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Funds Talk

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Kramer Levin's Funds Talk provides legal commentary on the news and events that matter most to alternative asset managers and funds.

In This Issue

Certain Initial Considerations Associated With Forming a Private Fund Management Business 1
Investments in the Marijuana Industry Hold Potential for Significant Growth, Despite Some Uncertainty 4
Seller-friendly Trends in M&A Transactions 8
New Legislation Affects the Taxation of Foreign Investments in U.S. Real Estate 9
ILPA Launches Fee Reporting Template for Private Equity Fund Industry 10

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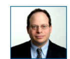
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Certain Initial Considerations Associated With Forming a Private Fund Management Business

In connection with the establishment of a private fund management enterprise and one or more private funds, there are common issues that the private fund manager must confront early on in the development of its business. This article briefly examines several of the most important initial issues a private fund manager should seek to resolve as early as possible. It is very helpful to involve legal counsel early on in the process to help identify and collaborate on the resolution of these matters.

Implications of the Investment Strategy

The private fund manager must first identify whether the private fund's strategy would generate certain types of income that may require some additional structuring. For instance, if the strategy will generate any U.S. effectively connected income such as a loan origination strategy, it would be important to modify the fund structure to accommodate non-U.S. investors if the private fund manager expects to target such investors. In addition, if the fund will employ leverage in connection with its investment strategy, the fund structure should include an offshore blocker entity if U.S. tax-exempt investors are part of the contemplated investor base, to avoid the receipt of unrelated business taxable income by any such investors since some of them may be sensitive to the receipt of such income.

Jurisdiction of Establishment

For both onshore and offshore funds, the regulatory environment of the chosen jurisdiction will impact the timing and cost of establishment and the burdens of continuing obligations in operating the fund. In the U.S., Delaware has established itself as the jurisdiction of

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choice for the majority of managers establishing onshore funds due to its convenience, flexibility and tax advantages. The decision on where to domicile an offshore hedge fund will be guided by a number of considerations, including, without limitation, the location of the investor base, tax treatment of the fund entity and the investors, regulatory regime, the availability of high-quality service providers and a business-friendly environment. The Cayman Islands, Bermuda, the British Virgin Islands, Luxembourg and Ireland are among the preferred locations for managers establishing hedge funds outside the U.S.

Key Terms

Prior to launching a fund, a manager must determine a number of key items, including the level of management fees and performance fees/allocations (and the ability to allow reductions, waivers or rebates), the base currency (including the ability to issue classes in currencies other than the base currency, if applicable), the use of hedging, minimum investment and/or holding amounts, and liquidity terms. The liquidity terms will encompass a broad range of considerations, including the frequency of withdrawals, notice periods for withdrawals, the use of a lock-up (which may be a specified lock-up period with no withdrawals or a specified lock-up period with withdrawals permitted subject to the imposition of a withdrawal fee), the use of a gate (which may be imposed on either a fundwide basis or on an investor-by-investor basis), the suspension of withdrawals, subscriptions, the calculation of net asset value and/or the payment of withdrawal proceeds under certain circumstances, and the ability of the fund or the manager to cause an investor to mandatorily withdraw from the fund. The offering documents should include a detailed description of all fees and expenses that the fund will bear. If the fund or the manager would like to retain the flexibility to deviate from the terms of the fund with respect to one or more investors, the potential use of side letters should be disclosed.

Potential Investor Base

In tandem with considering the issues identified above, the private fund manager needs to identify the types of investors the private fund manager is seeking to solicit for his or her private fund. Often the tax preferences of U.S. taxable investors are in conflict with the preferences of U.S. tax-exempt and non-U.S. investors. As a result, it is ideal to segregate these classes of investors into separate investment funds that may invest in parallel or may participate through a shared investment vehicle commonly referred to as a master fund.

For both onshore and offshore funds, the regulatory environment of the chosen jurisdiction will impact the timing and cost of establishment and the burdens of continuing obligations in operating the fund.

