Main Program

Schulte Roth & Zabel

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29TH ANNUAL

PRIVATE INVESTMENT FUNDS SEMINAR

JANUARY 21, 2020

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Practices

Investment Management

Blockchain Technology & Digital Assets

Hedge Funds

Private Equity

Stephanie R. Breslow

Stephanie R. Breslow is co-head of the Investment Management Group and a member of the firm's Executive Committee. She maintains a diverse practice that includes liquid funds, private equity funds and the structuring of investment management businesses. She focuses her practice on the formation of private equity funds (including LBO, mezzanine, distressed, real estate and venture) and liquid-securities funds (including hedge funds, hybrid funds, credit funds and activist funds) as well as providing regulatory advice to investment managers. She also represents fund sponsors and institutional investors in connection with seed-capital investments in fund managers and acquisitions of interests in investment management businesses and funds of funds and other institutional investors in connection with their investment activities, including blockchain technology and virtual currency offerings and transactions.

Recently serving as chair of the Private Investment Funds Subcommittee of the International Bar Association, Stephanie is a founding member and former chair of the Private Investment Fund Forum, a former member of the Advisory Board of Third Way's Capital Markets Initiative, a former member of the Board of Directors and a member of 100 Women in Finance, a member of the Board of Visitors of Columbia Law School and a member of the Board of Directors of the Girl Scouts of Greater New York. Stephanie has received the highest industry honors. She was named to the inaugural *Legal 500 US* Hall of Fame in the category of "Investment Fund Formation and Management: Alternative/Hedge Funds." Stephanie is also listed in *Chambers USA: America's Leading Lawyers, Chambers Global: The World's Leading Lawyers, Crain's Notable Women in Law, IFLR1000, Best Lawyers in America, Who's Who Legal: The International Who's Who of Business Lawyers*), *Who's Who Legal: The International Who's Who of Private Funds Lawyers*, *Who's Who Legal: Thought Leaders: Global Elite, Who's Who Legal: Thought Leaders: Private Funds, Expert Guide to the Best of the Best USA, Expert Guide to the World's Leading Banking, Finance and Transactional Law Lawyers, Expert Guide to the World's Leading Women in Business Law and PLC Cross-border Private Equity Handbook*, among other leading directories. Stephanie was named the "Private Funds Lawyer of the Year" at the *Who's Who Legal Awards* and the *Euromoney Legal Media Group*'s "Best in Investment Funds" and "Outstanding Practitioner," both at the Americas Women in Business Law Awards. She is also recognized as one of *The Hedge Fund Journal*'s "50 Leading Women in Hedge Funds." Stephanie's representation of leading private investment funds has won numerous awards, including, most recently, *Law360*'s Asset Management Practice Group of the Year. She is a much sought-after speaker on fund formation and operation and compliance issues, and she regularly publishes articles on the latest trends in these areas. Stephanie co-authored *Private Equity Funds: Formation and Operation* and *Hedge Funds: Formation, Operation and Regulation*. Stephanie received her J.D. from Columbia Law School and her B.A., c*um laude*, from Harvard University.

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Practices

Investment Management

Private Equity

Emily Brown

Emily Brown advises private equity and venture capital sponsors on fundraising, managed accounts and the capital-raising process, as well as on executive and employee co-investment arrangements, and the wider elements of operating a private funds business. With broad expertise across fund jurisdictions, including the United Kingdom, Luxembourg and the Channel Islands, she advises both sponsors and major institutional investors on a wide range of matters in the investment funds sphere, including fund formations, fund investments and co-investments. In addition, Emily regularly represents major institutional investors in relation to complex fund investments, separate managed accounts, anchor fund commitments and co-investments across a broad range of asset classes. Emily received a Graduate Diploma in Law, with commendation, from BPP Law School and a B.A., with honors, from New College, University of Oxford.

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Practices

Shareholder Activism

Mergers & Acquisitions

Hedge Funds

Regulatory & Compliance

Aneliya S. Crawford

Aneliya S. Crawford represents hedge funds and other large investors in matters concerning shareholder activism, proxy contests, hostile takeovers, corporate governance, and mergers and acquisitions. She is one of the leading attorneys representing activist investors globally with close to 200 major shareholder activism contests, including campaigns in the United States, the United Kingdom, Canada, Australia and Latin America. Aneliya has extensive experience providing strategic guidance to investors on activist strategies, including proxy contests, settlement negotiations, corporate governance, consent solicitations, letter-writing campaigns, hostile takeovers and M&A transactions. She provides counsel to clients on their equity investments in public companies, and she also represents public and private companies in mergers and acquisitions and asset purchase and stock purchase transactions. Most recently, Aneliya represented Trian Fund Management in the largest proxy contest to date. The successful campaign sought the addition of Trian CEO and founding partner Nelson Peltz to the Board of Directors of Procter & Gamble.

Aneliya has been recognized as a "Recommended Lawyer" in *The Legal 500 US* in M&A/Corporate and Commercial: Shareholder Activism — Advice to Shareholders for 2019. The leading industry publication noted how the 'hardworking and creative' Aneliya Crawford advised Trian Fund Management on its successful campaign to appoint the manager's co-founder Ed Garden to the board of General Electric." *The Legal 500* highlighted also her work advising "Sports Direct on its campaign at Iconix Brand Group, securing two board seats in a cooperation agreement" and "UBS, as financial advisor to Elliott Management, in relation to its campaign at NXP Semiconductors." A recognized thought leader, Aneliya has become a leading source for business journalists and business news organizations and a much sought-after speaker. She has served as a moderator and speaker at numerous conferences and events addressing shareholder activism, M&A and corporate governance. She contributed to *The Activist Investing Annual Review 2019* (produced by Activist Insight in association with SRZ) and the *2018 Shareholder Activism Insight* report (published by SRZ in association with Activist Insight and Okapi Partners) and has authored articles published in the *Harvard Law School Forum on Corporate Governance and Financial Regulation*, *Forbes*, *HFMWeek* and others. Aneliya was named to *Crain's* 40 Under 40 Class of 2018 and has been named a New York "Rising Star" by *Super Lawyers* magazine each year since 2014 for her shareholder activism and M&A practice. Aneliya received her M.L.A., *magna cum laude*, from Harvard University, her J.D. from Benjamin N. Cardozo School of Law and her B.A. from American University in Bulgaria.

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Practices

Investment Management

Regulatory & Compliance

Private Equity

Blockchain Technology & Digital Assets

Hedge Funds

Energy

Cybersecurity

Brian T. Daly

Brian T. Daly advises hedge, private equity and real estate fund managers on regulatory, compliance and operational matters. He has extensive experience designing compliance policies and processes and regularly represents clients in enforcement actions, examinations and informal inquiries from the U.S. Securities and Exchange Commission, the Commodity Futures Trading Commission, the National Futures Association, and numerous futures exchanges and SEFs. Brian is also well known for representing Asian-based managers with U.S. jurisdictional ties. Having spent nearly a decade in-house as general counsel and chief compliance officer of several prominent investment management firms, Brian is well versed in the wide range of legal and business challenges facing managers.

Brian is a recognized leader in advising alternative investment fund managers on regulatory and compliance matters and is highly regarded for his thought leadership in this area. *Chambers Global* and *Chambers USA* list Brian as a “leading individual” in investment funds. In addition, Brian is a member of the Managed Funds Association’s Outside Counsel Forum and its CTA/CPO Forum (of which he was formerly a Steering Committee member) and of the CFTC Working Group of the Alternative Investment Management Association. He formerly was a member of the New York City Bar Association’s Private Investment Funds Committee and the MFA’s General Counsel Forum, its CTA, CPO & Futures Committee and its Investment Advisory Committee. In addition to his legal practice, Brian taught legal ethics at Yale Law School. He received his J.D., with distinction, from Stanford Law School.

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Practices

Investment Management

Hedge Funds

Private Equity

Blockchain Technology & Digital Assets

Jennifer M. Dunn

Jennifer M. Dunn focuses her practice on advising hedge funds, private equity funds (including mezzanine and distressed funds), hybrid funds, funds of funds and investment advisers in connection with their structuring, formation and ongoing operational needs, general securities laws matters, and regulatory and compliance issues. Her experience includes structuring and negotiating seed and strategic investments, advising investment managers regarding the structure and sale of their investment management businesses and the structure of their compensation arrangements, and representing investment managers in connection with managed accounts and single investor funds.

Jennifer was named among the world's "50 Leading Women in Hedge Funds" by *The Hedge Fund Journal*. A member of the board of directors of 100 Women in Finance, Jennifer is recognized by *The Legal 500 US, Expert Guide to the World's Leading Banking, Finance and Transactional Law Lawyers* (Investment Funds), *Expert Guide to the World's Leading Women in Business Law* (Investment Funds) and has been named an *IFLR1000* "Rising Star" (Investment Funds). She co-authored *Hedge Funds: Formation, Operation and Regulation* (ALM Law Journal Press) and presented at conferences on topics including attracting and retaining capital, operational due diligence, compliance issues, hedge funds and management company structures and considerations for emerging hedge fund managers. Jennifer earned her J.D. from Columbia Law School and her B.A., *cum laude*, from the University of Pennsylvania.

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Practices

Investment Management

Hedge Funds

David J. Efron

David J. Efron is co-managing partner of the firm. He serves as co-head of the Investment Management Group and as a member of the Executive Committee. With more than 25 years of experience, David has a broad practice advising private fund managers that employ a wide range of investment strategies. He represents many of the world's largest private fund managers on formation, structuring, organization, compensation, operations, seed capital and joint venture arrangements and restructurings, among other types of matters related to their funds and management companies. Notably, David has advised on many of the largest start-up hedge fund launches in the industry over the past few years. Additionally, David also represents private fund managers in connection with SEC regulatory issues and compliance-related matters.

Schulte's Investment Management Group, which David co-heads, has been described as the "preeminent name in this area" and at "the forefront of this industry" by *Chambers*, a prominent industry publication that ranks firms and lawyers. David is listed in *Chambers Global*, *Chambers USA*, *Expert Guide to the World's Leading Banking, Finance and Transactional Law Lawyers*, *The Legal 500 US* and *Who's Who Legal: The International Who's Who of Private Funds Lawyers*. In particular, *The Legal 500 US* has praised his "superb judgment and deep expertise" and recognized him as "an extraordinarily capable attorney. He has a mastery of the pertinent matters, but he also brings a pragmatic approach." *Chambers Global* and *Chambers USA* noted that David is "an outstanding lawyer, with excellent judgment and the necessary soft touch during the delicate negotiations that occur during a start-up/launch" and that "he is attuned to the business considerations and provides measured, reasoned advice that reflects his deep experience and industry knowledge." A published author on subjects relating to investment management, he is a sought-after speaker for hedge fund industry conferences and seminars and a frequent guest lecturer at New York-area law schools and business schools. David received his LL.M. degree in securities regulation, with distinction, from the Georgetown University Law Center, his J.D., *cum laude*, from Syracuse University College of Law and his B.A. from Vassar College.

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Practices

Regulatory & Compliance

Blockchain Technology & Digital Assets

Cybersecurity

Energy

Hedge Funds

Investment Management

Litigation

Marc E. Elovitz

Marc E. Elovitz is co-managing partner of the firm. He serves as chair of the Investment Management Regulatory & Compliance Group and as a member of the firm's Executive Committee. Marc advises private fund managers on running their businesses consistent with the Investment Advisers Act of 1940 and all other applicable laws, regulations and legal requirements. Marc provides guidance to clients on SEC registration, examination and enforcement matters. He also regularly leads training sessions for investment professionals on complying with insider trading and market manipulation laws, and he has developed and led compliance training sessions for marketing and investor relations professionals. Marc works closely with clients undergoing SEC examinations and responding to deficiency letters and enforcement referrals. He develops new compliance testing programs in areas such as trade allocations and conflicts of interest, and he leads macro-level compliance infrastructure reviews with fund managers, identifying the material risks specific to each particular firm and evaluating the compliance programs in place to address those risks. Marc has a cutting edge practice covering the latest trends of interest to private funds, including blockchain technology and digital assets. He advises on the legal and regulatory considerations involving virtual and digital currency business initiatives and the blockchain technology behind them.

Marc is frequently invited to discuss current industry-related topics of interest at leading professional and trade association events. He has presented on whistleblowing, regulatory and compliance issues for private funds and SEC inspections and examinations of hedge funds and private equity funds, among many other topics. *Chambers USA*, *Chambers Global*, *The Legal 500 US*, *Who's Who Legal: The International Who's Who of Private Funds Lawyers* and *New York Super Lawyers* have recognized Marc as a leading lawyer. He has been a member of the Steering Committee of the Managed Funds Association's Outside Counsel Forum, the American Bar Association's Hedge Funds Subcommittee and the Private Investment Funds Committee of the New York City Bar Association. A recognized thought leader, Marc is regularly interviewed by leading media outlets, including *Bloomberg*, *HFMWeek*, *HFM Compliance*, *Compliance Reporter*, *IA Watch*, *Private Funds Management* and *Law360*, to name a few. Marc is a co-author of *Hedge Funds: Formation, Operation and Regulation* (ALM Law Journal Press), the "Protecting Firms Through Policies and Procedures, Training, and Testing" chapter in the *Insider Trading Law and Compliance Answer Book* (Practising Law Institute) and the "Market Manipulation" chapter in the leading treatise *Federal Securities Exchange Act of 1934* (Matthew Bender). He also wrote the chapter on "The Legal Basis of Investment Management in the U.S." for *The Law of Investment Management* (Oxford University Press). Marc received his J.D. from NYU School of Law and his B.A., with honors, from Wesleyan University.

Co-Founder and Chief Strategist
Partners In Health

Paul Farmer, M.D., Ph.D.

Medical anthropologist and physician Paul Farmer has dedicated his life to improving health care for the world's poorest people. He is co-founder and chief strategist of Partners In Health (PIH), an international nonprofit organization, that since 1987, has provided direct health care services and undertaken research and advocacy activities on behalf of those who are sick and living in poverty. Dr. Farmer and his colleagues in the United States and abroad have pioneered novel community-based treatment strategies that demonstrate the delivery of high-quality health care in resource-poor settings.

Dr. Farmer holds an M.D. and Ph.D. from Harvard University, where he is the Kolokotrones University Professor and the chair of the Department of Global Health and Social Medicine at Harvard Medical School; he is also chief of the Division of Global Health Equity at Brigham and Women's Hospital, Boston. Additionally, Dr. Farmer serves as the United Nations Special Adviser to the Secretary-General on Community Based Medicine and Lessons from Haiti. Dr. Farmer has written extensively on health, human rights, and the consequences of social inequality. He is the recipient of numerous honors, including the Bronislaw Malinowski Award and the Margaret Mead Award from the American Anthropological Association, the Outstanding International Physician (Nathan Davis) Award from the American Medical Association, a John D. and Catherine T. MacArthur Foundation Fellowship, and, with his PIH colleagues, the Hilton Humanitarian Prize. He is a member of the American Academy of Arts and Sciences and the Institute of Medicine of the National Academy of Sciences, from which he was awarded the 2018 Public Welfare Medal.

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Practices

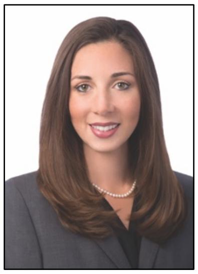
Finance

Distressed Investing

Marc B. Friess

Marc B. Friess focuses his practice on commercial and corporate finance transactions and the representation of hedge funds, private equity funds, commercial finance companies, investment banks and borrowers in a wide range of domestic and cross-border financing transactions, including asset-based and cash-flow facilities; acquisition and leveraged finance facilities; high-yield debt offerings; working capital facilities; debtor-in-possession and exit facilities; bridge and take-out facilities; first lien, second lien and first-out/last-out unitranche financings; secured financings; unsecured financings; subordinated debt financings; mezzanine debt financings; private equity portfolio financings; restructurings and workouts.

Marc is a member of the American Bar Association and the New York State Bar Association. Marc obtained his J.D. from Fordham University School of Law and his B.A., *cum laude*, from Franklin and Marshall College.



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Practices

Bank Regulatory

Blockchain Technology & Digital Assets

Financial Institutions

Litigation

Regulatory & Compliance

Melissa G.R. Goldstein

Melissa G.R. Goldstein advises banks, broker-dealers, investment advisers, funds, insurance companies and money services businesses, including those involved in global e-commerce and virtual currency, on anti-money laundering and sanctions regulations, rules and related issues governing their investment and business activities. She has particular expertise with issues arising out of the USA PATRIOT Act, as amended by the Bank Secrecy Act. Prior to joining SRZ, Melissa was an attorney-advisor with the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). At FinCEN, Melissa assisted in the development of anti-money laundering regulations and guidance, and served as counsel on enforcement actions involving issues such as failure to implement and maintain an adequate anti-money laundering compliance program, failure to register as a money services business, and failure to maintain confidentiality of suspicious activity reports.

