Hedge Fund Networking Event:
Market and Regulatory Trends Update

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Hedge Fund Market and Regulatory Trends Update

Scott A. Moehrke, P.C.
Kirkland & Ellis LLP

Nabil Sabki
Kirkland & Ellis LLP

Robert H. Sutton
Kirkland & Ellis LLP

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MARKET TRENDS

2011 Hedge Fund Market

- 2011 began on a strong note, with industry-wide invested capital rising to $2.04 trillion by the end of 1H, reflecting $64 billion in net new invested capital over that period
  - Strongest half-year period for new investments since 2H 2007
  - Fairly even dispersion of capital inflows across manager AUM cohorts; smaller managers not deemed off-limits
  - New fund offerings (578) far outpaced fund liquidations (191); strongest showing since 1H 2007
- The picture is changing with the deepening of the European sovereign debt crisis and of general economic and employment weakness in the U.S.
  - Causing some investors to pull back from new investments
  - Resulting in market volatility and losses, in many cases erasing year-to-date gains

Source: Hedge Fund Research, Inc. ("HFR")

2011 Hedge Fund Market

- Expectations of future capital inflows were also positive in 1H 2011
  - In several surveys from 1H, more than 85% of responding investors plan to maintain or increase their allocations to hedge funds, and 75% of responding fund managers expected to increase their AUM by 25% or more
  - Increasing proportions of investors willing to invest in smaller managers, including newly-launching funds
  - Seeding activity, in terms of the number of participants and the size of deals, also expected to increase, as is industry consolidation among existing firms
- Notwithstanding recent pullback from the markets, continuing expectations among institutional investors of increasing future allocations to hedge funds in the next 12 months
  - Funds of funds, sovereign wealth funds and public pension plans all showing strong interest
  - Continuing interest in emerging managers; many investors still willing to invest in newly-launching funds

Sources: "Institutional Hedge Fund Investing Comes of Age: A New Perspective on the Road Ahead," SEI Knowledge Associates/Greenwich Associates, April 2011 ("SEI/Greenwich 2011 Survey"); "Ninth Annual Alternative Investment Survey – Investor Insights on the Changing Hedge Fund Landscape," Deutsche Bank Global Prime Finance, March 2011 ("DB 2011 Survey"); "2011 Hedge Fund Outlook – Brighter Days Ahead?," Rothstein Kass, April 2011 ("RK 2011 Survey"); "Preqin Special Report: Hedge Funds — Institutional Investors on the Hunt for Hedge Funds," Preqin Ltd., September 2011; HFC Advisory investor survey, September, 2011.

Market Trends – Compensation Terms

- Crisis caused pressure on management fees (historically 1.5 – 2.0%) and, to a lesser extent, on incentive compensation (historically 20%)
- Fundraising pressure has abated from crisis-era lows, and management fee and incentive allocation levels seem to be holding constant in most cases
- Some recent evidence of softening fee levels, although expected to be most pronounced in cases of larger investments, or of investors agreeing to longer lock-ups

Source: RK 2011 Survey

Market Trends – Compensation Terms

- Management Fee: Industry-wide average of 1.57% at end of Q2 2011 (almost unchanged from 2009)
  - Actual amount charged varies across managers and asset classes
    - According to HFR data, a significant proportion of funds have a 2% management fee
  - Fee levels seem to be rising among newly launching funds
    - According to HFR data, average management fee for funds launched between Q2 2010 and Q1 2011 was 1.67%
  - Many funds, including start-ups as well as established funds, also now offering interests in multiple classes, with varying lockups and varying fee levels
    - Shorter lock-up classes bearing higher management fees, often 2%
  - Some institutional investors seeking scaled-down management fees at higher asset levels in order to discourage asset-gathering, although this has not been widely adopted

Sources: HFR; SEI/Greenwich 2011 Survey; DB 2011 Survey; RK 2011 Survey; "A Guide To Institutional Investors' Views and Preferences Regarding Hedge Fund Operational Infrastructures", The Alternative Investment Management Association Ltd, May 2011 ("AIMA 2011 II Guide")

Market Trends – Compensation Terms

- Incentive Allocation: At end of Q2 2011, slight decline from prior periods to 18.81% on average
  - Slight downward trend seems more pronounced in recent launches
    - According to HFR data, for funds launched in Q2 2010 through Q1 2011, average incentive allocation was 17.2%
  - Where 20%, additional concessions given (or demanded) in some cases:
    - Hurdle or preferred return, more often fixed, sometimes index-based
    - Multi-year performance measurement period, in some cases with clawbacks (less common in commingled funds)
    - Required reinvestment of earned incentive compensation for a stated period, often concurrent with investors' lock-up periods

Sources: HFR; SEI/Greenwich 2011 Survey; DB 2011 Survey; AIMA 2011 II Guide

Market Trends – Lockups and Redemptions

- Generally, investors continue to demand shorter lockup periods than pre-crisis, although tolerance varies depending on investor class
  - A large minority of investors are unwilling to lock up capital over a year
    - Longer lockups generally more tolerable among institutional investors than individuals, and are more tolerable among U.S. investors than non-U.S. investors
    - Many institutional investors emphasizing the liquidity profile of the underlying assets in pressing for liquidity terms, seeking correlation
  - Investors more willing to accept a "soft" lockup (*i.e.*, subject to a redemption fee) than a "hard" lockup (*i.e.*, where redemptions are simply not permitted)
- Overwhelming investor preference, by a 3 to 1 margin, is for quarterly or monthly redemptions following the lockup period
  - Decreased tolerance for notice periods of longer than 60 days (quarterly) or 30 days (monthly)

Sources: SEI/Greenwich 2011 Survey; DB 2011 Survey; AIMA 2011 II Guide; Preqin Ltd.

Market Trends – Lockups and Redemptions

- Some investors tolerant of longer lockup periods for funds with long-term investment theses, in order to deter early redemptions that may be harmful to overall fund
  - For example, certain distressed debt funds, other credit funds, event driven funds and activist funds
- Longer lockups also tolerated, particularly by institutional investors, where offered in a class that bears lower fees
- Funds' redemption terms continue to vary across the industry, depending on investment program and targeted investor base

Market Trends – Gates

- During crisis many funds put up gates, and the pressure is now to remove gates or apply them at a higher threshold level (e.g., 25% or more as opposed to 25% or less pre-crisis)
- Although gates are intended as protective features, most investors will avoid investing with a manager that actually invoked a gate in the past
  - In two recent investor surveys, three-quarters of respondents would either not invest in a fund that had previously invoked its gate provisions or would view such action in a very negative light*
- However, gate provisions themselves do not appear to provoke as negative a reaction among investors, at least where the manager in question does not have a history of having invoked them

* SEI/Greenwich 2011 Survey; DB 2011 Survey

Market Trends – Gates

- Pre-crisis, most gates were "first come, first served"
  - Skewed the incentive for investors to put redemption requests in at the first sign of trouble to maintain a higher priority over later redeemers
- More funds have moved to apply gates at the investor level (*i.e.*, on an investor by investor basis)
  - Mitigates skewed incentives
  - Less popular with smaller investors, who might not otherwise be gated if the gate were to be applied at the fund level
  - Adoption of this feature has been somewhat limited industry-wide
- Other approaches are now being used to avoid skewed incentives and encourage investors to refrain from redeeming quickly
  - Fund-level gates with early and later redeemers receiving equal priority
  - "Soft" investor-level gates with redemption fees

Market Trends – Side Pockets

- Generally harder to include in newly-launching funds unless justified by investment program
- Most new funds that include side pockets are limited to 10-15% or less of NAV at time of investment, as compared to higher average levels pre-crisis (20% to 25%)
- A minority of funds that are permitted to use side pockets offer investors the ability to opt out (similar to fund terms at the advent of side pockets)
  - However, can raise issues:
    - Does the opt-out apply to all side pocketed investments, including investments that are side pocketed as a result of an impairment?
    - Also, need to consider impact on ERISA 25% test calculations
  - Some managers charge higher management fees to opt-out investors than opt-in investors
    - Justification is that opt-out investors must “pay up” for better liquidity, although some investors feel this is inappropriate as they are already foregoing side pocket upside

Market Trends – Side Pockets

- Most institutional investors generally recognize that side pockets are appropriate in certain cases, but are stressing:
  - Clearly stated and consistently applied side pocket policy (including how fees and HWM are calculated and types of investments eligible to be side pocketed)
  - More specific mechanics for side pockets in partnership agreements
- A significant proportion of investors, even among institutional investors, are either avoiding investing in funds with side pockets (particularly those with high percentage limits on permitted side pocket investments) or else are asking for an opt-out right

Sources: SEI/Greenwich 2011 Survey; RK 2011 Survey

Market Trends – Seed Investors

- New launches often require the assistance of seed capital from a third party
  - Barriers to entry are increasing as a result of increased investor demands for more robust, "institutionalized" infrastructures from Day 1, plus increased regulatory and compliance costs
- Typically takes the form of a large investment in the fund, on preferential fee or other terms
- Often involves the seed investor being granted a stake in the management firm's revenue stream and, sometimes, its equity
  - Revenue split can be based on gross or net revenue; trend to "modified net" (*i.e.*, revenues minus some, but not all, operating expenses)
  - Terms are highly variable, but typically include various management controls and/or veto rights, minority protections
- Can be accompanied with operating capital lines, as well as marketing or operational support
- Seed investment size varies; often $50M or less, but can exceed $100M

Market Trends – Consolidation/M&A

- Many of the same factors that are leading to the prevalence of seed investors are also expected to lead to consolidation among hedge fund managers
  - Particularly the increased costs of doing business under increasing regulatory burdens and of maintaining more robust, "institutional" infrastructures
- Many larger firms are also seeking to expand and diversify their revenue streams by acquiring new product lines and investors in a single stroke, rather than through organic growth
- Several BDCs and other platforms actively seeking acquisitions
- Strong expectation among investors and hedge fund managers of continued industry consolidation

Sources: DB 2011 Survey; RK 2011 Survey

Market Trends – Other Investor Demands

- Very strong demands for increased transparency, especially among institutional investors
  - Types of disclosure requested include portfolio diversification (sector, geographical, issuer, etc.), leverage, valuation methodology, risk analytics, counterparty exposure and, in some cases, position-level detail
  - Continuing tension between investors' desire for transparency and managers' desire to protect proprietary investment strategies
- Demands for a clearly-articulated investment philosophy
- Demands for increase in the size of hedge fund manager investment in the fund

Sources: SEI/Greenwich 2011 Survey; DB 2011 Survey; RK 2011 Survey; AIMA 2011 II Guide

Market Trends – Other Investor Demands

- Emphasis on manager's risk management infrastructure
- Preference for more "institutionalized" firms
  - Greater focus on clear delineation of portfolio management and operational roles
  - Greater focus by larger institutional investors on managers' processes and procedures, from trading to valuation to compliance, including use of committees, descriptions of internal policies and guidelines, etc.
- Demands by large investors for separately managed accounts continue, although have decreased somewhat overall from prior periods
  - Demand for customized portfolios and advice remains strong in the fund of funds space
- Demands for segregation of assets to independent third-party custodians (particularly in managed accounts)

Sources: SEI/Greenwich 2011 Survey; DB 2011 Survey; AIMA 2011 II Guide

Market Trends – Increased Investor Diligence

- Investors continue to be more cautious due to Madoff-driven concerns, and lingering memories of poor performance during the crisis
- Investors are conducting more diligence on hedge fund managers prior to investing, including:
  - Scrutinizing prior performance (including the generation of positive alpha)
  - Reviewing prior use of gates, history of suspending redemptions and liquidation of prior funds (in order to reset HWM)
  - Requiring managers to respond more frequently, and in more detail, to due diligence questionnaires
  - Hiring outside counsel to review and negotiate fund documents/side letters
  - Hiring outside investment consultants to assist in background due diligence

Market Trends – Increased Investor Diligence

- Investors also placing greater emphasis on reputable third-party service providers, including:
  - Auditors
  - Administrators
  - Custodians
  - Prime brokers
  - Outside attorneys
  - Independent directors (for offshore or master funds in corporate form)

DODD-FRANK ACT
ADVISERS ACT REGISTRATION

Dodd-Frank Act Advisers Act Registration

- Many private fund managers, including hedge fund managers, have relied on longstanding exemptions from U.S. federal and state investment adviser registration
- July 2010 Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")
  - Dodd-Frank Act deals mainly with banking and derivatives reform, but also includes key changes for private fund managers
  - Will require most larger private fund managers (AUM > $150M) to register with SEC by March 30, 2012
    - The SEC extended Dodd-Frank Act's investment adviser registration deadline from July 21, 2011 to March 30, 2012
    - Fund managers should consider filing for SEC registration by late January or early February 2012 to ensure registration by the end-of-March 2012 deadline

Dodd-Frank Act Advisers Act Registration

- Modified Accredited Investor/Qualified Client Standards
  - Adjusts two financial tests for inflation:
    - Advisers Act “qualified client” tests for performance-based fees
      - Raised to $2M net worth/$1M AUM (up from $1.5M /$750,000) effective September 2011, to be raised every five years thereafter
      - SEC “grandfathers” existing investors who do not meet new qualified client standard
    - Reg D accredited investor natural person $1M net worth standard, but not until July 2014 (and every four years thereafter)

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FORM 13H – LARGE TRADER REPORTING

Form 13H – Large Trader Reporting

- New Form requires certain "Large Traders" to provide certain information regarding their trading activities to the SEC
- Intended to enhance the SEC's ability to identify large market participants, collect information on their trading, and analyze their trading activity
- Information that a Large Trader will be required to disclose on Form 13H or provide in response to a SEC request will not be subject to FOIA requests
- Large Trader reporting rules effective on October 3, 2011 and compliance required by December 2011

Form 13H – Who Must File?

