EisnerAmper
ACCOUNTANTS & ADVISORS

EisnerAmper LLP
Accountants and Advisors

www.eisneramper.com

May 2015

Asset Management Intelligence

A publication from The Financial Services Group

Ireland — The Home of Alternative Investments

by Ray Kelly, Partner, MKO Partners

I was talking recently to a Dublin-based client who is an asset manager for a large U.S. private equity firm. I asked him what drove him to set up in Ireland – why are he and his firm in Ireland? His answer surprised me. "It wasn't in the plan," he replied. "I came to buy assets; I stayed for the Irish welcome."

In this article, I will set out certain market trends that are helping Ireland develop as the location of choice for private equity asset managers.

IRELAND SERVING HEDGE FUNDS AND STRUCTURED PRODUCTS

Within the alternative investment universe, Ireland has long been recognized as a leading location for hedge funds and structured products.

The Irish funds industry has been phenomenally successful over the past 25 years in the domiciling and administration of hedge funds. In fact, over 40% of global hedge fund assets are serviced in Ireland, making it the largest hedge fund administration center in the world and Europe's leading hedge fund domicile.

In addition, for over two decades, Ireland has had a tax regime, known as Section 110, designed to ensure that special purpose vehicles ("SPVs") may be established in a tax-neutral manner. Together with the country's extensive tax treaty network with over 70 countries, this has meant that Ireland is highly regarded as the location of choice for international arrangers for the establishment of SPVs for CDOs, CLOs, distressed debt, repackaging, RMBSs, U.S. life settlements, and other structured finance transactions.

OPPORTUNITIES IN PRIVATE EQUITY EMERGING FOR IRELAND AS A RESULT OF THE FINANCIAL CRISIS

The financial crisis immensely impacted Ireland's economy, resulting in the collapse of the banking sector and causing property prices to fall by more than 50%. This created opportunities for a number of the largest U.S. private equity managers who have since been actively purchasing real assets and distressed debt in the Irish market.

As recovery begins to take hold these private equity investors are exiting their Irish investments. The country's investment community is now focused on ensuring that these investors continue to use Ireland as a location for domiciling and servicing their global private equity investment strategies. There are also certain market trends observable at present which point to this being an opportune time for Ireland to leverage its hedge fund and structured finance expertise to develop as the leading location for private equity.

TREND #1: MOVE TO REGULATED JURISDICTIONS

Since the financial crisis, demand for regulated, onshore funds has been growing strongly and this trend is expected to continue as regulatory changes such as the Alternative Investment Fund Managers Directive and Dodd-Frank are fully implemented.

TREND #2: CAPITALISE ON EU INITIATIVES TO PROMOTE NON-BANK FINANCE

The EU has developed frameworks such as the European Venture Capital Fund ("EuVECA") and the European Long Term Investment Fund ("ELTIF") and is currently consulting on a strategy to develop a Capital Markets Union within the EU. The Commission's Capital Markets Union Green Paper singles out private equity as a target area for future growth which would benefit from a more harmonized EU framework.

TREND #3: COMBINED STRATEGIES

Increasingly, hedge fund managers are seeking to adopt private equity strategies into their portfolios, also known as "hybrid strategies."

IRELAND'S RESPONSE TO THIS OPPORTUNITY

In response to this opportunity, the investment community in Ireland has been working hard to ensure that the country meets the needs of private equity managers. For example, the Irish Funds Industry Association has recently established a private equity committee to engage with the industry and government to identify areas for development.

Another example of this commitment to the alternative investment industry is the recently published Irish Collective Asset-Management Vehicle ("ICAV") Bill 2014 that has been welcomed by global fund promoters and, in particular, private equity firms.

The ICAV is being created in response to both industry and investor demands for a fund-specific vehicle that reduces the administrative burden on investment funds and provides a tax effective structure for U.S. investors. A distinct advantage of the new ICAV is that it will be considered to be an "eligible entity" for U.S. tax purposes, whereby it can elect to "check-the-box." This is an important feature for U.S. investors and is a common feature of offshore fund structures, such as Cayman master-feeder funds. If a check-the-box election is made, the ICAV will be considered to be a tax transparent entity for U.S. federal income tax purposes, which, in some circumstances, can produce better results for U.S. taxpayers.

