

Setting up a private equity fund?

Overcoming these operational challenges will get you off to the best start

We recently asked more than 100 CFOs and COOs what they considered to be the greatest operational challenges when establishing a fund in our latest research report, *Conquering complexity: How Europe's private equity CFOs and COOs are setting themselves up for success*.

As an experienced fund administrator, we're very much on the front line when it comes to setting up a fund, so we had a fair idea of what answers would make the list. What didn't surprise us was seeing cumbersome client due diligence (CDD) and anti-money laundering (AML), core elements of the investor onboarding process, and the challenges associated with setting-up bank accounts among the top spots.

They're what you could call traditional 'pain points' for the industry. But while there's no silver bullet to make the fund set-up process completely painless every time, there are a number of steps and measures that can be taken to make the journey a much smoother one, as this article explains.

Investor onboarding

Part of the reason why CDD and AML cause such frustration is down to the perception that it's simply processing information and data (i.e. what could possibly go wrong?). Unfortunately, it's not that straightforward.

You're usually dealing with a variety of investors, both individuals and institutions, from multiple locations with varying levels of complexity in their structuring. As such, there will be different laws, regulation and requirements in play. Throw in tight deadlines, the occasional overzealous regulator and the volume and complexity of the paperwork, and you can see why it's an area of the fund set-up process that often isn't looked upon particularly fondly - unless you're an AML specialist, of course!

It's all part of the process

Let's first remember that the AML process is part of one overall exercise to onboard an investor to a fund. So, alongside the various AML requirements, there will be key fund terms being negotiated, whether that be within the LPAs, subscription booklets or the side letter terms. Ultimately, this all needs to come together to ensure an investor is ready to be accepted into a fund on the day of closing.

Getting the AML right and making that as painless as possible is key, because, if the truth be told, it's the area an investor is least likely to want to spend their time on. The obvious solution to this issue is to simply to ensure the correct information is requested and submitted the first time.

Clear, consistent and frequent communication between the investors and the fund manager (or appointed administrator) is obviously a good starting point, but in our experience there is also no substitute for taking a "hands on" approach and guiding investors through the process. In short, the scenario you absolutely want to avoid is handing the paperwork to the investors, waiting for it to be returned and then needing to start from scratch due to errors. This will likely cause tension with your investors - something you absolutely want to avoid at such an early stage of a fund's life.

The importance of forward planning

Although CDD and AML offer little room for flexibility in terms of process, there's still an opportunity to speed up information collection and analysis. A third-party administrator is particularly well-placed to do this because they can draw on experiences with other managers and investors and apply best practice.

For example, as soon as we know an investor's name, we will review our database of more than 5500 investor records (including many of the well know institutional and corporate investors) and do a significant amount of preliminary work to understand the investor base and the likely requirements they will face, even before the onboarding process has commenced. This enables us to minimise the burden placed on the investor to provide information, while giving us the opportunity to identify and deal with potential hurdles before they become an issue.

We also bring to the table our knowledge of any trends we are seeing in terms of the regulator's expectations and proactively seek to deal with any related issues before they reach the fund manager or its investors.

Clear roles and responsibilities

Wherever AML and CDD is outsourced, it's essential that all parties have total clarity on roles and responsibilities. Once the AML team gets involved in the onboarding process, investors can sometimes call on them to answer questions on other fund establishment matters, such as subscription booklets and side letters. To help prevent potential confusion, all parties must fully understand their role and deliverables in the process from the outset and ensure checklists are correctly utilised and procedures followed.

Setting up bank accounts

There's no disguising the fact that setting up bank accounts has become a challenge, with banks seemingly becoming more risk averse and narrowing their business appetite. As a result, there has been an increase in both delays (where applications are ultimately accepted but not within a reasonable timeframe) and declines (where applications don't meet the bank's criteria for risk or business appetite).

But while we're never going to be able to shape or change a bank's risk appetite, it certainly is possible to manage and mitigate the impact of bank account set-up issues.

What you could call the "easy win" here, and something we routinely do for our clients, is to conduct an early investigation process that seeks to engage with the bank up-front, determining their risk profile and applying a crucial 'sense-check' before the application is made. Of course, declines can still happen, but taking this kind of pragmatic approach enables an informed decision to be made on whether an application to a particular bank should be made in the first place, thereby saving valuable time.

The argument for consolidation

The current climate also makes a strong argument for fund managers to consider

consolidating their banking relationships. It won't surprise you to hear that a bank will often be more accommodating to setting up new fund accounts if they already have an existing relationship with the fund manager and are providing banking services to entities within their wider structures.

Knowing the requirements inside out

The most avoidable delay with new bank accounts is the request from the bank for further information, which may not initially appear to be necessary when considering a bank's standard account opening process. These requests are increasing as the banks do more due diligence on the entity itself, its investors and the fund manager.

When navigating the process of opening accounts for fund entities, taking the time to fully understand the bank's requirements is critical, as is maintaining and nurturing relationships with the key banks in the respective jurisdiction. Giving account openings a personal touch by picking up the phone to an account manager that you know already can also assist in speeding up this process.

We are increasingly seeing banks run training sessions and workshops to ensure all parties have the skills and knowledge needed to engage in the process as efficiently as possible and ensure errors are minimised.

Preferred banks

Our preferred approach is to work with a small pool of banks, not only for the reasons outlined above, but also because the stronger our relationship with a bank, the more leverage we will have when it comes to securing a favourable outcome for the client. It's not always the case, of course, but it certainly helps.

A close relationship between the bank and the administrator can lay the foundations for achieving closer alignment of policies and procedures. This should be especially achievable if you are both in the same jurisdiction, as you will both be subject to the same regulations.

Understanding jurisdictional differences

Paperwork and procedures can vary between jurisdictions. For example, in the Channel Islands you incorporate the company first, and then open a bank

account. However, in Luxembourg, you open the bank account (with a blocking certificate) and then incorporate the company. The fund entity cannot be formally incorporated before the bank account is arranged.

The benefit of working with an experienced outsourcing partner will come into play here, as they will already have processes in place to deal with the jurisdictional requirements. They will also have enough experience with the banks to know at the outset what supporting information will be required, even where it's not explicit in the forms.

Final thoughts...

Hopefully this article has provided some useful insight into some of the traditional challenges that many of you will have experienced first-hand. Due to the rapidly evolving regulatory landscape it would be highly optimistic to expect to never encounter challenges in these areas of the fund set-up process. However, with the correct preparation and communication, they can be effectively managed and mitigated.

Taking the right steps to anticipate any likely complications before they occur, as well as outsourcing to an organised and experienced administrative partner, should leave you best placed to ensure the fund set-up process goes as smoothly as possible.

**Download the full report 'Conquering Complexity:
How Europe's COOs and CFOs are setting themselves up for success'**

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