Can Private Funds Go Public? Rethinking the Future of Funds

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Abstract. Most households' investments are now managed by funds. Yet the law that governs investment funds was not built for today's world. For nearly a century, the regulation of funds has rested on a simple division. Regulated funds, like mutual funds, are sold to the public and are heavily regulated under the Investment Company Act of 1940. The Company Act's mandatory rules restrict the fees, financing, governance, relationships, and disclosure of regulated funds. Private funds, in contrast, limit their investors to institutions and the ultra-rich and are entirely exempt from these rules. Each half has functioned on its own terms. Mutual funds and ETFs easily operated within the strictures of the Act; private equity or venture capital operated completely outside of it. Either way, the Company Act seemed like a sideshow because in practice its restrictions went unchallenged.

No more. The largest asset managers today are looking to repackage every private market strategy, from venture capital to private equity to private credit, in a fund sold to the general public and thus governed by the Company Act. The result is a collision between private equity and fund regulation that lets us see how the statute actually operates in practice. Using new data and analysis of these funds, I show that much of fund regulation matters far less than we thought.

However, one provision, Section 17, does impose a binding constraint on the emerging industry. Section 17 imposes a bright-line prohibition on transactions involving a fund and related parties, unless the SEC grants ad hoc exemptive relief. Section 17 embodies a pre-modern approach to regulating conflicts of interest: a flat-out ban. Yet regulated funds investing in private markets routinely seek to engage in conflicted transactions. Over the last five years, the SEC has sometimes granted expansive exemptive relief, but without any ultimate philosophy guiding what conflicts should be allowed. Meanwhile, the private equity industry's proposed alternative to Section 17 – approval by nominally independent directors – is a mirage, given the limited information and authority of fund directors. I argue for a third path. Rather than extending Section 17's prohibition or abandoning it, fund regulation should import the economic mechanisms already used by sophisticated actors to curb opportunism in private funds. More generally, my account helps clarify the fundamentals of fund regulation and retail investors' access to private markets.

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INTRODUCTION

Increasingly, investment funds and their regulation are at the core of finance. Eighty-five years ago, when fund regulation was enacted, individuals owned virtually all corporate stock.[1] Funds—legal entities that pool and manage investors' money—were a small, almost trivial, part of investment. Households invested directly in markets, banks dwarfed funds in size, and funds owned little of anything. Today, investing through funds has come to dominate finance. At over $70 trillion in assets, investment funds hold roughly three times the assets of the banking system and exceed the stock market in value.[2] Most Americans invest their savings and manage their retirement through investment funds.[3] Whether the regulation that governs funds is effective will shape not only the security of ordinary investors, but even whether our economy grows and succeeds.

Funds are governed by a complex, exacting, and mandatory body of law—federal fund regulation—centered in the Investment Company Act of 1940 ("the Company Act").[4] Generations of scholars and practitioners have viewed the Company Act as the most restrictive body of financial regulation short of banking law. The head of the SEC Division overseeing funds once observed that the Company Act is "the most complex of the federal securities laws" because it "is, in effect, a comprehensive corporate statute. It places substantive restrictions on virtually every aspect of the operation of investment companies."[5] Practitioners and scholars of fund regulation have concurred that the statute "imposes very strict controls" on funds.[6] Fund regulation not only imposes an extensive mandatory disclosure regime, like the rest of securities law, but also regulates how funds finance themselves (including tightly limiting borrowing by funds), funds' governance, fees, and transactions with affiliated parties. These rules create a far-reaching regulatory scheme that Congress designed to protect fund investors from self-dealing, excessive risk, and abuse.[7]

For nearly a century, a basic arrangement defined this world of investment funds, dividing it in half. Public or "registered" funds, like mutual funds or ETFs, can be sold to anyone. Because of this, fund regulation applies to them in full force, and they are governed by the Company Act. In contrast, private funds, like private equity or venture capital, avoid the

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[1] Jonathan B. Berk & Jules H. van Binsbergen, *The Economics of Intermediaries*, *in* SECURITIES MARKET ISSUES FOR THE 21ST CENTURY, at 280 (MERRITT B. FOX, LAWRENCE GLOSTEN, EDWARD GREENE & MANESH PATEL EDS.) (2018).
[2] *See infra* Section I.B. On the growing size of the fund universe, *see* William Birdthistle, *Funding Everything* (Working Paper 2025).
[3] INV. CO. INST., 2025 INVESTMENT COMPANY FACT BOOK, ii, 119; see also INV. CO. INST., 2023 INVESTMENT COMPANY FACT BOOK, 52 fig. 6.3.
[4] Pub. L. No. 76-768, 54 Stat. 789 (1940) (codified as amended at 15 U.S.C. §§ 80a-1 to 80a-64 (2012)) [hereinafter cited by U.S. code section or provision of the Act].
[5] Paul F. Roye, Director, Director, Division of Investment Management U.S. Securities & Exchange Commission, *The Exciting World of Investment Company Regulation*, Speech Before the American Law Institute/American Bar Association Investment Company Regulation and Compliance Conference (June 14, 2001).
[6] Matthew P. Fink, *The Role of the Mutual Fund Industry in the U.S.*, Investment Company Institute. *See also infra* notes 87 – 88 and accompanying text.
[7] Howell E. Jackson, *A System of Fiduciary Protections for Mutual Funds, in* FIDUCIARY OBLIGATIONS IN BUSINESS 132, 146 (ARTHUR B. LABY & JACOB HALE RUSSELL EDS., 2021) ("The regulation of mutual funds in the United States arguably contains the world's most extensive system of fiduciary protection, buttressed by elaborate liability rules and a host of procedural protections").

Company Act entirely by restricting their investors to institutions and the ultra-rich.[8] Historically, registered funds invested in public companies and other liquid assets.[9] Private equity and venture capital invested in private companies.[10] Each half of the fund universe functioned on its own terms. Mutual funds easily operated within the strictures of the Act; private equity or venture capital operated outside of it. Either way, the Company Act seemed like a sideshow because in practice its restrictions were unchallenged.

That era has ended. Today, the quest among the largest investment management firms, from Vanguard and Fidelity to KKR and Apollo, is to take every *private fund* strategy, from private equity to private credit to venture capital, "public" by placing them in regulated funds that can be sold to the *general public*. An industry that barely existed ten years ago, now manages almost $700 billion dollars (as Figure 1 shows).[11] It will soon surpass a trillion.[12] Yet this quest raises a set of puzzles that go to the heart of fund regulation: Is it possible to run a private equity or venture capital fund, while subject to the far-reaching, complex, and exacting mandatory rules that govern funds sold to the public? After all, fund regulation is understood to be highly restrictive and to favor a passive, diversified, low-risk style of investment[13]—the opposite of what private equity and venture capital funds do. Do fund regulation's mandatory rules genuinely constrain a fund intent on testing their limits, or are those rules, on their face mandatory and restrictive, in fact unimportant?

The rise of these "regulated private funds" (or "hybrid funds", as they are sometimes called) is the most serious challenge to fund regulation in fifty years.[14] The private equity industry is now dedicated to trying to squeeze through the Company Act's narrow-seeming confines. It is an experiment in testing the stringency of fund regulation's rules. This collision between private equity and fund regulation is also causing practitioners and regulators to ask, for the first time in decades, whether a ground-up rethink of fund regulation is called for and what it would involve.

The stakes for understanding fund regulation are high. As noted, funds are the major way in which households' savings are channeled across the economy. If fund regulation matters and does a good job, then the middle class's finances will be more secure, and capital will be allocated more effectively across the economy. If fund regulation doesn't matter to how firms behave, then Congress failed to establish the "highly restrictive"[15] regime it aimed to, and it's time to ask what the right framework would be.

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[8] *See infra* Section I.B.
[9] See INV. CO. INST., 2025 INVESTMENT COMPANY FACT BOOK.
[10] See Figure 1.
[11] *See* Empirical Appendix p.1.
[12] PITCHBOOK, 2029 PRIVATE MARKET HORIZONS, at 8 (2024) (estimating that hybrid funds will exceed $1 trillion by 2029).
[13] *See* John Morley, *Collective Branding and the Origins of Investment Fund Regulation,* 6 VA. L. & BUS. REV. 341, 368 (2012).
[14] *See* PITCHBOOK, *supra* note 12. There is no agreed-upon title for these funds, with candidates including "evergreen," "semiliquid," "hybrid" and the like.
[15] REGULATING HEDGE FUNDS AND OTHER PRIVATE INVESTMENT POOLS: HEARING BEFORE THE SUBCOMM. ON SEC., INS. & INV. OF THE S. COMM. ON BANKING, HOUS. & URBAN AFF., 111TH CONG. 1ST SESS. (2009).

In this paper, I study hybrid funds to understand how fund regulation actually operates and to ask how it should.[16] The paper makes three contributions. First, I develop a series of new stylized facts about hybrid funds and by analyzing the empirical evidence in their complex context, I show how regulation shapes (or fails to shape) how funds function. Using a variety of sources and methods—including hand-collected data, data scraped from regulatory filings, and commercial and SEC datasets—I gather new data on hybrid funds to interrogate how the core mandatory rules apply to them.

To give you a brief sense of the law, the Company Act mandates disclosure of a fund's investment portfolio, requires that a fund's board have a near- or actual majority of independent directors, bans fees based on how investments perform, prohibits transactions between a fund and its affiliates, and sharply limits fund borrowing to finance investments.[17] Anyone familiar with the private equity industry can see the problem. Traditionally, private equity funds have fought any disclosure mandate. The most famous part of private equity fee economics is "carried interest" – a performance fee based on whether a fund's investments increase in value.[18] Private equity is associated with nothing as closely as their love of debt-fueled investment. And private equity firms typically establish boards that consist primarily of senior management and representatives of the private equity firm itself, rejecting independent directors.

Yet I find that much of fund regulation is far less constraining than we have taken it to be. Many of the rules lack "bite." Some of them are unimportant because they target decision-makers with no actual powers. Other rules are avoidable because parties can structure around them with advance planning. Other rules prohibit funds from engaging in conduct that market forces would stop them from choosing anyway.[19]

For instance, I show that regulated private funds voluntarily adopt boards with supermajorities of independent directors that go far beyond what the law strictly requires.[20] Similarly, most regulated private funds borrow much less than what the law permits. Fund regulation misfires because it fails to target the decision point that actually matters to a private fund, namely, decision-making at the *adviser* level and leverage at the level of the *companies* the fund owns. Even the ban on performance fees is narrower and less constraining than it seems. These rules do not pose the binding or prohibitive constraints that practitioners and scholars assumed they would, although they do impose costs on a subset of funds.

On the other hand, I show that one rule of fund regulation does pose a binding constraint—the Company Act's exacting, bright-line approach to conflicts of interest and opportunism, embodied in Section 17 of the Company Act.[21] Using new data I assemble, I show

[16] Lucian A. Bebchuk, Alma Cohen & Allen Ferrell, *What Matters in Corporate Governance?*, 22 REV. FIN. STUD. 783 (2009).
[17] *See infra* Section II.B.
[18] Steven N. Kaplan & Per Stromberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSP. 121, 124-25, 128-29 (2009).
[19] These categories match up with a number of the reasons for triviality in corporate law developed by Bernie Black in a classic paper that much influenced my thinking as this paper progressed. Bernard S. Black, *Is Corporate Law Trivial? A Political and Economic Analysis*, 84 NW. U.L. REV. 542, 549 (1990).
[20] *See infra* Part III.
[21] In particular, Rule 17d-1, pursuant to Section 17(d), provides for an extremely broad approach to conflicted transactions. BDCs enjoy a somewhat lighter treatment of transactions with portfolio companies (i.e., downstream affiliates). Affiliated transactions for BDCs are governed by Section 57 of the Investment Company Act, 15 U.S.C.

that when the SEC permits certain conflicts, such as two affiliated funds investing together, the practice becomes pervasive in the industry.[22] Where the SEC does not permit conflicts, such as between a fund and a company it controls, the industry fails to develop at all. As I will show, although a number of regulated funds misleadingly brand themselves as "private equity," Section 17 effectively prevents true private *equity* funds from "going public" while permitting private *credit* funds to do so. As a result of this effect, Section 17 is under tremendous pressure from the private equity industry, as its representatives and like-minded advocates line up to attack the provision.[23]

My second contribution is to reenvision the regulation of conflicts of interest in funds. Section 17 creates a bright-line prohibition on transactions involving a fund and related parties, unless the SEC grants ad hoc exemptive relief. Section 17 embodies a pre-modern approach to regulating conflicts of interest: a flat-out ban. Where corporate law abandoned that approach long ago,[24] fund regulation has held on to it. Section 17 has become a focal point because hybrid funds pose conflicts on an entirely different scale than other regulated funds or ordinary companies.[25] Because they invest in private markets, hybrid funds routinely take concentrated positions in private companies' securities, restructure those companies, and then reinvest in them.[26] Moreover, multiple funds of the same adviser usually *do this together*. The result is a complex thicket of related party transactions, clearly barred by Section 17. It matters to get the regulation of these conflicts right. If we ban all conflicts, we stop funds from engaging in a wealth of transactions that are beneficial to fund investors and to the companies that funds own. If we let all conflicted transactions proceed, we expose investors to opportunism and abuse.

Over the last five years, the SEC has granted progressively greater exemptive relief in some areas, but not others, without any actual philosophy for what conflicts should be allowed or why. The private equity industry's proposed alternative to Section 17[27] – approval by nominally independent directors – is a mirage, given the limited information and authority of fund directors.[28] Yet the SEC is lurching in precisely that direction. I argue for a different paradigm. Rather than extending Section 17's prohibition or abandoning it, fund regulation should import the economic mechanisms already used by sophisticated actors to curb opportunism in private funds.[29] Regulators should turn to the well-functioning high-end of the private equity and credit markets, where opportunism is primarily addressed through the alignment of incentives and private ordering, rather than bright-line rules or litigation.

§ 80a-56, and Rule 57b-1, 17 C.F.R. § 270.57b-1 thereunder (2020). Rule 17d-1 governs a BDC's horizontal conflicts under Section 57(i).

[22] *See infra* Part III.

[23] *See infra* Section III.B and accompanying text.

[24] FOLK, THE DELAWARE GENERAL CORPORATION LAW — A COMMENTARY AND ANALYSIS 85-86 (1972).

[25] John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228, 1243 (2014). There has been ample disagreement as to the importance of Section 17. *Compare* Murphy, *supra* note 26 with *id*. ("Consider sections 10 and 17 of the ICA. These sections create an elaborate (but ultimately not very restrictive) set of rules to address conflicts between a manager's various funds and between a manager's funds and its other lines of business.").

[26] *See infra* Part III.

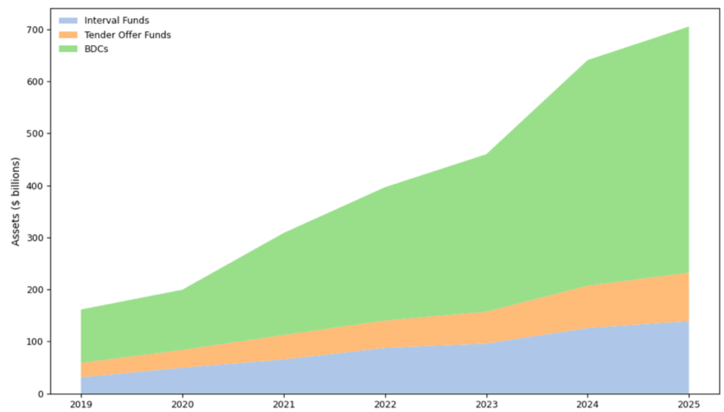
[27] For an astute overview of how Section 17 has evolved, *see* Jack W. Murphy, *Cutting Through the Gordian Knot: It's Time to Revise Rule 17d-1 Under the Investment Company Act of 1940*, 74 CATH. U.L. REV. 226, 233 (2025).

[28] *See infra* Part IV.

[29] *Id*.

My last contribution is to step back and think about the very big picture, including the motivations behind fund regulation and about the better and worse ways for retail investors to access private markets. While the debate about *whether* retail investors should access private markets is unlikely to be resolved, we can make genuine progress on *how* they should access those markets, if indeed they will.

Figure 1. The Rise of Hybrid Funds: Total Assets, 2019-2025[30]



The paper proceeds as follows. Part I provides the building blocks for understanding funds and their regulation, including what funds are, the structure of registered and private funds, the related literature, and the fundamentals of fund regulation. Part II addresses the rise of hybrid funds, including the drivers of their growth, their innovative structure, and the policy debate in which they are embedded. Part III offers a detailed analysis of where and whether fund regulation's rules might matter most, including new data on the fees, governance, conflicts, and leverage of hybrid funds. With that data, we can move beyond speculating about the importance of fund regulation's various core rules and make progress on seeing which ones actually stick. Part IV begins the process of reimagining fund regulation. Part V analyzes implications of this account for retail access to private markets and a deeper understanding of funds.

I. Investment Funds: Public and Private

In this Part, I aim to provide the building blocks for exploring the scope and importance of fund regulation. In Section A, I provide a brief overview of investment funds, the history of their regulation, and the structure of their industry. In Section B, I discuss the paradigm of a regulated and private fund. In Section C, I introduce the literature on funds and their regulation. In Section D, I survey the main mandatory rules imposed by federal fund regulation. We will then have set the stage for asking whether those rules matter, and if so, when.

A. A Very Brief Introduction to Funds

Investment funds are legal entities that pool investors' money and then manage it on their behalf. After initial growth in the 1920s and 1930s, much of the industry collapsed in the wake

[30] Total assets of interval and tender offer come from Form N-PORT filings from EDGAR. I extract their total asset disclosures from these filings (Item B.1.a). BDC assets come from BDC Collateral. See Appendix p. 1 for further detail.

of the stock market crash and ensuing Great Depression.[31] A postmortem of the industry revealed egregious exploitation of investors at the hands of powerful insiders.[32] At Congress' direction, the SEC conducted a vast, multi-year study of funds and proposed a major piece of legislation designed to envision federal regulation of them.[33] After heavy renegotiation with industry, federal fund regulation was eventually passed in the form of two connected statutes, the Investment Company Act of 1940 ("the Company Act"), the heart of fund regulation, and the Investment Advisers Act of 1940 ("the Advisers Act").[34] Investment funds thus have their own law, discussed further below.[35]

The Company Act aimed to regulate funds in general, but it made some fateful carveouts. In the Company Act, Congress not only exempted from the definition of a fund various financial institutions regulated elsewhere by federal law, like banks or broker-dealers, it also exempted from regulation any investment fund with 100 or fewer investors and that makes no public offering of securities.[36] Under securities law, the easiest way to avoid a public offering is to sell securities exclusively to well-off investors (known as "accredited investors").[37] Congress thought that these 100-investor funds simply did not raise issues of public policy.[38] They would be a "private fund" that raised no issues of public import. Congress did not foresee that an entire industry could evolve pursuant to that provision. Eighty-five years later, Congress was clearly wrong. If you count a large financial institution as one person, as securities law does, funds with 100 investors can control billions of dollars.

Congress eventually endorsed private funds, adding a second exemption to the Company Act. It allows a fund to avoid regulation if it sells its securities exclusively to "qualified purchasers" and makes no public offering. A qualified purchaser is a wealth filter, a category that includes natural persons with $5 million or more in investable assets, entities with $25 million or more, and a number of other specific institutions and entities. Figure 2 shows the growth of banks and funds' total assets over time (right-hand) as well as the declining share of corporate stock held directly by individuals (left-hand).

