The Fund

01 Typical Fund Structures

The relationship between the investment manager, the fund, its investors, and all other entities that make up that specific fund is an essential component of any successful fund launch. For the purposes of this guide, we have concentrated on three of the most popular fund structures: the components of the Master-Feeder, Stand-Alone fund, and Segregated Portfolio Company are listed below. The next section will cover the topics of fund domicile (the location where the fund is based) and vehicles (the legal form of the fund entities).

Many hedge fund managers also run Separately Managed Accounts (SMAs) on behalf of investors in addition to the main fund. While the assets in these accounts are invested by the fund managers using a similar approach to that employed for the fund assets, these accounts are often held separately from the fund. We go into additional detail about SMAs in **The Fund - Section 9: An Alternative Approach: The Separately Managed Account**

EVALUATING THE MASTER-FEEDER STRUCTURE

Under a Master-Feeder framework, feeder vehicles (Feeders) pass investment capital on to a single fund vehicle, which holds the portfolio and has the trading relationships (the Master). The Master-Feeder structure allows each Feeder to satisfy the regulatory or tax needs of different investor groups, while retaining the economies of scale and operational advantages of having a single portfolio held by a single entity and a single set of trading relationships. The main rational for using Master-Feeder structures is the tax benefits such arrangements offer funds targeting investors in multiple jurisdictions (the 'US taxable' and the "US tax-exempt" being the key examples). Ultimately, Master-Feeder structures increase the number of eligible investors a fund can accommodate. It is possible initially to establish only the offshore feeder and the Master (a "one-legged" master-feeder) and to add the LP Feeder at a later date if required.

THE STAND ALONE FUND

There are, of course, situations in which a Master-Feeder may not be preferable or practical. You might use a Stand-Alone fund type if your fund is just getting started or if the intricacy of a Master-Feeder is not necessary. Stand-Alone funds are straightforward—they consist of a single investor pool that makes investments in a single investment vehicle using a single investment strategy. This concept will work better for funds looking to raise capital from a smaller group of investors who can more readily be integrated into a single fund vehicle. A Stand Alone Fund may be able to accommodate either 'US taxable' or "US tax-exempt" investors but would probably need to be converted into a Master-Feeder structure if it was necessary to accommodate both to a material extent. Whether to start with a Stand Alone Fund or a "one-legged" master-feeder (described above) will need very careful consideration.

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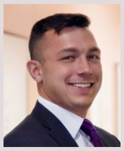

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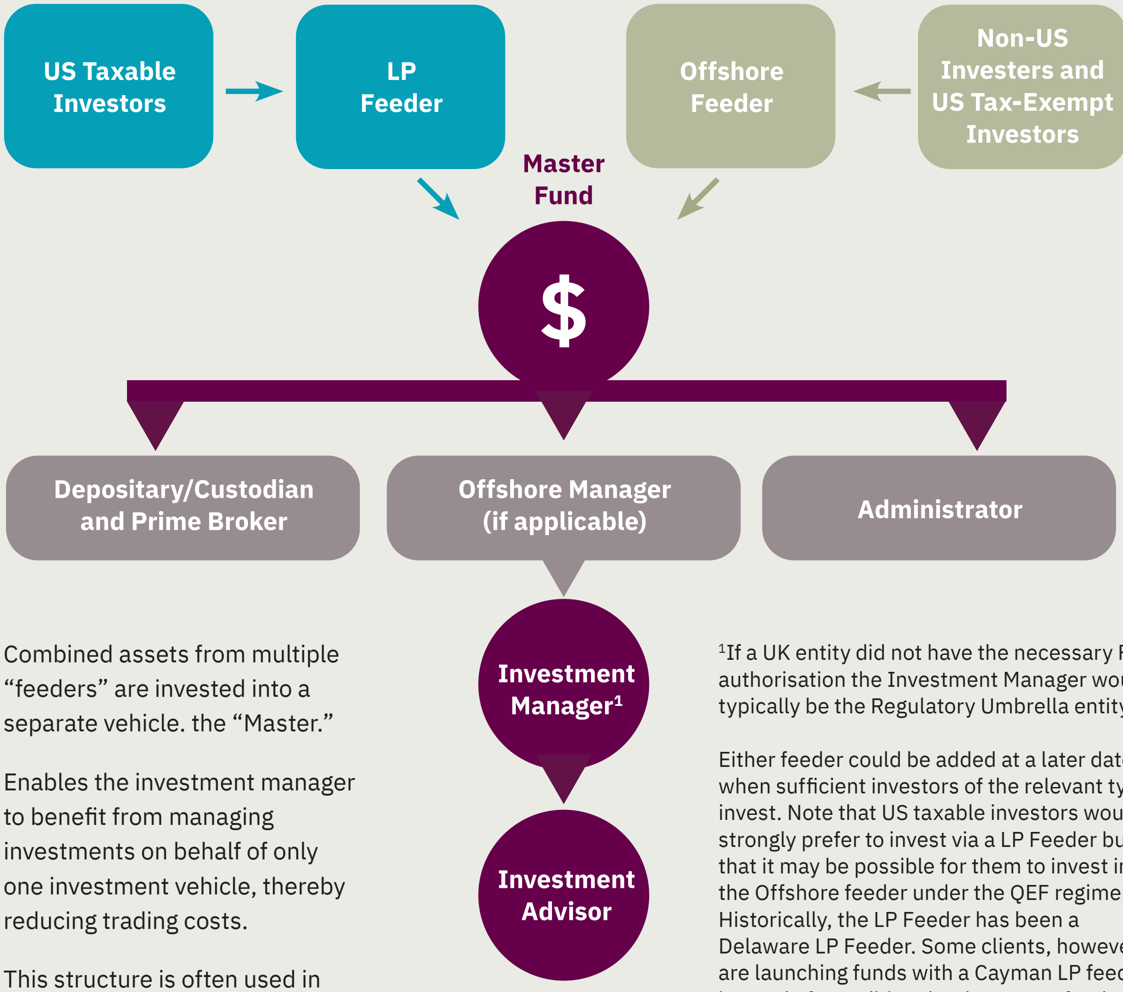
THE SEGREGATED PORTFOLIO COMPANY

The Segregated Portfolio Company (SPC) is another concept that is frequently utilised for the introduction of new hedge funds. An SPC has a single investor pool, but it builds a variety of portfolios using various investment strategies. Each portfolio is kept separate from other portfolios in the fund and from the overall business. These divisions give SPCs additional strategic flexibility and enable fund managers to provide investors with a wider range of options within a large umbrella structure (a practice known as “plug and play”) while still achieving some economies of scale.

