Natasha Vij Greiner
Director, Division of Investment Management
Securities and Exchange Commission
100 F St NE
Washington, DC 20549

November 8, 2024

Dear Director Greiner:

The following 10 undersigned organizations and individuals express our concerns around an application for an exchange traded fund (ETF) of illiquid, hard to value assets to mom-and-pop investors.[1] The proposed application for the SPDR SSGA Apollo IG Public & Private Credit ETF would stretch the boundaries of what assets are suitable to be included in an ETF that was then sold to retail investors. We are also concerned that such an ETF may also violate decades of investor protection precedents under the Investment Company Act.

ETFs were originally designed to improve public market investing not as a backdoor into private market assets that may be adversely selected

Exchange Traded Funds were originally launched in the 1990s to allow investors to purchase shares of an ETF that referenced a popular equities index, such as the S&P 500, rather than having to individually purchase and rebalance all of the underlying stocks of the index.[2]

However, fund managers have increasingly strayed from the original model of allowing ETFs to invest simultaneously in a wide variety of publicly traded stocks and instead now include riskier, more complex variations such as inverse and leveraged ETFs.[3] Inverse ETFs rely on derivatives like futures contracts to profit from declines in indexes, but the frequent trading of the underlying derivatives and short-term nature can carry high expense ratios and expose investors to losses. Leveraged ETFs are debt-financed investments that can magnify gains and losses and have high fees and transaction costs that can rapidly mount. Already, numerous investors have lost money simply because they failed to understand the return and payout characteristics of such increasingly complex ETFs, which in some cases lead to significant and sustained losses over a long period of time.[4]

This latest ETF by State Street deviates from the original intent and benefits of an ETF even further than these other complex ETF products by exposing unsuspecting retail investors to

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[1] Securities and Exchange Commission EDGAR. Form N-1A. SSGA Active Trust. Sep 10, 2024. https://www.sec.gov/Archives/edgar/data/1516212/000119312524216340/d878371d485apos.htm
[2] Securities and Exchange Commission Office of Investor Education and Advocacy. Investor Bulletin: Exchange Traded Funds. https://www.sec.gov/investor/alerts/etfs.pdf
[3] Investor Advisory Committee. Recommendation of the Market Structure Subcommittee of the SEC Investor Advisory Committee on Single Stock ETFs and Leveraged ETFs.
[4] Vericrest Private Wealth. Leveraged ETFs are a bad idea. Period. Leveraged ETFs are a bad idea. Period.

highly illiquid assets, excessive fees due to inflated valuations, and potentially significant losses. There are scant, if any, benefits for retail investors, but the proposed ETF would benefit private equity firms by serving as an avenue to sell their underperforming and hard to unload assets.[5]

<u>The addition of an institutional intermediary does not protect investors, especially because of embedded conflicts of interest from compensation structure</u>

Retail investors naturally are not suited to invest in private credit directly because the market is complex, opaque, and illiquid. The bespoke nature of private lending requires even large and sophisticated institutional investors to negotiate with well-paid law firms to secure covenants and other documentation necessary to make the purchases and the lack of a secondary market can make private debt extremely illiquid. But, the presence of an institutional manager, in this instance State Street Global, does not remotely address or mitigate either of these concerns sufficiently to protect vulnerable retail investors.

For one, institutional investors themselves have already struggled to properly negotiate their basic rights through covenants to protect themselves from companies or other creditors trying to transfer value from these private credit vehicles.[6]

More importantly, the compensation incentives of an ETF manager are not aligned with investors which creates a conflict of interest that exposes investors to unnecessary risk. The investment manager is paid based on a percentage of assets, encouraging them to gather more assets and investors rather than focus on performance.[7] It is important to note the ETF manager is not compensated based on the performance of the ETF. The combination of opaque, illiquid, high-risk underlying assets and compensation structures that contain a structural conflict of interest pose significant risks to retail investors.

<u>SEC's approval of private credit ETFs would expose retail investors to assets private equity firms are struggling to sell</u>

This application for an ETF represents the first step in allowing the private fund industry to offload private market assets at inflated valuations to a retail investor base who would be unable to collectively hold the ETF managers accountable for hyped-up valuations or potential conflicts of interest. This comes as the private fund industry is struggling to sell $3.2 trillion in assets[8] and

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[5] Hauptman, Micah. Consumer Federation of America. Re: SPDR SSGA Apollo IG Public & Private Credit ETF Investment Company Act of 1940 File No. 811-22542. Oct 4, 2024. CFA-Letter-to-SEC-Re-Private-Credit-ETF.pdf

[6] Dimler, Michael et al. Morningstar. A Closer Look at Private Credit Covenant Relief. Jun 17, 2024. A Closer Look at Private Credit Covenant Relief | Morningstar DBRS

[7] Institutional Investor. How 'Greedy' Asset-Gathering Undermines Performance. Jul 12, 2017. How 'Greedy' Asset-Gathering Undermines Performance

[8] Bain & Company. Global Private Equity Report 2024. Global Private Equity Report 2024 | Bain & Company

facing greater fundraising challenges from their existing investors.[9] Some of the largest private funds investors have also been stepping up their scrutiny of their investments and asking for much more detailed information about the companies and assumptions behind their valuations.[10] If the SEC approves this ETF application, retail investors could become the dumping ground of last resort for the private equity industry to unload the least attractive assets under management.

