

Hedge Fund Side Letters:
Regulatory, Business and Legal Concerns
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presented by:

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Introduction

- Industry overview
- Customary hedge fund documentation and structures
- Background information relating to side letters

General Use of Side Letters

- How side letters are used – lead/significant investors vs. seed investors
- Side letter negotiation
- Examination of factors necessary for use of side letters
 - *review of operative fund documentation – flexibility to allow side letters and consistency with fund documentation*
 - *contractual arrangement*
 - *risks of creation of separate classes*

General Use of Side Letters

- Rationale for use of side letters
- Standard provisions addressed through side letters
 - *Transparency rights*
 - *Liquidity/Redemption rights*
 - *Fee reductions or waivers*
 - *Most favored nations*
 - *Investment capacity*
 - *Notification of material events*
 - *Distributions in-kind*

General Use of Side Letters

- Standard provisions addressed through side letters (cont.)
 - *Key person provisions*
 - *Tax issues*
 - *Affiliate transfers*
 - *Investor-specific regulatory issues*
 - *Confidentiality provisions*
 - *Indemnification carveouts*
 - *Scope issues (e.g. to what extent does a side letter relate to matters involving the master fund, parallel funds, other feeders or managed accounts with same investment strategy?)*

Regulatory Landscape

- SEC Guidance
 - *Side letter terms raising few concerns*
 - *Side letter terms SEC finds “troubling”*
 - *Scope of Disclosure*
 - *Fiduciary duty issues – post-Goldstein concerns*

Regulatory Landscape

- UK Financial Services Authority (FSA) Guidance
 - *Disclosure requirements (existence of side letter vs. nature of side letter)*
 - *Failure to disclose is breach of Principle 1 of FSA Principles for Business*
 - *Management of conflicts*

Regulatory Landscape

- UK Alternative Investment Management Association (AIMA) Guidance
 - *General disclosure guidance – when necessary*
 - *Disclosure of existence and nature of side letters with investors if side letters contain “material terms”*
 - *Disclosure deadlines*
 - *10% of fund NAV – disclosure issues*
 - *Other issues*
- Additional Concerns – addressing disclosure/conflicts differently in master-feeder fund structures vs. parallel fund structures?

Industry Trends

- Hedge fund sponsor approaches to regulatory attention on side letters
- Side letter Renegotiation vs. MFN
- Investor reactions to side letter renegotiation and alternative approaches

Practical Considerations

- Ensuring compliance with all side letters
- Managing conflicting side letters and MFN provisions
 - *Ongoing monitoring and notice obligations*
 - *Implementation of a side letter review process*
- Considerations for negotiating a side letter

Conclusion

- Conclusions
- Questions and Answers