ALTERNATIVE INVESTMENTS QUARTERLY

AI QUARTERLY

SPRING 2021
VOLUME 15
ISSUE 1

SEC ADOPTS NEW FRAMEWORK FOR INVESTMENT ADVISER MARKETING

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ABOUT ADISA

ADISA (Alternative & Direct Investment Securities Association), is the nation's largest trade association for the non-traded alternative investment space. Through its 4,500 financial industry members, ADISA reaches over 220,000 finance professionals, with sponsor members having raised in excess of $200 billion in equity in serving more than 1 million investors. ADISA is a non-profit organization (501c6), registered to lobby, and also has a related 501c3 charitable non-profit (ADISA Foundation) assisting with scholarships and educational efforts.

$4.7 T

Nationally, the finance and insurance industry has a **revenue of approximately $4.7 trillion***

$2.7 T

Finance and insurance industry members have a **purchasing power of approximately $2.7 trillion***

$200 B

ADISA sponsor members (investment product issues) have raised in excess of **$200 billion in equity and serve more than 1 million investors****

4,500

Through its **4,500 financial industry members**, ADISA reaches over 220,000 finance professionals**

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ALTERNATIVE INVESTMENTS QUARTERLY

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*From IBISWorld World Sector Report 52
** From the ADISA Marketing Questionnaire

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Published by
NAYLOR ASSOCIATION SOLUTIONS
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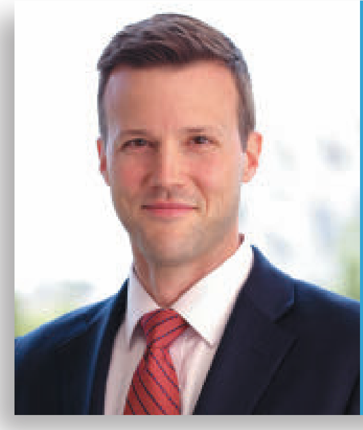
PUBLISHED MARCH 2021/REISQ0121/2177

COVER IMAGE: ISTOCK.COM/MORAKOT KAWINCHAN



President's Letter

By Matthew Malone, CFA, Esq., FS Investments
2021 ADISA President

Dear ADISA Members,

As we enter 2021 with a renewed sense of optimism, it is an exciting time for ADISA. After a challenging 2020, we are focusing our efforts on continuing to provide a strong member value proposition in a dynamic market.

The Board, in conjunction with the staff, met early this year to develop ADISA's 2021 strategic plan, which will focus on three areas:

- Enhancing our digital presence and offerings;
- Optimizing advocacy and strategic partnership; and
- Long-term planning for the future of ADISA.

Enhancing Our Digital Presence and Offerings

As we start the year, focusing and streamlining our digital activities is front and center. While we are confident the COVID-19 pandemic's impact on membership organizations like ours will lessen over time, we believe it has forever changed the way people do business, providing increasing opportunities to connect people through technology. As a result, while we will continue to maintain our signature high-quality in-person events, we intend to enhance our digital presence and virtual offerings, as well.

ADISA recently launched its updated website featuring simpler navigation, improved content, mobile compatibility and a fully functional search engine. Further digital initiatives include a more robust social media presence; multi-format content, including videos and blogs; and more promotional opportunities for our members. In addition, the website hosts our new Products & Services Directory as well as the AIQ digital library. Finally, we announced our first series of webinars for 2021 featuring a wide variety of unique speakers and current topics important to our members.

Optimizing Advocacy and Strategic Partnerships

In addition to the tragic impacts of the COVID-19 pandemic, the last twelve months also brought us new leadership in Washington, D.C. Advocacy has always been one of ADISA's core values, and we believe the change in administration presents both challenges and opportunities. For 2021 and beyond, ADISA plans to enhance its advocacy efforts through ongoing strategic engagement with law makers and regulators to educate and advocate for our industry.

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Executive Director's Letter

A Clue to Go On

By John Harrison, MBA, CRCP®, CAE
Executive Director, ADISA

A lot of mistakes are happening these days—as we fully head into 2021—because we don't have much of a clue as to what we're doing.

Oh, there are a few highly educated types who think they have a clue: just hide out until you starve to death; and there are some at the other end of the spectrum who say to throw all caution to the wind. Where is the via media, the great middle way of navigating which normally leads our daily lives?

The historian Barbara Tuchman came up with her famous law: "the fact of being reported multiplies the apparent extent of any deplorable development by five- to tenfold" (or perhaps an even greater number). In today's world, there are no journalists, just megaphone holders, and everyone's got a megaphone in social media. I've taken to reducing the vehicles of general news reporting that I observe to just one: the printed daily *Wall Street Journal*. No twitter or other social media, and no reading of bathroom walls (and have you noticed that those bathroom walls have gotten a lot cleaner now that the types who used to write on them now use social media instead?). Life looks a lot saner with at least no megaphones yelling at me. However, even what I read what we're doing seems rather clueless.

There are the ivory tower academics who think they have a clue. To take a stroll down an unfortunate memory lane, in my lifetime, I remember our country being led by a room full of Harvard types who masterminded the Bay of Pigs incident. To their credit, they did learn something and crafted a naval blockade of Cuba that averted a thermonuclear war. That was good. But that same room full of brains then turned around and got us into Vietnam. Which in turn became the downfall of a certain cowboy school teacher as president. That president said something to the effect of (and I paraphrase), "no bunch of little Commie bastards in Indochina is gonna push us around…" Barbara Tuchman, in her work, *The March of Folly,* outlines the great mistakes of history, and this (along with the Trojan Horse and several others) included the Vietnam War.

Does this pattern sound familiar? The nerdy research types tell us to hide under the bed and perish, and the backwoods types tell us to ignore it all and go belly up to the bar: "no stinkin' little virus is gonna make me wear a mask over my face."

Don't get me wrong, there's a time for the more brawny type, like when you need to get your car out of the ditch or open a can of whoop ass on that pesky terrorist trying to light a shoe bomb on the airplane. And, of course, we need a few experts, as well, like when you need to brag about the neurosurgery you just did, or if you want to impress those in class by asking a sesquipedalian[1] question.[2]

After this current unpleasantness passes—and it too shall pass—there will be a new school of thought with studies, white papers and pundits galore to analyze it all. Models will burst onto the scene which have the epidemiology on the same graph as the economics (gee, what a thought).

Perhaps that research is already out there, but there are few takers. The attention is going elsewhere, like to the contingent protesting and promoting a culture intent on cancelling any research if they don't like what it says: sort of their own version of spouting macho BS. I guess that odd political culture—if we can measure it—is another variable on the graph with epidemiology and economy; and three simultaneous variables and their interactions are about all humans can successfully try to read.

Where are the great heroes of today who have fine minds and tested leadership in the field? We need, say, a Henry the Fifth who, in addition to being the inspiration for Shakespeare to write arguably the greatest speech in history (St. Crispin's Day),[3] also led England to its greatest victory until Churchill took up the mantle a few centuries later. Both of those men studied at fine schools and were tested in battle. Somehow, they knew the middle of the extremes.

I read the St. Crispin's Day speech again. It is given before the battle on the field at Agincourt, where the English were terribly outnumbered and outgunned. It doesn't whine about not having more troops on hand or wish for better conditions or even a better leader. It doesn't complain about never having been on the awful terrain before. It simply declares the happy willingness to give it everything with only what is here. To not just go through the motions, but instead to live or die—and to be all in and all in with each other as we are—and to be glad to be in the fight with the scorecard we have and to hold it dear:

> …And gentlemen in England now a-bed
> Shall think themselves accurs'd they were not here,
> And hold their manhoods cheap whiles any speaks
> That fought with us upon Saint Crispin's day.

They didn't know if they would win, but with courage, they followed King Henry and did so. We have had in the past great leaders among us—those of sharpness and strength meant to save us in the moment. But they don't really save us, they only remind us of our better selves.

Notes:

1. Sesquipedalian is a great word. Sesqui means one and a half in Latin (hence sesquicentennial is 150 years), so sesquipedalian means one and a half feet, as in using words that are one and a half feet long.
2. I had a friend at Harvard Business School who said they spent a class learning how to raise their hands just so and formulate questions in such a way as to make one look impressive—getting the answer was irrelevant.
3. The speech is in Shakespeare's history, Henry V (Act IV, Scene 3); there have been excellent film adaptations (Kenneth Branagh's Henry V, and Netflix, The King). The speech has been used by many to rally strength and is a shining example of courage exemplified in the Western Cannon—for those who still learn from such great works. ▲

SEC Adopts New Framework for Investment Adviser Marketing

By Jennifer Klass
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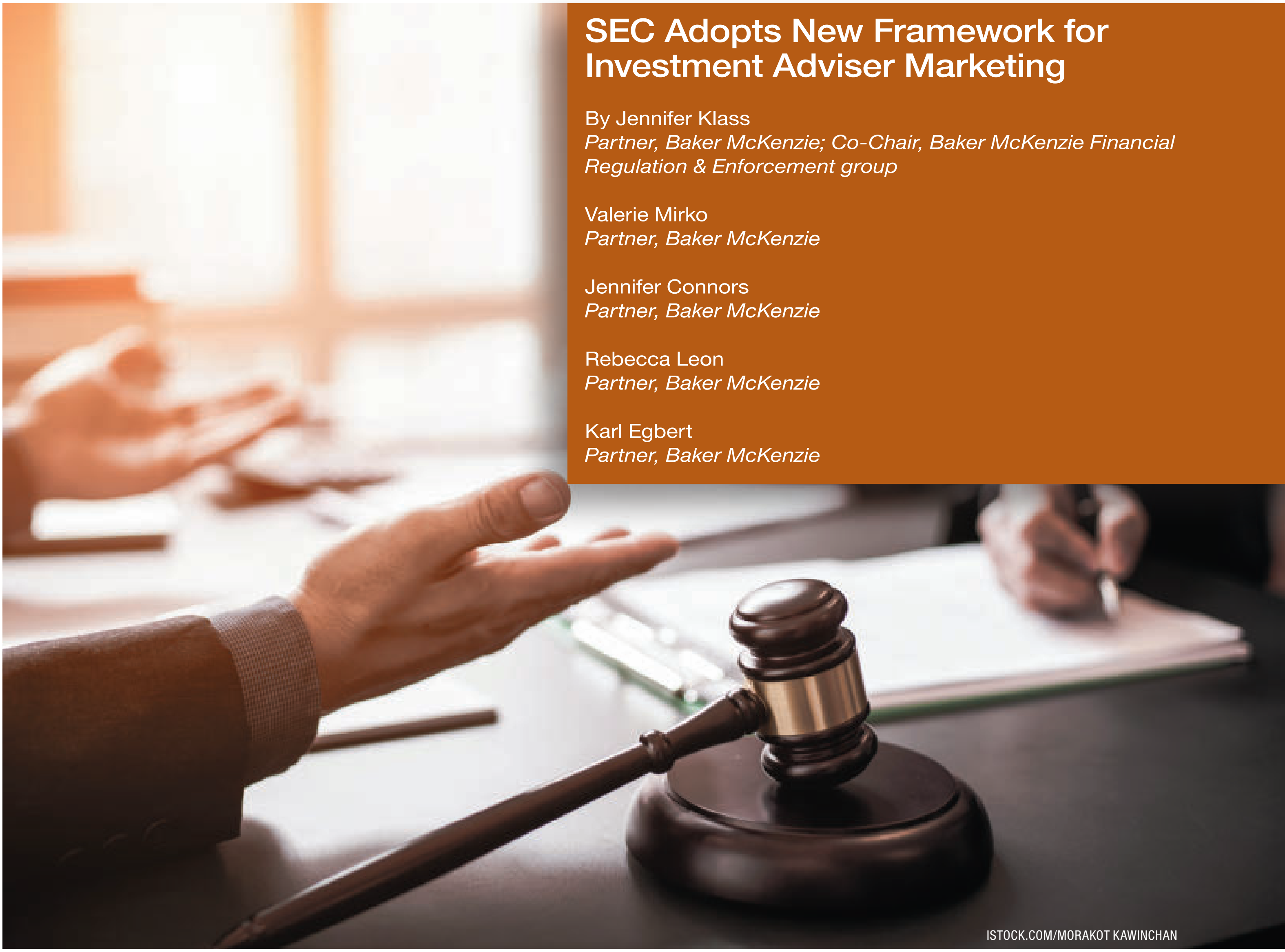

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In Brief

The SEC recently adopted amendments that dramatically reshape the rules governing investment adviser marketing by creating a single rule ("Marketing Rule") for investment adviser advertising and referral arrangements. The new approach is an elegant solution designed to fulfill the SEC staff's objective of retaining a principles-based framework while modernizing the rule to remain flexible to accommodate evolving technologies such as social media. The Marketing Rule is effective within 60 days after publication in the Federal Register, but advisers have 18 months to transition to the new requirements.

