SANNE

connect

Summer 2017

Private Equity

Focus on the Americas

In this edition

A warm welcome to our fifth issue of Connect, and our first US themed edition. Connect is our regular technical bulletin aimed at fund managers, their advisors and investors.

The US private equity industry finds itself in a period of significant change, with a number of trends reshaping the competitive landscape and market outlook.

Investments in private equity funds have increased significantly in recent years. Preqin experts' estimate that, as of June 2016, private equity advisor worldwide managed US$4.7 trillion, much of it in the United States, compared to just over US$700 billion in 2000. Many investors have invested in private equity based on their expectation that private equity investment teams actively create value and therefore returns should exceed public equity market returns. For the most part, they have been proven correct.

Together with leading experts in their field, this issue of Connect will explore the impact of some leading trends and developments that aim to facilitate global investment with a specific focus on Private Equity and Venture Capital Funds.

In our first article Chris Lombardy, Managing Director and Head of US Compliance Consulting at Duff & Phelps, navigates the new regulatory environment we now find ourselves in post the 2016 US elections.

We also feature an article from my colleague Andrew Shrimpton, Compliance Director at SANNE. He explains why London should be looked upon as an alternative place for private equity managers to open up outside of the US.

I am delighted that our second guest article features Adam Tope, Partner at Hogan Lovells. Adam unpacks some useful insights into the top four 2017 trends in the US Private Equity and Venture Capital Funds.

Our final insights focus on the 'three pillars' of a brave new world. Christopher Ruark, Director, CRM - Americas looks at how global administration businesses can support the demand for simpler, better and faster solutions for the industry.

I hope you find this edition of SANNE Connect interesting and engaging.

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THE DIFFERENCE

The SEC's Focus on Private Equity in 2017

Key topics

- What will the Trump Cabinet look like?
- Penalties could shrink, people could pay
- What new regulatory reforms await

The private equity model is very different

A private equity advisor is faced with temptations and conflicts, which most advisors do not contend,"[1] said Andrew J. Bowen, former Director of the Securities and Exchange Commission's Office of Compliance Inspections and Examinations, in a 2014 speech.

This quote illustrated the SEC's approach to private equity prior to the 2016 US election. We are in a new regulatory environment. The Trump Administration has already promised to substantially alter Dodd-Frank. Paul Atkins, a former Republican SEC Commissioner and staunch Dodd-Frank critic, is leading the Trump transition team's efforts at the SEC and was seen as a contender for SEC Chairman.[2]

Additionally, the Trump Administration is likely to support legislation that eases regulatory reporting requirements for private equity firms. For example, the Investment Advisors Modernization Act of 2016, which was passed in the house but will likely be filibustered in the Senate, would ease recordkeeping and reporting rules for private equity firms.[3&4]

What does this mean for private equity?

The SEC's areas of focus, specific to private equity, are less likely to change than its level of scrutiny.

There are certain elements of the SEC's focus that will not change substantially, simply due to the regulatory framework. Pursuant to the Investment Advisors Act of 1940, a registered investment advisor ("RIA") is required to adopt and implement written compliance policies and procedures, and to designate a Chief Compliance Officer responsible for administering the compliance policies and procedures.[5] The SEC will continue to focus on conflicts of interest and will expect RIAs to identify and address those risks. In the private equity context, the SEC typically focuses on the following areas:

- Collection of Fees and Allocation of Expenses
- Co-Investment Allocation
- Valuation
- Conflicts of Interest
- Custody

Valuation

The SEC focuses on whether private equity firms have, in practice, consistently applied the valuation processes disclosed to investors. Thus, CCOs should ensure disclosures to investors are clear, accurate and consistently applied and updated. Additionally, CCOs should evaluate whether an internal valuation committee is appropriate and/or whether the firm should engage a third-party valuation firm.

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Fees and Expense Allocation

The SEC and investors are very interested in the ways managers allocate and disclose fees and expenses. Failure to comply with the regulatory framework could lead to enforcement action by the SEC and investor lawsuits. Disclosure of material facts is very important. If there is a substantial likelihood that the disclosure of an omitted fact would be viewed by a reasonable investor as important to its investment decision, then the fact is material.

RIAs should review their fee and expense practices against disclosures made to investors to identify any inconsistencies. Additionally, third party service providers can conduct an external audit to assess fees and expenses the manager is charging to the fund. RIAs should be sure to document any shifting - moving expenses out of the management company and into funds without proper disclosure and investor consent.

