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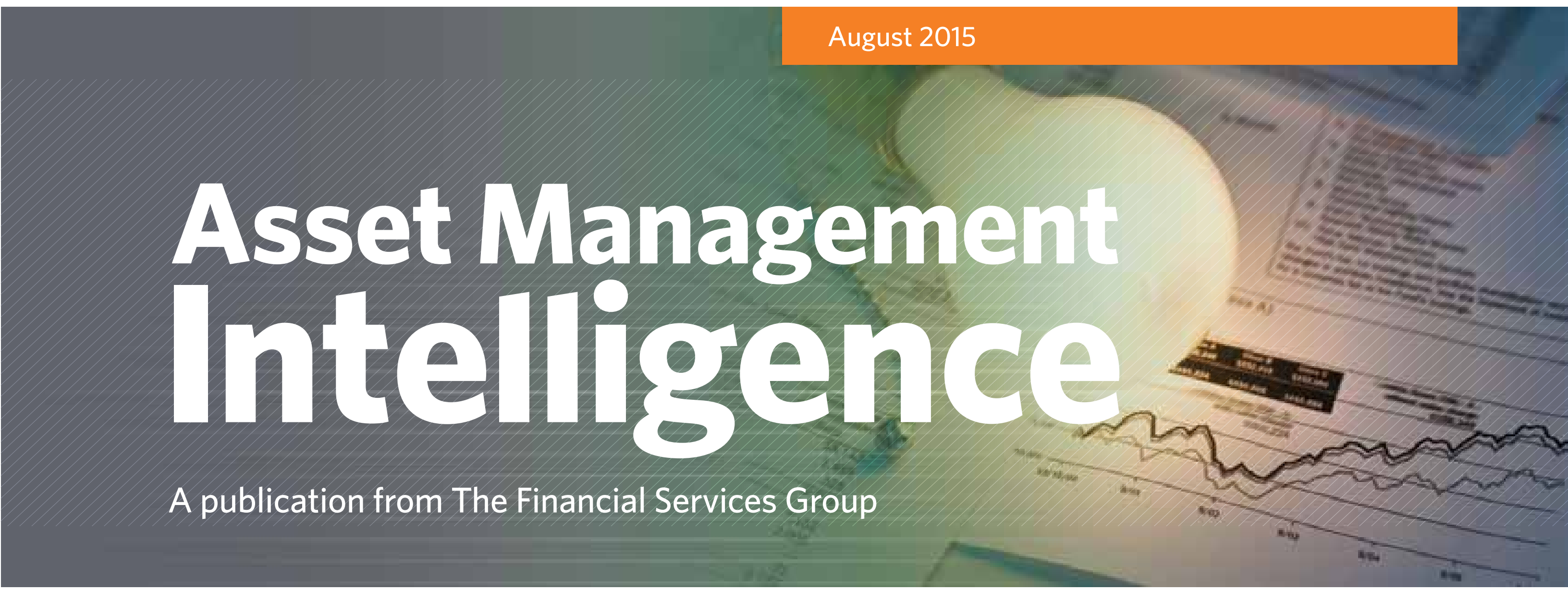

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Asset Management Intelligence

A publication from The Financial Services Group

Using the Tax Advantages of Ireland to Structure a Fund's Investments

By Cormac Doyle and Harold Adrion, JD

Ireland has positioned itself as a location of choice for structuring investments due to the favorable and flexible tax regime, a strong regulatory system, and experienced administration and compliance networks which support asset managers whose clients invest in all categories of asset classes. Here we have outlined how and why Ireland can be effectively used for investments in the following asset classes:

- Aircraft and Other Aviation Assets
- Real Estate
- Distressed Debt and Financial Assets (Securitization)

STRUCTURES & RECENT DEVELOPMENTS

Ireland provides a number of options for structuring investments.

The options include a Qualifying Investor Alternative Investment Fund ("QIAIF"), a "Section 110" company which is a resident of Ireland and meets legislative conditions under Section 110 Taxes Consolidation Act of 1997, an Irish trading company subject to the 12.5% corporate tax rate, and an Irish REIT.

WHAT IS A QIAIF?

A QIAIF is a fund vehicle targeted at sophisticated private investors and institutional investors. It was introduced upon the implementation of the Alternative Investment Fund Managers Directive ("AIFMD") in Ireland.

How are a QIAIF and its Investors Taxed?

Irish regulated funds, including QIAIFs, are exempt from Irish tax on their income and gains. Equally, no Irish withholding tax applies to income distributions or payments on redemption made to non-Irish resident investors regardless of where they are a resident. Since QIAIFs are exempt from tax in Ireland, some jurisdictions such as Canada and the U.K. will not grant tax treaty benefits to them. However the underlying QIAIF vehicle is generally entitled to treaty access under Irish rules.

