U.S. Securities and Exchange Commission

Asset Management Advisory Committee

Final Report and Recommendations for Private Investments

September 27th, 2021

## 1. Introduction

The Asset Management Advisory Committee ("AMAC") established a subcommittee to review retail investors' access to private investments (the "PI Subcommittee"). The AMAC offers the U.S. Securities and Exchange Commission ("SEC") this Final Report and Recommendations on increasing retail investor access to private investments[1] ("the Report"). Our observations, conclusions and recommendations are based on the information and input provided to the AMAC and PI Subcommittee by several industry and academic experts and on our independent research.

We structured the Report as follows:

1. Consideration of the macroeconomic supply and demand factors impacting the asset management industry and retail investors[2]. We discuss whether these factors warrant consideration of wider access to private investments by such investors.
2. Consideration of investment returns from 3 classes of private investments for which there were comparable public market investments. We believe that in the absence of sufficient evidence of equal or better returns from private investments, the risks of private investments may outweigh the benefits. We analyzed the returns from private equity, private debt and private real estate and compared them to the returns of similar public market investments.
3. Consideration of the main legal and regulatory requirements that apply to both retail and non-retail investors accessing private investments to round out our understanding of the current regime.
4. We offer some key principles based guidelines to the SEC that we believe could balance wider access with investor protection - our "Design Principles". We believe these Design Principles could guide any wider access by retail investors to private investments.
5. Specific recommendations of how wider access to private investments may be achieved within our Design Principles. In particular we focused on using the registered investment company ("RIC") framework with certain modifications.

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[1] Private investments are investments that are not generally available to ordinary retail investors usually because they require investors to have certain income, asset, educational or professional qualifications.
Private investments are investments that (1) typically have cash flows unlike those public equity, and when distributions occur, these cash flows cannot be re-invested in the original project; (2) are often made in stages, with capital calls occurring over multiple years; and (3) do not trade in a secondary market, and thus have no market price associated with them (instead, they are usually valued by fund management on a quarterly basis). See Interim Report of Subcommittee on Private Investments, SEC Asset Management Advisory Committee 7th July 2021, at pg. 7-8.

[2] By retail investors we are generally referring to individual investors who do not meet investor qualifications thresholds such as Accredited Investors, Qualified Purchasers or Qualified Clients.

## 2. Summary of Observations and Conclusions

Following our analysis and review of information provided to the AMAC and the PI Subcommittee, our main observations are:

1. There are several macroeconomic and structural factors that are resulting, and will likely continue to result, in:
    a. higher demand for investments and investment choices from retail investors; and
    b. a more concentrated supply of public market equity investment choices.
2. Currently most retail investors are precluded from accessing many private investments due to restrictions relating to investor qualifications and the immaterial amount of private investments held by traditional retail investment vehicles.
3. Returns from the private investment asset classes we reviewed exhibit similar or higher returns than their public market equivalents. Private investments are less liquid than public market investments and there is evidence of a higher dispersion of returns between private fund managers compared to public funds in some of the asset classes we reviewed.
4. In relation to the specific asset classes we reviewed we observe:

    Private Equity -

    a. Whilst the returns of private equity ("PE") investments are not easily comparable to public equity markets we find support for PE returns being at least slightly better to somewhat better than those for public equity markets historically but we have some concern that some performance measures used by PE managers (e.g., internal rate of return ("IRR")) are not fully understood by retail investors; and
    b. There is some evidence of a trend of declining additional PE returns as compared to public equity due to a lower illiquidity premium being required by investors and/or a lower interest rate environment.

    Private Debt:

    a. Returns from private debt in the categories we considered show similar to better returns to comparable public market indices.

    Private Real Estate

    a. Returns from private real estate investments in the categories we considered show similar to better returns to comparable public market REIT indices.

As a result of the observations above our main conclusions are:

1. The SEC should consider permitting retail investors access to a wider range of private investments;
2. Wider access could initially be considered within a set of "Design Principles" that balance the potential benefits to retail investors from wider access to private investments with sufficient investor protection; and
3. The current RIC framework could serve as the basis on which to achieve the balance sought by the Design Principles outlined.

Whilst not the focus of this Report, we have also outlined some specific recommendations that are focused on the main legal and regulatory areas that the SEC would need to consider to allow wider access to private investments under the RIC regime in Section 7 of this Report.

## 3. Macroeconomic and Structural Factors Impacting the Supply and Demand for Investments

Our first area of work was to understand the size and growth of the asset management industry, particularly with reference to retail investors on both the supply and demand side for investments.

### 3.1 Demand Side

The AMAC found clear data that the demand side for investments in the US is growing more quickly than the general economy due to combined economic, demographic and structural factors.

The size of the US asset management industry has grown from around $18Tn of assets under management ("AUM") in 2002 to around $45Tn in 2019[3], a compounded growth rate of around 5.5% compared to inflation over the same period averaging around 2.2% per annum[4] and GDP growth averaging around 2% per annum[5]. Retail investors and IRA accounts make up around 50% of the total AUM[6].

AUM within the retirement market was around $34.9Tn in 2020. Employer-sponsored defined contribution plans[7] have remained relatively static in the last 15 years in terms of their overall share of this segment at around 8% - 9% albeit more than doubling in dollar terms consistent with the overall growth of retirement assets in that period. IRA and 401(k) accounts (which are self-directed) have increased from around 40% to 54% of total retirement assets and from $5.8Tn to $18.9Tn over the last 15 years. In contrast, defined benefit plans have decreased from around 42% of total retirement assets to 30% even whilst notional assets have risen from $6Tn to $10.5Tn[8].

AMAC believes that an aging US population combined with forecasted GDP growth rates of around 2% per annum[9] should result in the notional size of the asset management industry continuing to increase over the next few decades. We expect the relative share of investment assets attributable to retail investors and self-directed retirement accounts (including 401(k) plans) to continue to grow more quickly than the general economy and the asset management industry. Retail investors and self-directed retirement investors are generally limited to public market investments.

