01 Choosing a Structure for your Management Business in the UK

Before starting the process to launch a fund, the founders must establish a business entity in the UK. The entity may act as the investment manager or the investment adviser in relation to the fund structure. For convenience, however, this section will refer to this UK entity as the 'investment manager'.

CHOICES OF STRUCTURE IN THE UK

The UK remains a prominent domicile for investment management firms, however prospective entities must obtain FCA authorization, or use a regulatory hosting platform, before engaging in regulated activities. Please see **Your Management Business - Section 2: UK Regulation: FCA Authorisation or Regulatory Hosting?** for an overview of both regulatory routes. A UK investment management firm will typically choose between two corporate structures: an English limited liability partnership formed under the Limited Liability Partnership Act 2000 ("***LLP***") or an English private limited liability company formed under the Companies Act 2006 ("***Ltd***"). Each has its own set of advantages for prospective managers.

THE LLP

The LLP structure combines features of two other corporate vehicles: it is treated as a partnership for tax purposes, but as a company (body corporate) for contractual and commercial purposes. A significant advantage of this combination is that it offers the greater flexibility of a partnership and enables LLP members to participate in business management without losing their limited liability status. However, the main selling point of the LLP is still its tax profile.

Generally, the majority of body corporates, including UK companies, are treated as 'tax opaque'. The result of this is that some shareholders are subject to so-called double taxation i.e., they are taxed once at the company level and then again at the shareholder level on the distribution of profits. LLPs, on the other hand, are often not considered as separate legal entities for tax reasons, making them tax transparent. This means that there is no tax payable at the LLP level and any earnings made by an LLP are immediately allocated to its members, who are then subject to taxation based on their respective tax status and rates. This is subject to some caveats, including that LLPs continue to submit a partnership tax return to His Majesty's Revenue and Customs ("***HMRC***") and continue to be treated as separate entities for VAT purposes. Despite this, the LLP remains the preferred structural option for UK investment managers due to its tax transparency, particularly where it is not intended that profits will be retained and reinvested into the business.

THE NUMBERS

UK corporate members of an LLP pay UK corporation tax (at the current rate of 25%) on profits and gains of the LLP that are allocated to them while UK individual members pay tax on trading income of the LLP that is allocated to them at an aggregate maximum of 47%, consisting of their personal income tax (up to 45% for additional rate taxpayers, i.e., currently taxpayers with income above £125,140), and national insurance contributions (“***NIC***”) of 2%. It is worth noting that, subject to the anti-avoidance rules, income received by members of an LLP does not trigger the 13.8% employer’s NIC charge that is normally levied on salaries. As a result, the LLP structure provides additional tax savings for key individuals who would otherwise be paid a significant salary by a UK company. The LLP is made even more appealing by the fact that capital gains attributable to UK individual members are taxed at the lower UK capital gains tax rates.

THE LIMITED COMPANY

The limited company (“***Ltd***”) is a more traditional corporate vehicle that is ‘tax opaque,’ which means there is tax at the level of both the Ltd and its shareholders. The aggregate tax burden on a UK individual receiving dividends from a UK company can be around 50%. It is worth noting that this double taxation cost does not apply to UK corporate shareholders, who are generally exempt from tax on dividends received. Nonetheless, certain dividend restrictions remain in place in UK company structures, such as the requirement for distributable reserves, and will apply in either case

WHY USE A COMPANY STRUCTURE?

The case for a company structure so far is not entirely encouraging. However, if the profits of an investment management business are reinvested back into the business, UK companies could provide a significant tax advantage. In these cases, UK corporations can provide a better tax profile than LLPs, as the only tax cost on profits reinvested by a corporation is the 25% corporation tax charge. In contrast, an LLP’s profit is directly attributed and taxed in the hands of its members regardless of whether it is distributed. Profits reinvested by an LLP are effectively taxed at rates of up to 47%. In such a case, a UK corporation would have 75% of its profits available for reinvestment after tax, whereas an LLP could have only 53%.

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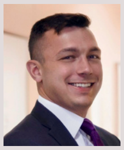

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Furthermore, in an effort to combat perceived tax avoidance, HMRC has made the tax treatment of LLPs more complex, making it far more difficult to navigate. Historically, LLPs with mixed membership (corporate and individual) could take advantage of the lower corporate tax rate by redirecting profits they wished to invest to corporate shareholders. Now that mixed membership rules have been implemented, however, this favourable 25% tax on working capital is nearly impossible to achieve with an LLP. Additionally, HMRC has implemented anti-avoidance rules that, through so-called ‘salaried member’ provisions, can reclassify certain members of LLPs as ‘employees,’ triggering the 13.8% NIC obligation described above. This development further erodes LLPs’ competitive advantage over their Ltd counterparts.

In summary, while an LLP is generally preferable for businesses seeking high annual pay-outs, investment managers seeking to re-invest and create working capital may still benefit from the traditional UK Ltd structure. A more detailed analysis of the differences between the LLP and the Ltd options is available on request

02 UK Regulation: FCA Authorisation or Regulatory Hosting?

Haynes Boone has significant experience of advising start-up and first-time fund managers or advisers in the UK in relation to the regulatory options for their business.

FCA AUTHORISATION

If a client wishes to be the manager of a vehicle that satisfies the definition of an "Alternative Investment Fund" (AIF) (and hedge funds almost always satisfy this definition), the client will need to be authorised by the FCA to "manage an AIF".

If the assets under management are under €100 million, then the client can become authorised as a small authorised UK AIFM. Some of the more onerous requirements of being an authorised full-scope UK AIFM do not apply to small authorised UK AIFMs (e.g. investor information disclosure requirements, fund annual report content requirements, requirements relating to liquidity, risk management, valuation, delegation and depositaries) and there will also be lighter "Annex IV" reporting requirements to the FCA. If the AUM exceeds the €100 million threshold in a non-temporary situation then a small authorised UK AIFM will need to apply to the FCA to become authorised as a full-scope UK AIFM. It should be noted that the AUM calculation should include any assets acquired through the use of leverage (which can involve the conversion of derivative instruments into the equivalent position in their underlying assets).

If the manager is managing a portfolio of assets but is not managing an AIF then it will need to be authorised by the FCA to "manage investments".

There is a specific definition of "AIF" in English law with a number of elements and exemptions.

A manager will not be managing an AIF in the case of most segregated management accounts (SMAs) (i.e. directly managing the portfolio of a client or its investment vehicle) and sometimes it is possible for an investment vehicle to fall outside the definition of "AIF" (e.g. by being a fund of one, a vehicle for a pre-existing family group, a joint venture etc.).

There is also a specific approach to interpreting the activity of "managing an AIF" and the basic principle is that an AIF can only have one AIFM. Therefore, where there is a delegation of investment management by the AIFM of an AIF to a UK entity, that UK entity will almost always need FCA permission to "manage investments" and not to "manage an AIF". However, the FCA may determine that the purported AIFM and/or its activities should be disregarded (e.g. where it fails the letter-box entity test[1]) and determine that the UK entity is the AIFM, requiring permission to "manage an AIF". By way of examples, in a hedge fund context, where an authorised Luxembourg AIFM delegates investment management to a UK entity, that UK entity will be managing investments. In contrast, however, where a typical Cayman hedge fund claims to be its own AIFM, the FCA is unlikely to agree.

One consideration for a new manager, which is applying for FCA authorisation, is whether they need both the permissions of managing investments and managing AIFs from the beginning. A manager with only the permission to manage AIFs will not be able to manage a SMA without a variation of its permission to include managing investments.

It is worth noting that the FCA will always look at what any relevant individuals are doing in the UK in order to determine what permissions are required. Often a UK entity will be established in order to insulate other relevant entities from the UK's regulatory jurisdiction. With respect to AI and systematic strategies, it is also worth noting that any argument to the effect that the management is taking place where the servers are located, rather than where the key individual(s) are will not be given much weight by the FCA.

Please refer to **Your Management Business - Section 3: FCA Authorisation: How to Navigate the Process** for a more detailed consideration of the FCA application process and **Your Management Business - Section 4: FCA Authorisation: Capital Adequacy and Reporting Requirements** for a look at the capital adequacy and reporting requirements that apply to FCA authorised firms.

