SUBMITTED ELECTRONICALLY

April 28, 2011

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

Re: Listing Standards For Compensation Committees, Release Nos. 33-9199/34-64149, File No. S7-13-11

Dear Ms. Murphy:

The Private Equity Growth Capital Council (the "PEGCC") is submitting this letter in response to Release Nos. 33-9199/34-64149 (the "Proposing Release"), in which the Securities and Exchange Commission (the "Commission") has requested comment on a proposed rule and rule amendments to implement Section 952 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act"), which adds Section 10C to the Securities Exchange Act of 1934 (the "Exchange Act"). Our comments focus on the provisions of the proposed rule directing the national securities exchanges (the "exchanges") to establish listing standards that require each member of a listed issuer's compensation committee to be a member of the board of directors of the issuer and to be "independent."

The PEGCC is an advocacy, communications and research organization and resource center established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are 33 of the world's leading private equity and growth capital firms ("private equity firms") united by their commitment to growing and strengthening the businesses in which they invest.[1]

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

The PEGCC understands that Section 952 of the Dodd-Frank Act was adopted in large part to address perceived abuses and conflicts of interest in the area of executive compensation, including the perception that compensation committees of some public companies were too lax in overseeing executive compensation arrangements, or that those committees, due to a lack of independence, were willing to award excessive management compensation not appropriately linked to performance, at the expense of shareholders and the health of the company in question. The PEGCC acknowledges the importance of compensation committees that are independent from management and the importance of rigorous oversight of compensation decisions—a role regularly undertaken by representatives of private equity and growth capital funds ("private equity funds") serving on portfolio company boards and board committees.[2]

The PEGCC supports the general approach taken in the Proposing Release. The PEGCC also strongly supports the decision by the Commission to leave to the exchanges decisions concerning compensation committee independence. Furthermore, the PEGCC shares the view adopted by the exchanges in their current rules, and recognized by Commission in the Proposing Release, that mere ownership by a private equity fund of equity securities of a listed company should not preclude employees or partners of (or

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

[2] See, for example, the following discussions of value creation by private equity firms, including in the areas of executive compensation and through board service: Robert C. Pozen, "If Private Equity Sized Up Your Business," Harv. Bus. Rev. (November 2007) , 78, 86 ("Most important, directors of public companies should learn from private equity not to allow top executives to leave with large exit packages despite poor performance."); Ronald W. Masulis and Randall S. Thomas, "Does Private Equity Create Wealth? The Effects of Private Equity and Derivatives on Corporate Governance," 76 U. Chi. L. Rev. 219, 227-228, 251 (2009) ("A second source of potential agency-cost reductions in LBOs arises out of a strong realignment of managerial incentives, which focuses executives' efforts more sharply on performance and value….A fourth source…arises from improved board monitoring of management as a result of stronger financial incentives for directors and better internal reporting….A fifth benefit of private equity…is the replacement of ineffective senior managers with highly talented executives.")("Private-equity transactions concentrate equity ownership. One implication is that management can have a large share percentage ownership stake, so they are highly motivated to work hard for their firm and focus intensely on creating value. The other large shareholders in these firms are sophisticated private-equity firms, who have strong incentives to monitor management carefully because their compensation is tied directly to creating firm value. At the same time, the private-equity firms typically have a dominant position on the board of directors, providing them with the power to discipline management as well."); Nick Bloom, Raffaella Sadun and John Van Reenen, Centre for Economic Performance, "Do Private Equity Owned Firms Have Better Management Practices?," 3 (July 2009)("[I]t seems that PE-owned firms have strong people management practices, in that they adopt merit-based hiring, firing, pay and promotions practices. Relative to other firms, they are even better at target management practices, in that PE-owned firms tend to have tough targets (evaluation metrics), which are integrated across the short and long run, well understood by the employees and linked to firm performance.").

other persons associated with) the private equity firm that manages the fund from serving on the compensation committee.

