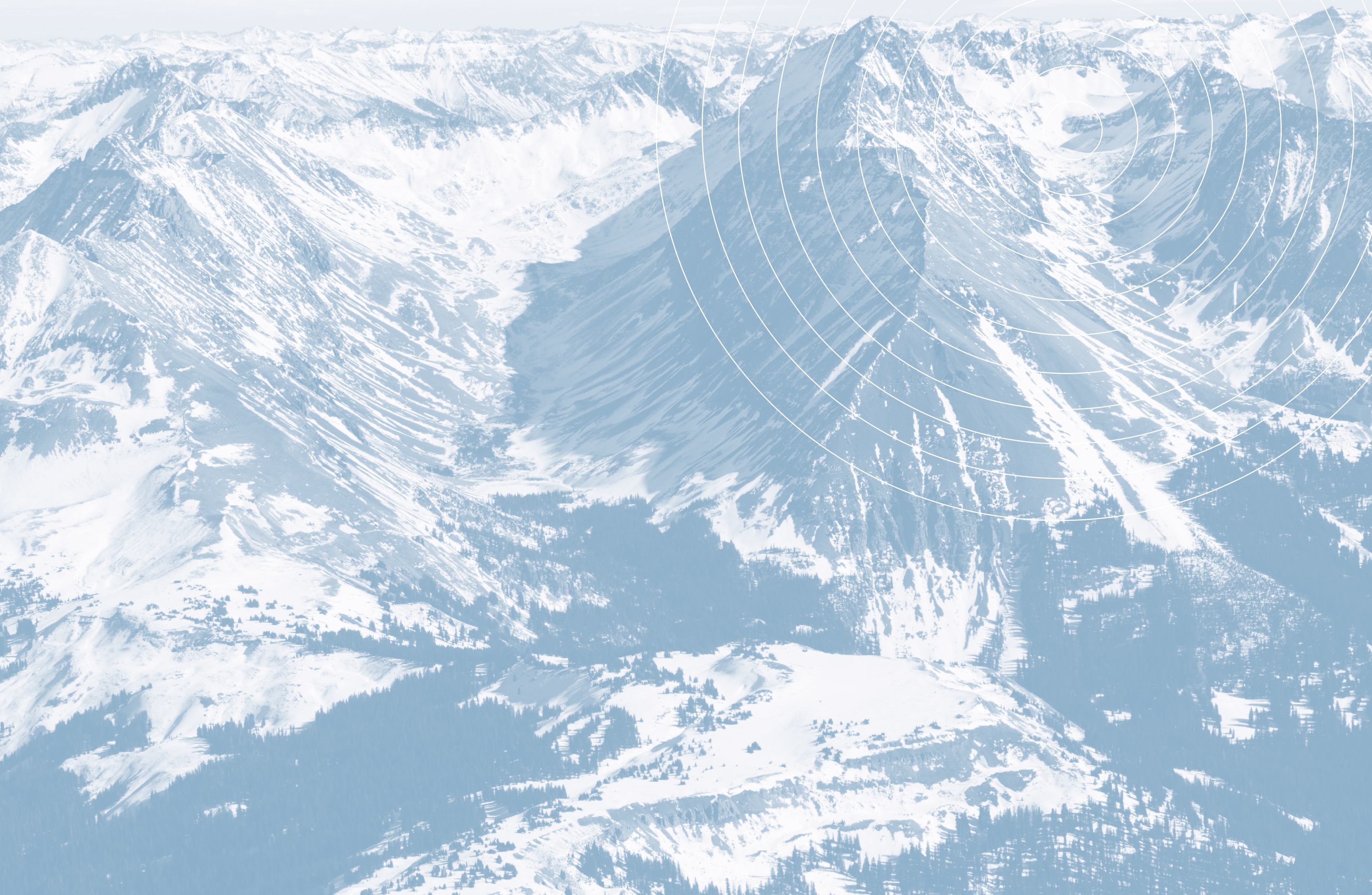
BRYAN CAVE

HIGHLIGHTS FROM

The 2016 Rocky Mountain Private Fund Advisers Summit



On November 30, 2016, Bryan Cave LLP, ALPS Alternative Investment Services, LLC, RSM LLP, and the University of Colorado School of Law co-hosted the annual Rocky Mountain Private Fund Advisers Summit in Denver, Colorado. More than 100 industry professionals and others attended from around the country. Three panels of industry specialists explored and discussed current Securities and Exchange Commission ("SEC") regulation and enforcement priorities, strategies for attracting and retaining institutional investors, and current trends in fund structuring. The following summarizes key discussion points from the panel members.

