Co-Investing: 2017

Increased Returns Through Successful Partnerships
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Financial Research Associates
Proudly Presents

Co-Invest 2017

March 29, 2017
The Princeton Club, NYC
Co-Invest 2017

Increased Returns Through Successful Partnerships

March 29, 2017

The Princeton Club of New York

8:00       Registration & Continental Breakfast

8:45       Chairperson’s Opening Remarks

Howard Cooper, Chief Executive Officer
COOPER FAMILY OFFICE

9:00       Co-investing in Today’s World: Evaluating Trends and Industry Overview

Andrew Beaton, Managing Director, Co-Investment
CAPITAL DYNAMICS

Leopold Peavy, CAIA, Head of Investor Products
PREQIN

9:45       Unique Challenges for Co-investment Deals of Different Sizes

Marc der Kinderen, Managing Partner
747 CAPITAL

Ian Lane, Managing Director
HARBOURVEST PARTNERS LLC

10:30      Networking Break
10:45  **Investor Panel: Investment Priorities from 2017 and Beyond**

*Moderator:*
Seth T. Goldsam, *Partner*
McGuireWoods LLP

*Panelists:*
Dawn Wilson, *Director of Investment Operations*
UVIMCO

Howard Cooper, *Chief Executive Officer*
COOPER FAMILY OFFICE

Marshall Bartlett, *Managing Director*
FISHER LYNCH CAPITAL

11:30  **Interactive Session: Networking Roundtable Discussions**

Eric Benhamou, *Founder and General Partner*
BENHAMOU GLOBAL VENTURES

Douglas Kelly, *Partner*
FAROL ASSET MANAGEMENT

12:15  **Luncheon for all Attendees**

1:15  **Negotiation Techniques to Create and Maintain Profitable Relationships**

Phyllis A. Schwartz, *Partner*
SCHULTE ROTH & ZABEL LLP

Jason Donner, *Chief Financial Officer*
VERITAS CAPITAL

2:00  **Best Practices for Moving Through Due Diligence within Restrictive Time Constraints**

Shaan Ebaum, *Managing Director*
PRICEWATERHOUSE COOPERS

Eric Benhamou, *Founder and General Partner*
BENHAMOU GLOBAL VENTURES

2:45  **Networking Break**
3:00  **Navigating Regulatory Complexities and Maintaining Compliance**

Aaron Schlaphoff, *Partner*
KIRKLAND & ELLIS

Robert Sutton, *Partner*
KIRKLAND & ELLIS

3:45  **Finding the Next Opportunity with Fund-less Sponsors and First-Time Funds**

Douglas Kelly, *Partner*
FAROL ASSET MANAGEMENT

A. Jabbar Abdi, *Managing Partner*
SIDEREAL CAPITAL GROUP, LLC

Rowan Taylor, *Partner*
LIBERTY HALL CAPITAL PARTNERS, L.P.

4:30  **Case Study: Lessons Learned and Best Practices in Co-Investing**

Todd Ruggini, *Principal, Co-Investments*
ALPINVESTPARTNERS

5:00  *Cocktail Reception*

6:15  *Conference Concludes*
Dear Conference Participant:

On behalf of Financial Research Associates, I would like to cordially welcome you to this industry event.

We have developed this event based on extensive industry research, structuring the topics and gathering together the speaker faculty based on feedback from numerous industry participants. **Our goal is to provide you with the most up-to-date industry information possible, along with top-notch networking opportunities.** Every effort has been made on our part to obtain the speakers’ presentations to be included in the PDF link that you have received via email. If a speaker’s presentation is not included in the PDF link, we ask that you contact the speaker directly. If we have failed to meet your expectations in any way, please let us know by completing the evaluation form provided at this event. Of course, we would like to hear positive feedback as well!

We appreciate that you have chosen to spend your time and training dollars with us, and we’re committed to satisfying your informational needs. Again, welcome to this event and thank you for your participation – we truly value your business.
Additional Questions

If you have any additional questions or requests for information beyond what is in this document book, please feel free to contact us at any time.

A link with final speaker presentations will be forwarded via email approximately 2 weeks after the conference.

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HarbourVest Private Markets Insights: Co-investment Series
Learn from the collective insights and experience of HarbourVest’s global co-investment team in this new three-part series aimed at making you a more successful co-investor.

For additional legal and regulatory information please refer to important legal disclosures
www.harbourvest.com/important-legal-disclosures.
Chairperson’s Opening Remarks

Howard Cooper, Chief Executive Officer
COOPER FAMILY OFFICE
Howard Cooper began his career trading public equities for his own account, becoming a full-time trader in the 1980s. In 2006 Mr. Cooper established a single-family office to manage his family assets, which were derived from his stock trading. His SFO has since then transitioned to global investing, primarily in alternative investments, including hedge and private equity funds as well as direct investments in operating companies. Mr Cooper is an honors graduate of Princeton University and has guest lectured at Princeton, Yale and Brown Universities.

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Co-investing in Today’s World: Evaluating Trends and Industry Overview

Andrew Beaton, Managing Director, Co-Investment
CAPITAL DYNAMICS

Leopold Peavy, CAIA, Head of Investor Products
PREQIN
Leopold Peavy joined Preqin in 2012, and is currently Head of Investor Products. In this role, Leopold oversees all commercial elements of Preqin’s investor-focused suite of products and managing various other strategic initiatives and partnerships. He is also responsible for publications and research reports for LPs/investors in alternative assets, and developing and promoting new products for this client-group. Leopold has a B.S. in International Business and Management from Fairfield University, and is a CAIA charter holder.
Co-investing in Today’s World: Evaluating Trends and Industry Overview

FRA Co-Invest 2017
Andrew Beaton (Capital Dynamics)
Leopold Peavy (Preqin)
March 29, 2017 - New York, NY

About Preqin

- **Private Equity & Venture Capital**
- **Hedge Funds**
- **Real Estate**
- **Infrastructure**
- **Private Debt**
- **Natural Resources**

Data available via online databases, publications and research reports

Clients include over 45,000 industry professionals from 17,000 firms in 90+ Countries

Multi award-winning service

San Francisco  New York  London  Hong Kong  Singapore  Manila
Drivers of Co-Investment Popularity

Private Equity: More Popular Than Ever

Mass Participation: 57% of all institutional investors globally are actively invested in the Private Equity asset class (second highest of all alternative asset classes, behind Real Estate at 61%)

Long Term LP Commitment: 48% of LPs plan on increasing their long-term target allocations to PE (only 6% will be reducing their allocations)

Short Term Confidence: In the current year, 40% of institutional investors will invest more capital in PE than they did in 2016 (just 11% will be investing less capital in PE than they did last year)

Positive Investor Sentiment: 84% of investors have a positive perception of Private Equity, the greatest proportion among alternative asset classes

Source: Preqin Dec '16 Investor Interviews
(Over 500 unique institutions surveyed)
As Participation in PE Increases, So Does LP Sophistication

As PE continues to grow, increased LP knowledge and comfort with the asset class has led to greater investor sophistication.

Investment structures and relationships between GPs and LPs have had to adapt by offering exposure to PE through alternative methods (SMAs, Direct Investments, Co-Invest).

