Proskauer

Private Market Talks:

Private Funds Under Scrutiny with MFA’s Bryan Corbett

October 13, 2023

This week on Private Market Talks, we welcome Bryan Corbett, a veteran of both Washington and Wall Street. As president and CEO of the Managed Funds Association, Bryan sits at the forefront of regulatory policy issues affecting the global alternative asset management industry. Recently, the SEC has made sweeping changes to the regulatory framework governing private funds and on this episode of Private Market Talks, Bryan dives deep into the potential impact of the new rules and the issues that they raise for managers and investors. This is a must-listen episode for any alternative asset manager.

Peter Antoszyk: Welcome to Private Market Talks. I'm your host, Peter Antoszyk. As you know my listeners, over the past 20 years AUM of private funds has exploded and naturally, it has caught the eye of the SEC. The SEC has for some time been considering new regulations to govern private funds. And after some comment period, the SEC finally adopted new, sweeping regulations. The new requirements will significantly expand SEC regulation of private fund advisers. These rules have been described as a sea change and a meaningful recasting of SEC mission. So, listeners, you're going to want to listen to our guest today, who is at the forefront of a heated battle with the SEC over these rules. Bryan Corbett is the Managed Funds Association's President and CEO. He is a veteran of Washington and Wall Street. Previously, he was a senior executive at The Carlyle Group, most recently as managing director in the corporate private equity segment and head of the firm's One Carlyle global investment resources group. In the first half of his tenure at Carlyle, Bryan managed U.S. government and regulatory issues affecting Carlyle, its investments and industry. In addition to serving on several boards of Carlyle's portfolio companies, Bryan started the firm's global corporate citizenship program. Prior to joining Carlyle, Bryan served in the George W. Bush administration as a special assistant to the President for Economic Policy, and as senior adviser to Deputy Secretary Robert Keenan at the Treasury Department. He also served as majority counsel on the Senate Banking Committee, so there is no one better situated to give us the lowdown on the new SEC rules affecting private funds than Bryan. We will post a link to the new regulations and to the MFA website, along with a full transcript of this episode and other useful information at privatemarkettalks.com. And as always, please don't forget to subscribe and hit "like" after listening. And now, my conversation with Bryan Corbett. So, Bryan, welcome to Private Market Talks.

Bryan Corbett: Great. Thank you, Peter. I appreciate the opportunity.

Peter Antoszyk: Absolutely. So, let's deal with the important things first. A strong performance this weekend over your Fighting Irish.

Bryan Corbett: Yeah. [**laughter**] I'll take 4 and 0. But the season starts this upcoming week with Ohio State, so we'll see.

Peter Antoszyk: Yes, that will be a perfect stage, I think, for one of the biggest games in college football this season. How are you feeling about it? Notre Dame's chances?

Bryan Corbett: As a Notre Dame fan, you're forever an optimist —

Peter Antoszyk: There you go.

Bryan Corbett: — and we're still at that point in the season where we can be very optimistic.

Peter Antoszyk: Perfect. Well, it's going to be quite a battle, and you have your own battle right now with the SEC over the new rules governing private funds. Before we jump into that, describe for our listeners what the MFA is and who its constituents are.

Bryan Corbett: Sure. So, MFA, the Managed Funds Association, is a trade association representing global alternative asset managers. We're based in Washington with offices in New York, Brussels and London. And our mission is to support the ability of fund managers to raise capital, invest it and generate returns for their institutional investors. So, we're very involved in shaping the rules and regulations, we play a large role in convening the industry, we host a conference series as well to bring together industry participants. Our membership ranges from traditional hedge funds with open-ended structures. We also have a number of managers that have closed-end structure. So private credit, for example, is a strategy that is increasingly popular with a lot of our managers, and we've seen a lot of growth in that area. So generally, we're not involved with real estate or leverage buyout, but alternative strategies in between those two poles are where MFA is very active.

Peter Antoszyk: And you're active on monitoring the policy front and being active in lobbying —

Bryan Corbett: Yes.

Peter Antoszyk: — for policy changes as well?