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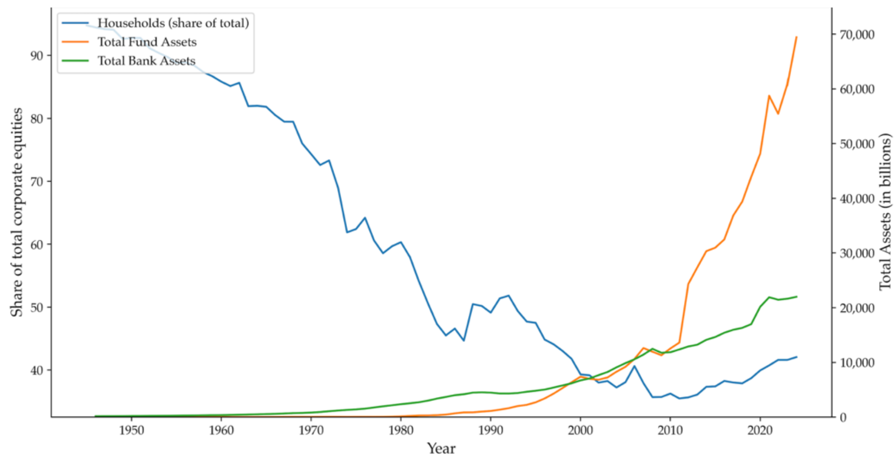
[31] JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE (3D ED. 2003); see also MATTHEW P. FINK, THE RISE OF MUTUAL FUNDS: AN INSIDER'S VIEW (2D ED. 2011).
[32] *Id*.
[33] SECURITIES AND EXCHANGE COMMISSION, INVESTMENT TRUSTS AND INVESTMENT COMPANIES, H.R. DOC. NO. 707 (1938-1942).
[34] 15 U.S.C. §§ 80b-1 to b-21 (2006).
[35] John Morley, *Why Do Investment Funds Have Special Securities Regulation?*, *in* RESEARCH HANDBOOK OF MUTUAL FUNDS 9, 9 (William A. Birdthistle & John Morley eds. 2018).
[36] Patrick M. Corrigan, *Shining a Light on Shadow Banks*, 49 J. CORP. L. 1 (2023).
[37] Regulation D, 17 C.F.R. §§ 230.501–.508 (2024).
[38] Allen Ferreell & John Morley, *The Regulation of Intermediaries*, *in* SECURITIES MARKET ISSUES FOR THE 21ST CENTURY, at 346 (MERRITT B. FOX, LAWRENCE R. GLOSTEN, EDWARD F. GREENE & MANESH S. PATEL EDS.) (2018).

Figure 2. Total Assets of Funds, Banks, and the Household Ownership Share



Besides having their own law, the institutional structure of the investment fund industry is also distinctive. Funds are defined by an institutional arrangement known as "external management," or as John Morley has put it, the "separation of funds and managers."[39] Unlike an ordinary company, investment funds generally have no employees. A fund raises and holds investor money, but the fund itself does not make decisions. Instead, the fund contracts with the firm that created it and that firm manages its affairs. So a fund begins its life when it is organized as a stand-alone legal entity by an investment firm (also called a sponsor), like KKR (a private equity firm), Sequoia (a venture capital firm), or Vanguard (a mutual fund and ETF firm). The investment firm raises investors' money to capitalize the entity (i.e., the fund), and the fund then *hires* the sponsor to operate the fund and make all investment decisions on its behalf. Both regulated funds and private funds are externally managed in this way. In a regulated fund, the adviser makes all of the fund's important decisions, aside from compliance questions overseen by the fund's board. The sponsors' primary business is serially creating and managing legally separate funds. KKR is a private equity *firm* that managers dozens of legally separate private equity, private credit, infrastructure, and hybrid *funds*.

In comparison to ordinary companies, external management changes the scale and intensity of conflicts of interests.[40] For a typical large corporation, conflicts of interest involving its senior executives are episodic and rare. For a large investment management firm, conflicts are a daily part of life. The largest private equity firms can manage over one hundred funds. Blackstone, for instance, currently has 19 growth and buyout private equity funds making investments.[41] Every new investment opportunity Blackstone that encounters may fall into the mandate of a dozen of those funds, baking conflicts of interest into the firm's daily business.

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[39] John Morley was the first to ask why this structure, or the "separation of funds and managers," as he calls it, defines the funds industry and its regulation. He emphasizes the powerful efficiency advantages of the arrangement, given investors' exit rights, risk tailoring preferences, and economies of scope and scale. John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228, 1243 (2014).

[40] Scholars and the SEC have often made this point. See, e.g., U.S. SEC. & EXCH. COMM'N, DIVISION OF INVESTMENT MANAGEMENT, PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION 491(1992); Morley, *supra* note 39, at 1261 ("").

[41] PREQIN, *Listed GPs' 2024 Results Show Improvements in Private Equity Fundraising, Deals, and Returns* (Feb. 13, 2025).

B. Public and Private Paradigms

The private and registered fund paradigms are worlds apart. They were designed to raise money from very different investor bases and to invest that money in very different markets. Yet today the quest for some of the country's largest financial institutions is to overcome these longstanding boundaries and combine retail investors with private markets. In this section, I briefly introduce the idea of public and private *markets*, before introducing the idea—and paradigmatic structure—of registered and private *funds*.

Public markets are the markets we are most familiar with. Public companies are the four thousand or so companies whose stock is listed on a stock exchange. They include most, but not all, of the largest companies in the economy, such as Amazon, Microsoft, Google, or General Motors. These firms have gone through a rite of passage known as "going public," whereby they apply for registration with the SEC, sell stock to the general public, and list their shares for trading on national stock exchanges.[42] Because they are public, federal securities law imposes a sprawling mandatory disclosure regime on them. Anyone can invest in a public company. Their stock enjoys enormous daily turnover, meaning that an investor can easily buy or sell their shares. Registered funds, which I will explain further below, overwhelmingly invest in these companies.[43] At 50,000 feet, they also share certain broad features with public companies. Anyone can invest in them, they are highly regulated, and they offer daily liquidity.

While there is no technical definition of them, private markets are essentially everything else—markets for assets that are not traded on financial exchanges. The stock and debt of private companies is the traditional core of private markets, but there are now large private markets for infrastructure, real estate, and commodities as well. These markets have grown enormously in size over the last few decades.[44]

The most familiar evidence for the rise of private markets is the *decline* of public markets. The number of public companies has fallen from a 1990s high in the 8000s to the 4000s today.[45] Yet this simple headcount statistic is misleading. Public companies are larger and older today. If they merged less, or spun off more divisions, there would be a greater number of them.[46] The better evidence of private markets' rise is more direct. Firms that once would have gone public, now stay private for years longer or even indefinitely. "Unicorns," venture-capital backed private

[42] JOHN COFFEE JR., HILLARY SALE & CHARLES WHITEHEAD, SECURITIES REGULATION, CASES AND MATERIALS (15TH ED. 2024).
[43] *See* ICI Fact Book 2025.
[44] Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 448 (2017); Michael Ewens & Joan Farre-Mensa, *The Deregulation of the Private Equity Markets and the Decline in IPOs*, 33 REV. FIN. STUD. 5463, 5463–64 (2020).
[45] The meaning of this decline is the subject of enormous controversy, which need not concern us here. *See, e.g.*, Mark J. Roe & Charles C.Y. Wang, *Half the Firms, Double the Profits: Public Firms' Transformation, 1996-2022*, 8 J. L., Fin. & Acct. 211 (2025). Longstanding causes of concern for diminishing IPOs have received powerful new evidence in recent years. Michael Ewens, Kairong Xiao & Ting Xu, *Regulatory Costs of Being Public: Evidence from Bunching Estimation*, 153 J. FIN. ECON. (2024).
[46] B. Espen Eckbo & Markus Lithell, *Merger-Driven Listing Dynamics*, 60. J. FIN. & QUANT. ANAL. 209 (2025).

companies valued at over $1 billion, have gone from rare to commonplace with several now being valued in the hundreds of billions.[47]

More importantly, while firms once raised most of their capital in public markets, far larger sums are now raised in private markets. This has been true for every year since 2009, and in more recent years, twice as much money has been raised through exempt offerings ($3 trillion) than through registered offerings ($1.5 trillion).[48] More strikingly still, in recent years, late-stage startups *alone* have raised nearly as much money as all public offerings.[49] In total, private markets assets seem to have almost quadrupled over just the last decade.[50] Most of that new capital has come from *private investment funds*, which have raised staggering sums.[51] It may not be intuitive, but the vast majority of the money raised by private companies comes from private funds rather than individuals.[52] Private equity and venture capital raise trillions and invest in private firms. The paradigm of private markets is thus a private *fund* investing in a private *company*.

So much for public and private markets -- on to private and registered funds. The paradigmatic registered fund is the open-ended mutual fund.[53] Anyone can invest in this fund. The fund offers shares on a continuous (i.e., ongoing basis). It offers daily redemption of shares, meaning that an investor has the right to "redeem" their shares in the fund on any business day. Redemption involves an investor returning their shares to a fund in exchange for her pro rata share of the fund's net asset value.[54] To appropriately offer redemption, the open-ended mutual fund must calculate a daily net asset value, subtracting its liabilities from its total assets.[55] An exchange-traded fund generally goes further, albeit in somewhat complicated ways. Its shares trade—generally at net asset value—throughout the day, like a stock.[56] Large institutional market makers directly redeem from the fund.

Only some of the institutional structure of the average mutual fund or ETF is required by fund regulation. Most importantly, a registered fund does not need to be open-ended—it does not need to offer investors' daily redemption of their shares at net asset value. A fund can be closed-end instead—a term for any fund that does not offer daily redemption. For a half-century after the enactment of the Company Act, however, the closed-end registered fund industry was

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[47] Ewens & Farre-Mensa, *supra* note 44; Elizabeth Pollman, *Startup Governance*, 168 U. PENN. L. REV. 155 (2019).
[48] SCOTT BAUGUESS, RACHITA GULLAPALLI & VLADIMIR IVANOV, U.S. SEC. AND EXCH. COMM'N, CAPITAL RAISING IN THE U.S.: AN ANALYSIS OF THE MARKET FOR UNREGISTERED SECURITIES OFFERINGS, 2009-2017, at 7–9 (2018)
[49] Michael Ewens & Joan Farre-Mensa, *Private or Public Equity? The Evolving Entrepreneurial Finance Landscape*, 14 ANN. REV. FIN. ECON. 271 (2022); Michael Ewens & Joan Farre-Mensa, *The Deregulation of the Private Equity Markets and the Decline in IPOs*, 33 REV. FIN. STUD. 5463, 5463–64 (2020).
[50] Eric J. Pan, *Playing a Bigger Game: Why ICI Is Moving Into Private Markets*, https://www.ici.org/speeches-opinions/25-moving-into-private-markets.
[51] The SEC reports that investment funds using the Company Act 3(c)(7) qualified purchaser exemption account for 81% of all offerings under Regulation D and the vast majority of money raised ($2.3 trillion). SEC OFFICE OF THE ADVOCATE FOR SMALL BUSINESS CAPITAL FORMATION, FISCAL YEAR 2023 ANNUAL REPORT, at 74.
[52] That does not mean individuals are completely absent from the market. *See* Edwin Hu, *Shining Light on Retail Private Markets* (Working Paper 2024).
[53] WILLIAM A. BIRDTHISTLE, EMPIRE OF THE FUND: THE WAY WE SAVE NOW 19 (2016). An open-end fund is subject to additional liquidity and leverage restrictions than other registered funds.
[54] INV. CO. INST., HOW U.S. REGISTERED INVESTMENT COMPANIES OPERATE AND THE CORE PRINCIPLES UNDERLYING THEIR REGULATION.
[55] *Id*.
[56] Henry T. C. Hu, John D. Morley, *A Regulatory Framework for Exchange-Traded Funds*, 91 S. CAL. L. REV. 839, 851 (2018).

characterized by two facts: First, it still invested in public companies, just like open-ended funds. Second, it was disappearing—a vestigial asset class with a stagnant or diminishing pool of assets.[57] As we will see with the rise of hybrid funds, that is no longer true.

Private funds differ in the structure, investor base, and how they invest. The main three types of private fund are private equity, venture capital, and hedge funds. The classic private fund is organized as a limited partnership in which an entity affiliated with the investment adviser, like Apollo, Blackstone, or KKR, serves as a general partner and the investors are limited partners.[58] The fund raises money from one hundred or fewer investors, or, more typically, exclusively from qualified purchasers, allowing it to remain a private fund under the Company Act.[59]

Institutionally, private equity and venture capital funds are organized as "drawdown" funds, meaning that investors contractually commit capital to the fund upfront (but do not actually transfer it), and that the fund then calls or "draws down" those commitments as investment opportunities emerge. The fund has a definite, limited term of six to twelve years, depending on the fund type, with limited extensions. At least for the first few of those years, little money, if any, is distributed and investors cannot redeem or otherwise sell their shares (they are very much "closed-end" funds). During the life of the fund, the sponsor of the fund acquires interests in a portfolio of investments and manages those investments. Venture capital, like private equity, is a form of private fund that primarily owns and manages private companies. Hedge funds initially invested primarily in public companies, but they now invest in a wide variety of assets. My focus will be on the private funds that have dominated private markets, namely, venture capital and private equity, of which private equity is by far the larger.

Most important, of course, is what private funds do in terms of investing and managing the money they raise. In its early years, private equity was dedicated to "leveraged buyouts." In the classic buyout strategy, a private equity firm uses extensive debt financing to purchase ownership of a public company, which it takes private, manages, and then exits through an IPO or acquisition.[60] More recently, private equity funds make minority investments in growing private firms ("growth equity"), real estate, and infrastructure. Increasingly, private equity dominates private markets and outpaces hedge funds or venture capital in growth.

A natural impression of what private equity does is that it focuses on financial transactions at the beginning of an investment and at exit and focuses on profitability by means of managerial and operational improvements in between. In reality, however, private equity funds engineer financial transactions over the entire lifecycle of an investment.[61] They routinely sell services to the companies they own. They engage in much larger transactions too. Some major examples include leveraged recapitalizations, where a company takes on new debt to finance a dividend to the private equity fund, which can then distribute profits to investors; a company's acquisition of other private firms, which is engineered by the private equity fund and often capitalized by it or by a different fund managed by the same adviser; and sales of divisions,

[57] INV. CO. INST., *The Closed-End Fund Market, 2024*, https://www.ici.org/system/files/2025-04/per31-04.pdf.
[58] DEBEVOISE & PLIMPTON, PRIVATE FUNDS KEY BUSINESS, LEGAL AND TAX ISSUES 3 (2025).
[59] *Id*. at 32.
[60] *Id*. at 14.
[61] Steven N. Kaplan & Per Stromberg, *Leveraged Buyouts and Private Equity*, 23 J. ECON. PERSP. 121, 124-25, 128-29 (2009).

intellectual property, or services by (or even among) the various portfolio companies a private equity firm owns.[62] Scholars of the subject suggest that private funds enjoy distinctive informational advantages and powerful incentives to finance their portfolio companies, and may sometimes be uniquely advantaged in doing so.[63]

The intensity of these transactions, and the number of affiliated PE entities that can be involved in them, will turn out to be particularly significant when we ask whether PE strategies can operate subject to fund regulation. There are a few other notable features of private funds that are worth appreciating as well. They charge high fees, generally following a so-called "two and twenty" model, charging two percent of the capital investors commit as a management fee and twenty percent of any excess return to the fund (above some predefined hurdle) as a performance fee ("carried interest").[64]

Registered funds, by contrast, generally charge much lower fees. If they are actively managed in pursuit of excess returns, they might charge 1%; if the fund follows an index, their fees can now be as large as 0.08%.[65] A private fund itself tends to have little in the way of governance at the fund level. External management means that virtually all funds have their investment and business decisions made by their manager, but while registered funds are required to have boards with independent directors that serve various compliance functions, private funds have no such thing. While private funds must report limited information confidentially to the SEC, they have no reporting obligations to the public and generally do not make return or fee information publicly available.

The size of the fund industry is now immense, and as surprising as its sheer size is the fact that private funds now manage almost as much money as all registered funds. Until only recently, mutual funds managed vastly more money. Mutual funds and ETFs manage roughly \$32 trillion,[66] along with another \$8 trillion in specially-regulated money market mutual funds.[67] Private funds manage \$31 trillion.[68] Alongside this explosive growth has come the increasing

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[62] See, e.g., Abhishek Bhardwaj, Abhinav Gupta & Sabrina T. Howell, *Capital Structure & Firm Outcomes: Evidence from Dividend Recapitalizations in Private Equity*, NBER Working Paper w33435 2025).

[63] Peter Iliev & Michelle Lowry, *Venturing beyond the IPO: Financing of Newly Public Firms by Venture Capitalists*, 75 J. FIN. 1527 (2020).

[64] Juliane Begenau & Emil N. Siriwardane, *Fee Variation in Private Equity*, 79 J. FIN. 1199, 1205 (2024).

[65] ICI RESEARCH PERSPECTIVE, *Trends in the Expenses and Fees of Funds*, 2024, at 6.

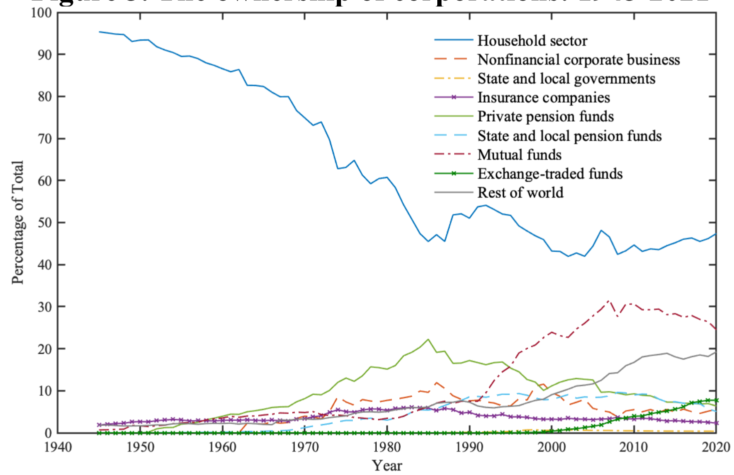
[66] SEC, DIVISION OF INVESTMENT MANAGEMENT, REGISTERED FUND STATISTICS FORM N-PORT DATA, tbl. 2.3, p. 6 (2025), https://www.sec.gov/files/investment/im-registered-fund-statistics-20241106.pdf (reporting on total assets under management of private funds).

[67] SEC, DIVISION OF INVESTMENT MANAGEMENT, MONEY MARKET FUND STATISTICS, tbl. 2.6, p. 8, https://www.sec.gov/files/money-market-fund-statistics-20250409.pdf (2025).

[68] INVESTMENT ADVISER STATISTICS, TAB. 5.1, p. 12 (2025), https://www.sec.gov/files/investment/im-investment-adviser-statistics-20250430.pdf (reporting on total assets under management of registered funds, excluding money market mutual funds). Funds in total thus manage roughly \$71 trillion. The total assets of all commercial banks are \$24.5 trillion. Fed. Res., Total Assets, All Commercial Banks, https://fred.stlouisfed.org/series/TLAACBW027SBOG (estimating total bank assets at \$24.5 trillion). The total capitalization of the U.S. stock market is \$63 trillion. Total Market Value of the U.S. Stock Market, https://siblisresearch.com/data/us-stock-market-value/. Of course, it's worth noting that the size of the banking system and fund industry lie downstream from contentious if often hidden policy decisions to allow a vast shadow banking sector to develop—much of it in the form of investment funds. See Kathryn Judge, Information Gaps and Shadow Banking, 103 VA. L. REV. 411, 414 (2017) (describing shadow banking as a systematically important regime alongside traditional banking and capital markets); Lev Menand & Morgan Ricks, *Rebuilding Banking Law: Banks*

domination of corporate ownership by funds. In 1945, effectively all corporate stock was held directly by individuals.[69] Today, it is less than half.[70] Since 1990 registered investment funds have become the largest class of institutional shareholder. Domestic mutual funds and exchange-traded funds combined own roughly forty percent of public company equity, as Figure 3 shows.[71] Indeed, a familiar fact is that the three largest index fund managers alone vote 25% of the shares in all S&P 500 companies.[72] On the private side, private funds own large swaths of the most highly-valued private companies.

Figure 3. The ownership of corporations: 1945-2021



C. Related Literature

This paper contributes to several literatures involving funds. The largest scholarly literature studying funds focuses on specific types of funds and the normative and legal issues they raise. Venture capital,[73] private equity,[74] and hedge funds[75] have been the focus of enormous scholarly attention. Likewise, large mutual fund complexes, and their role in shaping public

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as Public Utilities, 41 YALE J. REG. 591 (2024) (criticizing the shadow banking industry and offering an alternative vision for banks).

[69] Jonathan B. Berk & Jules H. van Binsbergen, *The Economics of Intermediaries*, *in* SECURITIES MARKET ISSUES FOR THE 21ST CENTURY, at 280 (Merritt B. Fox, Lawrence R. Glosten, Edward F. Greene & Manesh S. Patel eds.) (2018).

[70] BOARD OF GOVERNORS OF THE FED. RESERVE SYS., FINANCIAL ACCOUNTS OF THE UNITED STATES: FLOW OF FUNDS, FOURTH QUARTER 2019, at tbl. L.223.