Of these alternative structures, Co-investments are the most utilized by LPs, with the majority of institutions active in PE are co-investing alongside GPs, or will consider doing so in the future (54%).

Why Co-Investments?

Potential benefits for LPs:

• Potential for greater returns over direct commitment in commingled fund
• Lower fees
• Opportunity to put more capital to work
• Greater exposure to attractive assets
• Closer working relationship with GP
• Increased knowledge and experience for investment staff or in particular sector
Proportion of GPs Offering Co-Investments

Source: November 2016 Preqin Fund Manager Surveys
Data based on 322 responses of active PE General Partners

LP’s Perceived Benefits of Co-Investing

Source: Preqin Dec ’16 Investor Interviews
(Over 500 unique institutions surveyed)
LP Approaches to Co-investments

Source: Preqin Dec ’16 Investor Interviews

Typical LP Co-Investment Size as A Proportion of Fund Commitment

Source: Preqin Dec ’16 Investor Interviews
Types of Co-Investment Opportunities GPs Offer LPs

- **Syndicated Co-Investment**: 74%
- **Co-Underwrite**: 27%
- **Co-Sponsor**: 16%
- **Co-Lead**: 13%
- **Other**: 2%

Perceived Benefits of Offering LPs Co-Investment Rights

- **Build a Stronger Relationship with LPs**: 84%
- **Gain Access to Additional Capital for Deals**: 76%
- **Improve the Chance of a Successful Fundraise**: 55%
- **Benefits to the Portfolio Company**: 29%
- **Opportunity to Better Manage Risk**: 27%
- **Opportunity to Enhance Product Differentiation**: 16%
- **Other**: 1%
Co-Investment Returns to LPs Compared to Fund Investment Returns

The majority of LPs have seen positive performance from PE Co-Investment returns vs. commingled funds.

Over two-thirds (68%) of LPs saw higher returns from co-investments (breakdown: 42% slightly higher, 26% significantly higher).

29% saw similar returns to directly investing into a fund.

Only 3% saw lower returns when compared to directly invested into a fund.

Source: Preqin Dec '16 Investor Interviews
Median Net IRRs by Vintage Year: Co-Investment vs. Direct Fund Types

<table>
<thead>
<tr>
<th>Vintage Year</th>
<th>Co-Investment</th>
<th>Direct Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>6%</td>
<td>8%</td>
</tr>
<tr>
<td>2005</td>
<td>4%</td>
<td>9%</td>
</tr>
<tr>
<td>2006</td>
<td>9%</td>
<td>8%</td>
</tr>
<tr>
<td>2007</td>
<td>8%</td>
<td>10%</td>
</tr>
<tr>
<td>2008</td>
<td>13%</td>
<td>10%</td>
</tr>
<tr>
<td>2009</td>
<td>22%</td>
<td>13%</td>
</tr>
<tr>
<td>2010</td>
<td>23%</td>
<td>14%</td>
</tr>
<tr>
<td>2011</td>
<td>16%</td>
<td>15%</td>
</tr>
<tr>
<td>2012</td>
<td>23%</td>
<td>15%</td>
</tr>
<tr>
<td>2013</td>
<td>14%</td>
<td>12%</td>
</tr>
</tbody>
</table>

Source: Preqin Private Equity Online

Capital Dynamics – Global private asset manager

- 22% net/net IRR p.a. since 1991
- 20+ years of experience held by senior investment professionals
- Over USD 27 billion AUM/AUA
- Operating from 10 offices around the globe
- Direct, secondary and fund of funds, separate accounts and structured products
- Signatory since 2008

(1) This is Capital Dynamics’ private equity track record between 1991 and September 30, 2016. The net/net IRR is after giving effect to management fees, the general partner’s carried interest and other expenses and is annualized and calculated on the basis of daily/monthly/quarterly cash flows where available, assuming such inflows and outflows occurred at the values shown through September 30, 2016. Past performance is not necessarily indicative of future performance. (2) Average years of experience held by Capital Dynamics’ 20 most senior investment professionals. (3) AUM/AUA, as of September 30, 2016, include assets under discretionary management, advisement (non-discretionary), and administration across all Capital Dynamics affiliates. Investments are primarily on behalf of funds managed by Capital Dynamics.
The majority of co-investment funds outperformed the median private equity fund, and more so post-GFC

Vintage years 1999-2013¹
- Co-investment fund outperformed PE: 55%
- Co-investment fund underperformed PE: 45%

Net multiple: 54%

Vintage years 2009-2013¹
- Co-investment fund outperformed PE: 90%
- Co-investment fund underperformed PE: 10%

Net multiple: 83%

¹ Custom portfolio of 64 multi-manager co-investment funds and 1,621 private equity funds with buyout, growth, and turnaround strategies. Please refer to the description of the research data in the appendix. Source: Capital Dynamics based on Preqin Performance Analyst database, as of August 5, 2016.

Co-investment funds performed better than private equity funds in a top quartile comparison

Top quartile net IRRs (%)¹
- VY 1999-2013: Private equity fund = 20.8%, Co-investment fund = 21.9%
- VY 2009-2013: Private equity fund = 22.0%, Co-investment fund = 28.6%

Returns of co-investment funds exceeded returns of private equity funds for top quartile funds

Proportion of funds exceeding top quartile net IRR of combined sample portfolio¹
- VY 1999-2013: Private equity fund = 25%, Co-investment fund = 29%
- VY 2009-2013: Private equity fund = 24%, Co-investment fund = 50%

In a combined sample of co-investment and private equity funds, a higher share of co-investment funds was represented among top quartile funds

¹ Custom portfolio of 64 multi-manager co-investment funds of VY 1999-2013 including 24 funds of VY 2009-2013 and 1,621 private equity funds with buyout, growth, and turnaround strategies. Please refer to the description of the research data at the end of this presentation set. Source: Capital Dynamics based on Preqin Performance Analyst database, as of August 5, 2016.
Co-investment funds demonstrated more attractive risk characteristics than private equity funds

<table>
<thead>
<tr>
<th>% of funds with TVPIs below 1.0x</th>
<th>Return dispersion (Standard deviation of net IRRs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>VY 1999-2013</td>
<td>VY 1999-2013</td>
</tr>
<tr>
<td>Private equity fund</td>
<td>Private equity fund</td>
</tr>
<tr>
<td>Co-investment fund</td>
<td>Co-investment fund</td>
</tr>
<tr>
<td>14.2%</td>
<td>18.9%</td>
</tr>
<tr>
<td>10.9%</td>
<td>4.2%</td>
</tr>
<tr>
<td>18.1%</td>
<td>21.8%</td>
</tr>
<tr>
<td>12.1%</td>
<td>11.6%</td>
</tr>
</tbody>
</table>

Fewer co-investment funds lost capital compared with private equity funds. Return dispersion was lower for co-investment funds than for private equity funds.

(1) A custom portfolio of 64 multi-manager co-investment funds with vintage years 1999-2013, including 24 funds with vintage years 2009-2013 and 1,621 private equity funds with buyout, growth and turnaround strategies. Please refer to the description of the research data in the appendix. Source: Capital Dynamics analysis based on Preqin Performance Analyst database, as of August 5, 2016.