The UK is currently working on updating and improving the UK's regime for asset management, which largely derives from legacy EU law. In particular, the regulation of "small AIFMs" may change over the next few years

REGULATORY HOSTING

As an alternative to direct FCA authorisation, it is possible in the UK to use an existing FCA authorised firm as a regulatory host (also known as a regulatory umbrella or incubator).

There are a few versions of the regulatory hosting model in the UK, but the basic arrangements are the same. An individual (or individuals) ("PM") wants to manage an AIF, manage investments or deal as agent without having its own entity authorised by FCA. PM can set up a UK entity ("PM Ltd"). PM Ltd and PM then enter into arrangements with a regulatory host. Under these arrangements, the host is appointed by the client and PM is seconded from PM Ltd to the host with the intention of PM acting as the individual portfolio manager(s) or the dealer(s) at the host.

A fund would usually have PM Ltd's branding.

Usually, but not always, PM Ltd is appointed as the host's appointed representative ("AR"). As an AR, PM Ltd can provide non-discretionary investment advice, arrange deals in regulated investments and more easily market regulated investment products and services in its own name without requiring its own FCA authorisation. Whether or not PM Ltd needs to be an AR depends on what it wants to do in its own name (if anything) or whether it is comfortable to undertake all regulated activity through the host. The default position of some regulatory hosts is to make PM Ltd its AR, whether or not PM Ltd will be doing anything in its own name.

This model has been around in the UK for at least 15 years. It originally gained traction because applications for FCA authorisation were taking 9-12 months and sponsors wanted to launch their funds much sooner (it used to be a matter of weeks to get the model in place). In the beginning, the model was used as an interim measure until the manager had received its FCA authorisation. The model also provides several other advantages. In particular, the host should provide infrastructure, risk management and compliance support. The model can also provide managers with a good understanding of what it means to be regulated before the manager decides to become regulated in its own right.

You do still see managers who use the model as an interim arrangement, although the environment has shifted in two fundamental ways: (i) managers and hosts are generally happy for the arrangements to be longer-term and (ii) there are much higher barriers to becoming authorised and much greater uncertainty of capital raising and success.

The hosting model is now the default option for smaller first-time managers in the UK.

The regulatory hosting solution described above is not the same as becoming a "pod" at a multi strat/multi manager firm (such as Lighthouse, Millennium, Point72, Schonfeld, Man GLG et al). There are similarities and these firms would market the "pod" offering as being a form of regulatory hosting. It is not. At the end of the day, you and your team would be judged as employees of the multi strat firm – no matter how delineated your pod may be - and the firm would ultimately be your principal source of capital. In the event of negative performance, capital can easily be pulled away from your pod and your pod could even be closed and you and your team dismissed. Please refer to **Your Management Business - Section 5: Using a Regulatory Hosting Firm** for a more detailed consideration of using a regulatory host.

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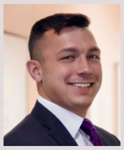

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[1]The letter-box entity test is set out in law and regulations. If the test is failed then the AIFM shall be deemed a letter-box entity and shall no longer be considered to be the manager of the AIF

03

FCA Authorisation: how to navigate the process

WHEN DOES AN ASSET MANAGER REQUIRE FCA AUTHORISATION?

The Financial Services and Markets Act 2000 (FSMA) prohibits any person without the required authorisation, or who can benefit from an exemption, to carry out regulated activities by way of business in the UK. Anyone seeking to perform discretionary portfolio management services from an establishment in the UK, unless doing so under an applicable exemption, would thus require FCA authorisation to perform certain regulated activities as defined in the FSMA (Regulated Activities) Order 2001 (RAO).

Fund managers managing private funds will typically require authorisation for managing an Alternative Investment Fund (AIF). Investment managers, including delegated portfolio managers and firms managing segregated client mandates, will require authorisation for managing investments and for certain connected activities such as dealing in investments.

In this section, we provide an overview of the FCA authorisation process, alongside guidance on how to navigate its challenges and complexities.

PREPARING A GOOD QUALITY APPLICATION

In 2023, the FCA highlighted that 20% of new firms were unsuccessful at achieving authorisation compared to just 7% in 2020-21.

Prospective applicants should not be discouraged by this data. The FCA has in recent years increased its scrutiny of new applications and taken a firmer stance by refusing or requesting the withdrawal of applications which do not meet expected standards.

It is important that firms make good efforts, and seek expert advice as necessary, to ensure that their application is of good quality and increase their chances of achieving FCA authorisation successfully and more quickly.

The FCA authorisation application pack is submitted online through the FCA's systems and will typically include:

- Relevant FCA application forms confirming proposed regulated activities, financial resources available, senior manager positions and a range of questions to demonstrate how regulatory requirements will be met
- A tailored regulatory business plan covering
  - The background to the business and an overview of the business model including growth strategy
  - Details of marketing, customer journey and how you will engage with your target market
  - Remuneration arrangements
  - Governance arrangements for the regulated entity (and group, where applicable) and how core responsibilities will be divided between senior management
  - An overview of IT systems and any material outsourcing
  - Details of how the firm will maintain compliance and key risks to the business
  - How the firm is/will be capitalised
  - An overview of core policies specific to the business model such as conflicts of interest, complaints policies, market abuse and anti-money laundering

- Senior Manager Forms covering questions on key individuals' backgrounds and supporting information such as CVs, regulatory references, skills gap analyses and criminal records checks
- Controller Forms posing questions on integrity of business owners as well as their financial standing
- Financial Forecasts of between 1-3 years (depending on the application) showing profit and loss, cash flow, balance sheet and regulatory capital forecasts
- Investment Management Agreements
- Where applicable, information about the fund supported by fund documents, depositary, custodian, prime broker and fund administrator details
- A compliance monitoring programme

Upon submission, applicant firms must also pay the FCA an authorisation fee which is typically £10,000 for fund or investment managers.

THE FCA ASSESSMENT OF THE APPLICATION AND ASSOCIATED TIMELINES

Once submitted, the firm's application is allocated to, and reviewed by. an FCA case officer. The FCA case officer will engage with the firm to address any questions and areas where clarifications may be required.

The firm's application will be assessed against the FCA's 'threshold conditions'. These are minimum standards that all firms must meet both at the point of authorisation and on an ongoing basis thereafter. More specifically, FCA will assess that each applicant meets specific standards with regards to their legal structure, location, availability of financial and non-financial resources and any links they might have with certain firms or individuals. The extent to which any of these factors might prevent effective supervision is also a key consideration for the FCA. Part of the assessment may involve interviews of key staff – with the compliance officer/MLRO most likely to be interviewed.

The FCA can take up to six months to assess and reach a decision on a complete application. This process can take up to twelve months, and sometimes even longer, if an application is deemed incomplete and does not meet expected standards of quality.

FCA PRE-APPLICATION SUPPORT

Alongside its statutory objectives of protecting consumers and ensuring that financial markets work well, the FCA also has objectives to promote competition and increase the international competitiveness and growth of the UK economy. As such, the FCA has made available pre-application support services to wholesale firms (https://www.fca.org.uk/firms/authorisation/uk-wholesale-markets-support). These services are aimed at helping firms get to market more quickly, whilst maintaining appropriate regulatory standards.