[71] *Id*. In Figure 3, I use Fed data to update the assessment (and aesthetic) conducted by Berk and van Binsbergen.

[72] *See, e.g.*, Lucian A. Bebchuk & Scott Hirst, *Big Three Power, and Why it Matters*, 102 BOS. U. L. REV. 1547, 1552 (2022).

[73] Robert P. Bartlett III & Eric L. Talley, Law and Corporate Governance, in *1* THE HANDBOOK OF THE ECONOMICS OF CORPORATE GOVERNANCE 177 (Benjamin E. Hermalin & Michael S. Weisbach eds., 2017) (discussing literature); see also Eric L. Talley & Sarath Sanga, *Don't Go Chasing Waterfalls: Fiduciary Duties in Venture Capital Backed Startups Don't Go Chasing Waterfalls: Fiduciary Duties in Venture Capital Backed Startups*, 53 J. LEG. STUD. 21 (2024).

[74] *See infra* note 49, 61 and accompanying text.

[75] For hedge funds, the question of the effects of hedge fund activism has probably attracted the greatest attention. Alon Brav, et. al, *Recent Advances in Research on Hedge Fund Activism: Value Creation and Identification*, 7 Ann. Rev. Fin. Econ. 579, 581 (2015); John C. Coffee, Jr., Robert J. Jackson, Jr., Joshua Mitts & Robert E. Bishop, *Activist Directors and Agency Costs: What Happens when an Activist Director Goes on the Board?*, 104 CORNELL L. REV. 381 (2019); Zohar Goshen & Reilly S. Steel, *Barbarians Inside the Gates: Raiders, Activists, and the Risk of Mistargeting*, 113 YALE L.J. 1219 (2024).

markets, is a major preoccupation of corporate governance.[76] Outside of law, the empirical literature on mutual funds in finance is astonishingly large. Fund returns, risk, and market efficiency have become core concerns of empirical asset pricing.[77]

Then there are hybrid funds themselves. To the best of my knowledge, this is the first academic paper to ask what hybrid funds tell us about the nature of fund regulation. There has been extensive study of one type of hybrid fund, the BDC.[78] That literature, however, has focused on different dimensions of BDCs—on their role in the growth of "private credit"[79] as an asset class or the risks of private credit to financial stability[80]—rather than on what BDCs and other hybrid funds can tell us about the nature of fund regulation.[81] A sizeable empirical literature studies the performance of BDCs and their economic role in substituting for bank lending and the causes of their growth.[82] Legal scholars have become concerned about the "democratization of private market."[83] Ben Bates has studied hybrid funds (or retail private funds, as he calls them).[84] He gathers partly overlapping data with mine on fees and leverage and argues that these funds underreport their volatility and underperform similar products, raising investor protection concerns. Cynthia Balloch and co-authors find that affluent individuals investing in private equity funds that offer broader access outperform public markets and achieve financial returns comparable to institutional investors.[85]

The most closely related literature is the body of work studying fund regulation itself and how it shapes the behavior of investment funds. There is a longstanding technical and historical

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[76] In recent years, major debates involving registered funds have often centered on their effects on corporate governance, whether through their passivity, *see, e.g.*, Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence and Policy*, 119 COLUM. L. REV. 2029, 2033 (2019); Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. Corp. L. 493 (2018), or common ownership, *see, e.g.*, Merritt B. Fox & Menesh S. Patel, *Common Ownership: Do Managers Really Compete Less?*, 39 YALE J. ON REG. 136 (2022), but scholars have tackled a range of issues relating to the role of regulated funds. Jill E. Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 U. Pa. L. Rev. 1961 (2010); Jill E. Fisch, *Securities Intermediaries and the Separation of Ownership from Control*, 33 SEATTLE U. L. REV. 877, 878-79 (2010).

[77] For some of the landmark work on the subject, *see* Jonathan B. Berk & Richard C. Green, *Mutual Fund Flows and Performance in Rational Markets*, 112 J. POL. ECON. 1269 (2004); Mark M. Carhart, *On Persistence in Mutual Fund Performance*, 52 J. FIN. 57, 57-58 (1997).

[78] *See, e.g.*, A. Joseph Warburton, *Business Development Companies: Venture Capital for Retail Investors*, 76 BUS. LAW. 59 (2021).

[79] *See infra* note 82.

[80] Michael Ohlrogge, *Stress Testing Private Credit* (ECGI Working Paper, 2025), available at https://www.ecgi.global/stress-testing-private-credit; Sergey Chernenko, Robert Ialenti & David Scharfstein, *Bank Capital and the Growth of Private Credit* (Sept. 30, 2024), available at https://www.hks.harvard.edu/centers/mrcbg/programs/growthpolicy/bank-capital-and-growth-private-credit.

[81] Elisabeth de Fontenay & Jared Elias, *The Credit Markets Go Dark*, 134 YALE L.J. 696 (2025); Michael Ohlrogge, Stress Testing Private Credit (Working Paper). Private funds, registered funds, and fund regulation as distinct topics have all been the subject of great study. See, e.g.,

[82] Tetiana Davydiuk, Tatyana Marchuk & Samuel Rosen, *Direct Lenders in the U.S. Middle Market*, 162 J. FIN. ECON. 103946, 1-2 (2024); Tetiana Davydiuk, Tatyana Marchuk & Samuel Rosen, *Market Discipline in the Direct Lending Space*, 37 REV. FIN. STUD. 1190, 1191 (2024).

[83] Colleen Baker & Christina M. Sautter, *Democratization of the Private Markets?*, 26 TRANSACTIONS: TENN. J. BUS. L. 67 (2025)

[84] Benjamin C. Bates, *Retail Access to Private Markets* (Working Paper 2025).

[85] Cynthia Balloch et al., *Democratizing Private Markets: Private Equity Performance of Individual Investors* (June 25, 2025), Columbia Business School Research Paper No. 5319498.

literature on fund regulation,[86] but it became a focus of vigorous academic work as scholars of corporate governance turned to fund regulation to explain the *absence* of various investors from U.S. public markets. Take a perennial question of corporate governance, which is why so few institutional shareholder seem interested in actively controlling and governing America's public companies.[87] An incisive body of scholarship offered fund regulation as an explanation, because of the various ways in which it limits what a fund can do.[88] Thirty years after those classics, the study of funds is having a renaissance, driven in part by the increasingly dominant role of funds in the financial system. John Morley,[89] William Birdthistle[90] and others have opened up new questions about the role of external management, the structure of the industry, and the ultimate point of fund regulation.[91]

D. Fund Regulation

Investment funds are defined by the two core statutes creating federal fund regulation—the Company Act and the Advisers Act.[92] Both were passed in 1940, although they have been repeatedly amended since then. The ICA defines investment funds and establishes the regulatory scheme governing them. That scheme is far more demanding than the set of mandates imposed on operating companies by the securities laws. It not only regulates who funds can raise money from and what they must disclose—the basic strategy of securities regulation—but also funds' capital structure, governance, fees, related party transactions, and more. The most familiar types of investment fund, like mutual funds and exchange-traded funds ("ETFs"), operate under the ICA's regulatory scheme. Fund regulation is more like a body of restrictive federal corporate law than it is a disclosure regime. Besides the Investment Company Act itself, there is also federal tax law and the Advisers Act. In providing a brief overview of core rules below I cannot hope to

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86 *See, e.g.*, Joseph W. Bartlett & Stephen P. Dowd, *Section 17 of the Investment Company Act—an Example of Regulation by Exemption*, 8 DEL. J. CORP. L. 449, 470 (1983).

87 Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 889 (2013).

88 *See* Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice,* 39 UCLA L. REV. 811, 879 (1992); Ronald J. Gilson & Reinier Kraakman, *Investment Companies as Guardian Shareholders: The Place of the M.S.I.C. in the Corporate Governance Debate*, 45 STAN. L. REV. 985, 985–86 (1993); Mark J. Roe, *Political Elements in the Creation of a Mutual Fund Industry,* 139 U. PA. L. REV. 1469, 1479 (1991). *See also* John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1291-93 (1991) (arguing that institutional investors face a powerful tradeoff between exercising control and the advantages of liquidity that profoundly shapes fund behavior); John C., Jr. Coffee, *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1 (2001).

89 John D. Morley & Quinn Curtis, *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds*, 120 YALE L.J. 84 (2010); John Morley, *Collective Branding and the Origins of Investment Fund Regulation,* 6 VA. L. & BUS. REV. 341, 368 (2012); John Morley & Quinn Curtis, *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds*, 120 YALE L.J. 84 (2010). *See also* Jason S. Oh & Andrew Verstein, *A Theory of the REIT*, 133 YALE L.J. 755 (2024). Oh and Verstein implicitly take the stance that the right working model for real estate investment trusts is an operating company, rather than a fund. While this strikes me as a problematic choice, REITs—a trillion dollar industry—are a useful illustration of the policy significance of getting the distinction between funds and operating companies "right."

90 BIRDTHISTLE, *supra* note 53.

91 *See, e.g.*, Anita K. Krug, *Investment Company As Instrument: The Limitations of the Corporate Governance Regulatory Paradigm*, 86 S. Cal. L. Rev. 263, 275 (2013).

92 In particular, the Advisers Act has been interpreted as establishing a fiduciary duty for all investment advisers, whether a fund is registered or not. *See* Investment Advisers Act of 1940, § 206, 15 U.S.C. § 80b-6 (2018).

do justice to the entire, massive body of law governing funds. Instead, I aim to cover the small set of central rules, widely viewed as the heart of fund regulation.[93]

Governance. Fund regulation imposes mandates on who the directors an investment fund's board should be. The central requirement is that forty percent of all directors on a fund's board must be independent. For a BDC, it is 50% or more of its directors.[94] Independence is defined negatively. A director must not be an "interested person," which is a category that includes a company's affiliates (and their family members) and a laundry list of other actors who provide material services to a fund or have otherwise interacted with it.[95] The Company Act does this in an effort to mitigate the conflicts of interest endemic to the operation of funds.[96] It is an aggressive mandate reminiscent of the controversial director requirements reflected in Sarbanes-Oxley or contemporary stock exchange listing requirements for public companies.[97]

The Company Act also empowers the SEC to enforce fiduciary duties against the officers, directors, or investment adviser of a registered fund.[98] Major duties of a fund board include approving and renewing the fund's advisory agreement with its adviser.[99] The Act even establishes a specific fiduciary duty with respect to an adviser's compensation for services, which either the SEC or an investor can enforce. This Section 36(b) claim has been the source of a large amount of litigation, but the results seem to have been both haphazard in shaping the behavior (or fees) of the industry as a whole.[100]

Disclosure. Registered funds are subject to comprehensive disclosure requirements. Registered funds typically register their securities for sale pursuant to variants on the general disclosure rules established by the securities laws, and most registered funds make public offerings and/or are publicly traded, though not all. Closed-end funds are also subject to their own specific disclosure requirements. This includes detailed investment-level disclosures of a fund's holdings. I will discuss the details of the disclosure regime further in Part IV.

Leverage. The Investment Company Act sharply limits the leverage or debt that a registered fund can incur. The central restriction, established by Section 18(a), requires the value

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[93] *See, e.g.*, Jackson, *supra* note 77, at 1-4.
[94] Company Act Section 56.
[95] An "interested person" is defined in Section 2(a)(19) (15 U.S.C. § 80a-2(a)(19)). If a registered fund's principal underwriter is affiliated with the fund's directors, officers, or employees, then a majority of the board must be independent. The *adviser* of the fund—usually an investment management company, like a private equity firm, that makes all of the major investment decisions for the fund—owes the fund fiduciary duties. This is true of all funds, whether registered or private. SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 184-85 (1963). For a fascinating study of the history of the centerpiece of adviser regulation, see Arthur B. Laby, *SEC v. Capital Gains Research Bureau and the Investment Advisers Act of 1940*, 91 B.U. L. REV. 1051, 1053 (2011).
[96] Burks v. Laster, 441 U.S. 471, 480-83 (1979).
[97] Eric L. Talley, *Corporate Inversions and the Unbundling of Regulatory Competition*, 101 VA. L. REV. 1649, 1694–97 (2015).
[98] Section 36(a) (15 U.S.C. § 80a-35(a)).
[99] Section 15(a) (15 U.S.C. § 80a-15(a)) (requiring board approval of an investment advisory agreement); Section 15(c) (15 U.S.C. § 80a-15(c)) (mandating annual board review and approval of advisory agreement as fair and reasonable). The Company Act also mandates governance in the broader sense of mandating requirements for shareholder voting, such as election of directors, Section 16(a) (15 U.S.C. § 80a-16(a)), and approval of certain fundamental transactions, Section 13 (15 U.S.C. § 80a-13).
[100] Section 36(b) (15 U.S.C. § 80a-35(b)). The major opinion interpreting the provision is *Jones v. Harris Associates L.P.*, 559 U.S. 335 (2010). See Curtis & Morley for a major study on the topic.

of a registered fund's total assets to equal or exceed three times the value of its borrowings (an asset coverage ratio of 3:1, or equivalently, a debt-to-assets ratio of 1:3, and a debt-to-equity ratio of 1:2).[101] Additional requirements solely applicable to open-end funds, like mutual funds and ETFs, limit the source and form of these funds' debts.[102] A mutual fund or ETF can only incur that debt by borrowing from a bank.[103] They cannot issue debt securities to a broader class of market participants.

Unlike open-end funds, closed-end funds can issue a single class of debt security (i.e., they are not limited to borrowing from banks).[104] In fact, because they can issue "preferred stock" with debt-like features, closed-end funds can have a total debt/preferred-to-assets ratio of 1:2, rather than 1:3.[105] Even so, the limit is strict: a closed-end fund must have double the assets of any debt and preferred stock outstanding.[106]

Following this pattern, there are significant leverage restrictions on BDCs, although they are lighter than the restrictions imposed on registered funds and in recent years were lightened at Congressional direction. Traditionally, Section 61(a) of the Company Act required BDCs' total assets to be worth at least twice their borrowings—a 200% asset coverage ratio (or, equivalently, a debt-to-assets ratio of 1:2, and a debt-to-equity ratio of 1:1). In 2018, new legislation enabled BDCs to opt to lower their asset coverage requirement from 200% to 150%.[107]

Performance Fees and the Advisers Act. One of the most distinctive features of fund regulation is that it prohibits any performance fee calculated on the basis of appreciation of a client's assets or a percentage of the fund's capital gains.[108] There are a number of exclusions and exceptions. Business development companies are allowed to charge performance-based fees, capped at 20% of the fund's realized net capital gains.[109] The other exceptions are either extremely narrow or have proved wildly unpopular among investment managers.

Under the first exception, a registered fund can charge a specific type of performance fee called a "fulcrum fee."[110] A fulcrum performance fee would reward an adviser for exceeding a

[101] A 300% asset coverage ratio means that for every $100 in debt incurred, the fund must have $300 in assets. Because, roughly speaking, the other $200 in assets must be financed by equity, the result is that $100 is debt-financed, $200 is equity financed, and the debt-to-equity ratio is thus 1:2. Section 18(f)(1); id. 18(h).

[102] John Morley, *The Regulation of Mutual Fund Debt*, 30 Yale J. on Reg. 343, 348-52 (2013).

[103] The open-end fund cannot issue a "senior security" to anyone but a bank. It can issue common stock to anyone, but that common stock can vary only in the fees involved. ICA 18(f)(3); Rule 18f-3.

[104] ICA Section 18(a).

[105] 18(a)(1)(a); 18(a)(2)(a).

[106] Elliot J. Gluck et al., *Why More Alternative Asset Managers*, 7 Inv. Law. 1, 4 (2023) ("Interval and tender offer funds . . . [are] subject to a 200 percent asset coverage ratio in the case of preferred stock and a 300 percent asset coverage ratio in the case of debt.").

[107] Small Business Credit Availability Act, Pub. L. No. 115-141, div. S, tit. VIII, § 803, 132 Stat. 348, 1143 (2018) (codified at 15 U.S.C. § 80a-60(a)(2)). These are only the headline numbers. There are a number of more complex ways, such as off-balance sheet financing, in which a BDC (or registered fund, for that matter) can further increase its leverage. There is an entire complex practice area that deals with regulated funds' use of leverage, for instance, and BDCs also engage in joint ventures with subsidiaries or own and manage Small Business Investment Companies, all of whose leverage does not count as the BDC's.

[108] Section 205(a)(1).

[109] Section 205(b)(3).

[110] Section 205(b)(2) (defining a fulcrum fee as "compensation based on the asset value of the company or fund under management averaged over a specified period and increasing and decreasing proportionately with the investment performance of the company or fund over a specified period in relation to the investment record of an appropriate index

specified benchmark, but must be symmetric and *reduce* the adviser's fee, if the fund fails to meet the benchmark. So if the adviser is paid a management fee of 2%, and has a benchmark of 8%, making a ten 10% return and thus exceeding the benchmark by 2% would result in a 2% performance fee. Making a 6% return, on the other hand, would result in a -2% performance fee being charged against whatever fee the manager would otherwise receive. A fulcrum fee is almost never used.[111]

Related Party Transactions. A pillar of fund regulation is its approach to related party transactions—to activities in which both a registered fund and an affiliate participate. In broad strokes, that approach is broad and rules-based. It seeks to regulate a vast number of possible conflicts of interest involving registered funds and to do so by means of bright-line prohibitions. The core provision is Section 17, and a cognate provision, Section 57, that imposes a broadly similar approach on business development companies.[112] The legislative history of Section 17 suggests that it aimed to limit or prevent opportunistic exploitation of a registered fund by those who control it, with the provision aiming to prevent "participation by the investment company on a basis different from or less advantageous than that of such other participants."[113]

Section 17(a) prohibits direct transactions between a registered fund and an affiliate, including sales of property, sales of securities, and loans in either direction. Section 17(d) prohibits "joint transactions" between a registered fund and an affiliate.

To get a sense of the scope of these prohibitions, it's necessary to understand the reach of "affiliate." An affiliate of a fund includes any person who controls five percent or more of the fund's voting securities, or five percent or more of whose voting securities are controlled by the fund;[114] any person controlling, controlled by, or under common control with the fund; any officer, director, partner, or employee of the fund;[115] and its investment adviser.[116] So affiliates of a fund include not only its officers, directors, and adviser—those with most obvious control

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of securities prices"). Even the fulcrum fee is limited to advisory contracts with specific kinds of counterparties, such as a registered fund or other party with assets managed by the contract exceeding $1 million.

[111] Henri Servaes & Kari Sigurdsson, *The Costs and Benefits of Performance Fees in Mutual Funds*, 50 J. Fin Intermediation 100959 (2022). The other exception is that registered funds can offer performance fees to "qualified clients," Advisers Act Rule 205-3; Investment Adviser Performance Compensation, Release No. IA-3372 (Feb. 15, 2012), IAA Section 205(a)(1), 15 U.S.C. § 80b-5; Release No. IA-721 (May 16, 1980), but a qualified client is based on financial criteria close to a qualified purchaser, as it must either have at least $1,000,000 under the management of the adviser or a net worth exceeding $2.1 million (to satisfy the definition of a "qualified client"). Just to be clear, this prohibition is not taken to bar compensation based on the total value of a fund, as of a definite date, or averaged over a specific period, such as the typical "assets under management" fee charged by a mutual fund. *See* Section 205(b)(1). The text of Section 205(a)(1) can be confusing. Facially, it applies to an advisory contract involving any registered investment adviser, including advisers of private funds. But the section later exempts performance fees in advisory contracts with company exempt under Section 3(c)(7) of the Company Act (i.e., private funds exempt because their investors are qualified purchasers). Section 205(b)(4).

[112] Rule 17d-1, pursuant to Section 17(d), provides for an extremely broad approach to conflicted transactions. BDCs enjoy a somewhat lighter treatment of transactions with portfolio companies (i.e., downstream affiliates). Affiliated transactions for BDCs are governed by Section 57 of the Investment Company Act, 15 U.S.C. § 80a-56, and Rule 57b-1, 17 C.F.R. § 270.57b-1 thereunder (2020). Rule 17d-1 governs a BDC's horizontal conflicts under Section 57(i).

[113] Investment Company Act of 1940 and Investment Advisers Act of 1940, H.R. Rep. No. 76-2639, at 17-18 (1940). LEXIS 1090, at *2–3 (Oct. 13, 1967).

[114] Section 2(a)(3)(A), (B).

[115] Section 2(a)(3)(C).