In addition, if the private fund manager is seeking to raise capital from benefit plan investors, the fund manager will need to monitor compliance with the Department of Labor rules and regulations to ensure that the fund is able to remain exempt from such rules or regulations or, if it is subject to them, that it complies with such rules and regulations. Further, will the fund include investors that are subject to the U.S. Bank Holding Company Act or that are registered investment companies? If so, the private fund manager should ensure that the fund documents provide the flexibility to issue nonvoting interests. Finally, will the fund include investors that are subject to ERISA? When ERISA plans invest in a pooled fund, that fund's assets will not be deemed to include plan assets if "benefit plan investors" do not own 25% or more of the value of any class of equity interests in the fund. The manager should decide in advance whether it will stay below the 25% threshold and should monitor compliance on an ongoing basis.

Distribution Effort

Now that the fund has been structured and the considerations triggered by the contemplated investors and investment strategy have been resolved, the private fund manager needs to consider how it will market the fund. In this regard, the private fund manager should ensure that its marketing activities do not violate the private placement exemption on which the fund will rely to issue its interests and should consider whether to engage a placement agent to assist with the marketing effort. It can be quite advantageous to employ a placement agent in order to utilize the placement agent's list of potential investors. However, a placement agent, as an agent of the fund, can cause the fund to violate the private placement exemption and, as a result, care should be taken in the placement agent agreement to ensure the placement agent pursues appropriate undertakings to avoid the violation of this exemption. In addition, to the extent the private fund manager seeks to solicit investors outside the U.S., consideration needs to be given to the requirements of the laws and regulations of those jurisdictions.

Another aspect of the marketing effort involves determining whether the fund will offer founders' share classes (i.e., share classes that generally provide for reduced fee rates for the initial investors) or whether the fund manager is interested in permitting an anchor investor to take a significant stake in the fund manager's business through an ownership interest or revenue share in the fund manager's business. These approaches can accelerate the growth of the fund manager's business but at a cost of some reduction in revenue received by the fund manager and its principals and in control over their business.

Regulatory/Compliance Matters

As part of the rollout of the fund manager's business, the fund manager must confront issues such as whether the fund manager's business might require registration as (i) an investment adviser with the Securities and Exchange Commission (the "SEC") or any state regulatory authority, or (ii) a commodity pool operator and/or commodity trading adviser with the Commodity Futures Trading Commission. For example, to the extent the private fund manager has "Regulatory Assets Under Management" (as defined on SEC Form ADV) of less than $150 million and its only clients are private funds (as defined in SEC guidance), the private fund manager will be able to rely upon an exemption from registration with the SEC. However, the fund manager will need to ensure it is not otherwise required to register with any state in which it conducts its advisory activities.

Relationship Among the Principals

Finally, the private fund manager will need to determine how the partners of the firm will organize their relationship with each other and with their employees as part of the governing documentation of the fund manager and/or employment agreements. In this regard, some items that are typically debated among the principals are (i) whether there will be vesting provisions associated with the receipt of the carried interest or performance allocation; (ii) what happens in the event of the departure of a member where such departure is voluntary, involuntary (including for cause or not for cause) or due to death or permanent disability; and (iii) whether the governing documentation of the private fund manager will impose noncompetition and nonsolicitation provisions. ■

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Harvests Ahead: Recent developments in the legal marijuana industry point to what investors should pay attention to.

$5.4 billion
Legal marijuana sales in the U.S. in 2015*

States that have legalized marijuana for recreational use: Alaska, Washington, Oregon, Colorado

Federal

Despite the spread of legalization in several states, marijuana remains illegal under federal law.

October district court ruling confirmed intent of Rohrabacher-Farr medical marijuana amendment blocking federal funds for prosecuting either states or marijuana companies operating in compliance with state medical marjiuana laws.

2016 budget bill re-enacts Rohrabacher-Farr; limited additional change to federal marijuana laws.

Canada

Has regulated medical marijuana since 2003.

With election of anti-prohibition prime minister in October, Canada appears to be on the path to full legalization of recreational marijuana.

California

New regulations in 2015: for-profit companies may now obtain licenses to grow and sell medical marijuana; cities and counties may now ban medical marijuana within their borders.

