SPOTLIGHT ON...

Fund Formation

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Andreas Loizou, Senior Manager, CPF, provides his advice on setting up a fund, avoiding conflicts of interest and ensuring you meet new regulatory requirements

Tell us about CPF and the latest developments at the firm

CPF, a member of the CPM (Cyproman Holdings Group), has been dedicated to providing comprehensive fund administration and accounting services to onshore and offshore funds for more than 15 years.

CPF services private equity funds and property funds with investments in the CIS, Africa and European markets. CPF and its affiliated companies' services comprise of fund accounting and reporting, corporate and trustee services, as well as shareholder / investor services.

Recently, CPF has joined forces with IFS, a leading firm from Mauritius and licensed by the local Financial Services Commission. The strategic collaboration agreement enables us to take advantage of any cross-border capabilities, strengthening and deepening skills in many jurisdictions.

What stages make up the fund formation process?

In practice, forming an investment fund is a relatively straightforward process, provided the manager has a reasonable understanding of the steps involved to successfully launch a fund.

First and foremost is selecting the right fund strategy. The manager should develop a clear vision of the investment strategy and the overall structures of the fund, taking into account legal and tax considerations, technology, service providers, human resources, insurance, operational structure and capital.

The next step is the selection of the competent team; appointing a legal counsel and tax advisor is critical. The choice of the fund administrator is often made at a much later stage. However, there are benefits in choosing the administrator early on as it enables the attorney and the administrator to liaise in relation to operational aspects of the fund structure at the outset.

Once the fund is registered and a license is issued, the fund is ready to be launched.

What are some of the main conflicts often associated with the fund formation?

When establishing and operating a fund, the fund manager regularly employs the services of third party advisors. For example, a fund manager may instruct an external placement agent to market the fund. However, any intention the fund manager may have to recover or attribute costs associated with the appointment of a placement agent to the fund on an undisclosed basis, would present a material conflict of interest with its fund investors.

Another issue of conflict of interest may arise over the final size of the fund. There are many factors which contribute towards assessing the optimum size of the fund, such as market conditions, investor appetite, the fund's proposed investment strategy etc. However, there remains a potential conflict of interest between the fund manager's desires to maintain its market position by raising funds of an increasingly larger size, set against the investors' need to ensure that whatever capital is raised can be effectively deployed towards suitably attractive investment opportunities.

How can these conflicts be avoided or managed successfully?

Where third party advisory fees are to be borne by the fund, the basis and/or amount of any such cost would normally be agreed in advance with fund investors, with the clear expectation that investors will receive appropriate disclosure of all actual costs as they are incurred.

With regards to fund size, the fund to be raised needs to be subject to the condition that the fund manager commits to co-invest a set percentage on a parallel basis alongside the fund, based on the total amount of investor committed capital. A fund manager's desire to protect its reputation and to maintain a good relationship with its investors to facilitate future fund raising is a significant motivating factor.

What are some of the key regulatory/legislative considerations to take as part of the fund formation process?

There are many: AIFMD (the Alternative Investment Fund Managers Directive), UCITS (the Undertakings for Collective Investment in Transferable Securities, FATCA in US and Anti-Money Laundering Laws (AML) in Europe.)

AIFMD essentially lays down the rules for the authorization, on-going operation and transparency of fund managers that manage and/or market alternatives investments (AIF) in the EU.

FATCA aims to achieve the objective by mandating Foreign Financial Institutions (FFI) such as funds, to identify and disclose certain US customer information to IRS

The Anti-Money Laundering Laws (AML) and KYC procedures set out clearly in the offering documents should accurately reflect all relevant regulatory issues and must not be in conflict with other regulations.

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