Master-Feeder



Combined assets from multiple "feeders" are invested into a separate vehicle. the "Master."

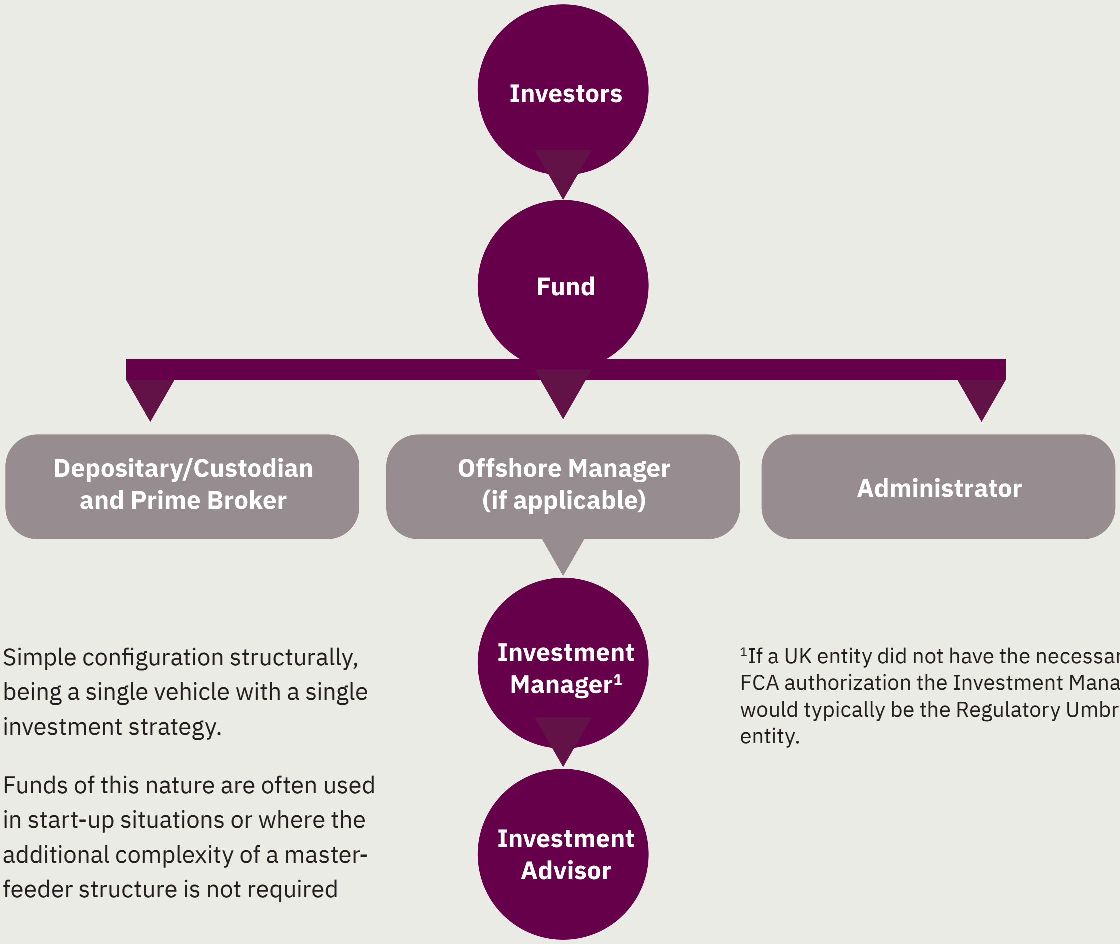
Enables the investment manager to benefit from managing investments on behalf of only one investment vehicle, thereby reducing trading costs.

This structure is often used in order to comply with different regulations across multiple target investor groups.

[1] If a UK entity did not have the necessary FCA authorisation the Investment Manager would typically be the Regulatory Umbrella entity.

Either feeder could be added at a later date when sufficient investors of the relevant type invest. Note that US taxable investors would strongly prefer to invest via a LP Feeder but that it may be possible for them to invest in the Offshore feeder under the QEF regime. Historically, the LP Feeder has been a Delaware LP Feeder. Some clients, however, are launching funds with a Cayman LP feeder instead of a traditional Delaware LP feeder in order to mitigate some of the requirements of the new private fund adviser rules in the US.