Legalization vote on recreational marijuana planned for Nov. 2016.

Ohio

November 2015 referendum for legalization rejected 64% to 36% amid concerns over its proposed oligopolistic industry structure.

Another legalization attempt is expected in 2016, with signatures being collected for the next ballot initiative.

Mexico

On Nov. 4, the Mexican Supreme Court ruled that growing, possessing and smoking marijuana recreationally is legal. Though limited to the named plaintiffs, the decision offers one potential path for expanded access.

Banking

Some improvement in banking access for marijuana companies, following Treasury Department guidance on financial crimes enforcement and marijuana credit union legislation in some states. However, check clearing, electronic fund transfers and other interbank services remain inaccessible due to ongoing federal restrictions.

Insurance

Some carriers reported to be providing coverage to marijuana companies. While the absence of legal guidelines at all levels of government means coverage may ultimately be deemed unenforceable or unlawful, the development of the marijuana industry itself points to the likelihood that the trend toward coverage provision will continue.

Intellectual Property

Trademark applications that include the term “marijuana” in the goods and services description have risen from 20 in 2012 to 200 in 2015, while issued registrations have risen from 12 to 33; states where marijuana has been legalized have also seen an increase in trademark applications.

USPTO continues to review multiple marijuana plant patent applications.

* Debra Borchardt, “U.S. Legal Adult-Use Marijuana Sales Grow 184% in One Year,” *Forbes*, Feb. 1, 2016

Investments in the Marijuana Industry Hold Potential for Significant Growth, Despite Some Uncertainty

Investors in marijuana-related companies witnessed several key developments in 2015 as the industry worked around initial obstacles, states refined regulatory frameworks, American public support of legalization increased, and banks and other service providers increasingly did business with marijuana companies. However, marijuana remains illegal at the federal level, and many investors will remain hesitant about making investments with growers in the U.S. until the federal government clarifies its position. In the meantime, many investors remain focused on businesses that provide products and services to growers or businesses in the Canadian market. That being said, with the market expanding as quickly as it is, even ancillary businesses have potential for significant growth, and investors and the media continue to closely monitor regulatory and other industry developments.

Developments at the Federal Level

Marijuana remains illegal under federal law, and while Congress and the executive branch have not legalized marijuana or rescheduled it from Schedule 1, they have taken steps to divert resources away from prosecution. In the Cole Memorandum of 2013, the Department of Justice ("DOJ") instructed federal prosecutors not to prosecute marijuana cases in states whose regulatory schemes meet specified regulation priorities. During 2014, when some federal prosecutors continued to pursue actions against vendors of medical marijuana in states that had legalized such sales, Congress included the Rohrabacher-Farr medical marijuana amendment in the end-of-year omnibus budget bill that stopped federal funds from being used to prevent states with medical marijuana programs from "implementing their own State laws that authorize the use, distribution, possession, or cultivation of medical marijuana."

In April 2015, a DOJ representative announced that the department interpreted the amendment to mean only that it was restricted from prosecuting states and that it did not forbid prosecution of individuals and medical marijuana companies. Representatives Rohrabacher and Farr disagreed, and the federal District Court in the Northern District of California in October held that the DOJ may not prosecute marijuana companies operating in compliance with state medical marijuana laws. The Cole Memorandum and Rohrabacher-Farr medical marijuana amendment are widely viewed as important steps toward legitimizing the industry, but do not resolve the ongoing conflict between state regulation and federal prohibition of marijuana. There were hopes that the budget bill for 2016 would take further steps to scale back federal prohibition. While it eliminated certain prohibitions on the hemp industry and re-enacted the Rohrabacher-Farr medical marijuana amendment, which had been set to expire, the bill failed to satisfy other hopes. For example, it did not end the ban on veterans affairs physicians discussing medical marijuana with veterans, nor expand the Rohrabacher-Farr medical marijuana amendment in a similar way to protect sales of recreational marijuana in states with established regulatory regimes, nor clarify banking access by state-regulated marijuana companies.

