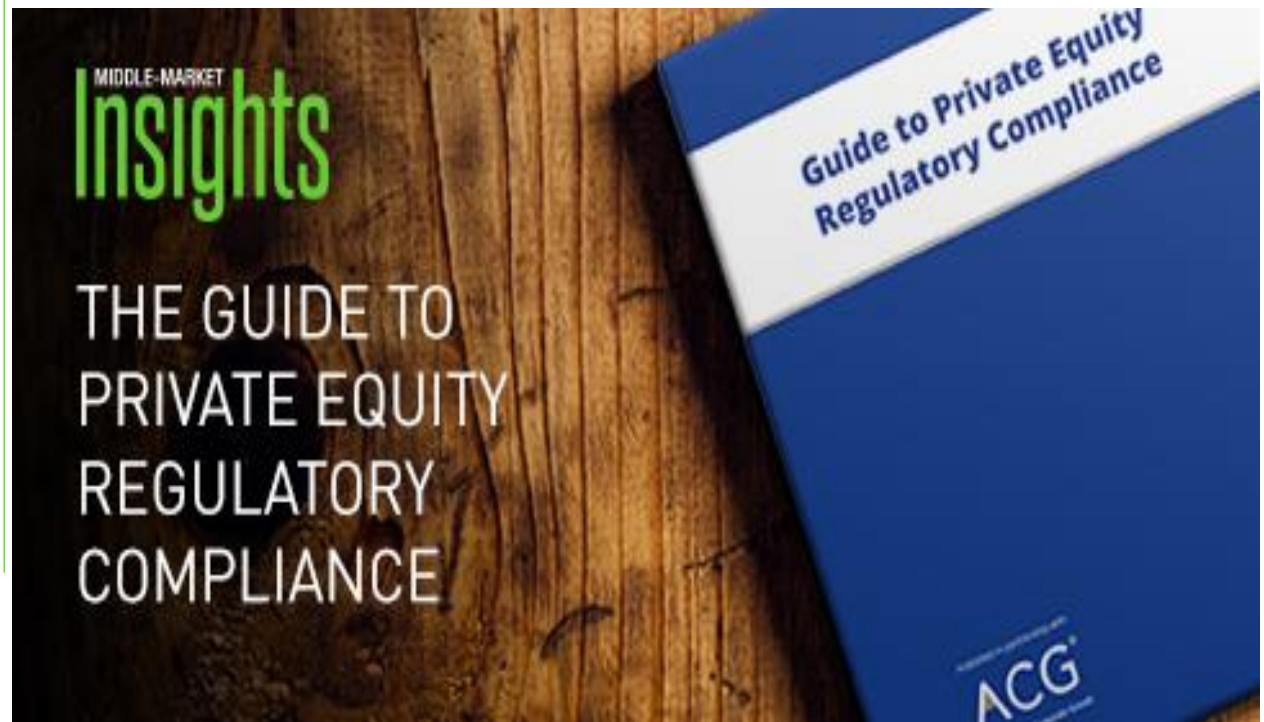


ACG/Thompson *Guide to Private Equity Regulatory Compliance*



September 29, 2016

Agenda

- Overview of the *Guide*
 - Current and Future Authors
 - Statutes Covered
 - Other Subjects
- Cybersecurity (Eric Feldman)
- AML/KYC (Tom Pratt)
- SBICs (Chris Rossi)
- Portfolio Company Valuations (Kevin Vannucci)
- Broker-Dealer Issues (Shane Hansen)
- Other Hot Issues (Scott Gluck)
 - Adviser as a Fiduciary
 - Fees and Expenses
 - Co-Investments

Private Equity Regulatory Task Force (PERT)

- 50+ Middle-Market Private Equity Firm Members
- Interacts with SEC on relevant issues
- Developing industry best practices
 - Advertising/Marketing
 - Co-Investments
 - Cybersecurity
 - Valuations
- Push legislation to modernize the Investment Advisers Act
- For more information contact Amber Landis
 - alandis@acg.org