Stand-alone Fund

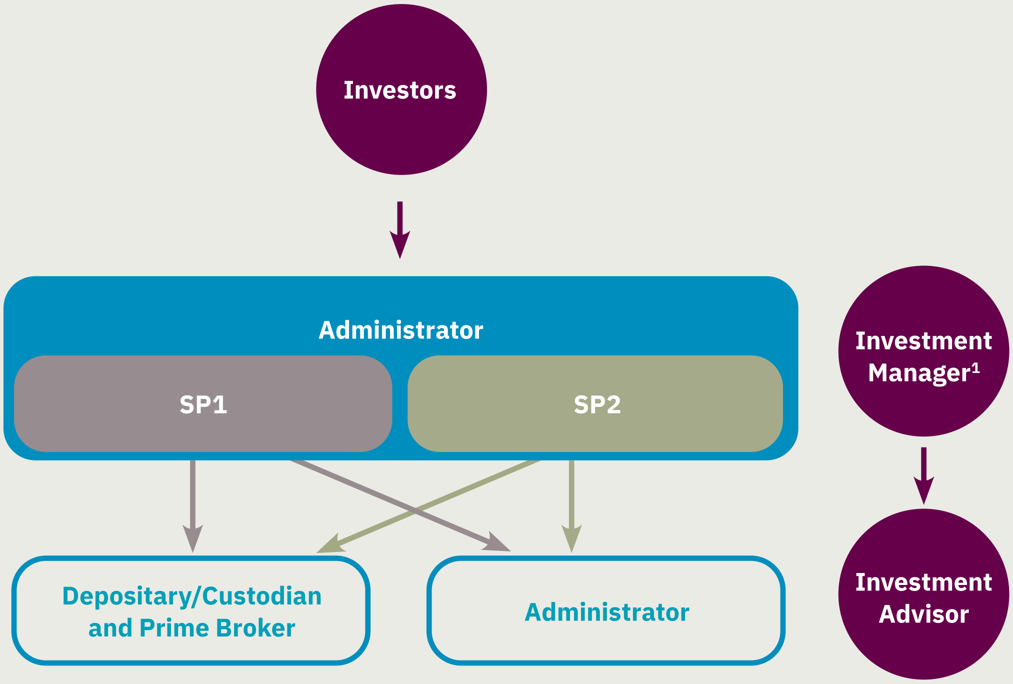


Simple configuration structurally, being a single vehicle with a single investment strategy.

Funds of this nature are often used in start-up situations or where the additional complexity of a master-feeder structure is not required

[1]If a UK entity did not have the necessary FCA authorization the Investment Manager would typically be the Regulatory Umbrella entity.

The Segregated Portfolio Company



The relevant company creates separate segregated portfolios, each ring-fenced from the assets and liabilities of other portfolios and the company itself.

This offers flexibility of strategy and investor base within a “plug and play” umbrella structure.

Often used to achieve economies of scale by centralising investment management and fund administration functions.

[1]If a UK entity did not have the necessary FCA authorisation the Investment Manager would typically be the Regulatory Umbrella entity.

02 Fund Domiciles: Cayman, Ireland and Luxembourg

The jurisdiction your fund vehicle is established in (the "fund domicile") will have significant implications on the fund's operations and success throughout its existence and therefore needs careful consideration. Whilst similar commercial outcomes can be achieved in each of the jurisdictions considered here, a key requirement for a new fund is the ability to raise investment, and therefore the preferences of seed and target investor groups should be considered from the outset.

The Cayman Islands has historically been the jurisdiction of choice for open-ended funds raising capital from investors based in multiple different jurisdictions and is widely accepted internationally as a fund domicile by investors. That said, if the intention is to market the fund principally to investors based in the European Union (**EU**), Cayman funds can face some challenges which would be avoided by EU domiciled fund vehicles. EU domicile can allow a fund to take advantage of the "passport" under AIFMD to market into any country within the bloc, whilst "gold-plated" AIFMD implementation in certain EU member states create regulatory hurdles for non-EU funds. Even where these are not in place, a non-EU fund would need to comply with the relevant "national private placement regime" for EU distribution, and these vary between EU member states. Non-EU funds pursuing ESG strategies distributed in the EU are subject to additional EU disclosure requirements. Historically, non-EU funds have sought to rely on "reverse solicitation" (accepting investors who approach the fund but who the fund has not actively marketed to) in accepting EU investors, however this approach has come under scrutiny by a number of EU country regulators and specific advice in this area should be obtained if you are considering this as the regimes vary significantly between individual EU jurisdictions. Funds primarily looking to market into the EU are increasingly looking to EU-domiciled funds (alone or as part of a master/feeder or parallel structures). Of the various EU member states providing viable options for fund vehicles, Ireland and Luxembourg stand out both in terms of the legal and regulatory environments available and acceptance by investors.

Investment managers established in the UK can opt for a fund vehicle domiciled in Luxembourg or Ireland, however, a management vehicle regulated in an EU member state will also be required to carry out certain functions in the case of a Luxembourg domiciled vehicle and the UK investment manager would need to complete a simple registration process with the Central Bank of Ireland in the case of an Irish domiciled vehicle. An Irish domiciled vehicle does not require an EU regulated management vehicle if the investment manager is willing to forgo the EU marketing passport. No equivalent restriction exists in relation to Cayman domiciled funds.

FUND VEHICLES: THE MAIN CONSIDERATIONS

The fund vehicle is the entity which investors will invest their capital in, which will carry out the investment activities and which will legally hold all fund assets. The features of this entity are therefore clearly important and the benefits, or limits, of the fund vehicle chosen will be important to its success. Each of the three jurisdictions considered here – Cayman, Ireland and Luxembourg – have particular strengths as jurisdictions and legal frameworks providing different options in terms of fund vehicle. The types of vehicle offered cannot always be directly compared between jurisdictions, but there are some key elements that should be considered in deciding on the optimal vehicle for your fund:

- **Terms:** How flexible is the vehicle? Can you tailor the features and terms to meet your investment strategy needs and target investor groups?
- **Liability:** Does the vehicle provide limited liability to investors? Most investors will be reluctant to invest in a fund vehicle that does not allow them to restrict their liability to an agreed amount, and most fund vehicles allow for this.
- **Tax:** Is it tax efficient? There is, unfortunately, no single straightforward answer to this question as both investor domicile and investment asset class need to be considered. Fund vehicles established in Cayman, Ireland, or Luxembourg are generally able to achieve no or minimal tax leakage at the fund level, but specific advice should also be taken in the planning phase.
- **Regulation:** What regulations will apply to the fund vehicle? This is in part a jurisdictional question – different countries impose different regulatory requirements – but within a single jurisdiction there are often a number of regulatory categorisations which will impact the fund's operations and costs. The most commonly used of these in each of Cayman, Ireland, and Luxembourg are explored below.
- **Structure:** Does one size fit all? Different investor groups may have different, and possibly incompatible, requirements; you may need to consider establishing more than one fund vehicle (possibly in more than one domicile) as a "master-feeder" structure or parallel fund. The cost and effort of doing so is greater than for a stand-alone vehicle and this may be deferred to after the first launch – however, there are steps that may be taken at initial set up which could make this easier to implement.