Co-Investment Allocation

The SEC's focus specific to co-investment allocation has been in the context of compliance policies and procedures and appropriate disclosure to investors. The SEC wants to ensure that managers are allocating co-investment opportunities consistent to what the manager has disclosed to investors. The SEC recommends a robust and detailed co-investment allocation policy that is shared with all investors.[6] When developing compliance policies and procedures, specific to co-investment allocation, CCOs should consider the fund's investment strategies objectives and targets; the fund's strategy; allocation methodologies; trade documentation and testing.

As President Trump has appointed a new SEC chair, it is clearer as to how the SEC will approach its agenda. As a harbinger of the sea change ahead, Mary Jo White, the current SEC chair, as recently as 12 December 2016, defied requests by Senate Republicans to delay adopting new rules until Trump assumed office.[7] White wrote a letter responding to a request by Senators Shelby and Crapo for the SEC to stop adopting rules until Trump is President. White is pushing for rules on capital and margin requirements for swap dealers and limits on how mutual funds and ETFs use derivatives to leverage returns. Moving forward, we should expect the unexpected.

> "The SEC's areas of focus, specific to private equity, are less likely to change than its level of scrutiny."

1. Andrew J. Bowden "Spreading Sunshine in Private Equity." Private Equity International (PEI), Private Fund Compliance Forum 2014. New York, New York May 6. 2014.
2. www.reuters.com/article/us-usa-trump-sec-analysis-idUSKBN13B0E2
3. www.investmentadviser.org/eWeb/docs/Public/160512IAModernizationBill_IAASummary.pdf
4. www.crainsnewyork.com/article/20161211/FINANCE/161209847/investment-firms-are-leading-the-fight-against-dodd-frank-regulation-buoyed-by-the-victory-of-donald-trump
5. Investment Advisers Act of 1940 Section 206(4)-7(a)
6. www.sec.gov/news/speech/private-equity-look-back-and-glimpse-ahead.html
7. www.fortune.com/2016/12/13/sec-chair-mary-jo-white-republicans-rules/

SEC Hedge Fund Regulation –

Time for America first?

> "I believe that the best approach to prevent managers gaming the system is to assign certain regulators as equivalent to the SEC."

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Key topics

- A new era for hedge funds
- Is London an attractive alternative?
- SEC impose new standards for hedge funds?

President Trump has publicly called for the overhaul of the post-crisis regulatory reforms making the nomination of Jay Clayton as the next Chair of Securities & Exchange Commission (the "SEC") an appointment with significant implications for the Alternative Investment Management Industry.

President Trump has so far looked to Paul Atkins to advise him on financial policies and appointments and influenced his choice of the new SEC chairman.

Paul Atkins is a vocal critic of the Dodd–Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and believes in fewer rules for hedge and private equity funds known as in the US "Private Funds". Mr Atkins, appointed to the SEC by Former President George W Bush was a leading Republican voice on the commission serving as a commissioner from 2002 until August 2008 so was a contender to be the next chairman.

This past July 2016 marked the six year anniversary of the Dodd-Frank Act, which required the Commission to implement a significant number of regulatory mandates, most of which are now completed.

Therefore, it is the right time for the SEC to identify which rules could be rolled back. Most prominent changes ushered in by the Act were the rulemakings creating new registration and reporting requirements for Private Fund Advisors. Since the implementation of these rules, approximately 1,500 new Private Fund advisors have registered with the SEC Registration and reporting have given the SEC significant insight into the nearly 30,000 private funds managed by 4,500 registered advisors.

One requirement that has been subject to many calls for deregulation for Private Funds over a number of years has been the SEC requirements for managers outside the US for example in the UK or Hong Kong to become SEC registered when they are already registered and supervised by the local regulators such as the Financial Conduct Authority (FCA) and the Securities and Futures Commission (SFC). This is not surprising as the Commission is the only national regulator that requires registration for managers operating outside its own national territory. The minimum investment allowed for nearly all private funds is at least a million US dollars, so why spend US federal tax dollars flying SEC examiners to London in order to enhance investor protection of very wealthy US and non US citizens? London based hedge funds are already supervised by the FCA and extensive data is already collected on the funds under AIFMD Annex IV reporting. While at the SEC, Mr Atkins emphasised protecting small investors and advocated leaving sophisticated ones alone. He opposed a rule that was later passed to require hedge funds and private equity firms to register with the SEC and be subject to examination.

