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HOW BLACKSTONE DOES LEGAL

IN CONVERSATION WITH
CHIEF LEGAL OFFICER
JOHN FINLEY

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jurisdictions

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in midterm elections

STATE ALLIANCE
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effort to tax carry



How Blackstone does legal

The firm's chief legal officer John Finley talks SEC settlements and artificial intelligence with *Dominic Diongson*

The polished brass and suit-and-tie work environment of The Blackstone Group's Park Avenue headquarters is a world away from the bare ceilings and hoodies of a technology start-up. John Finley, the firm's chief legal officer, looks like he belongs in the former. However, the work being done by his approximately 120-strong team of lawyers, compliance officers and other staff is being revolutionized by a group of code-writing millennials.

"It's not just the nice-to-have," says Finley, "the use of technology is essential in terms of enhancing the client experience, saving time, obtaining better information. The innovation [Blackstone's in-house tech] team has been an invaluable partner in working with us to identify and implement new opportunities to integrate technology in our day-to-day services."

For the technological know-how that can help the legal team become more efficient, it turns to Blackstone Innovations. This team, based in a separate office in Midtown Manhattan, is described on the firm's website as building "cutting-edge and easy-to-use systems that manage risk, create efficiencies and promote transparency at Blackstone" and within its community of investors and portfolio companies.

Any efficiencies that the tech department can bring must surely be welcome. Blackstone is a massive firm, with more than \$439 billion in assets under management across private equity, real estate, credit and hedge funds, as of the second quarter.

In private equity alone, its team of 250 professionals oversees more than 90 portfolio companies that employ more than 460,000 people globally.

There is a designated liaison from the innovations team to legal and compliance, who also sits on the legal team's technology committee. There are 115 items on the list of legal and compliance technology projects, some of which can be very granular, but it shows how the two teams are working together to reduce the manual nature of the work, automating more tasks and reducing reliance on paper, says Finley.

Automation activated

An example is the transformation of their anti-money laundering system. Finley's team moved from an antiquated manual hard-copy system to a proprietary product developed with the innovations team, streamlining documentation requests according to risk rating and investor type. That reduced the number of document requests to repeat investors because it all sits in the system, allowing for faster onboarding, Finley explains.

The automation extends to screening global economic sanctions imposed by the US Office of Foreign Assets Control on a nightly basis. Likewise, an automated conflict procedure was implemented that helps process trades.

"It used to be a very manual system – literally. When I arrived here, it happened to be one guy who had all of these manila folders in the back of his desk, and he would reach out when

Photos: Lea Rubin



one of these issues would come up,” he said. “Automation allows us to respond to investor requests much more efficiently. Having it systematized rather than by paperwork is much more efficient, much more productive and much more client friendly.”

Looking deeper into tech, artificial intelligence has the potential to assist in areas of high-volume contract management, such as non-disclosure agreements.

“It’s going to be more on simpler contracts. NDAs are a good example of where you might use them because you’re doing them over and over and over — you do thousands of NDAs. Or in contract management, where we have, again, huge numbers

of contracts. These are the first areas we’d be looking at,” he says.

“So I’m very excited; artificial intelligence is one of our major initiatives as a group for how we can look to leverage technology to improve the delivery of service at the firm and for our internal and external clients.”

The biggest firms are best positioned to take advantage of emerging technologies, notes Finley. And even the giants know their limitations. “You’ve got to walk before you run,” says Finley. “We’re a long, long way from reducing the legal department to five people.”

The global financial crisis brought on a whole new world of scrutiny to private equity.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was being rolled out, largely with a view to protecting individual investors on Main Street. At the same time, the Securities and Exchange Commission started requiring private equity firms with more than \$150 million in assets under management to be registered as investment advisors.

For Finley, that was the year he started work as Blackstone’s chief legal officer, overseeing a staff of about 50, and he knew that compliance — an area less familiar to him — was top of the to-do list. He was a veteran of corporate law and transactions and had joined Blackstone from New York-based law firm Simpson Thacher & Bartlett, where he had served as head of the global mergers and acquisitions group. He had been at Simpson Thacher since graduating from Harvard Law School in 1981.

Consensual resolution

It was a challenge to get up to speed on compliance, but Finley, who is 61, set about sharpening Blackstone’s policies and procedures in preparation for regulatory oversight.

In the more than eight years since Dodd-Frank’s passage, the SEC has been active in sanctioning private equity firms. In 2015 Blackstone agreed to pay almost \$39 million to settle charges for failure to inform investors about matters relating to accelerated monitoring fees and discounts on legal fees. It was the second-largest SEC settlement by a private equity firm, almost \$29 million of which was to be distributed to affected fund investors. That was eclipsed by Apollo Global Management’s \$52.7 million settlement in 2016, when the SEC found the firm to have misled investors about fees and a loan agreement

and for failing to supervise a senior partner who was charging personal expenses to funds. Blackstone's settlement could have been larger; the agency said the settlement reflected "Blackstone's remedial acts and its voluntary and prompt co-operation with the Division of Enforcement's investigation."

Finley describes the monitoring fee settlement as a "consensual resolution" with the SEC, calling it "an example of how I've sought to instill a legal strategy that anticipates rather than reacts to legal issues."

"The SEC explicitly noted that, relatively early in my tenure, Blackstone had already substantially eliminated this historic industry practice prior to any contact from the SEC," he says. "This early remediation was critical in mitigating the financial and reputational impact of the settlement."

Since then, Blackstone no longer takes accelerated monitoring fees. Looking at the state of SEC oversight today, Finley says the heat on PE has to some extent been turned down: "The SEC had targeted PE, but there is now more of a focus on retail investors and a recognition that, and this is according to the head of the Office of Compliance Inspections and Examinations, Peter Driscoll, 'I think we've hit that area [private equity] pretty hard.'