THE CAYMAN ISLANDS

The Cayman Islands has long been the domicile of choice for open-ended funds seeking international investment capital. Cayman's historical ties to the United Kingdom, its stable, common law based, judicial system along with its geographical (and time zone) proximity to the United States give Cayman a natural appeal to the hedge fund industry. Onto this frame the Island has built a strong and deep offering of service providers and a regulatory environment which is responsive to the needs of the funds industry. Cayman has built a strong reputation as, and remains, one of the most cost effective and tax efficient domiciles for investment funds.

Cayman Islands legislation provides for a number of legal entity types suited to use as fund vehicles. In this guide we focus on the most common vehicle for open-ended funds: the Exempted Company.

EXEMPTED COMPANY

Exempted Companies are formed under the Cayman Islands Companies Act (Revised) (**Companies Act**) with separate legal personality. Exempted Companies are not permitted to carry on business within the Cayman Islands and are consequently exempted from certain requirements that locally operating companies must adhere to. An Exempted Company is required to have a registered office in the Cayman Islands and, if carrying out relevant financial business, must comply with Cayman's Anti-Money Laundering Regime. The constitutive documents and share registers are not publicly available, providing significant commercial privacy. The Companies Act allows a high degree of flexibility when drafting company articles (including allowing for shares which are voting or non-voting and whose economic rights may be determined in the articles). Shareholders in an Exempted Company enjoy limited liability up to the value of their (fully paid) shares. An Exempted Company can be formed in a short period of time with minimal filing requirements and initially need

only have a single director and shareholder (neither of which need to be resident in Cayman).

REGULATION

Entities (of any type) established in Cayman and operating as investment funds are subject to regulation by the Cayman Islands Monetary Authority.(***CIMA***). Open-ended funds (ie funds allowing investors to withdraw at their option) are regulated under the Mutual Funds Act (Revised) (***Mutual Funds Act***). Closed-end funds (ie funds which do not allow investors to choose their exit timing) are regulated under the Private Funds Act (Revised). This guide focuses on open-ended funds and as such will only discuss the Mutual Funds Act.

There are four categories of registrable mutual funds, a fund registered under section 4(3) of the Mutual Funds Act (a ***s4(3) Fund***), a limited investor fund registered under section 4(4) of the Mutual Funds Act, an administered fund or a licensed fund.

A fund may qualify for registration as a s4(3) Fund if it restricts the minimum initial investment it will accept from each investor to KY$80,000 (US$100,000). This is by far the most common regulatory option used by hedge funds. Registration for a qualifying fund is made by filing the offering document and certain prescribed details with CIMA. Once registered, certain ongoing obligations exist, but there are no investment or leverage restrictions applicable, and the fund generally can determine its terms.

If the minimum initial investment requirement cannot be met, either limited investor funds (which may not accept more than 15 investors who must have the power to change the operator) or administered funds (which must have a Cayman licensed mutual fund administrator providing its principal office) may be used though either the limited number of investors or the added cost of the principal office make these less common. Licensed funds are designed to be suitable for retail investors and are generally not appropriate for hedge fund structures.

In addition to required filings, CIMA has published a number of rules relating to the operation of regulated mutual funds, including certain requirements regarding net asset value calculation policies, segregation of assets, the content of offering documents, corporate governance and internal controls. A regulated (corporate) fund must also have two directors who must register with CIMA.

OVERSIGHT

Regulated funds must make filings with CIMA of changes to offering documents and other prescribed information and must file their audited accounts annually with CIMA. CIMA has broad powers to inspect the operation of regulated funds, but funds are not inspected on a routine basis.

TAXATION

Exempted Companies (and other relevant types of fund vehicle) are not subject to any income, withholding or capital gains taxes in the Cayman Islands. Shareholders will not be subject to any income, withholding or capital gains taxes in the Cayman Islands with respect to their shares and dividends received on those shares, nor will they be subject to any estate or inheritance taxes in the Cayman Islands. Certain government registration fees are payable by an Exempted Company and by a mutual fund. Where the fund is seeking investment by US taxable investors, an Exempted Company can "check the box" to be treated as a pass through entity for US federal income taxes.

IRELAND

The Republic of Ireland benefits from a young, well-educated workforce along with a common-law based, well respected, legal system and is the only English speaking country in the EU. These advantages have enabled Ireland to develop into a one of the EU's most successful financial centres and fund jurisdictions.

Ireland is the 3rd largest global investment fund centre and the 2nd largest in Europe. 1,053 fund managers from 54 countries have assets administered in Ireland. 40% of the world's alternative investments fund assets are administered in Ireland and 17 of the top 20 global asset managers have Irish domiciled funds. The assets under management of Irish domiciled investment funds is in the region of €4 trillion, distributed among nearly 9,000 different Irish domiciled funds.

As with the Cayman Islands, Irish law offers a broad range of fund vehicle types, however, this guide will focus on the most commonly used vehicle for open-ended alternative investment funds, the QIAIF ICAV, and the QIAIF ILP.