President Trump's pledge to dismantle Dodd-Frank would partly require congressional action. In the past Congress has focused on banking regulation which more obviously impacts economic growth rather than Private Fund regulation. However, Anthony Scaramucci, founder of SkyBridge Capital, the fund of hedge funds, a member of President Trumps's transition team had also been mentioned as a potential Chairman of the SEC. As the founder of a business which selects the best hedge funds from around the world, he will be aware of the needless duplication of regulatory oversight when undertaking due diligence on the best London based hedge fund managers for investment by his fund of funds.

The current requirements go back to the original Investment advisors Act of 1940 (the "Advisors Act") and were intended to prevent managers setting up offshore entities in places such as the Caribbean to circumvent the regulations. I believe that the best approach to prevent managers gaming the system is to assign certain regulators as equivalent to the SEC. The FCA would be at the front of the queue to be deemed equivalent as by far the most registered managers outside the US are situated in London. The UK is home to around 200 (out of 2,800) Private Fund advisors or Investment Managers that each manage more than US$150 million in Private Fund Assets, compared to only around 100 that are based neither in the US nor the UK.[1]

On 22 June 2016, the SEC adopted rule 202(a) (30)-1 (the "Foreign Private Advisor Final Rule") codifying the foreign private advisor exemption from registration under Section 403 of the Dodd-Frank Act. The Act created a new exemption for a "foreign private advisor" (the "Foreign Private Advisor Exemption"). To be eligible for the Foreign Private Advisor Exemption, an advisor must:

1. Have no place of business in the United States;
2. Have in total, fewer than 15 clients
3. Have less than US$25 million in assets under management for US investors; and
4. Not hold itself out to the public in the United States as an investment advisor I believe all that is required to create a "Foreign Private Advisor Exemption for Advisors based in Equivalent Jurisdictions" would be to add to the existing rule the following:
5. Or is registered with a National Supervisory Authority deemed equivalent.

This may be viewed by many as a marginal benefit to the City in light of the impending upheaval coming down the pike under Brexit. However, I believe the choice of London as the most popular place for hedge fund and private equity managers to open up outside the US is greatly underestimated as an important contributor to the success of the City. If it helps to make London a more attractive place for managers to manage at least US$650 billion assets and the associated fees and market liquidity compared to say Paris or Frankfurt then surely it must be worth requesting from the new incoming administration.

Andrew Shrimpton - Authored the FSA discussion paper on hedge funds in June 2005.

[1] Source: SEC Division of Investment Management, Private Fund Statistics First Calendar Quarter 2016.

Four trends in US Private Equity and Venture Capital funds

Key topics

- Three key challenges and the trends that followed
- What is fund restructuring?
- Why the Co-Investment Manger class?

Prior to the Global Financial Crisis of 2007 and 2008, private equity funds, venture capital funds, and their managers followed a fairly consistent lifecycle in the US – raise a commingled blind pool fund, supplement it with occasional co-investment opportunities, and sell deals quickly.

Following the downturn, first time managers (and some existing managers) experienced a difficult fundraising environment; large investors, primarily sovereign funds, emerged with the ability to deploy significant capital in single purpose vehicles; and deal exits slowed. These three challenges helped create four fund-related trends we see today - the growth of fund restructurings, the increased usage of funds of one, the emergence of the "co-investment manager" class of fund managers, and growth of "holding company" structures in the venture capital industry.

Barring some significant industry-wide changes, we expect these trends to continue for the foreseeable future within the US.

Fund Restructuring

Funds with vintages between 2005 and 2008 are quickly approaching the end of their lives as their terms are ending. In many cases, these funds continue to hold portfolio companies. Typically, when a fund's term ends, funds are forced to sell any remaining investments, often at fire sale prices. To minimise this impact, funds will often seek investor consent to extend the term of a fund in order to buy some additional time to exit any remaining holdings. This tension has fueled the growth of a third alternative - fund restructuring.

In a fund restructuring transaction, the existing investments held by a fund are transferred to a new fund. Existing investors can either (a) redeem their interests in the current fund (usually for cash) or (b) move their interest in the existing fund to a new fund and, optionally, make an additional new commitment to the new fund. Additionally, in a fund restructuring, new investors are admitted to the new fund, often with differing economic arrangements as compared to the prior investors. This new capital is typically used to buy-out the existing investors that are redeeming. A number of placement agents and investment banks offer turnkey services to attract potential new investors and manage these fund restructurings.

