FinaTech is a portfolio of patent filings strategically designed to disrupt how equity fund managers raise capital as well as how investors invest in equity funds. The primary architect behind the solutions is Scott Smith, a pioneer in structured finance. Smith developed the model that became the cornerstone for today's mortgage-backed securities when he originated the first mixed-property commercial mortgage pool and secured a one billion-dollar line of credit from DLJ in 1993. Over $17 trillion in securities have been issued since then based upon the structural concepts embodied in that pool. Smith also structured the first phase of President Nelson Mandela's Redevelopment Program, which provided housing for some 11,000 families near Soweto, South Africa, and paved the way for affordable housing for millions more.

After the 90s, Smith began structuring finance for start-ups, where he learned the value of intellectual property. He found that many of the structured finance concepts he helped develop for mortgage-backed securities were applicable to the equity industry, so he founded FinaTech to develop solutions and file patents for many of the challenges facing equity funds today. FinaTech's filings cover venture capital, private equity funds, and real estate limited partnerships, with a focus on solutions that reduce the cost of capital and improve the return for partners.

As an example of the need for solutions today, pension funds invest in PE funds to help achieve the returns they need to meet the benefits they must pay out in the future. But even with the higher returns they achieve by investing in private equity, most pensions funds are underfunded today, casting doubt on whether they will be able to pay the future benefits they are obligated to pay. The challenge pension funds are facing is compounded by the fact that market yields have been dropping over time. In some countries declining yields have become so prevalent that many bonds are paying negative interest rates. Similarly, several top private equity funds recently warned their investors that the expected time-to-maturity for their most recent funds could be twelve years or more, instead of ten years as it has been in the past. This places further downward pressure on returns, as any multiple on an investment over a longer period of time results in a reduced ROI.

Despite these challenges, the private equity industry is projected to grow in size, as more investors turn to alternative investments as a way to boost returns. The head of one of the largest PE funds, TPG, projects that the private equity industry will grow from $4 trillion to $13 trillion over the next seven years. That will require new sources of capital beyond the current players. Notably, the industry has already been seeking solutions to "democratize" private equity in an effort to seek new sources of capital.

Since the inception of the private equity industry, the yield that a PE fund delivers its investors has been the driving criteria behind its success. Notably, FinaTech's solutions are able to improve the return for investors in private equity by an astonishing 700 basis points or more, solely through the use of structure. FinaTech anticipates being able to charge an annual licensing fee of 10 basis points for its solutions, a conservative figure representing less than 2% of the solution's economic value to a fund. If FinaTech's solutions are broadly adopted, a fee of 10 bp would generate $4 billion per year at the industry's current size. If the industry grows as expected, FinaTech's solutions could generate over $10 billion per year. Once FinaTech's solutions have been used by a few early adopters, it will be difficult for other PE funds to attract investors without structure, so it's likely that all PE funds will have to use structure to remain competitive. FinaTech expects the same advantage in introducing its solutions to venture capital and real estate limited partnerships.

Note that the increase in yield that FinaTech's solutions produce are not predicated upon improving the return that a fund earns from its portfolio. In fact, that is currently the industry's sole means for improving ROI—picking better assets and doing a better job of managing those assets. Instead, the increase in ROI that FinaTech brings to the table is gained by employing superior structures for how cash flow is allocated among the various new securities that will be sold by equity funds. Essentially, FinaTech's solutions can be used to reduce the cost-of-capital for funds, improve liquidity and yields for investors, and shorten the duration of an investor's exposure to positions.

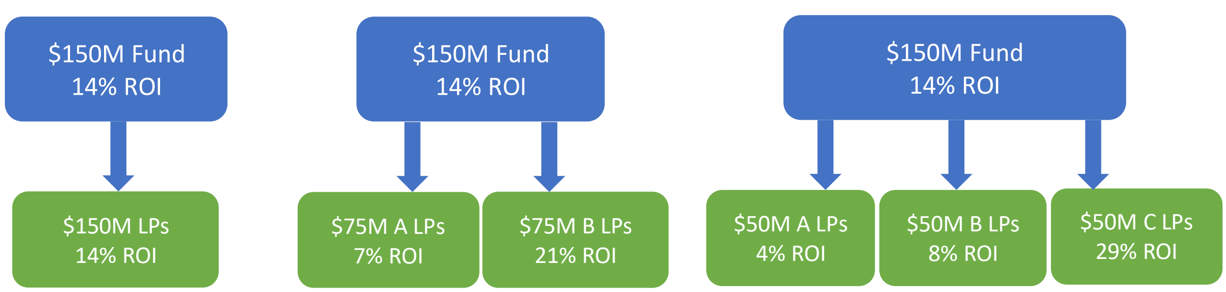
FinaTech has filed broad claims to protect the core concepts behind its solutions, so when variations of the solutions are spawned in the industry, they will still be covered by FinaTech's patents. Likewise, FinaTech has spent considerable time and expense filing patents on as many variations of the core concepts as possible. Thus, FinaTech's patent portfolio is anticipated to offer protection against most future developments in the industry. Notably, many of FinaTech's solutions have already been vetted by industry experts currently and formerly with Goldman Sachs, Morgan Stanley, Blackrock, CitiBank, Cambridge Advisers, and HarbourVest.

