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GLOBAL SPONSOR FORUM

Spotlight on Investors

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February 1, 2023



US Regulatory Update

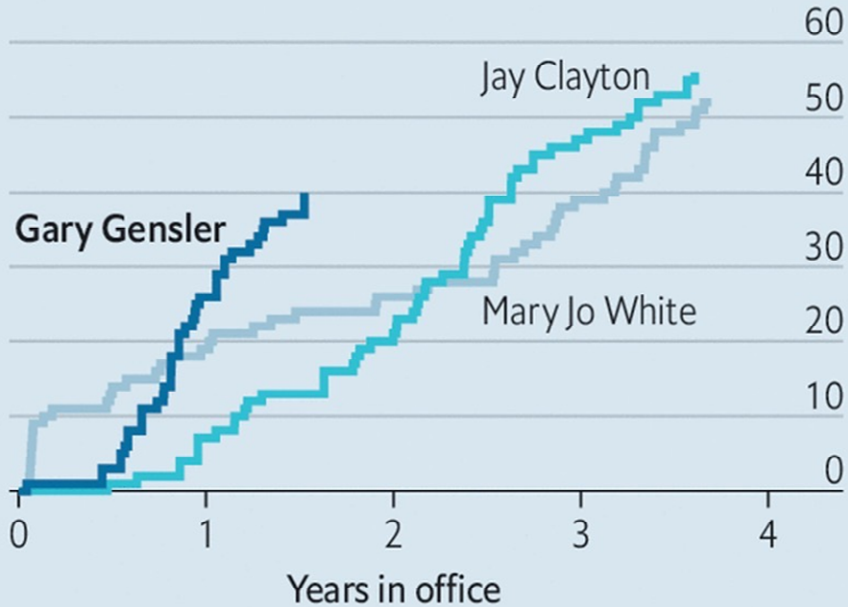
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SEC Rule Proposals

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The exception to the rule

United States, sets of rules proposed or finalised by SEC chairs



Source: Securities and Exchange Commission

Private Funds

- **Form PF**

- **Two separate proposals issued months apart**
 - Significantly expanded transparency/disclosure requirements
 - Current reporting

- **Advisers Act Private Fund Rules**

- **Proposed changes applicable to registered investment advisers:**
 - Quarterly investor reporting requirements
 - Private fund annual audit requirement
 - Fairness opinion requirement for adviser-led secondaries transactions
 - Annual review of compliance program
- **Proposed changes applicable to all advisers:**
 - Proposed prohibition on certain activities
 - Proposed reforms to side letters and “preferential treatment” of certain investors
- **The SEC has posed questions for comment asking whether other parts of the proposed rules should also apply to exempt reporting advisers**

SEC Rulemaking

- **Key Proposals:**

- IA-6176 – Outsourcing by Investment Advisers
- IA-5955 – Private Fund Advisers; Documentation of Registered Investment Adviser Compliance Reviews
- IA-5950 & IA-6083 – Amendments to Form PF
- 33-11068 – ESG Disclosures for Investment Advisers and Investment Companies
- 34-94524 – Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer
- 33-11028 & 11038 – Cybersecurity Risk Management
- 33-11030 – Modernization of Beneficial Ownership Reporting
- 33-11067 – Investment Company Names Rule Amendments

Outsourcing



- New requirements for advisers to conduct due diligence before outsourcing and to periodically monitor service providers' performance and reassess whether to retain them;
- Related requirements for advisers to make and/or keep books and records related to the due diligence and monitoring requirements;
- Amendments to the adviser registration form, Form ADV, to collect census-type information about advisers' use of service providers; and
- A requirement for advisers to conduct due diligence and monitoring for third-party recordkeepers, along with a requirement to obtain reasonable assurances that the third party will meet certain standards

ESG: Current Regulatory and Disclosure Framework

- Demand for information by investors is now driving disclosure
- SEC follows long-standing principles of disclosure and fiduciary duty
- Materiality-based approach by the SEC in the past
- Active regulatory and enforcement agendas
 - Exam priorities and risk alert warning against “greenwashing” and misstating sustainability practices
 - Division of Enforcement’s Climate and ESG Task Force
 - Proposed Rules on Climate-Related Disclosure for Public Issuers and ESG Disclosures by Investment Advisers and Registered Funds
- Proposed Rules would extend to registered investment companies and registered investment advisers



Introduction: What Is an ESG Strategy?