In recognition of her significant accomplishments during her Treasury career, Melissa received the Secretary's Meritorious Service Award, which honors individuals whose achievements are substantial and significantly advance the Treasury Department's mission. Melissa is listed in *Washington, DC Super Lawyers* as a "Rising Star." Melissa received her J.D. from Fordham University School of Law and her B.S., with honors, from Cornell University.

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Practices

Investment Management

Hedge Funds

Private Equity

Daniel F. Hunter

Daniel F. Hunter has an established practice focused on building complex hedge funds and credit funds across the liquidity spectrum (evergreen, open-end and closed-end). His clients manage sophisticated funds investing in debt, including closed-end private debt funds, direct lending funds, loan funds, distressed credit funds, opportunity funds and more. In addition, Dan has extensive experience within Schulte's iconic funds practice, advising some of the largest hedge funds in the world. He works on groundbreaking funds and strategies with new and emerging managers, as well as hedge fund formations for prominent, brand-name and global managers. Dan also provides day-to-day regulatory, operational, M&A and restructuring advice, and advises fund managers regarding the receipt of seed capital.

Dan has been ranked by *Chambers USA* in the Investment Funds: Hedge Funds – Nationwide category as well as *The Legal 500 US* in its Investment Fund Formation and Management – Alternative/Hedge Funds category. *Chambers* notes that clients praised him as "outstanding to work with," adding that "he is very smart, very experienced and very responsive." A sought-after speaker, Dan has spoken at the Goldman Sachs Annual Hedge Fund conference on "Succession Planning" and the Wells Fargo Prime Services conference on "Assessing Your Fund for Institutional Growth." He also presented at the AIMA Seminar: Navigating the Landscape of Side Letter Terms and was recently quoted in the *HFMWeek* article "Don't Play Favourites With Your Investors." Dan received his J.D. from the University of Michigan Law School and his A.B., *cum laude*, from the University of Michigan.

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Practices

Litigation

Complex Commercial Litigation

Real Estate Litigation

Securities Enforcement

Taleah E. Jennings

Taleah E. Jennings has served as lead counsel on various complex commercial litigation matters, with a primary focus on fiduciary-related issues, including matters raised in trust and estates litigation, shareholder disputes and litigations involving employment-related matters. Her clients include fiduciaries of large trusts and estates and other financial services entities, such as investment managers, private equity firms, interdealer brokerage firms, multiemployer pension funds and commercial real estate firms. Taleah has litigated cases in various state and federal courts, as well as regulatory and arbitration forums, from the commencement of claims through trials and appeals.

Taleah has been recognized as a leading lawyer by *The Legal 500 US, Benchmark Litigation: The Definitive Guide to America's Leading Litigation Firms and Attorneys* and by *New York Super Lawyers*. She received the Burton Award for Distinguished Legal Writing for the *New York Law Journal* article "Options When a Competitor Raids the Company," was honored with the Excellence in Pro Bono Advocacy Award by Sanctuary for Families and was named among *Savoy* magazine's Most Influential Black Lawyers. Taleah holds a J.D. from Rutgers Law School and a B.S. from the University of Maryland.

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Practices

Investment Management

Hedge Funds

Private Equity

Regulatory & Compliance

Jason S. Kaplan

Jason S. Kaplan concentrates on corporate and securities matters for investment managers and alternative investment funds. He represents institutional and entrepreneurial investment managers, financial services firms and private investment funds in all aspects of their business. Jason's practice focuses on advising managers of hedge, private equity and hybrid funds regarding the structure of their businesses and on day-to-day operational, securities, corporate and compliance issues; structuring and negotiating seed and strategic investments and relationships and joint ventures; and advising investment managers with respect to regulatory and compliance issues.

Jason's recent speaking engagements include discussing "Insurance Dedicated Funds and Related Strategies" and leading "A Conversation with Jason Dillow, Bardin Hill Investment Partners LP" at SRZ's 28th Annual Private Investment Funds Seminar. He also discussed "Shareholder Activism" at SRZ's 27th Annual Private Investment Funds Seminar and "Credit and Hybrid Funds" at SRZ's 26th Annual Private Investment Funds Seminar. Jason's publications include co-authoring "Information Security: Obligations and Expectations," an *SRZ White Paper*. Jason earned his J.D. from Fordham University School of Law, where he was a member of the *Fordham Law Review*, and his B.S. from the University of Michigan.

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Practices

PIPEs
Shareholder Activism
Distressed Investing
Energy
Mergers & Acquisitions
Private Equity
Regulatory & Compliance
Securities & Capital Markets

Eleazer Klein

Ele Klein is co-chair of the global Shareholder Activism Group and serves as a member of the firm's Executive Committee. He practices in the areas of shareholder activism, mergers and acquisitions, securities law and regulatory compliance. He represents activists, investment banks and companies in matters ranging from corporate governance and control to proxy contests and defensive strategies. His recent representations have included representing Trian Fund Management in multiple matters; Elliott Management in Marathon Petroleum, Akamai Technologies and Hess Corp.; JANA Partners in Jack in the Box, Whole Foods, Bristol-Myers Squibb and Tiffany; D.E. Shaw in Emerson Electric; Greenlight Capital in General Motors; Cevian Capital in Autoliv, ABB and LM Ericsson; Starboard Value in Papa John's International and Acacia Research; Caligan Partners in Knowles Corp. and AMAG Pharmaceuticals; Blue Harbour in Investors Bancorp; venBio Select Advisor in Immunomedics; Saba Capital in First Trust; Oasis Capital in Stratus Properties; Altimeter Capital Management in United Continental Holding; SRS Investment Management in Avis Budget Group; and Anchorage in connection with board representation at Houghton Mifflin. Ele works on numerous activist campaigns and related transactions every year for some of the largest private investment groups and investment banks in the United States and abroad. In addition, he advises on private investments in public equity (PIPEs), initial public offerings and secondary offerings, venture capital financing, and indenture defaults and interpretation, and he counsels clients in the regulatory areas of insider trading, short selling, Sections 13 and 16, Rule 144, insider trading and Regulation M/Rule 105.

Ele is recognized as a leading lawyer in *Chambers USA*, *The Legal 500 US*, *New York Super Lawyers – New York Metro Top 100* and *Super Lawyers Business Edition*. He has served as a moderator and speaker at numerous conferences and events addressing Shareholder Activism, regulatory and reporting issues, PIPEs, M&A deals, capital markets and other topics of interest to the alternative investment industry. He contributed to *The Activist Investing Annual Review 2019* (produced by Activist Insight in association with SRZ) and the 2018 *Shareholder Activism Insight* report (published by SRZ in association with Activist Insight and Okapi Partners). Ele received his J.D. from Yale Law School where he was senior editor of *The Yale Law Journal*. He received his B.S., *summa cum laude*, from Brooklyn College, CUNY.

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Practices

Securities & Capital Markets

Blockchain Technology & Digital Assets

Finance

Mergers & Acquisitions

PIPEs

Private Equity

F. Xavier Kowalski

F. Xavier Kowalski represents issuers, sponsors and investment banks in initial public offerings, high-yield financings, equity-linked financings, and other domestic and international capital markets transactions. He also counsels clients in general corporate and securities law matters. His practice includes a broad range of cross-border transactions across a number of targeted industries, including health care, media and entertainment, and technology. He also brings significant experience in private equity and leveraged finance transactions. Xavier received his J.D. from the University of Virginia School of Law and his B.A. from the University of Florida.

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Practices

Investment Management

Hedge Funds

Regulated Funds

Regulatory & Compliance

John J. Mahon

John J. Mahon represents private equity firms and other financial sector participants in a wide range of capital markets and securities law matters. He regularly assists clients in connection with the establishment and operation of business development companies (BDCs), registered closed-end funds and other similar public and private vehicles that comply with complex regulatory structures, including the Investment Company Act of 1940, the Investment Advisers Act of 1940 and the Dodd-Frank Act. With more than a decade and a half of experience, John has been involved with more than 100 debt and equity offerings, including over 20 initial public offerings (IPOs), reflecting an aggregate of over $10 billion in total proceeds. His work in securities law and mergers and acquisitions includes providing guidance to many New York Stock Exchange (NYSE) and Nasdaq-listed companies in connection with ongoing corporate governance and U.S. Securities and Exchange Commission (SEC) reporting and compliance matters. John routinely handles issues involving tender offers, proxy solicitations, going-private transactions and beneficial ownership reporting obligations.

John is listed in *The Legal 500 US* and *Washington, DC Super Lawyers*. A recipient of the SEC Capital Markets Award, he serves as an adjunct professor at The George Washington University Law School and is the former chair of the Corporate Finance Committee of the Corporation, Finance and Securities Law Section of the District of Columbia Bar. He speaks and writes on topics ranging from SEC regulations and disclosure obligations to public and private capital raising structures, 1940 Act regulated funds and M&A issues. John was interviewed for *The Hedge Fund Journal* article “BDC and RIC Research and Issuance Proliferating” and he was quoted in the *S&P Global Market Intelligence* article “BDCs Step Into Spotlight With Moves on Leverage, Fees.” John recently spoke on “Specialty Activism: REITs, Banking, Litigation and ‘40 Act Funds” at SRZ’s 9th Annual Shareholder Activism Conference. John received his J.D. from the Georgetown University Law Center and his B.S.B.A., *cum laude*, from the University of Richmond.

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Practices

Regulatory & Compliance
Investment Management
Hedge Funds
Cybersecurity
Private Equity

Anna Maleva-Otto

Anna Maleva-Otto concentrates her practice on advising asset managers on a range of UK financial services regulatory matters, including the impact of EU directives and regulations. She advises clients on all aspects of the establishment and operation of regulated businesses in the United Kingdom, as well as trading on UK and EU markets. Anna frequently participates in industry working groups in connection with new and emerging regulatory initiatives, and has advised asset managers on several key pieces of recent EU legislation (including GDPR, Short Selling Regulation, Alternative Investment Fund Managers Directive, MiFID II, MAR, EMIR and SFTR). Anna began her career as a regulatory consultant assisting clients in the financial services sector with the design and implementation of compliance procedures, conduct of internal compliance investigations, compliance audits and remediation exercises.

Anna is listed in *The Legal 500 UK* as a “Recommended” lawyer in Financial Services: Non-Contentious Regulatory. An interviewee described her as “excellent — highly responsive, well informed and pragmatic in her advice, and a pleasure to work with.” She has also been named among the world’s “50 Leading Women in Hedge Funds” by *The Hedge Fund Journal*. Anna frequently speaks and writes on topics related to her areas of expertise. She recently co-authored the UK chapter in the *Chambers Alternative Funds Guide 2019* — a guide examining key industry trends and regulatory and tax matters impacting funds, managers and investors. Anna has also worked with AIMA to produce *MiFID2 – A Guide for Investment Managers* and authored the “Insider Trading Law in the United Kingdom” chapter in the *Insider Trading Law and Compliance Answer Book* (Practising Law Institute). Her recent speaking engagements have addressed topics such as market abuse, insider dealing, monitoring electronic communications, and payments for research under MiFID II. Anna is admitted to practice in England and Wales, and New York. Anna received her J.D. from Emory University School of Law and her M.A. from Saint Petersburg State University.

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Practices

Investment Management

Hedge Funds

Peter G. Naismith

Peter G. Naismith focuses his practice on advising hedge funds, private equity funds, hybrid funds and investment advisers in connection with their structuring, formation and ongoing operational needs, as well as on certain regulatory and compliance matters. He represents a wide variety of institutional and entrepreneurial fund sponsors and asset managers. Peter also has extensive experience advising on mergers and acquisitions, including a range of complex, high-value public and private transactions across a number of industry sectors.

Prior to joining Schulte, Peter served as in-house counsel at a privately held investment firm, where he focused on fund formation, hedge fund and private equity fund seeding and family office matters. His broad expertise includes roles with firms based in New York, London and Adelaide, Australia. Peter received his LL.M., *magna cum laude*, from Duke University School of Law, his LL.M. (commercial), with honors, from The University of Melbourne, his Graduate Certificate in Legal Practice from The University of South Australia and his LL.B., with first class honors, from The Flinders University of South Australia.

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Practices

Investment Management

Energy

Financial Institutions

Hedge Funds

Private Equity

David Nissenbaum

David Nissenbaum is co-head of the Investment Management Group. He primarily represents institutional and entrepreneurial investment managers, financial services firms and private investment funds in all aspects of their businesses. He structures investment management and financial services firms along with credit, hedge, private equity, hybrid, distressed investing, activist and energy funds, co-investments, funds of funds and scalable platforms for fund sponsors. David also advises on fundraising, management company partnerships, compensation plans, succession plans, seed and strategic investments and spinoffs of investment teams. His work includes counseling clients on finding practical solutions to regulatory and compliance requirements, including the Volcker Rule, and managing conflicts of interest with an emphasis on reducing legal risk to the business.

Clients often seek David's advice on business matters and strategy and to assist on difficult negotiations. For many years, he has been named a "Leader in His Field" by *Chambers Global* and *Chambers USA* and has been recognized by *The International Who's Who of Private Funds Lawyers*, *PLC Cross-border Private Equity Handbook*, *The Legal 500 US* and *Expert Guide to the World's Leading Banking, Finance and Transactional Law Lawyers*. A past member of the Advisory Board of The Financial Executives Alliance and the Banking Law Committee of the New York City Bar Association, David is a sought-after writer and speaker. Works he has authored or co-authored include the chapter "Management Company Structures and Terms" in *Hedge Funds: Formation, Operation and Regulation*, published by *ALM Law Journal Press*; "Just Like Starting Over: A Blueprint for the New Wall Street Firm," published by *The Deal*; and "Succession Planning," published by SRZ. He has spoken at conferences and seminars on a range of topics, including fundraising, merchant bank structures, liquidity events, credit and lending funds and co-investment vehicles. David received his J.D. from Brooklyn Law School and his B.A. from the State University of New York at Albany.

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Paul N. Roth

Paul N. Roth is a founding partner of the firm and chair of the Investment Management Group. Throughout his career, Paul has acted as counsel to leading public and private companies in financial services and to their boards of directors. His extensive private investment funds practice, an area in which he has more than 50 years of experience, includes the representation of hedge funds, private equity funds, offshore funds, investment advisers and broker-dealers in connection with fund formations and compliance, securities regulation, mergers and acquisitions (domestic and cross-border) and other financial transactions. Considered the "dean of the hedge fund bar," Paul serves as a special adviser to the board of directors of the Managed Funds Association (MFA). He is the former chair of the Subcommittee on Hedge Funds of the ABA's Committee on Federal Securities Regulation and the New York City Bar Association's Committee on Securities Regulation.

Paul has been recognized as a leading funds lawyer by *The Best Lawyers in America,* which also named him New York City Private Funds/Hedge Funds Law Lawyer of the Year; *Chambers Global*, *Chambers USA*, *IFLR1000*, *Expert Guide to the Best of the Best USA*, *Expert Guide to the World's Leading Banking, Finance and Transactional Law Lawyers*, *Lawdragon 500 Leading Lawyers in America*, *The Legal 500 US*, *New York Super Lawyers*, *PLC Cross-border Investment Funds Handbook*, *Who's Who in American Law*, *Who's Who in America* and *Who's Who Legal: The International Who's Who of Private Funds Lawyers*. Paul was recently honored at *The Hedge Fund Journal* Awards for his outstanding achievement in the hedge fund industry. He also received a Lifetime Achievement Award from Hedge Funds Care in recognition of his prominence in the hedge funds industry and his extraordinary commitment to philanthropy. He was named to *HFMWeek's* 2010 list of the 50 most influential people in hedge funds. Paul is a former lecturer at the University of Pennsylvania's Wharton School, where he taught "Responsibility in Professional Services." of Business. He is currently an Adjunct Professor of Law at NYU School of Law, where he is teaching "Law and Management of Financial Services Businesses." Paul graduated *magna cum laude* from Harvard College, *cum laude* from Harvard Law School and was awarded a Fulbright Fellowship to study law in the Netherlands. He served on the Advisory Board of Harvard Law School's Center on Lawyers and the Professional Services Industry and formerly served as president and a trustee of the Harvard Law School Alumni Association of New York City. In addition, he is a senior director of the Legal Defense Fund of the NAACP and a member of the advisory board of the RAND Center for Corporate Ethics and Governance, and he is a fellow of the New York Bar Foundation and the Phi Beta Kappa Society.