In More Detail

The final rule transforms the existing regulatory framework by merging the existing Advertising Rule and Solicitation Rules together to create a single rule that governs the full spectrum of investment adviser marketing activities. At a high level, the new Marketing Rule:

- Abandons the proposed requirement for advisers to review and approve all advertisements prior to dissemination, a proposed provision that was highly controversial;
- Expands the definition of an advertisement, but excludes one-on-one communications and extemporaneous, live, oral communications;
- Applies to communications to prospective clients and investors and offers of new investment advisory services to current clients and investors; however, does not apply to communications designed to retain existing clients and investors;

Baker McKenzie has provided sophisticated legal advice and services to many of the world's most dynamic and global organizations since our founding in 1949. With a network of more than 4,200+ locally qualified, internationally experienced lawyers in 46 countries, we have the knowledge and resources to deliver the broad scope of quality legal services required to respond effectively to international and local needs—consistently, confidently, and with sensitivity for cultural, social, and legal practice differences.

Our Financial Regulation and Enforcement Practice provides clients with a full range of regulatory advice and enforcement counseling. This integrated approach helps clients navigate the challenges presented by developing new products and offering financial services in a rapidly changing regulatory environment, while simultaneously considering how to assess and minimize potential enforcement exposure. Enforcement investigations and regulatory examinations are similarly addressed, not only with considerable enforcement experience, but also by fully leveraging the enormous value added by regulatory expertise.

- Does not distinguish between retail and non-retail investors However, the Rule does expressly apply to communications directed to investors in private funds managed by the adviser;
- Eliminates the current prohibitions on the use of testimonials and past specific recommendations, and adopts general content standards based on anti-fraud principles;
- Requires the presentation of net and gross performance side by side and includes additional guidelines for standardized time periods, related performance and extracted performance, but does not dictate the methodology for calculating performance;
- Does not prohibit the use of hypothetical performance, but requires advisers to adopt policies and procedures reasonably designed to ensure that the hypothetical performance is relevant to the audience, and to disclose the criteria, assumptions, risks, and limitations. The final rule excludes investment analysis tools used by investors from the definition of hypothetical performance;
- Expands the concept of testimonials and endorsements to include solicitation and referral activities, and removes the disclosure delivery and client acknowledgement requirements that currently apply to referral arrangements;
- Requires that paid testimonials and endorsements (over the USD 1,000 de minimis threshold) include clear and prominent disclosure of the relationship between the solicitor (or, as the Marketing Rule frames the role, "promoter") and adviser, direct and indirect compensation, and material conflicts relating to relationship and compensation;
- Expands the disqualification requirements that apply to promoters and covers both cash and non-cash compensation;
- Eliminates the exception for registration for promoters, forcing them to consider whether their referral activities require investment adviser registration; and
- Updates applicable recordkeeping requirements and withdraws various no-action letters that are either incorporated into the Marketing Rule, or will no longer apply.

No Requirement for Prior Review and Approval of Advertisements

The final rule does not require advisers to review and approve all advertisements prior to dissemination or to retain a copy of all written approvals. Instead, advisers retain the flexibility under the Compliance Rule (Advisers Act Rule 206(4)-7) to design appropriate internal controls governing the review and approval of advertisements based on their business.

For advisers, this is a welcome reversal from the proposed rule. Many commentators criticized the proposed pre-use review requirement as being unworkable and costly. However, Commissioners Lee and Crenshaw made clear in their public statement that the decision to eliminate the pre-use review requirement "is a missed opportunity to promote better compliance in this critical area, and will likely place advertisements on the list of examination and enforcement priorities for years to come."

Expanded Definition of Advertisement

The expanded definition of an advertisement contains two parts. The first part covers communications that offer investment advisory services with regard to securities. The second part, which is discussed below, covers paid testimonials and endorsements—essentially, referral activity that was previously governed by Advisers Act Rule 206(4)-3.

Under the first part of the definition, an advertisement is "[a]ny direct or indirect communication an investment adviser makes to more than one person…that offers the investment adviser's investment advisory services with regard to securities to prospective clients or investors in a private fund advised by the investment adviser or offers new investment advisory services with regard to securities to current clients or investors in a private fund advised by the investment adviser." The second part of the definition covers "any endorsement or testimonial for which an investment adviser provides compensation, directly or indirectly."

The scope of the definition of an advertisement is key because it establishes the universe of communications subject to the Marketing Rule. There was great concern that the proposed rule would have covered virtually every communication with existing and prospective clients and investors; however, the definition of an advertisement in the final rule reflects a more refined and workable approach.

One-on-One communications are Not Covered. The final rule retains the exception for one-on-one communications—meaning that communications sent to only one person should not be considered advertisements. The concept of a single person extends to multiple investors that share the same household, as well as multiple natural persons representing a single entity or account. The one-on-one exception does not apply to communications (such as form letters and bulk emails) that are nominally "addressed" to one person or include basic information about an investor, but actually are widely distributed. In addition, "duplicate inserts" that are included in an otherwise customized communication would still be subject to the Marketing Rule because they are sent to more than one person.

Communications containing hypothetical performance do not qualify for the one-on-one exception, except in cases where the hypothetical performance is provided in response to an unsolicited investor request (where an investor is seeking the information for their own purposes) or to a private fund investor (because the investor will have the opportunity to ask questions and assess the limitations of this information during a one-on-one interaction).

Direct and Indirect Communications. The final rule reformulates the proposed concept of communications "by or on behalf of the adviser" to address any "direct or indirect communication an investment adviser makes." This includes communications sent by the adviser directly, as well as those that are distributed by intermediaries, consultants, other advisers and promoters. Third-party content may also be attributable to the adviser if the adviser explicitly or implicitly endorses or approves the information after its publication (adoption), or involves itself in the preparation of the information (entanglement).

Ultimately, it is a facts and circumstances analysis as to whether a communication was made by the adviser or whether the adviser should be responsible for third-party content.

In the social media context, the final rule aligns with existing guidance around responsibility for third-party content. An adviser will generally not be responsible for hyperlinked third-party content, unless the adviser knows or has reason to know that third-party content is fraudulent or misleading. An adviser will not be responsible for content posted by third parties on the adviser's own website so long as the adviser does not selectively delete or alter the comments or their presentation, even if the website gives the adviser the ability to do so. Finally, personal social media posts by associated persons generally will not be attributed to the adviser if the adviser adopts and implements policies and procedures reasonably designed to prevent associated persons from using their personal social media accounts to market the adviser's services.

Communications to Existing Investors are Not Covered. The final rule focuses on communications that offer investment advisory services to prospective clients and investors in private funds, and that offer new or additional investment advisory services to current clients and investors. This formulation effectively excludes communications intended to service existing clients and investors or to provide and report on the advisory services.

Brand Communications, General Educational Information and Market Commentary are Not Covered. Importantly, the final rule narrows the definition of an advertisement to focus on communications that "offer advisory services." This means that more general "brand" content relating to statements about a firm's culture, philanthropy and community activity, as well as displays of the advisory firm's name that are simply designed to raise the profile of the adviser would not be covered by the Marketing Rule, so long as they do not offer advisory services. Similarly, communications that provide only general educational information and market commentary generally would not be considered advertisements.

Extemporaneous, Live, Oral Communications are Excluded. In recognition of the difficulty of ensuring compliance with the Marketing Rule and in an effort not to chill communications with investors, the final rule excludes extemporaneous, live, oral communications. The exception applies to verbal communications that are "live" meaning effectively that the adviser does not have the time to review and edit the communication before dissemination. However, the exception does not apply to instantaneous written communications (e.g., text messages, chat), nor does it cover prepared remarks, speeches, slides or other written materials distributed to investors as part of a presentation or seminar.

Regulatory Communications are Excluded. The final rule excludes information contained in a statutory or regulatory notice, filing or other required communication; provided, that such information is reasonably designed to satisfy the requirements of such notice, filing or other required communication. Thus, information that goes beyond the explicit requirements of the regulatory requirement would not be covered unless it actually offers advisory services.

"Buh Bye" Solicitation Rule

Rather than retain a separate rule governing solicitation arrangements, the SEC expanded the definition of testimonials and endorsements to include solicitation activities and rescinds the Solicitation Rule (Rule 206(4)-3). Testimonials refer to statements by current clients or investors about the client or investor's experience with the investment adviser or its supervised persons. Endorsements refer to statements by a person other than a current client or investor that indicate "approval, support or recommendation of the investment adviser or its supervised persons or describes that person's experience with the investment adviser or its supervised persons." Importantly, both definitions now cover statements that "directly or indirectly **solicits** any current or prospective client or investor…or **refers** any current or prospective client or investor to be a client of, or an investor in a private fund advised by, the investment adviser."

In taking this approach, the SEC eliminates the distinction between paid advertisements and lead generation, on the one hand, and referral or solicitation arrangements, on the other. Under the final rule, any paid testimonial or endorsement (in excess of the USD 1,000 de minimis) is essentially considered a solicitation arrangement that is subject to additional requirements under the Marketing Rule so long as the compensation is paid, directly or indirectly, for the testimonial or endorsement.

Cash and Non-Cash Compensation is Covered. The concept of compensation now extends to any type of cash and non-cash compensation that is provided in exchange for a testimonial or endorsement. Non-cash compensation includes directed brokerage, sales awards or other prizes, gifts and entertainment. Compensation does not include regular salary or bonuses paid to an adviser's personnel for their investment advisory activities, or attendance at training and education meetings, provided attendance at these meetings and conferences is not in exchange for solicitation activities.

The SEC believes the timing of compensation is relevant to determining whether an adviser is providing compensation for the testimonial or endorsement, but it declined to provide guidance around either the timing of the compensation or the establishment of a mutual understanding as to whether any such compensation is provided in exchange for testimonials or endorsements.

Inclusion of One-on-One and Extemporaneous, Live, Oral Communications. It is important to note that, unlike the first part of the definition of an advertisement, the second part of the definition (which covers any paid testimonial or endorsement) does apply to one-on-one communications and extemporaneous, live, oral communications.

Clear and Prominent Disclosure. The new Marketing Rule eliminates the prior requirements that solicitors deliver a separate written disclosure statement and Form ADV to prospective clients at the time of the solicitation, as well as the obligation for advisers to receive and retain a signed client acknowledgement of receipt of those documents. Instead, the adviser or promoter needs to clearly and prominently disclose: (i) whether the person giving the testimonial or endorsement is a client or non-client; (ii) that cash or non-cash compensation was provided; (iii) the material terms of any compensation arrangement, including a description of the compensation and the amount of that compensation; and (iv) any material conflicts on the part of the person giving the testimonial or endorsement. These disclosures must be made at the time the testimonial or endorsement is disseminated.

The clear and prominent standard requires the relevant disclosures to be included within the testimonial or endorsement—so that the statements and the related disclosures are read at the same time. The SEC believes that these disclosure can be provided succinctly within the testimonial or endorsement, while other disclosures that are not "integral" to the testimonial or endorsement can be provided by hyperlink.

Adviser Oversight and Compliance. Any testimonial or endorsement, regardless of whether it is paid or unpaid, is subject to adviser oversight and compliance. Specifically, an adviser must have a reasonable basis for believing that any testimonial or endorsement complies with the Marketing Rule. This reasonable basis could involve making periodic inquiries of investors or pre-reviewing testimonials or endorsements, or imposing contractual limitations on the content of those statements.