- A "Large Trader" includes any person that, directly or indirectly (including through other persons controlled by such person), exercises investment discretion over transactions in U.S. exchange-listed equity securities and options in an aggregate amount equal to or greater than either:
  - During a calendar day, either 2 million shares or shares with a fair market value of $20 million; or
  - During a calendar month, either 20 million shares or shares with a fair market value of $200 million
  - For options, the volume and value are calculated by reference to the underlying shares
- Participation in offerings by or on behalf of an issuer (*e.g.*, IPOs) or by an underwriter on behalf of an issuer (other than offerings conducted through the facilities of a national securities exchange) are not included in determining whether the above thresholds are met

Form 13H – Who Must File? (cont'd)

- Form 13H filing obligations are imposed on the ultimate parent of the entity or entities meeting the definition of a Large Trader
- The trading activity of all entities controlled by the parent must be aggregated for purposes of determining whether the parent must file Form 13H
  - "Control" generally means the power (directly or indirectly) to direct or cause the direction of management or policies of an entity (whether through ownership of securities or otherwise), including the direct or indirect ownership of 25% or more of the voting securities of an entity, or, for a partnership, the contribution of, or the right to receive upon dissolution, 25% or more of the capital
- A person may voluntarily register as a Large Trader even if the transaction thresholds are not met
  - Voluntarily registering would prevent the adviser from having to monitor its trading activity levels
  - Voluntary registrants are subject to the same reporting obligations as a Large Trader meeting one or both of the above thresholds

Form 13H – What Information is Reported?

- Information required to be reported on Form 13H includes:
  - A list of the Large Trader’s affiliates that exercise investment discretion over exchange-listed securities and options;
  - A description of the Large Trader’s business and an organizational chart;
  - A list of all financial and business activities in which the Large Trader and its affiliates engage;
  - A list of any other filings the Large Trader or its affiliates make with the SEC;
  - Whether the Large Trader or its affiliates are subject to regulation by the CFTC or foreign regulators; and
  - A list of all broker-dealers where the Large Trader or its affiliates have an account and a description of the services each such broker-dealer provides

Form 13H – How to File

- Advisers meeting the definition of a Large Trader after October 3, 2011 must file Form 13H by December 1, 2011 and annually thereafter for as long as the Large Trader meets one of the applicable thresholds
- Advisers meeting the definition of a Large Trader after December 1, 2011 must file promptly (generally, within ten calendar days) after first effecting aggregate transactions in excess of one of the applicable thresholds
- If any information contained in Form 13H becomes inaccurate, a Large Trader is required to file an amended Form 13H by the end of the quarter during which the information becomes inaccurate
- Large Traders must file Form 13H electronically via the SEC's EDGAR system
- The SEC may not be compelled to disclose information collected from Large Traders, other than in response to requests from Congress and federal departments, agencies and courts
- Large traders must identify themselves to broker-dealers using their Large Trader Identification Number ("LTID") assigned by the SEC

TIC FORM SLT

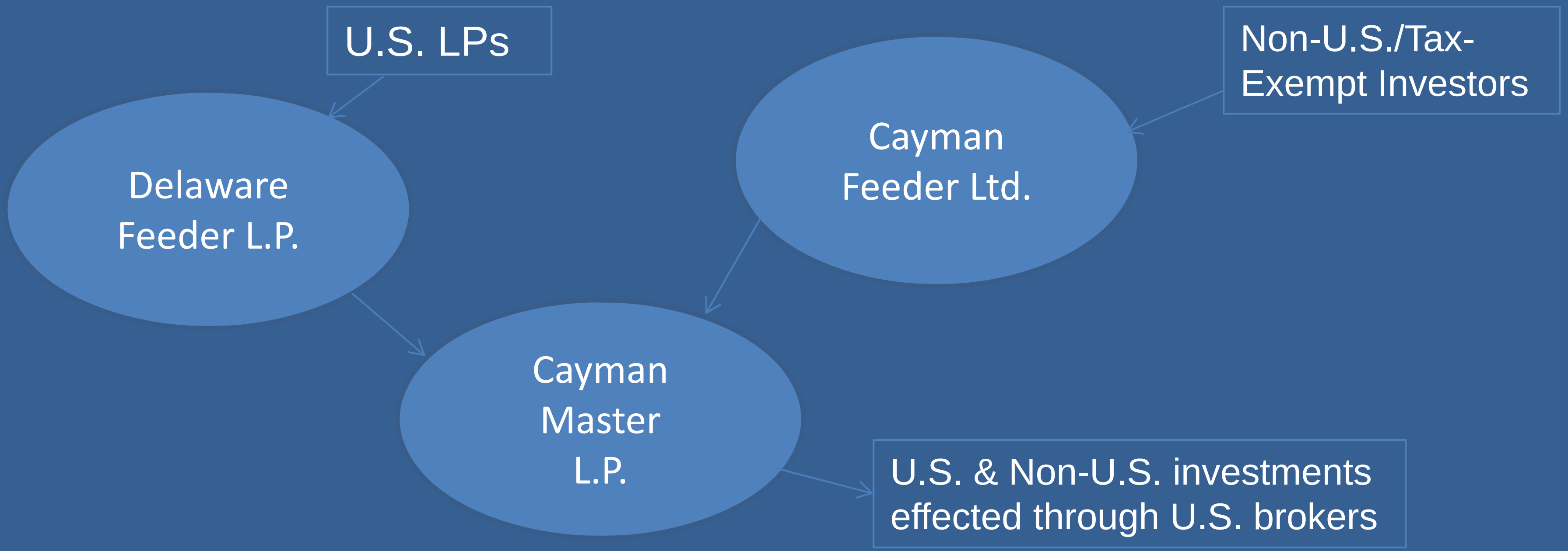
TIC Form SLT – Cross-Border Transaction Reporting

- Recently finalized form required to be filed by certain private fund managers as part of the Treasury International Capital ("TIC") reporting system
  - Used to help formulate U.S. international financial and monetary policies
- Information reported on Form SLT by individual advisers will not be publicly disclosed
- First report due October 23, 2011

TIC Form SLT – Who Must File?

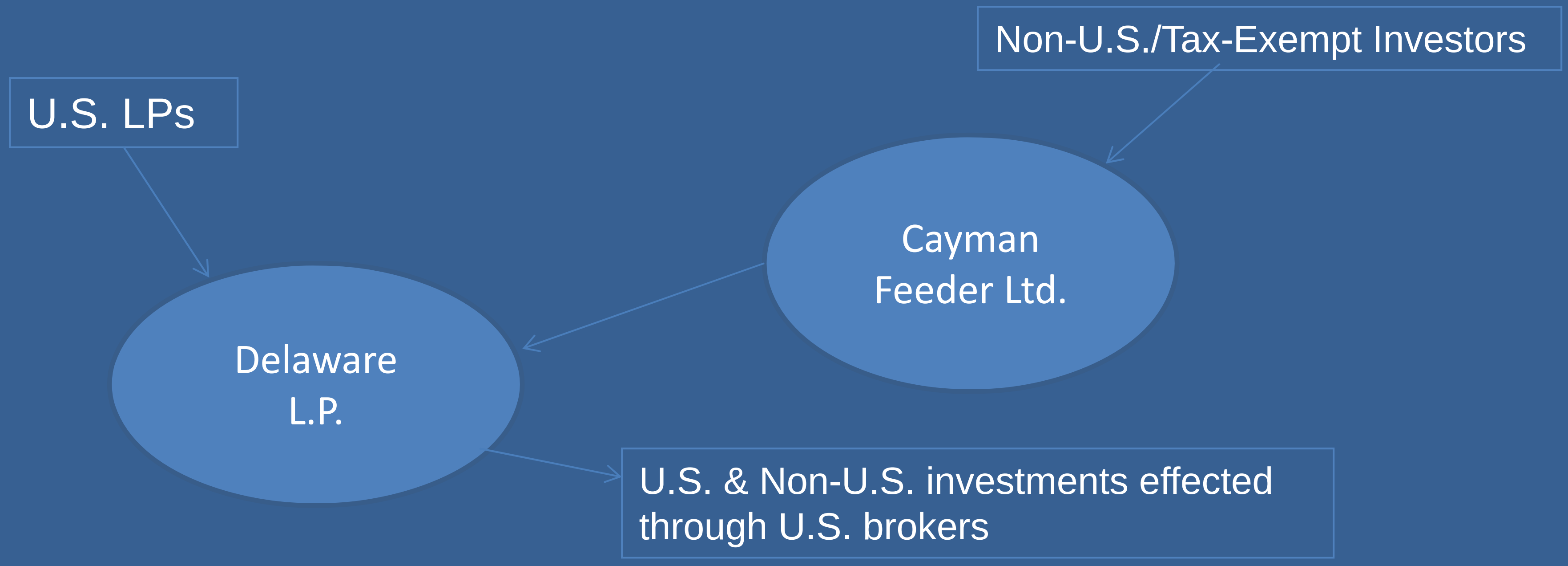
- A private fund adviser must file Form SLT on behalf of each U.S. entity it manages if, as of the end of a calendar month, the aggregate GAAP fair market value of the following equals or exceeds $1 billion:
  - All partnership interests (not including undrawn commitments) held by non-U.S. limited partners (including foreign feeder funds) in its U.S. partnerships;
  - All investments in non-U.S. issuers held by its U.S. partnerships representing less than 10% of the voting securities (generally not including limited partner interests) of an issuer; and
  - All long-term debt (*i.e.*, more than one year maturity) held by its U.S. partnerships of a non-U.S. issuer
- A private fund adviser generally will not have Form SLT reporting obligations with respect to:
  - Securities held in third-party accounts it manages;
  - Derivatives contracts, bank deposits, precious metals or currencies; or
  - Investments made on behalf of any of its foreign private funds

TIC Form SLT – Master Feeder Fund Example



- TIC SLT testing looks primarily to Delaware Feeder's investment into Cayman Master - ≥ $1B (< 10% of voting securities)

TIC Form SLT – Mini Master Fund Example



- TIC SLT testing looks primarily to Cayman Feeder Ltd.'s investment into Delaware fund - ≥ $1B (ownership of U.S. fund by non-U.S. investors)
- Delaware fund's investment in non-U.S. securities through brokerage accounts reported by broker

TIC Form SLT – What Information is Reported?