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Gary Stein focuses on white collar criminal defense and securities regulatory matters, complex commercial litigation, internal investigations, anti-money laundering issues, civil and criminal forfeiture proceedings and appellate litigation. He represents public companies, financial institutions, hedge funds, other entities and individuals as subjects, victims and witnesses in federal and state criminal investigations and regulatory investigations by the SEC, SROs and state attorneys general. He has conducted numerous internal investigations involving potential violations of the Foreign Corrupt Practices Act, financial statement fraud, money laundering and other matters, and advises companies on compliance with the FCPA and anti-money laundering and OFAC regulations. As a former Assistant U.S. Attorney and chief appellate attorney in the Southern District of New York, Gary investigated, prosecuted, tried and represented the government on appeal in numerous white-collar criminal cases involving money laundering, fraudulent investment schemes, bank fraud, insider trading, art theft, illegal kickbacks, terrorist financing and other financial crimes. His civil litigation experience includes claims of fraud and breach of contract, securities class actions and derivative actions, contests over corporate control, and disputes arising from the sale of a business. He has handled more than 150 appeals in federal and state courts involving issues of both criminal law and procedure and complex commercial law. He has successfully argued 17 appeals in the U.S. Court of Appeals for the Second Circuit.

Gary has been recognized as a leading litigation attorney by *The Legal 500 US, Benchmark Litigation: The Definitive Guide to America's Leading Litigation, New York Super Lawyers, Firm & Attorneys* and *Who's Who Legal: Business Crime Defence.* An accomplished public speaker and writer, he has presented on FCPA, insider trading, risk management and crisis management issues at a number of conferences. Gary has been presented with Burton Awards for Distinguished Legal Writing. In 2008, he won for co-authoring "The Foreign Corrupt Practices Act: Recent Cases and Enforcement Trends," which appeared in the *Journal of Investment Compliance* and in 2015, he won for authoring "Pension Forfeiture and Prosecutorial Policy-Making," which appeared in the *NYU Journal of Legislation and Public Policy Quorum*. Additionally, he co-authors the "Scienter: Trading 'On the Basis Of'" chapter in the *Insider Trading Law and Compliance Answer Book.* Gary serves on the Board of Editors of the *Business Crimes* Bulletin. He received his J.D. from NYU School of Law and his B.A. from NYU.

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Craig S. Warkol is co-chair of the Broker-Dealer Regulatory & Enforcement Group. His practice focuses on enforcement and regulatory matters for broker-dealers, private funds, financial institutions and individuals. Drawing on his experience both as a former enforcement attorney with the U.S. Securities and Exchange Commission and as a Special Assistant U.S. Attorney, Craig advises clients on securities trading matters and, when necessary, represents them in regulatory investigations and enforcement actions by the SEC, DOJ, FINRA, CFTC and other self-regulatory organizations and state regulators. Craig leads training sessions on complying with insider trading and market manipulation laws and assists hedge funds and private equity funds in connection with SEC examinations. He also has experience representing entities and individuals under investigation for, or charged with, securities fraud, mail/wire fraud, accounting fraud, money laundering, Foreign Corrupt Practices Act (FCPA) violations and tax offenses. In his previous roles in the U.S. Attorney's Office for the Eastern District of New York and the SEC, Craig prosecuted numerous complex and high-profile securities fraud, accounting fraud and insider trading cases.

Craig is recognized as a leading litigation lawyer in *Benchmark Litigation: The Definitive Guide to America's Leading Litigation Firms and Attorneys*, *The Legal 500 US* and *New York Super Lawyers*. He is a former law clerk to the Hon. Lawrence M. McKenna of the U.S. District Court for the Southern District of New York. Craig has written and spoken about enforcement trends in the private fund space and other industry-related topics. Most recently, he was interviewed for the article "Execution Enforcement Actions Escalate," published in *The Hedge Fund Journal*. Craig earned his J.D., *cum laude*, from the Benjamin N. Cardozo School of Law and his B.A. from the University of Michigan.

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David S. Wermuth focuses his practice on the tax aspects of onshore and offshore investment funds, private equity partnerships and their investment managers. Specifically, he represents investment managers in connection with the formation and the ongoing operation of investment funds, including navigating the tax issues related to the proper documentation and international tax reporting of investors in such funds. David also represents private equity fund managers in connection with the acquisition and disposition of portfolio investments. He received his J.D., *cum laude*, from the University of Pennsylvania Law School and his B.A., *summa cum laude*, from Yeshiva University.

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Boris Ziser is co-head of the Structured Finance & Derivatives Group. With over 25 years of experience across diverse asset classes, Boris focuses on asset-backed securitizations, warehouse facilities, secured financings, commercial paper conduits and specialty finance. His practice encompasses a variety of asset classes, including life settlements, equipment leases, structured settlements, lottery receivables, timeshare loans, litigation funding, merchant cash advances and cell towers, in addition to other esoteric asset classes such as intellectual property, various insurance-related cash flows and other cash flow producing assets. He also represents investors, lenders, hedge funds, private equity funds and finance companies in acquisitions and dispositions of portfolios of assets and financings secured by those portfolios.

Recognized as a leading lawyer in the industry, Boris is ranked in *Chambers USA*, *Chambers Global* and *The Legal 500 US* for his work in structured finance. He serves as outside general counsel to the Institutional Longevity Markets Association (ILMA) and is a member of the Structured Finance Committee of the New York City Bar Association, the New York State Bar Association and the Esoteric Assets Committee and Risk Retention Task Force of the Structured Finance Industry Group. A frequent speaker at securitization industry conferences, Boris has conducted various securitization, litigation funding and life settlement seminars in the United States and abroad. Most recently, Boris was interviewed for the article “Attorneys Must Tread Carefully in Litigation Funding’s Next Stage,” published in *Law360* and the articles “SRZ’s Leading Litigation Finance Practice: Holistic Expertise for a Booming Asset Class” and “Life Settlements and Longevity Swaps: Opportunities for Investors, Individuals, Insurers and Pension Funds,” both published in *The Hedge Fund Journal*. His speaking engagements have included “Flash Briefings on Alternative & Emerging Asset Classes — Structured Settlements” at SFIG and IMN Vegas 2018 and “Insurance Dedicated Funds and Related Strategies” and “Credit and Specialty Finance,” both at SRZ’s 28th Annual Private Investment Funds Seminar. Boris received his J.D. from NYU School of Law and his B.A., with honors, from Oberlin College.

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Elie Zolty focuses his practice on the tax aspects of onshore and offshore investment funds, private equity partnerships, real estate investment trusts (REITs) and real estate joint ventures. He represents investment managers in connection with the formation of funds and their ongoing operations, as well as sales of their investment management businesses. He also represents real estate sponsors in connection with operations, restructurings and workouts.

A published author, Elie recently contributed to "United States Fundraising" in *The Private Equity Review*, published by Law Business Research and he co-authored "PATH Act: Recently Enacted Legislation Modifies the FIRPTA and REIT Rules," an *SRZ Alert*. Elie received his LL.M. in taxation from NYU School of Law, his J.D. from Osgoode Hall Law School and his B.A., with distinction, from York University.

Credit

I. Trends in Funds and Strategies

A. *Market Highlights.* The rapid growth of private credit has slowed in 2019. Fewer funds were raised in 2019 than 2018.

1. According to recent surveys, investors are investing proportionally more in private investment strategies. Allocations to private credit and infrastructure decreased while allocations to PE and real estate grew.

   (a) According to *Preqin*'s Q3 2019 report on private debt, however, investors are looking to commit more to private debt strategies as compared to 2018.

   (b) A significant portion of investors are targeting direct lending strategies (47%).

2. The overall market view is that we are currently at the peak of the credit cycle. Investors are starting to think about distressed debt, despite recent lackluster performance in that space.

3. Managers are beginning to bet on Europe for increased distressed opportunities while the U.S. market remains less active. Companies such as Thomas Cook Group PLC and Galapagos SA represent the type of distressed opportunity that managers are not currently seeing in the United States.

   (a) According to *Preqin*, half of active private debt investors are targeting Europe. European funds bounced back from a slow Q2 to show strong fundraising in Q3 2019.

      (i) Investors similarly remain interested in Europe-focused funds, with 60% of investor mandates reviewed by *Preqin* in Q1 2019 seeking investment in Europe.

4. A recent 60-fund review of hedge funds conducted by *The Wall Street Journal* found that structured credit was the best-performing strategy of the funds reviewed.

5. Investors remain interested in litigation funding opportunities, as returns are uncorrelated to the equity and debt markets. Managers have responded to the demand but some managers believe the litigation finance market is becoming overcrowded.

B. *Strategies and Programs*. The "credit fund" marketplace contains a wide variety of strategies and investment programs.

1. Leveraged loan funds buy or originate bank loans and then lever the portfolio.

2. Special situations funds tend to have a broad focus and will buy a wide range of "unique" fixed-income opportunities.

   (a) Special situation funds often seek higher yields; frequently with "equity-like" returns.

3. Direct lending funds typically originate loans rather than purchase loans in the secondary market.

   (a) Direct lending funds represent a large portion of all capital raised by credit funds.

   (b) Direct lending funds typically focus on senior secured loans with floating rate interest and "unitranche" loans.

   (c) Cash flow distributions and lower yields than private equity funds are the norm for these types of funds.

   (d) Direct lending funds are often unlevered.

   (e) Often, loans are made to buyout fund borrowers as part of a leveraged buyout.

4. Multi-Strategy Credit Funds

   (a) These funds purchase assets in private or public credit markets.

(b) Multi-strategy credit fund structures can vary widely.

5. Distressed Debt Funds

(a) For the past six years, industry experts have been waiting for the distressed credit market to arrive.

(b) Fundraising efforts have slowed after a number of distressed debt fund managers launched funds between 2015 and 2018, only to find capital was not put to work or put to work at lower returns than expected.

(i) Fewer funds were raised in 2019 than in 2018.

(c) Distressed managers have a substantial amount of dry powder, more than in recent years.

6. *Specialty Finance Funds*. Specialty finance covers a wide range of strategies and deal types.

(a) Investments in litigation finance funds continued to increase in 2019. The size of the financing transactions also increased from previous years.

(b) Other esoteric asset classes are discussed below.

C. *Fund Structures.* A variety of structures and terms are used.

1. Many credit fund managers use a closed-end or "private equity-style" structure.

(a) The benefits of this structure are:

(i) Less pressure on valuations, which can be a complex task, especially in light of the shift to private credit.

(ii) No withdrawal rights by investors, so certainty of capital for the credit fund manager.

(iii) Capital call feature to reduce cash drag on the fund's returns.

(b) The difficulties inherent with this structure:

(i) Need to go to market with a new fund launch once capital has been called to a certain level.

(ii) Need to liquidate all assets before the end of the term.

(iii) Compensation can be delayed. When using a back-ended waterfall (or "European-Style Waterfall") for carried interest, the credit fund manager's employees must wait years for carried interest distributions.

2. Many credit funds have also moved to "hybrid terms" that combine open-end fund terms and closed end fund terms tailored to the characteristics of the fund's assets. For example:

(a) Capital commitments added to an open-end fund.

(b) Withdrawal rights and investor-level gates after a long lockup.

(c) "Fast pay-slow pay" redemption feature.

(i) These types of hybrid funds have built-in liquidating withdrawal accounts (the "slow pay" feature) which allow the credit fund manager to sell semi-liquid assets in the portfolio over a period of years, while the more liquid assets in the portfolio are sold more quickly to fulfill a portion of each investor's withdrawal requests (the "fast pay" feature).

(ii) Despite the "slow pay" feature, these funds are open-ended and rely on capital contributions, valuations, incentive allocations or sometimes private-equity style distribution waterfalls.

(d) The benefits of the hybrid structure are several, but the two key benefits are:

(i) For investors, there is some level of liquidity during the life of the fund; and

(ii) For the credit fund manager, there is one ongoing fund offering rather than subsequent funds and periodic fundraises every few years, and asking each investor to make a new decision to invest in the next fund.

3. Business development companies ("BDCs") have become more popular.

(a) BDCs are regulated funds under the Investment Company Act but with a generally lighter regulatory burden than typical registered investment companies (closed-end funds or mutual funds). In recent years, BDCs have often been first launched privately to establish a track record before a public offering.

(b) BDCs are sometimes used for direct lending strategies as the loan-originating activities do not create the same tax concerns for non-U.S. and tax-exempt investors as do other structures.

(c) BDCs can elect to be treated as regulated investment companies ("RICs") for federal income tax purposes, which allows a manager to give investors access to direct origination strategies while at the same time avoiding negative tax consequences its ECI and UBTI sensitive investors.

(i) Specifically, RICs are corporations for tax purposes, so they block ECI and UBTI in most cases. A RIC, though, can usually eliminate its corporate tax liability by paying dividends, and in many cases foreign shareholders in a BDC can receive those dividends free and clear of the usual 30% withholding tax on dividend income.

(d) With those tax advantages in mind, SRZ recently helped launch the first BDC structured exclusively for ERISA benefit plan investors that normally face challenges investing in direct lending funds.

(e) While publicly-traded BDCs have historically targeted true retail investors, newer models, including the "private BDC" structure, have increasingly targeted the high net worth accredited investor space through existing distribution channels, while other examples have sought to leverage the tax advantages of the BDC structure to target offshore and tax-exempt investors that would normally invest in a more traditional private fund structure.

(f) Investment Company Act of 1940 restrictions on things like co-investments and cross trades come into play when a manager invests private funds side-by-side with regulated funds (e.g., BDCs).

D. *Tax Considerations*. Tax planning is critical for most credit funds.

1. *ECI.* Funds that lend or lead workouts may generate effectively connected income, which requires special structuring for non-U.S. investors.

2. *Clean Energy Funds.* Funds that invest in clean energy have additional tax-planning requirements in order to take advantage of tax credits, which can have a significant impact on fund structuring and investor composition.

E. *Conflicts of Interest.* Resolving conflicts of interest with sister businesses and funds can be a significant issue and requires thoughtful planning.

1. Credit fund managers must decide in advance in their compliance policies and procedures how they will allocate trades among their various funds.

2. They must also decide how to resolve conflicts when investing in different parts of the capital structure of a given portfolio company.

F. *Focus on Valuation*. Valuations are a persistent concern for credit funds.

1. Valuing illiquid, thinly-traded or private investments can be difficult.

(a) Models using discounted cash flow analysis must include reasonable and supportable assumptions.

2. Undervaluing in order to sell at a profit has been an area of SEC concern, as has overvaluing to obtain higher fees.

3. Managers must decide when to use in-house valuations or when to assign this task to third-party valuation firms, as well as how often a third-party firm will conduct the valuation of the portfolio.

4. Given recent increased SEC interest in valuations, managers are seeking third-party valuations on a more frequent basis.

   (a) Managers should review reports provided by third-party valuation agents for areas of SEC scrutiny, such as the availability and use or exclusion of "outlier" or exceptional market trades in determining valuations.

G. *Credit Fund Terms*. Terms and conditions for closed-end credit funds continue to evolve.

1. *Length of Investment Period*. The market is often three years from the final closing date (or, in some cases, the initial investment date), but managers are starting to push for four-year investment periods.

2. *Terms*. The average term length we have seen is 6.5 years, and we have seen a push for even longer terms.

3. *Carried Interest Waterfall*. In closed-end funds, the market is still for a back-ended waterfall ("European-Style Waterfall"), however, some credit fund managers that seek higher returns (e.g., high teens) have tested the market and offered a deal-by-deal waterfall ("American Waterfall").

   (a) With the American Waterfall, the credit fund manager must still recoup prior realized losses and permanent write-downs.

   (b) In addition, investors who agree to an American Waterfall will often require the general partner to make interim clawbacks, if warranted.

   (c) The market for the carried interest rate varies mainly from 15-20%. In general, the higher the expected return, the more likely it is that the manager will ask for and receive the higher carried interest rate.

4. *Preferred Return*. The market for higher-yielding credit funds is 8 percent, and the market for direct lending funds ranges from 5-8%. In general, the lower the yield of the credit fund, the easier it is to ask investors for lower preferred return.

5. *Management Fees*. The management fee rate and what the management fee is calculated on are hotly negotiated. We are seeing rates that range from 1-2%; however the 2% rate is often for smaller investors — institutions tend to pay closer to 1.25%.

   (a) The basis for the management fee most often continues to be invested capital (i.e., cost basis of the assets being managed) or NAV, but a few managers have pushed investors to accept a management fee based on capital commitments.

      (i) Valuation becomes more important when net asset value is the management fee base.

   (b) Early bird discounts for investors who arrive for the first closing remain popular in the market, and we see discounts ranging from 25 to 50 basis points.

6. *Subscription Lines*. Subscription lines have been more popular than ever.

   (a) Managers should be adding the proper disclosure to their fund documents if use of subscription lines could alter internal rates of return.

   (b) In master-feeder fund structures, cascading pledges may need to be used if your credit fund is hardwired for ERISA purposes because the feeder funds should not be borrowing under these types of structures.