### 3.2 Supply Side

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[3] Issues Facing the US Money Management Industry – Presentation to the SEC Asset Management Advisory Committee by Michael L Goldstein of FMMI Inc – Slide 3

[4] Calculated from annual data from USA Facts

[5] U.S. GDP Growth Rate 1961-2021 | MacroTrends

[6] Issues Facing the US Money Management Industry, supra note 3 at Slide 5

[7] When referring to employer-sponsored defined contribution plans we are referring to plans that are managed by the employer (or an appointed investment manager) rather than self-directed plans such at 401(k) and ROTH 401(k) plans

[8] 2021 Investment Company Fact Book – A Review of Trends and Activities in the Investment Company Industry, Pg. 177

[9] FOMC Economic Projections, March 16-17, 2021 Meeting – Table 1

As retail investors and self-directed retirement accounts (including 401(k) plans) become a higher percentage of the overall asset management AUM we believe that they will place a higher demand on the industry for investment choices and products . Given this expected growing demand, AMAC next looked at whether the supply of investment products and choice for these investors is expected to keep pace. We focused primarily on the US public equity market as this market makes up the majority of investments open to retail investors.

US public equity markets have grown from a total capitalization of around $17Tn in 2005[10] to close to $50Tn at the end of March 2021[11]. There has also been significant growth in asset choice and low-cost products such as ETFs. The number of ETFs and their market capitalization have grown explosively: increasing from around 200 funds and $0.3Tn in assets in 2005, to around 2,200 funds and $5.4Tn in assets in 2020 but still remain at a little more than 20% of the AUM in mutual funds. Mutual funds have remained relatively static in terms of numbers (around 8,400 in 2005 and around 9,000 in 2020) even as their assets grew from around $8.8Tn to $24Tn over the same period[12]. Around 57% of the underlying investments in mutual funds and ETFs are in US domestic equities (43%) and global equities (14%)[13].

Against this apparent growth in the supply side of investments, there has been a sharp decrease in the number of listed companies. From the peak in 1996 of just over 8,000, the number has decreased approximately 45% companies to around 4,400 in 2018[14]. In addition, the concentration of the largest companies has increased. Four companies, all in the technology sector, now each has over a $1Tn market capitalization. Further, the top 10 companies of the S&P500 index now account for around one third of the value of the total index[15]. Being a market capitalization weighted index, the S&P500 is heavily tilted to these large technology companies.

We observe that, notwithstanding the close to 300% increase in the market capitalization of US listed companies over the last 15 years and the even more explosive growth of low-cost investment alternatives such as ETFs, public equity markets have become much more concentrated with fewer listed companies and a high concentration of the stock market capitalization in the top handful of companies. As such, we view the supply side for retail investors as being less diversified than 15 years ago.

### 3.3 Conclusions on the Supply and Demand for Investments

Given the growing demand by retail investors for investment product and choice and the more concentrated supply of the main component of most retail investments (public equities) we conclude that it is worthy to consider access to a wider range of investments for retail investors in order to better fulfil the growing demand for investment products and choice In particular, we believe that the SEC ought to consider wider access to private investments subject to:

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[10] World Bank Date: Market capitalization of listed domestic companies (current US$) - United States | Data (worldbank.org)

[11] Total Market Value of U.S. Stock Market | Siblis Research

[12] 2021 Investment Company Fact Book, supra note 8 at Pg. 40, 41, 98

[13] Id. Pg. 42, Fig 2.3

[14] World Bank Data: Listed domestic companies, total - United States | Data (worldbank.org)

[15] AMAC meeting, Sept 16, 2020, Slide 11 Private Investment Sub-Committee Update (sec.gov)

1. Such investments providing similar to better returns than comparable public market investments; and
2. Sufficient investor protection.

## 4. Measuring Returns from Certain Asset Classes

Our next area of work was to consider the returns from certain private asset classes. We considered returns from:

1. Private Equity;
2. Private Debt; and
3. Private Real Estate.

These asset classes were analyzed as they are most comparable to certain public market investments and AMAC believes that private investments ought to provide similar or better returns than current (primarily public) investment choices that retail investors have in order for wider access to be initially considered.

Other private asset classes were also considered but we did not proceed with a fuller analysis of them for the reasons outlined below:

- Real asset funds including infrastructure and mining funds lacked sufficient public market comparisons.
- Structured Products were also not analyzed further. Whilst there is a very large market (at over $7tn[16]) for products in this category, they are complex (CDOs, CLOs) and the investors are primarily large long-term investors like insurance companies seeking to match liabilities and assets.
- Hedge Funds are also a very large private asset class with over $3.5tn[17] of assets. Given the huge variety and flavors of hedge funds we felt it was not possible to compare hedge funds generally to public market investments.

Whilst the returns of these private investments were not considered, we believe the Design Principles and recommendations of using existing investment structures to allow wider investment in private assets apply equally to these asset classes.

### 4.1 Private Equity

#### 4.1.1 What is Private Equity?

Private Equity ("PE") refers to the equity of non-public firms whose shares are not traded on registered stock exchanges. It is a diverse asset class, encompassing venture capital, buyouts, growth, and distressed investments. While estimates vary, the size of the private equity market is approximately $4.5 trillion[18]. S&P Global reports transactions volume of $536 billion for venture capital and private equity deals globally in 2020.[19]

Similar to public equity, investors in private equity often gain their exposure through pooled investment vehicles. However, whereas the returns of pooled public equity vehicles can be readily compared to one

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[16] SEC Asset Management Advisory Sub-Committee Update, 19th March 2021 – Private Debt Landscape, John Suydam – Slides 5 - 8

[17] Id.

[18] SEC Asset Management Advisory Committee – Private Investments Sub-Committee Update, 1st December 2020 – Access to Alternative Investments, John Suydam – Slide 3

[19] See: S&P Global Market Intelligence – 2021 Global Private Equity Outlook

another, or to standard benchmarks such as the S&P 500 Index, such straightforward comparisons are not possible with PE pools. A primary reason for this is that an investment in private equity is often made in stages, with capital calls and distributions occurring over multiple years. This is distinct from public equity, where a single investment is all that is required to gain exposure to a given issuer's equity. The result is that customary holding period measures of return that are used for public equity pools are unworkable for typical PE investments.