"But that really won't change our way of doing business. The bar has been permanently raised. I arrived in a period in 2010 that was in the wake of Dodd-Frank, where PE was going to be a 'focus' of the SEC – it's a word that they used."

While the SEC has been looking at the fine print in the limited partnership agreement, investors have been pushing the agency to require more disclosure from fund managers, such

Resumé

Joined: 2010

Previous post: Head of global mergers and acquisitions at Simpson Thacher & Bartlett

Education: JD from Harvard Law School

BS in Economics from the Wharton School of the University of Pennsylvania

BA in History from the College of Arts and Sciences of the University of Pennsylvania

Memberships: The Advisory Board of the Harvard Law School Program on Corporate Governance

The National Advisory Board of the Netter Center for Community Partnerships of the University of Pennsylvania

The Board of Advisors of the University of Pennsylvania Institute of Law and Economics

Guest lecturer at Harvard Law School and the University of Pennsylvania Law School

as fees and expenses. The Institutional Limited Partners Association wants additional disclosure of information from Form PF, which lists a private fund manager's assets under management, among other potentially useful data points.

For Finley, meeting limited partners' expectations is part of the legal and compliance department's job. And there is a host of other issues that he keeps a tab on: exam priorities, fees and expenses, allocation issues, disclosure of conflicts, the whistleblower rule compliance, pay-to-play, valuation and cybersecurity.

"We must still meet LP expectations, and therefore it's a critical element of our job in terms of preparing for and enhancing how we deal with conflicts, how we assess our marketing materials," he says.

Regulatory shift to Europe

As regulatory oversight in the US looks like it might be dialed down, Blackstone's regulatory focus has shifted to Europe, where rules such as General Data Protection Regulation – aimed at data protection and privacy within the EU – have recently been put in place. This has led to a demand for more human capital, more processes and more procedures in Europe.

"One sees a deregulatory push in the US versus a continued increase in regulation in Europe, and no slackening of the imposition of regulatory requirements in Europe. It requires a degree of attention that in the past few years may not have been necessary."

Part of Finley's approach to regulation at Blackstone is being proactive and addressing the issues to the firm's advantage – switching from the reactive attitude during his days at

“You want to observe the legal imperatives without sacrificing the entrepreneurial spirit which is really at the soul of a place like Blackstone”

Simpson Thacher, where lawyers responded to client problems.

“At Blackstone, it’s much more proactive and there’s a phrase – ‘winning legally,’ which as a general counsel is using law to a competitive advantage,” he says. “It’s really [about] being more strategic and looking for ways to move the firm.”

An example of moving the firm forward was establishing a presence in Luxembourg to be in line with the Alternative Investment Fund Managers Directive to market Blackstone’s business in Europe.

‘Being legally astute’

“The establishment of an AIFM resulted in a material increase in AUM, and what could have been a burden in terms of having to comply with the marketing rules in Europe, [...] turned into a fundraising advantage by increasing our access to the market,” Finley says.

Blackstone can also help shape the regulatory environment. In a case before the Supreme Court, *Kokesh v the SEC*, Finley says that Blackstone



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worked with trade groups on an amicus brief (meaning Blackstone was not involved in the litigation but had an interest in the court’s decision). In this case, investor Charles Kokesh was found by the SEC to have violated securities laws by concealing the misuse of millions of dollars from four business development companies between 1995 to 2009, and the agency sought to force Kokesh to give up the profits, known as disgorgement. In 2017, the Supreme Court ruled unanimously against the SEC, setting the statute of limitations on disgorgement to five years.

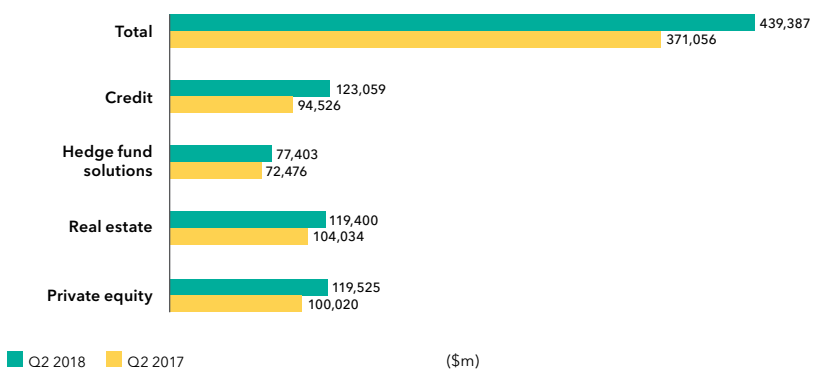
The AIFMD positioning and the Kokesh amicus brief demonstrated Blackstone’s strategic thinking and – borrowing a phrase from Harvard Law School professor David Wilkins – what Finley describes as “being legally astute, in using legal requirements and regulation to the firm’s advantage.”

“In a sense, a general counsel can always put in more policies, more procedures, more training. But you really want to try to get a good balance. That is, you want to observe the legal imperatives without sacrificing the entrepreneurial spirit which is really at the soul of a place like Blackstone,” he says.

“And you don’t want the compliance group to become a deadweight bureaucracy. I wanted to be sensitive and manage the risk, but not to such an extent that the firm dies of a thousand cuts in trying to make things more safe. You know the old law school example, ‘If everybody drove around in tanks we wouldn’t have any car accidents or injuries.’ But you know it’s not practical. And that balance is something a good general counsel tries to achieve in managing the compliance risk.”

Still growing

The firm’s assets under management have increased by 18% year-on-year, with private equity growing by a fifth



Source: Blackstone