Monte Carlo simulation shows that co-investment funds have a lower risk profile – owing to sponsor diversification

To explore the impact of sponsor diversification and portfolio construction on risk, Capital Dynamics used proprietary data on 284 private equity funds and their 5,127 underlying portfolio companies. Simulations were run in several steps to generate co-investment portfolios at random.

<table>
<thead>
<tr>
<th>Weighting</th>
<th>All funds in the sample</th>
<th>Randomly generated co-investment funds; parameters based on Capital Dynamics' co-investment strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weighting</td>
<td>n/a</td>
<td>At random</td>
</tr>
<tr>
<td>Investment period</td>
<td>n/a</td>
<td>At random</td>
</tr>
<tr>
<td>No. of Investments</td>
<td>5,127</td>
<td>At random</td>
</tr>
<tr>
<td>Geographical allocation</td>
<td>Global</td>
<td>At random</td>
</tr>
<tr>
<td>Smallest 25% of investments</td>
<td>Included</td>
<td>Included</td>
</tr>
<tr>
<td>Median TVPI (gross)</td>
<td>1.90x</td>
<td>1.91x</td>
</tr>
<tr>
<td>Lower quartile TVPI (gross)</td>
<td>1.29x</td>
<td>1.48x</td>
</tr>
</tbody>
</table>

Source: Capital Dynamics’ proprietary data and analysis, November 2016. The funds in the sample are of vintage years ranging from 1990 to 2009. Portfolio companies invested within three years of the inception of their respective funds were included to simulate randomly generated co-investment funds. The analysis and results are shown for illustrative purposes only and actual returns may differ.
Recent research demonstrates that adverse selection is a myth

Adverse Selection and the Performance of Private Equity Co-Investments, November 2016.
Professor Dr. Reiner Braun (Technical University of Munich ("TUM")), Professor Tim Jenkinson (Said Business School, University of Oxford) and Christoph Schemmerl (TUM)

Conclusions:
1. “the like-for-like comparison between co-investments and other deals [not offered for co-investment] finds no evidence of selection bias, either positive or negative”
2. “We show......that relatively small portfolios of 10 buyout [co-investment] deals on average out-perform fund returns, net of fees and costs”

The research refutes earlier academic paper on co-investments

<table>
<thead>
<tr>
<th></th>
<th>Braun, Jenkinson and Schemmerl (Munich TUM and Oxford), 2016</th>
<th>Fang, Ivashina and Lerner (INSEAD and Harvard), 1st ed. 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dates of Investments analyzed</td>
<td>1981-2010</td>
<td>1991-2011</td>
</tr>
<tr>
<td>Sample size</td>
<td>Co-investments</td>
<td>1,016</td>
</tr>
<tr>
<td></td>
<td>Total number of deals</td>
<td>13,430</td>
</tr>
<tr>
<td></td>
<td>Number of funds</td>
<td>465</td>
</tr>
<tr>
<td></td>
<td>Number of LPs</td>
<td>458</td>
</tr>
<tr>
<td>Domicile of co-investors</td>
<td>USA 61%, Europe 31%, Other 9%</td>
<td>USA, Europe, Asia</td>
</tr>
<tr>
<td>Conclusion</td>
<td>No selection bias for co-investments</td>
<td>Adverse selection exists for co-investments</td>
</tr>
</tbody>
</table>

(2) http://hbswk.hbs.edu/item/the-disintermediation-of-financial-markets-direct-investing-in-private-equity
The research further concludes that...

3. “relative returns on co-investments vary noticeably over time. We find that the sample used by Fang et al (2015) is heavily weighted towards investment years when returns on co-investments in our, much larger, sample were poor. This may provide a partial explanation for the different results we found”

4. “We also show that, within the average fund, only 35% (29%) of buyout (VC) deals beat the overall fund return.”


Conclusion

Co-investment funds should outperform private equity funds in general

<table>
<thead>
<tr>
<th></th>
<th>Actual Gross Return</th>
<th>Illustrative Net Return¹</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Commingled Co-Investment Fund (1% Management Fee &amp; 10% Carry)</td>
<td>Conventional Single-Manger Private Equity Fund (2% Management Fee &amp; 20% Carry)</td>
</tr>
<tr>
<td>IRR</td>
<td>29.7%</td>
<td>25.6%</td>
</tr>
<tr>
<td>TVPI</td>
<td>2.73x</td>
<td>2.40x</td>
</tr>
</tbody>
</table>

Co-investment funds should exhibit a lower risk profile due to sponsor diversification²

¹ Capital Dynamics’ track record data for the mature portfolio include investments made by the co-investment team between 1996 and 2004, prior to joining Capital Dynamics in 2007. The table is an illustration to highlight the impact of management fees and carried interest. Past performance is not an indicator of future results. The IRR is an internal rate of return. The TVPI is a total value to paid-in capital. Past performance is not an indicator of future results. The IRR is an internal rate of return. The TVPI is a total value to paid-in capital. Past performance is not an indicator of future results. The IRR is an internal rate of return. The TVPI is a total value to paid-in capital.

Positive LP Outlook for the Future of PE Co-Investing

Continued LP demand for Co-Investments remains high, this structure will continue to form an important part of the PE industry for years to come.

- 82% of LPs currently actively co-investing will be making further co-investments in the next 12 months.
- 29% percent of these LPs are planning to make five or more co-investments in the next 12 months, another indication of strong demand for these opportunities amongst institutional investors.

Competitive global PE fundraising environment will continue to persist with figures consistently pushing towards pre-GFC levels each year. As LPs demand co-investment rights, more GPs must provide these opportunities in order to secure capital

- 45% of GPs surveyed indicated they will be providing more co-investment opportunities to LPs over the next 12 months.
- Only 2% of GPs surveyed will offer less co-investment opportunities to LPs in the coming year.
Data Sources

- Free reports available from www.preqin.com/research
- Preqin’s online services: www.preqin.com/services

Further Information

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Leopold Peavy – leopold.peavy@preqin.com
Unique Challenges for Co-investment Deals of Different Sizes

Marc der Kinderen, Managing Partner
747 CAPITAL

Ian Lane, Managing Director
HARBOURVEST PARTNERS LLC
MR. MARC DER KINDEREN
Managing Partner

Marc co-founded 747 Capital and is a Managing Partner of the firm. His responsibilities include portfolio management and manager selection. In addition, he oversees the marketing and business development efforts of the firm. Marc is a member of the Investment Committee and holds various board seats. Prior to 747 Capital, Marc was Executive Vice President of Greenfield Capital Partners, in New York, the US subsidiary of a Dutch private equity group. Prior to Greenfield, Marc was a private equity analyst at the Noro Group of Companies in the Netherlands. He started his career with HomeBanc, a Savings and Loan in Atlanta.
Marc received a M.B.A. from Nijenrode School of Business and a B.B.A. from European University.
Ian Lane joined HarbourVest in 2003 and focuses on direct co-investments in venture, buyout, and mezzanine transactions in the US and around the world. Ian serves as a board member at Vix, ReCommunity, and Wayfair (NYSE: W) and is a board observer at Outbrain. He has been involved with several of the Firm’s other investments, including Acclaris, Datatel, Digital Insight, eTapestry, M-Qube, Miller Heiman, National Cardiovascular Partners, Nexidia, Planview, Towne Park, and Zayo (NYSE: ZAYO). Additionally, Ian serves on the Board of Overseers at Beth Israel Deaconess Medical Center, a teaching and research affiliate of Harvard Medical School and is on the Board of Directors at Veritas Christian Academy.