Written Agreement. Paid testimonials and endorsements above the de minimis requirement are subject to the further requirement that the adviser enter into a written agreement with the promoter that describes the scope of the solicitation or referral activities and the compensation.

Disqualification and Ineligible Promoters. The Marketing Rule prohibits investment advisers from compensating a promoter for a testimonial or endorsement if the adviser knows, or in the exercise of reasonable care, should know, that the promoter is subject to certain disqualifying SEC actions or disqualifying events at the time the testimonial or endorsement is disseminated. The rule does not require advisers to monitor the eligibility of promoters on a continuous basis. Employees, officers, and directors of an ineligible person (or any other individuals with similar status or functions) are also considered disqualified persons that may not be compensated by the adviser for testimonials and endorsements. Unlike the proposed rule, the Marketing Rule's definition for ineligible person does not include a disqualified person's control affiliates. There are certain exceptions under which the Marketing Rule defers to existing disqualification regimes under the Exchange Act and Rule 506(d) of Regulation D with respect to certain promoters in order to avoid duplicative and inconsistent disqualification provisions. The Marketing Rule also provides for a 10-year lookback for disqualifying events and a conditional exemption that permits a promoter to receive compensation if the SEC has issued an opinion or order to that effect.

Regulatory Status of Promoters. The SEC withdraws its long-standing position that a solicitor is an associated person of an investment adviser and therefore is not required to register individually under the Advisers Act, solely with respect to its solicitation activities, **but does not** replace this position with an analogous equivalent for promoters. Rather, the guidance notes that, depending on the facts and circumstances, a promoter may be acting as an investment adviser (e.g., in advising clients on the selection of an investment adviser), or as a broker-dealer (e.g., when soliciting investors for a private fund). There is no presumption of investment adviser or broker-dealer status. Instead, promoters will have to consider whether their activities require registration under federal and/or state securities laws.

Affiliated Personnel. Testimonials and endorsements provided by affiliates will not be subject to the requirement for a written agreement or the disqualification requirements, so long as the affiliation between the adviser and its affiliated person is readily apparent to, or is disclosed to, the client.

General (Content Standards) Prohibitions

Rather than continuing to rely on general anti-fraud provisions, the final rule includes a number of "general prohibitions" designed to provide greater clarity around misleading advertising practices. These general prohibitions make it unlawful for an investment adviser to disseminate advertisements that include:

- Untrue statements or omissions
- Unsubstantiated statements of material fact
- Untrue or misleading implications or inferences
- Statements that discuss potential benefits connected with or resulting from an investment adviser's services or methods of operation without providing fair and balanced treatment of any material risks or material limitations associated with those benefits
- References to specific investment advice that are not fair and balanced
- Statements that include or exclude performance results, or present performance time periods, in a manner that is not fair and balanced
- Statements that are otherwise materially misleading

Of particular note is that past specific recommendations are no longer prohibited. Rather, the general prohibitions around communications that are not fair and balanced would govern communications that refer to specific favorable or profitable past specific recommendations, including case studies. These provisions prevent "cherry-picking"—the practice of highlighting specific advice without providing sufficient information and context to evaluate the merits of that advice. Advisers have flexibility to determine how best to meet the fair and balanced standard, and although they can rely on practices developed under the no-action letters governing past specific recommendations, they have the flexibility to rely on other practices.

The Marketing Rule abandons the proposed distinctions between retail and non-retail investors; however, the SEC does explain on more than one occasion that the nature and sophistication of the audience is an important factor in considering the relevant facts and circumstances that determine whether an adviser is complying with the Marketing Rule. Depending on the audience, more or less detailed disclosure may be appropriate.

Third-Party Ratings

The final rule permits advisers to advertise ratings or rankings provided by a third party that is not a related person, so long as the third party provides ratings in the ordinary course of its business. In order to show the ratings, the adviser must have a reasonable basis for believing that any questionnaire or survey used in the preparation of the rating easily permits a participant to provide favorable and unfavorable results, and is not designed or prepared to produce any predetermined result. The SEC clarified that obtaining the actual survey or questionnaire used in the preparation of the rating is not the only way to satisfy this requirement. The adviser could seek representations from the third party or rely on information the third party makes available about its survey methodology.

The advertisement also must clearly and prominently disclose: (i) the date on which the rating was given and the time period on which the rating is based; (ii) the identity of the third party that created and tabulated the rating; and (iii) if applicable, that compensation was provided directly or indirectly by the adviser in connection with obtaining or using the third-party rating. Like testimonials and endorsements, the disclosure requirement applies to both cash and non-cash compensation.

Performance Advertising

The final rule does not dictate the methodology required to calculate performance, but it does incorporate specific requirements that apply to performance advertising. Following are some of the most notable changes:

Side-by-Side Net and Gross of Fees. The final rule prohibits any presentation of gross performance in an advertisement, unless the presentation also shows net performance with at least equal prominence to, and in a format designed to facilitate comparison with, gross performance. Further, the net and gross performance must be calculated over the same time period using the same type of return methodology. The calculation of net performance may include the deduction of a model fee when doing so would result in performance that is no higher than if the actual fee had been deducted.

Prescribed Time Periods. Performance returns must be shown for one-, five-, and 10-year time periods (or since inception), and should be shown as of a date that is no less recent than the most recent calendar year-end. The prescribed time periods must be shown with equal prominence. An adviser can always show performance for additional time periods on a supplemental basis. Importantly, private funds are not subject to this requirement.

Related Performance. The final rule permits advisers to show "related performance," meaning the performance of portfolios with substantially similar investment policies, objectives and strategies as those of the services being offered in the advertisement. In order to prevent cherry-picking, the presentation of related performance must include all related accounts—unless the exclusion of a particular account would not result in materially higher performance results and does not alter the presentation of any applicable time periods.

Extracted Performance. Advisers may show "extracted performance" also known as a carve out for the performance of a subset of investments from a single account or fund, so long as the extracted performance is also accompanied by the results of the portfolio from which the performance was extracted.

Hypothetical Performance

The final rule includes certain conditions that are specific to the use of hypothetical performance. It also retains the three categories of hypothetical performance: performance derived from model portfolios, back-tested performance that is generated by the application of a strategy to prior time periods when that strategy was not actually used to manage client accounts, and targeted or projected performance of a portfolio or advisory services offered by the adviser.

The final rule reflects the SEC's concern that hypothetical performance "pose[s] a high risk of misleading investors." This concern is based on the fact that hypothetical performance generally does not reflect investment decisions made in real-time or the investment results of actual client accounts. Further, particularly in the case of back-tested performance, it can be "optimized through hindsight." Notwithstanding the SEC's concerns, the final rule permits advisers to show hypothetical performance, subject to the following conditions:

- ***Policies and Procedures.*** The adviser must adopt and implement policies and procedures reasonably designed to ensure that the hypothetical performance information is relevant to the likely financial situation and investment objectives of the intended audience of the advertisement. This is a clarification from the proposed rule, which arguably would have required advisers to make the determination that the use of hypothetical performance is appropriate for each individual investor prior to dissemination. Although the SEC provides more flexibility in the final rule, it continues to take the position that advisers generally would not be able to use hypothetical performance in advertisements distributed to a mass audience or intended for general circulation because the adviser would not reasonably be able to form any expectations about the financial situation and investment objectives of a mass audience;

- ***Disclosure of Criteria and Assumptions.*** Advisers must provide sufficient information to enable the intended audience to understand the criteria used and assumptions made in calculating the hypothetical performance, including any assumptions that future events will occur; and
- ***Disclosure of Risk Information.*** Advisers must provide or, in the case of a private fund investor, offer to provide promptly sufficient information to enable the intended audience to understand the risks and limitations of using hypothetical performance in making investment decisions.

The definition of hypothetical performance expressly excludes interactive tools, where the investor uses the tool (directly, or through an adviser who inputs information into the tool). The use of interactive tools is subject to the general prohibitions, as well as additional conditions that are largely consistent with FINRA Rule 2214.

Portability

The Marketing Rule permits advisers to show "predecessor performance," meaning performance that was not generated by the adviser showing the performance. This commonly occurs when a portfolio management team leaves one advisory firm and joins another, or when there is a significant acquisition, restructuring or reorganization. The SEC adopted the following conditions, which are largely consistent with prior no-action guidance, for the use of predecessor performance:

- The person or persons who were **primarily responsible** for achieving the prior performance results manage accounts at the advertising adviser;
- The accounts managed at the predecessor investment adviser are **sufficiently similar** to the accounts managed at the advertising adviser that the performance results would provide relevant information to investors;
- All accounts that were managed in a **substantially similar** manner are advertised unless the exclusion of any such account would not result in materially higher performance and the exclusion of any account does not alter the presentation of any prescribed time periods; and
- The advertisement **clearly and prominently** includes all relevant disclosures, including that the performance results were from accounts managed at another entity.

Amendments to Form ADV

The final rule amends Part 1 of Form ADV to incorporate a new Item 5.L (Marketing Activities) that requires advisers to identify (via a yes/no question) whether their advertisements include: performance results, references to specific investment advice, testimonials, endorsements, third-party ratings, hypothetical performance or predecessor performance. Item 5.L also asks (via a yes/no question) whether the adviser receives cash or non-cash compensation, directly or indirectly, in connection with the use of testimonials, endorsement, or third-party ratings.

The responses to Item 5.L are only required to be updated during the annual update to Form ADV. We expect that these responses will be factored into the risk-based rankings the Division of Examinations (formerly known as OCIE) considers in conducting examinations.

Recordkeeping

The SEC amends various provisions of the books and records rule (Advisers Act Rule 204-2) to conform to the various provisions discussed above.

Next steps

As noted above, the Marketing Rule contains an 18-month transition period prior to the compliance date. The new requirements discussed above apply to advertisements disseminated **on or after** the compliance date. However, this also includes any advertisements that are available (e.g., online or through third parties) **as of** the compliance date. Given the scope of the changes, we would recommend that firms begin to think about the following:

- ***Existing Solicitation Arrangements.*** Review any solicitation arrangements or referral programs currently structured to comply with the Solicitation Rule. Advisers will want to consider how to modify the existing agreements and operational flow to bring them into compliance with the Marketing Rule. Advisers should also consider any indirect compensation and non-cash compensation that will be covered by the Marketing Rule, as well as the regulatory status of their promoters.
- ***Online Advertising and Social Media Influencers.*** Review any online advertising arrangements, relationships with social media "influencers," or other marketing relationships that involve the payment of cash or non-cash compensation. Although advisers may not treat them as solicitation arrangements under the current rule, these arrangements likely will be considered paid testimonials or endorsements requiring compliance with the Marketing Rule.
- ***Placement Agent Agreements.*** Advisers to private funds should be aware that, unlike the existing Solicitation Rule, the Marketing Rule will apply to the solicitation of interests in private funds. Accordingly, advisers should consider updating placement agent agreements and other referral arrangements relating to the promotion of private funds to reflect the application of the Marketing Rule.
- ***Training.*** Focus on training business, marketing and compliance professionals as to the new requirements so that they can consider how the Marketing Rule will apply to current and future marketing campaigns.
- ***Policies and Procedures.*** Begin updating policies and procedures to reflect changes to the Marketing Rule, including policies and procedures related to the use of hypothetical performance and the retention of books and records.
- ***Performance Calculations.*** Engage with performance calculation teams to advise them of the new requirements for performance advertisements, including the requirement to show gross and net performance and to show standardized performance periods.
- ***Existing Advertisements.*** Identify and start to develop a process for updating existing advertisements that will continue to be available as of the compliance date. Prioritize communications that will trigger the more specific requirements of the Marketing Rule such as advertisements that contain performance presentations (including hypothetical performance), testimonials, endorsements and third-party ratings, among other things. ▲

PRESIDENT'S LETTER...

Continued from page 5

ADISA will continue to emphasize education—an enhanced process within the Standards, Education & Publications Committee will ensure that efforts supporting consistent, best-in-class industry standards are successfully distributed as educational content. This collective body of citable work will help support and drive regulatory education and advocacy.