Bryan Corbett: Our primary focus is advocating on behalf of the industry. So that's identifying regulatory issues, whether they are focused on SEC disclosures or tax issues that affect the industry both here and abroad. We'll identify issues, we'll work with our industry participants to develop positions and then we will go forward, and we will advocate and try and lobby to shape the outcome. We have a government affairs team, a legal team, a communications team and a research group all working together in a very integrated way to deliver a policy result for the industry. In terms of policy outcomes, we want to see fair, efficient and competitive capital markets. So, all of our policy objectives are aimed towards that guiding principle.

Peter Antoszyk: So, let's talk about the new rules that have been adopted by the SEC regulating private funds. As I said in the introduction, these rules will have a significant impact on many of our listeners who are private asset managers and investors. And I know that you, on behalf of the MFA, have been an outspoken critic of these rules and in fact, have sued the SEC, challenging the adoption of the rules. Before we get into the problems with the rules, it would be great if you could unpack the new rules for us and generally describe what they are, and then we can get into the impact.

Read More >

Bryan Corbett: Sure. So, at MFA, we take a very constructive approach to engaging with the regulators. We have a long history of working with the SEC, the CFTC and others internationally to support policies that promote competitive markets. So, during my four years or so at MFA, I was working with the SEC very closely, giving them lots of feedback and comment on rules. So, I don't like to think of it as a battle; that's not how we frame it. We frame it much more as, you know, an ongoing process around policy and we try to make it as constructive as possible. So, in the last couple of years under Chairman Gensler's regime, the SEC has taken a very pro-regulatory approach. Right now, there are about 20+ rules that affect the industry. The private funds rule that you mentioned, it's just one and we can get into that in a bit more detail, but I think it's important to not lose sight of the overall agenda of the SEC towards private funds. As you think about these 20 rules, they affect every aspect of a manager's business. Certainly, depending on your strategy, some rules are more punitive than others. Broadly, the SEC is looking to require more information about a manager's book, looking for more disclosures on a more frequent basis, at a more granular level around equity positions, swap positions, et cetera. They're focused on a manager's operations. There's rules around custody, cyber, ESG. There's a new rule on predictive analytics and AI that the SEC has recently put out, and then the last issue is around a manager's relationships with its investors. And that's where the private funds rule, which just came to conclusion in late August, and as a rule that we, in coordination with five other industry groups, decided to litigate on.

Peter Antoszyk: So, let's take them in reverse order. That last one first — it's the most controversial. Can you describe it a little bit and walk us through what some of the aspects of the new rules are?

Bryan Corbett: So, for the first time, the SEC is injecting itself in the middle of negotiations between general partners and limited partners. As your listeners know, a registered investment adviser with the SEC has disclosure obligations to the public, they have disclosure obligations to the SEC and they're subject to exams and inspections. But with the private funds rule, the SEC is trying to dictate certain outcomes when GPs and LPs negotiate an investment in a fund. The SEC is coming at the private fund industry with very much a mutual fund, retail framework in mind, and that is where we are raising concerns, and that really forms the basis of our suit. We don't believe the SEC has the statutory authority to implement this type of regulation that goes to the negotiation of terms and conditions, side letters, preferences, things like that, which historically have underlied an investment in a fund by a sophisticated institutional investor.

Peter Antoszyk: So, describe some of the changes that affect the limits of those activities.

Bryan Corbett: Sure.

Peter Antoszyk: For instance, having to do with certain restricted activities, the limits on side letters —

Bryan Corbett: Yep.

Peter Antoszyk: Give us a little more detail.

Bryan Corbett: Sure. So, one of the hallmarks of an investment in a private fund is that when an allocator looks to make that investment, depending on when they come into the fund, the size of their investment in a fund, they have the ability to negotiate certain rights. Whether those are liquidity rights, information rights, certain fee provisions; an allocator has the negotiating leverage with the fund to negotiate the terms and conditions upon which they'll invest. The SEC, through this rule, is basically saying, "No more preferences;" that all allocators are going to come into funds on the same terms and funds are going to have to bring allocators in under the same terms. So, the proposed rule both looks to change the relationship between GPs and LPs, but also among the allocator community. It is looking to level the playing field. So, a multibillion-dollar pension fund will go into a GP [fund] on the same terms and conditions as a much smaller family office. And so, the dynamic is really shifting through this rule. And by functionally eliminating the ability to have preferences, the SEC is treating private funds much more like a mutual fund than a private fund.