### 4.1.2 Measuring Private Equity Returns

Alternative measurements of PE returns are used by investors and managers. The traditional method of computing PE returns is the internal rate of return ("IRR")[20]. Using IRR to measure returns has a number of drawbacks, including assumptions about the reinvestment of proceeds and the large effect on measured IRR from cash flows that occur early in the life of the pool. Although IRR remains one of the industry-standard means of reporting returns at present, these and other drawbacks make IRR difficult as a singular return measure, especially for retail investors who likely may not understand the limitations of the of IRR metric, and the differences between IRR and return metrics used for public equity or registered investment funds.

Several other measures have been developed that attempt to compensate for the shortcomings of IRR. Multiple of Money ("MoM") is the sum of the net asset value of the investment plus all the distributions received divided by the total amount paid in. MoM ignores the time value of money as well as the scale of the investment, but it is free from certain distortions of IRR. It also has the virtue of being simple to understand in that it is the ratio of value received divided by money invested.

The second common return measure is the Public Market Equivalent ("PME") and its variants[21]. It is formed by applying the cash flows of the PE investment to a public market index, such as the S&P 500. For example, when the PE investment has a capital call of $50M, the PME requires a $50M investment in the S&P 500 index. The PME has the advantage of allowing a comparison of the PE investment to public market investments that are feasible for retail investors to understand. However, it suffers from the same drawbacks as IRR in that it ignores the scale of the project and can be problematic if cash flows are extreme[22].

### 4.1.3 Private Equity Returns Data

Turning to the question of realized PE returns, while there is some disagreement between practitioners and academics about the precise magnitude of returns, some general results are summarized here. Hamilton Lane ("HL"), a firm that, among other things, collects data on the performance of the PE industry, reported that as an asset class, a 10-year trailing average of PE industry IRRs outperformed broad domestic and global equity market indices' PMEs in most years between 2001 and 2019.[23] There was some underperformance by PE relative to broad market returns over the last few years, however. Similarly, using IRRs and PMEs, Cambridge Associates ("CA"), another industry data provider, found that

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[20] For an illustration of IRR refer to: [SEC Asset Management Advisory Committee – Private Investments Sub-Committee Update,]() 16th September 2020 – Slide 24

[21] Id - Slide 25 and 26 for a brief explanation of the various types of PME measures

[22] For a good comparison of PE return measures, see [Measuring Private Equity Fund Performance, Background Note, INSEAD, 02/2019-6472, 2019]()

[23] [Presentation to SEC Asset Management Advisory Committee, Hamilton Lane, September 2020]()

as of the end of 2019, PE outperformed broad market indices over a range of investment horizons ranging from 3 to 30 years[24] .

Josh Lerner, an economist and academic[25] comes to slightly different conclusions using data from Prequin.[26] He finds that over vintage years from 2000 to 2017, PE only slightly outperformed public markets, with PMEs for most vintage years being close to 1.0. Using a slightly different measure of returns, Lerner finds that returns have been steadily declining over time, with a peak TVPI[27] (a return measure similar to PME) of 2.37 in 2010 steadily declining to a TVPI of .99 in 2017.

Both HL and CA note in their presentations that there are meaningful sources of variation in their respective reported returns. HL documents considerable cross-sectional dispersion of IRRs across PE managers by sub-strategy. For example, over an almost 40-year period, the dispersion of net returns across Growth Equity managers is approximately 15% per year. The dispersion falls to about 11% for large-firm buyout funds. The firm also documents different levels of dispersion by geography of the fund, range from 15% for the "World ex-Asia" category to about 10% for Global Funds. CA documents dispersion in other dimensions as well. When returns are partitioned by the AUM of the fund, a pronounced relationship between return dispersion and fund size is revealed. Funds greater than $10B have TVPI ranging from 1.1 to 1.9, whereas for funds less than $200M AUM, the range is of TVPI is from approximately .6 to 3.4.

Unconditionally, CA provides evidence that the range of outcomes for PE funds is much larger than for funds of publicly traded equity. For the period from 2005-2019, they find that the average dispersion from the 5th percentile to the median fund return is about 21% for PE pools, while for the primary strategies typical of publicly traded equity pools the same measure of dispersion is 3% or less.

Another aspect of PE funds that warrants mention is their fees. Lerner points out that relative to traditional mutual funds, PE fund fees are high. While management fee ranges vary from 1.2% to 2%, investors in smaller funds often pay a "2 and 20" fee, consisting of a 2% fee on the capital invested coupled with a fee of 20% of the profits earned by the fund. When structured for retail investors, Lerner states that these funds may have an additional layer of fees consisting of management fees, up-front sales loads, and/or redemption fees. Lerner states that the various layers of fund fees may sum to a level that negates the remaining alpha of the fund. CA, using a different measure of cost, finds that the spread between gross and net (to LP investors) IRR averages over 600 bp over a 28-year period (largely driven by the 20% profit share), and observes that general partners of PE funds extract a lot of value from the pool.

In addition to potentially higher returns, PE funds offer a benefit to traditional equity investors in the form of enhanced diversification. Lerner, citing a paper by Ang, et. al (2018), states that PE funds of

[24] Presentation to SEC Asset Management Advisory Committee -Private Investments, Cambridge Associates, September 16, 2020

[25] https://www.hbs.edu/faculty/Pages/profile.aspx?facId=9961

[26] Remarks to the SEC Asset Management Advisory Committee Private Investments Subcommittee, Josh Lerner, September 16, 2020

[27] TVPI (total value to paid-in capital) provides prospective clients or investors with a multiple that indicates how many times more the investment is worth compared with the original investment without taking into account the time value of money. See GIPS Standards Handbook for Firms (November 2020), Provision 5.A.4.

different strategies have different cyclicality to them.[28] An investor who holds a portfolio of diverse PE funds can enjoy considerable diversification within the PE domain alone. CA computes a correlation matrix of broad market-based indices with different styles of PE. They find than correlation coefficients are always below .65, and that the correlation coefficient becomes meaningfully lower as the market cap of the PE firms decline.