Indeed, the PEGCC believes that representatives of private equity firms that are shareholders of listed portfolio companies can and do remain independent (whether their stake is large or small), and bring significant value to those portfolio companies through board and compensation committee service. The PEGCC shares the views on this point of the commentators referenced at footnotes 46, 47, 48 and 49 of the Proposing Release. The PEGCC believes that the adoption by the Commission or the exchanges of rules barring representatives of non-management shareholders, like private equity funds, from serving on compensation committees of covered issuers would, in fact, conflict with the basic goals of Section 952 of the Dodd-Frank Act. The PEGCC urges the Commission, to the extent practicable, to encourage the exchanges to consider the positive impact that representatives of private equity firms can have on the goal of aligning compensation practices with the interests of shareholders.

I. Background

The PEGCC's comments above and below are informed by the nature of the private equity industry's investment model. That business model involves the active management by a private equity fund of its investments in portfolio companies,[3] with an emphasis on pay for superior performance. A private equity fund invests in businesses with a view toward generating superior, long-term investment returns to the fund (and its investors, which include corporate pension plans, state and local retirement plans and university endowments) when the fund ultimately disposes of those investments.

Regardless of their particular investment strategies, all private equity funds seek to increase the value of their portfolio investments during the time (typically a three- to seven-year holding period) that those investments are owned by the private equity fund.

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

An important means by which a private equity fund creates value in a portfolio company is by electing employees or partners of (or other persons associated with) the fund's affiliated private equity firm to serve as active members of a revitalized portfolio company board, and the compensation committee and other committees of the board.[4] A private equity fund may also create value, for example, by strengthening and, when necessary, replacing the management team, and/or by requiring the structuring and implementation of management and employee equity ownership plans, stock option plans and/or revised performance-based bonus plans that are tailored to the portfolio company's business and business plan and are designed to incentivize behavior that will maximize value over the long-term for shareholders of the portfolio company, including the fund.[5] However, private equity funds rarely, if ever, appoint partners or employees of their affiliated private equity firms to serve as executives of portfolio companies. The investment returns of private equity funds and their affiliates and general partners (including the performance or "carried interest" allocations to those general partners) are dependent on creating value and eventually realizing that value.[6] Those returns would be adversely impacted if management were improperly enriched.

Therefore, the interests of private equity funds, as significant shareholders, are aligned with the interests of other shareholders. Of course, a private equity fund and its board (and board committee) representatives seek to work with and incentivize management to create value for shareholders. But a private equity fund and its board (and board committee) representatives are by no means captives of management; indeed, they are fiercely independent of management.

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[4] If a private equity fund sells its entire stake in a portfolio company in a private sale to a strategic or other buyer, it typically no longer will be permitted to (nor wish to) continue to elect persons to serve on the company's board or board committees. However, a private equity fund may dispose of only a portion of its portfolio investment in a strategic sale, or at the time of or following an initial public offering by the portfolio company, but continue to retain an investment in the portfolio company for a period of time (frequently for a significant period of time) after the sale or IPO. In such a case, until the private equity fund sells its remaining stake in the company, the private equity fund may wish to continue to add value and protect its interests (including those of the fund's investors), and thereby the interests of the shareholders of the portfolio company generally, by having one or more of the fund's representatives continue serving on the board of directors of the company and as a member of the company's compensation committee.

[5] Private equity firms and funds frequently also work to increase the value of a portfolio company by (1) assisting the company in optimizing its capital structure, (2) professionalizing financial management of the company, (3) providing operational assistance, (4) developing and implementing a new or revised business plan and/or (5) causing the company, as appropriate, to make capital and R&D expenditures, to cut corporate waste and inefficiencies, to expand into new markets and develop new products and/or to make strategic acquisitions to create the scale required to compete more effectively and become market leaders.

[6] For a general description of the structure and operations of private equity firms and funds, see Annex A hereto.

The PEGCC has the following comments in response to certain questions posed in the Proposing Release.

II. Proposed Listing Requirements—Independence Requirements

Rather than establishing minimum independence standards that the exchanges must apply to compensation committee members, the proposed rule would permit each exchange to establish its own independence criteria, provided that the exchange considers the relevant factors specified in new Section 10C of the Exchange Act relating to affiliate relationships and sources of compensation. The PEGCC believes that this approach is sound and appropriate.