Developments at the State and International Levels

Notwithstanding the obstacles, marijuana legalization continues to spread, though the lack of uniformity among the state regimes is clear. For example, in Colorado, an entity that grows marijuana can, but is not required to, sell it via retail; in Washington state, one cannot do both; in New York state, retailers of medical marijuana

must grow their own product (which may not be smoked); and in Washington, D.C., it is forbidden to sell marijuana directly.

California: With record-high support for legalization in California, the state is mobilizing for a legalization vote on recreational marijuana in 2016. In 2015, efforts focused on increasing regulation of the state's legal medical marijuana program, which dates back to the 1990s. Historically, California has not successfully limited access to those holding marijuana licenses, but in October, the state passed the Medical Marijuana Regulation and Safety Act. "This new structure will make sure patients have access to medical marijuana, while ensuring a robust tracking system," Gov. Jerry Brown stated. "This sends a clear and certain signal to our federal counterparts that California is implementing robust controls."

The new regulations are noteworthy from an investor's perspective because, among other reasons, for-profit companies may now obtain licenses to grow and sell medical marijuana, and cities and counties may now ban medical marijuana within their borders. The latter regulation originally had a March 1, 2016, deadline for localities to ban medical marijuana, causing a stir of activity throughout the state, this deadline has since been removed. As these new regulations take effect, California is also approaching a November 2016 vote for the legalization of recreational marijuana, and support is gathering around the initiative, named the Adult Use of Marijuana Act.

Ohio: In November, Ohio could have become the fifth state to legalize marijuana for recreational purposes, but voters rejected the Issue 3 referendum by a wide 64% to 36% margin. With estimates of potential sales reaching $1.1 billion, it might have been the biggest legal market yet in the U.S. The referendum faltered in part because of a controversial feature that would have created a monopoly for 10 marijuana providers. The organization ResponsibleOhio, which spent millions of dollars to support Issue 3 behind contributions from the 10 listed providers, introduced a campaign mascot named Buddie, raising concerns among voters that the industry would target children. Aiming to stop Issue 3 even if Ohioans had voted for it, dozens of state legislators supported Issue 2, which, by imposing additional burdens on any referendum that would create a monopoly, would likely have conflicted with Issue 3 had both passed. Ohio voters passed Issue 2, 52% to 48%. The stage is now set for another legalization attempt in 2016, with signatures being collected for the next ballot initiative.

Canada and Mexico: The northern and southern neighbors of the U.S. also made headlines in 2015 relating to recreational marijuana. Canada has had medical marijuana regulations since 2003, prompted by the Supreme Court of Ontario ruling that patients with certain medical conditions had the constitutional right to medical marijuana. Important for investors and the industry, Canada's regulations have been enforced in a relatively clear manner. In October, with the election of Prime Minister Justin Trudeau, who has repeatedly called for the end of prohibition, Canada increasingly appears to be on the path to full legalization of recreational marijuana.

Meanwhile, on Nov. 4, the Mexican Supreme Court ruled that growing, possessing and smoking marijuana recreationally is legal under a theory of individual autonomy. This does not mean that marijuana is now widely available in Mexico. The ruling was limited to the named plaintiffs, and Mexico has not legalized medical marijuana, so it has no regulations yet in place. But the court decision offers one potential path for expanded access as discussions increase worldwide.

Banking Developments

Following guidance by the Treasury Department's Financial Crimes Enforcement Network ("FinCEN") that banks could offer services to marijuana companies whose activities were considered low priority, marijuana companies have had slightly improved access to banking services, although as a general matter continue to have difficulties maintaining accounts. In the absence of more definitive federal action, some states have drafted legislation to enable marijuana credit unions. Such legislation, however, has so far failed to overcome federal restrictions on providing either FDIC insurance or a Federal Reserve master account to financial institutions servicing the marijuana industry, without which marijuana companies are unable to access check clearing, electronic fund transfers and other interbank services. Indeed, Marijuana Business Daily reported in December that 70% of plant-touching businesses do not have a bank account, and accounts are frequently terminated. A Freedom of Information Act request revealed that, as of January 2015, 3,157 marijuana-related Suspicious Activity Reports had been filed by 374 individual financial institutions, with nearly half being "Marijuana Termination" reports indicating closure of an account. So while at least some established banks — possibly regional banks and credit unions — are providing services to marijuana companies, until the government acts more definitively, banking access will continue to be limited.