Fund restructurings are favored by managers because they allow mangers to potentially crystallise their carried interest with respect to the fund's final investments and give managers an extended time period to grow the remaining investments held by a fund into profitable transactions. Fund restructurings are favored by many investors because they allow investors accelerated liquidity at potentially better terms than a fire sale of a fund. We expect that fund restructurings will continue to grow this year as managers look for ways to maximise returns for remaining investments in funds.

Funds of One

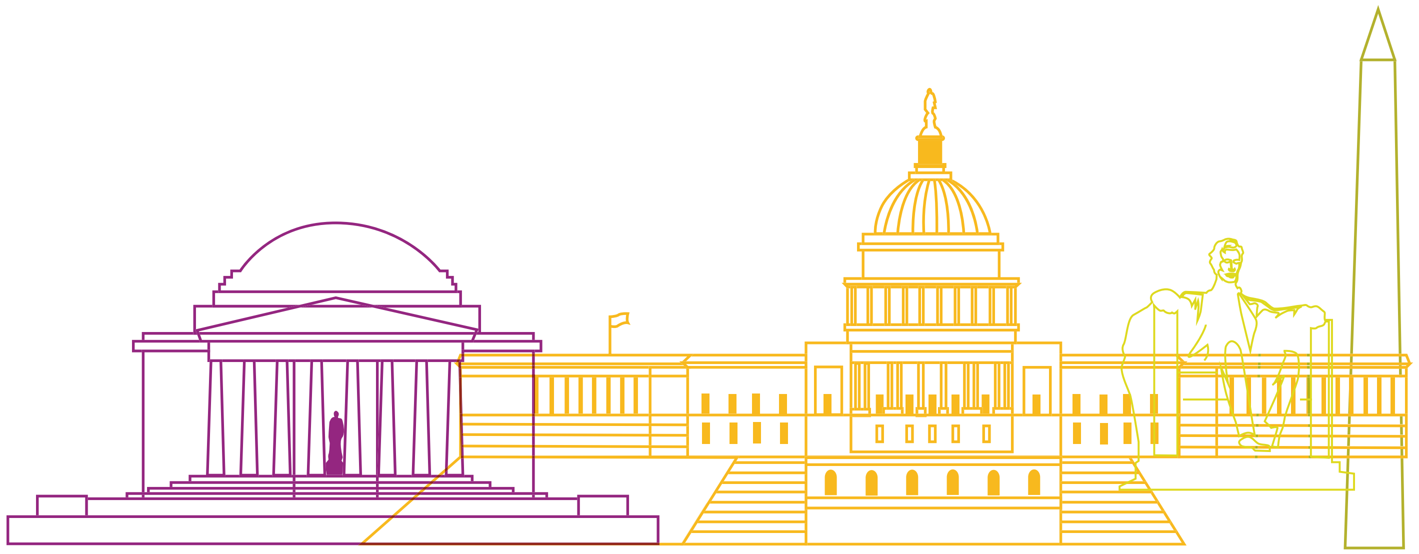
The use of 'funds of one' vehicles continue to grow. Funds of one are appealing to managers looking to grow assets under management quickly because they can be deployed on an accelerated timeframe and at a cheaper formation cost as compared to larger more complicated commingled funds. Funds of one are appealing to investors because they allow investors to create a customised investment strategy with a specific manager. They also typically have lower fees as compared to a commingled blind pool fund. Funds of one are very popular with sovereign wealth funds, pension fund investors and other investors looking to deploy significant capital quickly.

In addition to blind pool funds of one, we are also seeing the growing use of funds of one in a co-investment context where managers are raising single investor co-investment vehicles that invest alongside a commingled fund in a transaction. These are often being formed for a single strategic investor that can deploy capital on an accelerated timeframe.

Given investor appetite for funds of one and increasing demands to grow assets under administration, we expect this to be a continuing growth area for managers.

The Emergence of the "Co-Investment Manager" Class

One of the most interesting trends in the private equity and venture capital industry is the rise of the "Co-Investment Manager" class. We define "Co-Investment Managers" as investment managers that manage significant co-investment capital alongside a small blind pool vehicle. We typically see Co-Investment Managers in two types of situations. First, we see first time funds raising a commingled blind pool vehicle while also simultaneously raising a co-investment vehicle alongside it. Second, we see managers closing a small commingled fund and then raising significant co-investment capital at a future date as deal flow to the commingled fund begins. The rise of the Co-Investment Manager is particularly interesting since we are seeing managers emerge with significant assets under



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management, but where most of the assets under management relate to co-investment capital. In fact, we have seen managers where their co-investment capital is 5 to 10 times the size of their blind pool capital. This is transforming the industry, particularly with first time funds, because we are seeing investors make commitments to blind pool funds in hopes of receiving access to deal by deal co-investment flow. We expect that during 2017, more and more managers, particularly first time managers, will become members of the Co-Investment Manager class.