This ETF application mirrors other concurrent efforts by the private funds industry to sell hard to value assets with high fees directly to retail investors.[11] Legislation has been introduced in Congress to enable investment funds to purchase more private offerings.[12] Business Development Companies (BDCs), who are some of the largest private credit lenders and primarily sold to retail investors, are pushing to sell shares to mutual funds and included in indices to disguise their high fees.[13]

The private fund industry has been delaying losses and transferring private assets at inflated valuations through continuation funds, where funds running into the end of their investment period transfer assets into a new fund, sometimes with the same existing investors.[14]

In some cases, new continuation funds have been re-purchasing assets valued 28 percent higher than they were valued six months earlier.[15] If the institutional investors cannot determine whether they are getting a fair valuation of the transferred assets, what hope do retail investors have that assets sold into the ETF are not also being unloaded at inflated values?

<u>Institutional investors have recently been taking sizeable losses in private credit</u>

The private fund managers are looking to raise capital from retail investors through this ETF when private credit borrowers are increasingly distressed. These borrowers are deferring

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[9] Thrasher, Michael. Institutional Investor. Private Equity's Fundraising Skid Continues. Jul 29, 2024. Private Equity's Fundraising Skid Continues

[10] Bainbridge, Amy. Bloomberg News. Australia Pensions Step Up Private Asset Scrutiny, Stafford Says. Sep 23, 2024. Australia Pensions Step Up Private Asset Scrutiny, Stafford Says - Bloomberg

[11] OpenSecrets.org. H.R. 2627. H.R.2627 Lobbying Profile • OpenSecrets

[12] H.R. 2627 - Increasing Investor Opportunities Act. Apr 13, 2023. BILLS-118hr2627ih.pdf

[13] Swedroe, Larry. Morningstar. Considering Private Equity? Think Twice Before Investing in Business Development Companies. May 7, 2024. Considering Private Equity? Think Twice Before Investing in Business Development Companies | Morningstar; Brooke, David. Reuters Loan Pricing Corporation. Lawmakers join BDCs push for AFFE exemption. Mar 9, 2020. Lawmakers join BDCs' push for AFFE exemption | Reuters; See also the VanEck BDC Income ETF expense ratio of 11.17%. Very High-Cost Mutual Funds and ETFs (Along With Cheaper Alternatives) | AAII.

[14] Wiggins, Kaye. Financial Times. Selling to yourself: the private equity groups that buy companies they own. Jun 21, 2022. Selling to yourself: the private equity groups that buy companies they own

[15] Celarier, Michelle. Institutional Investor. Are Continuation Funds Losing Their Allure? Aug 20, 2024. Are Continuation Funds Losing Their Allure? "A recent Whitehorse Liquidity Partners' analysis of more than 1,000 transactions of assets sold by continuation funds found they were valued on average 28 percent higher than where the GP was valuing the business six months earlier."

interest payments because they are struggling to manage their debt burdens and some institutional investors in private credit are taking sizable losses.

Moody's and Bank of America estimate that between 7 percent to 9 percent of income generated by private credit funds are from borrowers deferring making cash interest payments, instead paying investors with additional debt, known as "pay-in-kind" (PIK).[16] In some cases, certain BDCs are seeing as much as a quarter of their income coming from these deferred PIK payments.[17]

A number of institutional investors have already experienced large losses from a 2021 leveraged buyout financed with private credit gone awry. The 2021 $3.5 billion leveraged buyout of software company Pluralsight by private equity firm Vista Equity Partners' resorted to transferring valuable assets out of the company when it ran into trouble and left private credit lenders BlackRock, Ares Management, and Oaktree Capital to take over the company in bankruptcy.[18] Australia's largest pension fund AustralianSuper alone has had to write off $750 million in losses from its investment in Pluralsight.[19]

Conclusion

The lack of transparency and defined investor protection in private credit already makes the asset class unsuitable for retail investors. The conflicts of interest for ETF investment managers who are paid based on how many assets are raised and not its performance, raises further problems about enabling illiquid, hard-to-value assets that have burned institutional investors to be sold to retail through an ETF.

We strongly urge the SEC to reject the application from SPDR SSGA Apollo IG Public & Private Credit ETF.

Sincerely,

Americans for Financial Reform Education Fund
American Federation of State, County, and Municipal Employees
American Federation of Teachers
AFL-CIO
Better Markets
Communications Workers of America

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[16] Pollard, Amelia and Platt, Eric. Financial Times. Corporate debts mount as credit funds let borrowers defer payments. Oct 14, 2024. Corporate debts mount as credit funds let borrowers defer payments.
[17] Id. at 14. Business Development Company Blue Owl Technology Finance Corp in 2Q 2024 reported 23.6% of its income was in the form of pay-in kind.
[18] Vinn, Milana. Reuters. Vista Equity in talks to hand over Pluralsight over to creditors, sources say. Jul 3, 2024. Exclusive: Vista Equity in talks to hand over Pluralsight to creditors, sources say | Reuters
[19] Seligson, Paula and Martin, Matthew. Bloomberg News. Saudi PIF Among Investors Who Lost Money on Pluralsight Deal. Aug 28, 2024. Saudi PIF Is Among Investors Who Lost Money on Pluralsight Deal - Bloomberg

Private Equity Stakeholder Project
Public Citizen
United Food and Commercial Workers
Jeffrey Hooke, Senior Lecturer, Johns Hopkins University Carey School of Business