SEC's Proposed Definitions

Integration	ESG-Focused (inclusionary/exclusionary)	ESG Impact
<ul style="list-style-type: none">• ESG information considered alongside other factors when making investment decisions• Portfolio managers “think” about ESG all the time	<ul style="list-style-type: none">• ESG is a “significant or main” consideration• ESG Exclusionary Screens:<ul style="list-style-type: none">○ Strategy excludes certain industries, sectors, or issuers (e.g., tobacco, firearms, fossil fuels)• ESG Inclusionary Screens:<ul style="list-style-type: none">○ Only certain securities are eligible for investment after “making the cut” based on predetermined criteria	<ul style="list-style-type: none">• Investment mandate is ESG-focused• Product is intended to effectuate an ESG impact or result as part of its objective

Cybersecurity

- Proposed Rules would:
 - Require advisers and funds to adopt and implement written policies and procedures that are reasonably designed to address cybersecurity risks;
 - Require advisers to report significant cybersecurity incidents to the Commission on proposed Form ADV-C;
 - Enhance adviser and fund disclosures related to cybersecurity risks and incidents; and
 - Require advisers and funds to maintain, make, and retain certain cybersecurity-related books and records.

Advisers Act Marketing Rule

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Marketing Rule

- Compliance date: November 4, 2022
- Adopting Release issued December 22, 2020
- No guidance issued during implementation period
- FAQs issued on January 11, 2023



SEC Risk Alert: Exams Focused on Marketing Rule

- On September 19, 2022, the SEC's Division of Examinations issued a [Risk Alert](#) to investment advisers identifying the staff's initial marketing rule exam initiatives and areas of review
- Marketing Rule Policies and Procedures
 - The written policies and procedures should include objective and testable means reasonably designed to prevent violations
- Substantiation Requirement
 - Advertisements are prohibited from including material statements of fact that the adviser does not have a reasonable basis for believing it will be able to substantiate upon demand
- Performance Advertising Requirements
 - The staff will review whether advisers are in compliance with performance advertising requirements, including the general prohibitions
- Books and Records

Other Regulatory Hot Topics

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SEC Risk Alert: Adviser MNPI Compliance Issues

- On April 26, 2022, the SEC's Division of Examinations issued a [Risk Alert](#) on notable deficiencies observed by the staff regarding investment advisers' controls around misuse of MNPI
 - Section 204A of the Advisers Act requires all investment advisers, registered and unregistered, to establish, maintain, and enforce written policies and procedures that are reasonably designed to prevent the misuse of MNPI
- Policies and Procedures Related to Alternative Data
 - Observed advisers that used data from nontraditional sources (alternative data), but did not appear to adopt or implement reasonably designed policies and procedures to address the potential receipt of MNPI through alternative data sources
- Policies and Procedures Related to "Expert Networks"
 - Observed advisers that did not appear to implement adequate policies and procedures regarding their discussions with expert network consultants who may have access to MNPI
- Policies and Procedures Related to "Value-Add Investors"
 - Observed advisers that did not adequately implement policies and procedures regarding investors (or in the case of institutional investors, key persons) who are more likely to possess MNPI
- Compliance Issues Related to Rule 204A-1 (the Code of Ethics Rule)
 - Observed advisers that did not identify and supervise certain employees as access persons and observed deficiencies related to the required reporting of access persons' personal securities transactions and holdings

Electronic Communications

- Enforcement Actions announced with fines totaling more than \$1 billion
 - Books & Records Violations
 - Use of Personal Devices
- SEC Examination Sweep
- 2018 SEC OCIE Risk Alert on Electronic Messaging



LP Considerations: Process, Expenses, and Governance

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First Closing to Final Closing

- First Closing Extensions
- Warehousing Matters
- Waiving Interest Charges
- Size Caps
- Portfolio Valuations
- Fundraising and Extensions

Organizational Fee Cap Ranges: Dollar vs. Commitments

FUND SIZE	ORG CAP – \$	CAP – % COMMITMENTS
Up to \$500 million	\$100k to \$2 million	1.00%
\$500 million to \$1 billion	\$1 million to \$2 million	1.00%
\$1 billion to \$3 billion	\$1 million to \$8.5 million	0.15% to 0.25%
\$3 billion to \$5 billion	\$3.5 million to \$5 million	0.15%
\$5 billion to \$10 billion	\$5 million to \$6.5 million	0.10% to 0.11%
Over \$10 billion	\$5.5 million to \$18 million	0.70% to 0.11%

Partnership Expenses

- What Are All These “New” Expenses?
 - MFN Costs
 - Special Expense Allocations
 - Audit and Exam Expenses
 - Broken Deal Expenses and Co-Investors
 - ESG Reporting Costs

Governance Queries

Voting:
LPAC and LPs, calculations, notice

Key Person:
Time/attention, notice, replacement

Fault vs. No Fault:
What's the mix?