While our organization is strong, we know that effective advocacy often requires broader industry coordination. We look forward to building stronger strategic partnerships and coalitions with other industry organizations and our members.

The Future of ADISA

As a membership organization, ADISA is constantly trying to refine its value proposition to ensure it can best serve its current members as well as attract new members. The board and staff plan to spend significant time analyzing ADISA's overall value proposition, ensuring our offerings align with our members' needs and goals, and looking to the future to ensure ADISA maintains its unique position in the alternative investment industry. ADISA's strength lies in its ability to bring together a broad constituency of alternative investment sponsors, distributors, financial advisors and service providers.

I am excited to partner with my fellow board members, the ADISA staff and all of our tireless volunteers on driving forward these initiatives in 2021. Of course, we cannot do this alone—I encourage all members to get engaged and reach out to us with your feedback and suggestions. Together, I am confident 2021 will be one of our best years yet! ▲

Non-Traded Retail Energy Report

By Brad Updike, LLM, JD
Mick Law P.C. LLO

ISTOCK.COM/KANOKE_46

Retail Sector Summary

In 2020, nine oil and gas sponsors raised $272,833,038 for use within various energy programs. This represents a year-over-year decrease of 26% from $367 million raised in 2019, which was not unexpected considering the headwinds of the COVID-19 pandemic and the oil/gas pricing volatility observed throughout most of 2020.

While this sector of retail fundraising did not achieve growth in 2020, the sector managed to outperform 2015's numbers, i.e., $247 million, which followed the oil market crash of Q4 of 2014.

Of the nine sponsors, six raised capital to fund drilling projects in various geologic basins that include the Permian Basin, Eagle Ford Shale, Marcellus Shale, Illinois Basin and shallow oil-producing zones in Tennessee. Leading the capital raising efforts among the drilling sponsors was U.S. Energy Development Corp. ("U.S. Energy") and MDS Energy ("MDS"), each of which raised approximately $60 million in capital. Also raising significant capital for drilling was Mewbourne Development Corporation ("Mewbourne"), which raised $55.31 million. While the capital raised from each of these sponsors was lower than what was achieved in 2019, the raised capital of each is sufficient to fund the drilling of many wells within each of the sponsor's designated operational areas (a commendable result, given the challenges presented by the COVID-19 pandemic).

Of the nine sponsors, three reported varying levels of capital growth from 2019 through 2020, which included: (i) STL Resources ("STL,") up $8.3 million from 2019); (ii) Waveland Capital ("Waveland,") up about $3 million from 2019); and John Henry Oil ("JHO,") up $4.35 million from 2019. We note that, while oil and gas fundraising was down in 2020, the volume of broker-dealers ("BDs"), registered investment advisors ("RIAs"), family offices, and other firms that requested our due diligence opinions on various energy sponsors and programs was strong in 2020, with over one hundred of such firms requesting our opinions on various oil/gas opportunities. This indicates that while the retail channel is being cautious as to what energy offerings are funded, the channel continues

Mick Law P.C., based in Omaha, Nebraska, is a specialty firm comprised of full-time and of-counsel attorneys who each possess a concentrated area of expertise and in-depth knowledge. While providing a broad range of legal services to their clients, the firm focuses on two principal areas of practice; broker dealer and registered investment advisor representation and real estate finance.

to be open minded to well underwritten opportunities. A chart of the fundraising totals of the nine sponsors we covered in 2020 is provided below:

Company	Strategy	2020 Raise	2019 Raise	2018 Raise
Mewbourne	*Drilling* - Horizontal Wells in the Permian Basin, Texas Panhandle and Anadarko Basin	$55.31 million	$99.31 million	$116.7 million
MDS	*Drilling* - Horizontal Wells in the Marcellus Shale Play	$60.0 million	$68.0 million	$65.5 million
APX	*Drilling* - Mississippian Oil Targets in the Illinois Basin	$12.0 million	$21.0 million	$23.4 million
STL	*Drilling* - Marcellus Shale of Eastern Pennsylvania	$17.3 million	$9.0 million	N/A
U.S. Energy	*Drilling* - Permian Basin, Powder River Basin and Eagle Ford Shale Play; the QOF is an Opportunity Fund Seeking Working Interests and Other Upstream Assets	$64.0 million drilling; $20.0 million QOF program	$99.0 million	$100 million
Waveland	*Opportunity Fund* Targeting Minerals and Non-Operated Working Interests in the Bakken Shale	$22.0 million	$18.6 million	$33 million
Resource Royalty	*1031 Program* Acquiring Minerals and Royalties in STACK Play of Oklahoma	$5.373 million	$19.15 million	$30 million
Montego Minerals	*1031 Programs* Acquiring Minerals and Royalties in the Permian Basin, East Texas, and Central Oklahoma	$12.5 million	$32.0 million	$27.9 million
JHO	*Drilling* - Oil Producing Zones in Tennessee	$4.35 million	Did not raise capital	$4.5 million

2020 Totals by Strategy

Total Capital: $272,833,038

Drilling: 76%

Opportunity Funds: 17%

Minerals/Royalties: 7%

Three Internal Revenue Code ("IRC") Section 1031 ("§1031") programs were wholly or partially funded by Resource Royalty and Montego Minerals. Overall, §1031 energy capital dropped from what was reported in 2018 ($58 million) and 2019 ($50 million). While the assets we reviewed within the §1031 programs are positioned to generate competitive returns under current commodities prices, COVID-19 developments, coupled with a severe level of commodities pricing volatility, presented substantial headwinds for these programs. Pending a more stable pricing environment, and perhaps with some additional advisor-level education concerning the virtues of royalties, we believe this segment can achieve capital growth in 2021.

We note that a sponsor-level review was completed by our firm for Bellatorum Resources ("Bellatorum"), a mineral rights acquisition company whose operations are based in Houston, Texas. Bellatorum specializes in acquiring mineral rights and royalties within various geologic plays in Texas. Bellatorum has achieved a respectable record of exits in prior programs and will seek to establish relations with RIAs, family offices and professional service providers in 2021.

Perspective Regarding the Future

We note that the size of the oil and gas sponsor group has been stable over the past couple of years (e.g., eight to nine sponsors in 2017-2020), with drilling programs outpacing royalties and opportunistic funds in terms of fundraising. The fundraising results of this sponsor group has been choppy over the past few years ($330 million in 2017, $401 million in 2018, $369 million in 2019 and $273 million in 2020). The choppiness has been caused by severe market volatility, coupled with the fact that the sector continues to seek the reestablishment of investor trust that was lost as a result of performance failures by several companies that no longer raise capital in the retail channel.

We note that the drop in capital in relation to private oil/gas programs correlates with a drop off in M&A activities in the broader upstream (i.e., E&P) sector of energy over the past few years, which fell year-over-year in both 2019 and 2020 by more than 50% in transactional value. On this point, no sector of the oil/gas universe is immune to the effects of an uneasy market, as reflected in the Alerian MLP Index, which continued to fall last year (it dropped 30% from mid-January 2020 to mid-January 2021). Due to severe price volatility, energy banks have also followed suit and have tightened their lending standards considerably.[1]

By analogy, the §1031 real estate segment went through restructuring and came back from approximately $200 million raised in 2009 and 2010 to over $3 billion in 2019 and 2020. For oil and gas sponsors, however, we anticipate a slow climb back to pre-2015 raise numbers (i.e., $800 million-$1 billion), as oil prices are expected to remain below the pre-2015 prices in 2021 and 2022. On a better note, we continue to believe that the overall strength of the oil and gas sponsor group today compared to what was the case ten years ago bodes well for this segment going into 2021.

Three Cycles in One

Oil and gas pricing has moved like a roller coaster over the past 15 years. Unfortunately, this has worked to the peril of some E&P oriented programs in which the CapEx spent was relational to the higher prices of the underlying commodities (i.e., as the costs for energy assets and drilling related services move in positive correlation with oil/gas prices). The cycles of the past decade are summarized as follows:

- The shale boom that took U.S. oil production from under four million barrels of oil per day ("BOPD") in late 2008 to more than 9 million BOPD in 2014 over-supplied the global market. Saudi Arabia's attempt to regain market share in 2014 caused the oil price to decline from over $100 per barrel ("bbl") to under $30 per bbl. The double bottom in early 2016 appeared to be the end of this cycle, and oil prices moved back to over $70 per bbl in the summer of 2018.
- Then, the U.S. vs. China trade war took oil back under $50 per bbl. The signing of phase one of the trade agreement had oil back on track to the $70s. In the first week of this year, oil was trading over $62 per bbl, and everyone thought the price was heading higher.
- Then, along comes the COVID-19 pandemic and the oil price crash in April 2020. From April through the first week of May 2020, we saw prices settle below $20 bbl and even dip below $0 for a day.

Better Times Ahead? Probably

Barring another round of severe COVID-19 shutdowns, oil, natural gas and natural gas liquids ("NGL") prices appear to be heading in a better direction. While oil prices have yet to return to the levels observed in 2018, such prices have rebounded quicker than what the futures markets predicted in April/May 2020, with oil prices stabilizing by December 2020 at around $45-50 bbl. Natural gas prices have also made a comeback, which have found a level of $2.50-$2.75 MCF (one thousand cubic feet) through December 2020.

Market experts, including Goldman Sachs and Raymond James, are predicting a continuation of better pricing for oil/gas. As to natural gas, both firms are bullish on pricing for 2021 based upon the reduction in drilling CapEx within major U.S. fields, which has led to a reduction in the U.S. rig count from over 750 rigs a year ago to approximately 340 rigs running as of January 8, 2021. While most of these rigs are deployed within fields whose economics are driven primarily by oil production (i.e., Permian Basin), less drilling for oil means *less associated natural gas will be produced as a consequence*. In view of a lower expected level of associated natural gas production, both Goldman Sachs and Raymond James have suggested the possibilities of $3.00 MCF through much of 2021 (but with natural gas expected to settle back to pre-COVID price levels in 2022 upon a rebalancing of market supply/demand for oil).

While oil is expected to move upward, the climb is expected to be slow rolling as worldwide GDP and associated oil demand are not expected to return to pre-COVID-19 levels until 2022. For this reason, Raymond James forecasted a moderately higher WTI price average of $57 bbl in 2021 as a result of a gradual reopening of worldwide economies and OPEC/Russian cooperation in continued production cuts. Raymond James anticipates oil pricing of $65 bbl in 2022 based upon a rebalancing of oil supply/demand.

While the above-mentioned sentiment gives us pause for hope, higher oil prices will require an economic re-normalization that depends upon the widespread availability of a COVID-19 vaccine for billions across the world. Taking a more conservative approach, the Energy Information Administration ("EIA") projects the Brent crude spot price to average $53 bbl in 2021, which compares favorably to the average of $42 bbl in 2020. This forecast, which is driven by the EIA's expectation for a GDP increase of 4% in 2021, implies an average WTI spot price around $50 bbl for this year. Similar to Raymond James' forecast, the EIA anticipates natural gas pricing of about $3.00 MCF through much of 2021.

So Where Is the Activity Today?

OPEC has been cooperative at keeping its output in check, as evidenced by its willingness to cut its production to 25.6 million BOPD in 2020.[2] Supporting this, the U.S. petroleum industry has curbed its drilling activities, with the number of U.S. rigs decreasing from 750 a year ago to 340 rigs today. The reduction in U.S. drilling is illustrated through the following activity data published by Baker Hughes:

Basin	1/8/2021 Rig Count	One Year Ago Rig Count	One-Year Change
Arkoma/Woodford Region	10	25	–60%
Barnett Shale	0	1	–100%
DJ-Niobrara	5	19	–74%
Eagle Ford Shale	26	67	–61%
Granite Wash	0	1	–100%
Haynesville Shale	43	45	–4%
Marcellus Shale	30	41	–26%
Mississippian Play	0	2	–100%
Permian Basin	179	397	–55%
Utica Shale	4	10	–60%
Williston Basin/Bakken	11	51	–78%

Baker Hughes, 1/3/2020

While no U.S. Basin has been immune to activity reductions, we note that the Haynesville Shale and the Marcellus Shale Plays fared better than the major oil producing basins in terms of their activity declines. This appears to be linked, in part, to a generally bullish outlook for the prospects of natural gas in 2021, coupled also with emerging opportunities in the U.S. to export LNG abroad. *Coincidentally, the retail fundraising channel appears to have taken notice of this, which is evidenced by the comparatively strong fundraising results of MDS and STL, both of which raised capital for natural gas drilling in 2020*.

