

Private Equity Fund Compliance Action Items in Light of SEC Examination Findings



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Introduction

- **SEC Examination Findings**
- **Selected Focus Areas**
 - Fees
 - Expenses
 - Marketing
 - Valuation
 - Custody
- **Questions**

SEC Examination Findings

- **Presence Exams of > 150 PE Firms**
- **The “Remarkable Statistic”**
- **Violations of Law or Material Weakness in Controls Related to Fees and Expenses > 50 percent of the Time When Examined**
- **Focus on “Inherent Conflicts” in Private Equity**
- **New Private Funds Unit Within OCIE**

Fees

Fees Overview

- **Fee Reductions for Certain Investors**
- **Fees Related to Co-Investments**
- **Fee Layering**
- **“Zombie” Funds**
- **Fees in Track Record Presentation**

Fees

Fee Reductions for Certain Investors

Fees

Fees Related to Co-Investments

Fees

Fee Layering

Fees

“Zombie” Funds

Fees

**Fees in Track Record
Presentation**

Expenses

Expenses Overview

- **SEC Focus on Expense Allocations**
- **LPA Versus Expense Allocation Grid**
- **“Operating Partners”/Consultants**
- **Back-Office/Administration Expenses**
- **Co-Investor Expense Allocation**

Expenses

SEC Focus on Expense Allocations

Expenses

LPA Versus Expense Allocation Grid

Expenses

“Operating Partners”/ Consultants

Expenses

Back-Office/ Administration Expenses

Expenses

Co-Investor Expense Allocation

Marketing

Marketing Overview

- **Track Record: Which Investments Included?**
- **Backup for Track Record**
- **Cherry-Picking**
- **Returns: Gross and Net IRRs**
- **Projections**

Marketing

Track Record:

Which Investments Included?

Marketing

Backup for Track Record

Marketing

Cherry-Picking

Marketing

Returns: Gross and Net IRRs

Marketing Projections

Valuation

Valuation Overview

- **Historical Backdrop**
- **FAS Statement 157 (now ASC Topic 820)**
- **Fundraising Context**
- **Subjectivity of Valuation Methodologies**
- **Focus on Fair Value Reporting**
- **Valuation Committee**

Valuation

Historical Backdrop

Valuation

**FAS Statement 157
(now ASC Topic 820)**

Valuation

Fundraising Context

Valuation

Subjectivity of Valuation Methodologies

Valuation

Focus on Fair Value Reporting

Valuation

Valuation Committee

Custody

Custody Overview

- **Custody Rule: “Qualified Custodians”**
- **Pooled Investment Vehicle Exception**
- **Annual Audit Exception**
- **Privately Offered Securities Exception**
- **Audits of Special Purpose Vehicles**
- **Escrows Used in M&A Transactions**

Custody

**Custody Rule:
“Qualified Custodians”**

Custody

**Pooled Investment Vehicle
Exception**

Custody

Annual Audit Exception

Custody

Privately Offered Securities Exception

Custody

Audits of Special Purpose Vehicles

Custody

Escrows Used in M&A Transactions

Other Developments

Other Developments

Knowledgeable Employee Relief

Other Developments

Political Contributions

Speaker Biographies



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Stephanie R. Breslow is a partner in the New York office, co-head of the Investment Management Group and a member of the firm's Executive Committee. Her practice includes investment management, partnerships and securities, with a focus on the formation of liquid-securities funds, private equity funds and providing regulatory advice to investment managers and broker-dealers. 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 she represents funds of funds and other institutional investors in connection with their investment activities.