[116] Section 2(a)(3)(D).

over it—but also any significant shareholder and *any company in which the fund is a significant shareholder*. As importantly, affiliates include both a fund's sponsor and *any other fund managed by that sponsor*.

Section 17(d) prohibits any affiliate of a registered fund, or any affiliate of any affiliate, to participate in a joint transaction with the registered fund (or a company controlled by the fund), in contravention of such rules as the SEC "may prescribe for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than that of such other participant."[117]

Pursuant to Section 17(d), the SEC promulgated a capacious interpretation of the provision in Rule 17d-1, which prohibits all transactions between a registered fund and an affiliate or affiliate of an affiliate (often called "first tier" and "second tier" affiliates).[118] Since the rule's adoption, the SEC has carved out a number of specific types of transactions (e.g., bonus, pension, or profit sharing plans, insurance policies) from the reach of the rule, but its general approach to Section 17(d) has been to maintain a broad prohibition prohibiting joint transactions generally unless the parties file an application with the SEC seeking approval ex ante and the Commission issues an order providing exemptive relief.[119]

As a result, the "law" governing Section 17 is actually hard to find because it lies mostly in exemptive applications filed by funds. The rule itself and its exceptions are hyper-technical and formalistic. Besides a few landmark cases, most of the "law" on the topic consists of narrow exceptions codified in rules, a few seminal no-action letters, and the law-in-practice of what the SEC currently permits in the exemptive applications it grants. These obstacles have basically prevented an academic literature from directly addressing the topic, even though the question of how to address opportunism in ordinary companies is the central concern of the literature in corporate governance.[120] It's worth stepping back from the morass of exemptive applications to see the big picture: the case law and no-action letters basically permit affiliated-party transactions if they are in anonymous public markets.[121] If a transaction is a negotiated, private transaction, then it is not permitted, absent specific applicant-specific relief.[122] Since virtually all major investments in private markets involve negotiation and customization, the prohibition seems to take in all of private markets. The question then is where and how the SEC has granted exemptive relief.

Broadly speaking, one can think of horizontal and vertical conflicts between a fund and affiliates. Horizontal conflicts arise when a fund is acting together with or transacting with a related fund, such as a fund managed by the same sponsor. Vertical conflicts arise between a fund and the companies it invests in, when it takes a substantial ownership position in those companies.

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[117] Section 17(d).

[118] 1946 Adopting Release, Investment Company Act Release No. 858, 11 Fed. Reg. 1461 (Feb. 8, 1946); 1967 Proposing Release, Investment Company Act Release No. IC-5128, 1967 SEC (expanding the original rule to encompass second tier affiliates). *See also* SEC v. Talley Industries, Inc., 399 F.2d 396 (2d Cir. 1968) (upholding the rule from challenge).

[119] 1951 Adopting Release, Investment Company Act Release No. 1598, 16 Fed. Reg. 2680, 2680 (Mar. 27, 1951).

[120] The major recent Murphy, *supra* note 27. That doesn't mean there is no literature on the broader them of opportunism in funds. See Morley, *Separation*.

[121] Securities & Exch. Comm'n v. Talley Indus., Inc., 399 F.2d 396, 406-09 (2d Cir. 1968).

[122] Massachusetts Mutual Life Insurance Company, SEC No-Action Letter (Jul 28, 2000).

The big picture on how SEC exemptive relief has evolved is that it has become quite accommodating toward horizontal, but not vertical conflicts. It is hard to get at this big picture. As I have mentioned, what is "legal" under Section 17 just consists of what the SEC will permit in the most aggressive requests for exemptive relief that it has granted. Those applications bury the big picture because the SEC relies on a list of a dozen or so technical conditions for how a fund's board must address conflicted transactions.

Diversification. Perhaps surprisingly, the Company Act does not directly mandate diversification. It does require a fund to declare whether it is "diversified" or not,[123] and it does classify funds as either open-end or not. If a fund is open-end, it means it offers investors daily redemption or the ability to tender their shares to the company in return for their pro rata share of its net asset value. The need to be able to satisfy daily redemption requests probably shapes what open-end funds do more than anything else. The vast majority of open-end funds choose to be diversified. Yet, many closed-end funds elect not to be "diversified," and by definition they do not offer daily redemption. More importantly, as we will see below, the need to qualify for favorable tax treatment causes even closed end funds to be quite diversified.

Tax. Tax law plays an important role by providing a much more attractive tax status to investment companies that elect and qualify for "RIC" status or "regulated investment company" status (confusingly close to registered investment company).[124] An entity that qualifies for RIC status avoids taxation at the entity level, or the double taxation typically applicable to corporations. This is highly desirable, but to qualify for RIC status, an entity must meet diversification,[125] nature-of-income,[126] and payout-policy requirements.[127]

II. The Rise of Hybrid Funds

The idea of a hybrid fund is to create a fund that raises money from public investors and invests that money in private markets. I use hybrid funds as a laboratory for understanding what matters in fund regulation. But this requires first understanding hybrid funds and answering a set of questions about them. One set of questions involves their institutional structure. How can a fund that invests in illiquid, opaque assets even be attractive in the first place to everyday households with their needs for liquidity and transparency? To do this, hybrid funds attempt to pull off a kind of magic trick. They are required to have a transparent net asset value, despite

[123] Section 5(b) of the ICA (15 U.S.C. § 80a-5(b)) (defining a diversified company as "a management company which, with respect to 75 percent of the value of its total assets," does not invest more than 5% of its assets in a single issuer and does not own more than 10% of the voting stock of any one issuer).
[124] For an incisive overview of the tax treatment of mutual funds, see John C. Coates IV, *Reforming the Taxation and Regulation of Mutual Funds: A Comparative Legal and Economic Analysis*, 1 J. LEGAL ANALYSIS 591 (2009).
[125] The fund cannot invest half of its assets in securities that constitute more than ten percent of the voting stock of a company or that are more than five percent of the fund's assets; separately, the fund cannot invest more than 25% of its assets in the securities of one issuer, the securities of two or more issuers the entity controls and that are in similar businesses, or the securities of one more publicly traded partnerships.
[126] Ninety percent or more of the entity's gross income must be derived from the entity's investment business ("good" income), such as dividends, interest income, or sales of securities. To qualify as a RIC, a fund must distribute at least 90% of its investment income to its shareholders annually, and distribute 98% to avoid an excise tax.
[127] To qualify as a RIC, a fund must distribute at least 90% of its investment income to its shareholders annually, and distribute 98% to avoid an excise tax.

holding private securities that are seldom traded and thus have no market price.[128] They offer a significant degree of liquidity to investors, even though their investments are extremely illiquid. Another set of questions involve why these funds are emerging right now. Lastly, it is important to understand that hybrid funds enter a policy debate that has been at the center of securities law for years regarding whether retail investors should invest in private markets.

A. Hybrid Funds: What Are They?

Hybrid funds represent a degree of convergence between the paradigms of a registered fund and private fund discussed above. Like a registered fund, a hybrid fund typically has an indefinite life; it is an "evergreen" vehicle.[129] Like a mutual fund or ETF, anyone can generally invest in a hybrid fund (although nothing about the legal forms requires this and some hybrid funds limit their investor base). They usually raise capital by offering their securities on an ongoing basis or trading publicly on a stock exchange. Yet, like a private equity or venture capital fund, hybrid funds invest overwhelmingly in private markets.

The three major types of evergreen funds are business developments companies (BDCs), interval funds, and tender offer funds.[130] They share a number of important institutional and legal features. They are all "closed-end" funds, which means they do not offer investors the right to sell their shares back to the fund on a daily basis. (Funds that offer this redemption right to investors are called "open-end.") They are also all governed by federal fund regulation, although BDCs are subject to modestly lighter treatment under certain rules.[131]

One way to appreciate the striking growth of hybrid funds is to think about them in the context of the larger closed-end fund industry. The traditional closed-end fund industry has invested in public markets. This industry dates back to before the 1940 Act. Indeed, the Company Act was in significant measure designed to regulate the closed end fund industry.[132] Yet as of 2024, hybrid funds had already grown to exceed *all traditional closed end funds in size*.[133] That is, closed end funds invested in private markets now exceed the size of closed end funds invested in public markets.

Arguably, the defining innovation of hybrid funds is *periodic redemption*. A fundamental design challenge for a hybrid fund is that retail investors generally demand a high degree of "liquidity," or the ability to easily sell their shares. Retail investors generally invest in assets with daily liquidity, whether public company stock that trades throughout the day or mutual funds that offer daily "redemption," where the fund will buy back an investors' shares for their cash value

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[128] SEC, Valuation of Portfolio Securities and other Assets Held by Registered Investment Companies - Select Bibliography of the Division of Investment Management.
[129] PITCHBOOK, THE EVERGREEN EVOLUTION, at 7 (2024).
[130] *Id*.
[131] The technical reason for this is that BDCs are subject to a set of provisions near the end of the Company Act, which first exempt BDCs from the Company Act and then re-impose the vast majority of its rules, although sometimes in slightly different form. *See* Steven B. Boehm, Hannah L. Friedberg, *Everyman A Venture Capitalist Taking Private Equity Public*, 17 BUS. L. TODAY 13 (May/June 2008). Where differences could be material, I discuss them. BDCs were created by the Small Business Investment Incentive Act in 1980 based on Congress' belief that small and medium-sized American businesses faced difficulties in raising money. *See* Warburton, *supra* note 78.
[132] Allen Ferrell & John Morley, *Intermediaries: Investment Funds*, *in in* SECURITIES MARKET ISSUES FOR THE 21ST CENTURY, at 280 (MERRITT B. FOX, LAWRENCE GLOSTEN, EDWARD GREENE & MANESH PATEL EDS.) (2018).
[133] INV. CO. INST., 2024 INVESTMENT COMPANY FACT BOOK at 68.

at the end of each day. Yet, as noted in Section I.C, private equity or venture capital funds generally lockup investors' money for *years*. After all, private assets are overwhelmingly illiquid. There tends to be no trading market for most private companies' stock or debt. Hybrid funds have innovated a set of structures that offer something in-between, through redemption at pre-defined intervals or the use of periodic tender offers by the fund to repurchase investor shares.

Interval funds and tender offer funds take their names from the legal mechanisms through which they provide investors with liquidity. An interval fund offers periodic liquidity to its investors at predefined intervals. An interval fund is governed by an SEC rule that requires it to commit to a "fundamental policy" of offering to repurchase between five and twenty-five percent of its outstanding stock from its investors at net asset value, at least annually.[134] The norm is quarterly repurchases.[135] A tender offer fund offers liquidity to its investors by periodically repurchasing their shares at net asset value. Rather than doing so through a fundamental policy of specific intervals, a tender offer fund retains discretion to offer repurchases by means of periodic "tender offers." A tender offer is a specific legal form of widespread solicitation for shares that an issuer (or a third-party) can conduct for its shares.[136]

Unlike interval funds and tender offer funds, some BDCs are publicly traded. That means the shares of the closed-end fund trade, like a stock, throughout the day on a stock exchange. Yet, as Figure 4 vividly shows, virtually all growth in BDCs in recent years has been in BDCs that are not listed. Do they provide liquidity? While the answers vary, the basic answer is yes, through periodic tender offers or declared intervals. The largest non-traded BDC, the giant Blackstone Private Credit Fund, illustrates. It maintains a "share repurchase program under which, at the discretion of the Board, the Company may repurchase, in each quarter, up to 5%" of the value of company shares through tender offers.[137]

Figure 5 (and Table 1 at the end of the paper) contrast the typical structure of a paradigmatic open-end registered fund, a paradigmatic private fund, and hybrid fund. As they grow in popularity, hybrid funds are increasingly a mainstream investment product. Financial advisors market them as part of a prudent investment package to clients. Interval and tender offer funds even appear in fund supermarkets for middle class households, like Charles Schwab and Fidelity.

[134] Rule 23c-3 governs the operation of interval funds. 17 CFR § 270.23c-3, https://www.ecfr.gov/current/title-17/chapter-II/part-270/section-270.23c-3. It provides for repurchase offers by closed-end registered funds, allowing for intervals of three, six, or twelve months; repurchase amounts of minimum five percent and maximum twenty-five percent, with discretion left to directors for each interval

[135] FINRA, *Investment Funds Interval Funds—6 Things to Know Before You Invest*, Jan. 29, 2025 ("This repurchase option typically comes on a quarterly basis"); KPMG, *Interval Funds*, at 2.

[136] Rule 13e-4 governs tender offers by issuers for their own shares. 17 CFR § 240.13e-4.

[137] Blackstone Private Credit Fund, Form 10-K, 2023, at 29.

Figure 4. Growth of BDC Types

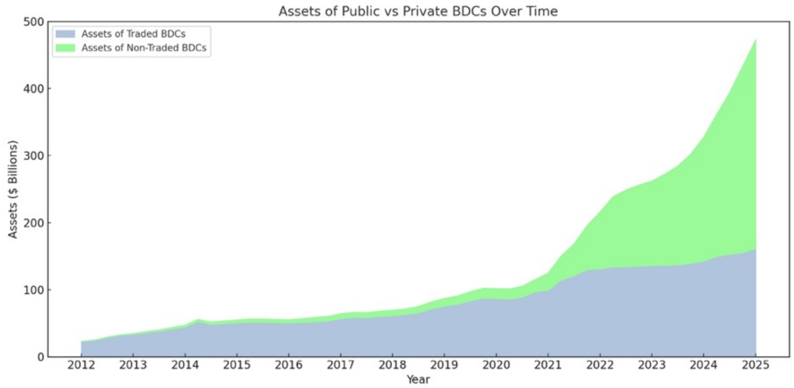
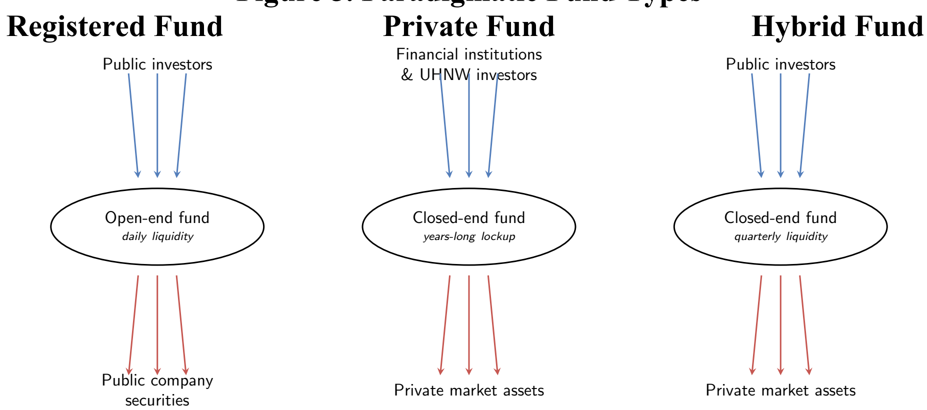


Figure 5. Paradigmatic Fund Types



B. Why Now? Explaining the Sudden Rise of Hybrid Funds

Why now? The private equity and venture capital industries are decades old. Likewise, the appetite for retail access to private markets has been decades in the making.[138] So what explains why the momentum behind retail access to private equity has suddenly become a front-burner issue for Wall Street with huge energy and billions of dollars pouring into the effort? Five key trends have led to the recent push of private markets into retail investment. Two developments fall on the "supply" side and involve changes to the private equity advisers who provide the investment strategies. Two developments involve the "demand" side of retail investors. In this section, I describe how these trends have collided in the last few years.

Arguably, the most important driver of retail access to private markets has been the continued growth appetite of private equity, even as its traditional investor base begins to reach its limits. The result is that the private equity industry has sharpened incentives to seek out individual investor money. Private equity's traditional investor base consists of large financial institutions, like public pension plans, university endowments, sovereign wealth founds, or private foundations.[139] Between 2000 and 2021, many of those investors ratcheted up their

[138] Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 FORDHAM L. REV. 3389 (2013).
[139] Michael Ewens & Joan Farre-Mensa, *Private or Public Equity? The Evolving Entrepreneurial Finance Landscape*, 14 ANN. REV. FIN. ECON. 271 (2022).

allocation to private equity multiple times, allowing the PE industry to enjoy enormous growth. Now, however, private markets occupy an *outsized* place in those investors' portfolios, relative to their absolute size, making further growth unlikely and a continued pace of growth impossible.[140] As a result, if private equity firms are going to continue their growth, they must find new financing sources. There are arguably some more troubling motivations behind private equity's quest for public cash as well. Call it the "pass the trash" motive. After boom years of fundraising, private equity firms hold large portfolios of companies they are finding difficult to exit.[141] Those private funds may have sophisticated institutional or ultra-high-net-worth investors. Private equity may be looking to offload those positions onto less sophisticated public investors.

At the same time, individual wealth is becoming an increasingly large and attractive pool of capital. Aside from the ultra-rich, individuals have not participated in the growth of private equity. Yet individuals in the United States hold over one hundred trillion dollars in wealth.[142] Direct contribution retirement plans and other individual retirement accounts hold $25 trillion, almost all of which is in the stock market and publicly traded bonds.[143] If individuals switched their current allocation to private equity from zero today to just five percent, it could easily fuel private equity's growth appetite for the next generation. The result of these supply factors is that private equity firms are increasingly interested in individuals' wealth as their new financing source.

On what you could call the "demand" side of the equation—individual investors themselves—the appetite for access to private markets has only increased.[144] As I will discuss below, the empirical evidence on excess returns to private markets is mixed. Yet, the sheer size of private markets is undeniable and only growing. If most money raised in the economy goes to private issuers, as it increasingly does, then the basic notion that retail investors are "missing out" grows more plausible. Registered fund complexes that cater to retail investors, seeking greater fees and product bases, have even jumped on the trend. Recently, Vanguard announced that it would launch an interval fund.[145]

A fourth key development has been a peak of enthusiasm among regulators and politicians for relaxing access to private markets. In recent years, the industry has pushed rapidly ahead with providing retail investors with innovative avenues to access to private markets, and over the last few months a new, deregulatory SEC has provided further aid and comfort to those developments. In the previous five years, the SEC (modestly) expanded the definition of an accredited investor to include persons who had passed various securities licensure

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140 *See, e.g.*, EQUABLE, THE STATE OF U.S. PENSIONS IN 2024, at 2 (2024) (reporting that between 2001 and 2023, public pension plans increased their allocation to alternatives from 8% to 28%); Ewens & Farre-Mensa, *supra* note, at 282 (reporting that from 2002 t 2019, higher education's endowment allocation to VC/PE funds increased from 5.5% to 20%).

141 Goldman Sachs, *Distribution Drought: The Quest for Liquidity in Private Markets*, Oct. 24, 2024, https://am.gs.com/en-us/advisors/insights/article/2024/the-quest-for-liquidity-in-private-markets.

142 PITCHBOOK, THE EVERGREEN EVOLUTION, at 7 (2024).

143 INV. CO. INST., RELEASE: QUARTERLY RETIREMENT MARKET DATA, Sept. 19, 2024.

144 Jennifer Surane & Kriti Gupta, *Apollo's Wealthy Customers Want In on the Private Markets Boom*, Jan. 29, 2025, BLOOMBERG.

145 Jason Kephart & Bridget B. Hughes, *Unlikely Allies: Vanguard and Others Team Up to Offer Private-Market Investments*, MORNINGSTAR, May 22, 2025.

requirements;[146] and further liberalized the marketing and variety of private offerings.[147] Over just the last few months, far more has happened. An extraordinary variety of new options for retail access have been contemplated or adopted. Legislation is before Congress that would direct the SEC to supplement the accredited investor standard, with its emphasis on net worth and income criteria, with an exam on financial sophistication.[148] President Trump signed an executive order in August directing the Department of Labor to ease the inclusion of private equity in 401k plans.[149] In May, the SEC abandoned a twenty year-old staff policy limiting the extent to which registered funds could invest in private funds.[150]

A final driver of the recent growth of retail private markets has been the growth of "private credit."[151] Private credit is fundamentally about loans to large and mid-sized companies being made directly by private funds, rather than banks.[152] For reasons that I hope to make understandable and persuasive by this paper's end, it is easier to package debt into a regulated fund-wrapper, rather than equity because the constraints of fund regulation have far less bite there. The asset a fund invests in turn out to matter for how strictly fund regulation constrains. Credit, like real estate or infrastructure investments, also generates an ongoing flow of income to a fund, which is useful in sustaining periodic redemptions and liquidity.[153] Because of this, the development of private credit has been a driver of the growth of retail private products.