- A private fund adviser required to file Form SLT generally must consolidate reportable positions for all of its U.S. partnerships
- For interests in U.S. partnerships held by non-U.S. limited partners, the adviser must report:
  - The fair market value of the interests;
  - The country of residence of the non U.S. limited partner; and
  - Whether the non-U.S. partner is a "foreign official institution" (*e.g.*, national governments, international and regional organizations and sovereign wealth funds)
- For non-U.S. securities owned by U.S. partnerships, the adviser must report:
  - The fair market value of the securities;
  - The country of residence of the non-U.S. issuer; and
  - The specific types of securities owned (*e.g.*, foreign equities or foreign government, corporate or other bonds)

TIC Form SLT – How to File

- If a filing is required, a private fund adviser must file Form SLT with the Federal Reserve Bank of New York electronically, by mail or by fax, with the first report due October 23, 2011 for positions held on September 30, 2011
- The next report is due January 23, 2012 for positions held on December 31, 2011, with monthly reporting thereafter no later than the 23rd calendar day of each month
- Once a Form SLT filing requirement is triggered, the private fund adviser must continue to file Form SLT for the remainder of the calendar year, regardless of whether the aggregate value of reportable securities falls below $1 billion
- Information reported on Form SLT will be kept confidential by the U.S. Treasury, the Board of Governors of the Federal Reserve System and the Federal Reserve Banks

FINRA "ANTI-SPINNING" RULE

FINRA Rule 5131 – Anti-Spinning

- Recently adopted FINRA Rule prohibits the allocations of "New Issues" to executive officers and directors ("Covered Persons") of current, and certain former or prospective, investment banking clients of FINRA member broker-dealers
- Designed to prohibit the practice of broker-dealers allocating New Issues to Covered Persons in exchange for investment banking business (commonly referred to as "spinning")
- Supplements existing FINRA Rule 5130
- Private fund managers that intend to invest in New Issues should consider obtaining additional information from investors in order to satisfy eligibility requirements
- Effective September 26, 2011

FINRA Rule 5131 – Definitions

- For purposes of Rule 5131, “New Issues” include most initial public offerings of equity securities as defined in Section 3(a)(11) of the Securities Exchange Act of 1934, made pursuant to a registration statement or offering circular
  - Same definition as existing FINRA Rule 5130
- Rule 5131 prohibits any FINRA member broker-dealer from allocating New Issues to any account in which a beneficial interest in excess of 25% is held by the following “Covered Persons”:
  - Executive officers or directors of a public company or a covered non-public company (*i.e.*, a company with (a) at least $1 million in income in the last FY or two of the last three FYs and $15 million in shareholder equity, (b) $30 million in shareholder equity and a two-year operating history, or (c) $75 million in total assets and total revenue in the last FY or in two of the last three FYs), having one or more “Covered Relationships” (defined below) with the broker-dealer; or
  - A person materially supported by such executive officers or directors
- “Covered Relationships” include:
  - Current investment banking clients of the broker-dealer, or companies with respect to which the broker-dealer has received compensation in the last twelve months
  - Companies that the broker-dealer knows or has reason to know will become investment banking clients in the next three months
  - Instances where there is an express or implied condition that the Covered Person, on behalf of the company, will retain the broker-dealer for future investment banking services

FINRA Rule 5131 – Fund Manager Responsibilities

- Although Rule 5131 only applies to FINRA member broker-dealers, managers that invest in New Issues on behalf of private funds will be asked to provide certain representations to their broker-dealer before they will be permitted to do so
  - Managers should consider circulating questionnaires to ascertain whether investors in private funds participating in New Issues may be Covered Persons with a beneficial interest in a fund of greater than 25%
    - Similar to Rule 5130, a private fund with Covered Persons who exceed the ownership threshold may still participate in New Issues by "carving out" or "carving down" the Covered Persons until they are below the threshold (25% in the case of Rule 5131, as compared to 10% in the case of Rule 5130), to the extent permitted by the fund operating documents
  - Managers also will need to obtain representations from new investors in their private fund subscription documents, similar to current FINRA Rule 5130 representations
  - Managers may rely on annual negative consent letters after the initial affirmative representations
- Implementation Issues:
  - Clarification, exemptive relief sought and generally denied by FINRA
  - Some managers seeking alternative approaches to allocation

FORM PF – PROPOSED RULE

Form PF – Systemic Risk Reporting

- Proposed Advisers Act Rule 204(b)-1 would require SEC registered private fund advisers (*i.e.*, advisers to funds relying on Section 3(c)(1) or 3(c)(7) of the ICA, excluding exempt reporting advisers and foreign private advisers) to file Form PF with SEC ("Private Fund Advisers")
- Information collected on Form PF will be shared with the newly created Financial Stability Oversight Council ("FSOC")
- Information reported on the Form would not be public (*i.e.*, generally not subject to FOIA request)
- Form PF is designed to assist the FSOC in its assessment of systemic risk in the U.S. financial system
- Expect that compliance date (currently early 2012) will be delayed given delay in private fund adviser registration deadline

Form PF – Periodic Reporting

- Annual Reporting: A Private Fund Adviser would be required to report certain basic information about its private funds at least once a year on Form PF within 90 days of the Private Fund Adviser's fiscal year end
- Quarterly Reporting: Large Private Fund Advisers (*i.e.*, Private Fund Advisers with over $1 billion of hedge fund, private equity or liquidity fund AUM) must provide more detailed information and file Form PF within 15 days of each calendar quarter

Form PF – Definition of Hedge Fund

- Form PF solicits different information from hedge funds, private equity funds and liquidity funds (*i.e.*, money market funds)
- Hedge Funds – are defined as any private fund that:
  - Has a performance fee or allocation calculated by taking into account unrealized gains; or
  - May borrow an amount in excess of one-half of its NAV (including committed capital) or may have gross notional exposure in excess of twice its NAV (including committed capital); or
  - May sell securities or assets short

Hedge Fund Reporting on Form PF

- Hedge Fund Managers would be required to report various information on Form PF, including:
  - Fund manager information, including:
    - Name;
    - Related persons; and
    - Aggregate total and net AUM by type of fund advised
  - Each advised private fund's information, including:
    - Name of each advised fund and related persons (generally would not need duplicative information for master-feeder funds)
    - Gross and net assets;
    - Aggregate notional value of derivative positions;
    - Basic information about fund's borrowings, including a breakdown of borrowings based on whether the creditor is U.S. or non-U.S. financial institution or non-financial institution and amounts owed to creditors when loans are over 5% of fund's NAV;
    - Derivative positions;
    - Detailed fund performance information;
    - Investor concentration levels;
    - Investment strategies;
    - Percentage of assets managed using computer-driven trading;
    - Significant counterparty exposure (including identity of counterparty); and
    - Trading and clearing practices

Form PF – Additional Reporting by Large Hedge Fund Advisers

- Large Hedge Fund Advisers (*i.e.*, advisers with more than $1 billion in hedge fund AUM) will be required to report additional aggregate information about managed hedge funds, including:
  - Market value of assets invested in different types of securities and commodities;
  - Duration of fixed income portfolio holdings (including indicating interest rate sensitivity);
  - Rurnover rate of manager's aggregate portfolios during a calendar quarter; and
  - Geographic breakdown of investments held

Form PF – Reporting For Hedge Funds with over $500 million in assets

- Large Hedge Fund Advisers must report even more detailed information for each hedge fund with over $500 million in assets, including:
  - The quality of the fund's portfolio liquidity;
  - Concentration of positions;
  - Collateral positions with significant counterparties;
  - The identity of and clearing relationship with its three largest clearing counterparties;
  - Certain risk metrics (e.g., VaR metric if calculated by the fund);
  - Certain financing information;
  - Certain investor information; and
  - Certain fund liquidity information (e.g., side pocket and gate provisions)

WHISTLEBLOWER RULES

Whistleblower Rules

- Under the Dodd-Frank Act, SEC obligated to pay an award to a whistleblower:
  - Who provides the SEC with original information about a securities law violation
  - Leading to a successful enforcement and/or related action
  - Resulting in monetary sanctions exceeding $1 million
- Given the incentives that this creates for potential whistleblowers, private fund managers should be prepared to respond quickly to internal reports of potential securities law violations and any inquiries from the SEC
  - Should also avoid punitive actions against any person believed to be a whistleblower, given applicable anti-retaliation provisions (discussed below)

Whistleblower Rules (cont'd)

- Final rules condition a whistleblower award on the following:
  - A whistleblower must be an individual (rather than a company or another entity) who submits original information to the SEC in accordance with specified procedures;
  - The submission must relate to a violation of the federal securities laws; and
  - The whistleblower must voluntarily submit information (*i.e.*, such submission must occur prior to a request by the SEC or other specified governmental bodies)

Whistleblower Rules (cont'd)

- The rules attempt to promote a "culture of compliance" within the firm, and mitigate incentives to bypass a firm's compliance program:
  - A whistleblower who simultaneously reports information to the SEC and to the firm through the firm's compliance program receives "full credit" with the SEC for the information, even if the firm ultimately reports the information;
  - A whistleblower's voluntary participation in an entity's internal compliance and reporting systems may increase the amount of an award; and
  - A whistleblower's interference with internal compliance and reporting policies may decrease the amount of an award

Whistleblower Rules (cont'd)

- The Dodd-Frank Act also contains anti-retaliation provisions, giving whistleblowers the right to sue if he or she is discharged, demoted or discriminated against for reporting potential violations to the SEC
  - For the protection to attach, the whistleblower need only have possessed a "reasonable belief " that the information that he or she provided to the SEC related to a possible securities law violation
  - The report need not have led to an enforcement action
- The SEC's rules also prohibit actions to impede a whistleblower from communicating directly with SEC
  - Including enforcing, or threatening to enforce, a confidentiality agreement

STATE LOBBYIST RESTRICTIONS

California Lobbying Law – General Rule

- The law prohibits a person from acting as a "placement agent" in connection with any potential investment made by a California state public retirement system – CalSTRS, CalPERS and the University of California pension system – unless that person is registered as a lobbyist and is in compliance with California laws regulating lobbyists
  - "Placement agent" means any person "hired, engaged, or retained by…an [investment] manager…who acts or has acted for compensation as a finder, solicitor, marketer, consultant, broker, or other intermediary in connection with the offer or sale" of the services of an investment manager to a California state public retirement system

California Lobbying Law – General Rule

- The definition of placement agent excludes "an individual who is an employee, officer, director, equityholder, partner, member, or trustee of an [investment] manager and who spends one-third or more of his or her time, during a calendar year, managing the securities or assets owned, controlled, invested, or held by the [investment] manager"
  - Fund sponsors will either need to limit California state public retirement system marketing activities to those that meet the one-third test or have certain of their personnel register as lobbyists
  - To date, there is limited additional guidance on the one-third test; CalPERS, a co-sponsor of the law, has taken the position that private fund professionals, such as a typical CFO, that have a "limited and intermittent role" in fundraising are not placement agents within the meaning of the definition

Prohibition on Contingency Fees

- Lobbyists may not accept or agree to accept any payment in any way contingent upon the outcome of any proposed administrative action, which would include a decision by any state agency to enter into a contract to invest state public retirement system assets on behalf of a California state public retirement system
  - The law allows a placement agent registered with the SEC and regulated by FINRA to receive fees for "contractual services" provided to an investment manager so long as such fees are not contingency fees

Lobbyist Law Requirements

- In order for an investment adviser to register an employee as a lobbyist, two forms must be filed
  - One form to register the investment adviser as a "lobbyist employer" and the other form to register the employee as a "lobbyist"
  - The forms need to be filed prior to contact with the applicable California state public retirement system
- In order for an investment adviser to engage a placement agent to solicit a California state public retirement system, it will need to complete a form authorizing the placement agent to act on its behalf
  - As a result, the investment adviser will be a lobbyist employer and subject to the lobbying law requirements.
  - The forms need to be filed prior to contact with the applicable California state public retirement system

Lobbyist Law Requirements

- Once registered as a lobbyist employer and a lobbyist, both the investment adviser and the employee are subject to California lobbying law requirements, including:
  - Filing quarterly reports regarding lobbying expenses, gifts and political contributions
  - A requirement that the lobbyist employee attend an in-person ethics course within 12 months of registering as a lobbyist
  - No political contributions and no gift of more than $10/month may be made to officials of the applicable California state public retirement system
  - Having a recordkeeping system in place to ensure accuracy and reliability of records
  - Being subject to an audit by the Franchise Tax Board

California Local Plans

- The law also requires a person acting as a placement agent in connection with any potential investment made by a California local public retirement system (*e.g.*, Los Angeles City Employees' Retirement System (LACERS)) to file any applicable reports with a local government agency that requires lobbyists to register and file reports and to otherwise comply with any applicable requirements imposed by such local government agency

Penalties for Non-Compliance

- If knowingly or willfully violate the lobbying laws, can be guilty of a misdemeanor
  - Misdemeanor conviction could potentially subject the fund, and affiliated funds, to disqualification from Rule 506 offerings under Reg. D, pursuant to the new "bad boy" disqualification provisions introduced under the Dodd-Frank Act
  - Also potentially disclosable on the adviser's Form ADV
- Subject to fines
- May be barred from acting as a lobbyist in California for up to 4 years

New York City Lobbying Law – Background

- New York City's Lobbying Law (NYC Admin. Code Title 3 §§ 3-211 to 3-233)
- The statute is not new, although its application to investments by NYC pension plans in private funds is new
  - Began being applied as a result of an advisory opinion issued by the New York corporation counsel to the New York City Clerk on March 31, 2010, which concluded that placement agents and fund adviser personnel involved in solicitation of NYC plan business qualified as "lobbyists" under the Lobbying Law
  - The advisory opinion was not publicized by the City Clerk until December 29, 2010, when the City Clerk sent a form letter to a number of private fund managers announcing that the Lobbying Law applies to the activities of placement agents and fund adviser personnel involved in soliciting investments from NYC plans