Peter Antoszyk: And those preferences, those side letters, have been important to the community because it's a recognition, as you said, not only of the differences in the dynamic between certain LPs, but also because it's a way of funds attracting early investors to give them some preferential treatment to be the first ones to buy into the investment thesis.

Bryan Corbett: Right. And the SEC, in the proposed rule, banned these preferences and said, "You just can't do it." They also were going to make funds have to go back and renegotiate existing LPAs. That's no longer the case; they grandfathered it in and rather than banning the preferences, what they've said is, "If you offer preference to one, you have to tell it to everybody and offer it to everybody," which then really doesn't make it a preference anymore. So, they've tried to kind of rebrand the prohibition in the guise of a restriction, and functionally it's the same outcome.

Peter Antoszyk: The other you mentioned is that there are certain restrictions on activities of fund managers, having to do with the charging of certain fees. Can you unpack that a little bit?

Bryan Corbett: I think for the first time the SEC is clearly looking to create fee compression and looking to drive fees and terms to, frankly, the lowest common denominator that they can. And that, we think, ultimately is not going to be in the interest of the pensions, endowments and foundations that need to access these funds to generate the return for their beneficiaries. So by taking a one-size-fits-all approach and forcing it on the managers and on the allocators, we think the SEC has exceeded their authority.

Peter Antoszyk: And my understanding is that those two aspects of the rules impact all private fund advisers —

Bryan Corbett: Correct.

Peter Antoszyk: — not just SEC registered private fund advisers. Is that right?

Bryan Corbett: The bulk of the rules are focused on registered investment advisers. There are a number of provisions where even if you're not registered, you still will need to comply, which is why the rule is very broad in its application and why you've seen such a large number of industry trade groups decide to litigate.

Peter Antoszyk: Right. And then in terms of the other piece you mentioned, particularly as it pertains to the SEC registered [investment advisers], there were disclosure requirement changes, there were audit requirement changes — can you walk through some of the others that those impacted?

Bryan Corbett: Yes, as your listeners will know, registered investment advisers file form ADV, they file form PF, they've negotiated other information rights and disclosure terms with their allocators in terms of when and, and what information the allocators will get. The SEC, through this rule, does create a new regime for annual reports that goes well beyond what was contemplated by LP's and GP's in the private fund context, so that is a significant change. And I just want to note that in the final rule itself, there are lots of provisions. It's over 600 pages. And Peter, you're doing a nice job of sort of taking some of the bigger issues. But when it comes to the litigation and why we filed suit, it's not any one particular provision that we are suing based on. It really is the succeeding statutory authority. And we think the overall rule in itself, when you apply all of these new provisions — we think it's unworkable. We don't think the SEC thought through how all this is going to work. We think it's going to really hurt competition in the market. A major policy argument has been the focus of all of the cost of these rules on new launches, smaller managers and how these rules are going to, frankly, undermine competition in the market. There's a statement in the SEC's release where they comment on the fact that women and minority owned investment firms are a growing percentage of small manager members and that small manager members are going to be hurt by this final rule. And there's a suggestion that in order to avoid these onerous regulations smaller managers should just stay below the 150 million AUM threshold; just don't register and then you won't have to deal with this entire headache. And to us that just seems like really bad public policy for the lead capital markets regulator to be encouraging funds not to grow to avoid onerous regulation.

Peter Antoszyk: Yeah, I think that one of my takeaways from reading about this and listening to you in this context and other contexts, is that — and you've mentioned this — that the SEC has in some ways blurred the lines between the retail investor and sophisticated asset manager. Limited partners, as you said, these pension funds managers —

Bryan Corbett: Yep.

Peter Antoszyk: — and others who are, you know, professional investors surrounded with advisors and research analysts and have leverage and bargaining power with the fund managers themselves to get information, to invest on terms that make economic sense for their fund. It seems like the SEC is really looking to impose their view of how that should be managed and substituting their view for that of the sophisticated fund managers.

Bryan Corbett: It's a very good point and in defense of their rule, the SEC has tried to create this narrative of the private fund on one side and the end beneficiary of the pension fund. So, a schoolteacher on the other side of the trade ¾

Peter Antoszyk: Right.