C. Retail Investment in Private Markets

Hybrid funds are an institutional innovation that cuts across one of the fiercest securities law debates in recent decades, namely, whether everyday investors should invest in private markets at all.[154] This debate is better understood as two debates—one old, one new. The first and longstanding debate is about whether retail investors should invest in private markets.[155] A defining trend of modern finance has been the explosive growth of private markets.[156] Yet federal securities law effectively limits investment in private markets to the wealthy.[157] Is this a mistake?

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[146] *SEC Modernizes the Accredited Investor Definition*, https://www.sec.gov/newsroom/press-releases/2020-191.

[147] *See, e.g.*, *SEC Harmonizes and Improves "Patchwork" Exempt Offering Framework*, https://www.sec.gov/newsroom/press-releases/2020-273.

[148] Jessica Hamlin, PITCHBOOK, *A New Bill Would Expand the Definition of 'LP'* (Aug. 5, 2025).

[149] Exec. Order No. 14330, *Democratizing Access to Alternative Assets for 401(k) Investors*, 90 Fed. Reg. 38921 (Aug. 7, 2025).

[150] Matthew E. Barsamian et al., *SEC Staff Opens Door to Expanded Retail Access to Private Funds*, May 22, 2025, https://www.dechert.com/knowledge/onpoint/2025/5/sec-staff-lifts-key-limit-on-retail-access-to-private-funds.html (ceasing staff policy of limiting closed-end registered funds to 15% investment in private funds, unless the fund limits sales to accredited investors investing $25,000 or more).

[151] Elias & de Fontenay, *supra* note 81.

[152] *Id*.

[153] PITCHBOOK, THE EVERGREEN EVOLUTION (2024).

[154] *See infra* Section II.C.

[155] Elisabeth D. de Fontenay et al., Securities Law Professor Comment Letter on Concept Release on Harmonization of Securities Offering Exemptions (Sept. 24, 2019), https://www.sec.gov/comments/s7-08-19/s70819-6193340-192501.pdf. See also Christina Parajon Skinner, *Private Equity for the People*, 171 U. PENN. L. REV. 2059 (2023) (arguing for greater retail access to private markets).

[156] *See infra* notes 45-51 and accompanying text.

[157] *See infra* notes 165-166 and accompanying text.

The newer debate is about *how* the public should access private markets—whether there are better and worse ways to enable it—even as the reality of *some* form of retail access becomes a fait accompli. To grasp the first debate, it is necessary to answer three questions: First, why would retail investors want to access private markets? Second, why have they traditionally not enjoyed access? Third, what are the policy arguments for limiting public investment in private markets? In this section, I provide more details on each of these issues.

On the first issue, private markets offer the prospect that investors can do better along the two main dimensions of investment, risk and return. An early generation of empirical research suggested that private equity offered investors a substantial excess return over public markets.[158] The question of whether private markets in fact offer an "alpha"—a risk-adjusted excess return over public markets—has proved to be one of the most active and vexed questions in the empirical literature on private equity.[159] For earlier periods, the empirical evidence, with qualifications, suggested that PE offered an excess return, at least before adjusting for risk. Yet even that persistence seems to have ceased.[160] At the same time, empirical research on the replicability of PE-like strategies in a public portfolio has grown far more sophisticated.[161]

Again, although the empirical evidence is decidedly mixed, advocates argue that private markets offer greater diversification to investors because they include assets less correlated with public markets or different risk factors.[162] Critics marshal a strong case too.[163] The evidence on whether private markets offer greater risk and return is mixed. But the fact that investors will be paying higher fees is a certitude, as is the fact that private markets are generally illiquid, opaque, and offer fewer legal protections than public markets.

Alongside the high fees, opacity, and illiquidity, a final concern is with adverse selection. Private market investments are not like public equities, where effectively all investors can buy the same investments at the same price.[164] Private markets are generally primary markets in which investors directly provide new debt or equity financing to operating companies. Rather than accessing the same securities as sophisticated traders, or even a broad cross-section of private market investments, commentators reasonably fear that retail investors will only be offered the investments that large, institutionalized asset pools would reject. They will be exposed to severe adverse selection—where the only investments offered to them would be the worst prospects.

Traditionally, retail investors have not been able to invest in private markets, although a full explanation of why would be rather complex. The short version is this: Federal securities law

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158 Victoria Ivashina & Anna Kovner, *The Private Equity Advantage: Leveraged Buyout Firms and Relationship Banking*, 24 REV. FIN. STUD. 2462, 2462-63 (2011).
159 *See, e.g.*, Robert S. Harris, Tim Jenkinson & Steven N. Kaplan, *How Do Private Equity Investments Perform Compared to Public Equity?*, 14 J. INV. MGMT. 14, 15 (2016).
160 See, e.g., Berk A. Sensoy, Yingdi Wang & Michael S. Weibach, *Limited Partner Performance and the Maturing of the Private Equity Industry*, 112 J. FIN. ECON. 320, 341-42 (2014).
161 Erik Stafford, *Replicating Private Equity with Value Investing, Homemade Leverage, and Hold-to-Maturity Accounting*, 35 REV. FIN. STUD. 299 (2022).
162 Greg Brown, *Private Equity for the People?*, Kenan Inst. Priv. Enterprise; Arthur Korteweg, *Risk Adjustment in Private Equity Returns*, 11 ANN. REV. FIN. ECON. 131 (2019).
163 See, e.g., de Fontenay letter; Ludovic Phalippou, *Performance of Buyout Funds Revisited?*, 18 REV. FIN. 189, 189 (2014).
164 Holger Spamann, *Indirect Investor Protection: The Investment Ecosystem and Its Legal Underpinnings*, 14 J. LEGAL ANALYSIS 16, 19 (2022).

requires any sale of securities to be registered with the SEC—subjecting the issuer to a complex mandatory disclosure regime—unless the sale falls under an exemption.[165] The most popular exemption by far—responsible for most of the exempt stock sold in the U.S. is Rule 506 of Reg. D. This exemption allows a firm to raise an unlimited amount of capital from an unlimited number of persons, as long as they are all "accredited investors," meaning, for individuals, that they have an income exceeding $200,000 per year (or $300,000 as a household) or a net worth exceeding $1 million (excluding their primary residence).[166] Recall that a private fund operates under one of two exemptions from fund regulation. The first and now rarely-used exemption involves sale to one hundred or fewer investors and no public offering—avoiding a public offering also typically requires complying with Reg. D. The other exemption involves sale exclusively to qualified purchasers—individuals with $5 million or more in investable assets. Together, these rules set up financial gates to accessing private markets.

As noted, the first policy debate has focused on whether retail investors should access private markets. The second debate concerns how retail investors should access private markets. The two debates may seem separate, but they are not. The main reason why is because how private markets are accessed can in fact ameliorate or exacerbate central policy concerns with retail access to private markets. Hybrid funds powerfully illustrate this fact, and I will return to this topic in Part V. But to see this it is worth quickly laying out the basic options for retail access.

The most intuitive form of retail access would be to permit everyday investors to invest directly in private companies. This could be done by radically lowering the accredited investor standard or replacing it with a test open to anyone, at least in principle. Another direct form of access would be to lower or change the qualified purchaser standard and allow investors to invest directly in private *funds*. These are the most obvious options. They are also the options that would offer investors the fewest protections, as the worst performing private companies and private funds could compete for retail money in an almost unregulated market.

Less direct mechanisms would allow registered funds to invest more easily in private funds, or in private companies, or to further ease hybrid funds' operations. All of these options have been considered over the years, and Congress or the SEC seems to be actively considering all of them right now. More complicated options have also emerged, as practitioners push to access retail money. The first option involves the recent emergence of entities, variously known as "conglomerate vehicles" or operating companies (or "OpCo's").[167] The key idea of these entities is to repackage private equity strategies in a *public company*. As a result, these entities are subject to the full mandatory disclosure regime of the securities laws, but they are *not* subject to fund regulation.

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[165] Securities Act of 1933 § 5, 15 U.S.C. § 77e (2020).
[166] *See* 17 C.F.R. § 230.506(b).
[167] Michael Doherty, Chelsea Childs & Andrew Lawson, *Conglomerate Vehicles as an Alternate Investment Structure*, 31 Investment Law. 6, 6–7 (2024). Another complex and surprising institutional option is private funds that register under the 1940 Act. This is a possibility—a kind of conceptual box—that seemed like it would never be utilized. A private fund cannot make a public offering, and these funds avoid that trigger by raising capital exclusively under Reg. D. A private fund can raise money from an unlimited number of investors under Section 3(c)(7), but if an issuer of securities has more than 2000 shareholders of record (and more than $10 million in assets), it must register under the Securities Exchange Act. Recently, several funds have begun pursuing this strategy of remaining private funds but registering under Section 12 due to the number of shareholders.

One of the first OpCos, KKR Private Equity Conglomerate LLC, describes itself, "We are a holding company that seeks to acquire, own and control portfolio companies with the objective of generating attractive risk-adjusted returns."[168] The conglomerate was established by KKR, and like a typical fund, has hired KKR to manage its investment activities. Yet the conglomerates are aggressively structured to be excluded from the definition of an investment company under fund regulation, even though *it has registered as a public company*.[169] The existence of now a half-dozen conglomerates (managing almost $20 billion) suggest something about what is and is not a sharp obstacle to running a private equity fund.

III. The Structure and Function of Hybrid Funds

In this Part, I analyze how regulation interacts with the effort to take private markets public by placing private investment strategies in regulated funds. I aim to construct a basic portrait of how hybrid funds operate in light of the mandatory rules governing them. By situating the empirical evidence in funds' institutional and legal context, we gain a sense of how the rules actually work. For those interested in further details on the sample and dataset construction, there is a more detailed Appendix.

A. Basic Facts

I first document some basic features of BDCs, including their year of formation, state of incorporation, organizational form, and whether they are externally managed, diversified, and their tax status. For most of these features, BDCs turn out to be uniform. The vast majority of BDCs are externally managed. Almost all of them are RICs. They are mostly incorporated either in Delaware (50%) or in Maryland (47%). They are generally formed as corporations (typically, in Maryland) or statutory trusts (typically, in Delaware). Most of them declare themselves to be "non-diversified," meaning that they choose not to be bound by the SEC requirement that a fund restrict 75% of its portfolio to ten percent ownership stakes and a minimum of twenty issuers, if it markets itself as diversified.[170] There is a considerable number of mergers and closures in the BDC, tender offer, and interval fund markets. Accordingly, the number of funds operating in any one year is considerably smaller than the number of funds that have existed over the space of any five-year period.

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[168] KKR Private Equity Conglomerate LLC, Form 10, at viii, https://www.sec.gov/Archives/edgar/data/1957845/000119312523102058/d398317d1012g.htm.

[169] In brief, the definition of an investment fund requires either that an entity be in the primary business of investing in securities or that forty percent or more of its assets consist of investment securities. The conglomerate structures its ownership of portfolio companies through a series of joint ventures with other KKR entities. Each joint venture is a separate holding company, and the conglomerate is a co-general partner of each entity. As a result, the conglomerate claims, its primary business is running companies (like Berkshire Hathaway), and its assets consist largely of general partner interests. And here's the technical "gotcha" moment—general partner interests are generally not considered "securities." Michael G. Doherty, Chelsea M. Childs & Andrew G. Lawson, *An Alternative Retail Offering: "Conglomerate Vehicles" and Their Regulatory Considerations*, 31 INV. LAW. 1 (2024).

[170] Investment Company Act, Section 5(b).

Table 1. Basic Features of BDCs (N = 186)

Feature	%
Externally managed (Yes)	95%
RIC status (Yes)	95%
Diversified	2%
Non-diversified	96%
Co-investment relief	86%

B. Data

While hybrid funds are widely covered in the business press and by several commercial databases, many of their most interesting features are not covered by standard databases. As a result, I utilize data both from commercial databases and a large-scale data collection effort.

Fees

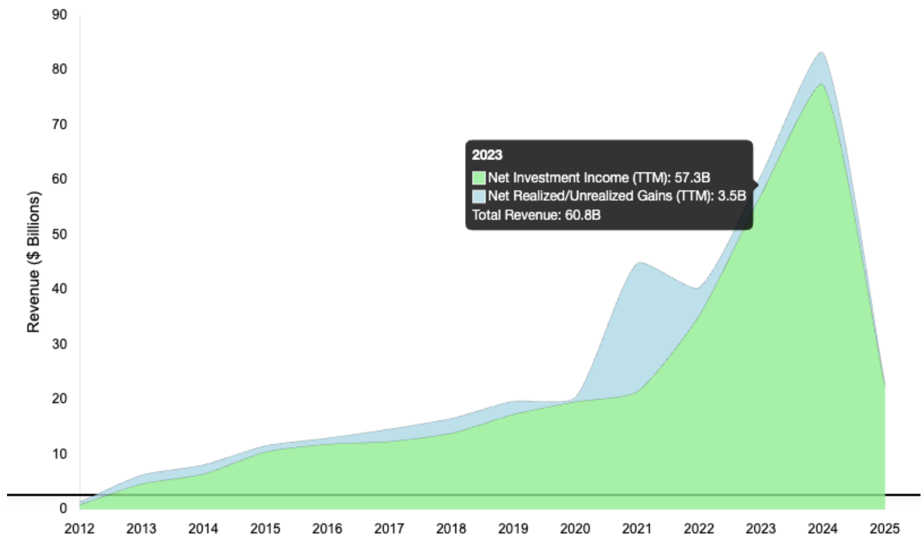
As you will recall from Part II, a central feature of fund regulation is its prohibition on performance fees based on the value of an investment portfolio. BDCs are not subject to this constraint; they are permitted to charge this kind of a performance fee as well as any other (up to a maximum of 20% of assets under value). In this section I first examine the fees typically charged by investment managers of BDCs. I collect information both on the structure of fees (where available) and the amount of accrued by funds. The results tell us something profound about how much fee regulation constrains hybrid funds.

As Table 2 shows, BDCs generally charge multiple types of fees: a management fee calculated as a percentage of assets under management and performance fees. One performance fee is based on capital gains to the fund's investment portfolio and the other is based on income directly generated by the fund's investments, like interest income on loans. Interval and tender offer funds do not impose a gains-based performance fee, but they often couple a management fee with an interest income-based performance fee. Figure 6 shows where fund revenue comes from in BDCs.

Table 2: Managers' Fees in BDCs (*N* = *116*)

	Median	Mean	25th Percentile	75th Percentile
Management Fee, BDCs (96%)	1.5%	1.4%	1.25%	1.7%
Income Performance Fee, BDCs (92%)	17.5%	17%	15%	20%
Capital Gains Performance Fee, BDCs (86%)	17.5%	17%	15%	20%

Figure 6. BDC Manager Economics



Together, the table and figure give us three key insights, which challenge the common impression that the Advisers Act flatly prohibits performance fees in regulated funds and that this prohibition is important to the industry. First, we learn that investment managers have an appetite for the kind of capital gains-based performance fee the Advisers Act prohibits. When managers can adopt these fees, as in BDCs, they are ubiquitous. Second, managers of all hybrid funds charge *income-based* incentive fees. These fees reward managers based on how much income they receive, such as income from infrastructure projects, or more commonly, income from interest payment by debtors of the fund.

Third, and most importantly, Figure 6 shows us that the vast majority of revenue to BDCs comes from *income*, rather than *capital gains*. As a result, the ban on gains-based performance fee has little bite, for now. Funds earn overwhelmingly more from investment income than capital gains. The amount funds earn from capital gains is often trivial, and even in the years when they are substantial, gains-based revenue remains a minority share of BDC revenue. As a result, the substantial majority of fee economics is the same whether or not a fund can charge a gains-based performance fee.

These findings go to whether the Advisers Act fee restraints *could* really matter. The reason the prohibition has little bite so far is that the vast majority of hybrid funds invest in private *credit*, and a portfolio of loans generates most of its revenue from interest income rather than from changes in loan value. Private credit funds overwhelmingly earn revenue—and fees—from income, rather than increases in the value of assets. Insofar as investment firms try to repackage private equity strategies in regulated funds, there is reason to think the prohibition on gains-based incentives would deter entry. Yet, the small BDC revenue from gains-based performance fees teaches an important lesson. It suggests that the prohibition on gains-based performance fees is not a decisive obstacle to retail private equity because BDCs, the largest class of hybrid fund, do not comply pursue these strategies, *even though they can and do charge gains-based performance fees*. We do not observe any genuine private equity or venture capital strategies being pursued by

BDCs. Instead, we see something far closer to private equity being repackaged in registered companies *not* subject to fund regulation, namely, the conglomerate vehicles.

It is also difficult to study how the prohibition of fees based on portfolio performance plays out in practice for hybrid funds without wanting to reimagine how fund regulation addresses fees. While the Advisers Act prohibition is often glossed as a prohibition on performance fees, it only bars incentive fees based on gains in value. The problem for Congress was that managers shared in the upside when investments prosper (interest income is high) but avoid the downside when investments fall through (interest payments are not repaid and debtors default on loans). It is true that gains in income exhibit a milder version of the asymmetry that Congress bemoaned in the fees they banned ("tails I win, heads you lose"). The more striking anomaly is that while BDCs and interval or tender offer funds invest in the same assets, raise capital from the same investors, and are managed by the same advisers, BDCs can offer any kind of performance fee, while the other hybrid funds cannot.

Leverage. As explained in Part II, registered funds are subject to strict leverage restrictions. Closed-end funds like interval or tender offer funds are limited to 300% asset coverage (and 200% asset coverage for preferred stock). BDCs are subject to 150% asset coverage (200% before 2018). If a fund falls below these limits, it incurs serious consequences, including a bar against making any dividends or incurring any further indebtedness.

These requirements are mandatory and facially a compelling candidate for a constraint on hybrid funds. In this section, I will explore the evidence for whether that is the case. Following the Federal Reserve and other scholars' approach to estimating fund leverage,[171] I estimate asset coverage ratios and leverage through funds' disclosures of their total assets and total debt. As a result, I can estimate the distribution of funds' asset coverage ratios, and more generally, the extent of their on-balance sheet leverage. For interval funds, I use a customized python program to download each fund's annual N-CEN disclosure. I extract total assets and total liabilities from these filings and calculate asset coverage from them. For BDCs, I use the total asset and liability numbers provided BDC Collateral, which they source from BDC filings.

The first thing to clarify is that while private equity is synonymous with leverage, the principal way in which private equity funds make use of leverage is by causing *target companies* to incur indebtedness as part of financing the funds' purchase of the company (hence the use of the term leveraged buyout).[172] The leverage occurs at the level of the portfolio company, rather than at the level of the fund. The limited empirical evidence available for leverage across private equity exempt funds suggests extremely light use of leverage for the industry as a whole.[173] Indeed, across the entire private fund industry as a whole, only a tiny portion of assets are held

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[171] See Empirical Appendix p. 3 for details.

[172] Steven N. Kaplan & Per Strömberg, *Leveraged Buyouts and Private Equity*, J. Econ. Persp. 121, 124-25 (2009) (describing how private equity buyout transactions are financed by 60 to 90 percent debt).