CONCLUSION

The opportunity for Ireland lies in developing the Irish welcome that my client received while continuing to respond to the needs of the global private equity industry. U.S.-based alternative managers considering their global investment structuring and servicing requirements will view Ireland as a domicile that is enthusiastic about helping them to grow their business. Already viewed as a leading location for hedge funds and structured finance, I expect Ireland to develop as a leading location for private equity managers in the coming years and cement its reputation as the home of alternative investments. ■

Ray Kelly is a Partner at MKO Partners (www.mko.ie). Questions? You can contact Ray at +353 1 2933449 or ray.kelly@mko.ie.

The New (and Difficult) Environment for Emerging Managers

By Richard S. Heller, Partner, Thompson Hine LLP

Although emerging hedge funds have, on average, the best alpha during their early years, they find it more difficult than ever to raise capital. There are numerous challenges that they face today that pre-2008, did not exist.

MARKET CONDITIONS

In the Dow, S&P and other trading platforms today, volatility in the market place has begun to set off alarms in the institutional and retail investor world. This was not helped by CalPERS' withdrawal from its hedge fund positions. Indeed, nearly every category of potential investor has begun to retreat from alternative investments because the prevalent question they seem to be asking is not if but when the six-year run-up in the present bull-market will end. Family offices have begun to hedge their portfolios by moving significant portions of their assets into cash. Hence, money that might have been available from these investors has evaporated.[1]

INFRASTRUCTURE AND COMPLIANCE

Due to increasing due diligence demands, emerging managers must be able to do more with less. Oftentimes, they are run by two or three people who may have a chief investment officer and chief operating officer. Indeed, the vast majority of the 8,000 funds that exist today are actually small businesses.

Because of Dodd-Frank, absent self-perfecting exemptions, they must now register as state registered investment advisors ("RIAs") and have robust conflicts and procedures manuals in place. With their typically small staff, not only do they need to make savvy investments that set them apart from their competition, they need someone to act as their in-house chief compliance officer (frequently the manager) who needs to ensure their manual is strictly adhered with. This is in addition to marketing the fund.

The New (and Difficult) Environment for Emerging Managers *(continued)*

To further complicate matters, the SEC's Office of Inspections and Exams ("OCIE") has increased its staff to enable it to visit over 1,400 RIAs (which will impact funds that are SEC registered). The OCIE will be reviewing a fund's private placement memorandum, limited partnership agreement, subscription agreement and LLC operating agreements as well as the fund's marketing materials. To ensure consistency, all the documents must be updated to ensure they're each saying the same thing. While this may sound easy, given the above-described numerous responsibilities a manager may have, it is not. More often than not, the OCIE has found that the marketing materials have been kept current while the other documents have not.

The SEC has recently announced that funds must establish robust cybersecurity systems. While there is no "magic bullet" that a fund can buy, there are numerous IT firms that offer services to combat the latest threat. In the context of this discussion, however, it is yet another added cost that an emerging manager needs to deal with.

POTENTIAL OPPORTUNITIES FOR EMERGING MANAGERS

While the discussion thus far has focused on the numerous obstacles emerging managers face, there are ways to deal with each problem.

First, hiring good professionals is key to attracting capital. The pedigree of a fund's counsel, accountants, prime brokerage relationships, administrator and third party consultants is key to launching a fund. In today's environment, when investors are doing their due diligence, the first thing (among many DDQ issues) they see are those providers. In addition, having fulsome term sheets are critical to that "first look" an investor sees. Because these are so many investment opportunities, having something that distinguishes your strategy and potential for success makes those choices critical at the outset of a fund's inception.

Next, an analysis of whether a launch in the Caymans, British Virgin Islands or Bermuda (an increasingly friendly jurisdiction) is something a manager should look at. Does a domestic stand alone fund suffice or should a master feeder approach offer the manager more flexibility to attract investors? Indeed, many emerging managers have contacts overseas in Europe, Asia or Latin America; it is not unusual to pursue an offshore fund in advance of starting a domestic fund.