Finally, academic and economist Ludovic Phalippou[29] offers some notes of caution when it comes to retail investing in PE funds[30]. He cites one fund that states in its marketing materials that it had a gross IRR of almost 50% over nearly 20 years of investing in the software industry. He notes that if this IRR were to be interpreted as an annual rate of return in the sense of a traditional mutual fund, the dollar returns earned would be so large as to be unrealistic. He uses this as an illustration of the difficulties of marketing track records using IRR, and how such reporting has the potential to confuse retail investors. His analysis highlights the need for serious thought about how PE returns can be presented in a way that is readily understandable, to retail investors who lack the sophistication of institutional investors that are the typical consumers of PE fund marketing materials.

After reviewing the data summarized above AMAC believes that PE funds offer potential benefits to retail investors compared to public equity investments due to their higher average returns and their diversification potential. However, the difficulty in measuring and reporting returns on a comparable basis, coupled with the potentially high fees associated with retail PE pools, requires that the SEC play a central role in designing an appropriate disclosure and regulatory regime for these products, should they be offered to the retail investing public.

[28] Ang, Andrew, Bingxu Chen, William N. Goetzmann, and Ludovic Phalippou. "Estimating private equity returns from limited partner cash flows." The Journal of Finance 73, no.4 (2018): 1751-1783.
[29] https://www.sbs.ox.ac.uk/about-us/people/ludovic-phalippou
[30] Presentation to SEC Asset Management Advisory Committee - Track Record Marketing in Private Equity, Ludovic Phalippou, September 16th 2020

### 4.2 Private Debt

### 4.2.1 What is Private Debt?

There is no common definition of "private debt" and the asset classifications within private debt can vary significantly depending upon which consultant or investor is viewing the market. With that in mind, we attempted to look at the markets generally for debt securities or loans issued by privately held operating companies ("Private Company Debt"). These are loans or debt securities that are not broadly syndicated, do not generally trade in a liquid secondary market and do not have a CUSIP designation. The private debt market is estimated to be around $850bn[31].

We did not attempt to look at certain categories of private debt such as structured debt products (generally pools of fixed income securities purchased with equity and leverage generating spread income above comparable non-structured yields) or the private debt markets associated with infrastructure or real estate investments. Although these markets are quite large, we decided to focus on Private Company Debt to limit the scope of the review and because return data for this segment seemed most accessible.

Within the market for Private Company Debt we found that there are differences in the types of securities issued by companies generally based upon the priority in right to payment (such as senior debt, subordinated or mezzanine debt) and whether the debt is secured by assets of the issuer or not (generally secured or unsecured debt). The private debt securities also seemed to differ based upon the type of target purchaser of the debt instrument, whether private funds, registered funds such as business development companies or mutual funds, banks or insurers.

### 4.2.2 Private Debt Returns Data

Members of the PI Subcommittee met by teleconference with a few firms that act as consultants for institutional investors that frequently invest in private debt funds to discuss returns in the private debt markets. We received data from CA and regarding performance statistics each maintains regarding the performance of overall private credit returns as well as returns within sub classifications of Private Company Debt, such as mezzanine, distressed, senior credit and opportunistic credit. Some of these subcategories appear to have an element of overlap depending upon how different investments are classified. CA and HL often act as consultants or advisors to investors looking to invest in funds focused on investments in Private Company Debt[32].

We received the data assembled by these groups over periods of 15-30 years. The data assembled consisted principally of asset level and fund level returns for fund investing in senior debt products, subordinated or mezzanine products and opportunistic or distressed products. The data also included aggregate returns for all Private Credit investment funds sampled by these groups. The data we received compared the private debt returns to returns for public indexes. The comparisons were not precise for asset classes but were compared to the Credit Suisse High Yield Index, the Bloomberg Barclays GOV Bond/Credit Index, the Bloomberg Barclays Corp HY/FTSE Index and the Russell 3000 Index, with adjustments in many cases, to the indexes to reflect cash inflows and outflows from the comparison private funds.

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[31] Access to Alternative Investments, John Suydam supra note 18 - Slides 3

[32] CA – Private Credit, Index and Benchmark Statistics (September 30th 2020) and HL – Hamilton Lane Market Insights, Fourth Quarter 2020 Report

After reviewing the data summarized above AMAC believes that private debt funds appear to outperform comparable public debt indices over most comparison periods (3, 5, 10, 15, 20 years) with the outperformance more significant over longer durations and with a lag in performance over shorter periods (generally less than 3 years). The data reviewed did not indicate a rationale for the outperformance of private debt funds but from discussions with industry participants we believe that the outperformance of private debt may be related to an illiquidity premium. The returns for the funds are higher to reflect the longer duration and limited liquidity of the underlying asset base.

### 4.3 Real Estate

#### 4.3.1 Types of Real Estate Investments

Public and private funds within the real estate sector generally invest in a wide variety of investments which are generally categorized as core, core plus, value add and opportunistic.

*Core properties* require very little asset management and are typically occupied with good credit tenants on a long-term basis. They include high quality assets in prime areas – generally office, multi-family and retail in cities.

*Core plus* properties have the ability to increase cash flows through light property improvements, management efficiencies or by increasing the quality of tenants. Similar to core properties, these properties tend to be of high quality and well occupied.

*Value add* properties often have little to no cash flow at acquisition but have the potential to produce cash flow once the value has been added. These buildings may have occupancy issues, management problems or deferred maintenance. Investments require deep knowledge of real estate, strategic planning, and oversight by owners.

*Opportunistic* real estate investments take on the most complicated projects and may not see a return on their investment for three or more years. These investments require deep real estate knowledge and experience. They include ground up developments, acquiring an empty building, land developments and repositioning a building from one use to another are examples of opportunistic investments. There is little or no cash flow at acquisition, but these investments have the potential for significant cash flow once the value has been added.

#### 4.3.2 How Can Retail Investors Currently Access Real Estate?

Retail investors can access real estate investments primarily through publicly traded and public non-listed REITs[33].

*Publicly Traded REITs*

Retail investors can access publicly traded REITs through a brokerage account. Publicly traded REITs generally tend to be focused on core and core plus investments and provide liquidity through secondary market trading. They file periodic financial statements (quarterly un-audited and annual audited financial statements) with the SEC.