Recently named chair of the Private Investment Funds Subcommittee of the IBA, Stephanie is a founding member and former chair of the Private Investment Fund Forum, a member of the Advisory Board of Third Way Capital Markets Initiative, a founder and former member of the Steering Committee of the Wall Street Hedge Fund Forum, a member of the Board of Directors of 100 Women in Hedge Funds and a member of the Board of Directors of the Girl Scouts of Greater New York. She is listed in *Chambers USA*, *Chambers Global*, *The Legal 500 United States*, *Best Lawyers in America*, *America's Leading Lawyers*, *Who's Who Legal: The International Who's Who of Business Lawyers* (which ranked her one of the world's "Top Ten Private Equity Lawyers"), *The International Who's Who of Private Funds Lawyers* (which ranked her at the top of the world's "Most Highly Regarded Individuals" list), *IFLR Best of the Best USA*, *IFLR Guide to the World's Leading Investment Funds Lawyers*, *IFLR Guide to the World's Leading Women in Business Law*, *IFLR Guide to the World's Leading Private Equity Lawyers*, and *PLC Cross-border Private Equity Handbook*, among other leading directories. She was named the "Private Funds Lawyer of the Year" at the Who's Who Legal Awards 2014 and was recognized as one of *The Hedge Fund Journal's* 50 Leading Women in Hedge Funds and the Euromoney Legal Media Group's "Best in Investment Funds" at the inaugural *Americas Women in Business Law Awards*. A graduate of Harvard University and Columbia University School of Law, Stephanie co-authored *Private Equity Funds: Formation and Operation*, co-authored *Hedge Funds: Formation, Operation and Regulation* and contributed a chapter on "Advisers to Private Equity Funds — Practical Compliance Considerations" for *Mutual Funds and Exchange Traded Funds Regulation, Volume 2*.

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Brad L. Caswell is a special counsel in the New York office, where his practice focuses on counseling hedge and private equity funds on operational, regulatory and compliance matters. He provides guidance to clients on a broad range of issues including those related to the U.S. Investment Advisers Act, other federal, state and self-regulatory organization requirements, and securities trading rules in the U.S. Brad also provides guidance to clients with operations in Hong Kong, Japan and other markets throughout Asia, and the U.K., with respect to regulatory, compliance, trading and operations.

With 12 years of in-house experience including as general counsel and chief compliance officer of investment advisers ranging from multi-billion dollar funds to start ups, and his experience in the asset management group of a leading investment bank, Brad offers a valuable perspective on investment management operations and compliance issues. He is a 1996 graduate of Boston College Law School and a 1992 graduate of Georgetown University.

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Brian T. Daly is a partner in the New York office, where he advises hedge and private equity fund managers and commodity pool operators on regulatory, compliance and operational matters, including registration and disclosure obligations, trading issues, advertising and marketing, and the establishment of compliance programs. Having spent nearly a decade serving in-house as general counsel and chief compliance officer at several prominent hedge fund management firms, Brian is well versed in a wide range of legal and business challenges facing investment advisers, commodity pool operators and commodity trading advisors and has extensive experience designing and improving compliance processes and organizational systems. Brian has represented clients in proceedings and interactions with regulators in the U.S., the U.K. and Asia.

Brian is well known for his thought leadership in the regulatory and compliance area as it affects alternative investment funds and is a key part of SRZ's educational outreach. He also teaches legal ethics at Yale Law School, focusing on the challenges faced by in-house counsel. He is a member of the Managed Funds Association's CTA, CPO & Futures Committee and the CFTC Working Group for the Alternative Investment Management Association, and formerly served as co-chair of the MFA's General Counsel Forum and as a steering committee member of its Investment Advisory Committee. Brian received his B.A., *magna cum laude*, from Catholic University of America, his M.A. from the University of Hawaii and his J.D., with distinction, from Stanford Law School.

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Marc E. Elovitz, a partner in the New York office, is chair of the firm's Investment Management Regulatory & Compliance Group. He advises hedge funds, private equity funds and funds of funds on compliance with the Investment Advisers Act of 1940 and other federal, state and self-regulatory organization requirements, including establishing compliance programs, registering with the SEC and handling SEC examinations. Marc provides guidance to clients on securities trading matters and represents them in regulatory investigations and enforcement actions, arbitrations and civil litigation. He also regularly leads training sessions for portfolio managers and analysts on complying with insider trading and market manipulation laws.

A member of the American Bar Association's Business and Litigation Sections and the Hedge Funds Subcommittee of the Committee on Federal Securities Regulation, Marc is a frequent speaker at hedge fund industry conferences and seminars. In addition, he co-authors the "Market Manipulation" chapter in the leading treatise, *Federal Securities Exchange Act of 1934* (Matthew Bender) and wrote the chapter on "The Legal Basis of Investment Management in the U.S." for the Oxford University Press book, *The Law of Investment Management*. After graduating with honors from Wesleyan University in 1986, Marc attended New York University School of Law, from which he was awarded his J.D. degree in 1990.