New York City Lobbying Law – Background

- NYC pension plans:
  - New York City Employee Retirement System
  - New York City Police Pension Fund
  - New York City Fire Department Pension Fund
  - New York City Teachers' Retirement System
  - New York City Board of Education Retirement System

General Rule

- Requires placement agents (whether or not SEC-registered), other third parties <u>and investment advisory firms (and their employees)</u> who attempt to influence the investment decisions made by New York City pension plans, to register as lobbyists if their compensation attributable to solicitation of such plans exceeds $2,000 per year ("Lobbyists")
  - There is a potential exception (discussed below) for certain officers and employees of a lobbyist, although it is unclear how the exception would apply in the context of an investment advisory business
- Also requires filings by "clients" of lobbyists (*i.e.*, those who retain or employ a person meeting the definition of lobbyist) ("Clients")

General Rule

- Once registered, Lobbyists and their Clients must also comply with other restrictions and reporting requirements, including a prohibition on receiving compensation that is contingent upon successful solicitation of an NYC plan
- Failure to comply constitutes a Class A Misdemeanor, punishable by civil fines of up to $30,000 per violation
  - Note that a misdemeanor conviction could potentially subject the fund, and affiliated funds, to disqualification from Rule 506 offerings under Reg. D, pursuant to the new "bad boy" disqualification provisions introduced under the Dodd-Frank Act
  - Also potentially disclosable on the adviser's Form ADV

Possible Exception for Certain Lobbyist Personnel

- Certain provisions of the Lobbying Law (NYC Admin. Code §3-211(c)(3)(vi)(A)) exempt from the lobbyist registration requirement certain personnel of a contractor or prospective contractor who communicate with non-elected officials
  - Note, however, that while certain City plan officials may not hold elected positions, the New York City Comptroller is an elected position so the exception would not apply where communications with the Comptroller are involved
- Personnel qualifying for this exception include "officers and employees of the contractor or prospective contractor who are charged with the performance of functions relating to contracts"

Possible Exception for Certain Lobbyist Personnel

- In order to qualify, their communications must occur "in the regular course of procurement planning, contract development, the contractor selection process, the administration of a contract, or the audit of a contract"
- It is unclear how this would be applied in the context of a private fund sponsor or investment adviser
  - To-date, no guidance from the City Clerk's office on this point
- Note also that the exception only applies to certain personnel of the contracting firm, not to the contracting firm itself, which would still be required to register

Registration Requirements

- Fund sponsors that reasonably expect to pay more than $2,000 in annual compensation cumulatively to their own personnel for soliciting business from NYC plans must file registration statements and periodic reports, listing themselves as both a Client and a Lobbyist
- Fund sponsor personnel that reasonably expect to receive more than $2,000 in annual compensation relating to soliciting business from NYC plans must file registration statements and periodic reports, listing themselves as Lobbyists

Registration Requirements

- Placement agents that reasonably expect to earn over $2,000 in annual compensation cumulatively from soliciting business from NYC plans must file a registration statement and periodic reports for each fund sponsor that retains them, listing themselves as a Lobbyist
- Fund sponsors that reasonably expect to pay more than $2,000 in annual compensation to placement agents to solicit NYC plans must file periodic Client reports

Contingent Compensation Prohibited

- Clients are not permitted to retain, employ, or designate any lobbyist if the rate or amount of compensation is partly or wholly contingent on the successful solicitation of NYC plan business
- Lobbyists are similarly prohibited from receiving any such contingent compensation
- Fees paid to placement agents would thus seem to be prohibited if the fees are contingent on an NYC plan's investment in a fund (which would include most traditional placement agent compensation structures)

Contingent Compensation Prohibited

- Currently, it is unclear whether a bonus payment to a fund sponsor's Lobbyist employee who engages in lobbying activities as part of his or her employment would be considered as a form of prohibited contingent compensation under the Lobbying Law
  - Note that such payments might raise separate issues under an Exchange Act/broker-dealer analysis

Filing Requirements for Lobbyists

- Registration Requirements
  - A separate Statement of Registration must be filed by a Lobbyist each calendar year for each Client via NYC's e-Lobbyist website (www.nyc.gov/eLobbyist)
    - Due on Jan. 1, or within 15 days of being retained
  - The Statement of Registration will include certain information about the Lobbyist, its lobbying activities and its employees who engage in lobbying activities
  - The Lobbyist must also file the written retainer agreement between the Lobbyist and the Client (or, if there is no such written agreement, a written statement summarizing the terms of the oral agreement)

Filing Requirements for Lobbyists

- Reporting Requirements
  - Six bi-monthly periodic reports must be filed each calendar year
  - Any Lobbyist who engages in fundraising or political consulting activities in any calendar year in which the Lobbyist is registered, or in the six months preceding any such calendar year, must also file fundraising and political consulting reports

Filing Requirements for Clients

- Must file a Client Annual Report via NYC's e-Lobbyist website (www.nyc.gov/eLobbyist)
  - Due on Jan. 15 of each year, unless the Client lobbies on its own behalf and registers as a Lobbyist

Filing Requirements for Lobbyist-Clients

- Where a person, such as a fund sponsor, is both a Lobbyist and a Client, the Lobbyist-Client must comply with the Lobbyist filing requirements
- In its Statement of Registration and other required filings, the Lobbyist-Client would include itself as both a Lobbyist and a Client
- The Lobbyist-Client would not be required to file a Client Annual Report with respect to its own lobbying activities. However, it would be required to file a Client Annual Report concerning lobbying activities conducted on its behalf by another third-party Lobbyist (*e.g.*, a placement agent)

Other Requirements and Considerations

- Notice of Termination of Lobbyist. A Client and its Lobbyist must submit written notice of termination within 30 days after a lobbying agreement is terminated
- Campaign Contribution Limits. Lobbyists may not make campaign contributions exceeding the following limits per calendar year:
  - Mayor/Public Advocate/Comptroller: $400
  - Borough President: $320
  - City Council: $250.

Other Requirements and Considerations

- Fundraising and Political Consulting Reports. Lobbyists who solicit contributions for a candidate running for a City office or who, for compensation, participate in the campaign of a candidate running for a City office or who provide political advice to the mayor or certain other City offices are required to file fundraising and political consulting reports
- Prohibition on Gifts to Public Servants. Lobbyists are generally prohibited from giving gifts to NYC public servants. The prohibition also extends to gifts given by a Lobbyist's employees, or by a Lobbyist's or employee's spouse, domestic partner or unemancipated children

Other Requirements and Considerations

- Recordkeeping Requirements. Lobbying records must be kept for five years by Lobbyists and Clients, including:
  - Compensation of any kind or amount with respect to lobbying activities;
  - Names and addresses of every person paying or promising to pay compensation of $50 or more and the date of that promise;
  - Names and addresses of every person to whom any item of expenditure of more than $50 is made and a receipted bill for each expenditure; and
  - All expenditures made by or on behalf of the Client
- Additional Ethics Requirements
- All Lobbyist and Client filings are public

Other Requirements and Considerations

- NYC Comptroller Requirements
  - *Use of Placement Agents*. Private equity fund sponsors are prohibited from using placement agents to secure investments from NYC plans. Hedge fund and other fund sponsors are required to disclose all fees and compensation paid to any placement agent in connection with securing investments from NYC plans. All placement fees must be borne by the fund sponsor. All fund sponsors must disclose any placement fees paid in connection with securing commitments from any other (*i.e.*, non-NYC plan) investors in the fund.
  - *Monitoring City Contacts*. All fund sponsors must disclose all contacts with employees of the City Comptroller's Office regarding new investments, as well as contacts with other individuals (such as the boards of trustees of the NYC plans), involved in the investment decision-making process with respect to the NYC plans.
  - *Gifts*. No fund sponsor or its personnel may give any gifts of any value whatsoever, in any form, to any NYC civil servants.

Further Guidance

- A number of parties are seeking further guidance from the New York City Clerk's office
  - An advisory opinion may be forthcoming, although no deadline has been stated
- The City Clerk does not seem inclined to provide relief to fund sponsors in this area

THE VOLCKER RULE

The Volcker Rule – Application

- *Covered Entities* – All bank holding companies (“BHCs”) and their subsidiaries and affiliates (*i.e.*, every entity in an organizational structure that has a bank)
  - Large, systemically important non-bank financial companies (*e.g.*, large broker-dealers) that are supervised by the Fed will be subject to additional capital and quantitative restrictions for Covered Fund investments
- *Covered Funds* – All §3(c)(1) and §3(c)(7) funds and “similar funds”
  - Explicit exception for SBIC investments
  - Does not apply to <u>completely</u> offshore activity (*e.g.*, an offshore bank not controlled by a U.S. parent investing in an offshore fund with no U.S. investors)

The Volcker Rule – Prohibitions and Exceptions

- *No Direct Investments in Third Party-Sponsored Funds* – All direct investments by a Covered Entity in a private fund sponsored or managed by a third party are prohibited (except for SBICs)
  - Subject to rulemaking, Covered Entities may be able to indirectly invest in third party-sponsored funds through fund-of-funds vehicle under "organizing and offering" exemption (discussed below)
- *Limited "Organizing and Offering" Exemption for Sponsored Funds* — Covered Entity may sponsor a Covered Fund ("Sponsored Fund") and provide 100% of seed capital only if:
  - Equity or partnership interest is reduced to not more than 3% of the "total ownership interests" of any Sponsored Fund within one year
  - Aggregate of all Sponsored Fund investments do not exceed more than 3% of Tier One Capital
  - Covered Entity provides bona fide trust, fiduciary or investment advisory services to the Sponsored Fund and the sponsored Fund is organized and offered in connection with such services
  - Covered Entities do not guarantee or insure the obligations or performance of the Sponsored Fund and makes it clear to investors that losses will be borne solely by investors, not any Covered Entity
  - No director or employee of the Covered Entity takes or retains any equity or partnership interest unless directly engaged in provision of advisory or other services
  - The Sponsored Fund and Covered Entities do not share the same name or variation of the same name

The Volcker Rule – Timing

Transition Period (4 Years)

- *Two Years Until the Effective Date* — Volcker Rule is effective at the earlier of two years (July 21, 2012) or 12 months from the adoption of final rules by federal regulators. No technical limitation on new investments by Covered Entities until that time
- *Two-Year Transition Period after the Effective Date* — Covered Entities will have two years from the Effective Date to come into compliance

Extensions (3-8 Years after Transition Period)

- *Three One-Year Extensions* — The Fed may by rule or order extend the transition period for not more than a year at a time, but not to exceed three years.
- *Up to Five-Year Illiquid Fund Extension* — The Fed may grant by application up to a five-year extension for “illiquid funds,” defined as a Covered Fund which as of May 1, 2010, principally invests in illiquid investments
  - “Illiquid fund” definition is designed to apply to private equity and real estate funds, not hedge funds

DERIVATIVES UPDATE

Derivatives Update: Overview

- The Dodd-Frank Act initiated sweeping reforms to the regulation of derivatives
- SEC, CFTC struggling to adopt, implement rules required by Dodd-Frank Act
  - Significant rule proposals since November 2010, industry sea change expected in coming months
  - Nearly all rules currently in non-final proposed format
  - Derivatives regulation lags behind some other Dodd-Frank rulemaking
  - Industry groups pleading for more time to comment on revisions
  - CFTC rejecting industry-proposed solutions

Derivatives Update: Overview

- June 14-15, 2011: SEC, CFTC announced implementation delays ahead of Dodd-Frank deadlines
  - SEC delay indefinite
  - CFTC delay until late 2011 and into 2012
    - implementation schedules announced
    - little progress on substantive rules
  - Potential state issues in interim

Derivatives Update: Overview

- Dodd-Frank and related proposed rules would:
  - Require all derivatives to fall under SEC or CFTC jurisdiction
    - Limited number of FX forwards exempt
  - Modify "eligible contract participant" definition to drastically reduce funds eligible for OTC trades
    - Substantial number of market participants to switch to exchange trading
    - As proposed, many private funds would not qualify
  - Require central clearing of nearly all OTC derivatives transactions
    - Raises questions as to cross-margining viability
    - Related increase in collateral, margin and transaction costs
  - Require commodity pool operator / commodity trading advisor registration for nearly all investment managers who employ futures or derivatives as part of investment strategy
    - CFTC would cancel CPO exemptions applicable to private fund advisers, RICs