Through the pre-application services, wholesale firms, including asset managers, can request a pre-application meeting which is generally available to:

- An overseas firm seeking to set up or expand business in the UK
- A firm setting up business outside London/South East England
- Has an innovative or unusual business model
- Is involved in complex or high-risk activities (or will be of significant size)

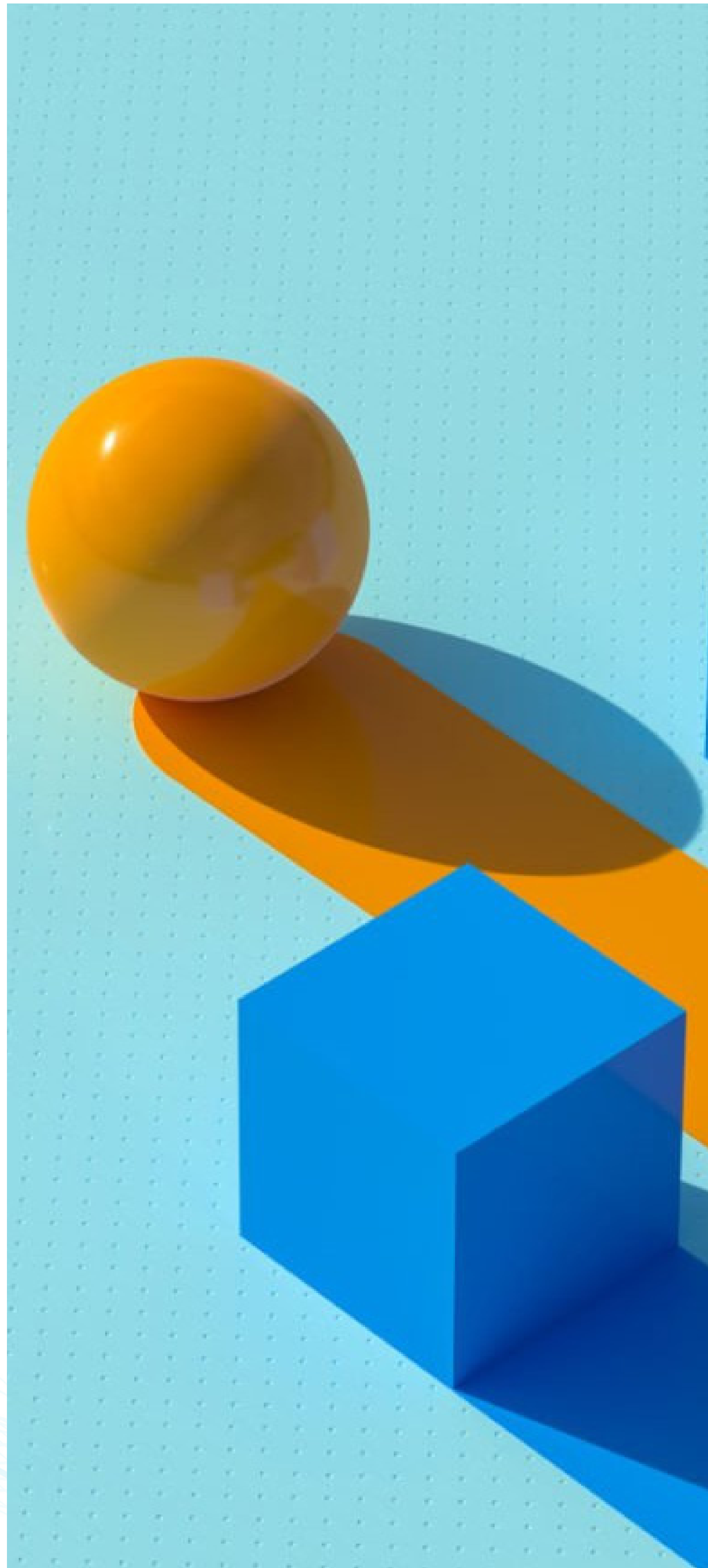
During pre-application the FCA will clarify what is expected from applicant firms and provide additional support and guidance on the authorisation process. Pre-application meetings also allow case officers to understand a firm's business in more detail. During the meeting the FCA will also highlight any concerns or potential risks linked to the proposed application. This gives applicants time to appropriately address these in their application for authorisation.

Our experience has been that most asset managers have found these meetings useful and that they can expedite the authorisation process.

CONCLUSION

Obtaining its own regulatory license from a leading global regulator like the FCA is an important first step for an asset manager. The effort required to achieve this should not be underestimated, particularly during the start-up phase while building the firm's operational infrastructure, hiring staff, dealing with prospective investors and other challenges.

A start-up asset manager will greatly benefit from expert advice and support to successfully navigate the FCA authorisation process while, at the same time, more efficiently focus time and resources on setting up and growing its business.



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04

FCA Authorisation: Capital Adequacy and Reporting

PRUDENTIAL CAPITAL ADEQUACY RULES

These are driven by the MIFIDPRU and Chapter 11 of IPRU-INV which apply to firms that are classified as 'Collective Portfolio Investment Management Firms' (these are firms that are regulated under the AIFMD and have MiFID top-up permissions). Capital adequacy and liquidity requirement is driven by either 'fixed overheads requirement' or 'funds under management' requirement.

MIFIDPRU RULES

Classification as a 'small and non-interconnected firm' or a 'non-small and non-interconnected firm' (SNI or Non-SNI) is determined based on a number of factors and thresholds.

The capital requirement is the higher of (i) Permanent minimum requirement (PMR), (ii) Fixed overheads requirement (FOR), and (iii) K-factor requirement (KFR) (*applicable to Non-SNI firms only*)

ICARA PROCESS AND WIND DOWN PLANS

All FCA investment firms including AIFMs are required to maintain and regularly update their ICARA process document.

A comprehensive ICARA should address the following:

- a clear description of your business model and strategy
- an explanation of the activities you carry out and connecting them to the MIFID permissions held and currently used by your firm
- an analysis of the effectiveness of your risk management processes and appetite for risk
- a detailed overview of the governance structure, linking this to the SM&CR
- a summary of the material harms your firm faces and the controls and mitigations in place
- an analysis of your capital and liquidity planning
- a summary of your compliance with the overall financial adequacy rule
- the outcome of stress testing you have conducted and managements response to these scenarios
- an overview of your wind-down planning, including the financial assessment of winding down your regulated business

An important part of the ICARA process is the preparation of an independent wind down plan which must discuss the following as a minimum:

- What is the estimated length of the wind-down period?
- What resources (both financial and non-financial) would be needed to implement it?
- Who needs to be available to assist the firm in winding-down?

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- How would the firm deal with redundancies and, conversely, which employees need to be retained with special financial arrangements?
- What systems (e.g., IT systems) need to be available to the firm during the winding-down?
- Will the firm need to engage professional advisors to wind-down?
- Has the firm considered the implications for any overseas offices and branches?

ANNEX IV REPORTING

In addition to the above, AIFMs have the obligation to report under Annex IV of the AIFM-Regulations to cover requirements under Article 24(1), 24(2) and Article 24(4) typically called as 'Annex IV reporting'. The frequency and content of the reporting depends on the size of the assets under management, marketing status of the AIFs and the amount of leverage used by the AIFs. The returns include reporting on top instruments, principal exposures, concentrations, markets, geographical exposures, currency exposures, investor and portfolio liquidity, counterparties, leverage etc. at asset class and sub-asset class levels. Non-EEA AIFMs are required to report into each EU jurisdiction where the AIFs are marketed.

05 Using a Regulatory Hosting Firm

Getting authorisation from the FCA can be a struggle for new fund managers. Not only can it take a long time, but the time and resource requirements are quite onerous. Unfortunately, anyone wishing to manage someone else's money, give advice, or even market funds in the UK needs to have the appropriate regulatory cover in place before doing so. This problem has spawned the growth of the regulatory hosting industry which allows people from new firms to operate under the hosting provider's regulatory umbrella. This enables the people from the start-up firms to carry out regulated activities without their own firms being directly authorised by the FCA. This cuts the time and expense of obtaining and maintaining direct regulatory authorization.

There are two ways that hosting firms provide their services, and these are: 1) using the appointed representative regime, and 2) using the secondment of staff.

If the activities of a start-up only require advising and arranging activities, then they will be well served by the appointed representative regime. However, if the client wishes to manage money, then the regulatory host will use the secondment approach to take control of the portfolio management staff, essentially taking them on almost as if they were their own staff. However, they are neither employed nor paid by the hosting firm. The secondment allows the host to register them with the FCA so that they can conduct discretionary investment management activity. Then the host will become either the fund's AIFM or a sub-delegated non-AIFM investment manager for a managed account or delegated portfolio management mandate.

The regulatory hosting firm will provide the compliance infrastructure to the client's firm and in effect becomes equivalent to in-house compliance and risk oversight teams. When using a good hosting provider, which has experienced people in it, they will add a degree of relevant expertise that you may struggle to equal in your own team (at an early stage).

ADVANTAGES

- **Speed** - 4-6 weeks to onboard with the regulatory host rather than a direct authorization with the FCA which can take 6-12 months.
- **Expertise**, enabling you to concentrate on running the business.
- **Independence** in the oversight of the compliance and risk functions.
- **Training** opportunity, it gives a firm a much better idea of the responsibilities of running an FCA-regulated business before they become regulated within their own right.
- **Cost.** In order to fully replace a regulatory hosting firm, the client would have to add additional people which would likely cost more than the reg hosting fees.