WHAT IS AN ICAV?

The Irish Collective Asset management Vehicle ("ICAV") Act 2015 (the "Act") was signed into law by Michael Higgins, the President of Ireland, on March 4, 2015. The Act provides for the establishment of the new Irish corporate investment fund vehicle that is specifically tailored to the needs of the global funds industry. The ICAV is a new option in terms of the form of vehicle in creating a QIAIF structure, adding to the existing investment company/Plc, unit trust, common contractual fund ("CCF"), and investment limited partnership options. One of the main advantages of the ICAV is that it will be able to elect in its classification, under the U.S. "check-the-box" taxation rules, to be treated as a transparent entity for U.S. federal income tax purposes. This will allow U.S. taxable investors to avoid certain adverse tax consequences that would normally apply to passive foreign investment companies ("PFICs").

WHAT IS A SECTION 110 COMPANY?

The Irish Section 110 SPV is based on the provisions of Section 110 of the Taxes Consolidation Act 1997 (as amended). The Irish Section 110 company pays tax at 25% on its profits. However, it is possible to structure the vehicle so that is can use any number of techniques to strip profits on underlying investments. One example is issuing profit participating notes ("PPN"). Since a Section 110 company is taxable in Ireland, it is entitled to Tax Treaty benefits in many countries.

USE OF A QIAIF WITH A SECTION 110 COMPANY

In this structure, a QIAIF will own a Section 110 company. The advantage is that the Section 110 company is entitled to tax treaty benefits; distributions to the QIAIF are not subject to tax in Ireland; and distributions, may be made from a QIAIF tax free even if no tax treaty applies. Section 110 companies need to rely on local legislative exemptions to remit interest to a foreign lender free of withholding tax. The two primary exemptions are through tax treaties or the Euro bond exemption. In contrast, QIAIFs are not subject to withholding on interest or dividends irrespective of who receives the income.

USE OF AN IRISH COMPANY FOR AIRCRAFT LEASING

A standard Irish limited company can be used for aircraft leasing activities and can avail of the 12.5% rate of tax provided it fulfills certain requirements with respect to trading substance. The company can take a tax deduction for tax depreciation (capital allowances) for the cost of equipment and plant and machinery (which includes aircraft and aircraft engines) over 8 years.

IRISH REITs

A real estate investment trust ("REIT") regime was introduced by the Finance Act 2013 to complement the existing regulated fund regime. Broadly speaking, a publicly quoted REIT which meets certain conditions is exempt from tax at a corporate level. The profits of the REIT are instead subject to tax at shareholder level only.

UNITED STATES TAX CONSIDERATIONS

From a U.S. tax perspective two tax regimes have to be considered for Irish investment vehicles: the controlled foreign corporation ("CFC") and PFIC provisions, described below. Also, the ability to claim a foreign tax credit for foreign taxes has to be considered.

CFCs

A CFC is any foreign corporation if more than 50% of (1) the total combined voting power of all classes of stock of such corporation entitled to vote or (2) the total value of the stock of such corporation is owned (or is considered as owned under certain attribution rules) by "U.S. shareholders" on any day during the tax year of such foreign corporation. With respect to a foreign corporation, a "U.S. shareholder" is any U.S. person who owns (or is considered as owning under certain attribution rules) 10% or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation. Notably, a "U.S. person" includes a domestic partnership but not a foreign partnership.

The U.S. Subpart F rules, which incorporate most of the features of CFC rules used in other countries, are designed to prevent U.S. citizens and resident individuals and corporations from artificially deferring otherwise taxable income through use of foreign entities.

The subpart F rules impute certain income to U.S. shareholders. Subpart F income generally includes passive-type income that is perceived as being easily moveable to low-tax jurisdictions. There are multiple categories of income that constitute Subpart F income.

PFICs

Like the CFC rules, the PFIC rules can apply when a fund invests in a foreign portfolio company. Unlike the CFC regime, however, there is no minimum ownership requirement for a foreign corporation owned directly or indirectly by a single minority U.S. person to be considered a PFIC. If a portfolio company is a PFIC, the potential tax consequences to taxable U.S. investors (regardless of ownership percentage) is based on the fact that tax deferral (or the benefit thereof) of the PFIC's income is precluded through an interest charge, phantom income, or through marking-to-market the stock of the PFIC.