Straight from the Source: SEC Perspective on Regulation

Kurt Gottschall, Associate Regional Director for Enforcement from the Denver office of the SEC, was interviewed by Cliff Stricklin, a Partner at Bryan Cave LLP and an Adjust Professor at the University of Colorado School of Law. Mr. Gottschall oversees investigations and enforcement actions by the SEC in a seven-state region. The SEC's Denver office has a staff of approximately 100 persons split evenly between the examination division and the investigation and enforcement division.

Mr. Gottschall noted that the SEC, including the Denver office, has reallocated more of its human and capital resources to the Asset Management Unit. That unit is tasked with examining and pursuing enforcement actions against investment advisers and the private funds that they manage. In connection with that focus, the SEC has hired former industry participants, such as traders, investment adviser principals and chief compliance officers, to assist with routine examinations and investigations of potential rules violations. While the SEC formerly followed a more formulaic process to determine which investment advisers to examine, Mr. Gottschall noted that the SEC now employs a more risk-based and data-focused approach to initiating and conducting its examinations. This has led to narrower but more focused exams of investment advisers.

> The SEC's current priorities are conflicts of interest, fee and expense allocations, and asset valuations.

When asked where the SEC focuses its examination efforts on private funds and investment advisers, Mr. Gottschall identified three current priorities: (1) conflicts of interest between advisers and their investors, (2) fee and expense allocations (particularly with private equity funds), and (3) inaccurate asset valuations. Cybersecurity is also a growing focus area. As noted in the SEC's Examination Priorities for 2016 (available on the SEC's website and recommended reading by Mr. Gottschall for all investment advisers), the SEC has identified significant lapses and failures in many investment advisers' cybersecurity policies and procedures. With data breaches and hacks of financial firms becoming more frequent, investment advisers must continue to monitor, strengthen, and ensure the integrity of their cybersecurity systems.

> Whistleblowers and data analytics are an increasingly important source of rules violation's for the SEC.

On investigations and enforcement actions, Mr. Gottschall highlighted three primary sources of complaints and rules violations that may lead to a subsequent SEC investigation and enforcement action: (1) routine examinations which identify fraud or rules violations, (2) whistleblowers, and (3) internal monitoring of publicly available information. He noted that not all complaints and rules violations referred to the enforcement division, in particular those identified during an examination, will lead to further investigation and enforcement action. He also noted that the SEC has and will continue to increasingly promote its whistleblower program as a key initiative. The SEC has also spent considerable time and resources developing its data analytics capabilities. For example, the its Aberrational Performance Initiative uses data analytics to identify statistically significant aberrations in an investment adviser's performance when compared to its peers. If such an aberration is identified, the SEC may investigate further to determine if any illegal conduct led to such performance aberration.

When asked about charges against chief compliance officers of investment advisers ("CCOs"), Mr. Gottschall first noted that most CCOs do a great job and are given the unenviable task of telling their employers what they cannot do. The SEC, according to Mr. Gottschall, will typically refrain from individually prosecuting a CCO unless the CCO (1) was affirmatively involved in misconduct, (2) affirmatively misled the SEC, or (iii) oversaw an on-going rules violation and did nothing to stop it. Absent systemic violations or investor harm, most compliance violations do not lead to enforcement actions against CCOs.

As some parting advice, Mr. Gottschall reminded the audience that disclosure is an investment adviser's best friend. While disclosure does not absolve an investment adviser from rules violations, it can mitigate the consequences of such violations with respect to SEC examinations and enforcement actions.

The comments and opinions of Mr. Gottschall described above are solely his own and do not reflect the formal or informal comments, opinions, and policies of the SEC.

Strategies for Attracting and Retaining Institutional Investors

This panel addressed issues and strategies relating to successfully marketing an investment fund to institutional investors. The panel was moderated by Mark Weakley, a Partner and co-leader of the Fund Formation Team at Bryan Cave LLP. The panelists were Kathleen Burke, Managing Director of placement and advisory firm Snowbridge Advisors; Jay Rollins, Managing Principal of Denver-based investment manager JCR Capital Investment Corporation; and Dan Sierra, Head of Capital Markets for the family office Silver Spur Capital LLC. Due to their diverse perspectives, the panelists offered valuable insight into institutional investors' thought processes when approached by funds for first-time investments.

The panel opened with a discussion of trends and general observations about the institutional investor community, as well as tactics they found most to lead to investments by these investors. A common observation was that managers would be wise to approach institutional investors with middle-of-the-road investment terms in their fund documents, but to differentiate themselves based on investment strategy. Mr. Rollins pointed out that institutional investors generally seem to have a sense of the type of terms their peers are agreeing to and advised that managers approaching institutional investors for the first time should not deviate too far from what institutional investors expect to see.

Established back office systems are appealing to institutional investors.