QIAIF ICAV

The QIAIF Investment Limited Partnership (***ILP***) offers the flexibility of a QIAIF (speed to market and flexibility) coupled with a limited partnership structure. The GP to the ILP may be a non-Irish corporate or non-corporate entity and the ILP may incorporate the usual provisions applicable to limited partnerships operating in the hedge fund space (eg. capital accounting, excuse and exclude provisions, capital commitment and contributions, drawdowns, defaulting investor provisions, carried interest, distribution waterfalls and advisory committees). An ILP which appoints an EU alternative investment fund manager (***AIFM***) under the Alternative Investment Fund Managers Directive (***AIFMD***) may avail of the pan EU marketing passport

REGULATION

An ICAV must be regulated as a "UCITS", "RIAIF" or "QIAIF". UCITS are principally retail focussed products and are unlikely to be the regulatory regime of choice for a hedge fund targeting sophisticated investors (an ILP must be regulated as a RIAIF or QIAIF). Retail investor alternative investment funds (RIAIF) may be marked to retail investors (like UCITS) but with fewer restrictions on their eligible investments; however, such structures cannot be passported to other EU jurisdictions. QIAIFs by contrast are eligible for EU passporting and have very few investments restrictions (thought the CBI does require that significant disclosures are made). The minimum permitted investment in a QIAIF is EUR 100,000 and the categories of investor such a fund may be marketed to is restricted.

The majority of hedge funds selecting Ireland as a fund domicile have been structured as ICAVs regulated as QIAIFs. An increasing number of hedge funds are being structured as QIAIF ILPs.

OVERSIGHT

The CBI is the regulatory body with oversight over all fund vehicles established in Ireland. A QIAIF (both QIAIF ICAV and QIAIF ILP) may be authorised by the CBI within 24 hours of the submission of final documents (including the dated PPM or prospectus and executed service provider contracts). The directors and service providers must be pre-approved prior to the 24 hour filing. A non-EU investment manager is subject to a clearance process with the CBI which is generally completed within 2 weeks (and 1 – 2 days for an EU investment manager). An ICAV must have at least 2 Irish resident directors and all directors of an ICAV or directors an Irish corporate GP to an ILP must be approved by the CBI pursuant to its Fitness and Probity regime.

TAXATION

An ICAV is fully exempt from Irish taxes on its income and profits and there are no Irish taxes on distributions or redemptions to non-Irish resident investors or Irish tax exempt investors. Certain taxes may exist in relation to distributions arising from Irish domiciled real estate assets . An ICAV is not subject to any form of Irish subscription tax or tax on its assets under management. For non-Irish resident investors, no Irish transfer taxes apply to the transfer, exchange or redemption of shares in an ICAV. No capital duty is payable on the issue of shares. ICAV's benefit from an exemption to certain VAT charges, including VAT on fund management and administration services. ICAVs are generally able to benefit from Ireland's extensive double tax treaty network. Ireland has one of the most developed and favourable tax treaty networks in the world including double taxation treaties with 74 countries, minimising the effects of withholding taxes at the asset level. Unlike certain other Irish fund vehicles, ICAVs are eligible to "check the box" in relation to US federal income taxes (an important consideration if US taxable investors are expected).

The ILP is tax transparent for Irish tax purposes. All income, gains or losses of an ILP are treated as accruing to each limited partner for Irish tax purposes as if such income, gains or losses had accrued to the limited partners without passing through the ILP. There is no Irish stamp duty on the transfer, exchange or redemption of units in ILPs. As is the case with ICAVs, management and administration services to an ILP are VAT exempt.

LUXEMBOURG

Luxembourg is one of the world's largest global financial centres, benefiting from flexible and attractive legal, regulatory and tax regimes and a significant concentration of professional service providers to the financial services industry.

Luxembourg's investment funds industry ranks as the largest EU fund domicile jurisdiction and the second largest fund domicile jurisdiction globally.

Luxembourg's legal system provides a wide range of potential fund vehicle structuring options and regulatory regimes including UCITS, regulated and unregulated alternative investment funds. Fund vehicles in Luxembourg will frequently be subject to the requirements of the rules governing the relevant corporate form and, as the case may be, the specific "product" law applicable to investment fund structures.

This guide will focus on the most popular form applied in the open-ended alternative investment fund context: the S.A. SICAV-RAIF.

SOCIÉTÉ ANONYME (S.A.) – SOCIÉTÉ D'INVESTISSEMENT À CAPITAL VARIABLE (SICAV)

An S.A. is a Luxembourg public limited liability company formed under the Luxembourg Law of 10 August 1915 (as amended) which, if formed as an investment fund subject to a product law providing for such possibility, may also benefit from the feature of having a variable capital and thus qualify as an investment company with variable capital – SICAV. This means its share capital will, at all times, be equal to the value of its assets and may be increased without recourse to a meeting of shareholders. An S.A.-SICAV is incorporated in front of a notary and must have an initial capital on incorporation of EUR 30,000.

An S.A.-SICAV is usually managed by a board of directors issuing shares to investors. Considerable flexibility exists in terms of what can be provided to different share classes. When governed by a specific "product law", such as the Law of 23 July 2016 on reserved alternative investment funds (***RAIF Law***), an S.A.-SICAV may also be formed with "compartments" allowing for the creation of an umbrella structure The board of directors must have a majority of Luxembourg residents in order to maintain Luxembourg substance for tax purposes, though it is possible to allocate voting decisions such that the approval of directors associated with the initiator of the fund is needed.

REGULATION - RESERVED ALTERNATIVE INVESTMENT FUNDS (*RAIF*)

An important feature of the continued success of Luxembourg as an investment fund domicile is the existence of the RAIF within the suite of regulatory options. Whilst a RAIF qualifies as an alternative investment fund (***AIF***) under the Alternative Investment Fund Managers Directive (***AIFMD***), and is therefore eligible for marketing passporting in the EU via its AIFM, it is not subject to direct supervision by Luxembourg's financial regulator – the Commission de Surveillance du Secteur Financier (CSSF). A RAIF must appoint a full scope AIFM (either based in Luxembourg or in another EU jurisdiction) as its alternative investment fund manager, responsible for risk and portfolio management. The AIFM may delegate portfolio management to another entity – allowing for portfolio management by a non-EU manager subject to certain regulatory requirements (including eligibility of the delegate) and the supervision by the AIFM. Besides the appointment of the authorised AIFM, RAIFs are required to appoint certain Luxembourg based service providers including their fund administrator, auditor and depositary.