A foreign corporation is a PFIC if 75% or more of the gross income of such corporation for the year is passive income or if 50% or more of its assets for the year produce passive income or are held for the production of passive income. For this purpose, "passive income" means income that would be foreign personal holding company income. For example, this would include interest, dividends, and certain rents and royalties. If a PFIC is also a CFC, the foreign corporation will not be treated as a PFIC (i.e., where both the CFC and PFIC regimes apply, the CFC rules trump the PFIC rules). Unlike the CFC regime, a corporation can be a PFIC even if only a single U.S. person owns only a small percentage (e.g., 1%) of the stock of the corporation.

U.S. shareholders in a PFIC can avoid the PFIC regime by making a Qualifying Electing Fund ("QEF") option. By making a QEF option, U.S. shareholders are not subject to the rules described above. Instead each of the U.S. holders will include its pro rata share of the PFIC's ordinary earning and net capital gain in income, regardless of whether the amounts are distributed to the U.S. holder in the taxable year.

The QEF election, however, does not enable the U.S. holder to obtain a foreign tax credit.

Using the Tax Advantages of Ireland to Structure a Fund's Investments *(continued)*

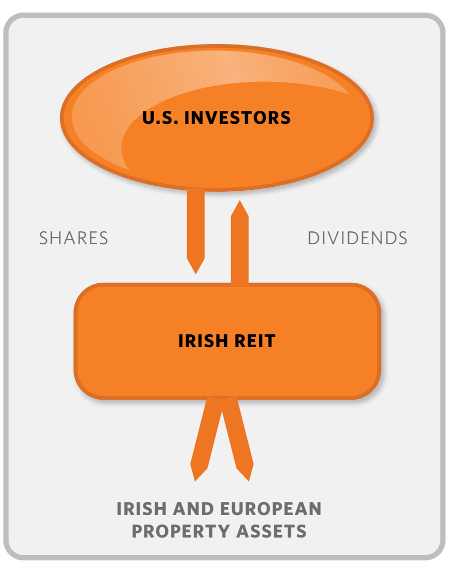
CHECK-THE-BOX ELECTIONS

From a U.S. tax perspective, it is often important to avoid the CFC and PFIC provisions when using an Irish vehicle. This is usually accomplished by using an eligible entity in Ireland which can elect to be transparent for U.S. tax purposes. The other advantage of the check the box election is the ability to use foreign tax credits in the U.S.

Examples of Irish Structures

Example #1: Aircraft & Aviation Assets

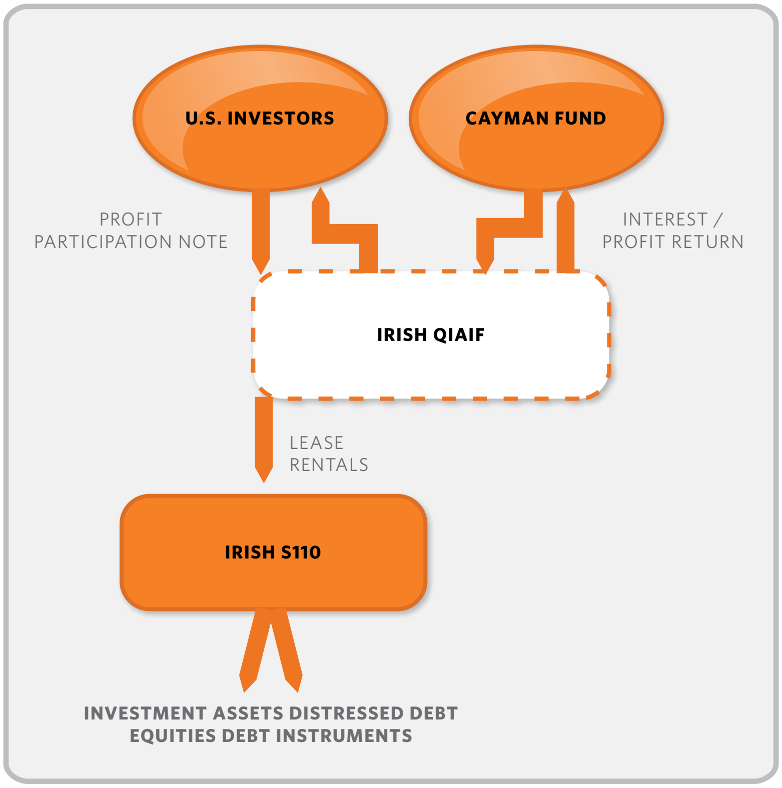
- Irish trading company pays tax at 12.5% on profits from leasing trade
- No withholding tax on interest or dividends paid to investors in the U.S.
- No or reduced withholding tax on lease rentals from jurisdictions with Irish Double Taxation Agreements
- Consideration of whether to elect to treat Irish company as transparent for U.S. tax purposes