CHOOSING A REGULATORY HOSTING FIRM

It is common for some new start-ups to focus purely on the cost of the regulatory host and opt for the cheapest. This is not a terrible strategy, since in many cases the start-up is not seeking to immediately raise hundreds of millions and is simply looking to build a track record first. However, due to greater scrutiny from both regulators and investors, sometimes choosing the cheap option can backfire, by discouraging investors.

Here are some aspects of the hosting firms that are worth investigating:

- Some firms will rely heavily on technology to interact with their clients, as this helps to keep costs down. This can be quite efficient, but it is also important to be able to speak to someone who understands the regulations and can make pragmatic decisions about compliance options. Is the firm simply ticking boxes?
- Make sure that they understand your business and have the appropriate permissions to cover your intended activity. Make sure they understand your strategy, have the capacity to handle your growth, and have systems in place to provide effective surveillance.
- If you are looking to raise institutional investment, make sure the regulatory hosting firm will be able to pass institutional due diligence processes. While sometimes it can be attractive to choose a hosting firm that operates with a "light touch," the client will regret the lack of suitable proficiency when it results in the failure to pass this extensive scrutiny of institutional investors. However, some start-ups are aiming to attract investors from non-institutional sources, so the extra cost and effort involved in adhering to a higher standard may not be worthwhile.
- Ask about response times, will they answer your questions quickly. For example, how quickly will they approve your marketing materials?

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- Ask for references. Is the firm growing? Is it attracting firms like yours? Do they sound like they understand your business?
- Ask your other service providers for recommendations, and preferably, some existing clients.
- Make sure you understand the different fee structures, are you paying a fixed monthly fee or are the costs based on AUM? Make sure that there are no additional fees in the fine print, like surcharges based on extra hours.
- Make sure that you are aware of any minimum and maximum contract periods.
- Ask how easy it will be to transition if you want to eventually apply directly for authorisation.
- Ask how the firm handles its regulatory capital requirements.

In the end, as with many decisions about service providers, you should feel comfortable in trusting your gut instincts – does the provider act like a partner, or do they just see you as a source of income?

06 An Introduction to the Alternative Investment Fund Managers Directive ("AIFMD")

For investment managers operating from or marketing a fund in the United Kingdom or the European Union, the chief regulatory barrier will be the Alternative Investment Fund Managers Directive (AIFMD or the 'Directive'), which has been implemented by member states across the EU and has been retained in UK law. Annoyingly, the EU member states and the UK have all implemented AIFMD in slightly different ways, although there are common features and a base set of requirements. The scope of AIFMD is broad and focusses on regulating the manager of a fund rather than the fund itself.

The provisions set out under AIFMD continue to apply in the UK (we set out what that means for marketing in **Raising Capital - Section 1: Marketing and Regulation**), but it is essential to note that the UK's version of AIFMD is entirely separate from the EU's version. The EU will treat the UK as a "third country" and the special treatment that is available under the EU's AIFMD for EU managers and funds is not available to UK managers and funds. Also, the UK and the EU regulatory regimes are diverging and this divergence is expected to accelerate. For example, the EU is about to implement AIFMD 2.0 and has also amended the rules relating to "pre-marketing". The UK is not taking the same approach.

WHO QUALIFIES?

AIFMD has a broad scope and sets out requirements for qualifying managers. Any entity in the EU or the UK managing an Alternative Investment Fund (AIF) must be authorised or registered as an Alternative Investment Fund Manager (AIFM) under AIFMD.

Also, any entity "marketing" any AIF within the EU or the UK will need to comply with the local AIFMD marketing requirements.

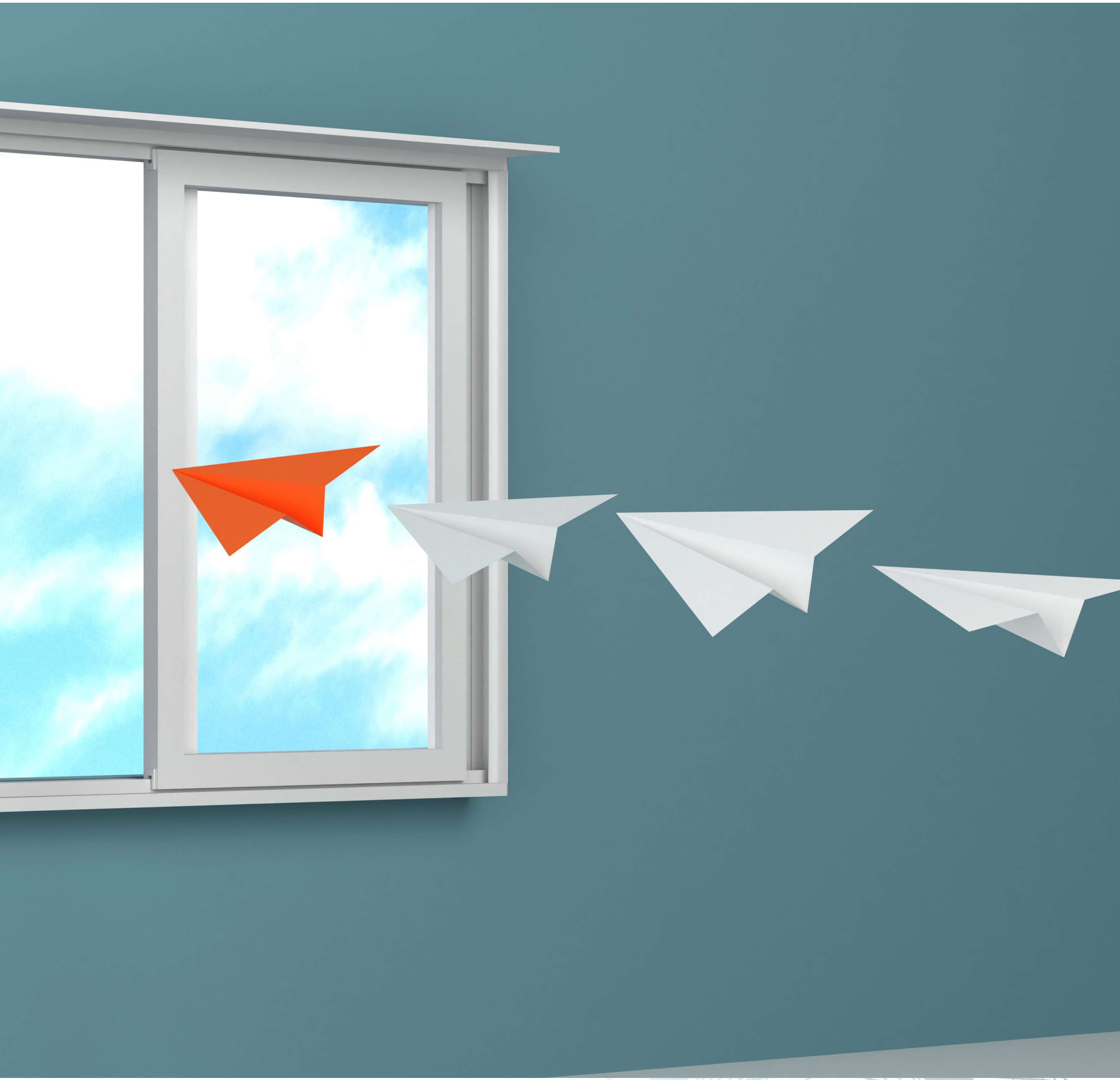
The definition of AIF given by the AIFMD includes any (non-UCITS) 'collective investment undertaking, including investment compartments thereof, which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors'. This is a wide net and the requirements of the AIFMD apply across the industry.

In the UK, there is a specific approach to interpreting the activity of "managing an AIF" and the basic principle is that an AIF can only have one AIFM.