Overview – Federal Statutes Covered

- **Investment Advisers Act of 1940;**
- **Investment Company Act of 1940;**
- **Securities Act of 1933** (David Feldman, Duane Morris);
- **Securities Exchange Act of 1934** (Shane Hansen, Warner, Norcross & Judd);
- **Commodity Exchange Act** (Basil Godellas, Winston & Strawn)
- **SBIC program** (Chris Rossi, Pepper Hamilton);
- **ERISA** (Adrienne Scerbak, Winston & Strawn);
- **FCPA** (Mauro Wolfe, Duane Morris);

Overview - Other Issues Covered

- **Compliance Policies, Procedures and Best Practices**
– (Angelique Thompson, Duff & Phelps)
- **Cybersecurity** (Eric Feldman, The Riverside Company; Mike Pappacina, ACA Aponix)
- **Preparing for an SEC Examination**
- **Fees and Expenses**
- **Co-Investments**
- **Advertising and Marketing Restrictions**
- **Expert Networks** (Mike King, GLG)
- **Family Office Exemption** (Marty Lybecker, Perkins Coie)

Overview - Contributing Authors



DUFF & PHELPS

GEN II
FUND SERVICES, LLC

Gerson
Lehrman
GroupSM

Pepper Hamilton LLP
Attorneys at Law

Overview - Contributing Authors (cont'd)

PERKINS COIE



Riverside



RSM

VENABLE_{LLP}

A logo graphic consisting of a blue square with a white stylized 'W' shape inside.
Warner
Norcross & Judd[®]
ATTORNEYS AT LAW

WINSTON
& STRAWN
LLP

Overview - Future Authors



Association for Corporate Growth



Grant Thornton



INSTITUTIONAL
LIMITED PARTNERS
ASSOCIATION

LATHAM &
WATKINS LLP

Paul | Weiss

Hot Topic - Cybersecurity (Eric Feldman)



Riverside

Hot Topic - Cybersecurity (Eric Feldman)

Private equity is an ideal (and easy) target

Hot Topic - Cybersecurity (Eric Feldman)

- How to build a pragmatic security program
 - Start with a governance strategy
 - Get to know the risks within your organization
 - Create policies that can be enforced
 - Train the weakest link: your employees
 - Be prepared for a data loss scenario
 - Get to know your 3rd parties

Hot Topic - AML/KYC (Tom Pratt)

GEN II

FUND SERVICES, LLC

Hot Topic - AML/KYC (Tom Pratt)

- Background
 - What is the Bank Secrecy Act?
 - How does it impact Private Equity?
- What constitutes a sound AML program
 - The Four Pillars
 - Know Your Customer Investor/Investor Information Program
 - Investor Due Diligence
 - Enhanced Due Diligence
- OFAC
- Best Practices

Hot Topic - AML/KYC (Tom Pratt)

- Going Forward
 - FinCEN Status
 - What to expect
 - What should I do?

Hot Topic - SBICs (Chris Rossi)

Pepper Hamilton LLP
Attorneys at Law

Hot Topic - SBICs (Chris Rossi)

- Regulatory Capital – A Key Concept
- Eligible Investments
 - Requirement to invest in U.S. “small businesses” and “smaller enterprises”
 - Principles of “Affiliation” in determining size and other matters
- Conflicts of Interest
 - Concept of “Associate”
 - Prohibited Transactions

Hot Topic - SBICs (Chris Rossi)

- Structuring Investments
 - SBA “Overline” limit
 - Forms and Duration of Investments (Equity, Debt Securities and Loans)
 - SBA “Cost of Money” Regulations
 - Documentation Requirements
- Limitations on Distributions to Investors
 - Retained Earnings Available for Distribution (READ)
 - Reduction in Regulatory Capital
 - SBA Approved Wind-Up Plans

Hot Topic - SBA Leverage (Chris Rossi)

- Reserving and Drawing SBA Leverage
- How SBA Leverage is Priced
- Uses of SBA Leverage

Hot Topic - Valuations (Kevin Vannucci)