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A RAIF is required to have a minimum invested capital of EUR 1,250,000 (though this amount is subject to a 24 month ramp up period during which the capitalisation can be below this).

As RAIFs are not directly supervised by the CSSF, pre-launch regulatory applications are not required (though the AIFM needs to make certain regulatory notifications (management and marketing notification) in connection with the RAIF's launch).

Shares or interests in RAIFs can only be offered to "well-informed investors" which includes professional and institutional investors as well as investors who have confirmed in writing that they adhere to the status of "well-informed" investor and either commit to at least EUR 100,000 or whose expertise and knowledge has been assessed as adequate by a credit institution or an investment firm.

OVERSIGHT

As a RAIF is not itself regulated by the CSSF; it does not come under its direct supervision. However, whilst RAIFs are routinely described as "unregulated" it may be more accurate to say that regulation of a RAIF takes a "hybrid" form in that it is required to appoint an authorised AIFM, which is subject to supervision by a European regulator, and indirect regulatory oversight is therefore provided. For AML/CFT purposes, the supervision of the RAIF is supervised by the Luxembourg's Registration Duties, Estates and VAT Authority (Administration de l'enregistrement, des domaines et de la TVA – ***AEDT***).

TAXATION

Depending on their legal and regulatory status, most Luxembourg funds will generally either not be subject to or be exempted from corporate income tax, net wealth tax, withholding tax on distributions and not be subject to non-resident capital gain taxation in Luxembourg. Depending on whether a product law such as the RAIF Law applies, Luxembourg funds may however be subject to a subscription tax (often 0.01% rate of the fund's NAV). Benefit from the extensive network of Luxembourg double taxation treaties (***DTT)*** would need to be analysed on a case-by-case basis. Management services rendered to Luxembourg funds are usually VAT exempted. Luxembourg VAT may however be payable on certain other service provider fees.

CAYMAN, IRELAND, OR LUXEMBOURG?

The range of potential fund domicile and fund vehicle structuring options can make the decision as to the optimal choice for your fund feel challenging. It can often therefore be helpful to focus on the most popular jurisdictions and structures in the first instance in discussion with your advisers and (if possible) key initial investors. For managers seeking an EU domiciled fund, Ireland and Luxembourg both provide regimes tailored to the fund industry, while Cayman's longstanding position as a major fund domicile provides a well-trodden path for non-EU structures. Considering how these vehicles can provide similar outcomes, and where they differ, can assist new managers in clarifying your options. A high level summary table is set out below to assist your review.

	Cayman s4(3) Fund	Irish QIAIF ICAV or QIAIF ILP	Luxembourg SA SICAV RAIF
Investment restrictions?	None	Some limited regulatory restrictions	Some limited regulatory restrictions
Leverage Restrictions	None	None (other than loan origination QIAIF's)	No statutory restriction (but limit must be stated in offering document)
Fund offering document required	Yes (filed with CIMA)	Yes (filed with CBI)	Yes (no filing requirement)
Investor Restrictions	Minimum of US $100,000 initial investment	Minimum of EUR 100,000 initial investment and restricted to certain investor categories	Well-informed investors (institutional, professional and opt-in by a minimum EUR 100,000 initial subscription or external assessment confirmation)
EU Marketing	Yes – via National Private Placement Regimes	AIFMD marketing passport	AIFMD marketing passport
Restrictions on Investment Manager Domicile	No	EU AIFM required if availing of the AIFMD marketing passport	EU AIFM required
Local directors required	No	Yes	Yes
Other local service providers required	CIMA approved auditor	Auditor Depository Administrator	Auditor Depository Administrator
Investor limited liability	Yes	Yes	Yes
Local taxation	No	No income or profits tax. No subscription tax. No distribution tax (unless Irish resident investors or Irish real estate assets). Broad VAT exemption on management and administration services.	No local tax save where subscription tax applies. DTT access to be reviewed case-by-case. Broad VAT exemption on management services.
Regulated Fund	Yes – CIMA regulated	Yes – CBI authorised	No – AEDT supervision for AML/CFT purposes
Master-feeder possible?	Yes	Yes	Yes
Master fund offering document required?	No	Yes	Yes
Umbrella structure possible?	Yes	Yes	Yes

03 Principal Documents

The fund receives its legal and fiscal shape from its principal documents. What are the objectives of the fund, what are the terms for investors, and what are the fund's service provider relationships? The documents listed below provide answers to these questions and more.

THE TEASER

A teaser is used to introduce the investment opportunity to potential investors. Only those aspects that identify and characterise the fund should be highlighted in the document, which should not be too detailed. The teaser's objective is to pique curiosity at first.

THE PITCH BOOK / SLIDE DECK

The pitch book serves as a longer, more in-depth teaser. The document, which is typically created by fund sponsors or outside parties, should outline the fund's strategy, expected returns, and managers. It is crucial to include any pertinent legal disclaimers, risk management policies, and major investment terms in the pitch book.

OFFERING MEMORANDUM/ ISSUE DOCUMENT/ PROSPECTUS/ PRIVATE PLACEMENT MEMORANDUM (PPM)

The PPM should be viewed as partly "marketing material", partly "regulatory/legal disclosure" and partly a "risk protection" document. It is essential to liaise with relevant service providers to verify that the statements contained within the PPM are accurate and not misleading.