Another factor not to be overlooked is the "friend and family" approach. Because a fund's track record over its first six months is so important, launching a fund with a de minimus amount "assets under management" ("AUM") is, in the long run, not as important as starting that six month track record. If a manager can "knock it out of the park" for its first two quarters, it will be easier to pitch to family offices and other major investors.

Another opportunity for emerging managers is the JOBS Act (Rule 503(c) offering). While that Act is presently being revised, it is currently available to funds who wish to put their materials on-line for anyone to view (as long as a timely filing is made with the SEC and actual sales are made only to accredited investors).

So, despite the challenges enumerated above, if a fund manager believes he or she has a product that is worth pursuing, obstacles can be overcome. Don't forget even the most successful funds had to start with humble beginnings! ■

Richard Heller is a Partner in Thompson Hine's Corporate Transactions & Securities and Investment Management practices as well as its Family Office Services group. (www.thompsonhine.com) Questions? You can contact Richard at 212.344.5680 or richard.heller@thompsonhine.com.

1. Note this is not the case for private equity deals. Because of the very nature of their long-term investment, PE funds have become more attractive than ever before.

New Consolidation Guidance Addresses Concerns of the Investment Management Industry

By Todd Hankin, CPA and Matthew Maulbeck, CPA

BACKGROUND

The consolidation analysis required under existing Generally Accepted Accounting Principles ("GAAP") is complex and often results in general partners having to consolidate investment funds that they manage even when they hold a small equity stake and direct the significant activities of the fund primarily on behalf of investors. Stakeholders have expressed dissatisfaction with this consolidation model, asserting that in many instances, deconsolidated results would provide users of a reporting entity's financial statements with information that better reflects the financial position and performance of the entity.

In response to those and other concerns, the Financial Accounting Standards Board ("FASB") has issued Accounting Standards Update No. 2015-02 Consolidation: Amendments to the Consolidation Analysis (ASU 2015-02) which, among other things, introduces changes to the consolidation model which will likely result in fewer instances of consolidation of investment funds by general partners and managing members.

THE NEW MODEL FOR EVALUATING LIMITED PARTNERSHIPS (OR SIMILAR ENTITIES) FOR CONSOLIDATION UNDER ASU 2015-02

Variable Interests

The first step in determining whether a general partner needs to consolidate a limited partnership or similar entity is to determine whether the general partner holds any "variable interests." Generally speaking, a variable interest is a contractual, ownership, or other interest that changes with changes in the fair value of the entity's net assets. Under existing GAAP, a general partner would often conclude that its equity interests in the limited partnership it manages and certain fees, such as incentive and management fees, are variable interests. ASU 2015-02 reduced the number of conditions that must be met in order to conclude that a fee paid to a decision maker

KEY CHANGES AFFECTING LIMITED PARTNERSHIPS AND SIMILAR ENTITIES

1. More limited partnerships (or similar entities) are likely to be considered variable interest entities ("VIEs"); however, it is less likely that the general partner of such entities will be required to consolidate them.

2. The presumption in current GAAP that a general partner should consolidate limited partnerships and similar entities that are not VIEs (currently ASC 810-20 and formerly known as EITF 04-5) is eliminated.

3. Limited partnerships that are considered voting interest entities would not be consolidated by the general partner.

4. The deferral of ASU 2009-17 (often referred to as the "FAS 167 deferral") is eliminated.

is not a variable interest; it retained the following three criteria in making this determination: a) whether the fees are commensurate with the level of effort required for the services provided; b) whether the general partner has any direct or indirect interests in the limited partnership that absorb more than an insignificant amount of the entity's variability; and c) whether the arrangement includes customary terms only. We expect that this change will result in fewer fee arrangements being considered variable interests.

Variable Interest Entities

Next, a general partner must determine whether the entity being considered for consolidation is a VIE. Under ASU 2015-02, limited partnerships and similar entities are classified as VIEs unless a simple majority (or lower threshold) of limited partners with equity at risk lack substantive kick-out rights (including liquidation or participation rights). As a result, a greater number of limited partnerships and similar entities in the investment management industry are expected to be evaluated for consolidation as VIEs under the new guidance.
If the limited partners or investors in similar entities have substantive kick out rights or participating rights, the entity is a voting interest entity. Under ASU 2015-02, a general partner would not consolidate a limited partnership that is a voting interest entity.

