BETTER MARKETS

November 13, 2024

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

Re: SPDR SSGA Apollo IG Public & Private Credit ETF
Investment Company Act of 1940 File No. 811-22542

Dear Director Greiner:

Better Markets[1] appreciates the opportunity to comment on the above-captioned filing.[2] The filing would expose retail investors to private credit through an exchange-traded fund (ETF). But the potential for ETFs to expose retail investors to private credit carries enormous risk.

I. The Potential for Unreliable Valuations Threatens Retail Investors.

ETFs are traditionally low-cost and low-risk investments that track a market index.[3] They are considered lower-risk investments because they offer diversification in the form of holding multiple stocks or other securities.[4] They are also required by law to invest in highly liquid assets.[5] An essential characteristic of ETFs is that they can be easily bought and sold on exchanges and trade freely throughout the trading day.[6] ETFs also normally "avoid the perils of unfair valuation by trafficking in publicly traded investments."[7] Investors will usually "be cognizant of recent and reliable prices for each of the ETF's component investments."[8] So ETFs normally offer retail investors a way to diversify their risk while investing in the public markets.[9]

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1 Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

2 Form N-1A, SSGA Active Trust, Securities Act File No. 333-173276, Investment Company Act of 1940 File No. 811-22542 (Sept. 10, 2024), https://www.sec.gov/Archives/edgar/data/1516212/000119312524216340/d878371d485apos.htm.

3 AJ Horch, *Here's why investors started pouring trillions into exchange-traded funds*, CNBC (May 29, 2020), https://www.cnbc.com/2020/05/29/why-investors-are-pouring-trillions-into-exchange-traded-funds.html.

4 *Id.*

5 Elisabeth de Fontenay and Yaron Nili, *Side Letter Governance*, 100 Wash. U. L. Rev. 907, 924 (2023).

6 Horch, supra note 3.

7 William A. Birdthistle, *The Fortunes and Foibles of Exchange-Traded Funds: A Positive Market Response to the Problems of Mutual Funds*, 33 Del. J. Corp. L. 69, 104 (2008).

8 *Id.*

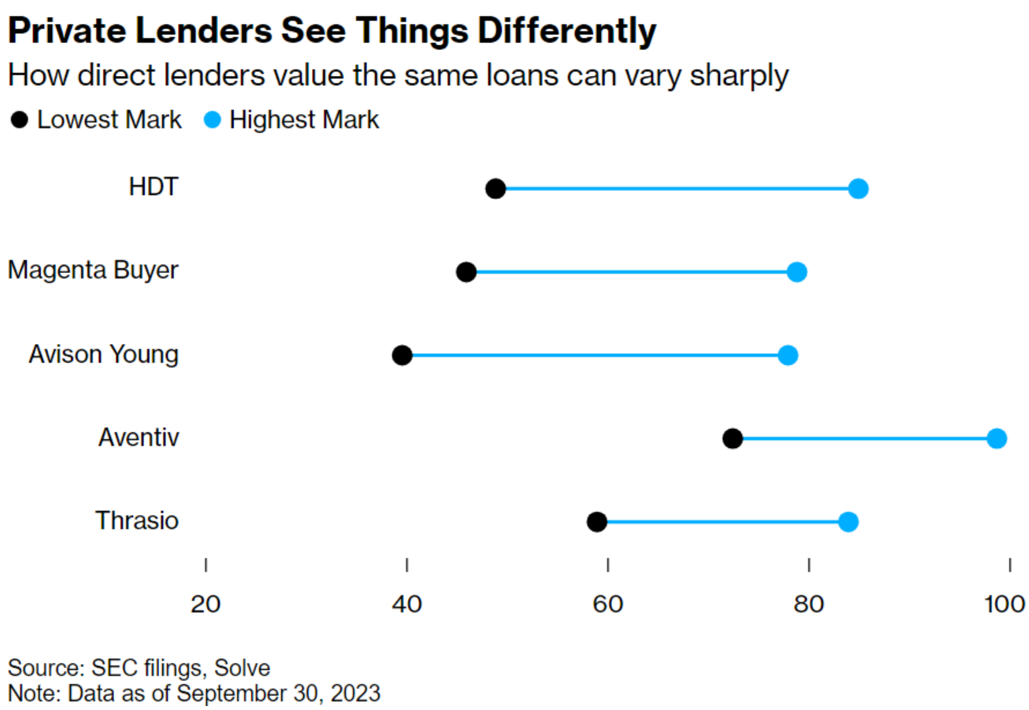
9 Rachel Evans and Carolina Wilson, *How ETFs Became the Market*, Bloomberg (Sept. 13, 2018), https://www.bloomberg.com/graphics/2018-growing-etf-market/?srnd=etfs&sref=mQvUqJZj.