Example #2: Real Estate

- No Irish tax on rental income or gains arising to the REIT
- The REIT is an Irish listed entity which will distribute 85% of property related profits annually
- Either exemption from or a reclaim of Irish withholding tax on distributions from the REIT to U.S. resident investors
- The REIT can invest in Pan European property
- Consideration of whether U.S. shareholders in REIT should make a QEF election

Using the Tax Advantages of Ireland to Structure a Fund's Investments *(continued)*



Example #3: Distressed Debt & Financial Assets
(Securitization)

- Profit neutral structure – profit repatriated to investors via PPN
- No substance requirements in Ireland
- Option to utilize a regulated fund as an intermediary between investors and the S110
- Consideration of whether to treat QIAIF as transparent for U.S. tax purposes

CONCLUSION

Ireland provides numerous flexible tax efficient structures for investments, in a stable and clear regulatory environment, where investors, their managers, and structures are serviced by the best talent in the world. From a U.S. tax perspective, Ireland now has a number of vehicles that can be treated as transparent if needed for U.S. tax purposes. ■

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Alternative Asset Managers: Cash Management Landscape in a Post-Basel III World

By Wendy Beer,
Director, Wells Fargo Securities Prime Services

As a result of the 2008 financial crisis, the Basel Committee on Banking Supervision ("BCBS") has proposed standards to provide stability to the banking sector by implementing safeguards that are intended to make banks more resilient in a financial crisis. Specifically, the BCBS, under its capital framework Basel III, has introduced, amongst other things, stricter capital requirements, leverage limitations and liquidity provisions.

IMPACT OF REGULATORY REFORM / LIQUIDITY COVERAGE RATIO

Compliance with new regulations has led banks to withdraw from, or change pricing for, accepting cash deposits from alternative asset managers ("AAMs"). In addition to Liquidity Coverage Ratio ("LCR") guidelines, banks face increased costs relating to compliance activities (such as enhanced know your customer requirements) and Securities Investor Protection Corporation ("SIPC"). AAMs and private equity funds have been left in a position in which many banks are unwilling to hold their cash. Several banks have, in fact, exited the cash management business. This article seeks to provide some background on the current landscape, and highlight some of the solutions that are being presented. At the highest level, AAMs are being forced to either pay higher fees in the form of negative spreads on cash or to accept risks in money market funds and other products rather than holding cash at their prime brokers.

BACKGROUND OF THE RULE

The Federal Reserve adopted the LCR in 2014. The LCR standard will apply in full to U.S. depository institutions and U.S. depository institution holding companies with greater than $250 billion in assets or $10 billion in international exposure. A modified LCR will apply to bank holding companies and savings and loan holding companies that maintain between $50 billion and $250 billion in assets and are not significantly engaged in insurance or commercial activities.

The LCR requires that these institutions hold enough high quality liquid assets ("HQLA") to withstand severe deposit outflows over a 30-day period. LCR, which focuses on the short end of a bank's funding liability side (less than 30 days), aims to improve the banking sector's ability to absorb shocks arising from financial and economic stress.

$$\text{Liquidity Coverage Ratio} \quad 100\% < \frac{\text{Total HQLA}}{\text{Net Cash Outflows over Stress Horizon}}$$

Bank holding companies with more than $250 billion in consolidated assets, or more than $10 billion in on-balance sheet foreign exposure, are subject to the LCR in full with implementation beginning in 2015. Bank holding companies between $50 billion and $250 billion in assets are only required to meet a LCR ratio of 70% and begin implementation in 2016.

WHAT IS CHANGING?

LCR has two parts: (i) HQLA and (ii) Total net outflows based on run-off factors applicable to bank liabilities. Basel III assigns run-off factors to different funding sources. Net outflow assumptions take into account the deposit's main purpose, and depositor type. Deposits can be wholesale or retail. Wholesale deposits (the category at issue for purposes of this analysis) are divided into operational and non-operational sub-categories. Regulators now require that all deposits from non-regulated institutions including investment advisors, investment companies and non-regulated funds are considered non-operational in nature. Operational deposits are subject to a 25% runoff factor. Non-operational deposits are subject to a 100% runoff factor. The regulations assume a 100% run off for all AAM and PE deposits.

WHAT DOES IT MEAN?