Us Production Can Turn On a Dime

Despite the sentiment for better oil pricing this year, a stable market commands a worldwide supply/demand balance. A potential disruptor to this equation is the fact that the U.S. drilling industry can drill and operate wells at lower break-even prices as compared with its OPEC counterparts. In contrast to the fiscal break-even prices of many OPEC countries that range within a $60-100 bbl pricing level,[3] U.S. oil producers operating in the Permian Basin, Eagle Ford and other basins can drill economic wells within a $45-50 bbl pricing level, while breaking even from a post-drilling operational perspective at $20-30 bbl.[4] A table that illustrates the break-even for drilling and operating wells within the above-mentioned oil fields is provided below (***reported on a "per bbl" basis***):

Play	Average Break Even Drilling	Range of Responses B/E Drilling	Average Price to Recover Operational Costs
Permian-Midland	$46	$30-60	$26
Permian-Delaware	$52	$35-60	$26
Permian-Other	$50	$30-70	$32
Eagle Ford	$46	$40-55	$23
Bakken Shale	$51	$40-60	$28
Other U.S. Shale	$51	$20-70	$30

Federal Reserve Bank of Dallas Survey 92 E&P Firm Responses Reported Jan. 6, 2021

Despite the abilities of U.S. producers to operate at lower prices, U.S. oil production in 2020 was tempered significantly by COVID-19, which caused U.S. oil prices to drop below $20 bbl in April 2020 and caused oil production to drop from 13.1 million BOPD in early March 2020 to 9.7 million BOPD in August 2020. However, as oil prices improved in Q3-Q4 2020, so followed U.S. oil production, which *quickly* moved back to 11 million BOPD through much of November and December of last year.

The EIA expects U.S. oil production to stabilize at about 11.1 million BOPD in 2021, with OPEC expected to gradually lift its production cuts and increase its output moderately from 25.6 million BOPD in 2020 to 27.2 million BOPD in 2021. While this sentiment is comforting at first blush, it must be noted that many U.S. producers operating in economically profitable areas are positioning themselves to increase their drilling and production activities in 2021.[5] In a recent survey conducted by the Federal Reserve Bank of Dallas that included about a hundred executives from various E&P companies, about 50% expressed their intentions to ramp up their drilling capital expenditures this year under the belief that oil prices will fall within a range of $40-50 bbl this year. As such, the ability of the world oil market to return to better pricing could be flustered by the desires of U.S. producers to achieve profits through drilling in 2021/2022.

On the political front, one might be inclined to consider the plans of the President Biden to ban fracking on federal properties. At first blush, it might also be tempting to assume this development will drive U.S. oil production downward. However, it should be noted that the impact of President-Elect Biden's plan is limited to *federally* owned lands, which account for about 10% of the U.S. oil production. Conversely, President Biden's anti-fracking position could be construed as a welcomed development by some U.S. oil producers that stand to see their oil properties become more valuable as a result.

Market Pricing

The following market information was derived from a number of informational sources:

Oil

As of January 14, 2021, the WTI spot price for crude was $53.33 per bbl, with the Brent spot price being $56.24 per bbl. The EIA forecasts Brent spot prices to average $53 per bbl in both 2021 and 2022 compared with an average of $42 per bbl in 2020. The EIA estimates global consumption of petroleum and liquid fuels averaged 92.2 million BOPD for all of 2020, down by 9.0 million BOPD from 2019. The EIA expects global liquid fuels consumption will grow by 5.6 million BOPD in 2021 and 3.3 million BOPD in 2022. The EIA expects oil prices to increase in 2021 due to the development of a COVID-19 vaccine and a gradual increase in oil demand as travel/GDP increases in the second half of this year.

The EIA's sentiments, which imply an average WTI price of about $50 bbl for 2021, are slightly lower, yet generally consistent with the NYMEX futures prices observed on January 12, 2021. While financial firms such as Raymond James and Goldman Sachs are assuming an optimistic posture regarding the future of oil, the broader futures market is more pessimistic due to the uncertainties surrounding a full-scale return to pre-COVID-19 economic conditions, coupled with the fact that U.S. production levels remain a wildcard due to the ability of U.S. producers to drill profitability at a $45-50 bbl price level.

Jan. 12, 2021

NYMEX Contract Month	Contract Price
Feb. 2021	$53.33/bbl
July 2021	$52.68/bbl
Jan. 2022	$50.73/bbl
Jan. 2023	$48.53/bbl
Jan. 2024	$47.24/bbl

In respect to oil produced from the Permian Basin, we note that pricing tensions in the basin appear to have eased based upon the pipelines added. While the Midland-Cushing pricing differential peaked at a negative $16.12 per bbl in September 2018, the differential worked its way down and has settled recently at about $1 per bbl.[6]

Natural Gas

As reported by the EIA, natural gas inventory in the U.S. stood at 3,198 BCF on January 8, 2021, which is 4.1% above the natural gas inventory reported a year ago. In view of higher inventories, natural gas futures prices remain consistent with prices generally observed since 2015:

Strip Jan. 14, 2021

NYMEX Contract Month	Contract Price
Feb. 2021	$2.68/MCF
July 2021	$2.81/MCF
Jan. 2022	$3.11/MCF

Natural gas price average—past five years

2015	$2.62
2016	$2.52
2017	$2.99

2018	$3.15
2019	$2.58
2020	$2.03

In relation to natural gas prices, it is important to consider circumstances that cause local natural gas prices to deviate from the main market. Such circumstances include gas supplies in an area and the area's ability to carry the supplies to market. Areas of the U.S. where most of the domestic natural gas is produced include Appalachia (Marcellus/Utica), 30,613 MCF/day, Permian Basin, 11,531 MCF/day, Haynesville Shale Play (East Texas and West Louisiana), 9.212 MCF/day, and the Eagle Ford, 4.047 MCF/day. Coincidentally, areas of high production can experience bottlenecks in takeaway capacity. Historically, this has played out in Pennsylvania, the core of the Marcellus Shale Play, and in the Permian Basin, which accounts for about 50% of the rigs operating in the U.S.

While substantial natural gas differentials were experienced in the Marcellus a couple of years ago, the addition of transmission infrastructure reduced price differentials from $1 per MCF and higher in 2015-2017 to about $0.46 per MCF today. Based upon DTI gas pricing, the differential expected for gas produced in eastern Pennsylvania that is purchased by Dominion Energy Transmission, Inc. is expected to average about $0.60 per MCF in 2021 (which is lower than the differentials observed in 2015-2017).

Interestingly, lower differentials have also been experienced by operators that deliver their natural gas to the Waha Hub in Pecos County, Texas, which services the Delaware and Midland Basins. The differential for gas delivered to the Waha Hub is $0.13 per MCF for February 2021 deliveries and is expected to remain under $0.20 per MCF through much of 2021. This result is a welcomed development in view of the differentials observed a year ago (i.e., exceeding $1.50 per MCF). The presence of additional pipelines, coupled with a drop in oil and associated natural gas production through 2020, appear to have eliminated much of the Waha pricing differential for now.

Market Pricing Summaries

WTI Oil Spot Price (1/14/2021):	$53.33 (2020 avg. was $39.17/bbl)
Brent Oil Spot Price (1/14/2021):	$56.24 (2020 avg. was $41.69/bbl)
NYMEX Gas (Feb. 2021 deliveries):	$2.68 MCF (2021 avg. was $2.03/MCF)
NYMEX Futures 2021/oil:	$51-53 per bbl (CME 1/14/2021)
NYMEX Futures 2021/gas:	$2.60-3.00 MCF (CME 1/14/2021)
DTI Average 2021 Differential:	$0.63 per MCF (CME 1/14/2021, futures prices)
WAHA Average 2021 Differential:	$0.20 per MCF (CME 1/14/2021, futures prices)
ILL/Countrymark Differential (1/14/21):	$7 per bbl (preferred pricing is available for certain operators in Southern Illinois based upon volumes)

Summary: What Makes Sense in 2021

As was the case a year ago, oil pricing remains a wildcard for 2021.

On the positive side, some respected energy finance firms are optimistic about the prospects for better oil prices. While the sentiment of the broader NYMEX oil futures market is somewhat more pessimistic than that of Raymond James and Goldman Sachs, NYMEX' expectations also bode favorably when compared with the average oil price realized last year. The uncertainties surrounding a full-scale return to pre-COVID-19 economic conditions, coupled with the question as to whether U.S. producers will keep their feet off the pedal long enough to allow the world's supply and demand fundamentals to rebalance, are undoubtedly the wildcards this year.

Despite the uncertainties, there are areas in the U.S. where oil/gas can be profitably developed and/or produced at low break-evens. As such, drilling and other E&P focused investments will continue to present viable opportunities to investors in 2021. However, cautious underwriting is key, as it is important to understand the break-evens of projects given their locations and corresponding challenges. Pro formas must factor relevant commodities pricing discounts based upon local supply/demand and available infrastructure. Additionally, special cost-related considerations, such as water disposal, sponsor/manager compensation and load must be built into the economic underwriting models.

While the press has historically favored the Permian and Eagle Ford, remember there are core and non-core areas in all popular plays. This is another area in which the value of independent project underwriting comes into play.

While capital raise numbers have yet to reach the levels realized five years ago, the foundation for growth continues to be better today than what we had a decade ago in a promoter-infested environment.

Underwrite, underwrite, underwrite. ▲

Footnotes:

1. Mark Holmes, Oil & Gas Industry Feels Financing Squeeze, debtexplorer.whitecase.com (June 23, 2020).
2. Energy Information Administration's Short-Term Outlook (Jan. 12, 2021).
3. Oil Profitability Around the Word—or—what is the cost to keep their social programs running? www.oilandgas36o.com (website visited Jan. 12, 2021).
4. Federal Reserve Bank of Dallas (Jan. 6, 2021).
5. Dallas Fed Energy Survey (Dec. 30, 2020).
6. CME, WTI Midland Argus vs. WTI Financial Futures (Jan. 12, 2021).

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Are You Prepared for the Second Wave? The QSR Sector Could Benefit Investors

By Brian D. Buehler
Triton Pacific Securities

The novel coronavirus virus disease (COVID-19) pandemic has heavily impacted the economy, public markets, federal and local government policy, and businesses of all sizes throughout America and the world. However, not all businesses have been impacted equally.

In the midst of a large-scale economic crisis, there are always winners and losers. For investors, under such conditions, the “bets” one makes are often a high-risk/high-reward proposition. We all witnessed this throughout Q2 2020 during the high stakes gamble on the recovery of markets and which sectors would be the winners. Among the winners has been a large, less volatile industry that demonstrated incredible resilience to the dramatic changes across our society and economy since April. This $275+ billion industry in the United State feeds almost 85 million Americans each day. It’s been classified as “essential business” by the federal government and is part of the fabric that makes America what it is.

The Quick Service Restaurant (QSR) industry does not offer a “get rich quick” scheme. It is a resilient industry that has demonstrated, time and time again, its relative stability in the face of volatility. For that reason, the importance of investing in this sector isn’t only predicated on its historical performance, but is germane today if you believe, as I do, that a second and perhaps third wave of the current pandemic is likely.

COVID-19 has been a devastating and disruptive force on our modern day society, similar in many respects to the rampant Spanish Flu (1918 H1N1 virus) pandemic of 1918 and 1919. The Spanish Flu spread during World War I from early Spring 1918 to late Summer 1919. Although the origin is not universally determined, the first formal identification of the virus was at Camp Funston at Fort Riley, Kansas. In the span of six months, as military troops were deployed to World War I, the flu spread from United States to Europe and Asia. There were over 50 million deaths worldwide, with 675,000 of those deaths in the U.S. out of a total population of 103 million. Additionally, the 1918 H1N1 virus infected 500 million people globally; one third of the world’s population, which was approximately 1.8 billion at the time.