[173] Private Funds Statistics 2024 Quarter 4 Report, Table 2.9 of pg. 8 (reporting that private equity and venture capital funds use leverage equal to approximately 0-5% of fund gross asset value).

by funds that incur a high degree of leverage.[174] Even the limited leverage used by private equity funds is in significant due to the last few years, when fund-level indebtedness has increased.[175]

As Figure 7 and 8 show, hybrid funds maintain asset coverage significantly in excess of their regulatory mandates, but the extent of asset coverage varies enormously. The Appendix provides a time series for interval funds.[176] BDCs, in particular, incur significant leverage. Like fees, the leverage requirements have not proved to be a binding constraint on the emergence of private markets strategies in regulated funds, but they are likely to be an industry pain-point with regulatory costs worth exploring further in future work.[177]

Figure 7. Tender Offer Fund Leverage

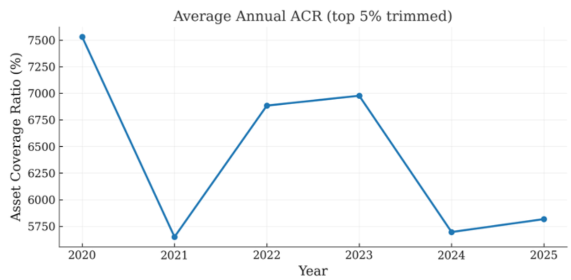
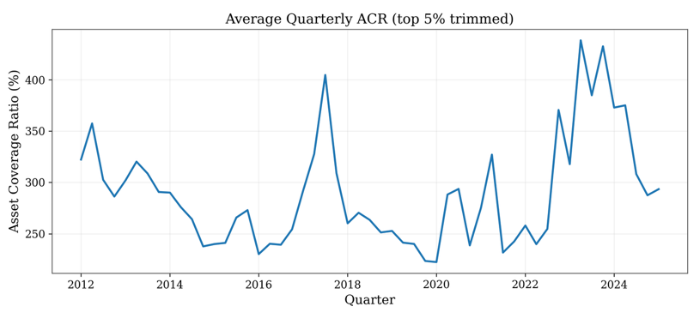


Figure 8. BDC Leverage



The bottom line is simple. The Company Act's restrictions are a friction, but far less limiting than they might have seemed. The basic reason is that they limit indebtedness at only a

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174 *Id*. at Table 2.11. Here, I am thinking of high leverage as requiring a leverage ratio of at least 1. Only a trivial portion of all private fund assets are held by a fund with a leverage ratio above 1.
175 Baker, Colleen M., *Net Asset Value Financing and Private Equity*, 171 U. PA. L. REV. ONLINE 45 (2024).
176 I trim the top five percent of observations per quarter to reduce skew of the average due to high outliers.
177 Leverage could be further studied through a bunching analysis, although a full implementation of such an approach—along the lines of recent work on the securities laws—would easily take up its own paper. Michael Ewens, Kairong Xiao &, Ting Xu, *Regulatory Costs of Being Public: Evidence from Bunching Estimation*, 153 J. FIN. ECON. 103774 (2024); Dhammika Dharmapala, *Estimating Firms' Responses to Securities Regulation Using a Bunching Approach*, 24 AM. L. & ECON. REV. 449 (2022). The idea of bunching is that if a regulation is costly to comply with firms will cluster below the regulatory threshold. As Ewens, Xiao and Xu describe bunching in the context of disclosure mandates based on public float, the "central insight of this approach is that more bunching by public firms to avoid financial regulation implies higher regulatory costs." Michael Ewens, Kairong Xiao &, Ting Xu, *Regulatory Costs of Being Public: Evidence from Bunching Estimation*, The CLS Blue Sky Blog, Jan. 8, 2021. An important lesson from the bunching literature is worth emphasizing here: The extent of bunching is not a sufficient statistic for understanding the costs of complying with fund regulation because the costs a fund incurs in managing its asset coverage ratio are not observable. *See* Dharampala, *id*. Nonetheless, both the average level of leverage and the distribution of leverage is inconsistent with asset coverage acting as a binding constraint on hybrid funds.

single *level*, namely, a fund's own on-balance sheet borrowing. Off-balance sheet borrowing is not counted against a fund's regulatory leverage limits. A fund's portfolio companies' borrowing does not count against the fund's leverage, nor does the leverage of a fund's debt financiers. By imposing a restriction at only point in a financial supply chain, the Company Act fails to effectively limit the amount of leverage to which an end-investor is ultimately exposed.

Affiliated Party Transactions

As Part I explained, fund regulation takes an extremely broad approach to potentially conflicted transactions, prohibiting direct transactions between affiliated parties as well as transactions affiliates engage in jointly. Informally, one can think of 17(b) as banning transactions where affiliates sit across from each other at the bargaining table and 17(d) as banning transactions in which two affiliates sit beside each other, across from some third (or also affiliated) party.

The most powerful evidence for the mandatory reach of Section 17 lies both in how the industry operates today and how it does not operate. As mentioned earlier, the SEC has basically evolved toward granting liberal exemptive relief regarding horizontal conflicts, in which two affiliated funds engage in related party transactions, but not vertical conflicts involving funds and their portfolio companies. I begin with the most prominent form of horizontal conflict, namely, co-investment, where two or more investment funds managed by the *same adviser* invest in the same operating company.[178] If two different KKR funds both make loans to Mid-Size Company LLC, that's co-investment. I present new evidence that co-investment not only occurs, it is pervasive. The industry only has something like its current shape—characterized by pervasive co-investment—because the SEC has aggressively expanded its exemptive approach. However, the SEC has not exempted transactions between funds and their affiliated companies, which thus remain unlawful. Indeed, what we see so far is the absence of anything like a traditional private equity strategy repackaged in a regulated fund.

Co-investment. A substantial amount of industry commentary and regulatory energy has been focused on co-investment.[179] Without exemptive relief, co-investment is clearly prohibited under Section 17(d) as a forbidden joint transaction. Yet there is no place in the regulatory practice around Section 17 where such a marked evolution has occurred as on co-investment.[180]

Private equity firms argue that by investing in the same companies as their private funds, hybrid funds obtain the same quality deals, ensuring attractive investor outcomes and mitigating

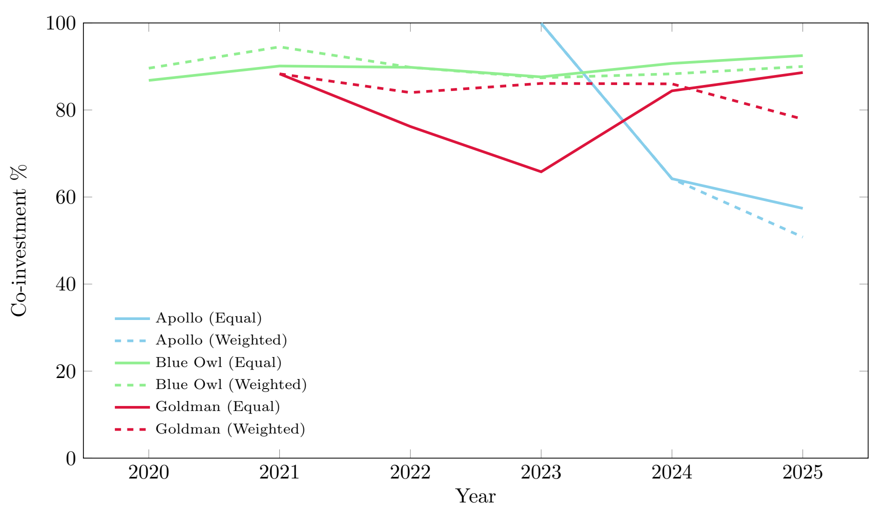
[178] This is distinct from the common use of the term "co-investment" to refer to investment by a limited partner in a company alongside a private equity fund.
[179] See, e.g., SimpsonThacher, *The Evolution of Co-Investment Exemptive Orders and Why They Should Become Extinct* (2018).
[180] Section 17(d) prohibits two funds of the same manager from investing in the same company, absent particularized exemptive relief. The seminal *MassMutual* no-action letters carved out the narrowest of exceptions, permitting two funds to co-invest on identical terms if no term beyond price was negotiated. Massachusetts Mutual Life Insurance Company, SEC No-Action Letter (Jun. 7, 2000); Massachusetts Mutual Life Insurance Company, SEC No-Action Letter (Jul 28, 2000). Your typical private markets investment with myriad bespoke terms remained completely barred. Since then, the SEC has substantially broadened what is permitted under the provision, while still maintaining a long-list of formalistic conditions and requirements that restrict various forms of co-investment.

the important adverse selection concerns associated with broadening access to private markets to retail investors. Because co-investment involves investment by a hybrid fund alongside an affiliated fund, the other fund may be another regulated fund, but it will also commonly be a private fund. The largest commercial databases for private funds do not systematically collect data with sufficient granularity to make private funds' investments—part of the "dark matter" of corporate finance—transparent. As a result, systematically determining the extent of co-investment across the whole industry is impossible.

I first document the incidence of exemptive relief involving co-investment. Without particularized relief, co-investment is prohibited under Section 17. Thus, if an entity wishes to engage in it, it must be covered by a current exemptive order issued by the SEC. How common are these orders? It turns out *the entire industry is covered by them*. By the latest year for which we have a filing, 92% of unique BDCs are covered by an exemptive order permitting co-investment.

How much co-investment actually occurs? Discussions with lawyers practicing in the space suggested that it might be impossible to get any traction on the question beyond anecdotal impression that the practice was commonplace. However, I observed that a number of major fund advisers voluntarily disclose in their BDCs' securities filings whether an investment was made pursuant to exemptive relief for co-investment at the level of each individual investment security. For these advisers, which are Apollo, Goldman, and Blue Owl, I reconstruct their BDCs' investment portfolios for the last five years and track the percentage of investments and total portfolio value representing co-investment. The results are striking. Co-investment is pervasive in the industry, constituting a supermajority of these major advisers' investments. Without the exemptive relief offered by the SEC, most of what these BDCs invest in would have to differ dramatically.

Figure 8. Adviser Co-investment Percentage Over Time



On the other hand, the SEC has not signaled a willingness to permit conflicted transactions between funds and their portfolio companies. So what do we do not see in the world of hybrid funds? Simply put: true private equity strategies in which a fund purchases majority stakes in private companies, places principals on their boards, and directs and participates in transactions over the lifecycle of that portfolio company. An observer of the industry might be surprised. There are dozens of hybrid funds marketing themselves as “private equity” and “venture capital.” What I can report is that after combing through their filings I find the label misleading. What these funds do is purchase interests in private equity funds, or passive stakes in private companies, or secondary market positions in the largest unicorns. A careful reader of each filing’s fine-print would know what they’re doing; everyone else might be misled.

Governance. Recall that the Company Act requires that 40% of the directors on the board of a registered fund be independent (i.e., “not interested” persons), and that BDCs must have at least 50% independent directors.[181] In ordinary companies, legislation requiring independent directors on corporate boards has been a major policy ambition for regulators and the object of both heated praise and criticism from academics.[182] A natural prior would be that board independence requirements would deter or prevent the emergence of regulated private funds. It is a central mandatory rule of the Company Act and goes, it would seem, to the heart of how these funds are governed and controlled. And it is plausible that private funds need to operate differently than regulated funds. It is certainly a major stylized fact about the private equity and venture capital industries that they routinely place fund principals on the boards of the companies they invest in.[183] Just as you might expect a prohibition (or limitation) of PE fund participation on the boards of portfolio companies to have real bite, you might have the same expectation for fund boards.

What happens in practice? Table 3 shows that each type of hybrid fund has a *supermajority of disinterested directors*—an average of 70-80% of directors on the board are disinterested, depending on the type of fund.[184] For interval and tender offer funds, details on the composition of the board are reported in Form N-CEN filings. As a result, I am able to directly observe the size of funds boards and the number of disinterested directors. For interval funds, between 2018-2023, there is an average percentage of disinterested directors ranging from 76-79% (N = 573).[185] For interval funds, between 2018-2023, there is an average percentage of disinterested directors ranging from 72-80% (N = 554). (Untabulated medians are approximately identical.) BDCs do not report these details systematically in their filings, but I find that applications for exemptive relief with the SEC frequently include them.[186]

Table 3. Board Independence in Hybrid Funds

Fund Type	Average Disinterested
Interval Funds (N = 573)	77%

[181] 15 U.S.C. § 80a-2(a)(19). The availability of a number of popular exemptions requiring higher numbers turn a majority into a de facto required number.
[182] For an overview of the debate and a nuanced expression of skepticism about it, *see* Michael Klausner, *Fact and Fiction in Corporate Law and Governance*, 65 STAN. L. REV. 1325, 1357-62 (2013).
[183] Ronald Gilson & Jeffrey Gordon, *Board 3.0: An Introduction*, 74 BUS. LAW. 350, 359 (2019) (describing the paradigmatic board of a private equity portfolio company as staffed by a supermajority of representatives of the private equity firm, the portfolio company CEO, and one outsider).
[184] These are high percentages for independent directors, but consistent with industry norms for other types of registered funds. See INV. CO. INST., *Overview of Fund Governance Practices* (1994-2022). *See* Krug, *supra* note 91.
[185] For further details, see Appendix p. 4.
[186] *Id*.

Tender Offer Funds ($N = 554$)	77%
BDCs ($N = 29$)	73%

What's going on? The key point to appreciate is that fund boards differ dramatically from corporate boards. In an operating company, the board of directors is the ultimate legal authority, it appoints the senior executives, and it participates in high-level operational and legal decisions. Requiring directors to be independent of a controlling shareholder or of senior management thus has real bite. A fund's board, in contrast, does not manage a fund. The adviser does. Most funds have no employees; every decision about investing is made by the manager. Instead, fund boards are compliance institutions, which approve material contracts and ensure the fund abides by the large number of regulatory mandates imposed on it.[187] While the board does have a fiduciary responsibility to review the advisory contract, terminations are extraordinarily rare. As a result, the managers of hybrid funds, which actually make the fund's major investment and operational decisions, are comfortable with independent directors staffing their hybrid fund boards.

Disclosure

There is no part of fund regulation where the emergence of hybrid funds so sharply reverses the burden of proof as with disclosure policy. A natural prior would have been that disclosure poses a powerful deterrent to "regulated PE."[188] Yet hybrid funds are subject to exacting disclosure regimes and seem to operate comfortably under them.

The institutional context of hybrid funds means they are actually subject to multiple, overlapping but distinct disclosure regimes. Interval and tender offer funds are governed by the mandatory disclosure rules generally applicable to closed-end funds. Their registration filing, Form N-2, as well as periodic filings, Form N-CSR, Form N-CEN, and Form N-PORT, all turn out to be important sources of information that I utilize in studying their operations. Closed-end funds must provide their investors with narrative-form discussion of their operations and finances; with census-like data on the identity of their directors, structure, and investments; and quarterly public disclosures of their investment portfolios, respectively.

Yet the information in these disclosures is still more limited than what we learn about BDCs, which file the 8-Ks, 10-Ks, and other periodic filings applicable to registered issuers under the Securities Acts. BDCs probably provide the most detail regarding their operations and investments. Yet, in further evidence of disclosure's limited bite, BDCs are the *most popular* form of hybrid fund. Why does disclosure not deter regulated funds from investing in private markets? The reason why lies in the systematic difference between the activities of private equity and venture capital funds and the funds that invest primarily in public markets. In particular, what is important is how easy it is to replicate a fund's investment thesis based on funds' quarterly disclosures. Traders in the stock market fear the revelation of their information because it is easy to imitate a trade. A trader building a large position would rather conceal her purchases from the market to avoid other traders' adjusting their behavior in real time. It is easy to imitate trading

[187] INV. CO. INST., *supra* note 184.
[188] See, e.g., Merritt B. Fox, *The Issuer Choice Debate*, 2 THEORETICAL INQUIRIES L. 563 (2001).

strategies in the stock market since other traders can buy the same fungible stock at the same prices (until the market moves).

The situation is dramatically different when it comes to the activities of private funds or private markets. The key difference is that a private equity or venture capital fund engages in negotiated, primary market transactions, while a hedge fund or informed mutual fund will typically engage in anonymous, secondary transactions. The private equity or venture capital fund forms a relationship that leads to an investment and then holds illiquid securities as a result. It typically has a minority to controlling ownership position. Revealing that position has consequences, but it does not enable a different investor to imitate its exact investment.

There are surely more indirect consequences. Disclosure plausibly has its greatest bite when there is significant proprietary value to the information revealed by the disclosure. This could be because there is an enormously profitable line of business into which competitors could enter, or a profitable trading strategy that competitors could enter. In broad strokes, private market fund investments are less prone to these kind of immediate, market-timing concerns. Funds are operating in a *relationship-driven primary market*, rather than an anonymous, liquid trading market. Further, many of the concerns associated with private fund disclosure are absent from hybrid funds. In private funds, advisers often fear disclosure because of investor-specific fee deals and side-arrangements. Hybrid funds' uniform fee structures mean this is not a concern.

In any event, ample room for further research exists. In particular, an immediate question of policy interest would be whether investment funds, like BDCs, that are subject to graduated disclosure requirements based on public float "bunch" below regulatory thresholds, and how the degree of any bunching compares with what is observed in public companies.[189]

C. Taking Stock

In this section, I diagnose the current state-of-play in order to draw lessons about how fund regulation works and whether it needs reform. Scholars and practitioners of the Company Act have generally treated its mandatory rules as decisive forces in shaping fund behavior. Descriptively, the impact of many of these provisions has been overstated. The reasons for this are a combination of unimportance, ease-of-evasion, and market-mimicking.

The prohibition on performance fees is easy to evade since it only applies to one way of measuring performance--essentially, carried interest--and not more broadly. Because most hybrid funds are private credit funds, it is also close to "market-mimicking" right now, since those funds are driven by the economics of interest income. The leverage restrictions and governance requirements are less important than they seem because they do not apply to the *level* at which real decisions are made, or real leverage is incurred. Think of a fund as midway in a financial supply chain. The fund is controlled by its investment adviser, who decides how the fund invests. The fund then takes investment positions in companies. For governance, the important decisions are made at the *adviser level*. The investment manager is ultimately deciding on investments, and the *fund's* directors have little ability to negotiate or even understand the investment landscape facing the adviser. For leverage, it's at the level of *portfolio companies* that major indebtedness

[189] Dharmapala, *supra* note 177; Ewens et al., *supra* note 177.

is incurred. Portfolio company leverage affects the risks affecting end-investors and the financial system as a whole, but it is not regulated by the Company Act. Disclosure is less important to private funds than it seemed because funds engage in privately negotiated, customized transactions with firms. They are not competing in an anonymous market where their investment strategies can be immediately copied.

On the other hand, Section 17 illustrates how the Company Act can impose regulations with real bite. Section 17 does not limit itself to one level. It defines "affiliate" liberally to go deep upstream and downstream, and the conflict rules apply to interactions between any part of that chain with a regulated fund. As a result, the rules are far-reaching and difficult to evade. That's an important lesson for regulators interested in designing rules with real bite. Of course, the very reason that the rule is important is the reason it has come under heavy criticism from the hybrid funds industry. Some of the criticism is apt. The rule is overly broad since it facially bans all related party transactions, and when exceptions are made, they are done in a costly, time-consuming, and ad hoc process. Yet the alternative the industry favors, and which the SEC increasingly favors, is even worse. I will discuss this more below.

A contrast here could be useful. Scholars of corporate law may remember that Bernie Black once asked, "Is Corporate Law Trivial?"[190] Black argued that while on its face, corporate law has mandatory rules, they are largely a mirage, because corporate law does not prevent companies from adopting any governance rules they could reasonably want.[191] For Black, it was clear that he believed the descriptive triviality thesis and found it normatively attractive. Corporate law was trivial, and it should be. Neither proposition is true of me. In the end, fund regulation is looser than it seems, but it still has real bite. As importantly, I do not find the ease of circumventing it attractive. Rather, I take it to be an occasion for rethinking how a more effective regulatory regime would work.

So how should we think about fund regulation in light of the new evidence? The Company Act imposed rules because Congress in 1940 saw problems in the fund industry. The avoidability of the statute's rules is only undesirable if Congress saw problems that were real and that remain with us. The question then is whether Congress was right. Are there problems in fees, fund-level governance, or opportunism, which justify these rules? Are there problems Congress missed that now justify additional rules or a new approach to fund regulation? Answering these questions is a whole agenda, but there are good reasons to think that if you are going to begin in one place, the most important issue to address is conflicts of interest.[192]

IV. Reimagining Fund Regulation

[190] Bernard S. Black, *Is Corporate Law Trivial? A Political and Economic Analysis*, 84 NW. U.L. REV. 542, 549 (1990).

[191] *Id*. As this project progressed, Bernie's paper surprisingly came to mind. Fund regulation, which seems to be a heartland of mandatory financial regulation, turned out to be more facilitative, less inhibiting, and more complicated than it had appeared. The issue of whether fund regulation's mandatory rules shape fund behavior merits close attention, even if the answer to the question of triviality is ultimately "no."

[192] Rethinking fund regulation of course does not start on a blank slate. See, e.g., Jeff Schwartz, *Reconceptualizing Investment Management Regulation*, 16 GEO. MASON L. REV. 521 (2009). For an illustration of hesitant critique of the Company Act's leverage restrictions, see Morley, *supra* note 102. On the other hand, the slate has a lot of blank space on it.

Better understanding the constraints that fund regulation actually imposes has important positive and normative implications. Without it we will ask the wrong questions and often take one policy lever to be influential, when it is actually of little consequence. It should also motivate us to return to the foundations of fund regulation and guide us in improving and reforming the regulation of funds.