Publicly traded REITs typically manage income producing properties such as office buildings, shopping centers and apartment buildings. They are typically sector focused. Sector examples include office buildings, data centers, hospitality and healthcare. Publicly traded REITs are generally internally managed (although some charge management fees) and after paying the expenses associated with

[33] For a general discussion of REITs please refer to https://www.investopedia.com/terms/r/reit.asp. Publicly traded REITs are REITs that are listed and traded on an exchange versus REITs that are widely offered but not listed or traded on an exchange.

operating their properties, they are required to pay out substantially all their taxable income to their shareholders annually as dividends under REIT tax rules[34].

Publicly traded REIT returns (excluding ongoing distributions) are based on secondary market trading like public stocks. As a result, their trading at times may not be correlated to the valuations of the underlying properties depending on other market factors that could influence the trading price.

While REITs may invest in value add or opportunistic investments, due to their focus on income producing properties and distribution requirements under the IRS REIT tax rules, these investments generally don't make up a significant portion of their portfolio holdings.

*Public Non-listed REITs*

Retail investors can access public non-listed REITs through a broker and paying a sales commission. Unlike publicly traded REITs, public non-listed REITs do not trade on a secondary market and as a result have limited liquidity. Redemption programs vary by company and can be limited.

Some similarities between publicly traded REITs and public non-listed REITS include that both provide periodic financial statements (quarterly and audited annual financial statements) that are filed with the SEC. Public non-listed REITs are also required to pay out a substantial amount of their taxable income to their investors under the IRS REIT tax rules. In addition, they generally manage income producing properties such as office buildings, shopping centers and apartment buildings, however they can be diversified, or sector focused.

Some differences between publicly traded REITs and public non-listed REITs include that public non-listed REITs charge management fees and can charge performance fees. The performance returns of public non-listed REITs are driven by changes in net asset value including distributions made to shareholders. They report on historical cost but disclose the fair value/NAV.

While public non-listed REITs invest in core and core plus investments, they also make investments in value add and opportunistic investment opportunities.

*Private Real Estate Funds*

Retail investors generally cannot access private real estate funds as these funds usually require investors to meet certain qualification requirements which are discussed further in Section 5.2. Private real estate funds do not trade on a stock exchange and provide limited liquidity. Redemption programs vary by company and are limited. The fund structure can vary, including closed-end, open-end, and limited life funds. Private real estate funds are taxed as partnerships and therefore do not follow the IRS REIT tax rules. They are not limited on how much income they can retain. They generally provide periodic financial statements, but the information is not public. They charge asset management fees and performance fees, and returns are based on internal IRR calculations. They invest across the real estate spectrum including all types of opportunities (core, core plus, value add and opportunistic) but generally focus on the value add and opportunistic assets. Private real estate funds generally carry more leverage than their public REIT counterparts.

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[34] Refer to Subchapter M, Part II of the IRC Code. For a general explanation refer to: https://www.investopedia.com/articles/pf/08/reit-tax.asp

#### 4.3.3 Private Real Estate Investment Returns

When analyzing return information of public REITs and private real estate funds, we reviewed information from CA and HL through September 30, 2020[35]. CA utilized the FTSE NAREIT All Equity Index and HL utilized the Dow Jones Equity REIT Total Return Index to compare against private real estate returns. Given the differences in investment performance methodologies between private real estate returns and public REITs, both CA and HL utilized a methodology to convert the private investment real estate IRR return to a public market equivalent or vice versa using certain assumptions in their methodologies.

It is challenging to compare private real estate returns against a public market benchmark given the differences in methodologies and assumptions which needs to be taken into consideration when performing the comparisons between these funds.

In looking at the return information, generally over a 3, 5- and 10-year period, the private real estate outperformed public REITs, however this information was based on the specific return comparison and assumptions. Different comparisons and return assumptions could yield different results.

In looking at the one-year return through September 30, 2020, there was significant over performance from private real estate funds. This may be explained by the difference in share based total return in public REITs compared to the asset-based valuation for a private fund during the pandemic.

Overall, like other private asset classes, it is difficult to draw a definitive conclusion on the returns of private real estate funds compared to those of public REITs given the differences in returns methodologies and assumptions as well as the different focus on sectors within the asset class. Public REITs generally focus their investments in core and core plus investment opportunities, while private real estate funds generally focus their investments on value add and opportunistic investment opportunities. Overall, we believe that private real estate funds do provide comparable to better returns to public REITs and therefore, we believe the SEC ought to consider providing retail investors access to private real estate funds. In addition, given the different types of real estate REITs and private funds generally focus on, private real estate funds may provide some diversification within the real estate sector for retail investors.

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[35] CA – Real Estate Index and Benchmark Statistics, September 30th 2020 and Hamilton Lane Market Insights, Fourth Quarter 2020 Report

### 5. Current Access to Private Investments by Retail and Non-Retail Investors

The AMAC also felt it necessary to consider what access retail investors currently have to private investments and what the main legal and regulatory requirements are currently for access to a wider range of private investments by non-retail investors in order to be able to make specific recommendations regarding potential changes to current requirements.

Our analysis focused on:

1. What access to private investments do retail investors currently have via retail investment vehicles; and
2. What are the key investor qualification requirements non-retail investors must meet for access to a wider range private investments.

#### 5.1 Current Access to Private Investment by Retail Investors

Currently retail investors can access private investments mainly through:

1. Open-end funds, such as mutual funds, that are allowed to hold up to 15% of their assets in illiquid investments[36];
2. Closed-end funds (including tender offer and interval funds) that hold no more than 15% of their assets in private funds[37]; and
3. Exempt securities offered by issuers primarily under certain small offering exemptions (Regulation A) and crowdfunding exemptions[38].

##### 5.1.1 Open-end Funds

While open-end funds may hold up to 15% of their assets in illiquid securities, we understand that most open-end funds limit themselves to a much lower percentage given the need to provide daily liquidity to investors. Overall, we believe that an open-end fund holding 5% - 10% of its assets in illiquid investments does not allow a retail investor to easily understand and track the performance of the

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[36] 17 CFR § 270.22e-4 (Liquidity Risk Management Programs). Rule 22e-4 under the Investment Company Act of 1940 (the "Investment Company Act") defines an illiquid investment as any investment that the fund reasonably expects cannot be sold or disposed of in current market conditions in seven calendar days or less without the sale or disposition significantly changing the market value of the investment, as determined pursuant to the provisions of the rule relating to the fund's classification of portfolio investments.