7. *Fund-Level Leverage*. Some credit fund managers negotiate for the right to lever the portfolio at the fund level or at special purpose vehicles below the fund level. Fund-level debt ratios vary but market for funds that use

leverage is less than 1 to 1 (debt to equity). Managers should remember to carve out subscription lines from any borrowing limits.

8. *Distribution of Current Income*. More investors in credit funds are insisting on some type of periodic distributions of cash. How much cash should be distributed and when it should be distributed varies widely in our experience. Some funds distribute current income, while others distribute an interest equivalent amount.

H. *The LIBOR Transition*. Replacement of LIBOR poses new challenges for credit fund managers.

1. LIBOR will be replaced with a new benchmark rate and will not be published after 2021.

2. In July 2019, the SEC Staff issued a statement encouraging market participants to begin managing the transition from LIBOR. The SEC's Division of Investment Management suggested that funds and advisers consider the following:

(a) The impact the LIBOR transition will have on the functioning, liquidity and value of investments, and on the effectiveness of liquidity risk management programs;

(b) The effects on legacy contracts and operating agreements;

(c) Whether the impacts and other consequences of the discontinuation of LIBOR are risks that should be disclosed to investors.

3. Managers should prepare for the discontinuation of LIBOR by doing the following:

(a) Establishing a point of contact for coordination of organization-wide approach.

(b) Working with counsel to identify investments and contracts that will be affected.

(c) Identifying and measuring risks of transition.

(d) Assessing remediation possibilities and planning for implementation.

(e) Considering potential effects on operations and technology, potential accounting and reporting issues, and potential tax and regulatory issues.

II. Bankruptcy Risks for Credit Strategies

A. *Liquidity Crunch.* Private funds seeking to provide liquidity, whether by taking advantage of short-term debt trading strategies or long-term strategies like loan-to-own, must be cognizant that the current liquidity crunch creates the very real risk of bankruptcy.

B. *Cram–Up*. A "cram-up" plan of reorganization is when junior classes of creditors impose a cramdown on senior classes of creditors. In such circumstances, senior classes of creditors can be forced to accept the terms of a proposed restructuring, even if they are not as good as the original deal, including, for example, take back paper with a below market interest rate. The "cram-up" risk is heightened when a junior lender holds the fulcrum security or can influence the restructuring path based on its significant holdings across the capital stack.

1. There are two primary cram-up methods: reinstatement and indubitable equivalent.

2. In a reinstatement cram-up, the maturity of debt is restored at the pre-bankruptcy level, collection on debt due as a result of defaults are decelerated, defaults are "cured" and lenders are compensated for damages, thereby continuing the terms of the pre-bankruptcy financing. Debtors may favor this approach in a market where interest rates have risen significantly or where debtors enjoy a favorable covenant package (as would be the case in many of the existing "covenant lite" financings).

3. In the alternative, debt can be crammed up by either providing the secured lender with deferred cash payments with a present value equal to the debt (assuming the lender is fully secured by its collateral package) or by providing the secured lender with the "indubitable equivalent" of its secured claim. Debtors may utilize this approach where the pre-bankruptcy maturity date is an issue or to compel lenders to involuntarily refinance using interest rates that may be lower than an existing facility.

(a) Courts have applied two methodologies for determining the appropriate interest rate to calculate present value: the formula approach and the market approach. The "formula approach" starts with a risk-free base rate (such as the Treasury rate or prime rate) and is adjusted by the court to account for risks based on the circumstances of the case, the nature of the collateral, the terms of the take back paper and feasibility of the plan. The "market approach" refers to the prevailing rate of interest the debtor would be required to pay for the same financing in an efficient market.

C. *Disallowance of OID*. Original Issue Discount ("OID") is the difference between the value of the proceeds of a debt instrument at the time it is issued and the face amount of the same at its maturity. In addition to OID created at the time of issuance, OID can also arise in debt-for-debt exchanges (including face value exchanges and fair value exchanges).

1. OID is paid only when the debt matures and is amortized over the life of the debt from an accounting and tax perspective (like regular interest accrual). As such, bankruptcy courts have held that OID constitutes interest for purposes of treatment under the Bankruptcy Code.

2. In bankruptcy, the allowed amount of a creditor's claim is determined as of the date the bankruptcy case is commenced. Consistent with this rule, claims for unmatured interest, and unamortized OID, are disallowed.

D. *Lien Avoidance*. In bankruptcy, a debtor may seek to unwind certain transfers or obligations it believes were fraudulently made. An LBO transaction that goes bad can be a prime target for fraudulent conveyance claims because lenders, management and shareholders may benefit greatly, while the debt used to finance the deal can render the company insolvent.

1. In general, an LBO or functionally similar transaction involves substituting debt for equity. Often, loan proceeds are obtained by the acquiring entity, secured by the target entity's assets and used by the acquiring entity to buy-out the existing equity holders of the target entity. With respect to lender risks, parties may initiate fraudulent transfer litigation to avoid the liens granted to the third-party lenders that financed the LBO.

2. There are two types of fraud for purposes of fraudulent transfers: actual fraud and constructive fraud. Actual fraud exists where a transfer was made with actual intent to hinder, delay or defraud investors. Because direct evidence of fraudulent intent is often unavailable, courts rarely find actual fraud in the case of an LBO. Constructive fraud does not require fraudulent intent, but, instead, seeks to unwind transfers that were not in the best interests of the transferor.

3. In order to avoid the liens under a theory of constructive fraud, the debtor must have been (i) insolvent or (ii) undercapitalized at the time of (or as a result of) the transaction. This is a fact-intensive inquiry and often requires expert analysis, but courts frequently look to three data points as a start:

(a) *Equity Market Cap*. With respect to solvency, courts prefer market evidence and have frequently relied on a public company's positive equity capitalization as dispositive proof of solvency in the absence of fraud.

(b) *Balance Sheet*. Another solvency data point, albeit not dispositive, is the balance sheet. If the assets of the company exceed liabilities by a meaningful cushion after the LBO transaction, courts may consider that to be evidence of solvency.

(c) *Adequate Capital*. If solvency is a snapshot at a particular point in time, a determination of "adequate capitalization" is forward-looking based on projections. If the company's projections show a sufficient operating income to deal with its operating liabilities based on reasonable assumptions, courts may consider that to be evidence of adequate capitalization.

4. *Risk Mitigants*. Lenders should be cognizant that a failed LBO will likely be subject to litigation. To mitigate risks, lenders should be prepared to conduct a thorough, independent solvency analysis of the potential borrower at time of transaction (both on an individual and post-LBO consolidated basis). When performing a solvency analysis and valuation, lenders should expect that courts will "collapse" the transaction and look at the net value received by the borrower, rather than consideration exchanged in any individual/incremental

transaction. Lenders may also require a third-party solvency opinion and representations in the loan agreement (and transaction agreement) and an officers' certificate on solvency.

(a) These steps would *not eliminate* the fraudulent transfer risk, but would be helpful to mitigate them in the event of a future bankruptcy filing.

III. Certain Material Provisions of a Typical Credit Agreement

A. Credit Facility

1. *Mechanics*. The facility section of the credit agreement sets forth the mechanics of making a loan, the payment of the principal of, and interest on, each loan, and the maximum amounts, sublimits, borrowing bases and other basic terms that relate to the facility.

2. Interest Rate

(a) Loan pricing may be divided into two categories: interest rates based on (x) an all-inclusive calculation of the bank's costs in extending credit, such as the bank's prime rate, and (y) the bank's "cost of funds." In each case, the lender may add a margin or spread to the foregoing base interest rates, based upon the lender's perceived risk of the credit. The most common cost of funds rate is LIBOR. Note that the Financial Conduct Authority of the United Kingdom plans to phase out LIBOR by the end of 2021. Discussions are underway to determine the new benchmark rate to replace LIBOR, which may include a benchmark rate based on the Secured Overnight Financing Rate ("SOFR").

(b) Most states have laws that limit the rate of interest a lender may charge on a loan. Most of these limitations do not apply to large commercial loans. For example, in New York, commercial loans in excess of $2,500,000 are not subject to usury restrictions. Some states, however, still have usury laws that are of concern to commercial lenders. Note that fees and equity kickers may be included as interest when calculating the interest rate for determining whether a loan is usurious.

3. *Incremental Facilities*. Credit agreements may have provisions that allow for (i) incremental facilities to increase the existing loans on same terms or different terms, and/or (ii) sidecar loan facilities that permit additional loans on same terms or different terms. The terms of the incremental facilities, the amounts, the economics and rights of existing lenders to participate or provide such facilities are all negotiated on a deal-by-deal basis.

B. Letters of Credit

1. A letter of credit facility is usually part of the revolving facility (i.e., reduces the amount available under the revolving facility) with a sublimit on the letter of credit facility.

C. Application of Payments

1. *Waterfall*. Governs how the proceeds from collateral or other payments are allocated among the lenders after the occurrence of an event of default.

D. Conditions Precedent

1. Conditions precedent establish the conditions to the lender's obligation to extend credit to the borrower.

2. Many credit agreements entered into in connection with an acquisition financing require "SunGard" closing conditions. SunGard provisions replace the customary conditions precedent to initial funding that require the perfection of security interest on the collateral and that all representations and warranties are true and correct, in each case, as of the closing date. The purpose of SunGard provisions is to reduce the number and scope of conditions precedent so there is more certainty for the seller that the financing will be available and the acquisition will close as expected.

E. Representations and Warranties

1. The representations and warranties of a credit agreement, together with the disclosure schedules that are attached to the credit agreement, provide a "snapshot" of the borrower at a particular point in time, and, if there is a gap between signing and closing of any funding, the representations and warranties are "brought down" (i.e., re-made) on the closing date and each funding date.
2. There are two broad categories of representations and warranties. The first category deals with standard issues, such as the borrower's due organization and compliance with laws. The second category deals with issues specific to the particular credit and borrower. These include such items as compliance with specific regulations applicable to the borrower's business and ownership of assets by the borrower.

F. Covenants

1. Through the covenants of a credit agreement, the lender seeks to maintain the "snapshot" of the borrower. If a covenant is violated, a lender may reevaluate the credit and declare an event of default. There are many types of covenants found in credit agreements. Covenants are generally divided into affirmative covenants (setting forth actions the borrower should affirmatively take), negative covenants (setting forth prohibitions on certain actions by the borrower) and financial covenants.
2. Examples of affirmative covenants: financial reporting, compliance with laws, maintenance of existence, maintenance of insurance, inspections/lender calls, maintenance of books and records and further assurances.
3. Examples of negative covenants: limitations on debt, liens, investments, dispositions, fundamental changes, dividends/distributions, change in the nature of business, payment on other debt and transactions with affiliates.
   (a) These covenants typically include certain exceptions and thresholds. Borrowers will often push to expand the threshold baskets by (i) setting the basket as the "greater of a fixed amount and a certain percentage of EBITDA" as opposed to a fixed amount; and (ii) using the "Available Amount/Builder Basket." All of the covenant baskets should be reviewed collectively – especially given the prevalence of EBITDA grower baskets and available amount baskets.
   (b) The "Limited Condition Acquisition" concept is fairly prevalent in large cap and upper middle-market transactions. Limited Condition Acquisition provisions were originally introduced so that a buyer in an acquisition could bolster its position by stating its offer to purchase is not conditional on obtaining third-party debt. Credit agreements that permit Limited Condition Acquisitions will allow a borrower to elect to test availability under debt incurrence baskets and/or conditions such as "no default or event of default" on the date of the execution of the acquisition documents rather than at its completion.
   (c) Some credit agreements also differentiate between "Restricted Subsidiaries" and "Unrestricted Subsidiaries." Restricted Subsidiaries are subject to the representations and warranties and the covenants of the credit agreement. Unrestricted Subsidiaries would not be subject to such provisions. If a credit agreement permits the borrower to have Unrestricted Subsidiaries, it is important to review all of the negative covenants for any potential issues.
   (d) Credit agreements should reflect the assumptions used to underwrite the deal. Credit agreements should prohibit transfers of assets that are material to the business of the borrower, and if certain baskets are expected to be utilized solely with cash (e.g., cash investments and cash restricted payments), the credit agreement should be drafted clearly to state such expectations.
4. Financial Covenants
   (a) *Weakening of Financial Covenants*. "Covenant-lite" approach, speculative EBITDA addbacks and increased cushion to sponsor models — all may affect recovery prospects for lenders.
   (b) Financial covenants should be tight enough to detect a financial problem in advance of a default. If the financial covenants are sufficiently sensitive and the credit is being monitored properly, the lenders should be able to exercise rights and remedies before a payment default occurs.

G. Events of Default and Remedies

1. Events of default are the triggers that allow the lender to exercise its rights and remedies, including acceleration of the loans and termination of commitments.

2. May include an equity cure provision to permit the borrower to cure its financial covenant defaults.

IV. Specialty Finance, Esoteric Deals and Yields Uncorrelated to Capital Markets

A. Uncorrelated investment opportunities continue to be in high demand.

B. *Specialty Finance*. This includes all areas that traditional banks can't fund.

1. *Consumer Credit*. Debt incurred by consumers when purchasing goods or services. Examples include rent-to-own and motorcycle leases. Other types of consumer funding are expanding, e.g., income-sharing agreements.

2. *Commercial Credit*. Examples include merchant cash advances and insurance-related receivables.

3. *Insurance Companies.* Are these the new banks? Insurance companies have begun to offer direct credit.

(a) Can be an additional source of leverage to funds.

(b) Sometimes need a rating.

C. "Esoteric" Deals

1. Litigation finance.

2. Income-sharing agreements.

3. Purchase of lottery winnings.

4. Medical liens.

Private Investments

I. Introduction

A. *Basic Trend*. A number of managers who have historically been focused either primarily or exclusively on public investments ("public investments") are investing in private equity-type investments ("private investments"), and not just by suspending redemptions.[1] Expansion to private investments can add complexities to structures and terms that managers would otherwise use.

B. *Reasons for Why this Trend Is Occurring*. This trend is occurring because it is becoming more challenging to invest in the public investment markets because of:

1. Fully priced and oversaturated public markets

2. Low interest rates in the public markets

C. *Structuring Approaches*. There are two general approaches to structure private investments within an existing fund complex otherwise focused on public investments.

1. Single fund structures (i.e., side pockets, hybrid fund structures)

2. Separate fund structures (i.e., co-investment vehicles, side-by-side structures)

II. Single Fund Structures

A. Development of Trends of Investor Interest in Single Fund Structures

1. Side pockets and other single fund structures were unpopular after the financial crisis. New funds were launched without them unless the investment program was something like distressed debt where they were unavoidable, and even existing funds often promised to stop using side pockets going forward.[2]

2. Recently, however, side pockets are becoming increasingly more acceptable again as part of the toolbox to maximize returns in a strategy rather than an emergency measure to address unintended illiquidity.

3. Examples of investment program sectors where side pockets are becoming more acceptable:[3]

(a) Credit funds[4]

(b) Emerging markets

(c) Litigation finance

(d) Insurance products

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[1] *See e.g.*, "2019 EY Global Alternative Fund Survey", page 13 (available for download at: https://www.ey.com/en_gl/wealth-asset-management/when-focusing-on-the-future-where-do-you-look) (reporting that "more than a quarter of hedge fund managers indicated they have either a private equity or venture capital offering" and that hedge fund's offering of co-investment vehicles or "best idea portfolios" has increased by 18% since 2018); Idzelis, Christine, "Hedge Fund Firms Ramp Up Private Investing", *Institutional Investor* (April 26, 2019) (available at: https://www.institutionalinvestor.com/article/b1f4r997t0wgtr/Hedge-Fund-Firms-Ramp-Up-Private-Investing); Whyte, Amy, "Two Sigma is Getting Into Private Equity", *Institutional Investor* (November 19, 2019) (available at: https://www.institutionalinvestor.com/article/b1j394r56c8336/Two-Sigma-Is-Getting-Into-Private-Equity); Karsh, Melissa "Hedge Funds Turn to Private Capital Playbook in Search of Assets", *Bloomberg* (Jan. 3, 2019) (available at: https://www.bloomberg.com/news/articles/2019-01-03/hedge-funds-turn-to-private-capital-playbook-in-search-of-assets).

[2] *See* Lovell, Hamlin, "Credit Funds: Evolving Hybrid and Other Structures — Insights from SRZ's Leading Investment Management Practice," *The Hedge Fund Journal* (December 2019); *see also* Shadab, Houman, "Financial Crisis to Slow Convergence of Hedge Funds and Private Equity Funds, But not For Long," *Hedge Fund Law Report* (March 4, 2019).

[3] *Id*.

[4] *Id*.

B. Considerations Regarding Exposure Limitations on Private Investments in Single Fund Structures

1. *Setting Fixed Allocation Amounts on a Fund-Level v. Investor-Level Basis*. When setting fixed allocations for side pocket exposure, managers should consider whether to set this on a fund-level basis (*e.g.*, the fund as a whole will not allocate more than 25% of its assets to side pockets) or on an investor-level basis (*e.g.*, no more than 25% of an investor's capital account(s) will be allocated to side pockets). Benefits to allocating it based on an investor-level basis are that it helps ensure that all investors get side pocket exposure and that the fund does not run of side pocket capacity because of partial redeemers.

