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HIGHLIGHTS FROM

The 2017 Southern California Private Fund Advisers Roundtable

On May 24, 2017, Bryan Cave LLP, ALPS Alternative Investment Services, LLC, and RSM US LLP co-hosted the inaugural Southern California Private Fund Advisers Roundtable in Santa Monica, California. With more than 40 industry professionals in attendance, two panels of industry specialists explored and discussed strategies for attracting and retaining institutional investors, as well as current trends in fund structuring. The following summarizes key discussion points from the panelists.

Strategies for Attracting and Retaining Institutional Investors

The first panel discussed 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 Private Funds Practice at Bryan Cave LLP. The panelists were Greg Kushner, Senior Managing Director and Chairman of the full service, boutique investment advisory firm Lido Advisors LLC; Emily Lehrer, Associate Director and Head of Operational Due Diligence at investment management consulting firm ICG Advisors LLC; and Charles Simonds, Market Investment Director at U.S. Trust. Due to their diverse perspectives, the panelists offered valuable insight into the key drivers of successfully marketing a fund to potential institutional investors.

The panel opened with a discussion of trends and general observations about the institutional investor community, as well as tactics they found most effective when marketing to these investors. All agreed it was important, if not necessary, to develop an investment strategy that aligns the interests of the manager with those of the investors. Mr. Kushner suggested as an example, and the other panelists agreed, to implement a tax efficient fund structure designed to minimize tax exposure to investors. Another common observation was that managers should be prepared with a thorough business plan, including a justifiable budget. Ms. Lehrer, who spends a significant amount of time analyzing and improving funds' operational efficiencies, indicated that, because each fund and each manager is different, the budget should be aligned with the fund's strategy and business objectives rather than industry standards.

Managers should prepare a thorough business plan, including a justifiable budget, aligned with the fund's strategy and business objectives.

The panelists also agreed that a manager can increase a fund's attractiveness to institutional investors by hiring well-regarded legal, administrative and tax professionals, thereby conveying that the manager has the capabilities to comply with the best practices diligence and reporting requirements these investors expect. Though all panelists agreed that a manager should engage a national accounting firm for audits and tax advice, Mr. Simonds cautioned managers from allowing the "tax dog to wag the tail" and to instead consider tax implications as one of many important variables when analyzing a fund's potential structure.

While tax implications are important to a fund's structure, don't allow the "tax dog to wag the tail."

The panelists also discussed investors' appetite for innovative strategies, such as co-investments and unique distribution models. Mr. Simonds noted that he is witnessing an increased demand for co-investments. If a fund decides to offer co-investment rights to its key investors, the panelists suggested that managers should consider structuring special purpose vehicles or side car/top-off funds to handle co-investment participations more effectively. As for distribution plans, the panelists

generally seemed to welcome new or different distribution models, though Mr. Weakley advised that seasoned institutional investors may be reluctant to invest in a fund using an unfamiliar waterfall or distribution plan.

We are seeing increased investor appetites for innovative strategies, such as co-investments and unique distribution models.

Lastly, the panelists agreed that a manager can increase a fund's attractiveness to institutional investors by having a well-developed back-office infrastructure. That should not discourage new or inexperienced managers, as the panelists also agreed that investors are generally willing to help managers, in Ms. Lehrer's words, get from "yes, but" to "yes." For example, investors can make introductions to service providers, fund administrators and even key employees, such as a controller. Therefore, as long as the managers present a well-supported strategy and a dynamic team, a fund will likely have a good opportunity to receive institutional investments.

A well-developed back-office infrastructure can increase a fund's attractiveness to institutional investors.

Current Trends in Fund Structuring

The second panel, moderated by Lloyd Miller, West Region Private Equity Leader at RSM US LLP, included representatives from the tax, legal and administrative sectors. The panelists included John Hague, Partner at RSM US LLP; Elizabeth Kemery Sipes, Partner and Co-Leader of the Private Funds Practice at Bryan Cave LLP; and Paul Garvey, Director and Senior Vice President at ALPS Alternative Investment Services. The panel offered insight into current trends and best practices in structuring funds.

The panel opened with a discussion of key factors to consider when structuring a fund. Ms. Sipes suggested that managers start with analyzing what is most important to their particular investors. For example, a fund should often be structured differently for high-net worth individuals than tax-exempt entities, such as IRAs and ERISA investors. Ms. Sipes also encouraged managers to think about how the funds will be deployed and to consider the different jurisdictions where the funds will be deployed to address needs of tax-exempt or non-U.S. investors. For example, funds with U.S. assets and targeting U.S. investors are relatively simple to structure, but the complexity and formation costs can increase dramatically when funds hold non-U.S. assets or target non-U.S. investors (or U.S. tax-exempt investors), necessitating various blocker entities and investment vehicles along the way.

Fit a fund's structure and jurisdiction to its targeted investor base.

The panelists advised managers to engage and involve experienced specialists – such as lawyers, auditors and administrators – early in the process so issues can be identified and resolved in a way that minimizes delay and cost. Mr. Hague emphasized the importance of working with attorneys with experience in fund formation and compliance. He also recommended including auditors as early as possible so they can give their opinion on the offering documents. Auditors may provide guidance on things like the accounting of the management fees or cash versus equity distributions, which are the types of decisions that are difficult to adjust without investor consent after offering documents have been finalized.

Involve experienced specialists early in the process so key issues and solutions can be identified in a way that minimizes delay and cost.

In addition to engaging tax and legal advisors, the panelists agreed that an experienced administrator is necessary when launching a new fund. The administrator is typically tasked with the internal accounting and reporting for a fund and often handling subscription document processing. Like attorneys and auditors, administrators should be engaged early to the process because they may be able to uncover practical issues with the fee structure and other economic drivers in the fund documents. Though some managers elect to handle administration in-house, Mr. Garvey said the trend, especially among private equity funds, is to use third-party administrators. Other panelists noted that third-party administration is often required by institutional investors, particularly with large funds. Since the role of the administrator is constantly growing and evolving, the panel also noted that there will often be investor pressure to engage a third-party administrator that is dedicated to providing the full range of administrative services independent from the manager.

Sophisticated investors want managers to engage independent fund administration services.

A final trend the panelists identified is an increase in oversight and enforcement from the U.S. Securities and Exchange Commission. According to Mr. Hague, the SEC seems to be specifically targeting the transparency of fees, the difference between what is promised in the fund documents and what is actually being delivered, and the internal cybersecurity of the firm and third-party administrators. To avoid unwanted scrutiny, Mr. Hague generally suggested to be consistent and transparent with investors, and to follow best industry best practices.

Increasing SEC oversight and enforcement of private fund managers merits consistent and transparent disclosures and adoption of industry best practices.

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