Derivatives Update: Overview

- Proposed rules would (cont.):
  - Require registration (with SEC and/or NFA) and significant additional compliance requirements on entities with swap dealer function or significant amounts of derivatives exposure
  - Require significant increases, more stringent requirements for margin on uncleared transactions
  - Impose position limits across futures and swaps markets
  - Require recordkeeping, subject to regulator inspection, of all derivatives trading by all market participants

Swaps under Regulator Authority

- OTC Derivatives brought under the authority of CFTC and SEC
  - Securities-based swaps will be "securities" under Securities Act, Exchange Act definition, regulated by SEC
    - Includes single-stock or single-loan TRS, narrow-based index or basket TRS, single-name or narrow-based CDS, certain loan-based swaps
    - Application in other contexts (e.g., Investment Company Act regulation) unclear
  - All other swaps subject to CFTC regulation
    - Includes interest rates, energies, broad-based CDS, broad security baskets and indices, agricultural swaps
    - Includes most foreign currency swaps
      - Treasury proposes exempting deliverable (*i.e.*, full physical exchange) forwards from all but reporting, anti-manipulation rules

Swaps under Regulator Authority

- CFTC intends to impose position limits across futures and swaps markets
  - Some difficulty in raising necessary internal CFTC votes
  - SEC to provide limits for security-based swaps in future rulemaking
- All swaps subject to CFTC antifraud, registration, reporting and recordkeeping authority
- Over-the-counter trading eligibility substantially decreased
  - Proposal to narrow, add lookthrough to Commodity Exchange Act's "Eligible Contract Participant" definition
  - Implementation questions remain

Swaps under Regulator Authority

- Central clearing required of nearly all swaps
  - To include standardized and commonly traded swaps accepted by a clearinghouse
  - Exceptions where one party is not a financial entity or is using swap to hedge commercial risk
    - "Financial entity" and "hedge commercial risk" terms subject to further rulemaking

New Regulation of Derivatives Users

- CFTC intends to eliminate longstanding exemptions from CPO/CTA regulation
  - Proposes eliminating following exemptions
    - CFTC Regulation 4.13(a)(3) - exemption for minimal trading of commodity futures contracts
    - CFTC Regulation 4.13(a)(4) - exemption for commodity pools with sophisticated investors
    - CFTC Regulation 4.5 - exemption for RICs and their operators

New Regulation of Derivatives Users

- CFTC intends to eliminate longstanding exemptions from CPO/CTA regulation (cont.)
  - As a result, under current proposals
    - RICs would return to pre-2003 regime:
      - Must represent that initial margin and premiums is less than 5% of liquidation value
      - Cannot market as commodity pool or a vehicle to gain exposure to commodity investing
    - Every other RIA, nearly every private fund manager, trading in commodity futures and/or non-security-based derivatives must register with NFA as a CPO and/or CTA
      - Regulation 4.7, which requires NFA registration but lessens compliance burdens on CPOs to QP funds, still expected to be available

New Regulation of Derivatives Users

- Swap Dealer
  - Conduct test (e.g., holds out to potential swaps counterparties, makes market in swaps)
- Major Swap Participant
  - Generally an entity that fits any of the following:
    - Maintains substantial positions in swaps, generally ≥$1B in average daily uncollateralized exposure / ≥$2B combined current and future exposure for each category of swap
      - Higher $3B / $6B thresholds for rate swaps
      - Future exposure to be determined by formula set out by SEC / CFTC
      - Hedged amounts excluded
    - Has substantial counterparty exposure that could have systemic effect
      - ≥$5B average daily / ≥$8B current and future swap exposure across all swap categories
    - Is a financial entity that is highly leveraged and maintains substantial positions in swaps

New Regulation of Derivatives Users

- Swap dealers and MSPs to be subject to substantial requirements:
  - Registration with applicable regulator, related compliance:
    - Minimum capital and margin requirements
    - Reporting and recordkeeping
    - Policies covering compliance, risk management, business continuity, supervision
    - Business conduct standards
    - Implementation of systems to avoid conflicts of interest
    - Appointment of chief compliance officer
- All swaps users required to maintain records of swaps use, subject to inspection by applicable regulator

Changes to Margin Requirements

- Uncleared swaps subject to strict and mandatory margin requirements
  - Initial margin (e.g., "Independent Amount") required for nearly all counterparties
  - Margin must be posted in cash or treasuries (initial margin may include agencies)
  - Uncleared contracts subject to significantly larger amounts of margin
  - Third-party custodians to hold initial margin
    - Initial margin posted by Swap Dealers, MSPs must be segregated
    - Unregistered end-users must be given option of segregating

AIFM DIRECTIVE

AIFM Directive

- New EU legislation introducing a pan-European regulatory regime for managers of alternative investment funds, including hedge funds, private equity funds, funds of funds, etc.
  - Any fund that is not a "UCITS" is an "alternative investment fund"
- Applies to any fund manager who:
  - Markets funds within the EU
  - Has its registered office in the EU
  - Manages an EU fund
- Applies regardless of where fund is based, so includes:
  - Non-EU-based fund managers who raise money from EU investors
    - E.g., U.S.-based fund manager (including hedge fund managers)
  - EU-based managers of non-EU funds
    - E.g., London-based manager of Cayman or Channel Islands funds

AIFM Directive - Authorization

- Fund managers within scope must be authorized by (*i.e.*, registered with) an EU regulator
  - Authorized managers have "passporting" rights
    - Can provide fund management services and market fund interests to institutional investors across the EU under a single set of rules
  - Implementation will be staged
    - Non-EU fund managers will not be eligible for authorization until mid 2015
    - EU-based firms must apply for authorization from mid 2013
  - Authorized firms are subject to extensive compliance obligations, including:
    - Regulatory capital requirement
    - Conduct of business rules
    - Limits on leverage
    - Custody rules
    - Valuation rules
    - Reporting requirements – to fund investors and to regulator
    - Remuneration code

AIFM Directive - Implementation Timetable

National implementation

First ESMA review

Second ESMA review

July 2011	July 22 2013	Q3/Q4 2015	Q4 2018/ Q1 2019
	EU AIFM must become authorised	Non-EU AIFM may become authorised	National private placement regimes terminated (?)

Authorised EU AIFM market EU AIF using passport and non-EU AIF under national private placement rules

Non-EU AIFM market under national private placement regimes plus some AIFMD rules

Authorised EU AIFM market non-EU AIF using passport

Authorised non-EU AIFM market using passport

QUESTIONS?

Kirkland & Ellis LLP – Investment Management

Scott A. Moehrke, P.C.
(312) 862-2199
scott.moehrke@kirkland.com

Nabil Sabki
(312) 862-2369
nabil.sabki@kirkland.com

Robert H. Sutton
(212) 446-4897
robert.sutton@kirkland.com

Tax and Accounting Developments

Matthew A. Koenig
Ernst & Young LLP

Anthony S. Rentz
Ernst & Young LLP

Donald E. Rocap
Kirkland & Ellis LLP

Industry Update

- Capital
  - Slow return of capital in 2009 and 2010/2011
  - AUM approximately $1.82 trillion
    - Back from peak of approximately $2.0 trillion (mid-2008)
    - Up almost 20% year-over-year
  - Big getting bigger
  - Currently the size of the European hedge fund industry stands at $US399.8 billion
    - Launch activity for the European market has picked up strongly over the last two years, primarily on the back of demand for UCITS III hedge funds. This trend of healthy launch activity has continued in 2011.
- Key highlights
  - Hege funds outperformed global markets by 5.57% in August 2011
  - Arbitrage, distressed debt, event driven, long/short equity and relative funds have had negative returns for the last four months
  - Net asset flows remained positive for the ninth consecutive month
  - Over 500 launches in the first six months of 2011
  - Net asset flows for first eight months stand at US$120.8 billion
  - 51% of hedge funds are above their December 2008 highwater marks as of July 2011

Industry Update

Eurekahedge Region Index return matrix

	All strategies		
	August 2011	**2011 YTD return**	**August AUM (billions)**
Asia	(3.40) %	(2.62) %	$118.4
Asia ex-Japan	(4.78)	(4.56)	-
Asia inc Japan	(3.76)	(3.16)	-
Australia/New Zealand	(1.72)	(2.31)	-
Emerging markets	(3.23)	(1.90)	-
Europe	(3.82)	(3.99)	399.8
Greater China	(5.05)	(4.46)	-
India	(9.56)	(14.82)	-
Japan	(2.34)	(0.88)	16.9
Korea	(5.10)	(0.89)	-
North America	(2.31)	(0.02)	1220.1
Latin America	(0.28)	2.16	63.1
Latin America (offshore)	(1.69)	(0.86)	-
Latin America (onshore)	0.20	3.35	-
All regions	(2.13)	(1.47)	1818.3

Industry Update

Eurekahedge Region Index return matrix

	By Strategy – All Regions		
	August 2011	**2011 YTD return**	**August AUM (billions)**
Arbitrage	(1.62) %	0.84 %	$137.2
CTA/Managed Futures	0.08	(1.25)	208.2
Distressed Debt	(3.36)	1.11	64.5
Event Driven	(3.22)	(2.59)	209.6
Fixed Income	(1.02)	2.40	105.2
Long/Short Equities	(3.93)	(3.36)	553.3
Macro	0.19	(0.07)	125.3
Multi-Strategy	(1.26)	0.01	306.0
Relative Value	(2.04)	(0.73)	48.4

Key Industry Trends

Product development

- Improved liquidity terms for investors
- Rationalize products and determine profitability
- Support for multi-asset class asset allocation
- FOF - RICs

Fees and expenses

- Pressure on fee structures
- Increased demands on infrastructure for enhanced risk management, regulatory reporting and overall transparency
- Fee structuring – management fees

Organizational focus

- Improved performance measurement and attribution reporting
- Scale and efficiency required to support new products
- Skills development related to complex products and retention of key resources
- Corporate governance

Data management

- Recognition of the value of data strategy, data governance and security master data management
- Increased demand for transparency from investors, regulators and Boards

Investment advisor hot topics

- Focus on operational due dilligence
- Administration (Full NAV/Light NAV/Shadowing)
- SAS 70

Key Industry Trends

Middle/back office focus

- Risk management/counterparty risk
- Treasury functions
- Key functions and responsibilities of a fund's organizational structure (front office, back office, middle office, etc.) should be clearly defined

Outsourcing

- Off-shoring of commodity activities such as reconciliation
- Outsourcing to third-party service providers or custodians and the need to rationalize and realize scale in back-offices, with increasing investment in middle office (T+1) functions

Accounting Update

- Accounting pronouncements:
  - ASU 2010-06, Fair Value Measurements and Disclosures: Improving Disclosures about Fair Value Measurements
  - ASU 2011-04, Fair Value Measurements and Disclosures: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs
  - ASC 210-20 Balance Sheet – Offsetting (formerly FIN 39, FSP FIN39-1 and FIN 41)
  - ASC 740, Income Taxes – Update
- Hot topics:
  - Valuation
    - Disclosures
    - Use of/Reliability of third party sources
    - Valuation Committee
  - Existence

Tax Update

- Proposed legislation - American Jobs Act 2011
  - Economic Stimulus
    - Payroll tax relief
    - Increase jobs credit
      - Unemployed veterans
      - Long-term unemployed
    - 100% deduction for investment qualified property through 2012
    - Infrastructure bank
  - Revenue Raisers
    - Carried interest as ordinary income
    - 28% benefit of certain individual itemized deductions/income exclusions (individuals earning more than $200,000 – joint filing $250,000)
    - Repeal many oil and gas industry preferences
    - Corporate jet depreciation to 7 years from 5 years
    - 5.6% surtax on income > $1 million?