2. *Investor Optionality in Allocations*. Traditionally, fund managers set fixed percentages for side pocket allocations (whether on a fund-level or investor-level basis). We are now seeing managers offering optionality to investors in terms of how much exposure they want to the side pockets within a portfolio (this optionality will only work if the side pocket allocations are set on an investor-level basis).

   (a) This can seem attractive from a marketing perspective.

   (b) However, managers need to think about the complexities that will arise if different people have different levels of side pocket cap and an investment needs to be moved into the side pocked midstream.

   (c) Also, if a manager gives investors a choice as to the amounts of side pockets investors will accept, managers may find that too many investors opt out of side pockets, giving managers less ability to pursue privates investments.

C. General Issues to Consider[5]

1. *Structure of Legal Entity.* While traditional fund legal entities can be used for single fund structures pursuing both public and private investments (e.g., Delaware limited partnerships, Cayman Islands companies or partnerships), the usage of Delaware series LLCs, Delaware series partnerships or Cayman Islands segregated portfolio companies can help facilitate a hybrid investment structure, as one series/portfolio can be used for the public investment portfolio while another series/portfolio can be used for the private investment portfolio.[6]

2. *Fund Terms.* Managers should consider various fund terms when incorporating private investments into funds otherwise focused on public investments.

   (a) Subscriptions

      (i) Managers using hybrid fund structures may consider accepting subscriptions through capital commitments they draw down over time (as opposed to capital contributions that are fully funded at the time of subscription).

      (ii) This can facilitate the ability to invest opportunistically in more illiquid assets.

      (iii) When using a drawdown mechanism, managers should generally include typical terms that funds use for drawdown mechanics (e.g., default provisions, a single capital account tracks the entire capital commitment amount; consider whether investor's voting rights should be based off of the total amount committed vs. the total amount contributed).[7]

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[5] While certain of these issues may be applicable to public and private investments pursued through separate investment fund structures, they have been included in the discussion of this outline regarding public and private investments pursued through single investment structures as they may more frequently or acutely arise in that context.

[6] *See* Braunstein, Yehuda M. and Warren, Todd K., "Understanding the Benefits and Uses of Series LLCs for Hedge Fund Managers," *The Hedge Fund Law Report* (Nov. 15, 2012).

[7] *See* Griffith Cara, "Can a Capital on Call Funding Structure Fit the Hedge Fund Mismatch," *Hedge Fund Law Report* (Nov. 5, 2019).

(b) Liquidity

(i) Some managers may consider creating more illiquid terms for the funds as a whole with lock-ups and gates.

(ii) Managers may also consider more liquid terms for the public investment portion of the portfolio and more illiquid terms for the private investments.[8]

(c) Management Fees

(i) Hedge fund management fees are often based on a certain percentage of the NAV of its investments. Private equity funds, though, often set management fees based on the amount of invested or committed capital. Managers should consider which approach is appropriate for a hybrid fund, or consider applying separate management fee terms for the private investments and public investments.

(ii) Private equity funds often offer management fee offset terms, whereby any transaction fees, consulting fees or similar fees the manager collects as part of managing the private investment, will offset the management fees the fund owes to the manager. Hybrid fund managers should consider adding such terms (to the extent they don't already exist) at least for the private investment portion of the portfolio.

(d) Incentive Compensation

(i) Incentive compensation on private investments is generally collected in a more back-ended manner once the investment proceeds are realized. Incentive compensation on public investments, though, is generally collected on an annual basis on both realized and unrealized gains.

(ii) Managers using a hybrid structure should consider whether to:

(1) Apply a private equity-type/waterfall incentive compensation structure for all investments;

(2) Apply a hedge-fund style incentive compensation on the entire portfolio (e.g., annually, based on realized and unrealized gains) — note this will often require the use of an "internal rate of return" valuation mechanism to value the illiquid portions of the portfolio; or

(3) Apply a private equity type incentive compensation term only to the private investment portfolio, and annual hedge-fund style incentive compensation term to the public investment portfolio.[9]

(e) *Participation of Incoming Investors in Current Private Investments*. Private equity funds often allow investors admitted to the fund at subsequent closings to participate in the fund's initial private investments (typically requiring them to pay interest and make-up management fees to put them in the same economic position as the initial investors). Hybrid funds may consider this strategy, though if a fund has an evergreen structure with investors being admitted and withdrawing frequently, it may be easier for the fund to only allow incoming investors to participate in future private investments.

3. Certain Tax Considerations

(a) One of the tax concerns with private investments is structuring around "effectively-connected income." Blockers can be used to create tax efficiency.

(b) If a manager is using blockers in its fund complex, the manager needs to consider the particular point in which the blockers are placed. Blockers can be inserted into a fund complex in a way that enables you to

[8] *See* Banzaca, Jennifer, "Hedge Fund Managers Turn to Hybrid Fund Structures to Reconcile Liquidity Terms and Duration of Assets," *Hedge Fund Law Report* (Feb. 4, 2009).

[9] *See generally Id*.

collect carried interest on a pre-tax basis. It might seem that this hurts the investor. In fact, taking the carry pre-tax is neutral for investors. Only the IRS loses.

4. *Certain ERISA Considerations*. If a fund decides to have a private investment portfolio and public investment portfolio in the same fund, it is possible to structure them such that the testing as to whether the fund has 25% or more of ERISA investors is done on a separate basis for the portfolio that holds the private investments. This is especially true if the private investments are held through different series of a Delaware series partnership or series LLC or a different portfolio of a Cayman segregated portfolio company.

III. Separate Fund Structures

A. General Benefits

1. Sometimes it makes more sense, either from a marketing perspective or because of the amount of private investments a manager wants to make, to run private investments in a separate vehicle rather than attempting to manage them through side pockets.

2. The separate structure might be attractive to investors who are not otherwise interested in the public market part of your strategy or who want a closed end fund with classic private equity terms.

3. Using a separate vehicle also provides a manager with more flexibility in creating structures and terms that are appropriate for these types of investments.

B. Types of Separate Fund Structures

1. *Co-investment Vehicles.* A manager can insert its more illiquid investments in a co-investment vehicle. These are generally used for single investments.[10]

2. Side-by-Side

(a) A manager may set up a dedicated separate vehicle for multiple private investment opportunities that invests alongside a separate vehicle used for public investments.

(b) A manager may initially set up multiple co-investment vehicles and then combine them into a dedicated private equity fund that it manages alongside its hedge fund.

C. General Issues to Consider[11]

1. Investor Protections in Private Investment Funds

(a) Fund sponsors who are used to running evergreen funds that invest in public investments may be surprised by the level of additional investor protections that investors in closed end private equity funds expect. Those can include: hurdles, clawbacks, investor rights to remove the general partner, and far more expansive investment restrictions and side letter requests.

(b) Sometimes, these requests can leak across from those investors to the manager's public equity products, such as with respect to fee terms:

(c) Fee Terms:

(i) Investors may seek MFN treatment, taking into consideration the assets they have across multiple funds, including both the funds that are focused on public and private investments.

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[10] *See* e.g., Lovell, Hamlin, "Co-Investments go Mainstream: Thoughts from the co-head of SRZ's leading investment management group," *The Hedge Fund Journal* (Aug. 2019); Kustin, Ira P., "Beyond the Master-Feeder: Managing Liquidity Demands in More Flexible Fund Structures, *Hedge Fund Law Report* (May 25, 2017).

[11] While certain of these issues may be applicable to public and private investments pursued through single fund structures, they have been included in the discussion of this outline regarding public and private investments pursued through separate fund structures as they may more frequently or acutely arise in that context.

(ii) Managers may want to offer common fee terms for public and private investments – when doing so, managers should consider the differences between terms used for public and private investments and whether this will work, *e.g.*,:

(1) It may be appropriate for management fees to be based off of NAV for public investments, but invested or committed capital for private investments.

(2) Incentive compensation may be more appropriately structured as a back-ended waterfall for private investments, while an annual incentive allocation on realized and unrealized gains may be more appropriate for the public investments.

2. Allocation of Investment Opportunities

(a) Managers need to be careful to fairly allocate investment opportunities between their funds focused on public and private investments. This can be challenging in some situations, e.g.:

(i) An investment is not easy to classify as being totally public vs. private.

(ii) If the public and private investments that will be made are not obviously distinct from one another. For instance, some managers use private equity structures for investments in which they are seeking control and a long-term hold, while using evergreen structures for passive investments. If the manager changes its thesis midstream towards taking control of an investment previously expected to be passive, the investment may become more appropriate for its private investment fund. In that case it will be important to have set clear expectations as to whether the evergreen fund will continue to invest in the same company, stand-still, or possibly sell its position to the private investment fund.

(b) The allocation of investment opportunities may create certain inherent conflicts of interest when different funds invest in a different portions of an issuer's capital structure (e.g., the public-investment-focused fund invests in publicly traded securities of an issuer, while the private equity fund invests in certain privately issued debt of the issuer or a new class of privately offered equity).[12]

(c) If the public and private investment fund invest in the same type of an investment, they should consider any conflicts related to entering and/or exiting the investment, e.g., it might be fair for each fund to exit an investment at the same time unless there's a specific reason to justify the difference in exiting the same opportunity.

(d) If the managers lures investors into a co-investment vehicle away from the main fund, particularly when the co-investment vehicle charges lower fees, the manager needs to be able to take the position that it wasn't taking opportunities away from the main fund.

(e) Managers may consider buying excess capacity in certain investments in order to allocate it to a co-investment vehicle that it intends to form (e.g., because the investment is too illiquid to be entirely held in a fund that is primarily focused on liquid investments).

(i) In these scenarios, managers should be able to defend this approach why it was fair to the more liquid fund to make the investment in this manner (e.g., the more liquid fund was able to buy the investment at a cheaper price because it bought the capacity it intends to eventually allocate to the co-investment vehicle).

[12] *See* e.g., Breslow, Stephanie, "Recent Trends in Credit Funds," *Expert Guides Women in Business Law*, pages 81-82 (Aug. 2019) (available at: https://www.srz.com/images/content/1/6/v2/165769/082319-SRZ-Expert-Guides-Credit-Funds.pdf) ("*Credit fund general partners must decide in advance how they will allocate trades among their various funds, as well as how to resolve conflicts when investing in different parts of the capital structure of a given portfolio company.*"); Banzaca, Jen, "Don't Play Favourites With Your Investors: How are firms managing a range of conflicts of interest when running different types of investment vehicles," *HFM Week.Com*, pages 17-18 (April 19-25, 2018) (available at: https://www.srz.com/images/content/1/5/v2/156833/HFMWeek-Don-t-Play-Favourites-With-Your-Investors.pdf).

(ii) Managers must also consider issues involving cross-trades in this situation, once the investment is eventually allocated to the co-investment vehicle.

(iii) Managers should realize that this arrangement may have adverse implications from a tax perspective if the fund takes the position that it is an "investor" vs. a "trader."

3. Allocation of Expenses

(a) The different funds need to fairly allocate common expenses amongst each other. This can be complicated in many situations.

(b) If the private investment-focused fund invests in an investment at a later date than the main fund, it may be appropriate for the private investment fund to pay its proportionate share of the expenses incurred by the other investment fund in the initial stages of the investments.

(c) Managers should particularly pay attention to how to allocate expenses among main funds and co-investment vehicles. The SEC has scrutinized such arrangements.[13]

(d) The SEC has also scrutinized whether "broken-deal expenses" are allocated fairly among funds.[14]

(e) Managers must clearly disclose their expense allocation disclosure to investors and follow it.

4. Cross-Defaults

(a) Assuming the private investment-focused fund in the structure accepts contributions through capital commitments (as opposed to capital contributions), managers may consider implementing terms whereby if an investor defaults on its capital commitment to the private investment-focused fund, the manager may deduct capital from the investor's capital account in the public fund to cover the shortfall in the private investment-fund created by the default (e.g., where the investor does not otherwise have capital in the private investment-focused fund from which to collect capital).

(b) Managers should note this arrangement may have adverse tax consequences to the extent either fund in the structure seeks to avoid being taxable as a "publicly-traded partnership."

5. *Certain Tax Considerations.* Using a separate structure focused solely on private investments allows you more flexibility. That said, the tools used by traditional private equity funds that have maybe a dozen investments aren't always the best for hybrid strategies with a more diverse portfolio mix. For example, the typical private equity model involves starting with a single partnership and rolling out alternative investment vehicles if a manager wants to block things. This could be expensive if a manager finds that a lot of investments need blocking. You have to weigh this against the tax drag of blocking everything for non-U.S. and tax-exempt investors and your marketing team's desire to have a fund that looks like a classic private equity fund.

6. *Certain ERISA Considerations*. The fund focused on private investments may qualify as a "VCOC" or "REOC" for ERISA purposes, thus allowing it to admit 25% or more of ERISA investors.

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[13] *See* e.g., Lees, Hena, "SEC Fines Fund Manager for Failing to Equitably Allocate Fees and Expenses to Its Affiliate Funds and Co-Investors," *Hedge Fund Law Report* (June 6, 2019).

[14] *See In the Matter of Platinum Equity Advisors, LLC* (Investment Advisers Act of 1940 Release No. 4772) (Sept. 21, 2017 (same); *see also* Pitaro, Vincent, "SEC Enforcement Action Involving 'Broken Deal' Expenses Emphasizes the Importance of Proper Allocation and Disclosure," *Hedge Fund Law Report* (July 9, 2015).

IV. Other Issues to Consider in Single or Separate Fund Structures

A. Team Compensation

1. Investment personnel of hedge funds focused on only public investments are generally paid annually based on the fund's realized and unrealized gains. This compensation structure may not be appropriate for private investments where carried interest is typically only paid once investments are realized. For example:

   (a) Managers of pure private equity funds typically grant the investment team slices of carry that are locked in subject to vesting and forfeiture so that a person working on the fund day one, knows they can receive carry in future years, even if they leave in the meantime. This type of issue does not arise in evergreen public funds, although it is relevant to side pockets. Fund firms that are expanding into private investments need to think about whether their compensation model need to be modified to deal with this issue.

   (b) A lot of you have gotten used to annual bonuses that are made in the manager's discretion. This becomes less tolerable when carry will not be earned for years after the work is done.

2. If managers have different teams running the private equity and public market investments, managers need to decide whether each team is being paid in the usual way for that asset class, or whether everybody is sharing in the common pool. It can be attractive to private equity investment team members to get a portion of their compensation based on annual mark to market performance on the public side. Correlatively, having private equity carry dangling in the future can be a good retention tool for public side investment professionals.

3. If managers decide to combine your public and private investments in a single hybrid fund, managers may need to limit investor liquidity. This can cause investors to demand that a manager's carry only be collected at the end of a multi-year lock-up. This can create complexities from a tax perspective, particularly when an investor has a managed account.

B. Performance Results and Advertising

1. Presentation of Performance Results

   (a) Performance results are often presented differently by funds focusing on private investments v. funds focusing on public investments:

      (i) Performance results attributable to private investments typically present more detailed performance information that includes deal-by-deal gross returns, projections and IRR calculations.

      (ii) Performance results attributable to public investments (e.g., in the hedge fund context) typically:

         (1) Are only based on NAV and annual performance information;

         (2) Are more limited because investors can act on this information to subscribe and redeem; and

         (3) Reflect "cash drag" as a result of holding more in cash reserves than a private equity fund run side by side.

   (b) As a result of the differences in presentation, performance numbers attributable to funds or portfolios focused on private investments vs. those focused on public investments may differ, even when their investment portfolios are substantially similar.

   (c) Furthermore, different structuring for tax issues between the public and private investments can also cause differences in performances due to "tax drag."

   (d) Investors who invest in both public and private investments may seek to receive more extensive information regarding the private investments than is generally available with respect to public investments. This could present selective disclosure issues since the investors could act on this information by withdrawing from the hedge fund in a side-by-side structure, or limiting their allocation to side pockets in a hybrid structure, to the detriment of other investors.

2. Performance Advertising

(a) Because of the foregoing differences, managers need to also be mindful about adapting performance results from a structure that pursues public and private investments and applying it to a structure that only pursues public or private investments, or similarly adapting performance results from a fund complex that pursues a different investment strategy than the one a manager currently pursues. Such advertising might potentially be too misleading in certain instances and, even where permitted, must also contain disclosures regarding the differences in investment strategies used between public and private investments.[15]

[15] *See* e.g., *Clover Capital Management, Inc.*, SEC No-Action Letter (available Oct. 28, 1986) ("In the staff's view, Rule 206(4)-1(a)(5) prohibits an advertisement that [with respect to model and actual results] . . . fails to disclose any material conditions, objectives, or investment strategies used to obtain the results portrayed.").