Indeed, an important implication of this paper's analysis is simply to clarify what about fund regulation matters. Studying how it applies to hybrid funds helps us to see which rules genuinely constrain their behavior. We can dedicate our attention and reformist impulses toward the rules that matter most. It also leaves those interested in fund regulation with a research agenda of key topics, including the structure and regulation of fees, leverage, and conflicts. Understanding which rules matter is an important baseline for further discussion. I focus here on what I view as the single most important rule, Section 17.

A. *Assessing the Status Quo and Its Leading Alternative*

Opportunism by powerful insiders is a pervasive and difficult problem in business and finance. Arguably, it is *the* defining problem for corporate law.[193] In many ways, the investment funds industry only ups the ante for the number and intensity of conflicts.[194] My study of hybrid funds shows that fund regulation's approach to these conflicts powerfully shapes the industry. Where fund regulation permits certain kinds of conflicted transaction, such as co-investment, they can easily become the norm. Where other forms of conflicted transaction remain prohibited, the industry may fail to develop at all because its economics require related-party transactions. Indeed, it would require a dramatic upheaval in how the SEC applies Section 17 to permit anything like the current practices of private equity funds.

In this section, I seek to rethink from first principles how the law should address opportunism in investment funds. To someone interested in corporate governance, there is something satisfying about seeing that the central concern of corporate governance—opportunism by powerful insiders—is also the central concern of fund regulation. Indeed, as many have noted, investment funds just ratchet up the scale and intensity of conflicts.[195] The private equity firm Apollo pursues private credit strategies through dozens of funds, including both private and regulated funds. Every time Apollo encounters a promising lending opportunity, it is potentially attractive to each of those funds. While Apollo owes a distinct fiduciary duty to each fund, it also faces conflicting incentives, as each fund's investor base, returns, term, and fees differ. Apollo faces a sharp conflict over how the investment should be allocated.

In this section I will begin by sketching the key normative ambitions for addressing opportunism in funds. I will then argue that the SEC's current approach is deficient, but that the

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[193] John Armour, Luca Enrique, Henry Hansmann, & Reinier Kraakman, *What Is Corporate Law?* 23 *in* THE ANATOMY OF CORPORATE LAW (eds. Reinier Kraakman et al, 3d ed.).
[194] Morley, Separation, *supra* note 39, at 1262 ("conflicts among funds in investment management companies are completely pervasive. They are far more common than in ordinary companies and indeed far more common than anyone seems prepared to acknowledge.").
[195] See, e.g., William A. Birdthistle, *Investment Indiscipline: A Behavioral Approach to Mutual Fund Jurisprudence*, 2010 U. ILL. L. REV. 61, 70–83; U.S. SEC. & EXCH. COMM'N, DIVISION OF INVESTMENT MANAGEMENT, PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION 253–73 (1992).

proposed alternative favored by private equity firms has even greater shortcomings. Where to go then? I will suggest a few different policy paths, all of which improve on the status quo and its leading alternative.

Let's start with the basic problem of conflicts and the normative stakes for regulating it. The basic problem is the same as in corporate law, although funds increase the scale and pervasiveness of conflicts. The problem of opportunism arises because insiders exercise vast discretionary power over shared resources, and they can use that power to serve their own interests, rather than those of investors generally. Yet it is undesirable to simply ban all transactions in which an insider has different interests than that of the firm because many of those transactions are efficient and desirable. Sometimes the best director for your company already serves on another company's board; the cheapest supplier for your company is owned by a director; or the best source of funding also invests in your competitors.[196] The basic problem is thus to filter related party transactions, permitting the efficient ones and precluding the opportunistic ones.

Consider a few simple illustrations of transactions that Section 17 treats as conflicts. In Exhibit A, Apollo has two private funds that engage in private credit. Both funds are at the high-end of the PE market, with sophisticated institutional investors. Apollo has also formed a private credit BDC with cheap capital because it can raise public money. Apollo, we can imagine, has strong incentives to manage it well so that Apollo can maintain its access to cheap retail capital. So when attractive large lending opportunities arise, Apollo has its BDC invest on the same terms in the same loans as its private funds. This co-investment is clearly a conflict transaction forbidden under Section 17, absent exemptive relief. Yet you can see why it might be efficient for Apollo to utilize economies of scale across multiple funds to make these loans, and that it serves all its investors equally. In Exhibit B, Apollo has those same two private funds invest in a different company. The company is struggling, but Apollo wants to ensure an attractive exit for those private funds, so it has its BDC (with its apathetic public investors) make a huge new loan to the company, bailing out the private funds at the regulated funds' expense. This is a conflict too, and an opportunistic and inefficient one. The problem about conflicts is that the managers of large enterprises exercise enormous discretion over shared resources; their incentives are often conflicted; but many of those conflict transactions are still desirable.

Or think of "vertical" related party transactions between Apollo's funds and the companies they invest in. Imagine that three Apollo funds have acquired a large Northeastern dental practice and is planning to merge them with other practices in the area, in order to operate the group as a larger and more efficient enterprise. Typically, the portfolio companies will take on new debt to finance the acquisitions and Apollo's funds will contribute new equity. This would be a forbidden related-party transaction multiple times over, but it is also standard practice for private equity.[197]

That's the basic problem, so how should corporate law tackle it? It offers two main paths: Conflicted transactions can be tried ex post in court on the merits of their fairness, or informed

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[196] Gabriel Rauterberg & Eric L. Talley, *Contracting out of the Fiduciary Duty of Loyalty: An Empirical Analysis of Corporate Opportunity Waivers*, 117 COLUM. L. REV. 1075, 1075–1143 (2017).
[197] Bain & Company, Inc., *Global Private Equity Report 2019* 38–41 (2019).

and disinterested decision-makers can approve the transaction ex ante (typically, the disinterested parties come from the board, shareholders, or both). The difficulty of the problem facing fund regulation will become clear when we appreciate not only how many conflicts there are, but that these options are not available to funds.

An ex post strategy is extremely implausible. The scale, intensity, and pervasiveness of conflicts mean that managing them by litigation would not only prove far too costly, but require enforcement when neither the SEC nor shareholders possess the relevant information. Making conflicted decisions is part of the daily life of investment managers investing in private markets. Yet the SEC almost never brings actions to enforce advisers' fiduciary duties.

It is more illuminating to think about the second strategy, which is increasingly favored by corporate law, namely, approval by informed and disinterested decision-makers. In a sense, that is where the SEC's approach is currently tending, and it is emphatically where the private equity industry would like it to go. So let's turn to the current SEC approach and whether it is a satisfying or stable one.

As a matter of administration, the current process has the arguable advantage of still being fairly restrictive, but it is also inconsistent, time consuming, and opaque. The SEC has granted more permissive co-investment overtime, meaning that newer applicants operate under a more expansive regime than older ones. Yet there is no formal guidance as to what is or will be permissible or what the SEC will demand or reject. SEC staff enjoys enormous discretion over what to permit, and the staff engages in highly discretionary review.[198] What is permissible is just what the most aggressive current applicant has gotten away with. This leads to prolonged negotiations with staff over creative new applications that can last literally for years.[199] The exemptive process is also unattractively ad hoc and applicant-specific. When it produces uniformity, it is only because an army of applicants copy-and-paste the most recently approved conditions into a new set of applications.

The central problem with the current approach, however, is not the administrative shortcomings, though they are real. It is the lack of a principled standard for guiding the SEC's increasingly permissive approach. What has happened to Section 17 overtime is its progressive, sometimes lurching liberalization, without any determinate standard guiding that evolution. It is not just a matter of the SEC failing to explicitly define its goal; it is unclear what the implicit philosophy guiding broadened relief is or could be. Unlike Delaware's courts, the SEC does not rely on open-ended, often equitable standards like good faith, negligence, or loyalty to define its analysis. Instead, it relies on lists of formalistic conditions micro-managing how potential conflicts are reviewed. In its text, Section 17 imposes bright-line prohibitions on a huge number of potential conflicts, but with a safety-valve of exemptive relief. As relief becomes the rule rather than the exception, it becomes unclear what the SEC would like regulated funds' approach to conflicts to be.

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[198] These latter deficiencies roughly parallel some of the drawbacks of the SEC's prior exemptive regime for ETFs, criticized in Henry Hu & John D. Morley, *A Regulatory Framework for Exchange-Traded Funds*, 91 S. CAL. L. REV. 839 (2018).

[199] For instance, the *FS Global* approach that represents the current state-of-play for co-investment was first proposed over six years ago.

What *is* clear is the philosophical end-game for the industry and that the current political economy leaves the wind at their back.[200] The extremely technical, formalistic, and opaque nature of the current legal regime hides this basic fact. That end-game is making disinterested director approval the only thing necessary to permit conflicted transactions.

Over a trajectory of several decades then a switch between two major paradigms for addressing funds conflicts is becoming visible. Fund regulation began with an extremely strict paradigm: prohibition of a capacious set of potentially conflicted transactions. Now a second paradigm beckons: disinterested director approval. In corporate law, this approach has many admirers.[201] But this approach is vastly less satisfying when applied to investment funds.

Simply put, external management causes disinterested fund directors to be completely outmatched by the scope of the conflicts facing them. First, external management causes the scale of potential conflicts to expand exponentially.[202] A private equity firm manages a fleet of separate funds. Distinct funds routinely invest in the same companies; investment opportunities are routinely applicable to multiple funds; and in the case of evergreen funds, these conflicts are ever-present. Conflicts are the rule, not the exception. Second, investment fund boards are not like operating company boards.[203] They do not make high-level decisions about how a fund should conduct its business beyond renewing (or in principle, terminating) the advisory agreement. Funds have no employees. Every investment decision is made by the adviser. Third party suppliers are hired by the adviser. As a result, the directors of fund board, however great their good faith and personal commitment, cannot hope to substantively second-guess or negotiate the fairness of transactions, like an operating company board.[204]

Return to corporate law's two basic approaches to opportunism: ex post litigation and ex ante approval by disinterested decision-makers. Litigation is an extremely implausible response for funds. Conflicts are a constant of funds' lives, not an exception. The SEC could not possibly attempt to oversee decision-making at the relevant level, and private litigation would face the extreme difficulty of detecting where conflicts were opportunistic. Decision-making by independent directors at the fund level is pursued, but as I argued above, amounts to little. Corporate law's basic approaches to managing opportunism—ex post enforcement or entity-level impartial decision-makers—thus will not work in funds. Replacing Section 17's traditional prohibitions with disinterested director approval would replace an approach to conflicts in funds that is considerably stricter than corporate law with an approach that is considerably weaker.

B. *Reimagining How We Address Opportunism in Funds*

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[200] The basic idea has been floated for a long time. See SEC. & EXCH. COMM'N, PROTECTING INVESTORS: A HALF CENTURY OF INVESTMENT COMPANY REGULATION, REPORT OF THE DIVISION OF INVESTMENT MANAGEMENT, SECURITIES AND EXCHANGE COMMISSION xvii (1992).

[201] Zohar Goshen, Assaf Hamdani & Dorothy S. Lund, *Fixing MFW: Fairness and Vision in Controller Self-Dealing*, ECGI Law Working Paper No. 818/2025.

[202] See, e.g., Morley, *Separation*, *supra* note 39.

[203] Eric D. Roiter, *Disentangling Mutual Fund Governance from Corporate Governance*, 6 HARV. BUS. L. REV. 1 (2016); see also MICHAEL S. BARR, HOWELL E. JACKSON & MARGARET E. TAHYAR, FINANCIAL REGULATION: LAW AND POLICY 1060-65 (2D ED. 2018).

[204] And it's worth noting that conflicts of interest in the OpCo's *are* subject to the ordinary law of business associations.

Is there another way out?[205] I don't think there is a magic bullet, and developing a full approach to regulating opportunism requires first agreeing on all of the objectives fund regulation should serve—a task beyond the scope of this paper. What I hope to do in this section is develop a range of possibilities with greater economic and institutional plausibility than the alternatives on the table. It's worth saying, however, that I aim to intervene in the current policy debate, rather than reimagine how fund regulation should ideally work. In the realm of political possibility, I sketch what I think would be a better path than the one the SEC is on or that the private equity industry favors.

My main proposal is that regulated funds should turn to the best functioning parts of *private markets* to look at how they have addressed the problem of opportunism. Private funds sharply raise the problem of opportunism, but top-down regulation is absent.[206] Neither state organizational law, nor investment fund regulation play a major role in structuring the relationships among private equity funds, their investors, and portfolio companies. The private equity market is vast, and so there are dysfunctional portions of the market with few positive lessons for public markets. However, at the high-end of the private equity market, the best-established private equity firms bargain with large, repeat private equity investors. These investors, like CalPERS or the Canada Pension Plan Investment Board (North America's largest private equity investor), have significant bargaining power and negotiate contractual bargains that manage the joint interests of the parties.[207] Here, sophisticated limited partners and private funds developed a range of private ordering devices that plausibly manage the risks and benefits of related party transactions. They rely on a number of contractually-designed governance devices at both the fund *and adviser* level as well as the design of ex ante *economic incentives*.

This market has generated two promising governance devices for managing opportunism. One is to relocate fund regulation's emphasis on approval by disinterested decision-makers to a

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[205] One very modest change is not worth mentioning in the main text but would still improve the status quo. The current approach to Section 17 could be reduced to a rule but otherwise not seriously changed. It is, even by the most pro-regulatory standards, extremely broad in the scope of affiliates it reaches and the set of related-transactions it prima facie proscribes. A rulemaking that codified and modestly extended current exemptive practice would represent a significant improvement over the status quo simply by abandoning the piecemeal approach of requiring particularized applications for what in effects turns out to be time-consuming and costly standardized relief anyway.

[206] The private funds market does not rely on direct regulation. The limited amount of SEC oversight that exists is implemented through SEC oversight of advisers as an indirect means of overseeing their funds. The SEC does conduct examinations and occasional enforcement actions regarding advisers' fiduciary duties. Joseph A. Franco & Karl-Otto Hartmann, *Investment Management Regulation: An Introduction to Principles and Practice* CH. 6 (2019). My set of suggestions is different from John Morley's illuminating suggestion that the basic ways in which funds structure their affairs is likely to reflect a deep economic logic concerning their conflicts. Morley, *supra* note **Error! Bookmark not defined.**, at 1264-65. So, Morley suggests, we see that hedge funds and private equity funds address conflicts in quite different ways, which he interprets as reflecting their distinct exit rights. I don't view the private markets solution to conflicts as arising specifically from how they address conflicts, but rather from the broader way in which they align advisers' interests with fund investor interests. Especially in the context of hybrid funds, I do not think the efforts by advisers to restrict employee activities are likely to make a decisive difference.

[207] Jason Kelly, Anne-Sylvaine Chassany & Sabrina Willmer, *Blackstone Discounts for CalPERS as Fee Fight Fuels Custom Deals*, Bloomberg (May 9, 2012, 10:29 PM EDT), https://www.bloomberg.com/news/articles/2012-05-09/blackstone-discounts-for-calpers-as-fee-fight-fuels-custom-deals.; see also Josh Lerner, Antoinette Schoar & Jialan Wang, *Secrets of the Academy: The Drivers of University Endowment Success*, 72 J. ECON. PERSP. 3 (2008). For instance, the Institutional Limited Partners Association (ILPA) proposes standardized terms that it finds congenial to the interests of PE investors. Institutional Limited Partners Association, *ILPA Model Limited Partnership Agreement* (Aug. 2019), https://ilpa.org/model-lpa.

level that is closer to real bargaining power and decision-making. As I have argued, directors of a fund lack the leverage or expertise to actively oversee, negotiate, and reject conflicted transactions. Directors of an *adviser*, like KKR itself, enjoy considerably more power and expertise. An important part of reenvisioning the regulation of opportunism is to consider placing control over a private equity firm's conflict of interest policy in the hands of independent directors of the firm itself. Some leading private equity firms already do this. Blackstone's investment management firm has a board of directors with a conflicts committee,[208] which is charged with overseeing the review and approval of related person transactions, and the members of which are independent.[209]

Private equity funds have developed another private ordering mechanism for addressing conflicts of interest, known as the "limited partnership advisory committee" or "LPAC."[210] The LPAC consists of a number of relatively large outside investors in the fund. When significant conflicts arise, the adviser is required to disclose all material facts concerning them to the LPAC, which has the power to negotiate, approve, or rejected the conflicted transaction. It may seem like an LPAC for hybrid funds is fanciful, because ordinary investors would staff it. This need not be the case though. Almost all hybrid fund investments are made through financial advisors, and the LPAC could be staffed by representatives of those advisors (Morgan Stanley and Charles Schwab), rather than by the end-investors. Those firms are plausibly more sophisticated than the traditional institutional investors in private equity.

Other features of private fund design address conflicts by more directly aligning fund advisers' interests with the fund. First, it is typical in private funds for advisers to make significant direct investments in the fund. Hybrid fund advisers could likewise be required to make a one-to-three percent capital contribution to the fund. While this investment is small relative to the size of a fund, it would actually be economically large and substantively meaningful to advisers. It would give them direct economic incentives to ensure that the hybrid fund itself was treated in a fair and efficient manner. The empirical evidence on private fund managers' investment in their own funds suggests it provides incentives to outperform.[211] It directly aligns advisers' interests with the interests of the shareholders in a specific fund. Second, managers of private funds receive a substantial performance fee if the fund outperforms its benchmark. These fees are mechanically complex, and they are also prohibited under the Advisers Act. However, the SEC possesses the authority to exempt funds from that provision,[212] and a properly designed performance fee would again give advisers strong incentives to ensure that hybrid funds perform well. Opening up hybrid funds to performance fees is well worth considering.

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[208] The Blackstone Group L.P., Form S-1, June 21, 2007, https://www.sec.gov/Archives/edgar/data/1393818/000104746907005100/a2178442zs-1a.htm.

[209] *Id*. at 162 ("The members of the conflicts committee will meet the independence standards for service on an audit committee of a board of directors pursuant to federal and New York Stock Exchange rules relating to corporate governance matters.").

[210] Robert Seber, *LPAC by Design: Six Recommendations for GPs to Define LPAC Features During Fund Formation,* PRIV. EQUITY LAW REP. (Feb. 25, 2020), https://media.velaw.com/wp-content/uploads/2020/03/02120713/PELR_LPAC-by-Design-Six-Rec.pdf.

[211] Arpit Gupta & Kunal Sachdeva, *Skim or Skim? Inside Investment and Hedge Fund Performance*, MGMT. SCI. (forthcoming).

[212] Investment Company Act of 1940 § 6(c), 15 U.S.C. § 80a-6(c) (2020). Jonathan B. Berk & Richard C. Green, *Mutual Fund Flows and Performance in Rational Markets*, 110 J. POL. ECON. 249 (2002).

Stepping back, other reform possibilities could also try to piggyback on the lessons of the private funds market. the inference to look to private markets and the choices of sophisticated major institutional investors suggests a different array of "pooling" strategies as well. These strategies would be designed to avoid the adverse selection risks or unsophistication of retail investors by having retail investors piggyback on the bargaining power and sophistication of institutional investors.[213] You could see them working in a number of ways. One possibility is that retail investors should only be able to access regulated investment funds that also have a material amount of institutional money invested in the fund.[214] A different strategy would be to channel retail money into regulated funds of private funds, where the regulated fund invests in a number of private funds that are principally capitalized through institutional money. As with all of these proposals, getting investor protections right in the details would be essential. That too would represent a path of public markets learning from private markets.

A reasonable question to ask is why regulatory intervention should be necessary to achieve these outcomes. Perhaps the law-on-the-books will become highly permissive but private ordering will evolve to protect fund investors' interests. Yet the private equity industry itself has not universalized these best practices, and the standard set of worries about retail investors' ability to protect themselves seem as strong here as anywhere.[215] If the worry is that retail investors often cannot defend their own interests, or shift private ordering toward the efficient equilibrium, then the case is strong for pushing the retail private market to incorporate the incentive alignment and best practices of the high-end institutional PE market.[216]

C. The Bigger Picture [Very tentative!]

To someone steeped in the Company Act, the reform of Section 17 will seem like a fundamental rethinking, but to an outside observer, it may seem small bore. In this short section, I step back and offer a schematic set of thoughts on the bigger picture for rethinking the regulation of investment management.

My thoughts deal with both investment management regulation as it is, and as it could be. Today, investment management regulation rests on two major statutes, the Investment Company Act and the Investment Advisers Act. The Company Act sets out a complex and wide-ranging substantive framework that I have discussed in detail. The Advisers Act is a light, almost census-like statute, that requires large investment managers to register with the SEC.

