

HEDGE FUND ROUNDTABLE

Investment Management and Hedge Funds – *What's Happening Now?*

Life Cycle Series 2018

Session 1: Choosing the Right Structure

September 25, 2018

Gregory J. Nowak | Pepper Hamilton LLP | nowakg@pepperlaw.com

Life Cycle Series 2018

Tuesday, September 25, 2018

- ▶ Choosing the Right Structure

Tuesday, October 23, 2018

- ▶ Outsourcing Options --Trading, CID, Compliance, CFO

Tuesday, November 27, 2018

- ▶ SEC / FINRA / DOJ – Enforcement Update

Tuesday, December 18, 2018

- ▶ Exit strategies for fund managers – Rollups, ESOPs, Sales

Service vs Product

Service

- ▶ Investment Management Services – Investment Advisers Act of 1940, as amended
- ▶ Separately Managed Accounts (SMA's)
 - Custody simplified
 - Accounting simplified
 - Transparency simplified
 - Control lost

Product

- ▶ Is it a security you are selling:
 - If yes,
 - Need Securities Act of 1933 Exemption
 - Need Securities Exchange Act of 1934 Exemption
 - Need Investment Company Act of 1940 Exemption
 - Need FINRA Exemption
 - Need a Tax Exemption and CFTC Exemption

Product (continued)

Investment Company Act of 1940

- ▶ 3(c)(1)
 - no General Solicitation
 - fewer than 100 holders (debt and equity securities are counted)
- ▶ 3(c)(7)
 - unlimited holders
 - all holders must be Qualified Purchasers
 - natural persons
 - Net worth greater than \$5 million
 - entities
 - Net worth greater than \$25 million unless all holders are QPs
 - No General Solicitation
- ▶ 3(c)(5)
 - receivables and debt funds
 - real estate funds

Product (continued)

Securities Act of 1933

- ▶ No General Solicitation (i.e. no “public offering”)
- ▶ No open website
- ▶ Friends and family only
- ▶ 30 day waiting period (rule of thumb)
- ▶ No resales within 1 year (see *also*, Tax Considerations, *below*)
- ▶ Limited liquidity – (see *also*, Tax Considerations, *below*)
- ▶ Reg D Safe Harbor filing of Form D
- ▶ State Blue Sky filings
- ▶ NY Martin Act filings

Product (continued)

Jobs Act Relief

- ▶ Since 2013, ***can do a general solicitation*** and still comply with '40 Act 3(c)(1) / 3(c)(7) and CFTC exemption
- ▶ Must file Form D with SEC
- ▶ Must check box for 506(c)
- ▶ Must verify accredited investor status of investors and retain records
- ▶ Beware the “disinformation campaign”!

Product (continued)

Securities Exchange Act of 1934

- ▶ Need an available exception from broker requirements – issuer's exemption
- ▶ NY Martin Act – Form 99
- ▶ Issuer's exemption does not cover sales activity regarding a Fund's portfolio company investments.
 - See *In Matter of Blackstreet and Gunty*, Exchange Act Release 77959, Advisers Act of 1940 Release No. 4411 and Admin. Proceeding File No. 3-17267 (June 1, 2016)
www.sec.gov/litigation/action/2016/34-77959.ptf

Product (continued)

CFTC

- ▶ Either become a CPO or fit within an exemption – Rule 4.13 and Rule 4.5

Tax Considerations

- ▶ IRC §7704 – publicly traded partnerships are taxed at the entity level
- ▶ LLCs or LPs generally prefer partnership (flow-through) taxation
- ▶ Must fit an exception in regulations
 - 100 person safe harbor
 - not substantially equivalent to an exchange – quarterly redemptions
- ▶ Offshore entity issues – tax avoidance, deferral and inclusion

SAM or FUND

<u>Issue</u>	<u>SAM</u>	<u>FUND</u>	
Audited Financial Statements	None	Yes, by a PCAOB Firm in accord with GAAP	
Organizational Costs	None	GAAP – expensed on startup Tax – 180 months amortization Issue of materiality	
Custody	Owner’s custodian	Fund must have qualified custodian – what to do with crypto	
Redemptions	Anytime	Depends if fund is open or closed ended, hedge or PE Model. Subject to tax constraints. Subject to liquidity constraints – how to raise cash in liquid investments	