RSM

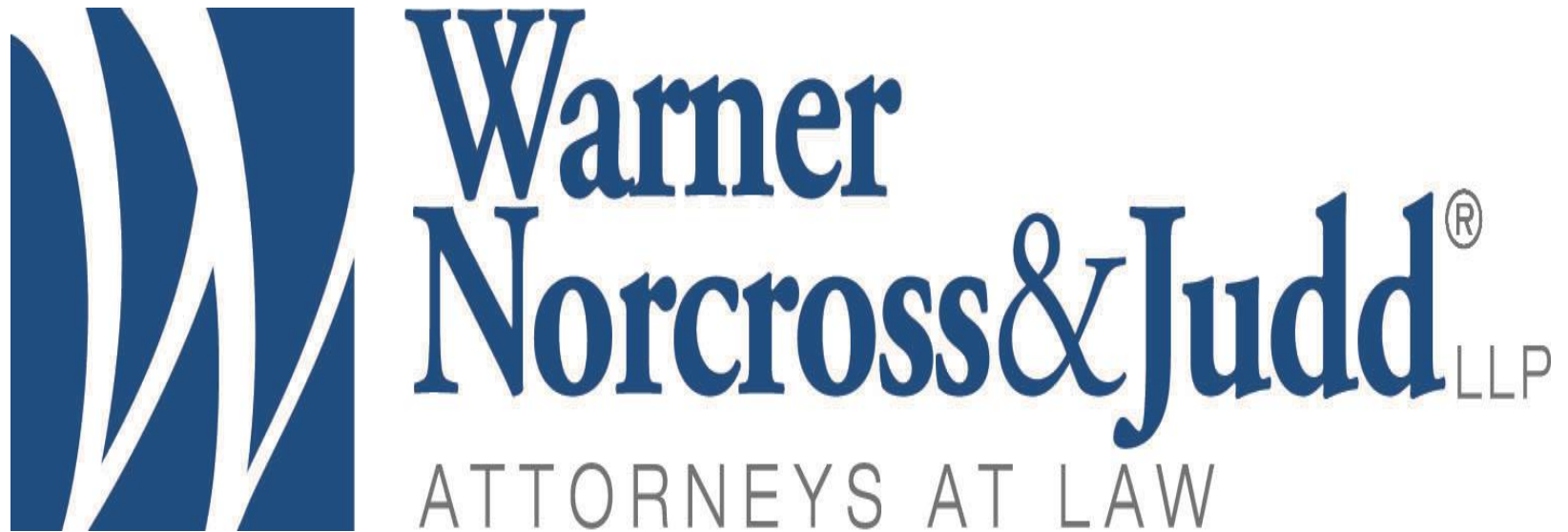
Hot Topic - Valuations (Kevin Vannucci)

- Increased Investor Scrutiny
 - Greater transparency
 - Enhanced governance
- SEC critical of certain Valuation Practices
 - Change in methodologies
 - Inappropriate add-backs
 - Cherry-picking market comps
 - Inflating valuations during fund raising

Hot Topic - Valuations (Kevin Vannucci)

- Valuation Governance Committee
 - Roles and responsibilities
- Valuation Policies and Procedures
 - Internal controls
 - Monitor ongoing performance
 - Robust, transparent and consistently applied
 - Common Errors
- Calibration
 - Qualitative and quantitative factors
- Reconciliation of different valuation conclusions

Unregistered Broker-Dealer Activities (Shane Hansen)



Unregistered Broker-Dealer Activities (Shane Hansen)

- SEC PE Fund priorities: unregistered "broker" activities
<https://www.sec.gov/ocie> (see OCIE's priorities for 2014)
 - 1934 Act definitions – "broker" means –
 - any "*person*"
 - "*engaged in the business*" of
 - "*effecting transactions*"
 - in "*securities*" for
 - the "*account of others*"
 - Typical contexts for PE advisers and funds . . .
 - Raising capital for the fund itself – "finding" investors
 - Buying/selling portfolio companies – "M&A"
- SEC/FINRA "broker-dealer" registration and regulation
- State(s) "broker-dealer" and "agent" registration

