The smooth establishment of a first-time fund: a fairy tale?

As a young boy, my nightmares always started the same way – the Evil Queen from Disney's Snow White and the Seven Dwarfs would turn to me, opening the casket holding Snow White's supposed heart, and the dream would arise from the box. The tale is still poignant, and I even went as far as spending some time studying fairy tales and their interpretation while at university, wanting to better understand their purpose. Essentially, the fears that I felt were manifested through the unknown. In the world of fairy tales, this is symbolised and revealed in the world of the forest – a place of wolves, witches and worry.

This is obviously a very roundabout way of talking about establishing a fund for the first time. The route to the safety of a castle with a closed fund and a happily ever after will involve a walk in the dark woods at some point! That step into the unknown is always a difficult one and, while in the tangled brambles of set-up, getting to the end unscathed can feel like a fairy tale – but it needn't.

Plan your route

The roles within fund set-up are usually well defined. Your fund lawyer will be the first point of call, dealing with the negotiating of terms, and drafting the Limited Partnership Agreement and related documentations due from investors. Your internal or outsourced compliance team will be concerned with the onboarding of those subscriptions, ensuring anti-money laundering processes and due diligence are carried out on the investor base. Finally, the placement agent and principals of the fund manager will be sourcing those investors, spelling out why the fund has strong potential for their portfolio.

That's a good number of moving parts. If it's the first time round for a fund manager's finance and operations lead, it may well be daunting, especially if faced with needing to staff-up their own team at the same time. However, there's always a route through the woods that's safe – as Red Riding Hood's mother says, stick to the path! That path is best laid out by an administrator.

There's little point in laying out breadcrumbs for someone to follow; the administrator should actively guide the fund manager, providing a solid route to bring all the elements together in a workable whole. The lawyers will be better placed to draft the documentation, but the administrator will be able to draw those terms into a defined process, interrogating specific terms, providing a carry model at the point of establishment, delivering compliance support, and tracking the investor make-up as the fund moves towards completion.

Safety first!

With a fund administrator on hand, there's a likelihood the investor base will feel more secure too. An independent body brings a focus to governance, control and procedure that can be burdensome to those running a fund in-house.

Most good administrators will now issue ISAE 3402 reports, meaning their control framework has been audited – essentially, they do what they say they will do, and they do it consistently.

The fairy tale world is full of cautionary examples of characters building superficial trust based on what they see on the surface; when considering an administrator, it's vitally important to look beyond the exterior and delve into the detail. It's crucial, for example, to ensure that the administrator's ISAE report is a Type II report – this gives assurance that the controls are in operation over a period of time, rather than being documented but not necessarily used. There's also an equivalent certification for information security best practice to keep an eye out for: the ISO 27001:2013 offers assurances that an organisation has robust controls and has taken careful note of threats and vulnerabilities.

Given this extra level of security, investors will usually agree that the cost of administration should lie with the fund rather than with the manager, so these services shouldn't be a drain on the general partner share.

Stick to the quest

It's important that any waypoints stopped at during the path to completion are worthwhile. The temptation to close might be strong and gingerbread houses, while attractive, can often hide danger! When launching for the first time, terms suggested by investors to offer their commitments may be aggressive. These terms are sometimes worth the compromise, but can have ramifications that need to be considered before agreements are made.

Essentially, the more that individual investors are treated differently, the more difficult the administration and tracking of fund terms will be. This can invariably lead to an increase in cost, resulting from a need for more seniority within the fund's internal team, or from the cost of third-party administration. These carve-outs can also lead to less transparency in fund reporting and more reliance on the controls around reporting documentation, so great care needs to be taken when determining the format and extent of investor reporting. A good administrator can draw on experience and guide first-time managers through this process, tallying with best practice.

Happily ever after?

There's still reason to believe in the underlying messages of fairy tales – that's generally what they were written to do! Every story includes a crucial support element, the someone or something that the protagonist can rely on as they complete their quest. It's no different in our world; a bit of extra time spent with an administrator during onboarding will be used to understand the needs of a first-time fund, and for the administrator to document and explain their approach effectively.

With a bit of hard work, determination and belief, there is usually a happy ending. With an administrator's support, there needn't be any sleepless nights – and certainly no nightmares of the Evil Queen!