The following diagrams offer a sampling of some of the solutions that FinaTech has filed patents on:

Senior/Sub Structures for Equity Funds

Today, the net return from a portfolio of assets, after paying the general partners' fees, is prorated among the limited partners on a *pari passu* basis. Thus, all of the investors in an equity fund earning a net return of 14% earn 14%. Under at least one of FinaTech's patent filings this would change.

In a structured equity fund, limited partners would share in the cash flow of a fund based upon their respective levels of seniority and preferences. The three diagrams below show how the net return to the true equity investor (the most subordinate investor) can be substantially increased simply through the use of structure.



Fund earns 14% (150 x 14% = 21)
All LPs earn 14% (21/150 = .14)

Fund earns 14% (150 x 14% = 21)
"A" LPs earn 7% (75 x 7% = 5.25)
"B" LPs earn 21% ((21-5.25)/75 = .21)

Fund earns 14% (150 x 14% = 21)
"A" LPs earn 4% (50 x 4% = 2)
"B" LPs earn 8% (50 x 8% = 4)
"C" LPs earn 30% ((21-2-4)/50 = .30)

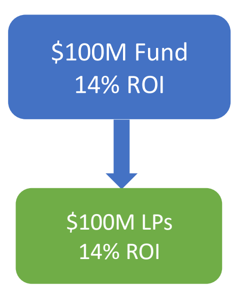
Reduced Outlay Investing (ROI) for Equity Fund LPs

Most equity funds today make use of capital call commitments, in which the limited partners (investors) commit to provide a certain amount of capital when called upon by the general partner. The general partner uses the capital to buy assets for the fund and to pay the expenses of the fund. FinaTech has filed numerous claims that develop the means to use the capital call commitments as collateral for long-term bonds that would provide the capital needed by a fund. Some equity funds have already begun using their capital call commitments as collateral for short-term borrowing, which FinaTech does not feel violates its filings, but using capital call commitments as permanent collateral for bonds, which could even be rated, remains a novel idea in the industry.

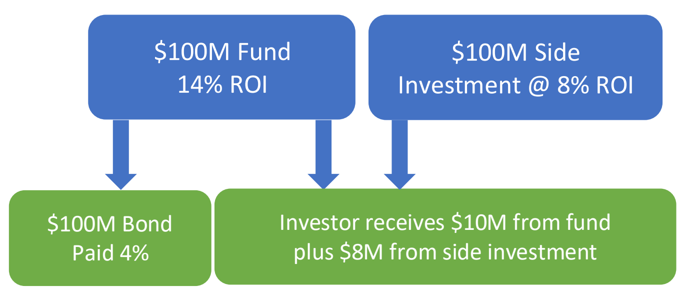
As contemplated in FinaTech's filings, there would be incentives built into the partnership agreement to reward the general partner for successfully repaying the obligations of the bond without having to call on the investor commitments. For example, a GP might receive a 25% carried interest if he never calls on the commitments, whereas his carried interest would drop to 15% if he does have to call on the commitments. This would allow limited partners to develop new investment strategies in which the capital they have set aside for a commitment could be invested in an alternate side investment. Thus, they could earn a return from their limited partnership interest in the equity fund, plus a return from the side investment. The side investment could be free and clear real estate, for example, with a line of credit on the property to enable the investor to honor their commitment if called.

Reduced Outlay Investing would provide general partners with the ability to pursue new strategies not available to them under current fund structures. For example, general partners could invest in safer, lower yield assets than they do today. As long as they can beat the cost of funds for the bond utilized to capitalize the fund, their investors would receive substantially higher ROIs than they do today, as any return over a net outlay of zero is technically an infinite return. Thus, Reduced Outlay Investing opens the door to new growth in the equity industries that would not otherwise be possible.

The two diagrams below show how investors would benefit from Reduced Outlay Investing.