Unregistered Broker-Dealer Activities (Shane Hansen)

- SEC Trading and Markets Division staff position –
 - SEC *Guide to Broker-Dealer Registration* (2008)
<https://www.sec.gov/divisions/marketreg/bdguide.htm>
 - "Finders," "business brokers," and other individuals or entities that engage in the following activities:
 - Finding investors . . . making referrals . . . splitting commissions with registered BDs, investment companies (. . . including hedge funds) . . . ;
 - Finding investors for "issuers" (entities issuing securities), even in a "consultant" capacity;
 - . . . finding investors for, VC or "angel" financings, including private placements;
 - Finding buyers and sellers of businesses (i.e., activities relating to mergers and acquisitions where securities are involved);
 - persons that act as "placement agents" for private placements of securities;
 - SEC Blass Speech: *A Few Observations in the Private Fund Space*
<https://www.sec.gov/News/Speech/Detail/Speech/1365171515178>

Unregistered Broker-Dealer Activities (Shane Hansen)

- SEC Enforcement –
 - ***Blackstreet Capital Management and Murry N. Gunty*** (June 1, 2016) – in-house M&A brokerage for portfolio companies
<https://www.sec.gov/news/pressrelease/2016-100.html>
 - Fully-disclosed M&A brokerage fees, but
 - Not registered as a broker-dealer – a "willful" violation
 - ***Ranieri Partners, LLC, Donald W. Phillips, and William M. Stephens*** (March 11, 2013) – capital-raising for the fund
<https://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171513172>
- Impacts include:
 - Cease and desist order, civil fines, and fee disgorgement
 - Future Form ADV, Form U4, and PPM disclosures
 - Press coverage – investor notification – damaged reputations

Other Hot Button Issues (Scott Gluck)

Duane Morris[®]

INNOVATIONS IN
PRIVATE EQUITY LAW

Hot Topic – Adviser as a Fiduciary

- Investment adviser is a fiduciary to its clients (*SEC v. Capital Gains Research Bureau Inc.*)
- As such, they must:
 - Provide fair and full disclosure to their clients;
 - Take reasonable care to avoid misleading clients;
 - Conduct their business in good faith;
 - Put the interests of their clients above their own.
- The client of an adviser to a pooled investment vehicle (fund) is the fund and not the investors in the fund (*Goldstein v. S.E.C.*)

Hot Topic – Fees and Expenses

- Insurance premium allocation – First Reserve
- Vendor discount – First Reserve/Blackstone
- Affiliated entities – First Reserve/Fenway Partners
- Accelerated monitoring fees – Blackstone/Apollo
- Loans between funds and manager affiliates – Apollo
- Broken deal expenses/co-investments – KKR
- Expense allocation between funds – Lincolnshire
- Personal expenses borne by funds - Apollo

Hot Issue – Co-Investments

- Keep in mind adviser is a fiduciary
- Know obligation to each investor – i.e. side letters
- Have a written policy re: allocation
- Make investors aware of the co-investment policy
- Follow written procedures throughout the co-investment process
- Ensure investors have sufficient time to respond
- Unless offering documents expressly states otherwise, consider allocating broken deal expenses *pro rata*
- Document, document, document

Hot Issue – Political Contributions

- Look Beyond the Federal Rules
- Understand Who you are Contributing To
- Consider Donor Disclosure Requirements
- Pre-Clear Political Contributions
- Distribute Quarterly Questionnaires
- Recordkeeping Requirements
- Understand Restrictions on Non-Contribution Political Activities
- Keep Optics in Mind and Consider the Timing

Key Features of the *Guide*

- Online and Print Versions Available
 - Appendix (online)
 - Key SEC speeches, FAQs and SEC Guidance
- User-Friendly Format
 - Text boxes and key points
 - Broad range of topics (statutory and non-statutory)
- Quarterly Supplements
 - Updated information
 - New topics being added (AIFMD, ESG, ILPA Template)
- 24-hour technical support
- <http://www.thompson.com/public/offerpage.jsp?prod=XFUND>

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