REQUIREMENTS

In broad terms, the requirements introduced by the Directive stand as follows:

- establishing conduct of business requirements, which include:
  - ensuring fair treatment for investors
  - managing conflicts of interest
  - ensuring proper remuneration procedures
  - providing accurate valuations and full disclosures to regulators and investors



- introducing minimum requirements for initial capital (set out below), a manager's own funds and professional indemnity insurance (for more information see **Running a fund and other considerations - Section 4: Insurance**)
- mandating the appointment of authorised depositaries, who are tasked with safeguarding the investments of the fund, monitoring cashflows and checking that distributions are made correctly
- restricting the delegation of certain tasks, with a particular focus on the ability of managers to delegate portfolio and/or risk management roles
- imposing requirements on the use of leverage by the AIFM. In addition, the Directive gives regulators powers to restrict access to leverage or introduce other appropriate supervisory measures to prevent the build-up of systemic risk

In the UK, the FCA rules are primarily contained in the FCA's Investment Funds sourcebook (FUND).

CAPITAL REQUIREMENTS

AIFMD sets out certain capital requirements, though these vary depending on whether the AIF is externally or internally manged by the AIFM.

Internally managed: If a fund's governing body elects not to appoint an external AIFM – as might be the case for a corporate fund managed by its board of Directors – then the AIF itself must be authorised as an AIFM unless it qualifies as sub-threshold (see below). Internally managed AIFs must meet an initial capital requirement of EUR 300,000.

Externally managed: Alternatively, a legal person may be appointed, either by or on behalf of the fund to act as the AIFM. Unless it qualifies as 'sub-threshold', an external AIFM will be required to maintain initial capital of EUR 125,000, in addition to holding own funds equal to the higher of:

- 25% of fixed annual overheads, or
- 0.02% of the amount by which total value of assets under management exceeds EUR 250,000,000. This amount is subject to a EUR 10,000,000 cap and the total amount can be reduced by up to 50% if the AIFM is granted a guarantee from a bank or insurer

Most hedge funds are externally managed, so these requirements are likely to apply to any start up manager wishing to be authorised as a full-scope AIFM under AIFMD.

'SUB-THRESHOLD'

Most AIFMs need to be AIFMD authorised and comply with all associated requirements. However, qualifying managers can apply for 'sub-threshold' status. To qualify a manager must have total AIF assets under management (AUM) under either:

- EUR 100,000,000
- EUR 500,000,000, where the portfolios of AIFs consist of AIFs that are unleveraged and where investors cannot redeem their interest in the first five years after investing

These funds are still regulated by their competent authority under a 'register and report' regime (if available), but are subject to reduced AIFMD requirements. As a result, qualifying managers enjoy significantly lower compliance costs, making this a popular legal pathway for start-up fund managers. However, EU 'sub-threshold' managers will not eligible for the EU marketing or management passports that come with full AIFMD status.

In the UK, ‘sub-threshold’ AIFMs are referred to as “small AIFMs”. There is no realistic option for a UK hedge fund manager to be “registered” with the FCA as a small AIFM. Instead, the small UK hedge fund manager could become authorised with the FCA as a “small authorised UK AIFM”. Some of the more onerous requirements of being an authorised full-scope UK AIFM do not apply to small authorised UK AIFMs (e.g. investor information disclosure requirements, fund annual report content requirements, requirements relating to liquidity, risk management, valuation, delegation and depositaries) and there will also be lighter “Annex IV” reporting requirements to the FCA. If the AUM exceeds the small AIFM threshold in a non-temporary situation then a small authorised UK AIFM will need to apply to the FCA to become authorised as a full-scope UK AIFM.

MARKETING AND NPPRS

The AIFMD introduced significant restrictions on the ability of AIFs to be marketed within the single market without the marketing passport that comes with full EU AIFMD compliance. Similarly, the UK’s AIFMD regime imposes restrictions on the marketing of AIFs in the UK. See **Raising Capital - Section 1: Marketing and Regulation** for more information about the restrictions which might apply and the barriers posed by individual National Private Placement Regimes (NPPRs).

It should be noted that the UK’s AIFMD marketing regime disapplies some of the more onerous requirements for non-UK small AIFMs that are marketing AIFs in the UK.

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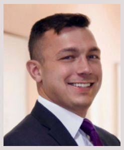

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POSSIBLE EXTENSION OF THE BENEFITS OF THE EU’S AIFMD TO NON-EU COUNTRIES?

The AIFMD contains provisions that could extend the marketing passport to non-EU domiciles in the future. Such a move has been contemplated in the past and the European Securities Markets Authority (ESMA) concluded in 2015 that that no obstacles existed to the extension of the passport to Guernsey and Jersey. In theory the UK should meet the same equivalence criteria. However, while the power to extend the marketing passport officially rests with the European Commission and ESMA, in practice the move would have to be approved by all 27 Member States. At present such a development seems highly unlikely.

07

U.S. Regulation

Prior to advising assets attributable to U.S. persons (as defined in Regulation S 17 C.F.R 230.902(k)), an investment adviser located outside the United States must register with the United States Securities and Exchange Commission ("SEC") or avail itself of an exemption from such registration. Most investment advisers obtain registration or an exemption from registration before even beginning to solicit U.S. persons in the United States. The below outlines important information non-U.S. advisers should possess when thinking about their regulatory exposures to the SEC.

DEFINITION OF INVESTMENT ADVISER

"Investment adviser" is defined in Section 202(a)(11) of the Investment Advisers Act of 1940 (the "Advisers Act") as any person or firm that:

- for compensation;
- is engaged in the business of;
- providing advice to others or issuing reports or analyses regarding securities.

A person or firm must satisfy all three above elements to fall within the definition of "investment adviser" set out by the SEC.

a) **Compensation** – Generally, the receipt of any economic benefit, whether in the form of an advisory fee, a commission, or combination of the two satisfies this element.

b) **Engaged in the Business** – Generally, the factors used to analyze whether a person or firm is engaged in the business are (1) whether the person or firm holds themselves out as an investment adviser; (2) whether the person or firm receives compensation that represents a charge for providing investment advice; and (3) the frequency and specificity of the investment advice provided.

c) **Advising Others about Securities** – Generally, a person or firm meets this element if they provide advice to others about specific securities, such as stocks, bonds, mutual funds, limited partnerships, and commodity pools. The SEC has stated that advice about real estate, coins, precious metals, or commodities is not advice about securities.

Exclusions from the definition of an "investment adviser" include the following: (1) US Banks and US Bank Holding Companies; (2) Lawyers; (3) Accountants; (4) Engineers; (5) Teachers; (6) Brokers and Dealers; (7) Publishers; (8) Government Securities Advisers; (9) Credit Rating Agencies; (10) Family Offices; and (11) Government Political Subdivisions.

EXEMPTIONS FROM REGISTRATION

The Advisers Act provides several exemptions from registration available to investment advisers located outside the United States that advise U.S. persons:

a) **Foreign Private Adviser Exemption** – Available to an investment adviser that (1) has no place of business in the United States; (2) has, in total, fewer than 15 clients in the United States and investors in the United States in private funds advised by the adviser; (3) has aggregate assets under management attributable to these United States clients or investors of less than USD $25 million; and (4) does not hold itself out generally to the public in the United States as an investment adviser. An adviser must "look through" private funds and count both its direct clients and each investor in any private fund it advises. Advisers utilizing the Foreign Private Adviser Exemption have no reporting obligations with the SEC.

b) **Private Fund Adviser Exemption** – Available to an investment adviser whose advisory clients are solely qualifying private funds and who has assets under management of less than USD $150 million managed at a place of business in the United States. An investment adviser that has any other type of client is not eligible for this exemption. An adviser with a principal office and place of business outside the United States may exclude its non-U.S. clients, such as a separately managed account whose beneficiary is not a U.S. person, and can continue to rely on the Private Fund Adviser exemption. This is the most common exemption from registration used by non-U.S. advisers. Investment advisers availing themselves of the Private Fund Adviser Exemption must report certain information about the business to the SEC (more details below) and are referred to as Exempt Reporting Advisers or ERAs. Advisers relying on the Private Adviser Exemption have to file an initial report on Form ADV and update it at least annually thereafter.

c) **Venture Capital Adviser Exemption** – Available to an investment adviser that solely advises one or more qualifying venture capital funds, regardless of the amount of assets managed. An adviser with a principal office and place of business outside the United States may not exclude its advisory activities outside the United States and all of an adviser's clients, including clients located outside the United States, must be qualifying venture capital funds. An adviser relying on the venture capital adviser exemption is an ERA and must therefore report certain information periodically to the SEC (more details below).