Ian’s previous experience includes two years with J.P. Morgan where he was an investment banking analyst in the mergers and acquisitions group. While earning his undergraduate degree, Ian founded and managed a chain of martial arts schools in Florida.

Ian received a dual BS/MS (with honors) in Accounting from the University of Florida in 2001 and an MBA from Harvard Business School, where he graduated with distinction in 2008.
Investor Panel: Investment Priorities from 2017 and Beyond

**Moderator:**
Seth T. Goldsamt, *Partner*
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**Panelists:**
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Howard Cooper, *Chief Executive Officer*
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Marshall Bartlett, *Managing Director*
FISHER LYNCH CAPITAL
Seth Goldsamt is a corporate partner in the New York office of McGuireWoods LLP. Seth advises his U.S. and international clients (including investment funds and family offices) on a broad range of private equity transactions, mergers and acquisitions, public and private securities offerings, equity co-investments and bridges, joint ventures, mezzanine financings, venture capital, and restructuring transactions.

Particularly experienced in representing clients in the technology, media and telecommunications (TMT), healthcare and consumer products industries, Seth also advises clients on general corporate matters, various aspects of corporate governance and compliance with federal securities laws.

Seth attended Columbia University School of Law (J.D. 1995), where he was a Harlan Fiske Stone Scholar, and Columbia College (B.A. 1991), where he graduated magna cum laude.
Howard Cooper began his career trading public equities for his own account, becoming a full-time trader in the 1980s. In 2006 Mr. Cooper established a single-family office to manage his family assets, which were derived from his stock trading. His SFO has since then transitioned to global investing, primarily in alternative investments, including hedge and private equity funds as well as direct investments in operating companies. Mr Cooper is an honors graduate of Princeton University and has guest lectured at Princeton, Yale and Brown Universities.

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Marshall Bartlett is a Managing Director of Fisher Lynch Capital, a boutique private investment firm with $2.7 billion in capital under management focused on private equity co-investments. He serves on the firm's Investment Committee, has overseen investments across multiple industries, geographies, and with multiple sponsors, and serves on several portfolio company boards of directors. He additionally plays a leadership role in marketing at Fisher Lynch Capital, along with the recruitment and management of the firm’s investment team.

Prior to joining Fisher Lynch Capital, Marshall was a partner at Parthenon Capital, a middle-market private equity firm with $3.5 billion in capital under management. While at Parthenon Capital, Marshall was involved in some of the firm’s most successful investments across a variety of industry sectors and transaction structures. Before joining Parthenon Capital, Marshall was with The Parthenon Group, a strategy consulting firm. Earlier in his career, Marshall was with Saugatuck Capital, a private equity firm focused on lower middle market buyouts and growth equity transactions, and the corporate finance and private equity group of Brown Brothers Harriman & Co.

Marshall earned his MBA at the Tuck School of Business at Dartmouth College and his BA in History at Yale University.
Interactive Session: Networking Roundtable Discussions

Eric Benhamou, Founder and General Partner
BENHAMOU GLOBAL VENTURES

Douglas Kelly, Partner
FAROL ASSET MANAGEMENT
Eric Benhamou is the Founder and General Partner of Benhamou Global Ventures (BGV). Eric has 40 years of experience in the IT industry, including 13 years of active venture capital experience, with active investments in early stage information technology firms focused on global enterprise markets. Eric currently serves on the boards of Grid Dynamics, Ayehu, Virtual Instruments, Cypress Semiconductors (CY), Silicon Valley Bank (SVBFG) and Finjan Holdings (FNJN). Prior to BGV, Eric Benhamou served as 3Com’s CEO until the end of 2000, and as Chairman until the acquisition of the company by HP. He also served as Palm’s CEO until the end of 2003, and as Chairman until the acquisition of the company by HP. Eric Benhamou has extensive corporate governance experience, having served on more than 25 corporate boards, including 10 publicly traded companies such as 3Com, Cypress, SVB, Finjan, Palm, Netscape, Legato and Real Networks. Through his career, Eric Benhamou participated in 7 IPO’s and 35 M&A’s. He served on the boards of several non-profit organizations and was the Founding Chairman of the Israel Venture Network. He holds a Masters degree from Stanford’s School of Engineering, a diplôme d’Ingénieur and a doctorate from the Ecole Nationale Supérieure d’Arts et Métiers.
Douglas Kelly Biography

Doug Kelly is a Partner at Farol Asset Management, LP. He is responsible for all investment activities of the firm and is a member of the Investment Committee and the Management Committee. Prior to Farol, Doug was a Partner at Pomona Capital where he focused on origination, investment analysis and portfolio management for Pomona’s co-investment business as well as its secondary and primary private equity businesses. Prior to Pomona, Mr. Kelly was a Director at Barclays Capital where he was responsible for the origination and execution of structured finance transactions. Previously, he spent seven years at General Electric working at GE Equity as well as GE’s Corporate Lending Group. Doug began his career as a Financial Analyst in private equity at Bariston Associates and in investment banking at Merrill Lynch. He received an MBA from Columbia Business School and a BA from Duke University.
**Jason M. Donner**

Mr. Donner is the Chief Financial Officer of Veritas Capital and is primarily responsible for accounting, financial reporting, investor communications, tax reporting and other administrative processes. Previously, Mr. Donner was a Vice President at a major private equity fund administrator where he co-managed the organizations institutional private equity sponsor group. Prior to that, Mr. Donner worked at Swiss Re Group as a Controller in its private equity division. Mr. Donner is a Certified Public Accountant and worked as an Audit Manager in Goldstein Golub & Kessler's financial services audit group. Mr. Donner holds a B.S. in Accounting from CUNY Brooklyn College.

**About Veritas Capital**

Veritas Capital is a leading private equity firm that invests in companies that provide products and services, primarily technology or technology-enabled solutions, to government and commercial customers worldwide including those operating in aerospace & defense, healthcare, technology, national security, communications, energy and education. Veritas seeks to create value by strategically transforming the companies in which it invests through organic and inorganic means.
Negotiation Techniques to Create and Maintain Profitable Relationships

Jason Donner, Chief Financial Officer
VERITAS CAPITAL FUND MANAGEMENT, L.L.C.

Phyllis Schwartz, Partner
SCHULTE ROTH & ZABEL LLP

March 29, 2017

I. Introduction

A. Relationships between general partners and investors are built through direct commitments to funds, and are enhanced with rights to co-invest

B. Terms of co-investments are discussed at the time of committing to funds, when investors may seek to negotiate the structure, fees and terms of co-investments separately from their investments in funds through their side letters; however, investors are more likely to negotiate the terms of a co-investment at the time offered

C. Co-investing remains a major draw for investors in private equity funds and an equally significant tool for managers in fund raising and to pursue investments

D. Co-investments provide additional sources of capital that is needed to pursue investments a fund could not otherwise pursue

E. The SEC continues to review the fairness of co-investments, disclosure, expense issues

F. Unlike private equity funds, which have fairly settled market terms, the market for private equity co-investments is not uniform or predictable; therefore negotiations will drive the outcome of co-investments

II. Definition of Co-Investment

A. A co-investment is a single investment that is made side-by-side with a fund on a one-off basis
B. Co-investments differ from investments made by parallel funds, since parallel funds are formed for the purpose of acquiring a pro rata share of each investment made by the main fund (except for regulatory, tax or other legal reasons); investors in parallel funds do not negotiate the terms of such side-by-side investment activity.