Transparency:
policies and procedures, disclosure

Conflicts of Interest

- Blanket Waivers in PPMs
- LP Conflicts/GP Stakes
- Investments Within the Fund Family
- GP Commitments
- Multiple Positions in the Capital Stack
- Co-Investments

GP-Led Transactions

- Sole Discretion
- No Longer Only End of Life
- Survival of Side Letters
- Status Quo vs. New Money
- Beyond Continuation Funds
- Response Time

Secondaries Overview

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Secondary Market Update

- Impact of Current Economic Environment
 - Discounted Prices
 - Valuations
- GP-Led Opportunities
- Forced Sellers
 - Financial Distress
 - Fewer Distributions
 - Denominator Effect
 - Regulatory Reasons

Secondary Market Update

- Increase in syndication of larger portfolio sales (assignment rights more important)
- Structured deals – purchase/sale of acquisition vehicle
- Tax withholding
- Increase in deferred purchase price deals
- Non-US ownership issues and potential for concentration of non-US ownership in GP-led deals and AIVs (possible FCC, CFIUS, energy, or other regulatory issues)
- Increase in AML diligence of counterparties

Liquidity Options and GP-Led Secondaries

- Term Extensions
- Fund Amendments
- Tender Offer
- Continuation Fund
- Stapled Secondary
 - GP faces conflicts of interest as the requirement for a buyer to commit to a new fund may adversely affect the price that a current investor can obtain by selling its interest in an existing fund
- Preferred Equity

Practical Considerations for GPs (LP Transfers)

- Bandwidth in Responding to Transfer Requests
- PTP Transfer Restrictions
- Withholding Tax
- Due Diligence Requests
- Disclosure of Confidential Information
- Creditworthiness of Buyer
- Stapled Transactions
- AML Issues

Practical Considerations for GPs (LP Transfers)

Disclosure of Confidential Information

Sellers are expected to provide buyers with financials, governing documents (LPAs, sub-books), and side letters. Buyers are expected to execute NDAs in order to access confidential information. Global NDAs are common, although some managers will require bespoke NDAs.

Notice Periods

Many managers have a notice period (e.g., 30 days), which may be waived.

ROFRs

Factor in timeframe for running the ROFR. If the ROFR is not exercised, the seller typically has a certain period in which the transfer must be completed or the ROFR must be run again.

Closing Timeline

Quarterly, semiannually, or at month's end. Parallel negotiations of purchase agreements and transfer agreements are common. Minimum threshold for closing is less common—instead, parties agree to use “reasonable best efforts” to close by a certain date.

Transfer Expenses

Transfer expenses are often a condition to closing. As a practical matter, consider how invoices will be paid before closing.

Legal Opinions

Most partnership agreements require a legal opinion; however, this requirement is almost always waived by the manager if the parties can provide customary representations.

Biography



Christine M. Lombardo

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Christine advises investment managers and broker-dealers on financial regulatory matters. She concentrates her practice on securities regulation for a broad range of financial firms including retail asset managers, private fund managers, family offices, broker-dealers, other professional traders, and high-net-worth individuals. Christine also counsels legal, compliance, and business personnel on the structure, operation, and distribution of advisory programs, including digital advisory offerings, and investment products, including hedge funds, private equity funds, venture capital funds, real estate funds, and other alternative investment products.

Read Christine's extended profile: [Christine M. Lombardo – Our Lawyers and Professionals | Morgan Lewis](#)

Biography



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The deputy leader of Morgan Lewis's global investment management practice, **Courtney** advises global institutional investor clients on the terms of their inbound and outbound investments, including into private equity and other co-mingled open-ended and closed-ended investment funds. She has over 20 years' experience drafting and negotiating the terms of investment agreements and side letters for clients investing into leveraged buyout, venture capital, distressed debt, special opportunity, real estate, hedge, energy, infrastructure, and credit funds. She also represents investors in opportunity and sidecar funds, co-investment funds and with the drafting and negotiating of funds of one and other bespoke strategic private investment partnerships.