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[213] Holger Spamann's important argument for "indirect investor protection" largely relies on the idea of pooling. Spamann argues that the central investor protections of public markets rely on the fact that retail investors benefit from the choices of high-powered, sophisticated investors.

[214] COMMITTEE ON CAPITAL MARKETS REGULATION, EXPANDING OPPORTUNITIES FOR U.S. INVESTORS AND RETIREES: PRIVATE MARKETS (August 2025).

[215] See, e.g., Lucian A. Bebchuk, *The Debate on Contractual Freedom in Corporate Law*, 89 COLUM. L. REV. 1395, 1403–10 (1989); Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549 (1989).

[216] There is a different, complementary approach that would also be worth considering: to base the optimal level of conflict-of-interest protections on the *institutional structure* of a hybrid fund. In his work, John Morley emphasizes the importance of exit rights in shaping fund behavior. Morley, *supra* note 39, at 1285. Morley argues that closed-end funds warrant greater investor protection than open-end funds because the ability to exit open-end funds is so robust that it sharply disciplines investment firms' opportunism. All hybrid funds are closed-end funds, but from the perspective of exit rights perhaps *the* defining institutional innovation of these funds is their *semi-liquidity*. From the perspective of liquidity, hybrid funds have managed to turn the traditional redemption window of a private equity fund (on the order of five to twelve years) into something much closer to a hedge fund (quarterly).

Substantively, it imposes only an anti-fraud and fiduciary requirements on those managers, although the SEC has stretched these requirements to mean quite a bit.

In retrospect, I think Congress got things almost *backward*. It would have been better to impose substantive regulatory requirements on managers rather than funds, if you were going to choose to do only one of the two. The primary reason for this is external management, the defining institutional feature of the funds industry. Recall that external management describes how funds are organized. Investment management firms sponsor, or create, individual funds. The fund raises a separate pool of capital, but the decisions about how the fund should invest, operate, and be organized are all made by the manager. A fund, unlike an ordinary company, does not have its own employees or decision-making apparatus. Simply put, external management means that the manager makes essentially all of a fund's operational and investment decisions. It also means that decisions about which markets new funds will enter, how conflicts are coordinated among funds, or what new investor bases funds will turn to, are all decisions being made at the manager-level.

As a result, regulation interested in affecting the substantive management of funds is more naturally be targeted at the manager level. The difference could be overstated. Fund regulation naturally shapes fund managers' incentives, albeit indirectly. Indeed, much of the Company Act's regulatory apparatus, while framed in terms of fund regulation, turns out to be regulation of *advisers'* activities. Section 17 works because it imposes hard-bans on transactions involving entities under common control, essentially acting to prevent an adviser from transacting among funds when a fund involved is regulated. Nonetheless, the focus on funds alters the starting points and feasible goals of investment management regulation: it becomes "micro." Yet the growth of asset management from a small fraction of the total financial system to a near-dominant position means that we have increasingly system-wide ambitions for it. As funds and investment managers stretch out across the financial system into insurance, private credit, and retail access to private markets, I see two major sets of concerns being added to investor protection, namely, financial stability and corporate governance. From a financial stability perspective, I think it is difficult to see macroprudential policy aimed at the generic "fund" level. The adviser or market levels seem like a more natural fit.

V. Access to Private Markets and Public and Private Markets

There are further implications of this account as well. It can tell us about how to design retail access to private markets and about the important of a fund's investment strategy to fund design and regulation.

A. How Should Retail Investors Access Private Markets?

A normative insight we get from studying hybrid funds is that retail investors can access private markets through institutional pathways that differ significantly in the investor protections they offer. As a result, we should think differently about hybrid funds when it comes to the main policy arguments for and against retail access. Many commentators have treated the topic of retail access in the abstract, arguing that concerns about adverse selection, opacity, and illiquidity amount to a strong case against retail access.[217] These arguments are extremely powerful if what we have in mind is direct individual investment in private companies or direct retail investment in private funds. Direct retail access to private company stock or to investment in private funds affords retail investors with no baked-in investor protections. Moreover, the bottom of the private equity market is likely to include the funds most desperate for everyday investors' money.

Arguing against retail access in the abstract is a mistake, however, once we realize that hybrid funds offer a dramatically different structure than direct forms of private investment. *At least some of the most serious objections to retail access to private markets are answered by the hybrid fund form*. This is due to both its institutional structure and to the fact that fund regulation governs these funds, ensuring some degree of transparency, fee caps, and perhaps even limits on adverse selection. Let me begin with the benefits of hybrid funds' institutional form and then turn to the benefits of their regulation.

At an institutional level, the major innovation of hybrid funds is their periodic liquidity. Shareholders' ability to redeem five or twenty-five percent of the funds' shares on a quarterly basis provides far more liquidity than direct investment in private companies or funds. Moreover, liquidity and the threat of exit can matter in two different ways. One way in which liquidity can matter is that during a time of crisis or financial panic many investors may wish to withdraw all of their capital. In that scenario, five percent redemption amounts to little. Liquidity can also matter, however, because ordinary investors will have random and uncorrelated occasions for needing cash. Five percent quarterly redemption can completely satisfy this need. As importantly, shareholders' ongoing redemption right provides an implicit threat that can discipline managerial opportunism. If the manager perform poorly, shareholders can withdraw money from the fund.

To illustrate the benefits of regulation, recall that a major concern with retail investment in private markets is that private markets are generally opaque. Indeed, traditional private funds are extremely opaque. Their fees and returns are not disclosed to the public. Even an investor in those funds may only enjoy limited information about the value of the portfolio during the fund's operations, prior to its liquidation. Determining the appropriate risk-adjusted return, net of fees, from investing in a private equity program is dauntingly complex. An individual investor in a fully private fund or private operating company could probably expect almost no disclosure and little sense of performance until exit. But hybrid funds are not opaque to anything like the same degree. If a BDC trades on a stock exchange, then it has a highly transparent price. Even non-trading BDCs, interval funds, or tender offer funds offer real liquidity at their claimed NAV, and they disclose their investment portfolio alongside each investment's claimed fair value.

There may be collateral benefits to regulated fund disclosure as well. Hybrid funds offer a level of mandatory disclosure that may ultimately be able to discipline the private market more generally. It limits fund-level leverage, and independent trustees and Section 17 offer investors greater protection against conflicts than completely private funds. Simply put, precisely because

[217] *See, e.g.*, Joint Statement by Commissioners Lee and Crenshaw on the Failure to Modernize the Accredited Investor Definition, Aug. 6, 2020, https://www.sec.gov/newsroom/speeches-statements/crenshaw-accredited-investor-2020-08-26; see also Ludovic Phalippou, *Private Markets for the People? Or Just More People for Private Markets?* (July 10, 2025), https://ssrn.com/abstract=5346980.

they are private at the assets level, but public at the fund level, hybrid funds offer considerably more in the way of investor protection than other forms of access to private markets.

B. *Structure Matters. But So Do Assets and Strategy*

John Morley has famously—and persuasively—argued that a fund's organizational structure matters decisively to making sense of what investments funds are and how they should be regulated.[218] In particular, Morley argues that external management explains why investment funds have a special body of law that governs them, and that the powerful exit rights held by investors in open-end funds mean that they will never exercise their governance rights.[219] However, studying how hybrid funds work and how regulation applies to them helps us see that *assets matter too*. What I mean is that how regulation applies to a fund, and how regulation *should* apply to a fund, turns not only on a fund's structure but on the type of assets the fund invests in, or, as you could also put it, the investment strategy that a fund pursues. Congress neither foresaw many of these interactions between regulation and strategy, nor could it plausibly have intended them.

The clearest way to see this is with the regulation of fees, and the fact that Congress's approach to performance fees in the Advisers Act works in dramatically different ways based on whether a fund invests in stock or in income-generating assets, like debt or so-called "real assets" (like infrastructure or real estate). While usually glossed as a ban on performance fees, the Advisers Act technically prohibits only performance fees based on increases in the value of assets. This prohibition squarely precludes the main performance fee used in private equity, which is based on increases in the value of companies the fund buys and restructures. But the prohibition turns out to have little bite if the same investment management firm is operating a *private credit fund* instead (or an infrastructure fund, for that matter).[220]

There is a more obvious way in which assets matter too. If Section 17 remains in place, it will be far easier to operate a private credit strategy in a regulated fund than a private equity strategy. That might initially strike some readers as attractive. After all, investing in credit is usually safer than investing in equity. Securities policymaking should be made for the long-term, however, and in a competitive market it is difficult to see how restricting retail investors to credit can be either justified or politically sustained. Credit is safer than equity, which is why equity investors *enjoy a premium* for the greater risk they bear by investing in equities.[221] The size of this premium is so large that an entire financial economics literature has arose seeking to explain the "equity premium puzzle" (i.e., the size of the increased return to equity over debt, given the difference in risk).[222] By investing in private markets, investors already seek out greater risk.

[218] Morley, *supra* note 39, at 1279.
[219] *Id*.
[220] One could defend the limited scope of the performance fee ban. The logic of Congress's opposition to performance fees applies more weakly in the context of debt. What Congress disliked was the asymmetrical character of performance fees, where an adviser shares in the upside but does not suffer from the downside ("tails I win, heads you lose"). This remains true, but to a more limited degree, for interest income.
[221] Rajnish Mehra & Edward C. Prescott, *The Equity Premium: A Puzzle*, 51 J. MONETARY ECON. 221, 222–24 (1983).
[222] Rajnish Mehra, *The Equity Premium Puzzle: A Review*, Vol. 2 FOUNDATIONS AND TRENDS IN FINANCE (2008).

Confining them to the less profitable half of a diversified investment universe not only seems like a dubious policy choice, but one that it will be impossible to keep up in practice.

CONCLUSION

The regulation of investment funds can no longer be ignored by those interested in the future of capital markets. Some of the most fundamental features of those markets—the boundaries, difference, and character of public and private markets, or the limits of investment and capital raising—are in flux. As some of the largest asset managers in the world push on the boundaries of the law, we see more clearly where true limits lie and where walls of paper have caved in. And we are motivated to see that the real limits should probably lie somewhere else.

I have suggested that the current path of fund reform is a mistake. The SEC is increasingly accommodative of conflicts of interest but has no vision for how effective regulation of them should work. The private equity industry favors the approval of disinterested directors, which amounts, in practice to little indeed. A better route is for regulators to nudge fund advisers toward the best of private markets.

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Empirical Appendix

In this appendix I provide further details of dataset construction, size, and analysis. In brief, I first identify populations of funds and then use a series of customized Python programs to scrape the SEC's EDGAR website for the relevant filings for each type of fund. I then use Python, hand collection, or large-language models to extract information from those filings, as described further below.

Identifying Funds

There are three types of regulated closed-end fund that are primarily being used to invest in private markets: tender offer funds, interval funds, and business development companies (BDCs). I first identify the relevant universe of entities for each type of fund. For BDCs, I use the SEC's dataset of entities that have filed a Form N-54A, which it is necessary for an entity to file to operate as a BDC, and then aggregate them across time for the last decade.[223] The result is a population of 393 BDCs, which is approximately the same as other estimates of the full BDC universe.[224] Interval funds also have a unique status under SEC regulation.[225] I use a customized python program to scrape EDGAR for registration Form N-2 (necessary to form a closed-end registered fund) to identify closed-end funds as interval funds and develop a population of 123 interval funds, which is approximately the same as other estimates of the interval fund universe.[226] Tender offer funds are registered closed-end funds that do not occupy a specific regulatory status within SEC disclosure policy. I source my list of tender offer funds from a widely used industry source, resulting in a population of 127 interval funds.[227]

In total, my independently developed estimates of the BDC, interval fund, and tender offer fund universes closely approximate estimates developed by commercial data providers for the industry.[228]

Total Hybrid Fund Assets

I extract all quarterly Form N-PORT disclosures for a population of interval fund and tender offer funds (discussed more below). I calculate the total assets and total liabilities of each type of fund based on quarterly disclosures of interval and tender offer funds' total assets. I use the total assets numbers for BDCs from BDC Collateral, a leading commercial data provider for the BDC industry. BDC Collateral sources those from BDCs' regulatory filings.

Total Assets and Household Ownership Share

I calculate the household ownership share of all corporate equities by using household corporate equity ownership as the numerator and the value of all corporate equities as the denominator. The Federal Reserve time series Households and Nonprofit Organizations; Corporate Equities; Asset, Market Value Levels (HNOCEA) provides the numerator.[229] To calculate total bank assets, I use the Federal Reserve time series, U.S.-Chartered Depository Institutions, Including IBFs; Total Financial Assets,

[223] U.S. Securities and Exchange Commission, Business Development Company Report, January 2012 - June 2025, https://www.sec.gov/about/opendatasetsshtmlbdc.

[224] See, e.g., Elisabeth de Fontenay & Jared Elias, *The Credit Markets Go Dark*, 134 Yale L.J. 696 (2025).

[225] This consists of a flag used in Form N-CEN.

[226] I use the assistance of a number of programs in developing customized software programs, including large language models (Claude.AI and ChatGPT), Cursor, and Warp, when using programming to create datasets and programs.

[227] Tender Offer Funds, Active Funds, https://www.tenderofferfunds.com/active-tender-offer-funds/#google_vignette.

[228] See, e.g., Interval Fund Tracker, Active Interval Funds, https://intervalfundtracker.com/data/active-interval-funds/.

[229] Technically, HNOCEA is the household and nonprofit share, although it is widely used a proxy for individuals' direct ownership of corporate equity. See, e.g., Berk & van Binsbergen, Regulation of Intermediaries. The time series for specific registered funds, but not private funds, is also presented by the Federal Reserve: mutual funds (LM653064100Q), (b) ETFs (FL563064100Q), and (c) closed-end funds (FL553064103Q).

Level (BOGZ1FL764090005Q). For funds I use the time series, Investment Funds; Total Financial Assets, Level (BOGZ1FL684090005Q), which includes only registered fund assets. There are not reliable estimates of the total size of the private funds industry until the SEC begins releasing them in Private Fund Adviser statistics. I use the SEC data from Form PF to calculate the total size of the private funds industry and add it to the BOGZ1FL684090005Q series from 2012 onward.[230]

Extracting Information

As noted in the main text, BDCs are subject to a different disclosure regime than interval and tender offer funds. Because BDCs are essentially subject to the disclosure regime for operating companies, their 10-K annual disclosure filings are the most comprehensive and detailed. I primarily rely on 10-K filings for BDC information, supplementing them with 10-Q filings when 2025 data is important and a 10-K is unavailable. A BDC's 10-K's financial statements include a Consolidated Schedule of Investments that presents detailed information on a BDC's portfolio of investments.

For interval and tender offer funds, I scrape EDGAR for a number of forms, which will be referenced further below. Form N-CEN, a census like filing, and Form N-CSR, provide much of the most useful information on these fund types. Form N-PORT presents a fund's investment portfolio on a quarterly basis. I use a series of customized python programs to extract the whole universe of a range of filings for each of class of hybrid fund. I obtain data on the revenue from various sources from BDC collateral, which extracts it from disclosure filings.

Specific Interval Fund, Tender Offer Fund, and BDC Features

I hand collect basic information on BDCs from their annual 10-K disclosures. Those filings typically present key information funds' tax structure, diversification, and the like in narrative form. Jurisdiction of formation is extracted directly from the document using rules-based classification implemented through a python program.

For BDCs, I hand collect the structure of information from BDC 10-Ks. While I extract information for hundreds of filings, the results turn out to be fairly uniform across time. As a result, I present summary statistics only for the most recent years in the main text. For fee economics, I use data on overall fee sources from BDC Collateral.

For leverage, I base my calculations of the asset coverage ratio on the ratio of a fund's total assets to total debt. This ratio can be translated into a debt-to-equity ratio, leverage ratio, or asset coverage ratio as a series of identities. The total debt reported by a fund is not precisely identical to its "senior securities," which is the technical input into a fund's asset coverage ratio.[231] The definition of senior securities does include virtually all on-balance sheet indebtedness of a fund. I also conduct a series of informal checks that suggest that total debt is a close approximation of senior securities. Discussions with the Investment Company Institute suggest they view senior securities as approximated by total debt. Total debt is also widely used in the literature as a proxy for senior securities.[232] In any event, when I attempt to reconstruct the precise senior securities numbers implicitly being used in the asset coverage ratio calculations of funds that present their own ratios, I find insufficient detail in the disclosures to match their numbers. For interval and tender offer funds, I extract total assets and total liabilities from each fund's annual N-CEN disclosure. For BDCs, I use the total asset and liability numbers provided BDC Collateral, which they source from BDC filings ($N = 3743$).

I seek to identify major hybrid fund managers that disclose co-investment, including sampling filings by the ten largest BDC managers. No manager seems to disclose co-investment in interval or tender offer funds. Given the disclosure limitations in the highly structured N-PORT and N-CEN filings, they do not provide

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[230] Investment Adviser Statistics, Table 5.1, p. 12 2024, https://www.sec.gov/files/im-investment-adviser-statistics-20240515.pdf

[231] See, e.g., Section 18(a)(1). See Investment Management Guidance Update, Business Development Companies With Wholly-Owned SBIC Subsidiaries—Asset Coverage Requirements, No. 2014-09, June 2014.

[232] FEDS Notes, Jose Berrospide, Fang Cai, Siddhartha Lewis-Hayre & Filip Zikes, Bank Lending to Private Credit: Size, Characteristics, and Financial Stability Implications (May 3, 2025), https://www.federalreserve.gov/econres/notes/feds-notes/bank-lending-to-private-credit-size-characteristics-and-financial-stability-implications-20250523.html.

sufficient portfolio-level detail to calculate co-investment. In their 10-Ks, Apollo, Blue Owl, and Goldman Sachs include footnotes to their Schedule of Investments disclosures flagging investments that are co-investments. I systematically reconstruct the portfolios of these advisers' BDCs for up to the last five years (or as long as they have been operating) and then aggregate the fair value of co-investments. This involves extracting and reconstructing the Consolidated Schedule of Investments from each filing, along with their footnotes. Using the footnote flags, I am able to place an indicator on each co-investment and determine the portion of the fair value of each fund's investment portfolio that constitutes co-investments.

As reported in the main text, I obtain information on the composition of hybrid funds' boards of directors (or trustees) from different sources. Interval fund and tender offer funds report this information on a systematic basis in their annual Form N-CEN filings. As a result, I am able to directly observe the size of funds boards and the number of disinterested directors. Item B.8. Directors provides information on each person serving as a director of the registrant, including their name and whether they are an interested person under the statutory definition. For an example, see below:

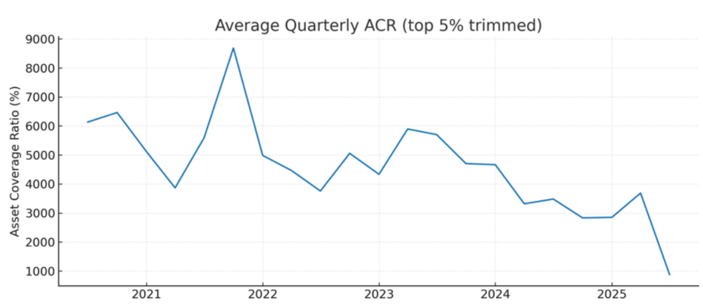
Provide the information requested below about each person serving as director of the Registrant (management investment companies only):

Director Record: 1

a. Full Name	Dominic Garcia
b. CRD number, if any	N/A
c. Is the person an "interested person" of the Registrant as that term is defined in section 2(a)(19) of the Act (15 U.S.C. 80a-2(a)(19))?	○ Yes ◉ No

For interval funds, between 2018-2023, there is an average percentage of disinterested directors ranging from 76-79% (N = 573). For interval funds, between 2018-2023, there is an average percentage of disinterested directors ranging from 72-80% (N = 554). Given the number of interval and tender offer funds, there are few missing observations. BDCs do not report these details systematically in their filings, but I find that applications for exemptive relief for co-investment frequently include data on board composition.[233] However, this data is not necessarily required, nor do all advisers present it. There is no guarantee that the BDC sample is representative, although there is no reason to doubt that it captures the general composition of BDC boards.

Figure A.1 Interval Fund Average Leverage (trimmed off top 5%)



233 See SEC, Investment Company Act Notices and Orders, https://www.sec.gov/rules-regulations/investment-company-act-notices-orders?category=All&title=&name=&field_rule_type_target_id=All. For an example, see https://www.sec.gov/Archives/edgar/data/1229262/000119312525095868/d931521d40appa.htm.