1. Parallel funds usually have the same terms as the main fund and invest on the same terms and conditions as the main fund.

2. Parallel funds will invest and divest on the same terms and conditions as the main fund.

C. Unlike investments made by parallel funds side-by-side with the main fund, co-investments are made when the main fund and its parallel fund have excess capacity.

D. Co-investments consist of the same security being acquired by the fund and, like parallel funds, co-investors generally acquire and dispose of co-investments on the same terms and conditions as the main fund and its parallel funds.

1. New investment in old company.

2. An equity investment and debt financing in the same transaction would normally not be considered a co-investment.

III. Sources of Co-Investors – Investors must have the financial resources and be able to make co-investment decisions quickly.

A. LPs of the main fund making the investment

1. Commitments to take up spill-over – no pro rata right.

B. Affiliated funds of the main fund – cross-over investments (as opposed to parallel funds) / cross investment.

C. Strategic sources (such as another fund that is likely to share deals in other transactions).

D. GP affiliates.

E. Co-investment Funds.

1. Structured quite similar to primary funds. Despite lower cost, still provides benefits of a regular fund (e.g., side letters on unique issues, excuse rights, tax...
structuring, monitoring & reporting, annual meetings, etc.)

2. Investors like them because (a) investors are charged lower fees and carry than charged by primary funds (not paying 2/20), (b) they get access to select managers and deals, and piggyback on their diligence; (c) they get the benefit of dedicated, experienced teams looking at each deal rather than investing in a blind pool; and (d) they get industry, vintage year diversification and manager diversification.

3. GPs like dealing with Co-investment Funds because: (a) ready-made source of committed capital, allows for quick decisions; (b) dedicated, experienced teams won’t hinder the process and can actually add value; (c) since mostly passive capital, using co-investment allows GPs to look at bigger deals they would not be able to do given their fund size, yet avoid having to bring in a co-lead; and (d) if CI Fund sits on a primary platform, great way for GPs to demonstrate their abilities.

IV. Allocation and Conflict Issues

A. A GP must consider its duties to the main fund and investors in the main fund before the GP can offer co-investment rights, even to LPs who have negotiated for the right to co-invest in their side letters.

1. J to discuss investment committee considerations multiple factors

2. Concentration caps are used as guidelines for allocation compliance, but follow-on capacity is also taken into account.

3. Other LPA restrictions make co-investment offers permissible, such as industry or geographic caps.

B. Consider whether a fund can offer co-investment rights where it does not source an investment, and is itself a co-investor with an unrelated fund.

C. Standard LPA provisions require the GP to make an entire investment opportunity available to the main fund, including parallel funds, before co-investments are offered to any other persons.

D. The limited partnership agreement of a private equity fund may provide that affiliated funds are permitted to co-invest with the fund regardless of investment restrictions and concentration caps.
1. In such cases, the GP will generally make a co-investment available based on the relative capital available for investment by the main fund/parallel fund and the affiliated funds

E. Side letters – If a limited partner desired co-investment rights as part of its decision to invest in a fund, the GP must determine the type of commitment that it can offer to such limited partner

1. Simple acknowledgement, without any duty

2. Firm co-investment rights; generally, a pro rata share of co-investment opportunities offered to other LPs of the same fund, as well as the GP's share, if any, of the co-investment

3. Occasionally, LPs insist on a co-investment rights as to the entire co-investment being offered outside the fund; however, it is more customary for a GP to be able to offer co-investments to strategic investors without sharing such arrangement with LPs

F. GP co-investing raises inherent conflict issues

1. GP "cherry picking", as opposed to more "skin in the game"

2. The trend in the market is to allow the GP may take up to a reasonable, but small percentage, of the co-investment

3. Delaware/fiduciary cover a GP's duty of loyalty and fair dealing. Such duty should be considered in light of a possible "lost opportunity" claim by investors if the GP takes some of the co-investment without sufficient authority in the fund's LPA

4. A manager should also consider how co-investments are shared among its own investment professionals and whether there is a duty to allocate GP co-investments within the firm

V. Process

A. NDA – carve-out for financing source
B. Contacting co-investors – allocating
   1. Equity Commitment Letters

C. Due Diligence by co-investors
   1. Consistent disclosure

VI. Structures of Co-investments

A. It has become common for a GP to set up an SPV (or a newly formed vehicle) to make a single co-investment
   1. SPVs are administratively easier for GPs to manage. From the LPs' perspective, SPVs may not fit perfectly with tax objectives, causing need to do internal structuring.

B. Co-investments are rarely commingled with other co-investments in a single vehicle, since losses from one investment are not intended to expose another investment to losses

C. Strategic investors who are not LPs of existing funds are likely to pursue co-investments directly into the deal

D. Occasionally, an LP will make a co-investment directly, but the GP may consider whether it should have a power of attorney or proxy from the LP to ensure that such LP and the main fund exercise rights consistently with respect to the investment
   1. Occasionally, a co-investor or the main fund will dispose of investments at different times if the underlying structure of the acquiring entity may need liquidity earlier (such as a hedge fund that may need to honor a withdrawal request), but such differing sales rarely occur

VII. Terms of Co-investments

A. Management fees/carried interest
   1. GPs like the idea of another revenue stream, but it is difficult to charge co-investors management fees and a carried interest, and if charged, they would normally be less than "2/20"
2. From an existing LP perspective, that LP adding value to GP’s franchise by making more capital available and the capital is incremental to that already committed to the fund

3. Existing LPs want to reduce the management fees and carried interest charged by the main fund on a blended basis with their co-investment capital

4. Strategic investors, such as other funds that already charge their own investors fees, are similarly are reluctant to pay any management fees or carried interest

5. Transaction fees can be meaningful substitutes for management fees

6. If the GP has leverage, then it may charge fees and carried interest. Lesser alternative for GPs is to take carry after hurdle rate return reached.