Insurance Developments

It appears from media reports that some carriers are already providing commercial coverage in this space. Although the FinCEN guidance to financial institutions described above does not apply to insurance companies expressly, it is possible that the federal government could expect insurers to be guided by it, and a number of the principles set forth in the guidance have analogues in the insurance business.

We are not aware of any particular legal guidelines — whether from the federal government, any state insurance regulator or any standard-setting body such as the National Association of Insurance Commissioners — governing the provision of insurance to businesses engaged in legal marijuana-related activities. In the absence of such guidance, and with marijuana remaining illegal in many states as well as at the federal level, it is possible that an insurance policy written to a policyholder in the U.S. purporting to cover risk associated with marijuana-related activities would be determined to be unenforceable or even unlawful under the laws of such states or of the U.S. However, notwithstanding the challenges, the development of the industry (and therefore data that can be used in making underwriting determinations) and the pricing power in a less competitive market suggest the trend toward provision of at least some types of coverage may continue.

Marijuana remains illegal at the federal level, however, and many investors will remain hesitant until the federal government clarifies its position.

Intellectual Property Developments

Companies have continued their efforts to build and defend their brands by utilizing both federal and state protections. Trademark applications that include the term "marijuana" in the goods and services description have risen from 20 in 2012 to 200 apiece in 2014 and 2015, while issued registrations have correspondingly risen from 12 to 33. States where marijuana has been legalized have also seen an increase in trademark applications. In Colorado there are approximately 700 trade names and 200 trademarks registered that include the word "marijuana" or a synonym. Additionally, the USPTO has not rejected and continues to review multiple marijuana plant patent applications that have been submitted.

Looking Ahead in 2016

Companies — and their investors — continue to face a myriad of risks associated with uncertainty over future regulatory developments concerning the marijuana industry. Companies with SEC-registered securities frequently reference risk factors, including ongoing federal prohibition; potential criminal and civil penalties; a reliance on additional states legalizing medical and recreational marijuana; increasing mobilization of groups and individuals opposed to legalization; banking difficulties; difficulties accessing bankruptcy courts; the rapid changes in the industry; and lack of access to adequate capital — most of which apply equally to privately held companies.

Notwithstanding the risks, investment in the marijuana industry has continued to escalate. It remains to be seen how much will be clarified through 2016, and the federal issues will depend in no small part on the U.S. presidential election. As large states like California and Ohio prepare for legalization initiatives, it is clear that there will be increasing pressure on the federal government to clarify its position on issues such as banking access. As these issues become incrementally clearer, and barring any significant policy change at the federal or key state levels, the trend toward increasing liberalization and associated comfort levels of investors seems likely to continue, with the tipping point still being the resolution of the federal-state conflict. ■

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Seller-friendly Trends in M&A Transactions

Kramer Levin recently completed its internal study of acquisition agreements for private target M&A transactions, and compared this data with the 2015 American Bar Association ("ABA") Private Targets Mergers & Acquisitions Deal Points Study and Kramer Levin's 2013 internal deal points study of private target acquisition agreements.

The results of these studies reveal a strong and continued shift toward seller-friendly terms in middle market M&A transactions. The shift is driven by robust competition in auctions, a continuing increase in sophistication and market awareness, and explosive growth in the use of representations and warranties ("R&W") insurance policies.