According to the U.S. Department of Health and Human Services’ Center for Disease Control and Prevention (CDC), the devastation of the Spanish Flu occurred in three waves. The first wave began in March 1918, lasting until around May 1918. The second wave was the most impactful, infecting the highest number of people from September to November 1918. Finally, the third wave

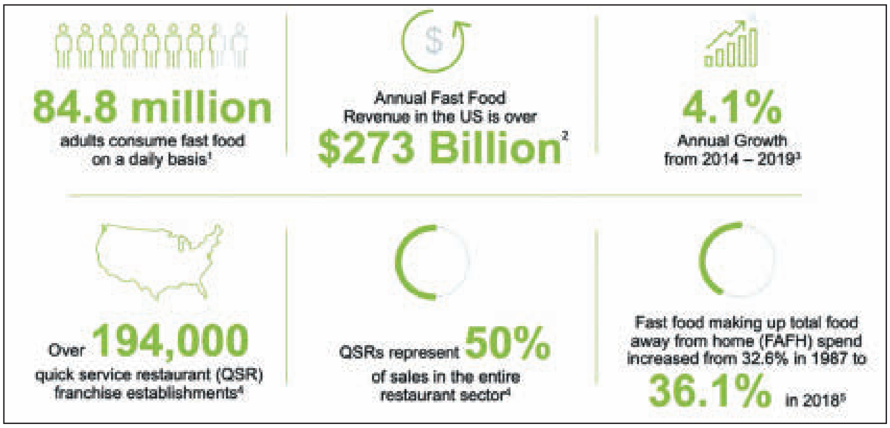
Triton Pacific partners with companies in high-growth or rapidly changing industries. They focus on solid management, operational excellence, efficient capital structure, and a sound business model.

lasted through Winter and Spring of 1919, dwindling down in the summer of 1919. The current coronavirus may be on a similar course as the Spanish Flu of 1918-1919, as we may now be entering a second wave.

What went right or wrong? Some research suggests global governments did not react fast enough to the Spanish Flu spread, as governments were preoccupied with WWI. Global economies closed down movie theaters, night schools, and public gatherings. Many manufacturing businesses shifted to staggered hours for workers. Public health officials pushed for good personal hygiene, use of masks, use of disinfectants, quarantine and self-isolation. Does this sound familiar? A vaccine for the Spanish flu was never developed, and the pandemic is believed to have likely ended by herd-immunity, which is the natural development of immunity throughout a large percentage of the global population.

In following health guidelines on restaurants from the CDC, QSRs are determined to be Lowest Risk, which CDC qualifies as food service being limited to delivery, takeout, curbside pickup and drive-through. As a result, the QSR industry has demonstrated strong performance during the pandemic, as brands like Burger King and Pizza Hut are becoming more popular throughout the quarantine period, as well as during limited reopenings across the country. Despite the dramatic decrease in the U.S. economy over the two quarters, most QSR brands are seeing an increase in same store sales in comparison to 2019. QSR has a clear value proposition that resonates for consumers under pandemic conditions—safety, value, and convenience.

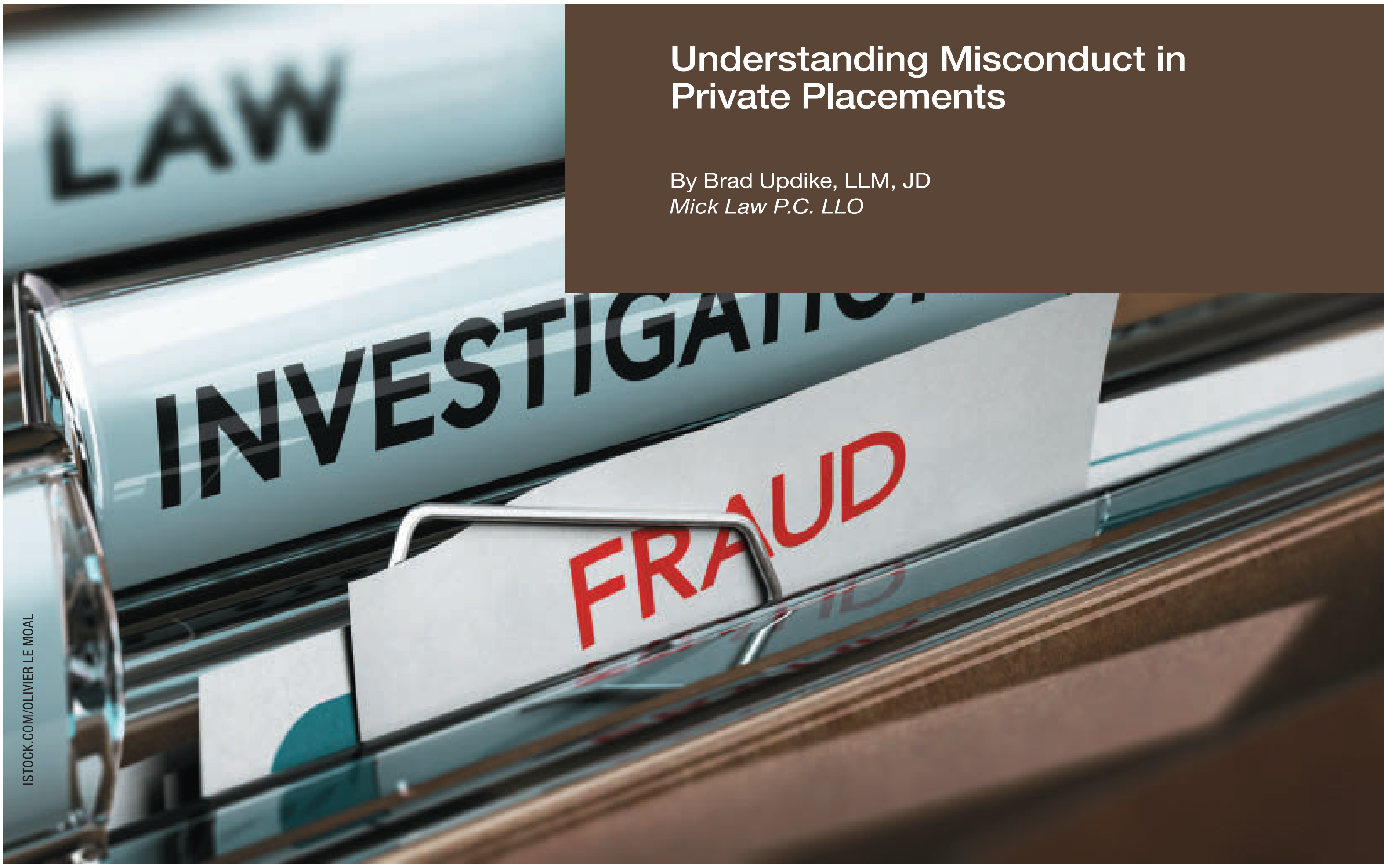
This isn't the first time we have seen strong QSR performance during challenging economic times. As shown in the graph above, during the great recession from 2007-2009, the QSR industry showed strong relative performance to the broader economy, with flat to growing sales. Looking beyond the current COVID-19 climate, the economy is likely to face sustained challenges for some time, and as evidenced by the industry's performance during the great recession, we expect strong recent performance to sustain.



With more people staying home, unable or unwilling to go to local restaurants, the reality is that a normal, pre-COVID, restaurant dining experience is not possible for some time. As a result, chain restaurants like Burger King, Pizza Hut, Taco Bell, KFC, Dunkin' and others have become a staple food option for the American consumer. This is not surprising, since more than 1/3 of Americans' expenditures on food away from home occur with quick service restaurants. The bottom line is, people need to eat, and QSR provides an efficient and cost-effective solution to American families in good times and bad. The question to ask yourself is, are your clients' portfolios prepared for the second wave? ▲

Understanding Misconduct in Private Placements

By Brad Updike, LLM, JD
Mick Law P.C. LLO



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Private placements are non-public securities offerings marketed to a limited number of investors. These offerings are used by tens of thousands of companies on an annual basis to raise money for use within many sectors of the U.S. economy that include real estate, energy and private equity.

The capital raised by these offerings has been substantial, as evidenced by 20,000-30,000 Form D filings a year from sponsors seeking to raise trillions of dollars for their businesses.

Despite the widespread use of private placements, they became the subject of controversy during the Great Recession after law enforcement authorities uncovered multiple instances of misconduct perpetrated by sponsors such as Provident Royalties, LLC; Medical Capital Holdings, Inc.; Sunwest Management, Inc. and others. Excluding $65 billion of capital that was eviscerated by the misdeeds of Bernard Madoff, in 2008 authorities uncovered forty other Ponzi or Ponzi-like cases that affected about $23 billion of investor capital. The second year of the Great Recession was almost as bad, with Ponzi activities also being linked by authorities to $15 billion of capital in 2009.

In view of the *wave of frauds* revealed during the Great Recession, hundreds of broker-dealers and professional service providers were called forward to answer for the misdeeds of the wayward sponsors. The fallout of this was substantial. After the smoke cleared, many broker-dealers were forced to close their doors due to the lawsuits, arbitrations and enforcement cases. In the case of Provident Royalties, LLC alone, twenty of the sponsor's 53 selling group members were forced to close. For those that survived the fallout, the damages paid out to the investors were considerable.

While cases of misconduct have been generally down over the past decade, they continue to surface from time to time; these have included recent cases filed by the Securities and Exchange Commission (SEC) against EquiAlt, LLC (filed February 2020)

Brad Updike joined Mick Law in August 15, 2006, and his areas of practice include securities law, oil and gas, private equity, conservation real estate, DPP due diligence, taxation analysis relating to securitized financing and securities advertising practices. On a local level, Mr. Updike has also served the legal needs of Omaha-based clients on matters relating to estate planning, private placements, trademark law and 501(c)(3) non-profit taxation matters.

and *GPB* Capital Holdings, LLC (filed February 2021). Acknowledging that these are open cases whose litigations are pending, the alleged wrongdoings unfortunately resemble those of the infamous cases that surfaced during the Great Recession.

On a positive note, our economy is positioned today for economic growth as the COVID-19 vaccine is administered on a broad scale and as various sectors of the U.S. and world economies reopen. *While we are encouraged by the prospects for economic growth, we believe it is important to reflect upon the challenges of the past to help empower our membership for responsible growth moving forward.* Accordingly, this article will provide a narrative of past misconduct cases to help facilitate improvements in the due diligence and risk management practices of ADISA's membership.

Misconduct Case Studies

We will discuss three cases involving private placement misconduct. These cases were selected based upon the finality of the underlying litigations. Despite the age of the cases, we believe they are worthy of reflection due to their common facts. These cases are similar in that each of the sponsors experienced success during the beginning of their business cycles, and in that the early promise of the sponsors led to successful fundraising results within the retail investment channel. Unfortunately, these cases are also similar in the sense that accountability and transparency were seriously lacking, which ultimately led to a pattern of misconduct in each sponsor's cash management practices within the programs.

1. Provident Royalties, LLC ("Provident")

Provident was an energy sponsor that acquired mineral interests and royalties. These acquisitions were accomplished through a series of preferred stock offerings whereby investors were to be paid dividends that ranged from 15% per year for shares with anticipated holding periods of two years and 18% per year for shares with anticipated holding periods of three years. Upon an investor's purchase of the shares, monthly dividends would commence at the beginning of the fourth month from the purchase date. At the end of the anticipated holding period, investors were to receive their invested principal and the monthly dividends that accrued during the initial three months of the investment.