Read Courtney's extended profile: [Courtney C. Nowell – Our Lawyers and Professionals | Morgan Lewis](#)

Biography



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Carrie, co-leader of the firm's global investment funds industry team, advises clients on private investment fund transactions with a focus on fund formation and the negotiation of governing terms. She has more than 15 years of experience across a variety of investment fund structures, including commingled funds, funds of funds, customized captive funds, and separate accounts. Carrie's clients include large US and international pension funds, banking institutions, alternative investment managers, universities, and family offices.

Read Carrie's extended profile: [Carrie J. Rief – Our Lawyers and Professionals | Morgan Lewis](#)

Biography



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Joe focuses on the private investment fund industry, including the structuring, formation, governance, and regulation of and investment in US and non-US hedge funds, private equity funds, venture capital funds, managed accounts, and other products. In addition, Joe has a significant practice representing buyers, sellers, and general partners in secondary transactions (including portfolio sales of fund interests and GP-led transactions). He also provides legal, regulatory, and transactional advice for investment managers and institutional investors. Joe is the practice group leader for the New York office investment management practice.

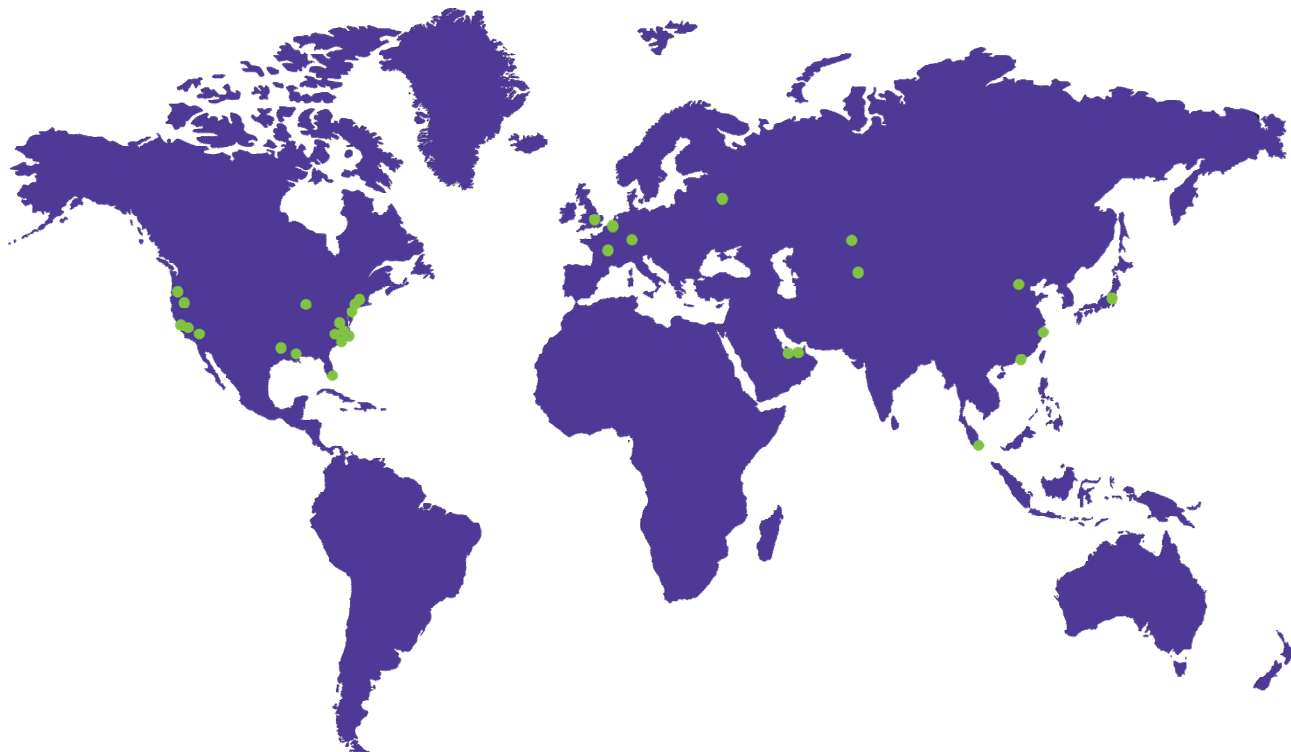
Read Joe's extended profile: [Joseph D. Zargari – Our Lawyers and Professionals | Morgan Lewis](#)

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Europe
Latin America
Middle East
North America

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Dallas
Dubai
Frankfurt
Hartford
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