[37] Although SEC rules do not expressly limit the percentage of illiquid assets that a closed-end fund may hold, the SEC staff has taken the position that a closed-end fund that holds more than 15% of its assets in private funds should only be offered to accredited investors. See Speech by Dalia Blass to PLI Investment Management Institute (July 28 2020), text accompanying footnote 29.

[38] For a fuller discussion of the various exemptions, please refer to _SEC Concept Release on Harmonization of Securities Offering Exemptions – Pg, 10 and 11.

fund's private investments as compared public investments as open-end funds do not provide separate performance related information between various assets in the fund.

### 5.1.2 Closed-end Funds

Closed-end funds are a relatively small portion of the overall investment company market. There are around 500 closed-end funds with around $279 billion of assets[39]. The wider mutual fund industry is estimated to manage around $24 trillion of assets and comprises over 7,500 funds.[40] Closed-end funds have declined in size and number over the last decade or so as funds were liquidated, merged or converted into open-end mutual funds or ETFs[41]. Closed-end funds are predominantly bond funds, and an analysis of their asset holdings reveal they mainly hold liquid assets.

### 5.1.3 Interval and Tender Offer Funds

Interval funds are a type of closed-end fund and therefore the restrictions on investments in private funds that apply to closed-end funds also apply to interval funds[42]. These are discussed in more detail in section 5.2.

In addition, given the pre-programmed nature of repurchases every 3, 6 or 12 months (most funds electing 3-month repurchase periods) and the 5% - 25% limit on repurchases, most interval funds need to hold a material amount of their investments in liquid securities. Even with a 5% repurchase limit, a fund would need to hold 20% - 40% of its assets in liquid investments to meet potential redemptions over the next 12 – 24 months. Given the liquidity needs, such funds may effectively be limited in how much they can invest in illiquid investments.

As of April 2021, there were only around 70 active interval funds with total net assets of approximately $35 billion; however, there are 34 interval funds currently in registration pending SEC approval of which 8 filed registration statements in 2021.[43] The largest interval fund, ACAP Strategic Fund, appears to account for around 30% of the total AUM of all interval funds and appears to hold virtually all its assets in public market equity securities and US government bonds.[44]

Tender offer funds are another type of closed--end fund but they have more flexibility on redemptions and repurchases[45]. There are around 80 active tender offer funds managing around $30bn of assets with the largest, Partners Group Private Equity, managing around $6.7bn. Most funds tend to be engaged in private equity or are a fund of hedge funds[46]. In contrast, interval funds tend to be concentrated in equity, credit and real estate[47].

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[39] 2021 Investment Company Fact Book (ici.org), supra note 8 at Pg. 119.
[40] Id. Pg. 66 (Fig 3.1) and Pg. 210
[41] Id. Pg. 119
[42] See further: Eisner Amper – Are Investment Advisors Sleeping on Interval Funds? Frank Attalla, March 5 2021.
[43] A Closer Look At New Interval Fund Registrations - Interval Fund Tracker
[44] ACAP Strategic Fund (XCAPX) | Kivalia
[45] What is the difference between an interval fund and a tender offer fund? - Tender Offer Funds
[46] Active Funds - Tender Offer Funds
[47] A further discussion of the requirements for interval and tender offer funds can be also be found in the sub-committee's presentation to AMAC on 19th March 2010 - Private Investments Meeting Slides (sec.gov) – Slides 4 - 10

Given the size of the mutual fund industry mentioned earlier, interval and tender offer funds play a less significant role accounting for less than 1% of mutual fund assets.

Closed-end funds (including tender offer and interval funds) may also require investors be qualified in the following situations, without limitation:

1. If the fund charges incentive fees investors will need to be Qualified Clients; and
2. Funds that invest more than 15% of their assets into private funds require all investors to be Accredited Investors.

Qualified Clients and Accredited Investors are discussed further in section 5.2.

### 5.1.4 Exempt Securities Offerings

With respect to unregistered securities issued directly to retail investors primarily under the Regulation A and Regulation Crowdfunding exemptions, we believe that these investments are not necessarily aligned with providing retail investors exposure to a diversified pool of private investments. Companies issuing these securities tend to be smaller companies in the early stages of their lifecycles. Also, there is limited due diligence being undertaken on the investment opportunity, as there is typically no professional manager between the retail investor and the issuer.

### 5.1.5 Conclusions

We conclude that whilst there are some methods for retail investors to gain access to private investments, these are either in the form of diluted exposure in open end mutual funds or in closed-end funds which have remained a very small minority of the retail investment landscape representing less than 2% of all mutual funds' AUM. Closed-end funds may also require investors to be Accredited Investors and / or Qualified Clients which limits many retail investors from participating in such funds.

As such, the vast majority of private investments are currently not available to retail investors via existing retail investment vehicles.

### 5.2 Current Access to Private Investments by Non-retail Investors

We now turn to consider the current regulatory requirements for access to private investments by non-retail investors.[48] Investors must generally meet qualification thresholds in order to access a wider range of private investments.[49] The two key thresholds are the:

1. Accredited Investor threshold; and
2. Qualified Purchaser threshold.

In addition, in order for investment advisers to be able to charge performance fees to clients (which is a common feature of many private investments), investors must generally be Qualified Clients.

It is estimated that around 13% of households meet the Accredited Investor threshold and that around 2% meet the Qualified Purchaser thresholds[50].

#### 5.2.1 Accredited Investors

Accredited Investors are generally permitted to participate in exempt private funds that have less than 100 investors (so called "3(c)(1) exemption") and in exempt offerings of securities from companies under Rule 506 of Regulation. In addition, as described above in Section 5.1, the SEC staff's position is that with respect to registered closed-end funds, if more than 15% of the assets of the registered fund are invested in private funds, all investors must be Accredited Investors[51].

The general requirements for an individual to be an Accredited Investor include:

1. Financial qualifications[52]:
    a. Individual or joint net worth with a spouse or spousal equivalent of at least $1 million; or
    b. Individual income of more than $200,000 (joint income with a spouse or spousal equivalent of more than $300,000) in each of the two most recent years and a reasonable expectation of meeting those thresholds in the current year;
2. Professional certifications of designations from an accredited educational institution that the SEC has designated as qualifying an individual as an Accredited Investor[53]; or
3. Status as Knowledgeable employees[54].