Regulatory

I. Standard of Conduct for Investment Advisers

A. On June 5, 2019, the U.S. Securities and Exchange Commission published four items of guidance related to the standard of conduct required of investment advisers and broker-dealers under the federal securities laws:

1. Commission Interpretation Regarding the Standard of Conduct for Investment Advisers ("Fiduciary Interpretation")[1];

2. Form CRS Relationship Summary; Amendments to Form ADV ("Form CRS Release")[2];

3. Regulation Best Interest; and[3]

4. Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser ("Solely Incidental Interpretation").[4]

B. Fiduciary Interpretations

1. The Fiduciary Interpretation is the SEC's first holistic statement regarding an investment adviser's federal fiduciary duties.

(a) Federal Fiduciary Duty

(i) The SEC cites U.S. Supreme Court decisions (and its own precedent), stating that the Investment Advisers Act unambiguously establishes a federal fiduciary duty for investment advisers.[5]

(ii) The Fiduciary Interpretation emphasizes that this fiduciary duty exists, that it exists for all categories of clients and that it cannot be categorically waived.

(b) Conflicts of Interest Waivers

(i) With respect to the efficacy of disclosure in curing conflicts of interest, the SEC clarified in the Final Interpretation that "[w]e believe that while full and fair disclosure of all material facts relating to the advisory relationship or of conflicts of interest and a client's informed consent prevent the presence of those material facts or conflicts themselves from violating the adviser's fiduciary duty, such disclosure and consent do not themselves satisfy the adviser's duty to act in the client's best interest."[6]

(ii) The Fiduciary Interpretation provides that an adviser must "eliminate or make full and fair disclosure of all conflicts of interest which might incline an investment adviser — consciously or unconsciously — to render advice which is not disinterested such that a client can provide informed consent to the conflict."[7]

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[1] Commission Interpretation Regarding the Standard of Conduct for Investment Advisers, Advisers Act Release No. IA 5248 (July 12, 2019) (hereinafter "Fiduciary Interpretation"), available here.

[2] Form CRS Relationship Summary; Amendments to Form ADV, Advisers Act Release No. IA-5247 (June 5, 2019) (hereinafter "Form CRS Release"), available here.

[3] Regulation Best Interest: The Broker-Dealer Standard of Conduct, Release No. 34-86031 (June 5, 2019) (hereinafter "Regulation Best Interest"), available here.

[4] Commission Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser, Advisers Act Release No. IA-5249 (June 5, 2019) (hereinafter "Solely Incidental Interpretation"), available here.

[5] Fiduciary Interpretation *supra* note 1, at 6.

[6] *Id.* at 23.

[7] *Id.* at 8.

(iii) The SEC, in the fiduciary interpretation:

(1) acknowledges that advisers are not required to "seek to avoid" all conflicts of interests; rather, an adviser may utilize disclosure in lieu of eliminating a conflict[8]; and

(2) validates an "informed consent" concept for conflict of interest disclosures by an adviser.[9]

(c) Contractual Limits

(i) The Fiduciary Interpretation expressly acknowledged that retail and institutional investors are differently positioned in their ability to assess conflicts, stating that "institutional clients generally have a greater capacity and more resources than retail clients to analyze and understand complex conflicts and their ramifications."[10]

(ii) The SEC made clear that this "greater capacity and more resources" point only goes so far, noting that "while the application of the investment adviser's fiduciary duty will vary with the scope of the relationship, the relationship in all cases remains that of a fiduciary to the client."[11]

(iii) The Fiduciary Interpretation specifically noted that overbroad waivers, such as the following, will not be permitted:

(1) A contractual provision purporting to waive the adviser's federal fiduciary duty generally;

(2) A statement that the adviser will not act as a fiduciary;

(3) A blanket waiver of all conflicts of interest; or

(4) A waiver of a specific obligation under the Investment Advisers Act.[12]

(d) Guidance on the Duty of Care

(i) The SEC stated that an advisers fiduciary duties encompass a duty of care as well as a duty of loyalty.[13]

(ii) Obligations with respect to the duty of care run to:

(1) Suitability (and a duty of inquiry to support a reasonable belief that advice is in the best interests of a given client);

(2) An obligation to seek best execution;

(3) A requirement to monitor performance over the course of a relationship.[14]

(e) Use of Contingent Language in Disclosures

(i) An adviser may not state that it "may" have a conflict when:

(1) the adviser, in fact, has a particular conflict; or

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[8] *Id.* at 23, n. 57.

[9] *Id.* at 9.

[10] *Id.* at 28, n. 70.

[11] *Id.* at 10.

[12] *Id.* at 10-11.

[13] *Id.* at 2.

[14] *Id.* at 12.

(2) has such a conflict with respect to some, but not all, of the adviser's clients.[15]

(ii) The SEC clarified that the use of "may" in disclosures of potential conflicts is appropriate when a conflict does not currently exist, but might reasonably present itself in the future.[16]

(f) Specific Guidance on Allocation Policies

(i) The SEC specifically addressed investment allocation policies, which have been a focus in many examinations.

(ii) The Fiduciary Interpretation stressed that "when allocating investment opportunities, an adviser is permitted to consider the nature and objectives of the client and the scope of the relationship. An adviser need not have pro rata allocation policies, or any particular method of allocation, but, as with other conflicts and material facts, the adviser's allocation practices must not prevent it from providing advice that is in the best interest of its clients."[17]

C. Form CRS Release

1. The Form CRS Release requires registered investment advisers that provide advisory services to "retail investor" clients to complete, file and deliver new Part 3 of Form ADV, also known as a Form CRS Relationship Summary.

2. The Form CRS Release confirmed that "[i]f a firm does not have retail investor clients … and is not required to deliver a relationship summary to any clients … , the firm will not be required to prepare or file a relationship summary."[18] As the DC Circuit held in Goldstein v. SEC[19], in the private fund context, the private fund itself is an adviser's client and, absent a separate relationship, investors in such private fund are not advisory clients.[20]

3. For those advisers with separately managed accounts, it is important to note that "retail investor" is defined as "a natural person, or the legal representative of such natural person, who seeks or receives services primarily for personal, family or household purposes," which the SEC interprets broadly as any services provided to a natural person for his or her own account.[21] In other words, wealthy and sophisticated individuals who have separately managed accounts are "retail investors" who must receive the new mandated disclosure in Form CRS.

4. Firms that are required to complete Part 3 of Form ADV must file their initial relationship summary with the SEC between May 1, 2020 and June 30, 2020.[22]

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[15] *Id.* at 25.

[16] *Id.*

[17] *Id.* at 26.

[18] Form CRS Release *supra* note 2, at 234.

[19] 451 F.3d 873 (DC Cir. 2006).

[20] The Division of Investment Management confirmed this approach in a recent FAQ on Form CRS:

> Q: My firm is an investment adviser to pooled investment vehicles, such as a hedge funds, private equity funds and venture capital funds. The investors in these funds include natural persons who may be "retail investors" as defined in Form CRS. Am I required to deliver a relationship summary to these funds?
>
> A: An investment adviser must initially deliver a relationship summary to each retail investor before or at the time the adviser enters into an investment advisory contract with the retail investor. "Retail investor" is defined as "a natural person, or the legal representative of such natural person, who seeks to receive or receives services primarily for personal, family or household purposes." In the staff's view, the types of pooled investment vehicles described above would not meet this definition and a relationship summary would not be required to be delivered.
>
> Frequently Asked Questions on Form CRS, (Nov. 26, 2019), available here.

[21] 17 CFR 275.204-5(d)(2).

[22] Form CRS Release *supra* note 2, at 239.

D. Regulation Best Interest and the "Solely Incidental" Interpretation

1. Regulation Best Interest and the Solely Incidental Interpretation apply only to broker-dealers and not to investment advisers.

2. Regulation Best Interest establishes a heightened standard of conduct for broker-dealers and their associated persons.

   (a) Specifically, the heightened standard of conduct requires broker-dealers to:

      (i) Act in the best interest of retail customers when recommending a securities transaction or an investment program involving securities ; and

      (ii) Establish policies and procedures reasonably designed to identify and disclose conflicts of interest and, when necessary, mitigate or, in certain circumstances, eliminate such conflicts.[23]

3. The Solely Incidental Interpretation provides that investment advice is "solely incidental" to broker-dealer activity (and therefore a broker-dealer is not classified as an investment adviser under the Advisers Act) when it "is provided in connection with and is reasonably related to the broker-dealer's primary business of effecting securities transactions."[24]

4. The Solely Incidental Interpretation reinforces that giving advice as to the value and characteristics of securities should not be the primary business of a firm relying on the broker-dealer exclusion from the definition of investment adviser under the Advisers Act, and it also provided guidance regarding the application of the "solely incidental" prong in the context of:

   (a) Exercising investment discretion over customer accounts, stating that "there are situations where a broker-dealer may exercise temporary or limited discretion in a way that is not indicative of a relationship that is primarily advisory in nature," but "unlimited discretion would not be solely incidental to the business of a broker-dealer;"[25] and

   (b) Account monitoring, providing that the SEC "disagree[s] with commenters who suggested that any monitoring of customer accounts would not be consistent with the solely incidental prong."[26]

II. Advertising Rule Proposal

A. Overview

1. On Nov. 4, 2019, the SEC issued proposed amendments to the "Advertising Rule" under the Investment Advisers Act of 1940 ("Advisers Act"),[27] which shift the model of regulating advertisements from a prescriptive to a principles-based approach.

2. The SEC is soliciting comments on a wide range of items relating to the proposed rule, with all comment letters due by Feb. 10, 2020[28]

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[23] Regulation Best Interest *supra* note 3, at 1.

[24] Solely Incidental Interpretation *supra* note 4, at 12.

[25] *Id.* at 16.

[26] *Id.* at 19.

[27] Investment Adviser Advertisements; Compensation for Solicitations, Advisers Act Release No. IA-5407 (Nov. 4, 2019) (hereinafter "Advertising Rule Proposal"), available here.

[28] *See* https://www.govinfo.gov/content/pkg/FR-2019-12-10/pdf/2019-24651.pdf.

B. Distinguishing Between Retail and Non-Retail Advertisements

1. The proposed rule creates a new category of "Non-Retail Advertisements," which would permit greater latitude in content and presentation, but the dissemination of which would be limited to "qualified purchasers" and "knowledgeable employees."[29]

2. Non-Retail Advertisements are also exempt from new performance reporting requirements that would require advisers to:

   (a) Show performance over specified time periods; and

   (b) Affirmatively provide certain disclosures accompanying hypothetical performance relating to the risks and limitations of such performance.[30]

C. Case Studies

1. The proposed rule incorporated a "fair and balanced" principle to evaluate the use of case studies and other past specific recommendations.[31]

2. The SEC noted that while the guidance from several staff no-action letters can be useful in applying the "fair and balanced" standard, the standard exists independently and advisers would not be obligated to follow the requirements of those letters.

3. "Cherry-picking" and other presentations of specific investment advice and related performance that are misleading would be prohibited under the "fair and balanced" standard.[32]

D. Hypothetical Performance

1. The proposed rule permits the use of hypothetical performance where advisers:

   (a) Provide sufficient information to enable the recipient to understand the criteria and assumptions underlying the performance; and

   (b) Provide (or, if a Non-Retail Advertisement, offer to provide) similar information addressing the risks and limitations of the use of hypothetical performance in making investment decisions.[33]

E. Extracted Performance

1. Under the proposed rule, advisers would be permitted to provide extracted performance in advertisements; provided that such advertisements contain or offer to promptly furnish the performance results of all investments in the portfolio from which the performance was extracted.[34]

F. Related Portfolios

1. The proposed rule would prohibit advertisements that show the performance of a "related portfolio" (which are those portfolios with substantially similar investment policies, objectives and strategies as those of the services being offered or promoted) unless the advertisement shows the performance of all related portfolios.

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[29] Advertising Rule Proposal *supra* note 27, 108. For example, advisers would be permitted to show gross performance without accompanying net performance in Non-Retail Advertisements; provided that the advertisement contains or offers to promptly furnish a schedule of specific fees and expenses.

[30] *Id.* at 109.

[31] *Id.* at 63.

[32] *Id.* at 58-59.

[33] *Id.* at 158-160.

[34] *Id.* at 352.

2. Advisers would be able to exclude the performance of a related portfolio only when the performance shown would be no higher than if the performance of all related portfolios were included.[35]

G. Compliance

1. The proposed rule would generally require review and pre-approval of advertisements by a designated employee.[36]

2. This review and approval requirement also applies to updates to previously-reviewed advertisements.[37]

3. The proposed rule would also require advisers to adopt policies and procedures with respect to the use of Non-Retail Advertisements and hypothetical performance.[38]

H. The proposed rule would generally permit the use of testimonials, endorsements and third-party ratings in advertisements, provided that they are accompanied by certain disclosures, such as whether compensation has been provided by or on behalf of the adviser to the person providing the testimonial or endorsement, or whether that person is a client.

I. Definition of "Advertisement"

1. The proposed rule fundamentally reworks the definition of an advertisement to cover "any communication, disseminated by any means, by or on behalf of an investment adviser, that offers or promotes the investment adviser's advisory services or that seeks to obtain or retain one or more investment advisory clients or investors in any pooled investment vehicle advised by the investment adviser," subject to certain enumerated exceptions.[39]

2. The proposed rule would make it clear that communications with existing clients and investors that "offer or promote" advisory services, which could, in certain circumstances, include the adviser's market commentary and discussions of the adviser's investing thesis, are considered advertisements.[40]

J. Additional General Prohibitions

1. The proposed rule expands on the general prohibitions currently included in the Advertising Rule.

2. Advisers would be prohibited from disseminating advertisements that:

(a) Contain any material claim or statement that is not substantiated[41];

(b) Contain untrue or misleading implications about material facts relating to the adviser, or that are reasonably likely to cause an untrue or misleading inference to be drawn concerning any material facts[42];

(c) Discuss or imply any potential benefits connected with or resulting from the adviser's services or methods of operation that do not also "clearly and prominently" disclose associated material risks or other limitations[43];

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[35] *Id.* at 145.

[36] *Id.* at 190.

[37] *Id.*

[38] *Id.* at 108.

[39] *Id.* at 19-20.

[40] *Id.* at 24-25.

[41] *Id.* at 56.

[42] *Id.* at 57.

[43] *Id.* at 59.

(d) Include or exclude performance results, or contain presentations of performance time periods, in a manner that is not fair and balanced[44]; and

(e) Are otherwise materially misleading.[45]

K. Comment Period, Transition Period and Existing No-Action Letters

1. The SEC is soliciting comments on a wide range of items relating to the proposed rule, with all comment letters due by Feb. 10, 2020.

2. The SEC is proposing a one-year transition period from the effective date of the proposed rule to formal implementation.

Advisers would be permitted to rely on the final rules during the period after the effective date but before the compliance date.

III. Cash Solicitation Rule Proposal

A. The SEC also proposed amendments to the "Cash Solicitation Rule" (Rule 206(4)-3) to expand the types of activities and compensation covered by that Rule and update certain compliance obligations under the Advisers Act.[46]

B. The proposed rule would expand the applicability of the Cash Solicitation Rule to include solicitors of private fund investors (currently the Rule only covers solicitors of "clients," not of "investors" in funds that are clients).[47]

C. An adviser's officers, directors, partners and employees would continue to remain exempt from the written agreement, compliance and oversight provisions of the Cash Solicitation Rule; provided that the affiliation is disclosed to clients or private fund investors.[48]

D. The SEC proposed expanding the applicability of the Cash Solicitation Rule to cover all forms of compensation, including non-cash compensation such as awards, prizes, free or discounted services, or directed brokerage.[49]

E. The proposed rule would eliminate the requirement that a solicitor deliver the adviser's brochure to clients and obtain from each client acknowledgements of receipt of the solicitation disclosures.[50]

F. Transition Period and Existing No-Action Letters

1. The SEC is proposing a one-year transition period from the effective date of the proposed rule to formal implementation.

2. Advisers would be permitted to rely on the amended rules during the period after the effective date but before the compliance date.

3. The proposing release contains a list of no-action letters under the Advertising Rule that the staff is reviewing for potential withdrawal in connection with the adoption of final rules.

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[44] *Id.* at 68.

[45] *Id.* at 72.

[46] *Id.* at 200.

[47] *Id.* at 201-202.

[48] *Id.* at 245-246.

[49] *Id.* at 205.

[50] *Id.* at 18.

IV. Proxy Voting Rule Guidance

A. On Nov. 5, 2019 the SEC issued guidance that detailed several issues that investment advisers should address in their proxy voting policies ("Proxy Guidance").[51]

B. The Fiduciary Interpretation[52] specified that voting decisions fall within the (fiduciary) duties of care and loyalty owed to clients by investment advisers.