Provident's preferred stock programs in 2007 raised approximately $100 million, and most of that capital was used to acquire mineral rights, royalties and working interests covering 90,000 acres within the Woodford Shale Play in central Oklahoma. This basin was deemed by the *Oil & Gas Investor* magazine in 2006 to be the next biggest E&P play in the U.S. due to the horizontal drilling results achieved by operating companies such as Newfield Exploration and others. Good fortune followed from Provident's ability to acquire its asset position, which included: (i) the procurement of a joint venture with SinClair Oil Corporation to develop the acreage position through additional asset purchases and through drilling; and (ii) the procurement of a $150 million credit line from Frost Bank (which was supposed to be used, in part, to manage Provident's dividend payments to investors and to fund drilling costs on new wells). This good fortune led to the funding of twenty programs that raised $465 million.

Despite Provident's promise, there were *serious* quirks within Provident's operations. First, Provident did not have a functional accounting system. While Provident hired a team of clerks and accountants to handle bookkeeping, at no time did it have a written set of practices and controls to follow when dealing with program capital and other sources of money. In accordance with the corporate charters of the program entities, Provident could pay investor dividends out of each program's capital surplus, i.e., determined by each program's net equity (as opposed to earnings). Also, Provident's offering materials allowed it to buy and sell assets to and from its managed offerings, i.e., enabling an earlier program to sell its assets to a later entity to help fund dividend payments to early investors.

Interestingly, Provident could have perhaps avoided its fate by managing its investor payments through the credit line, as the credit line authorized Provident to use up to one-third of the principal to pay dividends. However, Provident allowed itself to get caught up in a *shale buying frenzy*, in which it imprudently took money from whatever sources were immediately available to buy assets, drill wells and pay dividends to investors. In addition to having an undisciplined accounting system, a second problem with Provident's strategy was that it did not have a backup plan in the event that a divestiture of the program's assets became unachievable. Thus, all fortunes rode high on Provident's ability to exit its Oklahoma asset position quickly.

With the Great Recession's onset in late 2008 came a massive drop in oil and gas prices. Due to Provident's improper cash management practices, the balance sheets of *each* of its programs were riddled with related party receivables and payables. While Provident's entities collectively acquired a promising base of assets located within a discernible path of future drilling (the future net revenues of which were estimated by Albrecht & Associates in June 2008 to be $6.5 billion), many of these assets did not produce cash flow at the time they were held by the programs. At the end of the day, it was virtually impossible for anyone to confirm the exact source of the investor dividends, as Provident's sources of capital included $150 million of credit line proceeds and several millions of dollars of joint-venture reimbursements from SinClair, as well as the $465 million of investor capital.

With the recovery of oil and gas prices in late 2009, it was opined by a restructuring consultant during Provident's bankruptcy that its base of assets would have allowed it to restructure its finances and to recover from the carnage of the Great Recession. Provident was denied that opportunity, however, based upon the scope of the fraud and the magnitude of affiliated transactions conducted. In the end, assets were sold through the bankruptcy process, and losses were realized by investors and selling group firms.

2. Medical Capital Holdings, Inc. ("MCHI")

Formed in 1994, MCHI's business consisted of acquiring healthcare receivables owed to physicians or physicians' offices by medical patients or their insurance carriers. As of February 2001, and prior to the time in which it entered the retail broker dealer channel, MCHI had already purchased $500 million in healthcare receivables. MCHI was led by a number of individuals with respectable work backgrounds in insurance, finance, medical finance and accounting.

MCHI funded its healthcare financing activities by offering promissory notes ("notes") issued through a series of six special purpose corporations ("SPCs") formed at various times from 2003 through 2009. To raise capital, the SPCs sold notes through broker dealers. In these offerings, the notes had various maturities (one to seven years) and interest rates (8.5-10.5%). The notes with shorter maturities (i.e., one to three years) were automatically renewable for a one-year term unless the investor provided MCHI with written notice that he or she did not want to renew the note.

The capital raised by the SPCs was anticipated to be used to acquire healthcare receivables purchased by MCHI. MCHI would use its financial resources to acquire receivables at a discount from various healthcare providers. The SPCs would then use the capital raised from investors to purchase the receivables from MCHI at cost plus a significant portion of the unrealized discount (i.e., at a price close to face value). Upon an SCP's procurement of the receivables, the receivables would be used as collateral for the investor notes. Based upon the marketing appeal of the notes as income products and the operational success of the initial program, MCHI raised $1.76 billion from 2003 through 2009.

Despite a promising beginning, there were many pitfalls with respect to the notes and their administration. Initially, the investment strategy of the SPCs, beginning with the initial 2003 program, consisted of purchasing receivables from physicians and physicians' groups, smaller hospitals and equipment distributors. The investment strategies of the SPCs, however, changed after the first two programs. Beginning with the third offering launched in 2005, the scope of permitted investments was expanded to include non-receivable assets, including equity securities of all types of businesses and mortgage loans to receivable sellers or other parties in the healthcare industry. Unlike standard lending practices employed within the real estate lending community, which generally impose loan to value ratio (LTV) limits of 60%-75% upon loaned principal, MCHI's programs could make loans at LTVs of up to 100%.

MCHI's acquisition process was described within the offering materials of the SPCs. As stated within the materials, MCHI maintained a revolving credit line that enabled it to acquire receivables at discounted prices. Upon purchasing the receivables, MCHI would sell the receivables to the SPCs at a price equal to the sum of the money advanced to the seller of the receivables *plus* a significant portion of the unearned discount. The receivables purchased by MCHI and later sold to the SPCs were not subject to outside valuations.

According to the note agreements executed by the SPCs and the collateral agent banks, the definition of "Eligible Receivables" that could be purchased by the SPCs and ultimately used as collateral for the investor notes included receivables in which a claim for payment had been submitted to the approved payor within 180 days prior to the purchase of the receivable. As such, MCHI could sell "aged" receivables to the SPCs for which future collections were doubtful.

There were many other quirks of a problematic nature. The offering materials of the SPCs authorized MCHI to conduct related party asset sales among the SPCs for the stated purpose of diversification within each affiliate's portfolio. Despite the SPCs' collective issuance of approximately $1.7 billion in notes, neither MCHI nor any of the SPCs were required to procure audited nor reviewed financial statements, nor were they required to maintain accounting books and records that would otherwise enable them to provide GAAP-compliant financial statements to investors or stakeholders if requested. Unlike many note offerings, whereby a bank serves as a trustee on behalf of the noteholders and is empowered to monitor the note issuing entity's financial status and compliance with the borrower obligations, the borrowing agreements reduced the banks to the role of a collateral holding agent with limited monitoring powers.

MCHI's demise began with defaults of its payment obligations within its note programs in August 2008. As reported by Thomas A. Seaman, the court appointed Receiver for MCHI ("Receiver"), the climate of unaccountability within the various SPCs culminated in (i) massive collectability issues, (ii) a substantial number of related-party asset transfers among the SPCs, and (iii) ultimately, MCHI's misuse of investor funds. A summary of certain of the Receiver's findings is provided below:

- The purchases of receivables/loans of the programs were $2.288 billion (70% were receivables and 30% were loans);
- The collections of proceeds on the SPCs' purchased assets were $1.972 billion, thereby resulting in a collective loss of $316 million;
- Of the loss, almost all was attributable to the acquired loans (i.e., loan purchases exceeded loan collections by $352.556 million);
- Of the six SPCs, only the first was found to have realized profitable operations;
- Excluding the first program, the losses of the next five were $423 million; and
- Of the receivables/loan purchases by the SPCs, about $1 billion was derived from over 300 affiliate transactions among the SPCs.

On July 16, 2009, the SEC filed a Complaint against MCHI and its principals for various intentional violations of federal securities laws. Based upon the SEC's allegations against MCHI and its SPCs, many investors also filed a class action lawsuit against nine broker-dealers that were members of the selling group.

3. Sunwest Management, Inc. ("Sunwest")

Formed in 1992, Sunwest managed several senior living facilities throughout the U.S. Sunwest operated its business through certain affiliates, which included: (i) Canyon Creek Development, Inc., formed in 2001 to raise capital from investors through Tenancy in Common ("TIC") structured offerings; and (ii) Canyon Creek Financial, LLC, formed in 2005 to serve as a captive broker-dealer for the TIC offerings. At the peak of its activities in 2007, Sunwest managed 300 retirement facilities in 34 states, with the assets collectively valued at approximately $2 billion.

From 2001 through 2008, Sunwest raised $430 million from investors. Sunwest raised most of these funds from 2006 through 2008 in 99 broker-dealer syndicated offerings that covered about a hundred retirement facilities. Most of Sunwest's programs were structured as TICs, whereby the investors acquired direct interests in the retirement facilities. The targeted properties were usually underperforming facilities with lower occupancy levels (e.g., 50-70%), which Sunwest's management believed could be improved.

Upon purchasing a facility, Sunwest's objective was to increase the facility's occupancy rate through prudent management, which would help to increase revenues and hopefully produce positive cash flows. Sunwest's return objective was intended to provide investors with annual returns of 10% during the facility's lease-up period. This was to be accomplished through a "Master Lease Agreement," whereby an entity affiliated with Sunwest would enter into a rental agreement in which the Sunwest Master Tenant would be required to pay ongoing rent to the TIC investors. The Sunwest Master Tenant would also designate Sunwest as each facility's operator and property manager.

Upon the achievement of a higher stabilized occupancy level, the platform's exit strategy was to refinance the loans of the facilities at an LTV that would enable Sunwest to repay the TIC investors their capital and an additional 2% return for each year invested. Each TIC was marketed as a stand-alone facility with separate operations, books and records, and financial resources. The offering materials characterized the future success of the programs as being dependent upon the cash flows and performance of the underlying facilities acquired by the TIC investors.

From 2001 through July 2008, TIC investors received rent payments that were consistent with Sunwest's objectives. Sunwest's practice of making timely rental payments to the investors was used to promote the offerings. While Sunwest established a history of timely payments to its investors, the source of the rental payments and the overall quality of Sunwest's accounting system was *not* well understood.

Sunwest's program accounting practice from the outset of its business in 1991 involved a "collective management approach," whereby the individual TIC properties were treated as a single consolidated entity. Similar to the facts of Provident, Sunwest managed the cash of its portfolio of facilities on an "as available" basis. As various costs at the facilities became due (e.g., vendor bills, payroll, debt service and payments to investors), Sunwest's finance team located and took cash from whatever facility happened to have it.

Unfortunately, as the credit markets tightened in 2007 and 2008, Sunwest's financial prospects for success were greatly frustrated. Despite Sunwest's practice of paying distributions to investors, almost one-third of the facilities it managed were cash flow negative for many years. Many facilities had never been cash flow positive. On a portfolio basis, and during 2007-2008, approximately 60% of Sunwest's managed facilities experienced negative cash flows.

By 2008, the U.S. credit crisis rendered Sunwest's business model unworkable. Sunwest's ability to refinance its facilities disappeared, and it faced problems funding operations at many facilities. By the onset of the Great Recession in January 2009, a majority of Sunwest's retirement facilities had been placed into foreclosure, receivership or bankruptcy, resulting in the effective elimination of the TIC investors' interests in the facilities. Similar to the fates of Provident and MCHI, the SEC pursued litigation against Sunwest and, ultimately, many investors sued the selling group members for their involvement in raising capital for Sunwest's business.

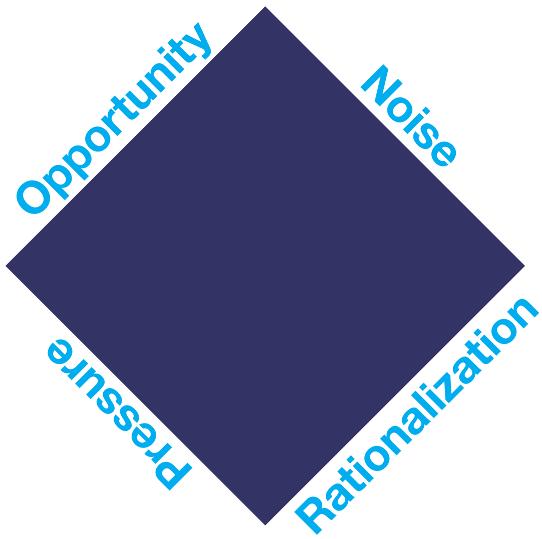
The Fraud Diamond

The Fraud Triangle, developed by criminologist Donald R. Cressey, is commonly used by fraud examiners to understand how and why fraud occurs in businesses. The three elements of the triangle are: (i) pressure (i.e., the motivation for the fraud); (ii) opportunity (i.e., operational weaknesses or weakness in the business's governance that allows the fraud to be undetected); and (iii) rationalization (i.e., the justification for the fraud). Note that we added a fourth leg into our analysis that we shall refer to as “noise.” The noise side of our “diamond” refers to the circumstances that distract stakeholders from discovering the misconduct.