As noted in Section II.A.2. of the Proposing Release, the current NYSE and Nasdaq rules require directors to meet objective criteria of independence and require their listed issuer's boards to affirmatively determine that each independent director either (in NYSE's case) has no material relationship with the company or (in Nasdaq's case) has no relationship that, in the opinion of the board, would interfere with the director's exercise of independent judgment in carrying out his or her responsibilities. These requirements and the independence factors of Section 10C of the Exchange Act are sufficient, the PEGCC believes, to assure an appropriate degree of independence in the context of compensation committees.

The PEGCC encourages the exchanges, in establishing their own definitions of independence (and the Commission, when it comes time to approve the definitions proposed by the exchanges), not to prohibit directors affiliated with a shareholder such as a private equity fund from serving on compensation committees. In particular, the PEGCC encourages the exchanges and the Commission to recognize that directors that are affiliated with a private equity fund should be considered independent members (absent other disqualifying factors) of the compensation committees of portfolio companies in which the fund has an investment, for the following reasons:

First, as discussed above, private equity funds and firms are organizations whose success and reputations are based on value creation for shareholders. Their success and reputations are undermined if they improperly enrich management. The same is true for the employees and partners of private equity firms and funds. All are well positioned and motivated to exercise independent judgment on compensation matters. In this way the interests of private equity firms and funds, and of directors elected by private equity funds to portfolio company boards and board committees, are aligned with the interests of other shareholders on matters of executive compensation.

Second, the income of private equity firms and funds, and of their partners and employees, are linked to and largely dependent on value creation for shareholders, and is reduced if they improperly enrich management. Private equity firms and funds, and their partners and employees, are highly incentivized to oversee rigorously management

compensation arrangements. In this way also the interests of private equity firms and funds, and of directors elected by private equity funds to portfolio company boards and board committees, are aligned with the interests of other shareholders on matters of executive compensation.

Third, private equity firms and funds typically have a strong institutional belief in, and thus an intense focus on, the importance of appropriately structured and reasonable compensation arrangements (including equity ownership by management) to the creation of value at portfolio companies. They believe in pay for performance, and will work to reward management that creates value and to replace management that fails to do so. In this way also the interests of private equity firms and funds, and of directors elected by private equity funds to portfolio company boards and board committees, are aligned with the interests of other shareholders on matters of executive compensation.

Fourth, directors elected by private equity funds to portfolio company boards and board committees are valuable members of those boards and committees. These directors frequently have deep knowledge of a portfolio company gained since the private equity fund's initial investment in the company, and devote substantial time to board and compensation committee service. In particular, they are likely to have deep knowledge of the company's compensation issues, plans and arrangements. Because they work for private equity firms, which emphasize a linkage between pay and performance, these directors frequently have deep experience with effective, performance-based compensation plans and arrangements in general, in addition to the company's compensation plans and arrangements in particular. For these reasons, they may be especially well qualified to serve on portfolio company compensation committees.

Fifth, compensation committee independence concerns are very different from those surrounding audit committees. The primary function of a company's audit committee—to ensure objective oversight of the company's financial reporting—is very different from the primary function of a compensation committee in reviewing and adjusting executive compensation in view of the performance of the company and its management. In the case of audit committees, concerns have been expressed that a significant shareholder may not have the same interest as other shareholders in full and fair disclosure. This concern is not present in the compensation committee context in the case of non-management shareholders—particularly where the shareholder is a private equity fund, whose interests in the area of executive compensation are aligned with those of other shareholders, as discussed above. Accordingly, the PEGCC believes that a greater degree of flexibility concerning independence determinations for compensation committee members—and in particular a recognition that representatives of private equity funds should not be precluded from serving merely because those persons are affiliated with a shareholder—is appropriate. The PEGCC shares the view described in the Proposing Release that the types of *per se* affiliate bans that have been implemented

in relation to audit committee independence are neither necessary nor appropriate in the case of compensation committees.

III. Implementation of Listing Requirements—Securities Affected—Listed Equity Securities

The PEGCC concurs with the Commission's interpretation of Section 10C of the Exchange Act as applying only to issuers with listed *equity* securities, and the adoption of this reading in the proposed rule, as discussed in Section II.B.2.a. of the Proposing Release. The PEGCC sees no reason why the historical treatment by the exchanges of debt issuers in this regard should be changed, and believes that a different interpretation of Section 10C would not advance the general intent of the Dodd-Frank Act's executive compensation provisions.