The most significant shifts in deal terms relate to the survival period for representations and warranties, and the related indemnity cap. The incidence of acquisition agreements in which the representations and warranties do not survive closing has grown dramatically. Such transactions accounted for only 1% of deals examined in Kramer Levin's 2013 study, but grew to 6% in the 2015 ABA study and 13% in Kramer Levin's current study. Notably, 65% of the transactions included in Kramer Levin's current study included the use of an R&W policy. Additionally, a majority of deals contain an indemnity cap of 10% or less of the total transaction value, with a significant number of deals trending toward a cap of between 5% and 7.5%, and the average is substantially lower when R&W policies are used. ■

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New Legislation Affects the Taxation of Foreign Investments in U.S. Real Estate

The Protecting Americans from Tax Hikes Act of 2015 (the "Act") became law on Dec. 18, 2015. The Act retroactively extended, either permanently or temporarily, various tax provisions that Congress had periodically been extending on a temporary basis. In addition, the Act made important changes affecting the taxation of investments, including several changes specifically affecting real estate investment trusts ("REITs") and foreign investments in U.S. real estate. Summarized below are certain provisions of the Act affecting foreign investments in U.S. real estate. Our previous issue addressed changes affecting REITs.

Foreign investments in U.S. Real Estate

The Act made significant changes to the taxation of U.S. real estate investments by foreign investors. Under the Foreign Investment in Real Property Tax Act of 1980, known as "FIRPTA," a foreign person's gain from the disposition of a U.S. real property interest (a "USRPI") is generally treated as income that is effectively connected with the conduct of a U.S. trade or business, which is taxable at the income tax rates applicable to U.S. persons.

Increase in FIRPTA Withholding Rate from 10% to 15%

The purchaser of a USRPI is generally required to withhold tax from the gross proceeds paid to a foreign person. Certain distributions to a foreign shareholder by a corporation that is (or was) a U.S. real property holding corporation (a "USRPHC") are also subject to withholding. A USRPHC is a U.S. corporation the majority of whose real property and business assets are represented by USRPIs. The Act generally increased the rate of withholding under FIRPTA from 10% to 15%, effective for dispositions and distributions after Feb. 16, 2016.

Increase in Minority Ownership Exception from FIRPTA for Certain REIT Stock

The disposition of stock of a USRPHC (or the receipt of a distribution from a REIT attributable to gain from a USRPI) can give rise to tax and withholding under FIRPTA, unless the stock is of a class that is regularly traded on an established securities market and the shareholder holds no more than 5% of that class of stock during the five years preceding the sale. The Act increased that threshold in the case of a REIT — but not a regulated investment company ("RIC") or other entity — from 5% to 10%, effective Dec. 18, 2015.

Exemption from FIRPTA for REIT Stock Held by "Qualified Shareholders"

Under the Act, "qualified shareholders" can own and dispose of any amount of stock of a REIT without triggering FIRPTA withholding. A qualified shareholder is, in general, a foreign publicly traded entity that is eligible for the benefits of a comprehensive income tax treaty with the U.S., is a "qualified collective investment vehicle" and maintains records with respect to its 5% owners. A qualified collective investment vehicle is a foreign entity that either would be eligible for a reduced rate of withholding under a comprehensive income tax treaty even if it holds more than 10% of the stock of the REIT; is a publicly traded partnership, treated as a partnership, that is a withholding foreign partnership and would be a USRPHC if it were a U.S. corporation; or is designated as a qualified collective investment vehicle by the Secretary of the Treasury and is either fiscally transparent or is required to include dividends in its gross income but is entitled to a deduction for distributions to its investors. However, withholding will still apply to the extent an investor in such entity holds, directly or indirectly, more than 10% of the REIT stock. This exception became effective Dec. 18, 2015.

Exemption from FIRPTA for Qualified Foreign Pension Funds

The Act exempts from FIRPTA tax any USRPI held by, and any distribution received from a REIT by, a qualified foreign pension fund (directly or indirectly through one or more partnerships) or a foreign entity wholly owned by a qualified foreign pension fund. To be qualified, the pension fund must, among other requirements, have no single participant or beneficiary with a right to more than 5% of its assets or income. This change generally applies to dispositions and distributions after Dec. 18, 2015, and should facilitate U.S. real estate-related investments by both private and governmental foreign pension plans.

The legislation retroactively extended, either permanently or temporarily, various investment-related tax provisions that Congress had periodically extended on a temporary basis.