The panelists all agreed that a manager can increase its fund's attractiveness to institutional investors by having a well-developed back-office infrastructure thereby conveying that the manager has the capabilities to comply with the robust diligence and reporting requirements these investors expect. Additionally, they agreed that knowing what such an infrastructure will cost the fund is integral to setting management fees at the outset as it is very difficult to increase the fee levels mid-stream in the fund raising process. The panelists specifically noted that lowering management fees but increasing other "junk" fees does not sit well with institutional investors. Ms. Burke suggested, and the other panelists agreed, that a 2% base management fee is still market, but that managers should be prepared to reduce the management fee during negotiations, particularly after the commitment or investment period expires.

Another concept the panelists discussed, though with different experiences, was the "No-Fault Divorce" provision, which enables a super majority of investors to remove a fund's investment manager without cause. Mr. Rollins and Ms. Burke indicated that they had seen an increase in provisions of this type and both indicated that advisers should be prepared to address them. Mr. Rollins suggested that a manager can get comfortable with this provision through confidence in the manager's ability to deliver strong returns. Mr. Sierra, whose role gives him the institutional investor perspective, indicated that he would not necessarily advocate that the provision be included, instead preferring to find managers with whom he can build strong partnerships and make the no-fault divorce provision unnecessary.

Caution: Too many side letters can create logistical and administrative nightmares.

The panelists also provided observations on the use of side letters, particularly with respect to "most-favored nation" provisions and co-investment rights. Ms. Burke indicated that many of her clients are in a position where they need to negotiate side letters in order to attract institutional investors but also cautioned that entering into too many side letters can create logistical and administrative nightmares. As a way to mitigate consequence, Mr. Rollins suggested limiting side letters to classes of investors based on the size of investment so that similarly situated investors receive similar terms. Finally, Mr. Sierra indicated that Silver Spur Capital invests as a side-car investor and negotiates their specific terms in that vehicle's limited partnership agreement, thus obviating the need for side letters.

Current Trends in Fund Structuring

The third and final panel, moderated by James Davis, Vice President at ALPS Alternative Investment Services, LLC, included representatives from the tax, legal and administrative sectors. The panelists included Alan Alfanz, Partner at RSM LLP; Elizabeth Kemery Sipes, Partner (effective January 1, 2017) and co-leader of the Fund Formation Team at Bryan Cave LLP; and Robert Alonzo, Director at ALPS. The panel offered insight not only into current trends, but also best practices in structuring funds.

From a structuring perspective, Ms. Sipes indicated that funds with U.S. assets and targeting U.S. investors are relatively simple to structure, generally as a Delaware limited partnership but with some funds opting to organize as limited liability companies. She further explained that the complexity and formation costs can increase dramatically when funds hold non-U.S. assets or target non-U.S. investors, necessitating various blocker entities and investment vehicles along the way. Funds offering co-investment rights to their key investors may opt to structure special purpose vehicles or top-off funds to handle co-investment participations more efficiently.

One trend the panel noted with respect to off-shore jurisdictions is the increasing cost and complexity of establishing an off-shore fund in the Cayman Islands. Managers targeting EU investors may have more success with Luxembourg or Ireland based entities, depending on the nature of the fund. It can be very costly to restructure after a fund has launched, so the panelists encouraged all managers to take the longer-view when initially deciding how to structure their funds.

Recommendation: Identify and vet key service providers early in the fund formation process.

The panelists also discussed other best practices when structuring and launching funds. All panelists agreed it prudent to prepare and run fee models to ensure that the contemplated fee structure will actually work as intended. The panel also encouraged managers to disclose how related party transaction allocations will be made and to ensure that all service providers know, for the purposes of accurate recordkeeping, who are a manager's or fund's related parties.

Fee models should be developed and run to confirm that a fund's fee structure will operate as expected.

With respect to service providers, the panelists advised managers to engage and involve experienced specialists early in the process so issues can be identified and resolved in a way that minimizes delays and costs. While tax and legal advisors are often some of the first calls made when a manager seeks to launch a new fund, the third-party administrator is often not involved until later in the process. This can be problematic as the administrator, who is typically tasked with the internal accounting and reporting for a fund, may uncover practical issues with the fee structure and other economic drivers with the fund documents. The panelists noted that third-party fund administration is very common and required by institutional investors, especially with larger funds. That said, the panelists acknowledged that some managers , particular of smaller funds, still endeavor to take on the role of the administrator in-house. The panelists advised that a manager considering self-administration ensure that it has the expertise and bandwidth to take on the role of administrator and to weigh those costs against the cost of a third-party administrator. Additionally, the panel noted that there will often be investor pressure to engage a third-party administrator because the administrator is viewed as independent from the manager, as well as has the expertise to perform the tasks associated with that role.