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[48] Non-retail investors are investors that meet investor qualification requirements and can therefore invest in a wider range of private investments not available to retail investors. The sub-committee also discussed this at the SEC AMAC meeting on September 16, 2020 - Private Investment Sub-Committee Update (sec.gov) – see Slides 15-19

[49] SEC Concept Release on Harmonization of Securities Offering Exemptions, supra note 37, at Pg. 177 – 183 provides a fuller discussion.

[50] Private Equity Report (print) (capmktsreg.org) – Pg 2, footnote 6

[51] See Speech by Dalia Blass, supra note 32

[52] See 17 CFR § 230.501(a)(5) and (6)

[53] See 17 CFR § 230.501(a)(10)

[54] See 17 CFR § 230.501(a)(11)

### 5.2.2 Qualified Client

Section 205(a) of the Investment Advisers Act of 1940 (the "Advisers Act") prohibits investment advisers registered or required to be registered with the SEC from charging clients' fees that are based on a share of the capital gains or capital appreciation of the funds or client accounts that they manage. Rule 205-3 under the Advisers Act provides an exception from this prohibition where the client is a Qualified Client. Given nearly all private funds charge incentive fees, in practice most private funds require all investors to be Qualified Clients.

In addition, as outlined previously, some registered closed-end funds (including tender offer and interval funds) charge incentive fees, and therefore also require all investors to be Qualified Clients. The Qualified Client requirements for individuals are:

3. Financial qualifications where:
    a. The individual has at least $1.1 million in assets under management with the adviser immediately after entering an investment advisor contract with the adviser[55];
    b. The adviser reasonably believes the individual has a net worth (including joint net worth) of more than $2.2 million[56]; or
    c. The individual is a Qualified Purchaser.
4. Role based qualifications where the individual:
    a. Is an executive officer, director, trustee, general partner or person serving in a similar role with the adviser; or
    b. Is an employee of the adviser who participates in investment activities of the adviser and has done so for at least 12 months.

### 5.2.3 Qualified Purchaser

For private funds that have more than 100 investors, such as many larger private equity funds, investors generally need to meet the much higher threshold of being a Qualified Purchaser in order for the fund to remain an exempt fund (so called "3(c)(7) exemption"). Qualified Purchasers can only qualify based on financial criteria requiring an individual to have more than $5 million of qualifying investments[57].

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[55] See Order Approving Adjustment for Inflation of the Dollar Amount Tests in Rule 205 3 under the Investment Advisers Act of 1940 (sec.gov) (declaring effective, as of August 16, 2021, an Order that adjusts for inflation the dollar amount thresholds of the assets-under-management test and the net worth test. The Commission stated that, based on calculations that take into account the effects of inflation by reference to historic and current levels of the PCE Index, the dollar amount of the assets-under-management test would increase from $1,000,000 to $1,100,000, and the dollar amount of the net worth test would increase from $2,100,000 to $2,200,000. These dollar amounts— which are rounded to the nearest multiple of $100,000 as required by section 205(e) of the Advisers Act—would reflect inflation from 2016 to the end of 2020.

[56] Id.

[57] 15 U.S. Code § 80a–2 - Definitions; applicability; rulemaking considerations | U.S. Code | US Law | LII / Legal Information Institute (cornell.edu) – para (a)(51)

### 5.2.4 Conclusions on Investor Qualification

Under the current regulatory landscape, particularly the financial thresholds for Accredited Investors, Qualified Clients, and Qualified Purchasers, most retail investors are precluded from investing in the majority of private investments.

Even in the case of registered funds (i.e. RICs), investors may need to meet the Accredited Investor threshold (eg: a closed-end fund that invests more than 15% of their assets in private funds) and /or the Qualified Client threshold (if the fund charges incentive fees). The majority retail investors will not meet these qualification criteria.

We believe that the SEC should consider how to amend the regulatory framework to provide wider access to private investments by retail investors whilst maintaining appropriate safeguards as set out in our Design Principles.

## 6. Design Principles

### 6.1 Why Design Principles Matter

The investor qualification requirements discussed in the previous section are based in part on concerns that retail investors lack the financial sophistication to properly consider the risks, expenses and illiquidity of private investments, or lack the financial resources to absorb potential losses that may result from such investments.

Accordingly, AMAC believes that options to create wider access to private investments must balance investor choice with sufficient investor protection. We propose therefore that the SEC evaluate wider retail access to private investments first and foremost according to a set of design principles that recognize these concerns ("Design Principles"). This section of the Report discusses what we view as the key principles and refers to them as "Design Principles".

### 6.2 Design Principles

#### 6.2.1 Liquidity of Investments

We believe that it is clear that an investment's liquidity is very important to retail investors. Yet liquidity is generally incompatible with private investments, since typically there are (1) no secondary markets or redemption rights associated with most private investments, and (2) private securities may be subject to resale-related restrictions to avoid creating a public offering of securities.

Retail investors' behavior with respect to mutual fund investments confirms the importance they place on liquidity. Industry data show that, over the past 30 years, yearly redemption rates for long-term mutual funds have ranged from 23.7% of the funds' average net assets to 39.9% of average net assets during periods of market turmoil, with an average yearly rate of 30.0%.[58]

AMAC believes any increased access to private investments will likely be subject to limited liquidity features. The SEC should consider favoring investment structures that offer at least limited redemption opportunities, or that can be traded on secondary markets without needing to liquidate an underlying private investment.

#### 6.2.2 Chaperoned Access

We recommend the that the SEC limit retail access to private investments to those which have certain types of third-party participation. We refer to this Design Principle as "chaperoned access". We believe that chaperoned access will ensure that retail investors only invest in private investments that balance risk, returns, and appropriate fees.