Primary Beneficiary

Once the determination has been made that the general partner holds variable interest(s) in the limited partnership under consideration for consolidation and that the limited partnership is a VIE, the final step is to determine whether the general partner is the primary beneficiary.

THE EFFECT OF FEE ARRANGEMENTS ON THE PRIMARY BENEFICIARY DETERMINATION

An entity is considered the primary beneficiary of a VIE if it has both (1) the power to direct the activities of the VIE that most significantly affect performance and (2) the obligation to absorb losses of and the right to receive benefits from a VIE that could potentially be significant to the VIE.

In an attempt to reduce the frequency with which investment management firms are required to consolidate the limited partnerships they manage, ASU 2015-02 excludes from the analysis of (2) above fees that are both customary and commensurate with the level of effort required for the services provided. In other words, compensation arrangements such as management fees and carried interests/incentive allocations will no longer be considered variable interests if they include only customary terms and are at market rates. Accordingly, under ASU 2015-02, the primary beneficiary determination will focus almost entirely on the extent to which the general partner and related parties hold equity investments in the partnership being analyzed for consolidation.

THE EFFECT OF RELATED PARTIES ON THE PRIMARY BENEFICIARY DETERMINATION

Under the new guidance, an investment management firm considers its own direct interest(s) together with any indirect exposure through related parties on a proportionate basis when evaluating whether it is required to consolidate a limited partnership or similar entity. This is a significant change from current practice, in which a reporting entity must evaluate indirect exposure through related parties as if those interests are its own (i.e., not on a proportionate basis).

ASU 2015-02 retains the existing related party analysis if the reporting entity and its related party are under common control, in which case the reporting entity must consider the interests of the related party under common control as its own (i.e., not on a proportionate basis) when analyzing whether it is required to consolidate a limited partnership or similar entity. For purposes of this analysis, common control refers to subsidiaries controlled (directly or indirectly) by a common parent, or a subsidiary and its parent.

TRANSITION

ASU 2015-02 is effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. For all other entities, it is effective for fiscal years beginning after December 15, 2016. Early adoption is permitted. Importantly, upon adoption of ASU 2015-02, a reporting entity is required to reevaluate all previous consolidation decisions under the revised consolidation model. An entity may apply the amendments in ASU 2015-02 using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the fiscal year of adoption or may apply the amendments retrospectively. ■

Todd Hankin and Matthew Maulbeck are Partners with EisnerAmper. Questions? Please contact Todd at todd.hankin@eisneramper.com, 415.357.4216 or Matthew at matthew.maulbeck@eisneramper.com, 212.891.6039.

Alternative Investment Industry Outlook for Q2 and Remainder of 2015

By Elana Margulies

INTRODUCTION

Following strong performance and resumption in investor inflows in the first quarter, EisnerAmper spoke to a number of asset management professionals to get their perspective on what's in store for the alternative investment industry this quarter and the remainder of the year. Consultants, investors and managers shared their predictions on allocator activity, strategies slated for best performance and what will happen with fees.

INVESTOR STANCE: COLLEGE AND UNIVERSITY ENDOWMENTS

Investors, specifically the largest endowments, are expected to continue to increase their allocations to alternatives, which will ultimately trump traditional investments in their portfolios. The renowned NACUBO-Commonfund Study of Endowments® ("NCSE") published earlier this year, which tracks data from over 800 colleges and university endowments on their investments and performance, confirmed that they are migrating from the new 60/40 model with 60% in traditional investments and 40% in alternatives to the *new* new 60/40 model with 60% in alternatives and 40% in traditional investments.

"It has totally shifted in the last nine years or so," said Cathleen Rittereiser, co-author of *Foundation and Endowment Investing* and Founder of Uncorrelated, LLC, an "act tank" focused on educating institutional investment leaders. "What it means is they are looking for good quality managers."