Tax Update

- Budget Control Act of 2011
  - Super committee
    - 6 Democrats – 6 Republicans
    - Report November 23rd / congressional vote by December 23rd
    - Goal of $1.5 trillion savings over 10 years
    - Failure: pro-rate spending cuts of $1.2 trillion over 10 years
  - Obama – balanced spending/tax increase
    - Same Jobs Act revenue raisers
    - Credit for scheduled tax increases

Tax Update

- Carried interest – "American Jobs Act of 2011"
  - Jobs Act – tax carried interest in investment and real estate partnerships at full ordinary income rates
    - 2010 versions taxed at 75%/50% blended capital gain/ordinary income rate with various other transition rules
  - Not applicable to "qualified capital interest"
  - Applies to sales of carried interest – enterprise value
  - Corporate treatment for publicly traded partnerships earning significant income from carried interest (effective date deferred 10 years)
  - Effective date January 1, 2013

Outlook

- Will CI proposals have any traction in 2011-2012?
  - Obama Administration continues to support treating CI as OI in recent legislative proposals
  - Continuing need for revenue and deficit reduction
  - Democratic-controlled Senate did not pass previous CI bills
  - House, which passed CI bills 4 times while controlled by Democrats, is now controlled by Republicans
  - Deficit reduction debate may complicate the issue

Update on Foreign Account Tax Compliance Act (FATCA)

- Foreign Account Tax Compliance Act ("FATCA"):
  - Imposes a 30% withholding tax obligation on "withholdable payments" made to a:
    - "Foreign financial institution" (an "FFI"), or
    - "Non-financial foreign entity"

    Unless the foreign entity identifies, or establishes the absence of, direct or indirect U.S. owners
  - "Withholdable payments" are payments of:
    - U.S. source dividends, interest, royalties, and other fixed or periodic payments ("FDAP payments"); and
    - the <u>gross</u> proceeds realized on the sale of U.S. property that could produce dividends or interest (e.g., stock or debt in a U.S. company) ("proceeds payments")

Notice 2011-53

- FATCA legislation was to be generally effective on January 1, 2013.
- IRS has delayed implementation date:
  - Withholding on FDAP payments will not begin until January 1, 2014.
  - Withholding on proceeds payments will not begin until January 1, 2015
  - To avoid 2014 withholding, FFI must enter into FATCA agreement with IRS by July 30, 2013
  - FFI must begin to file IRS reports on U.S. accounts by September 30, 2014 based on 2013 year-end balances
- Financial industry requesting further delay

- An FFI is any non-U.S. entity that:
  - Accepts deposits as a banking business,
  - Holds financial assets for others' accounts, or
  - Engages primarily in the business of investing in securities, partnership interests, commodities, futures contracts, or options
- Examples of Foreign Financial Institutions:
  - Non-U.S. bank
  - Non-U.S. life insurance company
  - Non-U.S. hedge fund
  - Non-U.S. feeder fund
  - Non-U.S. fund-of-funds
  - Non-U.S. family investment entity
  - Notice 2010-60: non-U.S. retirement plans will be exempt from withholding (in future guidance) if plan (i) qualifies as a retirement plan under its local law, (ii) is sponsored by a foreign employer, and (iii) does not allow U.S. participants other than U.S. employees working in the local jurisdiction

Requirements to Avoid Withholding

- FFI must enter into an agreement with the IRS to
  - Determine which (if any) accounts of the FFI are U.S. accounts:
    - Accounts held by "specified U.S. persons" (generally any U.S. person other than publicly-traded corporations, 501(c)(3) tax-exempt organizations, governments, REITs, RICs, banks, and certain trusts), <u>and</u>
    - Accounts held by any foreign entity with one or more direct or indirect 10% U.S. owner
  - Comply with various IRS verification and due diligence requirements:
    - FFI must attempt to obtain waiver of any foreign laws (e.g. bank secrecy laws) that would prevent disclosure of the relevant information, and, if not obtained, must close the account

Requirements to Avoid Withholding

- FFI must (continued):
  - File annual reports with the IRS of
    - Name, address, and TIN of each “specified U.S. person” holding an account
    - Name, address, and TIN of each 10% U.S. owner of any account-holder that is a foreign entity
    - Report account number, balance, gross receipts, gross withdrawals, and payments from the account.
  - Withhold 30% of “passthru payments” to “recalcitrant account holders”
  - Withhold 30% of “passthru payments” to any other FFI that has not entered into a FATCA agreement with the IRS

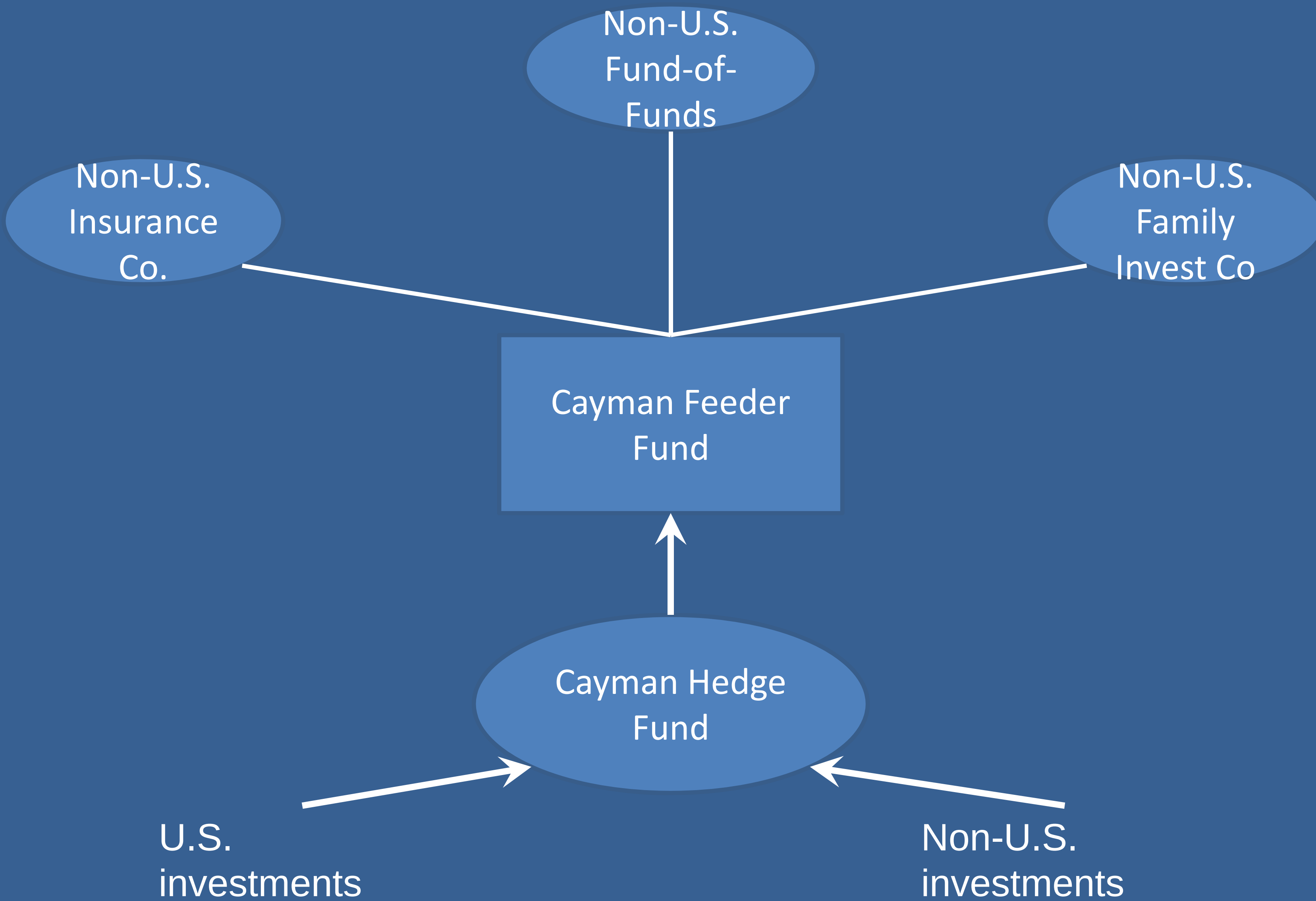
Requirements to Avoid Withholding

- "Passthru payment" defined to mean
  - Any payment that is a withholdable payment (e.g., non-U.S. partnership flows through to its partners U.S. source interest or dividends or proceeds from sale of U.S. stock or debt instruments) or
  - Any other payment "to the extent attributable to a withholdable payment"
    - Notice 2011-34 announces intent to issue regulations treating a payment as attributable to a withholdable payment based on the proportion of the FFI's assets that are represented (including indirectly through other FFIs) in assets of type that could give rise to withholdable payments.
    - Assume non-U.S. bank or non-U.S. corporate investment entity or non-U.S life insurance company has 20% of its assets invested (directly or indirectly through other FFIs) in U.S. stock and debt instruments
      - Interest paid by the non-U.S. bank, dividends paid by the corporate investment entity or insurance benefits paid by the non-U.S. insurance company generally would not be U.S. source and hence would not be withholdable payments under the general §1471 definition, but
      - Notice 2011-34 would treat 20% of the interest, dividends or insurance benefits as withholdable "passthru" payments
    - IRS asserts that a broad definition of pass-thru payments is necessary to prevent easy avoidance of FATCA rules
    - Financial industry argues that broad definition of pass-thru payments will force FFIs to divest U.S. assets
      - Even with broad definition of pass-thru payments, it will remain easy for U.S. tax evaders to avoid the FATCA rules by investing in FFIs that hold no direct or indirect U.S. investments

Requirements to Avoid Withholding

- Non-Financial Foreign Entity:
  - 30% withholding does not apply if:
    - The entity provides the withholding agent with either:
      - a certification that the Non-Financial Foreign Entity does not have any direct or indirect 10% U.S. owners, or
      - the name, address, and TIN of each direct or indirect 10% U.S. owner; <u>and</u>
    - The withholding agent does not know or have reason to know that the certification or information regarding 10% U.S. owners is incorrect; <u>and</u>
    - The withholding agent reports to the IRS the name, address, and TIN of each 10% U.S. owner.

Impact of FATCA on Hedge Funds



FATCA – Likely Consequences

- Huge compliance burden imposed on foreign entities investing in U.S.
- Non-U.S. investors seeking to avoid FATCA's complex reporting, diligence and withholding regime may avoid making U.S. investments entirely
- Non-U.S. investment entities may seek to prevent direct or indirect investment by U.S. persons or entities
- Little or no impact on U.S. tax evaders, who can continue to evade tax by investing in and through foreign entities that do not make direct or indirect U.S. investments

FBAR

- A U.S. Person with a financial interest in or signature authority over foreign "financial accounts" that exceed $10,000 in aggregate at any time during the calendar year must file Form TD F 90.22-1 (the "FBAR")
  - FBAR is not filed with the person's tax return and must be received by Treasury in Detroit not later than June 30th of the following year
  - Significant penalties for failure to file
- Form instructions state that a financial account for this purpose includes bank, securities, securities derivative, and other financial instrument accounts. Also includes "shares in a mutual fund or similar pooled fund."
- Notice 2011-54: FBAR filings for U.S. persons with "signature authority over, but no financial interest in," a foreign financial account in <u>2009</u> or prior years are not due until November 1, 2011
  - However, <u>all</u> FBAR filings for <u>2010</u> were due on June 30, 2011.

- In fund context, FBAR filing generally required if:
  - U.S. fund owns an interest in a foreign financial account
  - U.S. fund owns 50% or more by vote or value of foreign company (directly or indirectly) and the foreign company has one or more foreign financial accounts
  - An <u>individual</u> U.S. principal of a fund GP or management company has signature authority over a foreign financial account
  - A U.S. person owns an interest in a non-U.S. "mutual or similar pooled fund" that is treated as a financial account
    - After some initial confusion, IRS final regulations and FBAR instructions clarify that this definition is limited to foreign funds that are "available to the general public with a regular net asset value determination and regular redemptions" unless and until further guidance is provided
    - Thus, financial account does not currently include a non-publicly offered foreign hedge fund, foreign PE fund or foreign VC fund

Earnings from Self-Employment

- An individual's share of trade or business income (e.g., from management fees) is generally subject to 2.9% Medicare tax (scheduled to increase to 3.8% in 2013)
- Code § 1402(a)(13) exempts from self-employment tax income "of a limited partner . . other than guaranteed payments . . . for services.“
- Owners of fund management companies organized as LPs or LLCs have in the past taken the position that the § 1402(a)(13) exemption applies to their share of net management fee income

Renkemeyer (2011 Tax Court)

- Court held that partners of Kansas law firm organized as LLP do not qualify for § 1402(a)(13) exemption
- Rationale is that their status as limited partner was unclear and the legislative history indicates that the exemption was not intended to apply to active service providers
- Under Kansas (and other) state laws, an LLP is a form of <u>general partnership and all partners are general partners</u>
- Based on Renkemeyer (and other recent cases), members of a fund management company organized as an LLC or LLP likely do not qualify for the § 1402(a)(13) exemption
- But limited partners of a fund management company organized as a limited partnership should qualify for the exemption because their limited partner status is not ambiguous

QUESTIONS?