   B. Co-investors may seek rights of direct investors and therefore co-investment documents may include private equity investment type terms, including:

      1. Pre-emptive rights (i.e., right to make follow-on investments)

      2. Access to the information provided by the portfolio company to the fund

      3. Access to directors of the portfolio company

      4. Voting rights

      5. Co-sale rights/drag rights

   C. Expenses and liability obligations must be borne pro rata by the main fund and co-investors

      1. SPV has its own expenses. In addition to annual caps, co-investors may require estimates of expenses

      2. Broken deal expenses have historically been borne only by the main fund, but consideration should be given as to whether co-investors should bear a portion of such expenses. From co-investors’ perspective, if you are going to charge broken deal expenses, then you should share deal fees, advisory fees, monitoring fees, etc.
3. Since co-investors do not have committed capital allowing the GP to cover expenses, the co-investment documents should permit for recalls of distributions ("investor clawbacks") and additional obligations to cover expense obligations, including the cost of audits of financial statements, as well as indemnification obligations after an exit, but these arrangements are limited in time (e.g., 2 years) and amount (e.g., lesser of 25% of investment and % of actual amounts distributed)
Best Practices for Moving Through Due Diligence within Restrictive Time Constraints

Shaan Ebaum, Managing Director
PRICEWATERHOUSE COOPERS

Eric Benhamou, Founder and General Partner
BENHAMOU GLOBAL VENTURES
Eric Benhamou is the Founder and General Partner of Benhamou Global Ventures (BGV). Eric has 40 years of experience in the IT industry, including 13 years of active venture capital experience, with active investments in early stage information technology firms focused on global enterprise markets. Eric currently serves on the boards of Grid Dynamics, Ayehu, Virtual Instruments, Cypress Semiconductors (CY), Silicon Valley Bank (SVBFG) and Finjan Holdings (FNJN). Prior to BGV, Eric Benhamou served as 3Com’s CEO until the end of 2000, and as Chairman until the acquisition of the company by HP. He also served as Palm’s CEO until the end of 2003, and as Chairman until the acquisition of the company by HP. Eric Benhamou has extensive corporate governance experience, having served on more than 25 corporate boards, including 10 publicly traded companies such as 3Com, Cypress, SVB, Finjan, Palm, Netscape, Legato and Real Networks. Through his career, Eric Benhamou participated in 7 IPO’s and 35 M&A’s. He served on the boards of several non-profit organizations and was the Founding Chairman of the Israel Venture Network. He holds a Masters degree from Stanford’s School of Engineering, a diplôme d’Ingénieur and a doctorate from the Ecole Nationale Supérieure d’Arts et Métiers.
Valuation Update
March 29, 2017

American Institute of Certified Public Accountants (AICPA)

Accounting and Valuation Guide - “Valuation of Portfolio Company Investments of Venture Capital and Private Equity Funds and Other Investment Companies”

Background:
- ASC 820 - Provides guidance on how to arrive at fair value through the use of the market and income approach (no implementation guidance).
- Different types of investors, LBO, Co-investment vehicles, industry specific valuation and allocation of value.
- Seeing a continued push for transparency from regulators, LP’s etc.

Practice Aid - Task Force objectives (March 2013):
- Harmonize the diverse views of industry participants, auditors and valuation specialists
- Produce a user friendly guide with examples that can be used to reason through real situations faced by valuation specialists and auditors
- Timeline – AICPA (FinRec) review April 2018 and working draft in April 2019 (final publication following a comment period).

Key areas of focus:
- Calibration, Transaction Cost, Enterprise Value, Allocation of Value, Market Participant Examples etc.
- Calibration - process of utilizing assumptions from a transaction (i.e., acquisition multiples) and updating those assumptions at a later date (i.e., valuation date), adjusting for market performance and company performance.
Certified in Enterprise and Intangible Valuation (CEIV)

Background:
- Valuation industry has evolved quickly over the last 10 years
- The regulators has questioned practitioners qualifications, training, and credentials

Fair Value Quality Initiative (FVQI):
- Develop a “gold standard” credential within the valuation industry with the objective of enhancing quality, consistency and transparency in fair value measurement reporting
- The initiative has the support of three valuation professional groups (AICPA, ASA, RICS) and six large accounting firms
- Key Considerations 1) Initial testing for credentialing, 2) Requirement for individuals, 3) Quality review process, and 4) Development of performance standards (i.e., audit standard equivalent)
- Mandatory Performance Framework (MPF) – 3 parts
  1. Professional standards (ethics, credentialing, training etc.)
  2. Technical standards – “how to”
  3. Performance framework – “how much”
- Two step process to be Certified in Enterprise and Intangible Valuation, (‘CEIV’)
  1. Education / work experience (ASA, ABV accredited business valuation, RICS etc)
  2. Measurement exam to obtain a CEIV
- Initially for public companies
- Effective as of December 2016

Securities and Exchange Commission (SEC)

SEC Speeches
Andrew Ceresney, Director, Division of Enforcement, September 22, 2016 and May 12, 2016
- 1) Enhanced investment in PE has driven more focus from SEC and 2) Repeated audit and other related failures around management valuation estimates, including considerations for methodologies, assumptions and timing of valuation.
Mary Jo White, Chair of the SEC, March 31, 2016
- Highly subjective nature of developing venture valuations and pressure to achieve unicorn benchmarks leading to increased risk of financial reporting problems.
Kris Shirley, Professional Accounting Fellow, SEC’s Office of the Chief Accountant, December 9, 2015
- Management’s responsibility for fair value measurements of illiquid assets, includes estimates developed both internally and by third-party service provider.
Andrew J. Bowden, Director, SEC’s Office of Compliance Inspections and Examinations, May 6, 2014
- Examiners are focused on 1) Cherry-picking comparables, 2) adding back inappropriate items to EBITDA, 3) Changing the valuation methodology from period to period without additional disclosure

SEC Enforcement Actions
October 18, 2016 – Mutual Fund - Fine $3.9 million
- Discovered errors in third-party valuation tool which substantially inflated the prices of previously purchased bond securities.
August 19, 2015 – Hedge Fund - Fine $5.0 million
- Alleged to have inflated the prices of MBS securities in private investment funds it managed.
March 30, 2015 – Private Equity – Open Litigation
- Alleged to have breached fiduciary duties and defrauded clients by overvaluing assets not using appropriate methodologies per offering documents.
Navigating Regulatory Complexities and Maintaining Compliance

Aaron Schlaphoff, Partner
KIRKLAND & ELLIS

Robert Sutton, Partner
KIRKLAND & ELLIS
Aaron Schlaphoff

**Professional Profile**

Aaron Schlaphoff is a partner in the New York office of Kirkland & Ellis LLP, where he is a member of the Investment Funds group.

Prior to joining Kirkland, Mr. Schlaphoff was most recently an attorney fellow in the Division of Investment Management at the U.S. Securities and Exchange Commission (SEC). Drawing on his private sector experience, he contributed to a wide range of matters relating to investment advisers and investment vehicles subject to SEC regulation, including private funds, mutual funds and exchange-traded funds (ETFs). In the private funds area, Mr. Schlaphoff advised various SEC divisions and offices, including the Office of Compliance Inspections and Examinations (OCIE) and the Division of Enforcement, on interpretive matters under the Advisers Act, as well as on market practice in the hedge fund and private equity fund industries.

Mr. Schlaphoff was a key member of the team that developed the SEC’s recently proposed rule relating to the use of derivatives and financial commitment transactions by registered funds and business development companies, and worked with various SEC divisions and offices on derivatives-related policy and legal matters. In addition, he participated extensively in the SEC’s work with representatives of the Financial Stability Oversight Council (FSOC) and Financial Stability Board (FSB) analyzing the potential impact of asset management activities on U.S. and global financial stability.