Growth in the use of a "Holding Company" Structure in Venture Capital

A popular trend we have seen grow significantly since 2015 and 2016 was the creation of the "holding company" structure among venture capital funds. This structure is particularly popular with first time venture capital funds that want to shy away from the traditional GP/LP model. In the holding company structure, a pass through tax entity such as a limited liability company is structured in a way to give the look and feel of a corporation. Often the holding structures are managed by a board, similar to a board of directors of a corporation, and these boards

> One of the most interesting trends in the private equity and venture capital industry is the rise of the "Co-Investment Manager" class.

will often include investors alongside the manager's investment team. In a holding company, investments are often structured with option pools and other features that mimic an investment in a corporation. Investors in the holding company receive "units" which have the same look and feel as a share of corporate stock. The argument in favor of holding company structures is that investor interests are more aligned with the managers. From the manager's perspective, holding company structures benefit from very long durations as compared to a typical fund. We often see a 15 to 20 year term with these structures. We expect to see more holding companies in the future, particularly in the venture capital space. We believe the growth of this structure will be driven by the longer timeframe venture capital funds are experiencing before making an exit from their portfolio companies.

A brave new world:

Will disruptive innovations reshape closed-ended fund administration?

People → Processes → Technology

Key topics

- What changes are we to expect?
- Will new technology solutions be expensive?
- Should you adapt now or later?

For private equity managers prices are high across markets, competition is fierce, and opportunities are scarce. Now more than ever, managers need specialist insights to find value where others cannot.

So how can one add value to clients without them making any operational improvements?

Despite us living in a technological age where information is at our fingertips – the core pillars of people, processes and technology is what makes the biggest impact. Some might say it sounds cliché or even old school; however, to achieve organisational success these three pillars stand true in the administration of alternative asset classes.

Leading industry professionals agree that the illiquid alternatives market is "hot", particularly in comparison to the hedge fund markets which have been lacklustre of late. There are a number of indicators to support this trend including record asset valuations, plenty of dry powder and the increase in investor appetite for these strategies.

The increase in demand for the product has not necessarily been followed by a ramp-up in new technology. It could be argued that the industry supporting these asset managers have not evolved as rapidly as the hedge-fund industry or the retail asset management space.

Rethinking your service architecture

Given the current environment, there appears to be a strong appetite for change driven by an increased demand for greater transparency, faster information, improved risk management and increased global regulatory reporting requirements. Recent interest by large private equity houses in fin-tech investing has provided a tailwind for changing existing back and middle office support models.

Sophisticated institutional and non-institutional limited partners used to daily NAV's and other metrics related to their hedge-fund positions, including the

GREATER TRANSPARENCY

FASTER INFORMATION

IMPROVED RISK MANAGEMENT

INCREASED GLOBAL REGULATORY REPORTING REQUIREMENTS

"Despite us living in a technological age where information is at our fingertips – the core pillars of people, processes and technology is what makes the biggest impact."

availability of dynamic data reporting, and the increased quality of analytics available online to the individual retail investor all contribute to increased expectations for enhanced illiquid alternative asset reporting.

The rise in regulatory compliance and reporting requirements, as evidenced in today's alphabet soup of regulatory acronyms such as AIFMD, FATCA, CRS etc., has placed significant burden on investment managers, particularly those fund raising in and investing through European structures. For US managers, these requirements are now becoming "top of agenda" as they strive to maintain their global reach.

Early adaptors are now seeing the benefits

Hedge fund administrators have been quicker, perhaps by necessity, to create and adopt technological enhancements into their service model. Given the liquid nature and relatively rapid turnover of hedge fund portfolios, the resulting higher transactional volumes have necessitated automation. Given the greater number of hedge fund managers and administrators, the breadth and depth of the traditional hedge fund market, and its required automation, software companies have been naturally more attracted to servicing this market.

Hedge fund administrators willing to make significant technology investments were able to increase operational efficiencies while providing transparency to hedge fund managers and their investors.

Back and middle office functions for illiquid strategy managers and administrators are only now beginning to recognise the potential of nascent automation and digital solutions. The days of heavy reliance on Excel spreadsheets will continue to wane as future-fit technology investments are being developed and become more accessible. This should result in a consolidation of the illiquid fund administration industry in much the same way as historically seen in the hedge fund administration industry.