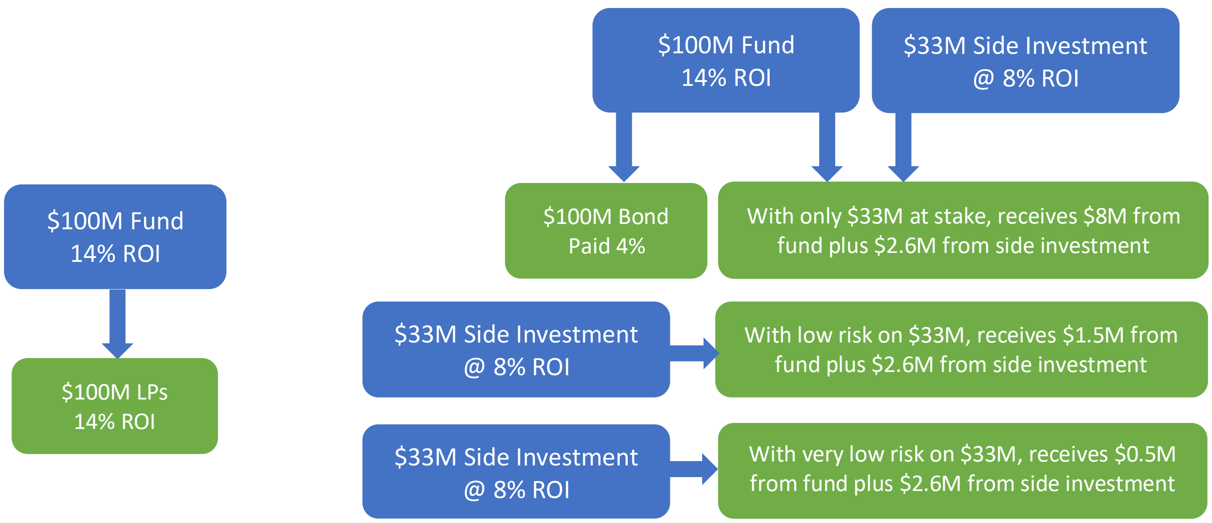
Fund earns 14% (100 x 14% = 14)
LPs earn 14% (14/100 = .14)



Fund earns 14% (100 x 14% = 14)
Bond earns 4% (100 x 4% = 4)
LPs earn 10 on an investment of 0, plus 8 on side investment

Ordered Capital Calls with Reduced Outlay Investing

FinaTech's Reduced Outlay Investing strategy can be modified to further benefit both the equity investor and the general partner. The capital call commitments can be ordered in the event that returns from the portfolio prove to be insufficient to pay the fund's obligations on the bond used to capitalize the portfolio. In general, Reduced Outlay Investing strategies will be structured to minimize the need to call on capital, but should a call become necessary, then the fund's operating agreement can designate a call order. Thus, the investors with the highest likelihood of being called would earn a higher return than the ones who are at the bottom of list. By structuring the order of calls, the investors with the lowest probability of being called could be paid nominal fees for providing credit enhancement for the fund. The diagram below shows how this could work.

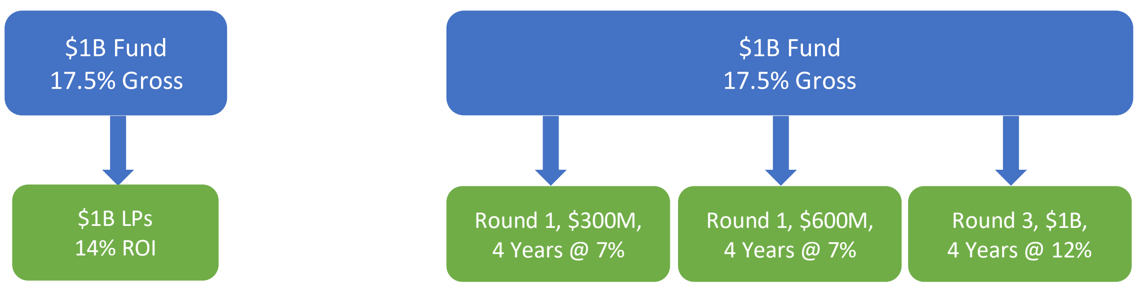


Fund earns 14% (100 x 14% = 14)
LPs earn 14% (14/100 = .14)

Fund earns 14% (100 x 14% = 14)
Bond earns 4% (100 x 4% = 4)
High risk LP earns 8 with $33M at stake, plus 2.64 on side investment
Low risk LP earns 1.5, plus 2.64 on side investment
Very low risk LP earns 0.5, plus 2.64 on side investment

Short-Term Financings with Take-Outs

Today, the exit strategy for investments in equity funds depend upon selling the portfolio assets to provide investors a return of their principle plus a profit. The investors in an equity fund thus tie their capital up for the duration of a fund, which is typically 12 years. The cost of capital for an equity fund is thus high, since investments using this strategy are illiquid, entail long-term maturities, and have uncertain ROIs. One strategy that FinaTech has developed resolves these issues by capitalizing equity funds with a series of security offerings over time. This provides a short-term maturity for the early rounds of financing and shifts the risk of exit away from selling assets to refinancing. The strategy also means the cost of capital for the final round won't involve the uncertainty of a blind pool, but an evaluation of real assets that can be sold in a few years instead of 12-years. This strategy would appeal to a broader range of investors than currently invest in private equity and it would enable the general partners of a fund to earn substantially more than they do today, as illustrated in the diagram below.