As an attorney in the private sector prior to joining the SEC, Mr. Schlaphoff advised many of the largest, most sophisticated firms in the global asset management industry on a wide range of legal, regulatory and compliance matters arising under the Investment Advisers Act, Investment Company Act, Commodity Exchange Act and related securities and banking laws and regulations. He frequently advised clients on regulatory and compliance issues for new and novel products, such as registered alternative investment funds (e.g., mutual funds sponsored by traditional hedge fund managers), ETFs investing in physical commodities and derivatives, and structured product and derivative wrappers for conveying discretionary investment management services. Mr. Schlaphoff’s fund formation experience includes advising clients on the structuring and offering of a variety of pooled investment vehicles, including private equity funds, hedge funds, open- and closed-end mutual funds and ETFs. He also has substantial experience with M&A, IPO and restructuring transactions involving investment advisers and funds.

Mr. Schlaphoff has extensive knowledge of the regulation of derivatives and derivatives market participants by the Commodity Futures Trading Commission (CFTC) and National Futures Association (NFA) under the Commodity Exchange Act, including the regulation of commodity pool operators (CPOs) and commodity trading advisors (CTAs) and the
implications of swap regulations under Title VII of the Dodd-Frank Act for asset managers. His clients in this area have included five of the 20 largest hedge fund managers in Institutional Investor Alpha’s Hedge Fund 100 firm ranking, in addition to many other sponsors of investment vehicles subject to CFTC and NFA regulation.

Aaron is one of several members of the SEC’s Division of Investment Management who have recently joined Kirkland’s Investment Funds Group Regulatory Practice. Jamie Walter served as senior counsel in the Private Funds Branch of the Division’s Rulemaking Office. Norm Champ was the director of the Division of Investment Management.

Memberships & Affiliations

Secretary, Committee on Private Investment Funds, New York City Bar Association June 2009–2012

Seminars

Speaker, The SEC’s Proposed Rule on Registered Funds’ Use of Derivatives Explored, Knowledge Group webcast, September 15, 2016.

Panelist, Private Equity Fund Restructuring: Negotiating Terms, Avoiding Conflicts of Interest and Avoiding Regulatory Scrutiny, Strafford Publications Webinar, August 10, 2016.

Speaker, Chief Compliance Officer Response to SEC Update, SuperReturn Boston, June 7, 2016.


Practicing Law Institute (PLI), Hedge Fund Management 2014 (Sept. 25, 2014), “Registration and Regulation”*


* Conducted while at SEC

Prior Experience

U.S. Securities And Exchange Commission, Attorney Fellow, Division of Investment Management, Rulemaking Office, January 2014–March 2015

Davis Polk & Wardwell, Counsel, September 2006–January 2014

Sullivan & Cromwell LLP, Associate, September 2004–August 2006

Sullivan & Cromwell LLP, Summer Associate, 2003
Co-Invest 2017: Navigating Regulatory Complexities and Maintaining Compliance

March 27, 2016
Robert H. Sutton, robert.sutton@kirkland.com
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General Standards Under the Investment Advisers Act of 1940

- The Advisers Act imposes a fiduciary duty on an adviser to act in its client’s best interests
  - Investment advisers must guard against conscious and unconscious conflicts
  - SEC polices the duty through examination and enforcement powers
- The SEC is focused on undisclosed conflicts of interest, including:
  - expense allocation practices
  - undisclosed arrangements or income streams
  - side-by-side management of accounts with different fee structures
  - principal transactions

SEC Enforcement Trends

- Enforcement results for SEC’s fiscal year ended September 2016:
  - 868 total enforcement actions (807 in 2015), and the most ever (160) involving investment advisers or investment companies
  - Over $4 billion in aggregate disgorgement and penalties (approx. $4.2 billion in 2015)
  - Whistleblower program awarded over $57 million to whistleblowers in fiscal year 2016, which is more than in all previous years combined, and the SEC brought its first stand-alone action for retaliation against a whistleblower
Allocations: Examples of SEC Focus

- **Broken Deal Expenses**
  - **Kohlberg Kravis Roberts & Co. (June 2015):** Between 2006 and 2011, private equity fund adviser generally did not allocate broken-deal expenses to co-investors and did not disclose this practice in its funds' LPAs or marketing materials at the time of offering fund interests.
    - Co-invest vehicles were either committed or pledge fund-type structures
    - Co-invest vehicles were allowed to take set percentage of deals (< 5%)
    - Co-investors included adviser executives
    - Adviser entered into settlement with SEC to pay over $18 million in disgorgement of broken-deal expenses and prejudgment interest; $10 million penalty; cease and desist

Allocations: Examples of SEC Focus (cont’d)

- **Transaction Fee Offsets**
  - **WL Ross & Co. (August 2016):** SEC settles charges with private equity adviser over transaction fee allocation and offset methodology and alleged lack of specific disclosures.
    - In instances where multiple funds invested in a portfolio company, adviser determined to allocate transaction fees based on relative ownership of portfolio company, thus retaining the portion of such fees allocated to co-investors without a transaction fee offset
    - LPAs seemed to create potential for greater than 100% offset if multiple investing funds
    - Consent order focused on alleged lack of disclosure and ambiguity in governing documents related to chosen allocation methodology, and suggested that a pro rata allocation methodology among funds with an offset provision would have benefited the funds in the amount of $10.4 million from 2001-2011
Allocations: Examples of SEC Focus (cont’d)

- **Allocation Of Expenses Between Manager And Funds**
  - First Reserve Management (Sept. 2016): SEC settles charges with private equity adviser over, among other things, allocation of certain expenses to its funds without making appropriate disclosures relating to structuring deals
    * Funds invested in a pooled investment vehicle ("Sector Vehicle") to deploy capital for investments in a sector of energy industry; adviser authorized the Sector Vehicle to form advisory subsidiaries and enter into an advisory relationship with such advisory subsidiaries, then used the funds’ invested capital to pay the fees and expenses of the advisory entities
    * Adviser employees served on the board of the Sector Vehicle’s general partner and as members of the investment advisory committee of one of the advisory entities
    * Following SEC exam, adviser voluntarily refunded more than $7.4 million of fees to the funds

- **Use Of Affiliated Service Providers**
  - Centre Partners Management, LLC (Jan. 2017): SEC settled charges with a private equity fund adviser for the adviser’s failure to disclose relationships between certain of its principals and a third-party information technology service provider used by portfolio companies of the private funds and the potential conflicts of interest resulting from those relationships
    * Three principals had made personal investments in the service provider, two principals occupied two of the three seats on the service provider’s board of directors, and the wife of one principal was a relative of the service provider’s co-founder and CEO
    * Funds’ governing documents required these conflicts to be disclosed to advisory committees
    * Neither the adviser nor the principals financially profited from the relationship with the service provider, however, the SEC alleged that the adviser breached its fiduciary duty to its fund clients and made materially misleading statements to the funds’ investors by failing to disclose these potential conflicts of interest
Disclosure

- In examinations, the SEC staff has been increasingly focused on disclosure around co-invest vehicles, particularly with regard to:
  - The allocation process applicable to co-investors and co-invest vehicles, and how the adviser mitigates any potential conflicts of interest in the allocation of investment opportunities between co-investors and the adviser’s fund clients, and
  - Disclosure being clear and concise with respect to the reason for a co-invest vehicle’s formation and how allocations are made.