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Omoz Osayimwese is a partner in the New York office, where he focuses his practice on the representation of sponsors and investors in the formation and structuring of private equity funds, hedge funds and hybrid funds. Omoz has extensive experience representing sponsors and investors on funds employing real estate, buyout, credit, distressed investment, activist, multi-strategy and long-short equity strategies. He also represents hedge fund managers and investors in the negotiation of seed capital transactions, and advises sponsors of private equity firms in the structuring of complex carry-sharing arrangements among principals and employees. Recent representations include institutional sponsors and boutique firms in the formation of private equity funds, hedge funds and hybrid funds; lead investors on their investments in private equity funds; hedge fund managers and investors in seed-capital arrangements; investment managers in joint venture arrangements; and investment managers and investors in the formation of special purpose acquisition and co-investment vehicles.

Omoz speaks regularly to investment managers about current developments relating to private investment funds. His speaking engagements have included “Management Company Structuring and Operations” at SRZ’s 23rd Annual Private Investment Funds Seminar, “Ongoing Operations and Firm Growth” at SRZ’s 2nd Annual Private Equity Fund Conference, a roundtable discussion at the AIFEA meeting regarding investment adviser registration for private equity firms and the Hedgeworld Webinar “Emerging Managers: Raising a Hedge Fund in a Bear Market.” Omoz received his B.A., with highest honors, from Michigan State University and his J.D. from University of Michigan Law School.

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Phyllis A. Schwartz is a partner in the New York office, where she focuses her practice on the structuring, formation and operation of private equity funds, including buyout funds, venture capital funds, mezzanine funds, distressed funds, real estate funds and small business investment companies. She represents both fund sponsors and investors in her practice. In addition to assisting fund sponsors with their internal management arrangements and the creation of internal investment vehicles, she has extensive experience with institutional investors and regularly advises on the acquisition and disposition of partnership interests and market terms of investment funds. Phyllis also represents private equity funds in connection with their investments in, and disposition of, portfolio companies.

A member of the Private Investment Fund Forum, Phyllis frequently shares her insights on effective fund formation strategies at industry conferences and seminars. She is co-author of *Private Equity Funds: Formation and Operation* (Practising Law Institute, 2009-2013), which is considered the leading treatise on the subject, and contributed a chapter on “Advisers to Private Equity Funds – Practical Compliance Considerations” to *Mutual Funds and Exchange Traded Funds Regulation, Volume 2* (Practising Law Institute, 2013). Phyllis is a graduate of Smith College and Columbia University School of Law.

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Joseph A. Smith is a partner in the New York office, where he represents private equity fund sponsors and institutional investors in connection with fund formation, the acquisition of portfolio investments and the implementation of exit strategies. In this capacity, Joe advises clients on securities, governance, ERISA, Investment Advisers Act and structural issues. He has extensive experience with all alternative asset classes, including venture capital and later-stage growth equity investments, leveraged buyouts, mezzanine investments, real estate ventures and opportunity funds, secondary investments, funds-of-funds and hedge funds. Joe has also represented many fund managers in connection with spin-offs and consolidations.

In addition to domestic representations, Joe has advised private equity clients in connection with the acquisition and structuring of portfolio company investments throughout Europe, Latin America and Asia. His representation of asset managers in the real estate sector includes advice concerning REIT offerings and privatizations, partnership roll-ups and cross-border investments. Joe's clients include Arcis Group, Collier Capital, DRA Advisors, DuPont Capital Management, GE Asset Management, Harbert Management Corporation, Hemisfério Sul Investimentos, Intel, Kotak Mahindra Group, LCN Capital Partners, The Praedium Group, Ram Realty Services, REAL Infrastructure Partners, Royalton Partners, The Silverfern Group, Top Tier Capital Partners, Value4Capital, VCFA Group and Westport Capital Partners. Joe has been recognized as a leading practitioner by *Chambers Global*, *Chambers USA*, *The Legal 500 United States* and *The Legal Media Group Guide to the World's Leading Private Equity Lawyers*. He received his A.B. from Columbia University and his J.D. from New York University School of Law.