Bryan Corbett: ¾ they're looking to just see through the pension fund with its staff, its CIO team, its lawyers, its consulting firms, its audit firms, all of the professional advice that goes into an allocation to a fund. And to the point you're making, we are really trying to keep that line between private funds and retail that is in statute and is in place today. Whereas this rule does begin to try and blur that. And the SEC has talked about this false narrative of the pension fund and the beneficiary. It's not. It's the pension fund and it's the private fund on the other side of the deal, and that's something we're very focused on continuing to make sure that the public and policymakers (more broadly) understand the dynamics of play in markets today.

Peter Antoszyk: You mentioned that there is going to be a significant anti-competitive impact of these new rules. Can you unpack that a little bit, in terms of how you see that playing out?

Bryan Corbett: Sure. So, as we look at a typical private fund, we think they're going to be challenged in two ways: both capital raising, as well as the costs and expenses of operating their fund. They're going to be challenged with capital raising because it is going to be harder to bring in anchor investors into a new fund. It's going to be harder to bring in a pension fund with a certain size investment where you might want to give them a preferred term, so they commit more capital. So, you're likely to see a more challenging environment for managers to raise capital as the playing field gets leveled under this rule. And then you're also going to see the costs and expenses skyrocket. Because remember, this private fund rule is one of 20 that the SEC is focused on. This ruling in itself will be a significant burden. There have been some cost estimates of, you know, multi-billions of dollars in implementation cost for managers. It's going to be a lot more. It's going to be a lot harder to generate that return that you need for your pension fund client. And that means that small and medium sized managers may decide not to launch, to close shop; they may decide to join a platform which will lead to consolidation in the industry. We long have had a vibrant, entrepreneurial marketplace among private funds. We're very focused on continuing to promote that, and this rule really begins to undermine that dynamic.

Peter Antoszyk: I think also, when you are talking about smaller funds having more challenging environment to be established and to grow, that's an important part of the market because those funds tend to work with and invest in the lower middle market companies.

Bryan Corbett: Right.

Peter Antoszyk: And those are major engines of our economy and sources of future growth.

Bryan Corbett: Right. The small firm today in 10, 15 years becomes the larger firm, right? Like that's just the life cycle of maturation of a private fund. And if we're cutting off and dampening the new launches, we may not see that impact in year one. But by the time you get to years five through ten, you're going to begin to see less capital flowing to many of those small and medium sized companies and importantly, less options for allocators, right? Allocators, many of them have new launch programs where they're looking to identify emerging managers and put money behind them early, on the hopes that they grow. There are going to be much fewer options and many of those new emerging manager programs are likely going to close at allocators.

Peter Antoszyk: Now, on the flip side, supporters of these regulations have described them as promoting transparency, competition and fairness. You've described some of the aspects which you find objectionable. Are there other aspects that you would say, "Yeah, this is actually moving in the right direction?" Broadly speaking?

Bryan Corbett: Well, I think you've seen the GP community be very creative in responding to information requests from allocators. I haven't talked to any of our managers who have said when an allocator asks for transparency information — I haven't met any who say, "We're not going to give them that information." There's very much a free flow of information between the GPs and LPs under the agreements that they negotiate. But what is happening with this rule is the SEC, without authority, is clearly trying to put their thumb on the side of the allocator and give them more negotiating leverage in what historically has been a privately negotiated economic agreement. And I think that is what is challenging and isolating. People are for transparency. We talk to our managers all the time and our LPs get all the information —

Peter Antoszyk: It's like apple pie, right?

Bryan Corbett: Yeah, it's hard not to like in the abstract, right? I mean, who's against transparency? No one is. But what people are against is the SEC, without authority, again trying to change the negotiating leverage in a way that I think a lot of LPs are beginning to see isn't necessarily in their favor. One of the myths of this process has been that the LP community is monolithic and they're all behind this rule. They're not. We've talked to a lot of LPs and you've seen some come out publicly criticizing the rule, saying, "I'm losing preferred terms that I've spent two decades developing and building relationships with managers. Now that's gone. How is that fair to me and my pensioners?" So, this is not good for everybody, despite what the SEC is proclaiming.