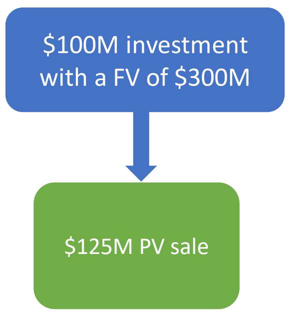


Fund grosses 17.5% (1B x 17.5% x 12 = 2,100)
LPs earn 14% (1B x 17.5 x 12 x 80% = 1,680)
GPs earn 420 (2,100 – 1,680)

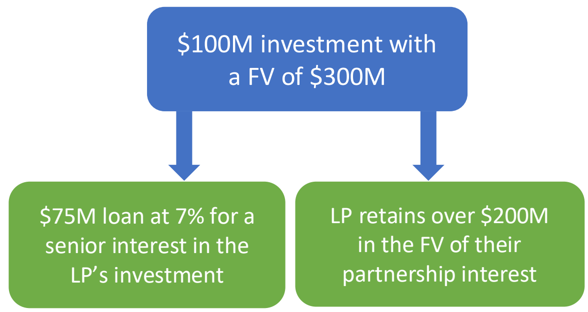
Fund grosses 17.5% (1B x 17.5% x 12 = 2,100)
Round 1, $300M @ 7%, 4 years (300 x 7% x 4 = 84)
Round 2, $600M @ 7%, 4 years (600 x 7% x 4 = 168)
Round 3, $1B @ 12%, 4 years (1B x 12% x 4 = 480)
GPs earn 1,068 (2,100 – 84 -168 – 480)

Using Structure to Create Liquidity for LPs

FinaTech's solution can be used to improve an investor's liquidity in legacy funds having conventional structures. Generally, when an investor sells their interest in a fund, they must sell at a discounted present value (PV) to make up for the uncertainty in the future value (FV) of their interest in the fund. But by selling a senior interest in the cash flow from their interest, it is possible to minimize the discount rate while also allowing the seller to retain their upside in the fund. The net amount they would receive from this strategy would be less than the proceeds from an outright sale, of course, but would be more than made up for by retaining the upside value of their ongoing investment in the fund. The diagram below shows how this would work.



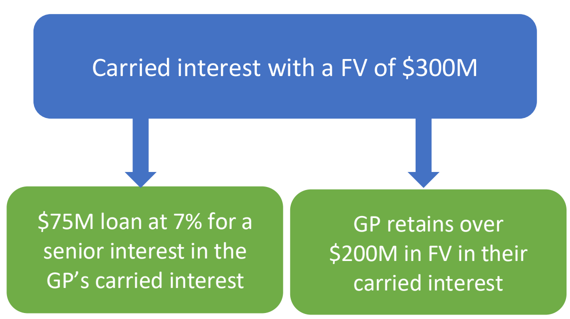
Investor receives $125M, but loses $175M in FV



Investor receives $75M at 7% per year, but retains over $200M in FV

Using Structure to Create Liquidity for GPs

Similarly, FinaTech's solution can be used to provide a GP liquidity in their carried interest. By selling a senior interest in the GP's carried interest, it is possible to minimize the cost of the loan while allowing the GP to fully retain the upside in their carried interest.



Status of Patents and FinaTech’s Go-to-Market Strategy

FinaTech is waiting on the approval of its patent filings before introducing its solutions to the equity fund industry. Several months ago, the examiner overseeing the filings at the patent office informed FinaTech that they agree the subject matter in FinaTech’s filings is patentable. The examiner is now working with the company’s attorney to establish the proper wording in the filings, so the patents will comply with the patent office’s recently released regulations for financial technology patents. FinaTech anticipates its core filings to be approved in 2020.

Once its patents have been approved, FinaTech will transfer them to a special purpose vehicle (SPV) and offer a carried interest in the vehicle to the general partners of targeted private equity funds that agree to roll out structured offerings. FinaTech will also offer limited partnership interests in the SPV to selected pension funds and endowments. The purpose of this strategy is 1) to align the interests of the powerhouses in the industry with FinaTech’s interests, 2) to introduce structure to the industry with a high level of visibility and credibility, and 3) to be able to better enforce licensing within the industry. By granting an interest in FinaTech’s solutions to major funds and key investors, it makes it untenable for anyone in the industry to ignore FinaTech’s patents, as they would risk litigation with their own investor base along with key industry players.