Unfortunately for AAMs and PEs, for deposits considered non-operational in nature, the incoming cash is considered "fast outflow money" subject to withdrawal from the banks in the event of a liquidity crisis. As a result, banks are required to hold liquid assets against the cash, which has a cost associated with it. This cost needs to be mitigated by either moving the cash off of the bank's balance sheet or with appropriate fees. This means that for every $1 in finance-related deposits a bank holds, it will be required to hold $1 in HQLA. In this new regime, banks are required to put aside additional lower yielding HQLA in order to support deposits from alternative asset managers. Holding a higher balance of lower-yielding HQLAs to cover these liabilities adversely impacts profits, and may drive prime brokers to re-evaluate the overall relationship and their ability to finance certain client portfolios to ensure that they are holding an adequate ratio of unencumbered HQLA.

HOW ARE BANKS AND AAMs/PEs RESPONDING?

Garret Sloan, Wells Fargo's Fixed Income Market and Portfolio strategy analyst, anecdotally describes a range of responses from AAMs and PEs on what to do with their cash. He said on one extreme, an AAM invests its cash in its own high-yield fixed-income fund. On the other end of the spectrum, he said an AAM invests only in Treasury money market funds and will not consider prime funds or any deposit product, as it is unwilling to accept additional exposure to a bank counterparty. Asset management companies are offering money market funds and other cash investment vehicles as alternatives to cash deposits. Bank deposits are still an option available to AAMs; however, banks have started passing LCR costs on to clients and are generally not offering a spread on balances. Banks are also offering money market sweeps as an alternative to holding deposits on balance sheet. Wells Fargo expects the trend of moving cash off bank balance sheets into money market funds and other investments to increase going forward. Additionally, Wells Fargo expects banks to continue passing on the LCR and increased operational expenses to AAM clients. Having a holistic relationship with a bank will be paramount.

WHAT DOES THE LANDSCAPE LOOK LIKE NOW AND IN THE FUTURE?

The effects of the regulatory climate will continue to change the way AAMs and prime brokers interact. Prime brokers may push out all cash accounts and/or sweep cash into money market accounts. Banks have to consider return on assets ("ROA") in addition to return on equity ("ROE"). With leverage ratios as a constraining factor, banks may need to stop doing business with clients that are not meeting ROA hurdles. AAMs, in turn, will need to better understand their holistic relationship with an organization, considering all elements of wallet share — including non-capital/balance sheet consumptive services such as custody and fund administration as well as execution. Following the financial crisis in 2008, several AAMs sought to diversify their prime brokerage relationships and banking counterparties to avoid a situation where cash was concentrated among a few counterparties. In contrast, today we expect that AAMs will reevaluate prime brokerage relationships more holistically, and potentially reduce the number of counterparties they face in order to be a more meaningful component of wallet-share. Banking institutions that provide a full range of services may be the natural winners as AAMs recognize the need to concentrate wallet share. Banks with healthy balance sheets are able to take on AAM banking accounts as part of a holistic relationship. Increasingly, prime brokers that have cash management capabilities may see more partnerships as AAMs recognize the need to be relevant to banking institutions as a whole. ■

The opinions expressed in this article are general in nature and not intended to provide specific advice or recommendations. Contact your investment representative, attorney, accountant or tax advisor with regard to your specific situation. The opinions of the author do not necessarily reflect those of Wells Fargo Prime Services LLC or any other Wells Fargo entity.

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Fraudulent Returns, Identity Theft, and the IRS

By Mary Ho, CPA

A little while ago, I had a colleague who sent me her wedding invitation by mail, which is not unusual except for the fact that no one gave her my home address. She had wanted to surprise me and so looked me up online! That was a friendly gesture, but in this electronic age of smart phones, e-commerce, data streaming and government-mandated electronic filing of tax returns, do we really know how secure our personal information is? Meanwhile, the federal Office of Personnel Management announced in early July that personal data of 21.5 million federal employees, contractors, applicants and family members was stolen in a massive cyber theft. This is in addition to the 4.2 million files stolen one month earlier.

In late May, the IRS announced that due to a data breach from February through May of this year to its online Get Transcript application system, information of over 100,000 taxpayers was stolen. The system is the online version of a function that the IRS has always provided to the taxpayers. For a fee, if for any reason the taxpayer requires a copy of their previously filed tax return, a transcript of that return can be requested. The transcript does not look like the return but contains all the information that was on the filed return. As a result of the breach, these unknown criminals then created phony accounts and filed approximately 13,000 fraudulent returns with the IRS, successfully claiming up to $39 million in tax refunds.

Each year we hear about massive refund amounts issued for returns that were fraudulent because of identity theft. According to a recent *Wall Street Journal* article that cited the Government Accountability Office, more than $5.8 billion was lost in 2013 because of identity theft related fraud.