IV. Implementation of Listing Requirements—Exemptions—Issuers Not Subject to Independence Requirements

The PEGCC concurs with the approach proposed by the Commission in Section II.B.3.b. of the Proposing Release to give effect to Section 10C(a)(1) of the Exchange Act, by expressly providing in proposed Rule 10C-1(b)(1)(iii) that the five categories of issuers identified in the Dodd-Frank Act as excepted from the compensation committee independence requirements, including controlled companies, are not subject to an exchange's compensation committee independence requirements.

V. Implementation of Listing Requirements—Exemptions—Relationships Exempt from Independence Requirements

The PEGCC agrees with the Commission's proposal, discussed at Section II.B.3.c. of the Proposing Release, to leave to the exchanges the decision whether to exempt from the compensation committee independence requirements particular relationships between an issuer of listed equity securities and members of the company's compensation committee.

For the reasons discussed above in this letter (including the alignment of the interests of a private equity fund and its representatives with the interests of other shareholders, and the value that representatives of a private equity fund can bring to a portfolio company's compensation committee), the PEGCC would support strongly a decision by the exchanges to exempt expressly from the compensation committee independence requirements any person who otherwise would be deemed not independent merely by virtue of that person being a partner or employee of (or otherwise associated with) a non-management shareholder, including a private equity fund, that holds an equity stake (whether large or small) in a covered issuer.

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

Respectfully submitted,

Douglas Lowenstein
President
Private Equity Growth Capital Council

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

April 28, 2011

Structure and Operations of Private Equity Firms and Funds.

This summary was prepared by the Private Equity Growth Capital Council (the "PEGCC"). The PEGCC is an advocacy, communications and research organization and resource center established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy. Established in 2007 and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The members of the PEGCC are 33 of the world's leading private equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest.

1. Private Equity Firms

Private equity firms sponsor, manage and advise private equity funds (which are described below). Private equity firms, or the owners of private equity firms, typically own and control their funds' general partners (or, in the case of a fund that has a non-partnership structure, the equivalent controlling entity), which make investment decisions for the fund ("GPs"). Private equity firms most frequently are privately owned and controlled by their senior investment professionals. Subject to limited exceptions (for small firms, certain non-U.S. firms and venture capital firms), private equity firms are, or after July 21, 2011 will be required to be, registered as investment advisers under the Investment Advisers Act of 1940.

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

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

2. Private Equity Funds: Typical Structure

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

3. Private Equity Funds: Investment Strategies and Diversification

Private equity funds pursue a variety of investment strategies (*e.g.,* venture capital, growth capital, buyout, real estate, distressed and mezzanine investing) and invest in a broad range of industries and geographies.[1] While an individual private equity fund may hold a limited number of investments, and while some private equity firms and/or private equity funds have a geographic or industry focus, private equity funds in the

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

aggregate are diversified across multiple geographies and industries and thus lack concentrated exposure in any single region or sector.[2]

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

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

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

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

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

5. Private Equity Funds: Strictly Limited Hedging and Trading

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

6. Private Equity Funds: Limited Lending, Limited Borrowing

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

With the exception of certain real estate funds, private equity funds almost never borrow, and frequently they are prohibited by their partnership agreements or other governing documents from borrowing. To our knowledge none are reliant on short-term credit markets or regularly roll-over debt as part of their operations. Private equity funds rarely borrow because of the particular tax concerns of tax-exempt LPs concerning "unrelated business taxable income."[3]

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[3] It is true that some private equity funds, such as buyout funds, purchase companies using equity and borrowed money—but the funds themselves do not borrow or guarantee that debt. In a leveraged buyout transaction, a buyout fund may, for example, incorporate an acquisition vehicle and make an equity investment; the acquisition vehicle then uses the capital that the fund invested, together with cash that it borrows from a bank or other lender, to purchase the target company from the seller of that business, with repayment of the debt being secured by a lien on the assets of that company and by a

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

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

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

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

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

If one or more private equity funds advised by a private equity firm fail(s) to generate satisfactory returns for their LPs, it may be difficult if not impossible for the private equity firm to raise new private equity funds. If the private equity firm fails to raise new funds, it will continue to advise its existing funds (which existing funds, in

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

turn, will manage and eventually wind down their portfolios over the terms of those funds), and then the private equity firm will quietly go out of business.