Peter Antoszyk: What problems do you think the SEC has seen or is trying to address by these rules?

Bryan Corbett: It's a good [question].

Peter Antoszyk: Because these have been sort of percolating for a while and so wondering what motivated them in the first place?

Bryan Corbett: You know, it's a challenge to kind of decipher the SEC's motivations here. As we talked about earlier, the SEC has talked about the end beneficiaries, those pensioners, as sort of being on the other side of the trade, but that's not the case. It's the pension fund that's on the other side of the trade. So, when we begin to unpack it a little bit, you know, I think there is a concern by the SEC about fees. I think they are clearly trying to drive down fees as a result of this rule and hoping that by eliminating preferences, they're going to push fees down. I think there's a concern about the growth of private markets and private funds, generally. The market has grown significantly post-Dodd-Frank, as Congress passed a statute that pushed some risk-taking out of the banks into the private markets; the private markets have responded. So, I think this rule is a bit of an SEC effort to try and get at the growth of private funds, again, without the clear statutory authority to do it. So, the motivations, you can kind of piece it together, but it hasn't been very clear. As you said, it has percolated for a number of years. It's long been a policy preference for many progressive consumer groups that have looked to push this. And now in this environment, they may have their moment to try and push it over the finish line but, along with those other groups, we're certainly going to challenge it.

Peter Antoszyk: Yeah and I don't understand. You've mentioned two things. One is, you know, the fee structure, which is trying to push down the fees, which I'm not exactly sure I understand why the SEC would want to get involved in that in the first place. But the second is the concern about the growth. We know that there has been concern at the regulatory level with the growth. For instance, in the private credit industry, there's some momentum to further regulate the private credit industry, the fear of failure by one of the funds, which could create financial instability across the board. But I think that fundamentally misunderstands the industry, don't you think?

Bryan Corbett: That's right. I do; I agree with that. Certainly, we've seen indications from regulators both in the US and abroad that they're looking to better understand private credit, understand its interconnectedness, if any. And what we have said is, "Look this is very different than a bank." Let's not use the troubles with the mid-tier banks in the US, the Silicon Valley Banks. Let's not use that as a pretext to expand bank-like regulation to private credit. We've made the argument that private credit does not pose any systemic risk, right? There's no depositors. There are investors who have a risk tolerance and invest based on a certain risk thesis. You can't redeem your money in a single day if you are in a private credit fund, unlike a bank. And also, there's no risk of contagion. The private funds are structured in a way where losses in one fund go to those investors in that fund. They don't spread across the financial system the way we've seen bank failures. So, we've been very proactive in trying to articulate why private credit is not like bank lending and that there are very clear fundamental differences underlying the business models, and regulations should be sensitive to those dynamics.

Peter Antoszyk: Indeed. So, I know as you said, one of the ways you push back on this is to file the lawsuit against the SEC. I'm sure you've also been very active on the lobbying front and maybe you could describe those efforts and the reaction that you're getting from Capitol Hill.

Bryan Corbett: Sure. So, we are, as we noted earlier, one of several groups litigating, representing a broad range of strategies. But, at the same time that lawsuit's underway, there are a number of other rules that the SEC's focused on. And what we are starting to do as a group is talk more broadly about how all of these rules are going to work together. There's a concern when you implement just one rule. What will the impact be? How will the industry implement it? Let alone 20 happening within a year of one another.

Peter Antoszyk: Right.

Bryan Corbett: So, the interconnectedness of these rules — and we've seen examples of where the SEC has proposed a rule and then two months later, they propose a different one — that they actually don't work together the way they should. And through the comment process you try and work that out. How these rules work together and also importantly, from a resourcing and cost perspective, what's the burden going to be on the industry and on the end pension, and who is invested in a fund? These costs are going to get passed along, right? Ultimately, the LPs are going to bear a lot of these implementation and new rule costs, and the SEC hasn't really presented a compelling cost benefit analysis showing the overall aggregate impact. And we think it's a little sneaky, in some ways, to do these one at a time and try and push them through as opposed to doing it more holistically, where the industry policymakers, the public, the LPs can get a better sense of what the overall impact will be.