As marketing material, the PPM is the single most significant marketing document. It must have all pertinent information regarding:

- the applicable process for subscription and redemption
- a description of the management team, their background, experience and track record
- the domicile
- any liquidity management tools, taking note of any redemption gates or applicable lock-up period
- the fund's service providers
- leveraging powers
- the legal structure
- the offering
- investment restrictions (if any)
- the investment objectives and strategy
- a summary of management terms, including all costs and expenses related to the fund
- the targeted investors

This document should also contain further technical information, such as a summary of the fund's and its investors' tax profiles as well as its main risk factors, as appropriate.

THE GOVERNING DOCUMENT

The constitutional contract between a fund and its partners or shareholders is outlined in the governing document. The fund's legal structure determines the actual character of the document. Articles of Association or Incorporation will regulate alternative funds organised as companies or segregated portfolio companies, while Limited Partnership Agreements are utilised for limited partnerships.

THE SUBSCRIPTION AGREEMENT

The Subscription Agreement is executed to formalise the relationship between investors and funds. Investors explicitly recognise their comprehension of the risks associated with subscribing for shares and agree to be governed by the constitutional documents of the fund. Investors must then supply certain personal information to the fund, its managers, and its prime brokers in order to fulfil their duties under the know-your-customer and anti-money laundering laws, as well as providing any necessary covenants, warranties, confirmations undertakings, and indemnities. Their eligibility to invest in the fund must be covered by one of these confirmations.

SIDE LETTERS

If key investors are offered supplemental or modified terms to those in the PPM, subscription agreement or governing document these preferential terms will be set out in a Side Letter. Side Letters will typically grant certain investors waivers for or reductions to management fees, enhanced transparency, as well as special liquidity provisions (though the offer of preferential redemption rights has become more controversial in recent years). In many cases existing investors will request a Most Favoured Nation (MFN) clause, which will allow them to benefit from any more advantageous terms offered to future investors. Fund managers are required to disclose the details of any Side Letters under AIFMD.

The "investment contract" between the fund and an investor comprises (1) the Offering Memorandum/ Issue Document/ Prospectus/ PPM; (2) the governing document; (3) the Subscription Agreement; and (4) any applicable Side Letters.

THE MANAGEMENT AGREEMENT

The Management Agreement will contain the details of the relationship with any offshore manager that the fund retains. Such agreements can cover a wide range of topics, but they should at the very least appoint the manager, and outline their responsibilities and the conditions under which the agreement will terminate. Many of the management duties of the manager under the Management Agreement will be delegated to the onshore investment manager (if applicable). The use of an offshore manager has become less common.

INVESTMENT MANAGEMENT AGREEMENT

The Investment Management Agreement will set out the relationship between the investment manager and the fund and/or offshore manager. Such agreements can cover a wide range of topics, but they should at the very least appoint the investment manager, and outline their responsibilities and the conditions under which the agreement will terminate. Depending on the arrangement, either the fund or its manager will pay a management fee to the investment manager. Additionally, a performance fee may also be paid to the investment manager. Where a regulatory hosting arrangement is being used, the Investment Manager would typically be the regulatory host entity. In such circumstances, there will also be other documents between the fund sponsor and the host that comprise the regulatory hosting arrangements. See **Your Management Business - Section 5: Using a Regulatory Hosting Firm** for more details.

INVESTMENT ADVISORY AGREEMENT

Should the fund retain an investment advisor, the terms of the relationship between the investment advisor and the investment manager will be outlined in the Investment Advisory Agreement. Such agreements can cover a wide range of topics, but they should at the very least appoint the investment advisor, and outline their responsibilities, the terms of remuneration and the conditions under which the agreement will terminate.

ADMINISTRATION AGREEMENT

The Administration Agreement specifies the terms of the Administrator's engagement. These agreements can cover a wide range of topics, but they should at the very least appoint the administrator, and outline their responsibilities, the terms of remuneration and the conditions under which the agreement will terminate.

PRIME BROKER AGREEMENT

If a prime broker is appointed, its relationship with the fund will be set out in the Prime Broker Agreement (and accompanying trading documents, including the ISDA). There is no industry standard for this document, but it will generally protect the prime broker in cases of fund solvency issues. A prime broker will normally act as custodian with respect to the assets that are allocated to it.

ISDA AGREEMENTS

The standard agreement used in over-the-counter derivative transactions is the International Swaps and Derivatives Association Master Agreement.

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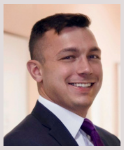

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THE DEPOSITARY AGREEMENT

The Depositary Agreement will specify the extent of the depositary's obligations. EU-domiciled funds must keep a local depositary that complies with all applicable AIFMD rules. EU-managers of non-EU funds, such as Cayman-domiciled funds, (and UK managers of non-UK funds) may designate one organisation (or more) to satisfy the less rigid 'depo-lite' standards. In general, non-EU domiciled funds with non-EU managers do not need a depositary unless one is required to be appointed under local AIF marketing rules.

CUSTODIAN AGREEMENT

If a custodian is appointed the duties and services expected of that entity will be set out in the Custodian Agreement. Such agreements can be wide-ranging but should at the very least provide for the appointment of the custodian, its duties, the custody and sub-custody arrangements, the circumstances under which the agreement will be terminated and the remuneration terms.

04 Principal Parties

A fund's performance depends heavily on having service providers who are knowledgeable, responsive, and focused. Below are a few of the key figures.

Haynes Boone has strong industry ties and our partners are delighted to guide you through the selection process.

OFFSHORE MANAGER

It may be the case that a fund will assign some management functions to an offshore management business (which then delegates the investment management function to an onshore Investment Manager). Offshore managers are typically set up as offshore private limited companies. If the onshore Investment Manager is in the UK it will be authorised by the FCA. The use of an offshore manager has become less common.

INVESTMENT MANAGER

The Investment Manager, who is authorized by the UK Financial Conduct Authority and is overseen by the fund's board overall, implements the investment strategy for the fund and then manages its portfolio trading activities.