The difference between the usual fraudulent returns and the ones filed this year is the breadth of information that was supplied and the breach itself. An identity theft return would typically have a name, social security number and employer information. In the current cases, the returns would also have information such as names of dependents and their social security numbers along with last year's Adjusted Gross Income, and all other information that would be present on the previous year's tax return.

Apparently, the criminals used personal information stolen elsewhere and used that data to access prior year tax information from the Get Transcript system, which enabled them not only to then simulate a credible fraudulent tax return, but also obtain information on the taxpayer's dependents and income sources.

The ease with which this can be done is partly due to the somewhat primitive authentication process that is still being used at the IRS. To obtain a transcript from the IRS of your last year's tax return one would need $50, name, address, date of birth, social security number, and filing status; information that is readily available on the black market. According to a recent Dell SecureWorks report, personal information is sold ranging from $50 - $1,000 per record.

> *According to a recent* Wall Street Journal *article that cited the Government Accountability Office, more than $5.8 billion was lost in 2013 because of identity theft related fraud.*

Taxpayers who have had fraudulent returns filed in their name would either find that they are unable to electronically file their return (as those had already been filed under their social security number), or would receive a letter from the IRS that a return has been received but additional information is required to process the return. In either case, it will be up to the taxpayers to provide proof that they are who they say they are which will include a laundry list of items, signed and notarized.

The case will then be passed along to criminal investigations and, up until late May of this year, the taxpayer has been left in the dark as to what information was stolen that appeared on the fraudulent return, and has little understanding of the extent of the theft that would enable them to take steps to protect themselves and their family. The IRS has cited privacy concerns (of the criminal) but recommends that a credit report be requested from one of the credit agencies like Equifax.

After the recent theft and some very pointed questions from Senator Kelly Ayotte (R-NH) the IRS has agreed to release fraudulent tax returns to the affected taxpayers, redacting information belonging to other taxpayers on the same return such as a spouse. At this time, no procedure has been published to allow taxpayers to make requests. The Get Transcript service is also currently unavailable.

This past May, Senator Ron Johnson (R-WI) introduced a bill, S.1323, the Social Security Identity Defense Act of 2015, that would require that the IRS disclose tax return information to victims of identity theft and assessing a $5,000 penalty against transgressors. The penalty is in addition to any other laws that are also violated.

In the meantime, the IRS and state tax authorities are working in conjunction with tax return software preparers to implement a new return processing system that will include a multifactor authentication system for the 2016 tax filing year. In addition, transmissions of returns will be reviewed for repetitive use of IP addresses among other steps to help flag suspicious return filings. All this while the House Appropriation Committee is proposing to cut the IRS budget by 8% for the fiscal year 2016. ■

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FASB Issues Updated Disclosure Guidance for Investments in Entities That Use NAV per Share as a Practical Expedient

By Ari Samuel, CPA

BACKGROUND

Under the FASB Accounting Standards Codification Topic 820, *Fair Value Measurements*, an entity is permitted, as a practical expedient, to measure fair value of certain investment at Net Asset Value ("NAV"). Under existing guidance, investments which are valued using NAV as a practical expedient are categorized within the fair value hierarchy based on whether the investment is redeemable at NAV on the measurement date (Level 1), never redeemable at NAV (Level 3), or redeemable at NAV at a future date. For investments that are redeemable at NAV at a future date, current guidance requires entities to take into account the length of time until those investments become redeemable to determine whether to categorize those investments in Level 2 or Level 3. To the extent future redemption dates are not in the "near term," those investments are categorized in Level 3. The FASB noted that there is diversity in practice as to how entities defined near term. To resolve this diversity, the FASB issued ASU 2015-07 *Fair Value Measurement: Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)* (the "ASU").

KEY CHANGES

The ASU removes the requirement to categorize within the fair value hierarchy investments for which fair value is measured using NAV as a practical expedient. By removing the requirement to categorize within the fair value hierarchy, the FASB eliminated the diversity in practice among entities of the categorization of investments with future redemption dates. This change also has the added benefit that all investments that are categorized in the fair value hierarchy are done so on a consistent basis, as using the NAV as a practical expedient does not consider the observability of the inputs. Investments that calculate the NAV per share but for which entities do not use the practical expedient will continue to be required to be categorized in the fair value hierarchy.

Although the ASU does not require the classification of investments measured using NAV within in the fair value hierarchy, sufficient information must be presented in order to permit the reconciliation of the fair value of assets that are categorized within the fair value hierarchy to the amounts presented on the statement of financial condition.