Peter Antoszyk: And so, what has been the reaction, if any, from Capitol Hill?

Bryan Corbett: I think there's been a lot of interest in Chair Gensler's agenda. I think we've seen that in both the House and Senate. Certainly, these rules are very complicated. There's a lot of them happening at one time. So, we've tried to be very strategic, and talking about some of the more high-profile rules. And making sure that those members and committees of jurisdiction that have oversight of the SEC, are aware of what's happening and appreciate the dynamics. But it's an ongoing process and it's one that we are engaged in every day. And we've seen some positive signs that members on both sides of the aisle are concerned about the SEC. You've seen several letters sent to Chair Gensler, from both Democrats and Republicans in the House and Senate, raising concerns. He testified last week in Congress and was asked a number of questions about these rules. So, it's an ongoing process and we will certainly continue to represent the industry on Capitol Hill.

Peter Antoszyk: Do you sense that the SEC has flexibility here? Or do you think that it's going to have to be imposed upon them to make changes?

Bryan Corbett: On the private funds rule, it has gone final. So that litigation will play out over the next year or so. There are many other rules that are out there that are still in process where the SEC has flexibility to adjust them and make changes. Once a rule goes final and firms begin to implement it and come up with lots of questions and problems with the implementation — we're already starting to see it with the private funds rule — at some point, I suspect there will be an effort to begin to seek clarification on some issues, but that's a long process and so far the evidence of the SEC providing clear guidance on other rules, other final rules, doesn't encourage us that we'll get any clarity in the future.

Peter Antoszyk: Many of our listeners, as I mentioned, are asset managers or investors, LPs and GPs. Any advice for them that you would give in terms of action they could take that would be helpful to this endeavor?

Bryan Corbett: I think it's important for the managers to be talking to their LPs about this, making sure they're communicating to their allocators about what the impact will be. I think for some time the risk of implementation and all the costs around this rule have been a bit theoretical. Sort of, out there the SEC's doing all these rules, yeah, yeah, yeah. But now, it's starting to hit home. And it's going to come fast and furious over the next year as these other rules come to conclusion. So, I think that the communication between GPs and LPs is really important. Especially, as we begin to hear more stories, more anecdotes from LPs who didn't quite know all this was happening and frankly don't really think the SEC is doing them any favors. I would also encourage the managers to reach out to us. If you have questions, if you have certain issues that you think MFA could be helpful in addressing, we'd love to hear from you. We know that it's a very creative, dynamic and innovative industry, and I'm sure there are people already thinking about these rules in ways that we haven't. And we would love to hear from that community and keep the managers very engaged as we go forward.

Peter Antoszyk: You put out a lot of material and we'll post a link with this episode to your site, although easily found by just by googling it. Moving from this, which is obviously central to your activity, generally, are there any other major regulatory or policy developments affecting the private markets that you would highlight?

Bryan Corbett: We talked a lot about the line between private funds and mutual funds retail product; that's a clear line we're looking to maintain. The other line, and we talked about this a little bit before, is the line between bank and non-bank, and making sure that the regulators, especially the Fed and Treasury, and Europe, the ECB and Bank of England don't come at the private fund industry with a bank-like framework, and think about prudential-like regulation for the private fund industry. We talked about it in the context of private credit, but it's also an issue that policymakers are contemplating just more broadly across the hedge fund industry and the use of leverage across private funds. So, it's a challenging time. We're very front footed and arguing that private funds do not pose systemic risk for many of the reasons we articulated earlier. And that policy debate around non-bank financial intermediation is one we are going to see play out over the next year or two, as well.

Peter Antoszyk: Yeah, that's been a hot topic within the industry in terms of whether it creates a systemic financial risk. But I tend to agree with you. It's a very different industry and requires a very different focus. Well, I'd say this has been a great conversation. You are doing heavy lifting for the industry. I now have a much better understanding of the new rules and why they're so controversial, and I encourage my listeners to go to the MFA website. As I said, we'll post to monitor these developments and to reach out to you and your colleagues and to get additional information. You put on great programs. I know you have some coming up soon. And I want to thank you, Bryan, for sharing your views. We're in private market talks.

Bryan Corbett: Great. Thanks Peter. Terrific conversation and look forward to following up.

Close