One way to achieve chaperoned access would be to ensure that funds that invest in private investments and which retail investors would be allowed to invest in are managed by independent investment advisers who (and whose affiliates) (1) do not receive fees or other income from the underlying investments and who have an obligation to act in the best interest of investors (if broker-dealers) or (2)

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[58] 2021 Investment Company Fact Book (ici.org), supra note 8 pg. 235, Table 26,. These figures reflect both regular and exchange redemptions for a year as a percentage of average net assets at the beginning and end of each year between 1991 and 2020. Excluding exchange redemptions, redemption rates ranged from 16.5% to 30.1% of funds' average net assets, with an average yearly rate of 22.8%.

have a fiduciary obligation to the investors (if investment advisers). Compensating such independent advisers will add an additional layer of fees that institutional investors do not incur and an appropriate balance will need to be struck between the benefit of the chaperoned access and the cost.

Another way to achieve chaperoned access could be to require any private investment that retail investors have access to also have material participation in the fund or investment from more sophisticated institutional investors on substantially the same terms on the basis that such institutional investors would have carefully considered the risk and potential returns of the investment and the appropriateness of the fees being charged.

#### 6.2.3 Disclosure of Fees, Risks, Terms and Returns.

Based on our research and discussions with industry members, AMAC believes that another Design Principle is that any increased access to private investments must include standardized disclosure of important information about the private investment, particularly with respect to fees, risks, key terms and returns.

#### 6.2.4 Diversification

A typical private investment fund tends to be fairly concentrated both in terms of industry / asset theme as well as the number of investments it holds. There also tends to be a higher dispersion of returns from private fund managers compared to public managers[59]. To the extent feasible, AMAC believes retail access to private investments should be via holding a diverse portfolio of underlying private investments. There are two primary ways of ensuring diversification:

1. A portfolio of separate investments in different private funds; or
2. An investment in a fund that holds a reasonably diversified mix of private investments.

To date retail access to private investments has been mostly via mutual funds that may hold up to 15% of their assets in illiquid investments (such as private funds) but generally hold a much lower percentage.[60] We believe that it would be better to diversify exposure to private investments via the methods outlined above, so that investors can better evaluate the performance of private investments particularly in relation to public market investments. As discussed earlier, this is not possible in a mutual fund which holds mainly liquid assets and relative performance information of the illiquid assets is not split out.

AMAC believes that the SEC should encourage retail investors to hold a diversified pool of private investments within their overall portfolio which should also comprise more liquid investments. We acknowledge that it may be beyond the SEC's ability to mandate overall portfolio diversification. There are situations, such as under Regulation Crowdfunding and Regulation A, where the SEC does mandate the maximum investment in a particular issuance based on a non-Accredited Investor's annual income or net worth[61].

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[59] Presentation to SEC Asset Management Advisory Committee, Hamilton Lane, September 2020 (n23) – Slide 9
[60] See supra note 36
[61] See 17 CFR 230.251(d)(2)(i)(C) (Regulation A investment limits) and 17 CFR 227.100(a)(2) (Regulation Crowdfunding investment limits)

#### 6.2.5 Use of the RIC framework

Chaperoned access via a RIC could fulfil many of the Design Principles. The SEC should consider whether the RIC framework is an appropriate method to balance investor protection with access to private investments. Whilst the SEC may need to make some specific modifications to deal with the nature of private investments, some of the features of RICs that could be applied in this context include:

1. Use of a qualified independent registered investment adviser with a fiduciary duty to investors and/or a broker-dealer with an obligation to act in the best interest of a retail investor, to access private investments; and
2. Required standardized disclosure of key items such as fees, risks, key terms and returns.

### 7. Specific Recommendations

Lastly, in this section we provide some specific recommendations for the SEC to consider, some of which have been discussed in the body of this Report:

1. The SEC should consider whether its staff's current position that a closed-end fund that holds more than 15% of its assets in private funds should only be offered to Accredited Investors is appropriate. Investors in such funds already have the benefit of comprehensive investor protection under the RIC rules including having an investment adviser, independent directors and extensive disclosure and reporting requirements. In addition, this requirement is an impediment to closed-end funds listing and creating a secondary market (and thus liquidity) for investors' in closed-end funds.
2. Similarly, the Qualified Client requirement for closed-end funds that charge incentive fees should be reviewed for the same reasons as in the 1st recommendation.
3. The SEC should allow closed-end funds to list on a public market more easily. This may provide secondary market liquidity while allowing the closed-end fund itself to invest in illiquid assets. In turn this would likely require that investor qualifications such as being an Accredited Investor or Qualified Client would need to be removed. We note that substantial discounts between the trading price of a closed-end fund compared to its NAV may occur during times of market stress and could be problematic but similar issues arise in some types of ETFs and in listed REITs.
4. Chaperoned access will cause an additional layer of fees payable to the RIC investment adviser which may be mitigated by allowing large sponsors to also play the role of investment adviser to closed-end funds. Conflicts of interest would need to be disclosed and managed. The SEC should consider allowing large sponsors to play the role of investment adviser
5. Chaperoned access may also be achieved by allowing closed-end funds to invest only in "approved" private funds with such approval status being based on size and diversification of investments as well as potentially at least a majority of capital commitments to the underlying private funds coming from Qualified Purchasers or other large institutional investors. The SEC should consider whether such "approved private" funds could be invested into directly by retail investors without the need for the additional layer of an investment adviser.
6. Interval funds and tender offer funds may also be suited to deal with the cashflow profile of investing in private funds[62] however the SEC should consider providing these funds with additional flexibility including:
    a. More flexibility on the initial investment period of an interval fund before the first repurchase and allowing flexible repurchase dates based on underlying liquidity instead of a fixed schedule; and
    b. allowing the more flexible repurchases of a tender offer fund to be undertaken in a similar manner to interval funds – ie: aligning the Form N-23 (interval funds) with the Form TO requirements.
7. The SEC should consider standardized disclosure of fees, risks, key terms and returns as well as liquidity constraints of private investments that retail investors have access to.

[62] Typical private equity funds for example have a drawdown profile as the fund goes through an initial investment phase and then periodically returns cashflows in later years as it exits investments.

8. The SEC should consider whether diversification requirements within a RIC should be required for RICs investing in private investment funds that retail investors can invest in. These may include:
    a. Minimum fund size and other qualifying criteria for each private fund that a RIC invests in; and
    b. RICs to have a defined maximum exposure to any particular private fund investment.

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