But the filing seeks to offer retail investors a way to invest in the private markets. Private credit is a part of the private markets that involves lending by non-bank institutions.[10] The issue for retail investors is that private credit funds typically invest in illiquid debt investments.[11]

> Private loans by their very nature rarely trade. That means fund managers do not have market data to rely on for objective valuations.[12]

As a result, the loans that private credit funds make are difficult to value in the best of times.[13]

This means that nobody really knows how to value the loans. Because nobody knows the loans' true valuation, it is unclear how anybody can know what the loans are worth.[14] The upshot is that the valuation of the loans can vary widely based on who is doing the valuation.[15]



The absence of a consensus as the loans' value could also be hiding loans that are in trouble.[16] Investors "could be left in the dark or potentially misled if a lender or buyout firm has

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[10] Sam Boocker and David Wessel, *What is private credit? Does it pose financial stability risks?*, Brookings (Feb. 2, 2024), https://www.brookings.edu/articles/what-is-private-credit-does-it-pose-financial-stability-risks/.

[11] de Fontenay and Nili, 100 Wash. U. L. Rev. at 922 n.65.

[12] Eric Platt and Amelia Pollard, *A messy loan restructuring highlights risk lurking in private credit*, Financial Times (July 10, 2024), https://www.ft.com/content/b10dbb08-c745-40d0-a7fc-9b4024f1fd10.

[13] Matt Wirz, *Wall Street Races to Bring Private Credit to the Masses*, The Wall Street Journal (Oct. 3, 2024), https://www.wsj.com/finance/investing/wall-street-races-to-bring-private-credit-to-the-masses-8a25b624.

[14] Silas Brown et al., *Flawed Valuations Threaten $1.7 Trillion Private Credit Boom*, Bloomberg (Feb. 27, 2024), https://www.bloomberg.com/news/articles/2024-02-28/how-private-credit-market-boom-is-hiding-potential-valuation-problems?sref=mQvUqJZj.

[15] *Id.*

[16] *Id.*

been overly optimistic about its portfolio."[17] As a result, the "inherent difficulty of valuing non-traded loans . . . could expose investors in these funds to unforeseen losses."[18]

This is especially a problem for the filing. It is not clear that the ETF will use a third party to help value the loans.[19] Apollo's role as the "'originator, buyer, seller and valuation provider of the ETF's private credit investment'" presents "'potential conflicts of interest.'"[20]

II. The Potential for a Lack of Liquidity Threatens Retail Investors.

In addition to unreliable valuations, the illiquid nature of the loans that private credit funds make poses additional risks. ETF investors normally need high liquidity.[21] Indeed, as listed securities, ETFs normally are traded constantly.[22] But private investments "are known for barely changing hands."[23] So it is unclear how retail investors can easily withdraw money from funds loaded with illiquid assets.[24] This "raises questions about how the mechanics of the fund would operate—especially in the event of a wave of redemptions amid a major selloff or credit crisis."[25]

The filing is essentially trying to build "a highly liquid ETF out of illiquid private loans."[26] ETFs are designed for liquidity, but the underlying securities in this ETF effectively would not "'trade at all.'"[27] This "'limited liquidity'" creates issues for the ETF structure.[28]

There is also the problem of "'trying to offer a deeply illiquid instrument in a highly liquid wrapper such as the ETF.'"[29] There is a mismatch between the illiquidity of private credit

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17 *Id.*

18 Platt and Pollard, supra note 12.

19 Brian Moriarty and Ryan Jackson, *A Closer Look at a Groundbreaking Active ETF Proposal*, Morningstar (Sept. 12, 2024), https://www.morningstar.com/funds/closer-look-groundbreaking-active-etf-proposal.

20 Kathie O'Donnell, *Should private market ETFs be available to the public? One former SEC regulator has concerns.*, Pensions & Investments (Sept. 30, 2024), https://www.pionline.com/exchange-traded-funds/apollo-ssga-private-credit-etf-filing-challenges-key-regulatory-barrier-ex (quoting Bryan Armour, director of passive strategies research for North America at Morningstar Research Services).

21 Kelly Cloonan, *Investing giants want to offer retail traders access to a booming sector of financial markets*, Business Insider (Oct. 3, 2024), https://markets.businessinsider.com/news/etf/private-credit-etf-state-street-apollo-sec-investor-investing-funds-2024-10.