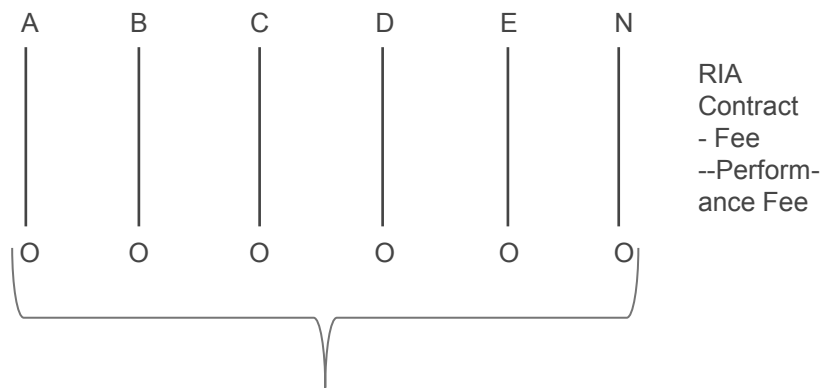
SAM or FUND (continued)

<u>Issue</u>	<u>SAM</u>	<u>FUND</u>	
Performance Fee	Fee / expense	Fee / expense or allocations of owner's share	
Taxation	Direct to owner	<ul style="list-style-type: none"> • Domestic partnership or LLC (pass through) or • Corporation* <ul style="list-style-type: none"> • RIC • REIT • BDC • Offshore Corp <p>* All pay dividends out of earnings and profits</p>	
Defensive Strategies (to protect against a run on the fund)	N/A	<ul style="list-style-type: none"> • Gates • Redemption Suspension • Mandatory Redemption • Liquidation of the Fund 	

SAM or FUND (continued)

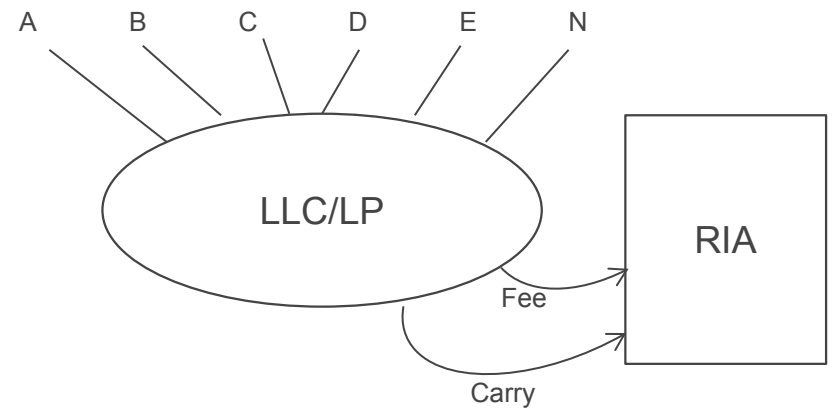
<u>Issue</u>	<u>SAM</u>	<u>FUND</u>	
Indemnification	Look to Investment Management Agreement <ul style="list-style-type: none"> • No securities hedge clauses 	LPA/LLC Operating Agreement/Articles and Bylaws <ul style="list-style-type: none"> • No hedge clauses • Costs of defense • Threat of suit will reduce NAV • Investors pay 	
Diversification	Limited by account size and lot size	Investor shares in commingled pot	

Decentralized Fundless Model



- Managed co-terminously
- No "Entity"
- Joint transactions – compliance issues
- Allocation wheel/algorithm

Private Fund Model



- Commingled/One pool
- Diversified returns
- Larger # of names possible
- Higher expenses

Series

- ▶ SPV
- ▶ Throw forward model

Private “open end”

- ▶ Hedge Fund model
 - periodic sales and redemptions at NAV

Private “closed end”

- ▶ Private Equity model
 - commitments made, assets deployed, cash distributed over time