The revolutionary impact of Blockchain

Innovative use of digital technology, including the theoretical perfect-world use of "Blockchain" concepts, has been topical within the finance industry since it was first introduced to the wider world through the advent of Bitcoin. Blockchain technology brings data sharing and authentication into a distributive environment and is revolutionary much in the same way as the LAN revolutionised computing in a way that main frame computing couldn't.

Blockchain solutions would theoretically enable investors, managers, administrators and auditors to safely work with the same information and data in real-time, in essence providing a single transparent platform. This would have a significant positive impact on back and middle office efficiencies.

Are these changes imminent? Yes or no?

Current systems and platforms will bring greater transparency and dynamic real-time data as focus continues on data management. However, significant change within the illiquid asset industry from a technological perspective will take time.

Change is not imminent, but the wheels are moving. From a technological advancement perspective the hedge industry is more easily understood. There are more players in the industry and more coverage as hedge is a derivative of standard fund management.

Private equity is unique in itself, assets are not priced regularly, there is little transparency and there is more of a reliance on relationships and building partnerships as opposed to being systems based. This is where the core pillar of 'people' comes in. Though larger industry players are invested in research and development for more advancement, there are myriad legal, regulatory, compatibility and cost implications. Further, industry adoption of new future-fit technology solutions will require support and backing from leaders in the user community.

Though there is a driving force for improved technological solutions, standardisation efforts have been slow to develop. For example, the Institutional Limited Partners Association ("ILPA") has been around since the 1990's, but industry adoption of their recommended reporting standards are only now beginning to take place. Other industry related efforts, such as to standardise and centralise KPI's on private equity backed companies, and centralise KYC and FATCA reporting, require industry wide acceptance to succeed. Processes are changing, however these changes are not easy to action and implement. Like with any successful strategy, avoid market noise and focus on the long term.

Critically evaluating your needs

We believe that the volume and highly complex nature of illiquid asset investing by any individual asset manager will not change thereby reducing the motivation for investments in technology at the level of most managers. Accordingly, a paradigm shift in supporting technology will likely come at the industry level. Regardless of the advent and adoption, the illiquid fund administration industry will continue to require highly experienced and knowledgeable professionals to be effective. New technology, as expected, will simply enable administrative professionals to keep pace in meeting the industry's needs in an ever increasing complex and regulated environment.

We remain committed to monitoring and evaluating the constant changing needs of our clients. We have a team of highly skilled industry professionals who strive to develop and enhance our solutions to ensure they remain future-fit. We use the three core pillars of people, process and technology as a cornerstone of our business propositions to enable you to remain leaders and disruptors in the financial services industry.

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SANNE

About our offices and network in America and beyond

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SANNE is a leading global provider of outsourced alternative asset and corporate administration and reporting services. Established for over 25 years and listed as a FTSE 250 company on the Main Market of the London Stock Exchange, SANNE employs more than 1,000 people worldwide and administers structures and funds that have in excess of £160 billion of assets.

Following the acquisition of FLSV Fund Administration Services LLC ("FAS") in November 2016, SANNE now include New York and Belgrade, Serbia as part of its global footprint. Our network of offices provide US based managers with highly skilled and director-led teams of asset class specialists.

FAS was founded in 2009 by Jeff Hahn and Brenda Grayson, as a fund administration firm offering end-to-end accounting, tax, operations, reporting and investor services.

> "We offer bespoke solutions across a range of alternative asset classes, and pride ourselves on our precision and eye for detail."

Following the successful integration into SANNE we have established a high quality, at scale, platform in North America. Our New York business works closely with our operations in Europe, the Middle East, Asia and Africa as cross-border investment between these key global investment regions grow.

SANNE provides both fund and corporate services including the establishment and ongoing servicing of investment vehicles and holding entities in many jurisdictions across the globe including America, the Caribbean, Asia, London, the Channel Islands, Dublin, the Netherlands as well South Africa and Mauritius.

We offer bespoke solutions across a range of alternative asset classes including private equity, distressed debt, fund-of-funds, carried interest, debt and capital markets, real estate, portfolio monitoring and infrastructure.

Should you wish to find out more about our services and operations in the Americas, or our global offices please speak to us, we would be delighted to hear from you.

About Sanne Group plc

Over 1,000 people worldwide

Over £160 billion assets under administration

Global expertise, local experience

Nurturing relationships for over 25 years

Fastest growing administration business

FTSE 250 Listed business

Experience the difference

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THE DIFFERENCE