Kirkland & Ellis LLP

Donald E. Rocap
(312) 862-2266
donald.rocap@kirkland.com

Ernst & Young LLP

Matthew Koenig
(312) 897-3535
matthew.koenig@ey.com

Anthony S. Rentz
(312) 879-3957
anthony.rentz@ey.com

SEC Enforcement Trends, Including Insider Trading and Expert Networks

Charles J. Clark
Kirkland & Ellis LLP

Andrew M. Genser
Kirkland & Ellis LLP

John F. Hartmann, P.C.
Kirkland & Ellis LLP

Current Enforcement Trends

- Structural and Policy Changes at the SEC
  - Specialization: Asset Management Unit
- Dodd-Frank SEC Enforcement Provisions
  - Expanded Secondary Liability
  - Jurisdiction Over Foreign Securities Transactions
  - Whistleblower Bounty Program
- Aggressive Enforcement Environment
  - Focus on Wall Street Trading Activity
  - Expert Network Cases
  - "New" Investigative Techniques

SEC Enforcement Structural and Policy Changes

Structural and Policy Changes

- A Swifter Enforcement Division
  - Eliminating an entire layer of management and restricting the use of tolling agreements.
  - Delegating authority to obtain formal orders and issue subpoenas.
  - Streamlining the Wells process and other processes.
- Increased Credit for Cooperation
  - Formalized policy for entering into cooperation agreements with individuals.
  - Utilizing DOJ-style deferred- and non-prosecution agreements.
  - Expedited process for securing criminal immunity requests.

Enhanced Specialization

- Five Specialized Units
  - ***Asset Management Unit**:* Largest of new units; focus on investment advisers, investment companies, hedge funds and private equity funds.
  - ***Market Abuse Unit:*** Large scale market abuses and complex manipulation schemes by institutional traders, market professionals and others.
  - ***Structured and New Products Unit:*** Complex derivatives and financial products.
  - ***Foreign Corruption Unit:*** Focus on new approaches to identifying violations; more cooperation with foreign counterparts.
  - ***Municipal Securities and Public Pension Unit:*** Offering and disclosure issues, tax, or arbitrage driven activity, under-funded liability, and pay to play.
- Asset Management is the Largest Unit with the Highest Profile

Asset Management Unit Specifics

- Considerable Resources
  - Units were given their choice of experienced and skilled attorneys.
  - Asset Management Unit granted authority to hire Wall Street market specialists.
  - Relatively immune from budgetary pressures to which the Enforcement Division staff more generally may be subject.
- Emphasis on Expertise Within the Unit
  - Unit members are assigned particular area of expertise within fund management area and serve as subject matter experts for the Unit specifically and for the Enforcement Division generally.
  - Unit members responsible for generating resource materials to aid investigations.

Asset Management Unit Specifics (cont'd)

- Proactive Coordination with Other Divisions and with Exam Staff
  - Unit members and heads meeting regularly with staff of Division of Investment Management and Office of Compliance Inspections and Examinations.
  - Leveraging expertise and oversight in other divisions to identify anomalous trading and compliance failures.
- Aggressive Leadership - Unit and Division Level
  - Seasoned and assertive attorneys co-leading the Asset Management Unit.
  - Chairman and Division Director have signaled support for aggressive prosecutions.

Playing Field is Not Level:
Units Given Resources to Succeed

Asset Management Unit Priorities

- Potential Enforcement Cases
  - False Disclosures
  - Valuation
  - Portfolio Performance
  - Safekeeping of Assets
  - Redemption Issues
  - Side Pockets, Lock-Ups
  - Selective Disclosures
  - Record Keeping
  - Failure to Supervise
  - Misappropriation
  - Improper Short Selling
  - Insider Trading
  - Due Diligence
  - Conflicts of Interest
  - Affiliate Transactions
  - Placement Agents
  - Complex Derivatives
  - Municipal Securities
  - Public Pension Fund Investments
  - Market Manipulation
  - Rumors

Dodd-Frank SEC Enforcement Provisions

Dodd-Frank SEC Enforcement Provisions

- Expanded Secondary Liability
  - Reduces required intent for aiding and abetting liability to a showing of "recklessness" (as opposed to "knowingly").
  - Adds aiding and abetting liability under the Securities Act, Investment Company Act, and the Investment Advisers Act.
  - Clarifies SEC's authority to bring "control person" claims.

Dodd-Frank SEC Enforcement Provisions

- Jurisdiction Over Foreign Securities Transactions
  - Attempts to grant SEC jurisdiction over foreign transactions if "significant steps" taken in the U.S. to further the violation, or if foreign misconduct had a "foreseeable substantial effect" in the U.S.
  - Passed in response to Supreme Court's June 2010 "f-cubed" case; however, language creates some ambiguity whether the provision accomplishes that objective.

Dodd-Frank SEC Enforcement Provisions

- Whistleblower Bounty Program
  - Mandatory cash awards of 10% to 30% of total sanctions recovered by government (greater than $1 million) as a result of the whistleblower's assistance.
  - Rewards voluntary submission of original information
    - Derived from independent knowledge/analysis
    - Must not be legally obligated to provide information
  - Broad eligibility: employees, analysts, suppliers, customers.
  - Concern for potential impact this program could have on compliance policies and procedures designed to promote internal self-reporting.

Aggressive Enforcement Environment

Aggressive Enforcement Environment

- SDNY Focus on Wall Street Insider Trading Cases
  - Last two years: 54 charged with insider trading, no acquittals
- Galleon-Related Cases (*Rajaratnam*, et al.)
  - Raj Rajaratnam convicted after 2-month trial
  - Government alleges approximately $72 million in gains from insider trading and is seeking up to 24.5 years
  - Collected tips from a Goldman board member, senior company executives, a Moody's ranting analyst, an outside investor relations consultant, a McKinsey consultant, and a hedge fund consultant
  - SEC Lit. Rel. Nos. 21255, 21284, 21397, 21493, 21526, 21732, 21834, 21839, 22010, 22021, 22042, 22071, 22114 (most recent Oct. 5, 2011) (S.D.N.Y.); see also 21740, 21802, 21827.

Aggressive Enforcement Environment cont.

- "Octopussy" Insider Trading Ring (*Cutillo/Santarlas*)
  - Tips originated with 2 associates at Ropes & Gray, counsel to private equity firms (Blackstone, Silver Lake, Bain, and TPG), in exchange for kickbacks
  - More than $10 million in gains from insider trading
  - Leader of the ring sentenced to 10 years
  - SEC Lit. Rel. Nos. 21283, 21332, 21470, 21587, 21826, 22011, 22051, 22078 (most recent Aug. 31, 2011) (S.D.N.Y.); see also 21741, 21999.
- FrontPoint Funds Trading (*Skowron/Benhamou*)
  - French medical researcher tipped healthcare funds portfolio manager regarding negative clinical trial results for experimental drug
  - More than $30 million in losses avoided in advance of 44% stock decline
  - Both researcher and portfolio manager have plead guilty and are awaiting sentencing
  - SEC Lit. Rel. Nos. 21721, 21928 (most recent April 13, 2011)

Expert Network Cases

- Expert Network Cases
  - Criminal investigation by U.S. Attorney's Office in Manhattan and the SEC's Enforcement Division into unlawful exchange of material, nonpublic information between industry "experts" and market professionals, and associated trading. See Department of Justice Press Releases dated Nov. 24, Dec. 16, Dec. 29, 2010, and February 8, 2011.
  - Parallel SEC actions filed on February 3 and 8, 2011.
  - These prosecutions raise very difficult issues regarding what is acceptable conduct on the part of hedge funds, and to what lengths funds and their employees must go to insure that they are not trading while in possession of material, nonpublic information.

Old Techniques; New Uses

- “Mob” and “Drug Cartel” Techniques Applied to Insider Trading
  - Telephone Wiretaps
  - Confidential Informants Taping Calls
  - “Wired” Cooperating Witnesses
- Additional Charges Relating to Obstruction of Justice and Destruction of Evidence

QUESTIONS?

Kirkland & Ellis LLP

Charles J. Clark
(202) 879-5064
charles.clark@kirkland.com

Andrew M. Genser
(212) 446-4809
andrew.genser@kirkland.com

John F. Hartmann, P.C.
(312) 862-2215
john.hartmann@kirkland.com

Office Contact Information

Chicago
300 North LaSalle
Chicago, IL 60654
+1 (312) 862-2000
+1 (312) 862-2200 fax

Hong Kong
26th Floor, Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong
+852-3761-3300
+852-3761-3301 fax

London
30 St Mary Axe
London EC3A 8AF
United Kingdom
+44 20 7469 2000
+44 20 7469 2001 fax

Los Angeles
333 South Hope Street, 29th Floor
Los Angeles, CA 90071
+1 (213) 680-8400
+1 (213) 680-8500 fax

Munich
Maximilianstrasse 11
80539 Munich
Germany
+49 89 2030 6000
+49 89 2030 6100 fax

New York
601 Lexington Avenue
New York, NY 10022
+1 (212) 446-4800
+1 (212) 446-4900 fax

Palo Alto
950 Page Mill Road
Palo Alto, California 94304
+1 (650) 859-7000
+1 (650) 859-7500 fax

Mailing Address:
P.O. Box 51827
Palo Alto, CA 94303

San Francisco
555 California Street
San Francisco, CA 94104
+1 (415) 439-1400
+1 (415) 439-1500 fax

Shanghai
11th Floor, HSBC Building
Shanghai IFC
8 Century Avenue
Pudong New District
Shanghai 200120
P.R. China
+8621 3857 6300
+8621 3857 6301 fax

Washington, D.C.
655 Fifteenth Street, N.W.
Washington, D.C. 20005-5793
+1 (202) 879-5000
+1 (202) 879-5200 fax

INVESTMENT MANAGEMENT SPEAKER BIOGRAPHIES

Scott A. Moehrke, P.C.

Partner, Investment Management

300 North Lasalle
Chicago, Illinois 60654

t: +1 (312) 862-2199
f: +1 (312) 862-2200
scott.moehrke@kirkland.com

Scott A. Moehrke leads the Investment Management practice group and is a partner in the Corporate practice group of Kirkland & Ellis, where he practices in securities and corporate law with significant experience representing financial services companies, such as investment advisers, investment companies, business development companies and broker-dealers. His practice focuses on complex business transactions, including registered and exempt fund formations and ongoing operations, mergers, acquisitions and joint ventures of funds and fund managers, public and private securities offerings, novel product design and structuring, SEC compliance, board of directors and governance matters and institutional shareholder rights matters. He also has significant experience advising public and private companies on investment company status issues under the Investment Company Act of 1940. In *The Legal 500 U.S.*, an independent commentary on leading law firms around the world, clients describe Scott as "proactive and accessible" and say he has "an unusual mix of being knowledgeable about regulations, while maintaining good business knowledge."

Nabil Sabki

Partner, Investment Management

300 North Lasalle
Chicago, Illinois 60654

t: +1 (312) 862-2369
f: +1 (312) 862-2200
nabil.sabki@kirkland.com

Nabil Sabki is a partner in the Investment Management practice group of the Corporate department where he focuses his practice on the representation of financial service companies, such as hedge fund managers, registered and unregistered investment advisers, private investment funds, open- and closed-end mutual funds, business development companies and broker-dealers. He has significant experience forming and representing various private funds and their sponsors, including both domestic and offshore hedge funds. He also advises clients in connection with complex financial services related transactions, including mergers and acquisitions, joint ventures and private securities offerings. In addition, Nabil represents numerous registered investment advisers in connection with ongoing regulatory and compliance matters and frequently advises clients with respect to SEC and SRO inquiries and/or inspections.

INVESTMENT MANAGEMENT SPEAKER BIOGRAPHIES

Robert H. Sutton

Partner, Investment Management

601 Lexington Avenue
New York, New York 10022

t: +1 (212) 446-4897
f: +1 (212) 446-6460
robert.sutton@kirkland.com

Robert H. Sutton is a partner in the New York office of Kirkland & Ellis. Robert focuses his practice on the formation and operation of hedge funds, other private investment funds and their sponsors, as well as the regulation of the managers and advisers of private funds. He advises clients on a wide variety of fund related matters, including the structuring, formation and operation of investment funds, investment advisers and fund management companies, investment adviser registration and regulation, seed arrangements, spin-off transactions, joint venture relationships, agreements with service providers, general securities law matters and other compliance and trading matters.

TAX SPEAKER BIOGRAPHIES

Donald E. Rocap

Partner, Tax

300 North Lasalle
Chicago, Illinois 60654

t: +1 (312) 862-2266
f: +1 (312) 862-2200
donald.rocap@kirkland.com

Donald Rocap is a tax partner in the Chicago office of Kirkland & Ellis. His practice focuses on the tax and structuring aspects of acquisitions, dispositions, and reorganizations and private equity fund formations. He is a lecturer at the University of Chicago Law School and is a Volume Coauthor of Mergers, Acquisitions, and Buyouts, by Martin D. Ginsburg and Jack S. Levin, and a Special Editor of Structuring Venture Capital, Private Equity, and Entrepreneurial Transactions, by Jack S. Levin. Known for "bringing a level of sophistication that's two or three levels up from anybody else," Mr. Rocap has been selected as one of America's Leading Lawyers for Business in Tax by *Chambers USA* every year since 2004 and as one of The World's Leading Lawyers for Business in Tax by *Chambers Global* each year since 2002.