RIC

<u>Open End</u>	<u>Closed End/BDC</u>
1. '40 Act registration Form N1A	1. '40 Act Registration Form N2
2. no performance fee (certain fulcrum fees allowed)	2. BDC can have performance fee if assets qualify; closed end fund cannot
3. any one can invest subject to general suitability	3. same
4. '33 Act registered	4. likely '33 Act registered
5. redeemable security	5. Exchange listed or tender offer/interval fund
6. must meet Sub M diversification and distribution requirements	6. same
7. no miscellaneous itemized deduction floor on expense deduction for individuals – expenses reduce E&P at the fund level, so dividends are net of expenses	7. same
8. manager must be registered	8. same
9. no senior securities may be issued – can issue multiple classes of common. each class with different distribution fees (i.e., “I” and “A” shares)	9. may issue a preferred class/senior security

Gregory J. Nowak

Partner, Financial Services & Technology

212.808.2723

nowakg@pepperlaw.com

- ▶ concentrates his practice in securities law, particularly in representing investment management companies and other clients on matters arising under the Investment Company Act of 1940 and the related Investment Advisers Act of 1940
- ▶ represents hedge funds and other alternative investment funds in fund formation and investment and compliance matters, including compliance audits and preparation work
- ▶ writes and speaks frequently on issues involving investment management, health care and other matters, and is the author of five books on hedge funds, the most recent published in February of 2018



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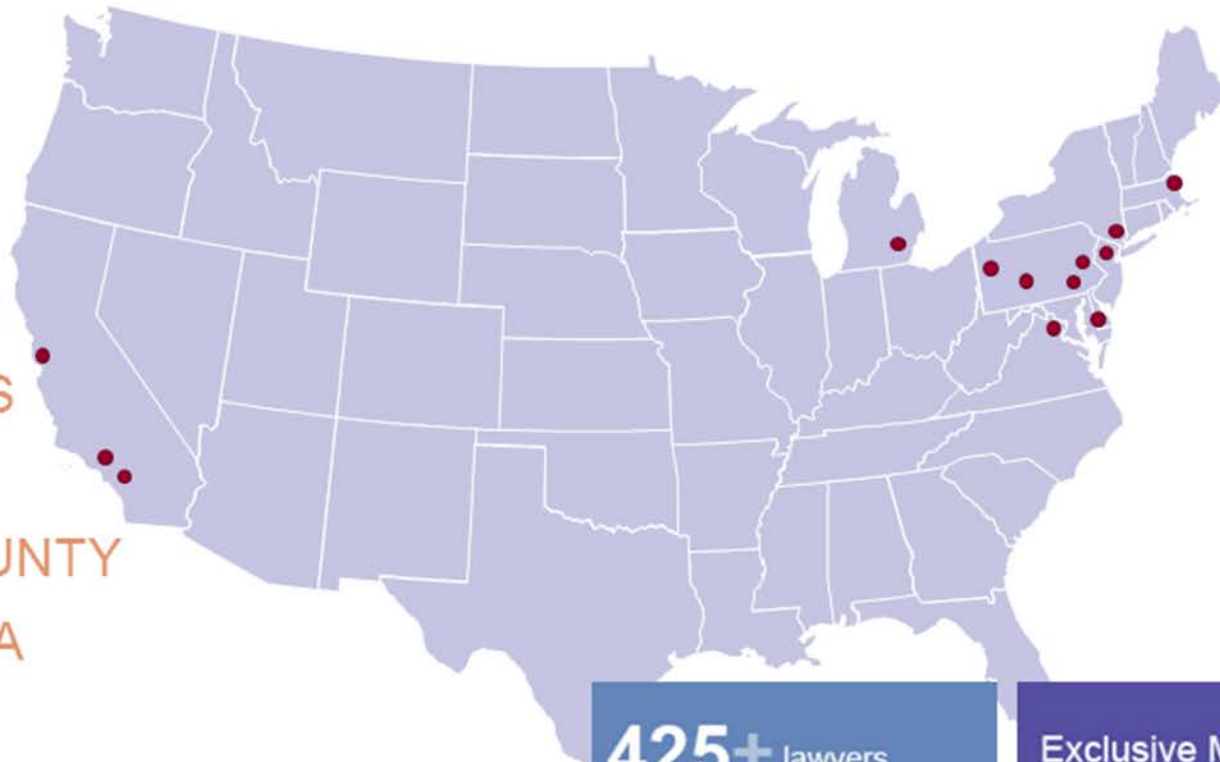
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