm industry and was first disclosed to investors very recently, well after many private equity investors had committed to the relevant funds. Yet only Blackstone has been sanctioned for this behavior.

### **Conclusion**

We, the undersigned, recognize that the SEC faces severe resource constraints and that responsibility for those constraints rests ultimately with Congress, which has chronically underfunded the Commission. In the face of such constraints, it is clearly tempting for the SEC to pursue a “light touch” approach to enforcement against advisers whose investment products are available only to sophisticated investors, based on an assumption that those investors “can fend for themselves.”

However, as the Commission staff well appreciates, the people whose funds are ultimately invested in private equity are overwhelmingly Americans of modest means. Andrew Ceresney, chief of the Division of Enforcement, made this point in a recent speech:

[I]t is important to understand that retail investors are significantly invested in private equity. For example, public pension plans frequently invest the retirement savings of their plan beneficiaries — which include teachers, police officers and firefighters — in private equity funds. Similarly, institutional investors have increased their investments in private equity funds, often on behalf of retail investors who themselves are saving for retirement. Further, university endowments — which fund scholarships and other important academic programs — invest in private equity funds. So, if an adviser defrauds a private equity fund, the underlying victims frequently include retail investors, who in many cases are not in a position to protect themselves. In addition, while the managers of these pension funds and other institutional investors who invest in private equity can be sophisticated, even experienced investors can be defrauded if they lack transparency into the various fees, expenses, and practices - which has been the case in the past.<sup>8</sup>

On behalf of the retail investors Mr. Ceresney highlighted, we urge the Commission to vigorously, comprehensively, and expeditiously enforce the securities laws as they apply to private equity advisers.

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<sup>8</sup> Speech By Andrew Ceresney, Director, SEC Division of Enforcement. Securities Enforcement Forum West 2016, May 12, 2016, available at: <https://www.sec.gov/news/speech/private-equity-enforcement.html>

Sincerely,

Americans for Financial Reform

**Following are the partners of Americans for Financial Reform.**

*All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.*

- AARP
- A New Way Forward
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Center for Effective Government
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability

- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Green America
- Greenlining Institute
- Good Business International
- Government Accountability Project
- HNMA Funding Company
- Home Actions
- Housing Counseling Services
- Home Defenders League
- Information Press
- Institute for Agriculture and Trade Policy
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women's Policy Research
- Krull & Company
- Laborers' International Union of North America
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United

- National People’s Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer’s for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- UNITE HERE
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now
- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalists for a Just Economic Community

***List of State and Local Partners***

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA

- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation, NY
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville AR
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network
- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY

- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- New Economy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- New Yorkers for Responsible Lending
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis MN
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO
- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund

- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG

***Small Businesses***

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Phoenix AZ
- UNET