Extension of RIC Qualified investment Entity Treatment Under FIRPTA

Interests in "qualified investment entities" are subject to special rules under FIRPTA. Except for shareholders who own no more than 5% of a class of stock that is regularly traded on an established market in the U.S., foreign shareholders are generally subject to tax under FIRPTA on distributions from a qualified investment entity to the extent they are paid out of gain derived by the entity from sales of interests in U.S. real property. Gain realized by a foreign shareholder on the disposition of an interest in a qualified investment entity that is "domestically controlled" is not subject to FIRPTA tax. Qualified investment entities include REITs and, until Dec. 31, 2014, included RICs. The Act retroactively and permanently includes RICs as qualified investment entities. ■

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ILPA Launches Fee Reporting Template for Private Equity Fund Industry

On Jan. 29, 2016, the Institutional Limited Partners Association ("ILPA"), the global organization representing private equity fund limited partners ("LPs"), released a new fee reporting template and guidance document outlining recommended reporting practices related to the disclosure by private equity fund managers ("GPs") of the fees and expenses borne by the private equity funds managed by the GPs. The template details all income a GP has collected from LPs and portfolio companies — including fees, fund expenses, applied offsets, carried interest, and income from a fund's related parties or vehicles — and seeks to supplement a fund's standard financial disclosure. Its purpose is to provide a clear and uniform reporting method for use within the private equity industry.

ILPA released a draft of the fee reporting template in October 2015 as part of an initiative it launched in May 2015 to increase transparency between LPs and GPs surrounding fees and expenses. It subsequently accepted feedback from interested parties on the proposal in an attempt to instigate a collaborative dialogue between GPs and LPs to identify a standard method of fee reporting that would be acceptable to all parties.

The final template requires GPs to disclose specific fees received from their portfolio companies in a clear and regular manner, as well as to report how much of those fees they have passed on to investors via reduced management fees. While the original template outlined a

requirement for reporting fees on a trailing-12-months basis, the consultation process revealed that GPs preferred a year-to-date reporting format, and the template was modified to conform to this request.

The final product was shaped by feedback from nearly 50 LP and 25 GP organizations, as well as numerous fund administrators, consultants and service providers. ILPA indicates it has been endorsed by prominent LPs, including several public pension plans, while private equity giants Carlyle and TPG have indicated their support as GPs.

The template details all income a GP has collected from LPs and portfolio companies and seeks to supplement a fund's standard financial disclosure.

In addition to the template, the industry group released guidance regarding its implementation. ILPA expects GPs that choose to use the template to take up to a year to do so. The template is only intended to be applied on a prospective basis to future funds and "where feasible" to reporting on current vintages. ILPA advises against requiring GPs to "retroactively report the full breadth of the information within the template for older funds."

Moreover, since the majority of the fees charged to portfolio investments are tracked in a separate ledger from the fund's accounts, ILPA says implementation of the template "will likely require meaningful revisions to GP reporting procedures, and ultimately entailing a manual process, to aggregate information from multiple ledgers into a single report."

ILPA's efforts are part of an overall emphasis within the private equity industry aimed at increasing the level of transparency private equity fund managers offer their investors. Fee and expense practices have faced increased scrutiny since May 2014, when the SEC's Office of Compliance Inspections and Examinations identified high rates of fee- and expense-related violations in investment adviser examinations. More recently, public pension funds — including the California Public Employees' Retirement System and the New York City Retirement Systems — have advocated for better reporting practices from the private equity fund managers with which they invest.

In the future, ILPA states that it would be in the best interests of the industry to explore how to automate the generation, presentation and dissemination of the data contained within the template. A version of the template will be available on the ILPA website in a software-agnostic, XML format to facilitate integration into LPs' and GPs' existing back-end reporting systems. ■

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This memorandum provides general information on legal issues and developments of interest to our clients and friends. It is not intended to provide legal advice. Readers should seek specific legal advice before taking any action with respect to the matters we discuss here. Should you have any questions or wish to discuss any of the issues raised in this memorandum, please call your Kramer Levin contact.

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