SEC ENFORCEMENT SPEAKER BIOGRAPHIES

Charles J. Clark

Partner, Litigation

655 Fifteenth Street, N.W.
Washington, D.C. 20005

t: +1 (202) 879-5064
f: +1 (202) 654-9479
charles.clark@kirkland.com

Charles J. Clark is a partner in the Washington, D.C. and New York offices of Kirkland & Ellis. Charles is a multi-faceted securities lawyer whose experience includes nearly nine years of public service in the Division of Enforcement at the U.S. Securities and Exchange Commission, and four years as the head of litigation for a Fortune 100 financial services company. While at the Commission, Charles had day-to-day responsibility for leading the Division of Enforcement's investigation into Enron Corporation. His practice focuses on counseling individuals and companies in securities-related enforcement proceedings before a wide range of governmental entities, and counseling public companies on issues of securities disclosure and corporate compliance. In addition, Charles conducts internal investigations on behalf of management and boards of directors, and provides guidance on corporate governance for public companies and regulated entities.

Andrew M. Genser

Partner, Litigation

601 Lexington Avenue
New York, New York 10022

t: +1 (212) 446-4809
f: +1 (212) 446-4900
andrew.genser@kirkland.com

Andrew Genser is a partner in the New York office of Kirkland & Ellis LLP and a member of the litigation and white collar criminal defense practice groups. Mr. Genser represents individuals and corporations in a wide variety of criminal and regulatory investigations by both state and federal authorities, and conducts internal investigations on behalf of corporate clients. Mr. Genser's civil practice includes representing investment banks, broker-dealers and corporations in complex commercial and securities-related disputes.

John F. Hartmann, P.C.

Partner, Litigation

300 North Lasalle
Chicago, Illinois 60654

t: +1 (312) 862-2215
f: +1 (312) 862-2200
john.hartmann@kirkland.com

John Hartmann is a litigation partner concentrating in shareholder litigation and white collar criminal defense matters. A former federal prosecutor and an experienced trial lawyer, Mr. Hartmann has represented issuers, auditors and directors and officers in a wide variety of securities fraud cases, including several large matters arising out of accounting irregularities and, more recently, the financial crisis of 2008-2009. He has also represented numerous clients, including hedge funds and private equity funds, in connection with SEC and government inquiries regarding securities, antitrust, health care and environmental matters, and has conducted internal investigations for management, boards of directors and special committees.

Engagement leadership

Matthew Koenig

Assurance Partner
Chicago
+1 312 879 3535
matthew.koenig@ey.com

Matthew is a partner with more than 18 years of experience serving clients in the asset management industry, including hedge funds, private equity funds and investment advisors. He spent his first seven years with the firm in Ernst & Young's New York office, serving the asset management industry.

In addition to his service to clients, Matthew develops and leads training courses for Ernst & Young professionals on accounting and auditing issues facing the hedge fund and private equity industries and on the use of various financial products. Matthew also has extensive product and operational knowledge. He has assisted in documenting and issuing policy and procedures manuals for hedge funds and advisory businesses. Matthew has experience in valuation and assessment of complex portfolio positions for hedge funds.

Matthew has been a panelist at various hedge fund industry conferences, including GAIM Cayman and NICSA's Midwest Regional Meeting. He is a CPA and a member of the American Institute of Certified Public Accountants as well as the Illinois CPA Society.

Tony Rentz

Tax Partner
Chicago
+1 312 879 3957
anthony.rentz@ey.com

Tony is a partner in the National Financial Services Asset Management Tax Practice at Ernst & Young and leads the Chicago Asset Management Tax Group. He has over 22 years of experience serving financial service organizations.

Tony has significant experience providing tax consultation and planning strategies related to the formation of onshore and offshore funds, debt and equity securities, taxation of derivatives, cross-border transactions and various financial products.

He is a regular presenter at various internal hedge fund seminars and training courses, and presents at many of our hedge fund client events, including the Ernst & Young Hedge Fund Symposium and National Year End Tax Update Webcast. Tony is also actively involved in campus and experienced-hire recruiting as well as training and education of the tax group.☐

Tony is a CPA and a member of the American Institute of Certified Public Accountants as well as the Illinois CPA Society.

INVESTMENT MANAGEMENT PRACTICE

"With substantial depth of regulatory expertise, the firm presents a solid option for those involved in the mutual fund and registered investment companies space, and its broad experience, together with the firm's interdisciplinary ethos, makes it capable of handling some of the largest and most complex matters around. Clients 'think very highly of' the investment management group, 'find it to be excellent,' and deem that the firm 'has done a good job of growing the practice.'"
– *The Legal 500 U.S.*, 2010

Listed among the best in the Global, U.S. and Asia categories in Investment Funds
– Chambers & Partners, *Chambers Global 2011*

Kirkland & Ellis has a dedicated team of more than 12 attorneys focused on investment management. The Investment Management practice represents public and private investment funds and their management companies, including hedge funds, mutual funds, closed-end registered funds, BDCs, investment advisers and broker-dealers. The group also has extensive experience with SEC-registered advisers forming and operating private funds from structuring and formation issues to ongoing compliance and SEC examinations.

Kirkland's Investment Management practice also works as part of a cross disciplinary team on mergers, acquisitions and similar complex transactions involving investment management firms. Our attorneys bring dedicated industry knowledge to complex transactions in this highly regulated business and creatively address and execute these transactions. Representative transactions include acquisitions and sales of investment management firms, minority investments, spin-offs, seed capital arrangements, staged sales and acquisitions, and joint ventures. Over the last several years, our attorneys have worked on some of the largest asset management transactions in the industry.

The Investment Management practice is part of Kirkland's Private Funds Group, which was recognized as "second to none" according to a recent survey by Chambers & Partners, a leading publisher of research on the legal profession. With approximately 60 attorneys focused on private funds across ten offices in six time zones — including in the U.S., UK and Asia — the Firm is uniquely positioned to serve its clients in connection with the organization and operation of private funds of all types, as well as their respective management companies.

SEC ENFORCEMENT PRACTICE

Finalist for Litigation Department of the Year
– The American Lawyer, "Litigation Department of the Year," January 2010

Kirkland's Securities and Regulatory Enforcement group represents individuals and companies in securities-related proceedings before a wide range of governmental entities (U.S. Securities and Exchange Commission, U.S. Department of Justice, Financial Industry Regulatory Authority (FINRA), Financial Services Authority (FSA), federal bank regulators, and various state Attorneys General and Securities Divisions). Our attorneys have also conducted internal investigations on behalf of management and boards of directors, and regularly counsel companies on issues of disclosure and corporate compliance. The Firm has represented hedge funds, hedge fund managers, and individuals in matters involving, among other things, proxy contests, insider trading, insider lending, PIPEs trading, market timing, late trading, naked short selling, rogue trading, market manipulation, disclosure issues, kickbacks, foreign corruption, "pay to play" and conflict of interest, and other alleged violations of the securities law.

TAX PRACTICE

"[Kirkland's Tax Practice Group has] top-notch tax attorneys who are creative, thoughtful and very commercial."
– Chambers & Partners, *Chambers USA 2011*

Kirkland's Tax Practice provides its clients the most creative tax planning available in a responsive and cost-efficient manner. The Firm's Tax Practice has a strong international reputation for providing sophisticated tax counseling on U.S. and foreign tax issues and effectively representing its clients in tax disputes worldwide. Chambers USA lists Kirkland as one of the best tax practices in the country and the top tax practice in Chicago.

Financial services

Hedge Fund Services

Ernst & Young is a leader in serving the hedge fund industry. Our emphasis on quality and value has been a major factor in the growth of our hedge fund practice. We have assisted many leading hedge funds through every phase of their business – from starting up to obtaining listings on exchanges and going public. Ernst & Young offers a wide range of services designed to provide support to organizations in the start-up phase. In fact, our practice was founded on start-ups. We have been the preferred service provider for hedge fund start-ups with services including the following:

- Audit
- Fund structuring
- Global regulatory and compliance advisory
- Tax advisory
- Tax compliance
- Selection of domiciles
- Selection of service providers
- Implementation of IT infrastructure
- Development and enhancement of operations
- Risk management

Many of our clients have gone from start-ups to some of the largest funds today. As these organizations mature, we continue to support their evolving requirements through our extensive portfolio of audit, tax, advisory and transaction services.

Our hedge fund practice globally is one of the largest of The Big Four and is led by highly skilled professionals who are intimately familiar with the demands of developing and maintaining a successful fund business. Our global knowledge network includes more than 200 partners, principals and executive directors and 2,000 industry-focused professionals. Teams are located in key financial centers throughout the world to serve clients wherever they need assistance. Clients benefit from the collective skills and know-how of this interconnected, worldwide network. Because of our presence in more than 60 cities worldwide, we bring firsthand insight on local market trends and accounting, tax and regulatory issues.

A market leader*

Widely considered a market leader, Ernst & Young:

- Audits approximately 40% and provides tax services to approximately 50% of the top 100 Global Billion Dollar Club hedge funds
- Audits approximately 40% and provides tax services to approximately 50% of top 100 US hedge funds
- Audits 40% of the top 50 European hedge funds
- Audits more than 50% of the top 25 Asia hedge funds
- Audits 40% of the top 25 fund launches of 2009
- Audits 36% of top 50 global funds of funds

Awards and accolades

Ernst & Young has won the following awards:

- Hedge Fund Manager Week 2009 and 2010 – Best Accounting Firm to the hedge fund industry
- Hedge Fund Manager Week UK 2009 – Best Advisory Firm to the hedge fund industry
- Asian Investor 2009 – Best Auditor and Tax Services for Funds
- Hedge Fund Journal US 2008 – Leading Fund Auditor

* Sources: *Hedge Fund Intelligence, Absolute Return, Alpha Magazine, Hedge Fund Journal*

A global network

Our wide-ranging and diverse global clients employ all strategies – from simple long/short funds to the most complex trading funds. Our client service teams have extensive experience in structuring and servicing complex funds, as well as extensive experience helping to form and service multifaceted tax structures anywhere in the world.

Thought leadership

Our participation in the hedge fund industry

Ernst & Young works to provide our clients with the latest information on trends and issues affecting the hedge fund industry. In addition, we sponsor many events and publications throughout the year to keep our clients informed, including roundtable discussions with senior hedge fund executives, hedge fund surveys, papers and alerts on hot issues affecting the industry, articles, interactive webcasts and industry conferences.

Global hedge fund symposium series

Our annual series of hedge fund symposia in 19 cities worldwide brings together more than 3,500 senior industry thought leaders and Ernst & Young professionals. Discussions cover emerging trends, industry outlooks, regulatory developments, current hot topics and wide-ranging views on challenges and opportunities facing the industry.

Global hedge fund survey

The Ernst & Young annual global hedge fund survey typically attracts the responses of senior executives from more than 100 of the world's largest funds.

For more information, please contact:

Global leaders

Arthur Tully	Michael Serota
Co-leader, Global Hedge Fund Practice	Co-leader, Global Hedge Fund Practice
+1 212 773 2252	+1 212 773 0378
arthur.tully@ey.com	michael.serota@ey.com

Chicago area leaders

Matthew Koenig	Tony Rentz	Benji Wolken
Audit Partner	Tax Partner	Audit Partner
+1 312 879 3535	+1 312 879 3957	+1 312 879 2450
matthew.koenig@ey.com	anthony.rentz@ey.com	benji.wolken@ey.com

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Ernst & Young is a leader in serving the global financial services marketplace
Nearly 30,000 Ernst & Young financial services professionals around the world provide integrated assurance, tax, transaction and advisory services to our asset management, banking, capital markets and insurance clients. In the United States, Ernst & Young LLP is the only public accounting firm with a separate business unit dedicated to the financial services marketplace. Created in 2000, the New York City-centered Financial Services Office today includes more than 3,300 professionals in over 30 locations across the US.

Ernst & Young professionals in our financial services practices worldwide align with key global industry groups, including Ernst & Young's Global Asset Management Center (based in London), Global Banking & Capital Markets Center and Global Insurance Center (both based in New York), which act as hubs for sharing industry-focused knowledge on current and emerging trends and regulations in order to help our clients address key issues. Our practitioners span many disciplines and provide a well-rounded understanding of business issues and challenges, as well as integrated services to our clients.

With a global presence and industry-focused advice, Ernst & Young's financial services professionals provide high-quality assurance, tax, transaction and advisory services, including operations, risk and technology, to financial services companies worldwide.

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