C. Rule 206(4)-6 under the Investment Advisers Act specifically requires registered investment advisers that seek "to exercise voting authority with respect to client securities" to adopt and implement written policies and procedures that are reasonably designed to ensure that the investment adviser votes proxies in the best interest of its clients.

D. Annual Reviews

1. The Proxy Guidance makes it clear that the SEC expects an investment adviser to review and document, "no less frequently than annually," the overall adequacy of its proxy voting program.[53]

2. The SEC noted that such a review allows the adviser to confirm that its voting policies and procedures have been:

(a) Reasonably formulated (both in the abstract and in actual operation); and

(b) Effectively implemented.

E. Compliance Confirmations

1. The SEC stated that a registered investment adviser "should consider reasonable measures to determine that it is casting votes on behalf of its clients consistently with its voting policies and procedures."[54]

2. The Proxy Guidance suggests that reviewing a sampling of voting decisions, presumably by a compliance officer, is a viable way for an adviser to evaluate its compliance with Rule 206(4)-6 and confirm compliance with the manager's policies and procedures.[55]

F. Multiple Clients

1. The Proxy Guidance also focuses on how the actions of an investment adviser should change when the adviser has multiple clients.

2. The SEC questioned whether a single policy for all of the adviser's clients would be in the best interest of each of its clients, and in a footnote said "nothing in [Rule 206(4)-6] prevents an investment adviser from having different policies and procedures for different clients or different categories of clients."[56]

G. Managers That Make Specific Voting Decisions

1. The Proxy Guidance expressly states that advisers exercising voting authority must "conduct a reasonable investigation into matters on which the adviser votes and to vote in the best interest of the client."[57]

2. The SEC noted that any conflict of interest the adviser has in connection with a proxy vote must be carefully addressed.

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[51] Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Advisers Act Release No. IA-5325 (Sept. 10, 2019) (hereinafter "Proxy Guidance"), available here.

[52] Fiduciary Interpretation *supra* note 1, at 12, n. 32.

[53] Proxy Guidance *supra* note 51, at 16.

[54] *Id.* at 15.

[55] *Id.*

[56] *Id.* at 15, n. 40.

[57] *Id.* at 13.

3. The SEC also indicated that a "reasonable investigation" should consider whether particular votes request a more detailed analysis (e.g., mergers and acquisitions).[58]

H. Managers That Abstain from Voting

1. The Proxy Guidance confirms that an investment adviser is not required to cast votes on behalf of its clients, but this ability to abstain is limited only to two situations[59]:

   (a) Where an investment adviser and the client have agreed in advance to limit the conditions under which the investment adviser would exercise voting authority; and

   (b) When an investment adviser has determined that refraining from voting is in the best interest of that client (such as where the adviser determined that the cost to the client of voting the proxy exceeds the expected benefit to the client).

2. The SEC cautioned that when abstaining under a "best interests" analysis the adviser is still subject to the undertakings it made to its clients and, more broadly, to its duty of care.

I. Mangers That Employ a Proxy Advisory Firm

1. The primary focus of the Proxy Guidance is on advisers' use of proxy advisory firms.

2. The guidance applies not only to firms that empower proxy advisory firms to formulate positions and cast ballots on behalf of an adviser's clients, but also to advisers that utilize proxy firms for research and recommendations while retaining the ultimate decisions for itself.

3. The Proxy Guidance recommends that advisers employing a proxy advisory firm[60]:

   (a) Consider additional steps to evaluate whether the investment adviser's voting determinations are consistent with its voting policies and procedures;

   (b) And in the client's best interest; and

   (c) Before the votes are cast.

4. Examples of "additional steps" steps to evaluate whether the investment adviser's voting determinations are consistent with its voting policies and procedures proposed in the Proxy Guidance include[61]:

   (a) Reviews of the proposed voting slates

   (b) Additional substantive analysis of proposed votes on matters that are contested or controversial, that are not subject to any specific guidance in the manager's policies, or that may have been recommended prior to new information coming into the market

5. Capacity and Competence Assessment

   (a) The SEC also has suggested that an adviser, as a condition of continued engagement, should evaluate the "capacity and competence" of any proxy advisory firm, suggesting a focus on "the proxy advisory firm's staffing, personnel, and/or technology."[62]

   (b) The Proxy Guidance further recommends that the adviser "should also consider whether the proxy advisory firm has an effective process for seeking timely input from issuers and proxy advisory firm

[58] *Id.* at 14.

[59] *Id.* at 10-11.

[60] *Id.* at 15.

[61] *Id.* at 15-16.

[62] *Id.* at 17.

clients"[63] in formulating its recommendations; in other words, the adviser's investment staff should understand:

(i) How the proxy adviser formulates its recommendations;

(ii) How it deals with conflicts of interests (examples of several kinds of conflicts are included in the Proxy Guidance); and

(iii) How it utilizes technology in disclosing conflicts.

6. Effectiveness

(a) The Proxy Guidance states that an investment adviser should consider the "effectiveness" of the proxy advisory firm's process for obtaining "current and accurate information" related to matters on which is makes voting recommendations.[64]

(b) The SEC guidance suggests that advisers consider matters such as:

(i) How a proxy advisory firm engages with issuers and ensures that it has complete and accurate information;

(ii) How the firm tries to identify and correct deficiencies in its analysis;

(iii) The quality of the proxy advisory firm's disclosure of these matters to the adviser; and

(iv) Whether and how the adviser employs factors specific to a given issuer or proposal.[65]

7. Investigating Errors

(a) Situations where an adviser becomes aware of potential factual or methodological errors in a proxy advisory firm's work were also raised.

(b) The SEC suggested that an adviser "should conduct a reasonable investigation into the matter" and, more generally, review its own policies and procedures to ensure that they have been "reasonably designed to ensure that its voting determinations are not based on materially inaccurate or incomplete information."[66]

V. Alternative Data and Webscraping

A. Background

1. Private investment firms are increasingly utilizing "alternative data" obtained from a variety of sources, including via so-called web scraping. Regulators are focused on the policies and procedures firms have in place to vet the source and types of data fund managers are using.

2. Alternative data can be acquired from a variety of sources including, social media, credit card panels, price and payment information, geolocation information and satellite imagery. Investment managers use a variety of tools to analyze this data and incorporate it into their investment process (often relying both on internal resources and third party vendors).

3. Web scraping, also referred to as data scraping, spidering or crawling, among other names, can use various methods to collect information from across the Internet but generally relies on software that simulates human Web browsing. Web-scraped data can include product pricing, search trends, web traffic or insights from expert network sites.

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[63] *Id.*

[64] *Id.* at 21.

[65] *Id.* at 21-22.

[66] *Id.* at 21.

4. *Web-Scraped Data*. Data harvested from online sources using automated software — carries the risk that firms may unwittingly be in receipt of material non-pubic information, personally identifiable information, information improperly obtained in breach of confidentiality obligations or privacy laws, or information that the provider is prohibited from disclosing.

B. Potential Issues

1. Insider Trading

(a) Where data aggregators purchase data that is not public from the source or data is scraped that was not intended to be public (such as from behind a login or paywall or from the dark web), it may be considered MNPI.

(b) Exclusivity agreements with a web scraper who may have a proprietary tool not available to others in the market could also give rise to a claim that the collected information is MNPI.

(c) There is potentially a low threshold for establishing materiality where Big Data is concerned:

(i) In *SEC v. Huang*[67], the defendant, a data analyst at Capital One, misappropriated non-public credit card transaction data to trade various retailers' stock.

(ii) The Third Circuit upheld the $13 million jury verdict against the defendant, rejecting his argument that the data was not material because Capital One data on average represented only about 2.4% of transactions in the market.[68]

(d) If data is collected in a manner that is deceptive — e.g., disguising or failing to reveal the scrapers' identity or circumventing technological controls (such as the "I am not a robot" tests), it would be deemed a "deceptive device" for 10b-5 purposes (dispensing with the requirement of a breach of duty).

(i) In *SEC v. Dorozhko*[69], the Second Circuit held that the defendant's hacking to obtain confidential earnings data in advance of a public announcement was a deceptive act because the hack involved affirmatively misrepresenting himself.

(ii) Computer Fraud And Abuse Act Of 1984 ("CFAA")

(1) The CFAA prohibits accessing a computer without authorization or in excess of authorization[70]

(2) Thus far, efforts to stop scrapers using the CFAA have mostly be unsuccessful:

a. In September, the Ninth Circuit held that LinkedIn could not use the CFAA to block a web scrapers' access to its public data.[71]

(iii) Breach of Contract And Other Common Law Claims

(1) Data harvesting can take place in a manner contrary to, or inconsistent with, the terms of use and privacy statement of the websites from which the data is collected.

(2) Sources selling their own data could potentially be in violation of their customer agreements.

(3) Although the Ninth Circuit rejected CFAA claims in a case brought by LinkedIn (in *HiQ Labs v. LinkedIn*), it noted that other common law remedies are potentially available in response to web

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[67] 684 Fed. Appx. 167 (2017).

[68] *Id.*

[69] 574 F.3d 42 (2009).

[70] 18 U.S.C. § 1030 (2019).

[71] *HiQ Labs v. LinkedIn*, DC No.3:17-cv-03301-EMC (9th Cir. Sept. 9, 2019).

scraping, including trespass to chattels, copyright infringement, misappropriation, unjust enrichment, conversion, and breaches of contract or privacy.[72]

C. Recent SEC Exam Focus

1. The Office of Compliance Inspections and Examinations ("OCIE") has recently engaged in examinations focused primarily on web scraping and the use of alternative data.

2. Requests in these examinations address:

(a) Web-scraped data obtained via third party vendors, and how it is used in the research and investment process;

(b) Due diligence surrounding vendors providing web-scraped data;

(c) Data that firms may scrape and aggregate themselves; and

(d) How data is allocated or made available across a firm.

VI. California Consumer Privacy Act

A. Jan. 1, 2020 is the effective date of the California Consumer Privacy Act ("CCPA"), the country's first comprehensive privacy law.

B. Entities and Individuals Required to Comply:

1. The Act defines a "consumer" as any "natural person who is a California resident."[73]

2. The law applies to any business with at least $25 million in gross annual revenue[74] that collects personal information from "consumers," which in the private fund context could be an investor, prospective investor, employee, job applicant, independent contractor or potentially even a business contact who resides in California.[75]

3. A business that does not meet the threshold may still be subject to the CCPA if it controls, or is controlled by, a business that meets the criteria and shares common branding.[76]

4. This expansive covered business concept means that, in the private fund context, managers will need to assess the potential coverage of the CCPA at both the adviser or sponsor level as well as for the funds themselves.

5. The definition of "personal information" receives broad treatment, being defined as information that "identifies, relates to, describes, is reasonably capable of being associated with, or could reasonably be linked, directly or indirectly, with a particular consumer or household."[77]

(a) This is much broader than other privacy laws and expressly includes items such as email addresses, internet protocol addresses and biometric information.[78]

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[72] *Id.*

[73] California Consumer Privacy Act, CAL. CIV. CODE § 1798.140(g).

[74] *Id.* § 1798.140(c)(1)(A). The statute does not specify whether the $25-million gross annual revenue threshold is based on gross revenue in California, the United States or worldwide. For the time being, fund managers are advised to assume it is worldwide revenue.

[75] *Id.* § 1798.145(a)(6). For a company without a physical presence or affiliate in California, the statute provides a narrow exemption if the "commercial conduct takes place wholly outside of" and it is not otherwise "doing business" in California. This requires not having a single investor, prospective investor, employee or independent contractor in California.

[76] *Id.* § 1798.140(c)(2). Two other criteria less likely to apply to private funds are businesses that (i) annually buy, sell, receive or share, for commercial purposes, personal information of 50,000 or more consumers, households or devices; or (ii) derive 50% or more of annual revenue from selling consumer's personal information. *Id.*§ 1798.140(c)(1)(B)-(C).

[77] *Id.* § 1798.140(o)(1).

[78] *Id.* § 1798.140(o)(1)(A).

C. *Overview*. The CCPA requires covered businesses that collect personal information about California residents to:

1. Make certain disclosures concerning the collection and use of personal information, including the purposes for which the personal information is used and the categories of third parties with whom the personal information is shared;

2. Inform individuals of their rights to request detailed information about how their personal information is used or to request deletion of their personal information, and implement policies to comply with such requests;

3. Provide "conspicuous" notice and a means for individuals to opt out of the sale[79] of their personal information; and

4. Be accountable for data breaches that result from a failure to maintain reasonable security practices.

D. Compliance and Enforcement Timing

1. The California Attorney General, who is primarily tasked with enforcement, is still in the process of finalizing regulations.

2. Because final regulations are unlikely to be published before Jan. 1, 2020, the CCPA precludes the commencement of any enforcement actions prior to July 1, 2020.[80]

3. Actions brought after July 1, however, may relate to conduct between Jan. 1 and July 1, 2020. The California Attorney General may assess civil penalties of up to $2,500 per unintentional violation and $7,500 per intentional violation. A business is not liable if it cures any noncompliance "within 30 days after being notified of alleged noncompliance,"[81] although the California Attorney General has stated some violations may not be capable of being cured after the fact.

4. Private Right of Action in the CCPA

   (a) Limited solely to consumers whose personal information (defined more narrowly for these purposes)[82] has been subject to unauthorized access or disclosure as a result of the covered business' failure to maintain reasonable security procedures.[83]

   (b) A consumer must give the business 30 days' written notice and an opportunity to cure (if a cure is possible) prior to bringing any action.[84]

   (c) A consumer may seek statutory damages in an amount of not less than $100 and not greater than $750 per consumer per incident, or actual damages, whichever is greater, as well as an injunction or any relief a court deems proper.[85]

E. *Private Fund Manager Implications*. Personal information that private fund managers collect from existing investors who are individuals (i.e., natural persons) typically will be exempt from the CCPA, but other categories of information are covered:

1. Existing Individual Investors

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[79] "Sale" is defined broadly to include any disclosure or dissemination of personal information "for monetary or other valuable consideration." *Id.* § 1798.140(t).

[80] *Id.* § 1798.185(c).

[81] *Id.* § 1798.155(b).

[82] For purposes of the private right of action, the definition of "personal information" is defined as an individual's unencrypted and non-redacted first name or initial and/or last name combined with certain other types of personal information, such as social security number, account number or credit card number. *Id.* § 1798.150(a)(1)

[83] *Id.* § 1798.150(a)(1).

[84] *Id.* § 1798.150(b).

[85] *Id.* § 1798.150(a)(1).

(a) The most pertinent CCPA provision for private fund managers is the exemption for any information collected "pursuant to" the Gramm-Leach-Bliley Act ("GLBA").[86]

(b) The GLBA regulates information privacy practices of financial institutions and covers personal information that is collected in the specific context of providing an individual with a financial product or service.

(c) The exemption for information collected under the GLBA may effectively cover all information that funds collect about their existing investors.

(d) For example, name, contact information, social security or other tax identification number and bank routing information collected in the context of a subscription agreement is covered by the GLBA and therefore should be CCPA exempt.

2. Prospective Individual Investors

(a) Because the GLBA does not reach prospective investors, personal information collected from prospective individual (natural person) investors in California will be presumptively subject to the CCPA, requiring CCPA disclosures at the point of collection.

(b) The method of making these disclosures will depend on the context in which the personal information is collected.

(i) A fund manager that makes substantive information available to prospective investors via its website might add CCPA disclosures to an existing online privacy policy.

(ii) A manager may also add a CCPA disclosure along with other disclosures in pitch books or other marketing materials, or as a notice at the bottom of investor relation emails.

3. B2B Contacts

(a) Unlike most privacy laws, the CCPA's expansive definition of "personal information" encompasses information that identifies an individual person exchanged in a purely business-to-business context, such as the email address of a California resident acting on behalf of an institutional investor or service provider.

(b) The California legislature has placed a one-year moratorium on the statute's coverage for personal information obtained by a business from a California resident acting for another entity occurring "solely within the context of the business conducting due diligence regarding, or providing or receiving a product or service to or from" the other entity.

(c) The moratorium delays enforcement for things like the professional email address of a California resident working on behalf of an institutional investor or service provider but does not appear to apply to information obtained from a third party, such as a list provider.[87]

F. Human Resources Related Information

1. The CCPA requires disclosures to be made to employees, job applicants and independent contractors in California about the categories of personal information collected and the purposes for which the personal information will be used.

(a) This can be accomplished by adding notices in job applications, employee handbooks and independent contractor agreements.

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[86] *Id.* § 1798.145(e). The CCPA contains exemptions in relation to certain other statutes, including the California Information Privacy Act, but the GLBA exemption is the most relevant to fund managers.

[87] *Id.* § 1798.140(o) (as amended by AB-1355). The moratorium does not apply to the private right of action or the right to opt out of selling for these type of business contacts.