Dealing With and Documenting Conflicts

- Fees, Expenses and Disclosure of Conflicts
  - Focus on actions/arrangements that appear to benefit the adviser at the expense of investors
    - Sample deficiency letter comment: “The adviser may have violated the Advisers Act, Securities Act, and Exchange Act by failing to specifically disclose the conflicts of interest associated with the fact that operating partners may co-invest in portfolio companies.”
    - Sample deficiency letter comment: “Discussions with management revealed that co-investors of the funds currently do not pay a management fee, carried interest, or other compensation. However, this material fact was not disclosed to the funds' limited partners in any subsequent communications. . . . Going forward, the adviser should proactively disclose whether or not it will receive management fees, carried interest, or other compensation from co-investors.”
Dealing With and Documenting Conflicts (cont'd)

- If a process for allocation is described in the LPA, make sure actual policies and procedures are implemented to support that process.
- Sample deficiency letter comments:
  - "The staff found no policies or procedures that evidenced the process by which the adviser exercised its discretion in connection with the allocation of co-investment opportunities to prospective co-investors. As such, the staff recommends that the adviser incorporate policies that address its processes for determining whether to permit co-investments, as well as ensuring their fair allocation."
  - "The adviser did not maintain a record detailing whether or not the fund's limited partners were interested in co-investment opportunities. To ensure co-investment opportunities are allocated fairly, the adviser should establish policies and procedures to initially and periodically determine which fund investors are and are not interested in co-investments and maintain a record of their interest.
  - "Additionally, the adviser should adopt and implement procedures to test that those limited partners who expressed an interest in co-investment opportunities were contacted when such opportunities arise and that the investments were allocated fairly."

Treatment of Co-investment Vehicles under the Custody Rule

- Avoid comingling: Assets should be listed in the name of each client with bank
  - March 2010 SEC Staff guidance states the Staff's position that co-invest vehicles should be considered "clients" for purpose of the Custody Rule, whether or not fees are charged
  - We have seen deficiency comments related to older co-invest vehicles not being audited, even though the adviser was not receiving compensation from those vehicles
Treatment of Co-investment Vehicles under the Custody Rule (cont’d)

- Auditing Non-Pool Accounts: SEC FAQ Question X.1

  - Q: Can an adviser use the audit approach under the rule with respect to the account of a client that is not a pooled investment vehicle (e.g., an endowment, an individual, or a pension fund)? What if the client co-invests alongside an audited private pool?

  - A: No. The audit approach is not available if the client is not a pooled investment vehicle; account statements must be sent to the client by a qualified custodian. The answer does not change if the client co-invests alongside an audited pool. (Modified March 5, 2010.)

SEC Under the New Administration

- We do not expect a seismic shift in the way the SEC oversees private fund advisers or the staff’s areas of focus

  - SEC has added/redirected staff to focus on investment adviser examinations

  - Formalized Private Funds Unit (PFU) of specialized examiners who can be deployed nationally

  - Exams have progressively intensified and lengthened as SEC gains more staff with private fund expertise

  - Request letters are getting longer with more follow-ups

  - Exams lasting 6 to 9 months now common; some exams lasting 12 months or longer

  - SEC expecting quicker production/response time

  - SEC referring more private fund adviser cases to enforcement and/or requiring significant remediation as part of deficiency letter process
SEC Under the New Administration (cont’d)


- Investment Adviser Modernization Act, passed by the House in September 2016, and intended to "modernize" the Advisers Act; outlines potential reforms that could be undertaken through legislative or agency action, including amendments to advertising and custody rules.
Finding the Next Opportunity with Fund-less Sponsors and First-Time Funds

Douglas Kelly, Partner
FAROL ASSET MANAGEMENT

A. Jabbar Abdi, Managing Partner
SIDEREAL CAPITAL GROUP, LLC

Rowan Taylor, Partner
LIBERTY HALL CAPITAL PARTNERS, L.P.
Douglas Kelly Biography

Doug Kelly is a Partner at Farol Asset Management, LP. He is responsible for all investment activities of the firm and is a member of the Investment Committee and the Management Committee. Prior to Farol, Doug was a Partner at Pomona Capital where he focused on origination, investment analysis and portfolio management for Pomona’s co-investment business as well as its secondary and primary private equity businesses. Prior to Pomona, Mr. Kelly was a Director at Barclays Capital where he was responsible for the origination and execution of structured finance transactions. Previously, he spent seven years at General Electric working at GE Equity as well as GE’s Corporate Lending Group. Doug began his career as a Financial Analyst in private equity at Bariston Associates and in investment banking at Merrill Lynch. He received an MBA from Columbia Business School and a BA from Duke University.
Biography

A. Jabbar Abdi is a Managing Partner of Sidereal Capital Group, LLC, a boutique private equity investment firm which sponsors transactions in selected industries with emerging companies at the lower end of the middle market. He is experienced in all aspects of the investment process and has broad sector experience, including value-added manufacturing, consumer products, software, and business services. He currently represents Sidereal on the board of directors of UC Coatings and Flexo Transparent.

Prior to co-founding Sidereal, Jabbar was a Managing Director at Cordova, Smart, & Williams, LLC (“CSW”), a middle-market private equity firm where he was a key member of the investment team. Jabbar joined CSW from GE Capital where he held various positions. As a Vice President in GE Capital’s Merchant Banking Unit, Jabbar was responsible for originating and underwriting debt and equity financings for leveraged buyouts in the middle market in addition to managing a portfolio of debt and equity investments in various industrial companies. Jabbar also worked in GE Capital’s Private Equity Unit, GE Equity, where he executed and managed early- and late-stage equity investments in growth companies and other investment funds. Prior to his tenure at GE Capital, Jabbar was a management consultant with First Manhattan Consulting Group where he focused on strategy development and implementation in the financial services sector. Jabbar began his career with Furman Selz, a New York-based investment bank where he conducted an assortment of mergers and acquisitions, public equity offerings, and private placements.

Jabbar earned an A.B. from Harvard College and an M.B.A. from the Wharton School of Business at the University of Pennsylvania.
Rowan Taylor Biography

Rowan G.P. Taylor is the founding Partner of Liberty Hall Capital Partners, L.P., a private equity firm focused exclusively on investments in businesses serving the global aerospace and defense industry. Liberty Hall’s current portfolio companies include Accurus Aerospace Corporation, AIM Aerospace Corporation and Bromford Industries Ltd.

Prior to founding Liberty Hall in July 2011, Mr. Taylor was a Partner of Oak Hill Capital Management, a private equity firm with more than $8 billion under management. While at Oak Hill, which he joined in 1999, Mr. Taylor was head of its Basic Industries group where he led a team of investment professionals focused on industrial and transportation businesses, including those serving the aerospace and defense industry, and served on Oak Hill’s Investment Committee. Prior to joining Oak Hill, Mr. Taylor was a Principal of The Clipper Group and its successor, Monitor Clipper Partners, both private equity firms associated with CS First Boston, which he joined in 1991. Mr. Taylor began his career as a Financial Analyst in the Merchant Banking group of CS First Boston in 1989.

Mr. Taylor serves on the boards of directors of each of Liberty Hall’s portfolio companies. He also currently serves as a member of the Board of Regents of Portsmouth Abbey School and the Board of Trustees of Washington and Lee University. He earned his B.A. in Economics, summa cum laude, from Washington and Lee University where he was elected to Phi Beta Kappa.
Case Study: Lessons Learned and Best Practices in Co-Investing

Todd Ruggini, Principal, Co-Investments
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