22 Vildana Hajric, *Apollo, State Street Strive to Prove Private-Debt ETFs Can Work*, Bloomberg (Sept. 30, 2024), https://www.bloomberg.com/news/articles/2024-09-30/apollo-state-street-need-to-show-how-private-debt-etfs-can-work?sref=mQvUqJZj.

23 *Id.*

24 Lydia Beyoud, *Apollo's Race Toward Private-Credit ETFs to Face SEC Scrutiny*, Bloomberg (Nov. 1, 2024), https://finance.yahoo.com/news/apollo-race-toward-private-credit-142000095.html.

25 Hajric, supra note 22.

26 Cloonan, supra note 21.

27 Hajric, supra note 22 (quoting Cinthia Murphy, investment strategist at data provider VettaFi).

28 O'Donnell, supra note 20 (quoting Armour).

29 *Id.* (quoting William Birdthistle, former Director of the SEC's Division of Investment Management).

as an underlying asset and the expectation of retail investors that ETFs are highly liquid.[30] Retail investors may not understand the risks in the illiquid asset class that is private credit.[31]

The proposed solution to the liquidity problem is that Apollo has entered into a contract with the fund to act as a liquidity provider.[32] It says it will provide private credit instruments for the fund to buy and provide it with intraday, executable bids on all its holdings.[33] But State Street admits that if Apollo can't provide bids for its private credit instruments, then assets that were deemed to be liquid may become illiquid.[34] This is "significant because US regulations only allow open-ended funds to hold 15% of their holdings in illiquid assets."[35] So the "risk is that swaths of the portfolio deemed liquid could become illiquid if Apollo fails to provide the bids.[36]

Fundamentally, it seems like the filing is trying to fit a square peg in a round hole.[37] The ETF intends to treat the private credit portions of the fund as though they were liquid.[38] But the way the ETF says its assets will be liquid is "'not the way we usually define liquidity.'"[39]

III. The Potential for Systemic Risk Threatens Retail Investors.

Aside from the need for an ETF that seeks to invest in private credit to ensure reliable valuations and sufficient liquidity, the bigger issue "'is whether or not instruments specifically constructed for the private market can or should be made available to the public market.'"[40] The filing's proponents say that making private debt more accessible to a wider swath of investors would "'democratize access to private asset exposures.'"[41] But exposing retail investors to riskier assets in the name of democratizing finance can have deleterious consequences. For example, Robinhood says that its mission is to democratize finance for all.[42] Yet Robinhood has induced "users with little to no investment experience" to "trade the riskiest products" and "trade more frequently to their detriment."[43] Its "business model depends on the 'poor'—ordinary investors with surplus capital—making capital allocation decisions without regard to information relevant to a security's payoff, so that the 'rich' can benefit."[44] As a result, it "generates profit to principal trading firms, rather than investment in economic coordination and social provisioning that will

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30 Wirz, supra note 13.
31 Robin Wigglesworth, *Private credit is even larger than you think*, Financial Times (Apr. 17, 2024), https://www.ft.com/content/bf3f3e70-e849-41db-9a29-f2e5ed988e97.
32 Moriarty and Jackson, supra note 19.
33 *Id.*
34 *Id.*
35 Hajric, supra note 22.
36 Moriarty and Jackson, supra note 19.
37 O'Donnell, supra note 20.
38 Beyoud, supra note 24.
39 *Id.* (quoting Duke Law Professor Elisabeth de Fontenay).
40 O'Donnell, supra note 20 (quoting Birdthistle).
41 Kelly Cloonan, *Investing giants want to offer retail traders access to a booming sector of financial markets*, Business Insider (Oct. 3, 2024), https://markets.businessinsider.com/news/etf/private-credit-etf-state-street-apollo-sec-investor-investing-funds-2024-10.
42 https://robinhood.com/us/en/about-us/.
43 Lindsay Sain Jones and Goldburn P. Maynard, Jr., *Unfulfilled Promises of the Fintech Revolution*, 111 Calif. L. Rev. 801, 830 (2023).
44 James Fallows Tierney, *Investment Games*, 72 Duke L.J. 353, 410 n.227 (2022).

grow the real economy."[45] This is why "democratizing finance" has been described as "'open[ing] up the casino to as many people as possible, while masking it in the language of universal stock ownership.'"[46] Skepticism is therefore warranted that supposedly democratizing access to the private markets through the filing will actually benefit retail investors.