Rittereiser elaborated that higher education endowments have shown a bias toward long/short equity managers, especially with an interest in the handful of former Ziff Brothers Investments money managers who spun out their own hedge funds. Additionally, she said colleges and universities continue to demonstrate interest in activist funds and selectively, if they have an expertise in credit, structured credit.

STRATEGY SPOTLIGHT: FOHFs FAVOR EQUITIES AND EVENT-DRIVEN

College and university endowments are not the only investor type with their eye on equities and event-driven managers. Fund of hedge fund ("FoHF") managers also appeared to express an interest.

Michael Dubin, managing director, Silvercrest Asset Management Group, a New York-based $18 billion registered investment advisor, $2 billion of which is in alternatives, said the firm is also looking at long/short and event-driven managers.

"In an economic environment when there is not a lot of growth of top line, there is a lot churning going on, mergers and acquisitions, spinoffs, etc., so that is one positive area," he said.

He added that U.S. and European equities present attractive investment opportunities due to the price-to-earnings ratio.

Another FoHF manager in Connecticut said he prefers long/short and event-driven opportunities in Europe over the U.S.

"We think toward the end of year and early next year, they are behind the U.S. in terms of an event-driven cycle which will be an attractive investment opportunity," he said.

Regarding European long/short, he argued the alpha potential is higher because valuations are cheaper. Less mainstream strategies expected to garner interest include RMBSs and other mortgage strategies in both the agency and non-agency space.

FEES: TOP PERFORMERS TO DEFEND THEIR FEES, DESPITE INVESTOR PUSHBACK

Despite investors continuing to press funds to lower their fees on the heels of last year's sub-par returns, fees are expected to go to up for the best managers. And top performers will continue to defend them.

"I think that the best managers will continue to command a strong fee structure," said James Shelton, CIO of Kanaly Trust Company in Houston. "I just don't see a lot of real success in bringing that down and in fact, we tell clients all the time that we want to pay a higher portion of the fee and performance fees because that means we're typically doing pretty well, so if you are adding value, you are going to be paying the fees and I can't do anything about that." Alternative investment data provider Preqin's I*nvestor Outlook: Alternative Assets H1 2015* confirmed that fees are one of the top two issues for both hedge fund and private equity investors this year with over 60% of respondents indicating that management fees can be improved.

CONCLUSION

If the larger college and university endowments continue migrating toward the new 60/40 model, the alternative investment industry will reap the benefits of new inflows, in particular long/short equity hedge fund managers and event-driven ones. If FoHFs follow through on their anticipated outlook, they will also help boost the growth in those strategies, both in the U.S. and Europe. And finally, the industry should brace itself for the debate on fees to continue as managers are expected to defend them on the heels of pushback from investors.

GLOBAL ECONOMIC OUTLOOK

Renowned economists from Wall Street's top investment banks who wished to remain anonymous said they were bullish on the global economic outlook, pointing to a few indicators. The U.S. unemployment rate has dropped the last few years to 5.5% as of March from its high of 10.0% in October 2009. And further, on the top of employment, unfilled job openings were at an all-time high of 5.1 million as of the end of February, the highest level since January 2001. Also, Europe will benefit from lower interest rates and its Quantitative Easing program. ■

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

State Income Taxation of Cross-Border Asset Management Services

By Stephen Bercovitch, J.D.

As institutional investors increase their allocations to non-traditional investment vehicles, the states are taking notice. There are state income tax issues that lurk just below the surface which include the treatment of sourcing and destination of asset management services rendered to alternative investment vehicles other than mutual funds (regulated investment companies or "RICs").

THE SOURCING OF SERVICES — HISTORICAL BACKGROUND AND CONTEXT

As a general matter, the attribution of receipts for state income tax purposes from sale of services raises both tax policy and practical questions. The tax policy question is whether the taxing state should be the market state of the services and not the production or performance state. The practical matter relates to the "location question" — what is the location of the taxable service when the source income-producing activity is in one state, and the benefit or destination of the service is in one or more other states. Asset management services that are performed in one state, where the ultimate beneficiaries of the advisory services are located in multiple different states, raise state income tax issues unique to the industry.