REGISTRATION WITH THE SEC

If an investment adviser cannot avail itself of the previous exemptions from registration, then registration with the SEC is required. Investment advisers registered with the SEC are aptly referred to as Registered Investment Advisers. In addition, there are certain triggering events/scenarios that require registration with the SEC, regardless of the exemptions. These scenarios are:

a) **Separately Managed Accounts for the Benefit of One United States Person** – An investment adviser that advises a separately managed account for the benefit of a single U.S. person, which includes a single corporate entity that is organized, incorporated, or domiciled in the United States, is required to become registered with the SEC unless they can avail themselves of the Foreign Private Adviser Exemption and the conditions thereunder.

Prior to advising assets attributable to U.S. persons (as defined in Regulation S 17 C.F.R 230.902(k)), an investment adviser located outside the United States must register with the United States Securities and Exchange Commission ("SEC") or avail itself of an exemption from such registration.

b) **ERISA** – The U.S. Employee Retirement Income Security Act of 1974 ("ERISA") is a United States federal law that governs the management and investment of U.S. private sector employee benefit plans.[2] An investment adviser is a fiduciary under ERISA if it exercises discretionary authority and management over an "ERISA plan assets vehicle." If an investment adviser's private fund client has 25% or more of its assets attributable to ERISA plan assets, the fund automatically becomes an ERISA plan assets vehicle, and the investment adviser must comply with ERISA and become registered with the SEC.

c) **Registered Investment Companies** – An investment adviser is required to become registered with the SEC if it advises a "registered investment company," a company that issues securities under the Investment Company Act of 1940 (the "'40 Act") and commonly referred to as a '40 Act Fund or a RIC.

d) **Investment Advice Provided from the United States** – An investment adviser availing itself of the Private Fund Adviser Exemption (as outlined above) that operates at a place of business in the United States from which it provides investment advice must count all assets attributable to that U.S. operation towards the applicable USD $150 million threshold. If the threshold is exceeded (or, pursuant to the exemption, the investment adviser advises any client that is not a qualifying private fund), then it is required to become registered with the SEC.

EXEMPT REPORTING ADVISERS: REPORTING OBLIGATIONS AND ONGOING COMPLIANCE

Investment advisers relying on the Private Fund Adviser Exemption or Venture Capital Adviser Exemption must file the Form ADV Part 1A with the SEC to become ERAs.

The Form ADV sets forth the information the SEC requires investment advisers relying on an exemption from registration to submit to the SEC. ERAs complete a short form version of the Form ADV, Part 1A which is a standardized form application that requires information about the adviser's business, ownership, information about private funds, specific advisory activities, business practices, and any disciplinary events of the adviser or its employees. Part 1A is organized in a check-the-box and fill-in-the-blank format.

A USD $150 filing fee is required to be paid by ERA-applicants upon initial submission of its Form ADV, Part 1A application. An ERA initial filing is submitted through the SEC's online Investment Adviser Registration Depository (frequently referred to as IARD) portal and is effective upon acceptance by the IARD system.

Once an adviser files as an ERA, it must update the Form ADV, Part 1A periodically: (i) at least annually, within 90 days of their fiscal year end, or (ii) on an other-than-annual basis upon material changes to the Form ADV Part 1A's substantive sections. An annual fee of USD $150 is charged for Form ADV annual updating amendments (no fee is applicable to other-than-annual amendments to the Form ADV).

All current information contained in Form ADVs filed with the SEC is publicly available through the SEC's Investment Adviser Public Disclosure (frequently referred to as IAPD) website: www.adviserinfo.sec.gov.

ERAs are not subject to the majority of the rules and regulations contained under the Adviser Act due to their "exempt" status. However, ERAs remain subject to certain general elements of the Advisers Act and must adopt and implement policies, procedures, and controls covering the following areas:

- Pay-to-Play Rule
- Insider Trading Rule
- Whistleblower Protections
- Record Retention Rule
- Fiduciary Duty
- OFAC Sanctions
- Foreign Corrupt Practices Act
- Anti-Fraud Provisions
- Marketing into the U.S.

REGISTERED INVESTMENT ADVISERS ("RIA"): REPORTING OBLIGATIONS AND ONGOING COMPLIANCE

Applicants for registration with the SEC must file a Form ADV Part 1A, as well as the additional Form ADV Part 2A (both described below). Furthermore, RIA-applicants must prepare and maintain in their records a Form ADV Part 2B for certain supervised persons (Form ADV Part 2B(s) do not need to be filed with the SEC).

a) **Form ADV, Part 1A** – A standardized form application that requires information about the adviser's business, ownership, clients, employees, information about private funds, specific advisory activities, conflicts of interest, business practices, and any disciplinary events of the adviser or its employees. Part 1A is organized in a check-the-box and fill-in-the-blank format.

a) **Form ADV, Part 2A** – Requires RIA-applicants to prepare a narrative brochure "in plain English" that includes disclosures pertaining to business practices, investment strategies, fees, conflicts of interest, ownership, industry affiliations, types of clients, brokerage practices, reviews of accounts, custody, proxy voting procedures, financial information, and any disciplinary events of the adviser or its employees.

b) **Form ADV, Part 2B** – Serves as a supplement to the Part 2A and contains information about each employee, or "supervised persons," that provides investment advice to its clients, including their educational background, business experience, other business activities, and disciplinary history.

RIA-applicants must pay a variable initial filing fee of not more than USD $225, calculated based on an applicant's regulatory assets under management.

Once the initial Form ADV application for registration has been submitted via the SEC's online Investment Adviser Registration Depository portal, the SEC must either approve the applicant's registration or institute an administrative proceeding to deny the registration within forty-five days.

> If an investment adviser's private fund client has 25% or more of its assets attributable to ERISA plan assets, the fund automatically becomes an ERISA plan assets vehicle, and the investment adviser must comply with ERISA and become registered with the SEC.

Once its registration with the SEC has been approved, a RIA must update its Form ADV Part 1A, Form ADV Part 2A, and Form ADV Part 2B(s) periodically: (i) at least annually, within 90 days of fiscal year end, and (ii) on an other-than-annual basis upon material changes to the Form ADV's substantive sections. A variable annual fee of not more than USD $225 is charged for Form ADV annual updating amendments (no fee is applicable to other-than-annual amendments to the Form ADV).

All current information contained in Form ADVs filed with the SEC is publicly available through the SEC's Investment Adviser Public Disclosure website: www.adviserinfo.sec.gov.

RIAs are subject to the full scope of the Advisers Act. The Advisers Act does not provide a comprehensive regulatory regime for advisers, but instead imposes a broad fiduciary duty to act in the best interests of their clients. Generally, there are five types of requirements on RIAs: (1) fiduciary duty to clients; (2) substantive prohibitions and requirements; (3) contractual requirements; (4) recordkeeping requirements; and (5) administrative oversight by the SEC.

RIAs must adopt and implement numerous policies, procedures, and controls.

Form PF – RIAs managing one or more private funds with at least USD $150 million in private fund assets under management must report certain information pertaining to such private funds to the SEC on a regular basis.

The Form PF categorizes RIAs based on the type and amount of assets under management attributable to private funds. The frequency of submission and the type of information required to be submitted depends on a RIA's categorization:

- **Large Hedge Fund Advisers** – RIAs with at least USD $1.5 billion in hedge fund assets under management are categorized as "Large Hedge Fund Advisers" and must file Form PF within 60 days after the end of each calendar quarter.
- **Large Liquidity Fund Advisers** – RIAs with at least USD $1 billion in combined money market and liquidity fund assets under management are categorized as "Large Liquidity Fund Advisers" and must file Form PF within 15 days after the end of each calendar quarter.
- **Large Private Equity Fund Advisers** – RIAs with at least USD $2 billion in private equity fund assets under management are categorized as

"Large Private Equity Fund Advisers" and must file annually within 120 days of fiscal year end.

- **All Other Private Fund Advisers** – All other RIAs required to submit a Form PF must file annually within 120 days of fiscal year end.