The ASU also will require entities to continue to disclose information that helps users understand the nature and risks of investments measured using NAV as a practical expedient. The required disclosures include:

- The fair value of the investment by class,
- A description of the terms and conditions which an investor may redeem the investment (such as lock-up periods and notice requirements), and
- Information on significant restrictions on the ability to sell the investment

The ASU removes the requirement of the above disclosures for investments that calculate NAV per share but for which entities do not use the NAV as a practical expedient.

TRANSITION

The ASU is effective for public entities for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years. For all other entities, the effective date is for all fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. As the ASU is required to be adopted retrospectively, the categorizations of level within the fair value measurement should be removed for all periods presented in the financial statements. ■

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Alternative Investment Industry Outlook for Q3 and Remainder of 2015

By Elana Margulies

INTRODUCTION

With hedge funds overall outperforming (as calculated by the Hedge Fund Research Index) the first half of 2015 despite navigating extremely choppy markets in June and July, especially those with exposure to Greece, China and Puerto Rico, a range of investors, both institutional and individual, are expected to capitalize on their positive returns and deploy more capital to this alternative investment the second half of the year. Pensions, endowments and RIAs are amongst those slated to be most active as they continue to transition from long-only mandates to long/short equity ones; and additionally, multi-strategy offerings, commodity trading advisors ("CTAs") and equity market neutral portfolios are a few options that also appear to be poised for inflows from those allocators. Further, there continues to be interest in emerging hedge fund managers, especially women and minority-owned ones (typically known as women and minority business enterprises or WMBEs), from both institutions and seeders actively looking to fund them. Meanwhile, investors are also anticipated to demonstrate continued interest on the private equity side, especially after managers in this space have outperformed in all market conditions.

INVESTOR OUTLOOK

Pensions, endowments and RIAs are eyeing multi-strategy portfolios, CTAs or market neutral offerings, all for different reasons, according to Richard Taglianetti, managing director, Corinthian Partners, who specified that multi-strategy managers are appealing for diversification, CTAs are attractive because they show low-to-negative correlations to traditional asset classes and commodities over the last ten years, and equity market neutral is in favor as everyone awaits a less accommodating Fed. All three strategies seek uncorrelated, absolute returns. "Ten years ago if asked to name the top ten investors, nine of ten would have been long-only," he said. "Today, that's reversed. Alternatives continue to grow."

A survey released by Altegris Advisors at the end of June confirmed that institutional and high net worth investors are bullish on alternatives, with 66% of respondents confirming they intend to boost their allocation the second half of the year.

WMBE

Institutional investors and seeders continue to express interest in WMBE funds, whether through a fund of hedge funds ("FoHF") vehicle made of up them or via a direct hedge fund investment.

Erik Serrano Berntsen, CEO, Stable Asset Management, a fund seeding firm with offices in London, New York and

A survey released by Altegris Advisors at the end of June confirmed that institutional and high net worth investors are bullish on alternatives, with 66% of respondents confirming they intend to boost their allocation the second half of the year.

San Francisco, said he is currently looking to seed women-owned managers.

"There is significant research and certain anecdotal evidence that female managers perform better than male managers in certain strategies and during certain market conditions," he said. "We believe that by definition a female manager in a portfolio would bring diversification if their approach is differentiated."

Pensions & Investments a few months ago reported that a number of pensions allocated to a number of women or minority-owned FoHFs, including New York City Retirement Systems, New York State Common Retirement Fund and Connecticut Retirement Plans & Trust Funds. It also revealed that a number of FoHFs specifically look to allocate to WMBEs including Appomattox Advisory and the Rock Creek Group.

PRIVATE EQUITY

On the leveraged buyout side, following the stellar performance of 2014, investors continue to be eager about the prospect for managers in this more illiquid alternative investment type.

Harold Zlot, investment committee member for the San Francisco-based Jewish Community Federation and Endowment Fund, said the private equity and venture capital investments were amongst the best-performers in their portfolio. Therefore, he continues to be bullish on these longer-term alternative investments. "I think the reason private equity and venture capital added so much value to the total portfolio was that they had long dated investments in these spaces which given the hot IPO market the past few years they have been able to pay off," he said. "Going forward, who knows, but I would guess there are other positions that might have a big payoff—Airbnb, Uber, etc."

CONCLUSION

If investors continue to be positive on alternative investments going forward—both hedge funds and private equity—and, more specifically, initiate WMBE mandates, managers overall are poised for robust inflows. That's if these funds continue to navigate the very choppy markets across three continents. ■

Elana Margulies is a senior manager in EisnerAmper's Financial Services Group. Questions? Contact Elana at elana.margulies@eisneramper.com or 212.891.6977.