2. For persons already engaged by a fund manager, disclosure can be made through circulating an email with a link to the disclosures.

3. In this context, there is a one-year moratorium during which the disclosure requirements are limited to a description of the categories of information being collected and the purpose for which the categories of information will be used.

4. Absent an extension to the moratorium or amendment, the CCPA's more extensive disclosure requirements will apply commencing Jan. 1, 2021.[88]

G. *Alternative Data.* Such data in which personal information has been "deidentified" or "aggregated" is excluded from the CCPA.[89]

H. Sharing Personal Information with Service Providers

1. A business must disclose to consumers the purposes for which it shares personal information.[90]

   (a) This can be accomplished by adding language in an online privacy policy or similar disclosure.

2. The contains certain more burdensome obligations with respect to the "sale" or use for a "commercial purpose"[91] of consumer information, such as providing the ability to "opt out," providing consumers the right to request deletion of their information or responding to other individual information requests.[92]

3. Transferring a consumer's personal information to a service provider for a "business purpose" is generally an exception to what constitutes a "sale" under the CCPA.[93]

4. Most of the purposes for which fund managers share information with service providers will fall into one of the CCPA's seven categories of "business purposes," which are, in short:

   (a) Auditing interactions with consumers;

   (b) Detecting security incidents and protecting against illegal activity;

   (c) Debugging to repair errors;

   (d) Short-term "transient" uses;

   (e) Performing services on behalf of the business that collected the information;

   (f) Internal research for technological development; and

   (g) Maintaining and verifying quality and safety.[94]

   (h) The CCPA requires businesses to contractually prohibit its service providers from retaining, using or disclosing the consumer's personal information for any purpose other than performing the services specified in the contract.[95]

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[88] *Id.* § 1798.145(h).

[89] *See*, e.g., *Id.* §§ 1798.140(o)(2); 1798.145(a)(5).

[90] *Id.* § 1798.100(b), 1798.140(t)(2)(C)(i).

[91] "Commercial purposes" means to advance a person's commercial or economic interests, such as by inducing another person to buy, rent, lease, join, subscribe to, provide, or exchange products, goods, property, information, or services, or enabling or effecting, directly or indirectly, a commercial transaction. *Id.* § 1798.140(f).

[92] *Id.* § 1798.140(t)(2)(C); 1798.140(v).

[93] *Id.* § 1798.140(t)(2).

[94] *Id.* § 1798.140(d).

[95] *Id.* § 1798.140(v).

5. CCPA and GDPR Compliance

   (a) GDPR compliance does not ensure CCPA compliance because there are significant differences in requirements, definitions and scope.[96]

   (b) Data inventorying and mapping that many firms have already undertaken for purposes of GDPR compliance can be leveraged to assess the categories of information collected and how such information is used for purposes of CCPA compliance.

VII. Insider Trading Law Passed in Congress

A. On Dec. 5, 2019, the U.S. House of Representatives passed the Insider Trading Prohibition Act, which seeks to amend the Securities Exchange Act of 1934 to provide an explicit definition or insider trading.[97]

B. The bill would prohibit the purchase or sale of securities by someone while aware of material nonpublic information regarding such securities "if such person knows, or recklessly disregards, that such information has been obtained wrongfully, or that such purchase or sale would constitute a wrongful use of such information."[98]

C. Knowledge Requirement and Newman

   1. The bill states that a person need not "know[] the specific means by which the [material nonpublic] information was obtained or communicated, or whether any personal benefit was paid or promised by or to any person in the chain of communication, so long as the person trading while in the possession of such information or making the communication, as the case may be was aware, consciously avoided being aware, or recklessly disregarded that that such information was wrongfully obtained or communicated."[99]

   2. The language in the bill would legislatively overturn the decision of the Court of Appeals for the Second Circuit in *Newman*,[100] that a tippee (a recipient of inside information) must have actual knowledge that the tipper (the provider of inside information) received a specific personal benefit from passing along the material nonpublic information, to prove that a tippee is liable for insider trading.

D. The House of Representatives passed the bill in a near-unanimous vote, 410-13.[101] The bill currently sits with the Senate Committee on Banking, Housing and Urban Affairs.

VIII. United Kingdom and European Union Updates

A. AIFMD — Cross-Border Distribution Directive

   1. The Cross-Border Distribution Directive (Directive (EU) 2019/1160)[102] amends the EU Alternative Investment Fund Managers Directive ("AIFMD") by introducing the concept of "pre-marketing."

      (a) The new rules are due to take effect from Aug. 2, 2021.

      (b) Pre-marketing is defined as: "provision of information or communications, direct or indirect, on investment strategies or investment ideas in order to test their interest in a fund which is not yet established, or established but not yet notified for marketing."

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[96] The California Attorney General has in fact specifically rejected a safe harbor exemption for GDPR-compliant businesses. See OFFICE OF THE ATTORNEY GEN., STATE OF CAL. DEP'T OF JUSTICE, INITIAL STATEMENT OF REASONS (ISOR) (2019), available here.

[97] Insider Trading Prohibition Act of 2019, H.R. 2534, 116th Cong. § 16A (2019).

[98] *Id.* § 16A(a).

[99] *Id.* § 16A(c)(2).

[100] *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

[101] 165 Cong. Rec. H9278 (daily ed. Dec. 5, 2019) (vote total).

[102] Directive (EU) 2019/1160 of the European Parliament (June 20, 2019), available here.

2. Under the new rules, pre-marketing of an alternative investment fund ("AIF") will be permissible without first notifying the regulator, subject to the following requirements being met:
   (a) The information cannot be sufficient to commit an investor to an investment;
   (b) The information cannot include subscription forms in draft or final form, or constitutional documents, prospectus, or offering documents in final form;
   (c) Any subscription within 18 months of pre-marketing is considered the result of marketing and requires a marketing notification to the supervisory authority.
3. As drafted, the new pre-marketing provisions only apply to EU-domiciled AIFs (e.g. Irish or Luxembourg funds).
   (a) However, Recital (12) of the Cross-Border Distribution Directive confirms that the legislative intent was not to disadvantage EU funds vis-à-vis non-EU funds.
   (b) It is also widely expected that a similar provision will be applied to non-EU funds and their managers in the proposal to revise AIFMD (known as "AIFMD II") which is expected to be published in the first half of 2020.
4. In the meanwhile, it is expected that the new concept of pre-marketing will inform the supervisory approaches of EU regulators to marketing and reverse solicitation offers made by non-EU managers with non-EU funds.

B. Switzerland — Marketing of Funds

1. Federal Act on Financial Services ("FINSA") and its implementing ordinance enter into force on 1 Jan. 2020, subject to a transitional period of 24 months for some of the new requirements.[103]
2. Among other things, FINSA modifies the current distribution rules under the Swiss Collective Investment Schemes Act ("CISA"), so that the requirements to appoint a Swiss representative and paying agent are largely lifted, except in the case of marketing to high net worth individuals (e.g. private clients who meet the specific net asset and knowledge/experience requirements and who request to be treated as professional clients).
3. The new rules will also introduce obligations for fund managers/distributors to implement a code of conduct, certain organizational requirements and maintain an affiliation with a Swiss financial ombudsman scheme subject to a two-year transitional period.
4. During the transitional period or until the manager can demonstrate that they comply with FINSA obligations, non-Swiss fund managers and distributors may be required to maintain the distribution agreements they have entered into with the Swiss representative.

C. Self-Reporting to the FCA

1. The FCA Principle for Business 11 requires an FCA-regulated firm to deal with its regulators in an open and cooperative way, and disclose to the FCA appropriately anything relating to the firm of which the FCA would reasonably expect notice.[104]
2. The FCA generally considers that matters such as material regulatory breaches, or notices of investigations or enforcement by an overseas regulator have a serious regulatory impact, and must, accordingly, be notified to the FCA as soon as possible.

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[103] Federal Act on Financial Services, Federal Assembly of the Swiss Confederation, available here.

[104] PRIN 2.1 The Principles, Financial Conduct Authority (March 1, 2018), available here.

3. In addition, a self-reporting regime applies under the EU Market Abuse Regulation with regards to any suspicions of insider trading or market manipulation (this is known as Suspicious Transactions and Orders reporting, or STOR).[105]

D. UK Senior Managers and Certification Regime

1. The Senior Managers and Certification Regime ("SMCR") replaced the Approved Persons Regime for FCA-regulated firms on Dec. 9, 2019.[106]

2. The new regime applies to almost all UK firms authorized by the FCA, as well as branches of non-UK firms with permission to carry out regulated activities in the UK.

3. The regime aims to reduce harm to consumers and strengthen market integrity. It sets a new standard of personal conduct for everyone working in financial services. The key elements of the regime are:

   (a) *The Conduct Rules*. The Conduct Rules set minimum standards of individual behavior in financial services firms and apply to employees who carry out financial services activities, or linked activities. Some Conduct Rules apply to all employees, while others only apply to Senior Managers.

   (b) *The Senior Managers Regime*. The most senior individuals within the firm ("Senior Managers") who perform key roles ("Senior Management Functions") require the FCA approval before starting their roles (subject to grandfathering arrangements for existing Senior Managers). Every Senior Manager will need to have a "Statement of Responsibilities" which clearly sets out their responsibilities and accountabilities.

   (c) Statutory Duty of Responsibility for Senior Managers which requires Senior Managers to take reasonable steps to prevent regulatory breaches.

   (d) The Certification Regime applies to employees whose role means it is possible for them to cause significant harm to the firm, its customers, or the market more generally. These roles are called "Certification Functions". Unlike under the Approved Persons regime, the FCA will no longer approve individuals in Certification Functions; instead, the firms will need to check and certify that they are fit and proper to perform their role at least once a year.

[105] Market Abuse Regulation (EU) 596/2014 of The European Parliament (April 16, 2014), available here.

[106] Senior Managers and Certification Regime, Financial Conduct Authority (Sept. 12, 2019), available here.

Terms and Trends

I. U.S. Trends

A. Performance and Investor Outlook

1. Performance is good.

(a) Hedge Funds

(i) Hedge funds on average were up 12.19% through Dec. 31, 2019.[1]

(ii) Best performing hedge funds, through Dec. 31, 2019, were macro (23.36%) and long equity (21.85%) strategies; worst performing were market neutral (4.23%) and relative value (5.30%) strategies.[2]

(b) Private Equity

(i) Meanwhile, *Preqin* reports that private equity returns (IRR) globally continue to be strong over one-year (16.3%), three-year (17%), five-year (14.4%) and 10-year (15.6%) time horizons to June 2019.

(ii) *Preqin* also reports that buyout funds have outperformed all other private equity strategies, with IRRs of 18.9%, 18.3%, 15.7% and 16.9%, respectively, over the same time horizons.[3]

2. Current fundraising environment is challenging for some.

(a) Hedge Funds

(i) $3.25 trillion assets under management by hedge fund managers at end of June 2019, up from $3.1 trillion at the end of 2018.[4]

(ii) *Eurekahedge* reports that net flow since 2013 has been in — not out — for a total of $98.4 billion new assets invested in hedge funds.

(iii) *Eurekahedge* reports that the largest funds have been the drivers of growth. Funds with $1 billion in assets under management or more have accounted for more than half of the gains of the industry, and nearly half of the net asset inflow.

(b) Private Equity

(i) *Preqin* reports that:

(1) 1,319 private equity funds were raised in 2019, compared to 1,794 in 2018; and

(2) $595 billion aggregate capital raised by private equity funds in 2019, down from $628 billion raised in 2018.[5]

(ii) Mega-funds are raising capital (*Private Equity International* reports that in Q4 2019, nine funds were seeking $10bn or more from investors, with U.S., European and Asian funds all featuring).[6]

3. Investor Outlook

(a) Hedge Funds

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[1] *See https://pro.preqin.com/analysis/hedgeFundPerformance/marketBenchmarks/benchmarkReturns/1.*
[2] *See https://pro.preqin.com/analysis/hedgeFundPerformance/marketBenchmarks/benchmarkReturns/1.*
[3] *See https://pro.preqin.com/analysis/horizonIRRs.*
[4] *The Wall Street Journal,* Oct. 6, 2019.
[5] *See https://pro.preqin.com/analysis/historicalFundraising.*
[6] *See http://docs.preqin.com/reports/Preqin-Private-Capital-Fundraising-Update-Q4-2018.pdf.*

(i) Bifurcation of fundraising market

(1) Well-known and large managers can go without a seed investor, and rely on two or more early anchor investors.

(2) Other managers use a seed deal or try to grow organically, which requires patience and fee discipline.

a. Managed accounts grow capital, but the cost here is liquidity.

b. Build in MFN and common side letter terms to fund documents.

c. Offering a founders' class of interests, which often includes capacity rights.

(b) Private Equity

(i) *Preqin* reports that large proportions of investors expect to commit more capital in 2020 than they did in 2019.[7]

(ii) Rise of the "one and done" closing, offering investors a volume discount based on size.

(iii) Rise of dry closings, with no management fee payable until fund begins sourcing investments, i.e., once the prior fund reaches the end of its investment period.

B. Private Fund Strategies

1. Popular Hedge Fund Strategies (based on the number of funds launched)[8]

(a) Equity

(b) Event-Driven Strategies

(c) Credit

(d) Relative Value

(e) Managed Futures/CTA

2. Popular Private Equity Fund Strategies (based on number of funds launched)

(a) Venture

(b) Real Estate

(c) Growth

(d) Buyout

C. Fund Structuring and Conflicts

1. Due to cost cutting, more managers want complex funds built out in advance rather than multiple AIVs (e.g., dual master fund structures).

2. Conflicts inherent to fund structure (e.g., warehousing, structuring and servicing of loans) built in from day one. Advisory board use is becoming common from day one.

3. More REIT subsidiaries than we have seen in the past. Conflicts exist on exit and no pro rata sales could happen.

4. Co-investments — almost every large private equity deal is underwritten by manager and syndicated to limited partners or co-investments.

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[7] *See http://docs.preqin.com/reports/Preqin-Private-Capital-Fundraising-Update-Q4-2018.pdf.*

[8] Preqin Quarterly Update: Hedge Funds Q3 2019, p. 7.

5. SEC fiduciary duty interpretation is driving more robust conflicts disclosure.

6. Multi-strategy private equity fund managers establishing allocation committees and written allocation policies to address potential conflicts of interest in allocating investments between funds.

D. Other Trends

1. Hedge Fund Trends

(a) Increasing interest in long-only funds due to market success.

(b) Some experimentation with hurdle rates, either against a fixed rate or against an index.

(c) Stabilization of the management fee rate around 1.5%.

(d) Stabilization of the incentive around 17.5%.

(e) Making accommodations for consulting firms and bank platforms (e.g., liquidity and/or fee breaks on a consultant-wide basis), with proper disclosure.

(f) Venture investing by hedge funds increasing as search for alpha widens.

(g) Increasing use of Insurance Dedicated Funds ("IDFs").

2. Private Equity Trends

(a) The two-track fundraising market continues to develop, with LPs looking to place ever more capital with GPs they know and trust. These GPs in turn are establishing new strategies in order to soak up this latent demand (e.g., buyout GPs moving into credit, infrastructure, etc.).

(b) The private equity market is maturing, with secondary fund investments and co-investments becoming standard parts of LPs' portfolios and large increases in the numbers of GP-led secondaries and funds established solely to invest in GPs.

(c) Top European GPs are seeking to compete for talent with their U.S. peers by moving to deal-by-deal or hybrid waterfalls.

(d) ESG is becoming an essential area for GPs, as LPs increasingly focus their due diligence on the double bottom line.

(e) Succession planning is becoming an issue as founders reach retirement age.

(f) Expense granularity.

(g) Allocation of broken deal expenses.

II. U.K. and EU Trends

A. Hedge Fund Trends

1. London remains the core hedge fund center in Europe, both for European-based firms and for European offices of non-European firms. Some firms have looked to establish a presence in Ireland, Luxembourg or Malta as well.

2. The downward pressure on management fees is causing a number of managers problems given the high capital costs of running a European-based fund manager and the need to maintain regulatory capital.

3. The vast majority of funds established by London-based managers continues to be Cayman funds. However, there is a small trend towards Irish and Luxembourg funds, especially where the cornerstone investor is European or European investors are the primary target. In some cases, Irish or Luxembourg funds are part of a master-feeder structure including Cayman funds and, in other cases, they run in parallel to a Cayman flagship fund.

B. Private Equity Fund Trends

1. Brexit has led to the effective end of the English limited partnership (“ELP”) as a private equity fund vehicle for GPs investing outside of the UK. Managers who would formerly have used ELPs are moving back and middle-office operations to either Luxembourg or the Channel Islands.
2. Tightening of substance rules in Luxembourg and offshore jurisdictions means that Luxembourg and offshore funds must now have “real” operations in the host country.

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