The Fraud Diamond:
A framework for spotting high-risk fraud situations

Opportunity
Ability to execute plan without being caught

Noise
Circumstances that distract stakeholders from fraud



Pressure
Financial or emotional force pushing toward fraud

Rationalization
Personal justification of dishonest actions

A summary of the circumstances applicable to the three cases that fit into our Fraud Diamond are presented below, with each circumstance being applicable to two or all of the above cases.

Pressure/Motivation

- The market turns unfavorable, which affects cash flow of the programs
- Operations are unprofitable due to a failure by the sponsor to execute the core business strategy
- Operations are unprofitable because the sponsor moved away from its core business model
- The sponsor has a perceived need to pay investor distributions to preserve its reputation
- The sponsor has a perceived need to manufacture an exit within its first syndicated program to demonstrate a proof of concept to selling group members and investors
- The sponsor needs to continue to raise capital to accrue program management revenues and to stay in business

Opportunity

- The offering materials and organizational documents cultivate a “culture of unaccountability” stemming from a lack of oversight and transparency
  - (i) Lack of accounting practices/controls
  - (ii) Unconditional ability to change the program’s investments
  - (iii) Ability to buy and sell assets among programs

(iv) Ability to loan funds among programs
(v) Unconditional ability to pay investors from capital
(vi) Lack of sponsor-level audits or reviewed financials
(vii) Lack of integrity as to the program-level accounting

- Failure of stakeholders during their due diligence to confirm/understand the:
  (i) Quality of the program's assets through independent underwriting
  (ii) Quality of the sponsor's accounting system
  (iii) Sources of investor distributions
  (iv) Accuracy of the sponsor's track record
- Failure of stakeholders to conduct ongoing due diligence after the first couple of offerings are funded

Noise—Why the Misconduct Went Unabated

- The sponsor's business started legitimately
- Investors received distributions on a timely basis
- Sponsor teamed up with well-respected industry partners
- There is a sentiment that the sponsor is on the verge of executing its strategy (i.e., cultivating a perceived need to be patient a little longer)
- The program offers a competitive yield that appeals to investors
- The sponsor has been in business for years, and the business just seems to work (i.e., assets are being acquired, money is being raised and investors are being paid)

Rationalizations

- *Administrative convenience*: the conduct is viewed as a temporary fix to a short-term liquidity problem
- *Ego*: the sponsor's accountability obligations are limited, and the sponsor therefore feels that its misconduct is allowed
- *Survival*: the sponsor believes it "has to" perpetrate misconduct to either save a troubled program and/or to stay in business

Conclusion

While the more recent cases may resonate negatively within the mainstream media, we should acknowledge that these unfortunate cases apply to a small segment of the sponsor/program universe. On this point, we acknowledge and commend the multitude of sponsors that have adopted sound operating practices and that are treating their investors as true partners.

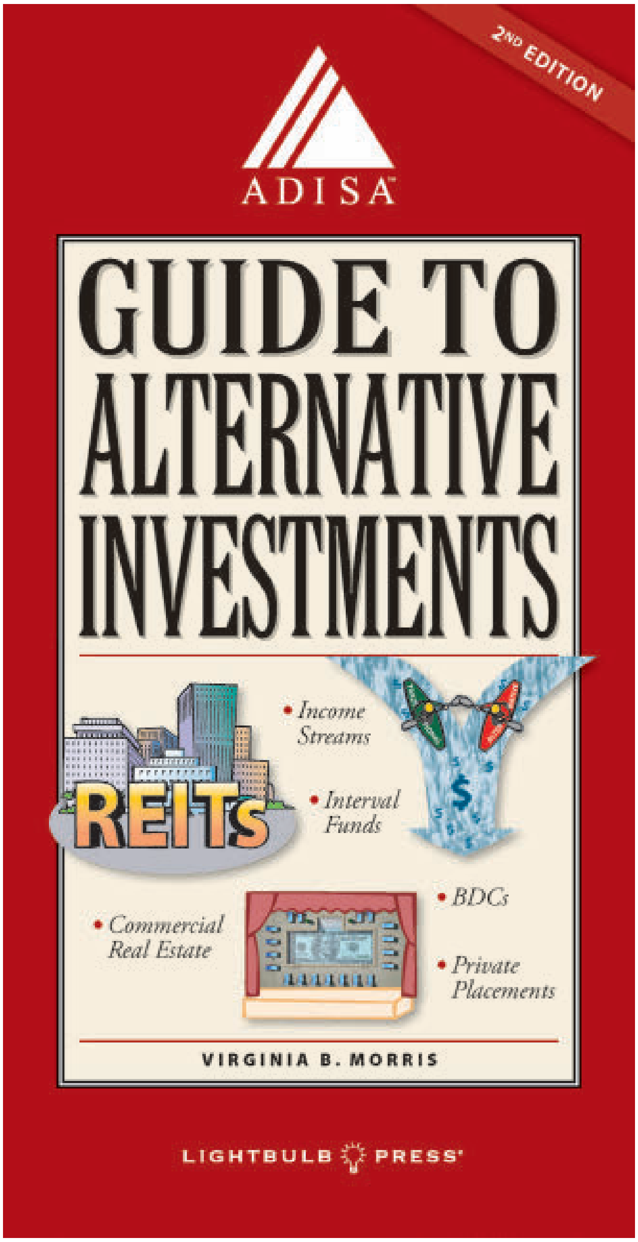
As of the dates of this article, we believe our economy is positioned for growth as COVID-19 vaccines become available and as various sectors of our economy begin to reopen in earnest. With such growth will also come unprecedented opportunities for our membership to evaluate and perhaps approve of sponsors seeking to move their businesses forward through offerings of non-traded securities products. As such, we hope to empower our membership with a greater ability to evaluate and manage risks that have historically proved to be problematic.

Finally, I wish to acknowledge the contributions of the ADISA AI Betterment Task Force, whose feedback was instrumental in my ability to put this article together. ▲

2020-2021 ADISA NEWS & EVENTS

2nd Edition of the Popular Guide to Alternative Investments Now Available

ADISA has once again partnered with Lightbulb Press to publish an informative overview on alternative investments, The Guide to Alternative Investments. With thanks to John Grady, Practus; and Laura Sexton and Sherri Cooke, AI Insight, the popular Guide has been revised, with additions of interval funds, Regulation A/ Regulation A+, liquid alternatives, and more. You can download the Guide below, and printed copies will be available soon. To request a sample, please contact the ADISA office at adisa@adisa.org or 317.663.4180. If you wish to order additional and/or bulk copies, please contact Lightbulb Press directly at info@lightbulbpress.com or 212.485.8822.



ADISA Launches Online Products & Services Directory

ADISA's fully searchable online financial Products & Services Directory is LIVE! The directory, made available by our publisher Naylor Association Solutions, is aimed to give our advisor community the at-your-fingertips information they have been looking for to find who offers what investment products, as well as other supplier support.

The directory features live dynamic search capability, robust functionality and vendor profiles, and will be open only to ADISA members and not the general public. ADISA members will also be able to sort and contact companies by product or service category, keyword, location or keyword. Listed providers can upgrade their general listing and use text, images, videos, maps, to

showcase and position their business as a trusted source. For more information on upgraded listings, please contact Robert Shafer, Naylor Publication Director, 352.333.6986.

To access the Directory, ADISA members will need to log into ADISA's USER PORTAL. If you need helping accessing the User Portal, please contact ADISA's Membership & Data Systems Manager Erin Balcerzak, 317.663.4180. For other questions regarding the Products & Services Directory, please contact ADISA's Director of Marketing Jennifer Fitzgerald at jfitzgerald@adisa.org.

ADISA Launches Brand New Website

ADISA has recently launched its brand-new website, a much-overdue project. The site features a simpler navigation, robust content, mobile compatibility, and a fully-functional search engine. The site is so much more user-friendly, with content easily found and news & event updates posted regularly.

Save the 2021 Dates

As we look forward to once again meeting in-person, ADISA will continue its commitment to providing industry-leading conferences for those who sponsor, design, analyze, market, distribute or sell alternative investments. Our conferences bring together the nation's leading alternative investment professionals to learn the latest industry trends, marketing recommendations and current regulations. ADISA events are the most efficient way to meet with more sponsors, affiliates and associate members actively working in the alternative space.

ADISA 2021 Spring Conference
May 10-12
JW Marriott Scottsdale Camelback Inn Resort & Spa
Scottsdale, Arizona

ADISA 2021 Annual Conference & Trade Show
October 4-6
The Wynn Las Vegas ▲

ADISA

ADISA (the Alternative & Direct Investment Securities Association) is the nation's largest trade association for the alternative and direct investment industry, providing education, networking and advocacy for members. ADISA's volunteer leadership works for its members to maintain the integrity and reputation of this industry by promoting the highest ethical standards, providing education and networking opportunities, and in representing the industry in the public and political arenas.

MEMBER BENEFITS

Unlimited company representatives

Complimentary quarterly magazine, *AIQ Alternative Investments Quarterly*

Complimentary white papers

News and information email alerts

Ability to join committees

Opportunities to submit company articles for publication

Consideration for speaking slots

Substantial discounts on event admission and exhibiting *(Sponsor & Affiliates only)*

Additional discounts on other advertising

Support of advocacy on behalf of the alternative investment industry

Support of ADISA Foundation scholarships

MEMBERSHIP RATES

Sponsor Firm (Companies engaged in the issuance, sale and/or management of alternative investment securities)—$6,500 annually

Affiliate Firm (Law firms, independent wholesaling firms, sponsors-affiliated broker-dealers, managing broker-dealers, investment banking broker-dealers, due diligence firms, real estate firms, licensed real estate brokers, management companies, mortgage brokers, lenders, accountants, consultants, appraisal firms, qualified intermediaries, trust companies, clearing firms, custodians and other industry-related parties)—$3,000 annually

Affiliate Individual (Single Member)—$1,000

Associate Firm (An Independent Broker-Dealer, Registered Investment Advisor (RIA) or Family Office firm that has the ability and primary purpose to directly execute selling agreements and raise capital for programs of non-related sponsor firms on behalf of producing Registered Representatives and Investment Advisory Representatives)—COMPLIMENTARY MEMBERSHIP (and two hotel room night at ADISA events)

Associate Individual (Licensed professional who primarily offers third-party, non-related products to retail clients and is associated with an Independent Broker-Dealer, RIA or Family Office ADISA member. Dually-licensed professionals will be classified as an Associate Individual Member)—COMPLIMENTARY MEMBERSHIP (and one hotel room night at ADISA events)

ABOUT ADISA Because of the support of professionals looking for business opportunities and education, we have grown rapidly from less than 500 members in 2011, to more than **5,000 members** in 2020. ADISA's members are key decision makers influencing more than **220,000 financial service professionals**, with sponsor members having raised in excess of **$200 billion in equity** while serving more than **1 million investors**.

ADISA has adapted to the industry changes and developments by offering increasingly popular **educational programming** at events, **white papers**, and other **communications** to our members. The work of our member-run association places ADISA as the **number one association** in the alternative space in both size and stature.

ADISA provides **exceptional events** filled with great networking and education, while keeping an eye on the cost for participants. With more than 6,000 financial services professionals having attended an ADISA events since 2013, our conference audiences are balanced, representing all sponsors, service providers and funding sources.

Your membership also helps support our **advocacy efforts**, allowing for direct action with Congress and government agencies. As a registered lobbyist, ADISA keeps members informed of legislative and regulatory issues.

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