These vexing questions were not always present. In the mid-1960s, when the states developed methods of apportioning the income of multi-state enterprises, the state that imposed the income tax on services and the location of the services were one and the same. Services were generally localized — among others, consulting services, repair services and other professional services were performed almost always in the same state jurisdiction as the state where the benefit or delivery of the service was received; and, there was a single recipient. Thus, the inclusion of a taxpayer's receipts from the performance of a service never raised a location issue.

In that era, most states rested their apportionment methods on three factors — property, payroll and sales. The presence of 'brick and mortar' manufacturing and retail afforded a tangible basis for imposing a state income tax based upon the physical location of property and payroll. The migration over the years to a service economy, compounded with the advance of technology and advent of the Internet commerce, has resulted in a sea change in the way that services are rendered. It is no longer expected that the income-producing activity be located in the same state where the benefit of the service is received. One of the most outstanding examples of an impacted industry in this setting is asset management services.

HOW THE RULES HAVE CHANGED — "FACTOR PRESENCE" NEXUS AND APPORTIONMENT

Since 2011, a taxpayer is also deemed to be "doing business" in California if it meets the "factor presence" test. That test — which applied to taxpayers as a whole but not explicitly to asset management services — specified that a taxpayer is doing business if its sales, property, or payroll in California exceed 25% of its total sales, property or payroll; or if the taxpayer's

State Income Taxation of Cross-Border Asset Management Services *(continued)*

sales, payroll, or property exceeds one of the following applicable amounts: $529,562 in sales, $52,956 in property, and $52,956 in payroll, respectively, for 2014 (these amounts will be adjusted each year for inflation). Then in 2014, the Franchise Tax Board's ("FTB") proposed regulation amendments added examples of factor presence specific solely to the assignment of receipts derived from asset management services rendered to non-RICs. Assuming formal adoption of these examples, the FTB plans to make the change applicable to taxable years beginning on or after January 1, 2015.

The examples to the proposed regulations provide that these receipts are assigned to the *domicile of the shareholders, beneficial owners, or investors* in a non-RIC entity (i.e., pension plan, retirement plan, limited partnership, hedge fund, private equity fund, or other alternative investment vehicle). Further, if such domicile cannot be determined, then domicile may be "reasonably approximated." The FTB considers the California population to be a reasonable approximation. Accordingly, where the ultimate beneficiaries, shareholders or investors are nationwide, the ratio of California population over total U.S. population is reasonable. California has approximately 38 million residents, or 12% of the population of the United States.

This means that if an entity is providing asset management services, and it cannot otherwise determine the actual domicile of the ultimate beneficiaries or investors, then — based on "factor presence" criteria — an entity with either 25% of its total fees, or with $4,413,017 of receipts and applying a reasonable approximation (i.e., California population over total U.S. population, or 12%), would have over $529,562 sourced to California and thus, beginning with 2015, may have a filing requirement regardless of the absence of other in-state activity.

The novelty of market-based sourcing, the absence of a consensus in theory regarding the location where the benefit or delivery of a service might occur, and the advent of the ever-broadening variety of dissimilar situations impacted, coupled with the pressures on the states to generate revenue and correspondingly aggressive views on income tax nexus, have created an abundance of practical challenges that are here to stay. Many of these issues will be litigated in the coming months and years. It's incumbent upon fund managers and their advisors to stay abreast of developments, and, within reason, to comply with state income tax requirements without at the same time creating unnecessary state income tax costs.■

Stephen Bercovitch is a Tax Director with EisnerAmper LLP. If you'd like more information, you can contact him at 347.735.4611 or stephen.bercovitch@eisneramper.com.

Insider Trading: More Confusion or Clarity?