To Tweet or Not To Tweet — A Regulatory Perspective

By Carmine Angone

INTRODUCTION

With the explosion of social media around the world, it is no wonder it has caught the attention of almost every regulatory body. Social media (Linkedin, Twitter, Facebook, etc.) has become so widely used that it is now the way many individuals communicate with each other and cuts across the socio-economic and generation gaps from Baby Boomers and Gen Xers to Millennials. Social media is also becoming more widely accepted in the financial services world, especially in selling activities and getting the word out as to the capabilities of investment advisers, wealth managers, broker-dealers, et al. to a broad group of potential prospects in a very cost-effective way. This type of communication raises the bar for misrepresentation and fraud in an area that had not been addressed by regulators and legacy enterprise risk management programs until recently. Social media has been responsible for wide-spread fraud through fraudulent stock market and other postings that have had a negative impact to company brand recognition.

In this ever-changing environment, and at the speed with which social media is expanding, how does management keep up with, monitor and manage its social media risk?

MANAGING SOCIAL MEDIA RISK

For an investment adviser or broker-dealer, managing social media is somewhat of a daunting task as there are many areas of vulnerability and regulatory concerns—yet they are required to do so under SEC and FINRA directives.

Some of the regulatory inflection points start with antifraud considerations. For example, financial services firms, law firms, merger and acquisition departments within financial service firms and even publicly traded companies must consider the impact of the unauthorized release of proprietary and insider information that could lead to an SEC claim of insider trading. These firms would not be able to avoid the potential impact of postings of information without authorization or employees misrepresenting themselves and their firm's investment advisory capabilities, for example, or broker-dealer sales staff making false claims of safety or "ensuring" either investment performance or a secure retirement life when seeking retail prospects. While many of these types of disclosures are appropriate, they must be accompanied by disclosures and/or disclaimers and approved by the firm. Employees of publicly traded companies who disclose confidential financial information in advance of a company announcement potentially trigger both a claim of insider trading and Regulation Fair Disclosure ("FD") infractions. Regulation FD requires a simultaneous release of information by the company when a person acting on its behalf discloses material non-public information. In this instance, if the employee releases the information by posting to Linkedin or any other social media site, there is no technology process, procedure or control that can prevent or even notify the subject firm of such posting, other than a company official responsible for compliance being "friended" or somehow connected to that given employee (which, essentially, means the compliance officer would need to monitor every employee in the company) for that site. This is not a manageable solution without some form of social media software to detect these unauthorized disclosures. Even if they are detected, it may be impossible to officially release the information in line with SEC expectations.

In addition, social media communications could potentially result in impermissible general solicitation of private placement Regulation D offerings or gun-jumping the market in advance of a public offering. General solicitations could result in a discontinuance of the private offering in a cooling-off period and a rescission of sales

To Tweet or Not To Tweet – A Regulatory Perspective *(continued)*

during the period. Instances where a private offering is being made in reliance on 506(c) could have adverse impact with 502 offerings within a 6-month window; triggering integration issues that can disqualify the 506(c) offering if the timing of the release of information deemed to be prospectus general solicitation information is premature.

One the most common areas of concern that triggers a regulatory reaction that all investment advisers deal with is whether certain disclosures are, or can be deemed to be, a testimonial. Any language disseminated by an adviser that, directly or indirectly, relates to a testimonial is explicitly verboten under Rule 206(4)-1. The Rule also references untrue or false representations and to omit information that would make other statements made not misleading, in light of the circumstance in which such statements were made, as well as past specific investment recommendations without adding additional disclosures, referencing the use of a chart to buy and sell securities unless disclosing the limitations of the chart or formula, among many of the other requirements.

The previous represents some of the regulatory issues, but certainly not an exhaustive list of scenarios, that can arise when social media is inappropriately used in a financial services business context. This can present both regulatory and headline risks that a financial services firm must avoid to perpetuate its growth.

WHERE DOES THE SEC STAND ON SOME OF THESE REGULATORY MATTERS?

As in most conflicts of interests between advisers and its clients or potential clients, it is the SEC's view, as expressed in various pronouncements, that as long as there is a process to address the conflict of interest and that process mitigates the conflict to an acceptable level where the client or prospective client is or may not be adversely affected, then publicly made commentary about an adviser and its capabilities to reasonably ensure that inappropriate language is not posted on social media sites should not be problematic. When commentaries go undetected is when there can be a devastating downstream regulatory response.

What would constitute a reasonable process is an ongoing active means of monitoring to detect potential damaging disclosures posted on public websites, which would entail an active review process memorialized in the adviser's SEC Rules 206(4)-7 or 38a-1 compliance programs and a broker-dealer's written supervisory procedures that makes use of both technology and in-house compliance oversight. ■

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