From December 2023, Large Hedge Fund Advisers to "qualifying hedge funds" are required to submit current reports to the SEC via Form PF as soon as practicable, but not later than 72 hours, after the occurrence of one or more current reporting events at a qualifying hedge fund that they advise. Current reporting events include (1) extraordinary investment losses, (2) significant margin and default events, (3) termination or material restriction of a prime broker relationship, (4) changes in unencumbered cash, and (5) large withdrawal and redemption requests, inability to satisfy redemptions, or suspensions of redemptions.

From June 2024, private equity fund advisers, including but not limited to Large Private Equity Fund Advisers, who would otherwise be required to file annually within 120 days of fiscal year end, must file on a quarterly basis information pertaining to certain "private equity events" such as (1) execution of an adviser-led secondary transaction, (2) implementation of a general partner or limited partner clawback, and (3) investor election to remove a fund's general partner or to terminate a fund's investment period or the fund itself.

Importantly, if a RIA's principal place of business is outside the United States, for purposes of the Form PF, the registrant may disregard any private fund that, during the adviser's last fiscal year, was not a U.S. person, was not offered in the United States, and was not beneficially owned by any U.S. person.

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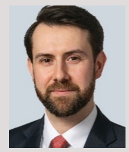

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ANNUAL REVIEW OF COMPLIANCE PROGRAM

Rule 206(4)-7 of the Advisers Act requires a RIA to conduct a thorough review on its compliance program no less frequently than annually. An independent third party or the Chief Compliance Officer should undertake a review of the policies and procedures to determine the adequacy and effectiveness of their implementation. This review must include specific consideration of the following:

a) Changes in the firm's business, affiliates, status of registration with various regulatory bodies or other circumstances which may require new policies, procedures, and controls;

b) Compliance matters that arose during the previous year; and

c) Changes to the Advisers Act or other applicable laws, rules or regulations that might require revisions to the compliance framework.

[2] ERISA covers U.S. private sector pension plans. Although government pension plans are not technically subject to ERISA, many such plans are subject to ERISA-like regulations pursuant to state legislation.

08 Outsourcing

CORPORATE SERVICES

Setting up a company in the UK requires several key steps and adherence to certain legal requirements from the outset. First, the company name and legal structure need to be decided upon, typically investment managers would be a private company limited by shares (Ltd) or a limited liability partnership (LLP). Second, the company's registered office address must be provided. This is the official address where all legal correspondence will be sent. Third, and depending on the structure, the details of the company's directors, shareholders, LLP members and company secretary must be given. Additionally, the company's Memorandum of Association and Articles of Association, which detail the rules governing the company's internal affairs, must be prepared. The process can be completed online at Companies House or via a competent advisor, and there are fees associated with the registration process.

Corporate Governance is an important requirement of authorised firms. Annual filings at Companies House, such as confirmation statements and filing of financial statements, need to be done as well as event driven filings, such as changes in persons of significant control (PSCs) or Directors/Members. Maintenance of statutory registers and regular board minutes of a firm are also an important governance aspect of running a Company. Directors will have statutory requirements to ensure these are being done and maintained in accordance with legislation. Ongoing company secretarial services can provide value in a number of ways; saving time, reducing cost and, importantly, mitigating risk.

ACCOUNTING AND PAYROLL

Accountancy is an important element of any business operation, which requires time and attention to detail. Many firms outsource some or all of their accountancy and payroll needs as an efficient and cost-effective option which provides cost savings, access to specialised expertise, improved efficiency, greater flexibility, and compliance with legal and regulatory requirements. This allows firms to concentrate on maximising outputs in other parts of the firm. and focus on their core business activities.

As an FCA regulated firm developing the infrastructure and procedures necessary to maintain accurate financial records, provide information to relevant authorities, and manage all your day-to-day accounting needs to be considered as follows:

- **Management accounts and bookkeeping** – FCA regulated firms require strong financial control and must monitor the regulatory capital requirement at all times. Management accounts, underpin calculations and monitoring of regulatory capital, liquidity levels, provide necessary information for quarterly regulatory returns and form the basis for the audited year end accounts. As well as meeting a firm's regulatory responsibilities, accurate and up-to-date records provide the foundation for accurate forecasting, providing firms important data needed to manage a business effectively.
- **VAT** – Once registered for UK VAT, it's important to ensure correct record-keeping and application

of VAT rules, as well as the submission of quarterly VAT returns using Making Tax Digital ("MTD") compliant software. In most cases, newly registered Firms will also have a HMRC inspection on their first submission which can be daunting but having the right advisor on hand can ensure it goes smoothly.

- **Financial Statements** – Firms will have a statutory requirement to provide year-end accounts of all UK entities to Companies House and will be subject to audit as an FCA regulated firm. It's important to understand that due to the regulation, these financial statements will need to be audited within 80 business days of the year end.
- **Payroll** – Having experienced payroll advisors on hand ensures that a firm is able to pay employees correctly and on time. Ensuring that correct deductions are made for PAYE income tax and National Insurance contributions as well as other benefits such as pension, need to be done accurately and in accordance with HMRC requirements. Firms will also need to file monthly and annual reporting to HMRC including P11Ds for employees.

TAX COMPLIANCE

- When establishing an investment firm in the UK, you will need to decide on the type of entity in which you will undertake your investment firm activities, see **The Fund - Section 1: Typical Fund Structures** for more details.

- Once the structure is established, the entity may wish to register for VAT as it may be able to recover VAT on its expenses, and provided that the investment firms' services are "outside the scope with a right to recover" (meaning that VAT is not charged on investment management services to the fund) this will result in an inflow of cash following the submission of the VAT returns.

- During the accounting period, the entity or certain individuals may require tax advice on a variety of matters, such as:
  - Investment Manager Exemption
  - Permanent establishments
  - Reporting Fund Regime (see below)
  - Employment Taxes
  - VAT Recovery

  When the accounting period has ended, the entity will need to prepare a tax return and computation. This will involve an analysis of the entity's underlying transactions to determine the appropriate tax deductions and reliefs that may be available and to ensure that the correct amount of tax is payable. Individual members of an LLP and high earning employees/directors will also need to prepare their own personal tax returns and may require tax advice relating to transactions or planning outside of their employment or LLP activities. Typically, most firms outsource the entity and personal tax return and advisory services. Larger companies may also need to prepare tax calculations in year, if within the scope of the UK's quarterly instalment payments regime.

- Reporting Fund regime

  If the offshore fund is available to UK investors, it is important that you consider entry into the reporting fund regime. Where appropriate, by offering UK-resident individuals – through offshore funds that comply with the requirements of the Reporting Fund regime – the opportunity to enjoy gains that are taxed at lower rates than would otherwise be applicable, investment firms, improve the appeal of their fund range to existing and potential UK-resident individual investors and improve their chances of success. Entry into the reporting fund regime must be applied for. Once the Fund has joined the regime, it must prepare and file with HMRC an annual reporting fund computation and investor summary (which helps investors complete their personal tax returns). The reporting fund computation and investor summary, typically need to be filed within six months from the end of the fund's accounting period.

CLIENT SERVICES

- It is important to consider the digital services your outsourced service providers are able to offer, and how effectively they will deliver improvements to accessibility, client experience and efficiencies in time and cost.
- Your provider should have a digitised platform that has encrypted security on file sharing, real-time direct messaging capabilities, secure document storage, 24/7 access, video-call capabilities and seamless client-advisor collaboration.
- Working with a service provider who has a client portal which is also available via a mobile device, it is the perfect opportunity to enhance your provider relationships, modernise your practice, gain time back for yourself and manage your required services in a personalized and flexible manner.
- Digitisation is undoubtedly improving communication between provider and client, enabling the power to shift from companies to the consumer. Ensure that this is balanced with safe digital practices and a willingness to diligently test new developments that can add further value to your relationship.

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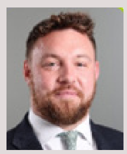

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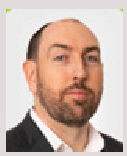

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09 Your People

When you launch a hedge fund, HR is another item on your to-do list. Like most of the list, you know that it has to be done properly to manage the large investment you will make in the people within your business.

HR helps you manage the performance of your people, helps manage the risk and keeps your people costs within budget.

Whether it is you or a colleague looking after HR matters, you need to know you have everything covered well before you hire the first employee.

We would always think about splitting the tasks into three sections. Things you **MUST** do, things you **SHOULD** do and then things you **COULD** do.