By Carmine Angone

With all the recent headlines related to insider trading, one would think that there would be a clear picture of what constitutes insider trading. This has always been a nagging question, especially for SEC regulated firms providing advisory and brokerage services in exchange for a fee. The source of frustration intensifies because guidance must be provided to employees through written procedures that contain controls to ensure a violation of federal securities laws does not occur. This is difficult when there is confusing, at best, guidance provided by the very same regulatory agency mandating these procedures and a process for ensuring compliance with procedures or face censure, fines, or even worse, an enforcement proceeding. This raises two nagging questions:

1. What is the source of confusion?

2. What can be done to ensure your firm is not caught up in an insider trading scandal?

A primary source of confusion is the often conflicting opinions issued by courts hearing insider trading cases, many of which have been brought by United States Attorney in Manhattan, Preet Bharara. Mr. Bharara has a track record of securing 85 convictions and guilty pleas from traders, analysts and industry consultants. One of his most prominent cases was:

- Anthony Chiasson and Todd Newman, co-founders of Level Global Investors, were convicted on charges stemming from being the two most-senior Wall Street traders in an eight-member "criminal club" that traded shares of Dell Inc. and Nvidia based on corporate secrets, and received 6- and-a- half years apiece.

In a turn of events late in 2014, the United States Court of Appeals for the Second Circuit issued a landmark opinion overturning the insider trading convictions relating to the insider trading in Dell and Nvidia stock. It also rendered a view that would cast a pall over what constitutes insider trading.

The Second Circuit's landmark opinion reversing Newman's and Chiasson's convictions effectively narrowed the scope of insider trading liability. The court held that the Newman Chiasson "jury instruction was erroneous because … in order to sustain a conviction for insider trading, the Government must prove beyond a reasonable doubt that the tippee knew that an insider disclosed confidential information *and* that he did so in exchange for a personal benefit." While the proposition that the exchange of confidential information for personal benefit is the fiduciary breach that triggers liability for securities fraud is not new, the question now is what is the standard that a personal benefit must meet? Previously, 'any' benefit would suffice; however, there appears to be a new standard of personal benefit that interjects a materiality standard, meaning the person must receive a material benefit. The Second Circuit Court's opinion has thrown the SEC and U.S. Attorney's Office into a tailspin, resulting in an inability or hesitation to move forward with new insider trading cases. The good news is the book is not yet closed. The U.S. Attorney's Office for the Southern District of New York has filed a petition for a rehearing and further suggested a rehearing "en banc" (or before the entire bench rather than a panel), arguing that the panel got it wrong and in the process has threatened the integrity of the entire securities markets.

This process of proving the tippee's motive and degree of personal benefit is difficult and confusing; what's material to one person may not be material to another. This creates a degree of difficulty for groups such as investment advisers to private and registered funds,

Insider Trading: More Confusion or Clarity? *(continued)*

broker-dealers, banks and wealth management firms, attempting to thread the needle of continuing with business as usual and, at the same time, not violating federal securities laws.

The natural course of action for firms to take is to turn to their compliance department for advice on how to not violate the law. This is a daunting task and leads to our second question.

What can be done to keep your firm from being caught up in an insider trading scandal? The best approach is to keep it simple. Since it is almost impossible to address the nuances surrounding the legal interpretations of what constitutes insider trading, it would not be a productive use of time to attempt to sort it all out. Simply be sure you are aware of business activities in high-risk areas, especially those that would most likely obtain possession of non-public information of a public issuer. For investment advisory firms, these areas would include portfolio management, trading, direct access to a public reporting company's CFO, participation in creditor committees, access to virtual data rooms, outside business activities, industry conferences and personal relationships where access to non-public information is available, such as family or close friendship with an attorney at a law firm or a trader at a sell-side brokerage firm.

Lastly, be sure you have a tailored compliance program with well-trained compliance professionals performing risk-based forensic testing and monitoring, and compliance personnel embedded in high-risk business areas, such as trading, portfolio management and M&A departments. The chief compliance officer participates in senior-level meetings where sensitive firm decisions are made and ongoing reviews of department head activities is part of your supervisory oversight process to help uncover emerging and not previously identified conflicts of interest. A well-structured compliance program and oversight process will send the right message to your regulator that you have done all that is possible to reasonably ensure a violation of federal securities laws do not occur. ■

Carmine Angone is a Director with EisnerAmper Compliance and Regulatory Services ("CARS"). You can reach Carmine at 212.891.6095 or carmine.angone@eisneramper.com.