The implications extend beyond retail investors. Jamie Dimon recently warned that private credit markets could cause turmoil as retail investors are increasingly exposed to the space and encounter private credit assets that might be illiquid, improperly marked, or not stress-tested.[47] He said "'there could be hell to pay'" as retail investors get access to private credit assets that tend to be less liquid than traditional financial assets.[48] Perhaps most troubling, Dimon noted that the opaqueness of the market reminded him "a little bit of mortgages."[49]

Indeed, Professor Lenore Palladino at the University of Massachusetts at Amherst has warned that beyond the risks to retail investors private credit poses systemic risks.

> Private credit funds pose a unique set of potential systemic risks to the broader financial system because of their interrelationship with the regulated banking sector, the opacity of the terms of their loans, the illiquid nature of the loans and potential maturity mismatches with the needs of limited partners to withdraw funds, and the fact that this growing market has never been through a downturn in the business cycle.[50]

So, according to Palladino, private credit involves "loans made to companies using financial assets that ultimately come from households, in which the loans are risky and opaque, and the terms bespoke, and in which risk is passed along through securitization so that it's unclear where it lives."[51] Palladino concludes starkly that if you replace "financial" with "mortgage" "we have the basic setup of the last financial crisis."[52] The SEC needs to consider the characteristics of private credit and the concomitant risks as it considers the filing for a private credit ETF.

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[45] *Id.*

[46] *Id.* at 411 n.232 (quoting Luke Savage, *The Gamestop Affair Is Just the Latest Incarnation of the "People's Capitalism" Delusion: An Interview with Edward Ongweso Jr*, Jacobin (Feb. 2, 2021), https://jacobin.com/2021/02/gamestop-stock-market-reddit-robinhood).

[47] Filip De Mott, *Jamie Dimon says there could be 'hell to pay' if the swelling private-credit market starts showing cracks*, Business Insider (May 30, 2024), https://www.businessinsider.com/jamie-dimon-private-credit-market-risks-retail-investors-debt-investing-2024-5.

[48] Hannah Levitt, *Dimon Says 'Could be Hell to Pay' if Private Credit Sours*, Bloomberg (May 29, 2024), https://www.bloomberg.com/news/articles/2024-05-29/dimon-says-there-could-be-hell-to-pay-if-private-credit-sours?sref=mQvUqJZj.

[49] *Id.*; Joe Hernandez, *How Lehman's collapse 15 years ago changed the U.S. mortgage industry*, NPR (Sept. 15, 2023), https://www.npr.org/2023/09/15/1199321274/lehman-brothers-collapse-2008-mortgages (describing the role of mortgages in the global financial crisis and how the fall of Lehman Brothers was "due in large part to millions of risky mortgages propping up an unstable financial system").

[50] Lenore Palladino, *Private Financial Markets are Eating the World* (July 10, 2024), https://lpeproject.org/blog/private-financial-markets-are-eating-the-world/.

[51] *Id.*

[52] *Id.*

Conclusion

The issue that the filing raises is that a "key boundary exists in U.S. securities regulations between the types of investments sophisticated investors with long time horizons like pension funds are allowed to invest in and investments like ETFs that are available to retail investors."[53] In the Investment Company Act of 1940, Congress sought to protect retail investors in public funds "by imposing extensive public reporting and investor disclosure obligations" on the funds, and by requiring that they "maintain liquidity standards, promptly pay investor redemption demands, and calculate and publish a daily (NAV) for the fund."[54] These requirements do not apply to private funds.[55] Yet despite the fact that the filing seeks to create an ETF that invests in private credit, the filing does not contain sufficient information to ameliorate the concerns about potentially unreliable valuations and a lack of liquidity. Indeed, the filing is not that different from a filing for a more typical ETF.[56] Even advocates of expanding retail investors' access to private credit markets agree that investor protection measures are "critical to any initiative to allow retail investors to participate in private funds."[57] The filing lacks such sufficient measures.

We hope these comments are helpful as the Commission considers the filing.

Sincerely,

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53 O'Donnell, supra note 20.
54 Wulf A. Kaal and Bentley J. Anderson, *Unconstrained Mutual Funds and Retail Investor Protection*, 36 Rev. Banking & Fin. L. 817, 842 (2017).
55 *Id.*
56 Beyoud, supra note 24 ("'The lack of details in the filing is pretty staggering,' said Elisabeth de Fontenay, a law professor at Duke University. 'It feels like a cut-and-paste job from your usual ETF filing.'").
57 Christina Parajon Skinner, *Nonbank Credit*, 9 Harv. Bus. L. Rev. 149, 187 (2019).