MUST DO

The five things you **must** do if you are employing anyone in the UK:

- have a properly structured employment contract that will protect the company as well as meeting the requirement for the employee
- you must ensure the individual has the right to work in the UK
- pay the salary through a properly registered PAYE scheme
- you must enrol the employee onto an approved UK pension plan and make contributions
- you need to have Employer's Liability insurance in place

SHOULD DO

Once you've got these arranged, you probably **should** consider the following:

- check that your documentation (eg employment contracts, offer letters, employee handbook) is appropriate for the business, protects the business and reflects the ethos or culture of the business
- undertake pre-employment screening - even if you have known or worked with the person previously you should still undertake this. This could be to satisfy investors, for a proper governance structure or for employee risk management etc.
- 'you should also consider ongoing screening which is essential for FCA "senior manager" designated individuals (***"SMF"***), highly recommended for certification staff (i.e. those carrying out FCA Certification Functions) and recommended for all employees

- use the HR Consultant for effective but not excessive HR admin
- help make new employees effective as possible as soon as possible by having an effective on-boarding process
- consider the HR policies that your business will have e.g., holidays, maternity, paternity, sickness etc.

COULD DO

There will be many other questions that come up where you need help from an experienced HR Consultant such as:

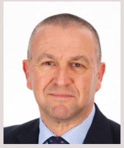
- ongoing HR advice – disciplinary, grievances, disputes, performance issues, managing redundancies or dismissals etc.
- how to establish an effective annual performance review process for employees
- determining a suitable benefit schemes in conjunction with a benefits specialist that suits your budget and the ones valued by employees
- how to run an effective recruitment plan
- guidance on expat and international move packages
- helping to develop an in-house HR team when the business grows

WHAT NEXT?

Your fund launch will be different from others and there is no single way to handle these matters. Make sure that HR is looked after properly even before you plan to hire your first employee.

An effective HR Consultant will guide and advise you on the parts that need to be managed at the appropriate time they need to be done.

Author



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> We would always think about splitting the tasks into three sections. Things you **MUST** do, things you **SHOULD** do and then things you **COULD** do.

10 Insights from Hedge Fund COOs

Paul Clement and Anil Joshi share their top tips for new investment managers below.

WHAT MOTIVATES YOU?

Why are you launching your own hedge fund management entity? Is this just a financial and lifestyle decision? Launching a new venture entails a large level of commitment. It can be counterproductive when starting up to have a rigid plan, expectation and direction. It should not be underestimated how key being fluid with plans and expectations is; especially when combined with detailed planning and a clear commitment to the ultimate goal. Resources to begin with are (normally) finite and will need to be carefully managed over the launch process.

FLEXIBILITY, OUTSOURCING, LEASING

The aim should always be to launch big, the plan should always be to launch small. Potential investors may not say no to you, but many will not concretely know the size of their ticket until very close to launch. It is important to avoid over-stretching resources in this period by agreeing to large inflexible liabilities.

Leasing assets is normally a better option then incurring large spending costs. Things are liable to change in the first initial months and renting space in a serviced office is normally a prudent option to start with. The quality and cost will vary but many providers offer telecoms and internet as part of their package. Look in particular for those with tested business continuity plans that will satisfy both regulatory and Operational Due Diligence (ODD) requirements.

Employing staff naturally raises costs, although, it is all the expenses that are associated with these that can be more significant, think office space, software licences, office supplies etc. Initially, external suppliers of services such as IT, payroll, compliance monitoring and accounting can address these issues. Naturally, the impact of these may vary for you as the exact nature and complexity of your requirements should lead decision making at each stage.

LOCATING SERVICE PROVIDERS THAT ARE RIGHT FOR YOU

It cannot be understated as to how important it is to engage service providers who are well recognised and have a proven track record within the hedge fund industry. Their experience becomes invaluable when external shocks occur and they are able to continue providing their services regardless of this, with minimal (if any) disruption to you. It is best to use service providers that your prospective investors are familiar of and comfortable with. However, do not just select a service provider on reputation alone, make sure you do your own research and are happy that they will provide

the services you require. Names appearing as sponsors of industry events or in industry publications is not necessarily indicative of quality and instead could just be a well drilled marketing team. Explore the market to see what there is to offer and who is offering key differentials. An experienced Chief Operating Officer (COO) can identify what you require and what is just nice to have/superfluous, eliminating the unnecessary costs of additional services.

The cornerstone to getting the best out of these relationships is by building good relationships with the key people at each provider. Treating them more like business partners and less like a provider ensures that you can maximise the relationship. Make sure your interactions with them are collaborative and continuous, instead of isolated one offs. These providers are there to help you and so honesty with them can go a long way.

STICK TO YOUR EXPERTISE

Managing a business is a very different to managing a fund's portfolio. Delegating the management of the business to a COO can be an excellent allocation of resources. Engaging a COO from the start will ensure that you can have a successful launch, both on time and on budget. COO's will act as an ambassador for your fund in the market, help you manage your business plan, mitigate operational risks, manage investors and eventually become a trusted advisor to yourself. Anyone you plan to engage as a COO should have extensive experience in managing relationships with multiple service providers over a large number of years. This will allow them to identify the best partnerships for your business. This will save you both time and money in the long term.

OPERATIONAL DUE DILIGENCE

The ODD teams at prospective investors are increasingly more influential in the fund selection process. They are not there, however much it may feel like it, to catch you out. Instead it is important to work with them. Acquaint yourself with the industry standard Due Diligence Questionnaires to give you an idea of the range of issues that investors are considering. This is an important process and should not be treated as a tick box exercise to 'pass' the due diligence process. While is a minimum standard that must be complied with most investors are looking well beyond that and want to see your thought process around each provider you have selected and the services you have asked them to provide. During launch, investors will not expect you to have their ideal level of infrastructure, but they will expect you to keep them aware of your continuing plan to improve at each milestone you achieve. Your selected COO will be able to advise you on this throughout the launch process and beyond, ensuring your resources and budget are managed correctly while addressing these issues.

PERMANENT OR CONSULTANT COO

If it is difficult finding good employees, it can be even more challenging picking the right COO from the beginning. A permanent and correctly experienced COO will more than likely ask for a high base salary, a guaranteed bonus, market standard staff benefits as well as taking some equity in your business. There is no guarantee that after all this and the excitement of the launch, that you will be able to retain them, especially if there arises a change between their financial expectations and the updated business plan. It then becomes awkward to explain to investors why your permanent COO has suddenly left your business. This also doesn't address the fact that the skills required for the launch may be different to those you will need on an ongoing basis.

It is worth considering contracting with a specialist hedge fund COO consultant to guide you through your launch. They will have the right contacts to pick and deal with all of the service providers you require, manage the launch the fund and then assist with the recruitment and transition to a business team suited to the launch size. This does not mean though that you cannot retain them to provide ongoing services/advice. COO consultants are regularly involved in fund launches and this gives them a range of experience and a strong network which can prove invaluable to those starting out. An experienced COO consultant will already know the right questions to ask and how to identify the answers will which will save you time and money.

AN OVERVIEW OF THE COO'S ROLE

- act as the key point of contact for your legal counsel as they produce the documents required by local and offshore regulators
- assist with compliance, be that by supporting and overseeing the wider team or taking responsibility for designated roles (such as Compliance Officer/ Senior Manager within the FCA's SMCR rules)
- oversee finances by producing a complete business plan, reconciling this plan with the bank accounts while also working with your appointed auditors and accountants to prepare VAT, tax returns, and the financial audit. A COO can also confirm and reconcile a fund's NAV when required

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- collate and provide internal update reports for your management team, summarising the firm's financial position, any operational or compliance sign offs and any notable updates
- assisting with the sourcing and hiring of candidates. Focusing particularly on your back-office requirements such as payroll, pension contributions, GDPR requirements and background checks
- ensuring you have the required internal policies/ manuals, including:
  - AML Policy
  - Anti-Bribery Policy
  - Trade Error Policy
  - PA Dealing Policy
  - Conflicts of Interest Policy
  - GDPR Policy
  - Operating manual
- assist with all aspects of marketing your fund, be that on the investor outreach side or regulatory side
- manage the development, and subsequent maintenance, of robust operational infrastructure.