INVESTMENT ADVISER

Some fund structures call for the appointment of both an Investment Manager and an Investment Adviser. In an appointed representative arrangement, this is reasonably standard (please see **Your Management Business - Section 5: Using a Regulatory Hosting Firm** for more information).

FUND ADMINISTRATOR

The Fund Administrator is responsible for determining the fund's Net Asset Value (NAV) and any performance or management fees, as well as managing subscriptions and redemptions etc. and carrying out KYC/AML checks on investors. Additionally, they can be required to serve as a registrar or transfer agent.

FUND DIRECTORS

The directors of a fund, as the fund's governing body, constitute the mind and management of the fund. The directors decide which service providers to appoint (including the Investment Manager), they should oversee the performance of those service providers and are generally relied on by investors to protect investors' interests. Generally, all fund decisions that do not relate to investment management should be made by the directors.

LEGAL COUNSEL

The primary function of legal counsel during a fund launch is to advise the investment manager on the best structure and jurisdiction for its funds and to draft fund documentation. They will also be required to communicate with local law firms who offer jurisdiction-specific knowledge.

PRIME BROKER

The Prime Broker serves as a conduit between the markets and the Fund. Typically, they offer the following three essential services: (1) securities lending (funding borrowing of stocks and bonds); (2) margin financing (funding borrowing money to buy stocks and bonds); and (3) consolidated reporting.

Prime Brokers may also facilitate capital introductions between fund managers and potential investors. Some Prime Brokers may also serve as a fund's custodian and may be involved in the capital raising, marketing, or service provider selection processes.

CUSTODIAN

The investment manager appoints the custodian as a separate legal body with sole authority to represent the interests of the fund's investors. The assets of the fund must be protected by the custodian. Please also see "Depositary" below.

DEPOSITARY

The depositary's duties are threefold: safeguarding assets, cash monitoring and general oversight of the fund. This means that the depositary combines the roles of custodian and auditor. It is not uncommon for certain depositary duties to be provided by entities in the same group as the administrator. It is important to note that an all-EU UCITS or AIF fund structures require a fully authorised EU depositary. An EU manager of a non-EU AIF (and a UK manager of a non-UK fund) will be subject to reduced depositary requirements ('depo lite') when marketing to EU (or UK, in the case of UK managers) investors through private placement. See **The Fund - Section 3: Principal Documents** for more information.

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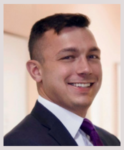

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FUND AUDITOR

Works with the administrator and/or depositary to audit the fund. KPMG give their thoughts on choosing the right auditor in **The Fund - Section 7: Choosing the Right Auditor**

REGULATORY UMBRELLAS OR HOSTS

The process of becoming fully authorised and regulated by the FCA takes a significant amount of time and may be a sticking point for funds which are otherwise ready to launch. Regulatory umbrellas or hosts provide funds with regulatory coverage until such a time as the investment manager can get the fund fully authorised. See **Your Management Business - Section 5: Using a Regulatory Hosting Firm** for more information.

CAPITAL INTRODUCTION/ PLACEMENT AGENT

Searches for prospective investors and introduces them to the fund manager.

FUND ACCOUNTANT

Works with the Investment Manager to ensure accurate bookkeeping but can also provide HR support in certain circumstances.

05 Fund Directors

The practice of effective governance and independent oversight is evolving. There are many items to consider when implementing effective/good governance and these are eloquently summed up by the CFA Institute's guide to Investment Management Governance. "A good fund board is characterized by independence, transparency and a focus on the primacy of client interests. The well-managed board will ensure the appropriate organizational structure and supervision to prevent any conflicts of interest." It adds "a fund board should be composed of at least a majority of independent board members acting independently from the management of the fund. An independent board is necessary to protect the interests of investors and mitigate any conflicts of interest that may arise between investment managers and fund investors in the operations of the fund. Board independence helps uphold the primacy of client interest over those of the investment manager."

Independent directors should be able to demonstrate that they are free from all conflicts with the fund, the investment manager, administrator, legal firm, and other key service providers where relevant.

With the focus of regulators and investors on governance ever increasing, and new guidance and requirements being released recently, it is important that founders consider the qualifications, experience, independence and capacity of each director that is to be appointed to the board of the fund. The most effective boards will have members with complementary skill sets. In addition, diversity has become important for many investors, so consideration should be given to the board composition.

It has become standard practice to have at least two independent directors combined with a member of the investment management team be appointed to the board, with further directors being added where there is added complexity and risk while still ensuring an independent majority.

Investors expect there to be representation of the investment manager on the board of the fund. This ensures that the investment manager has responsibility and liability at the fund level. Investors also expect all board members to be active members of the board, including attending all board meetings.

It is best practice for board meetings to be held quarterly, one of which should ideally be held in person by the directors (although the frequency of in-person meetings should be considered against the costs with respect to fund size and complexity). The board meetings should include all key service providers providing an update to the board on their activities including any risks to the fund either past or present.

ITEMS TO CONSIDER PRIOR TO APPOINTING AN INDEPENDENT DIRECTOR:

- Is the proposed independent director affiliated with any of the key service providers of the fund? Could the affiliation be considered a conflict?
- Does the proposed independent director have the relevant experience required to add value?
- Has the proposed independent director dealt with complex or extraordinary issues in the past, do they have the skill set to lead a fund in times of trouble?
- Does the proposed independent director have the capacity to take on the appointment? How many relationships/funds do they have?
- How does the experience of the proposed independent director sit with other board members, and do they provide a complementary skill set?
- Will the proposed appointment align with the diversity requirements of the investors?

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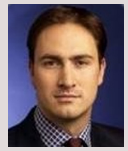

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> Independent directors should be able to demonstrate that they are free from all conflicts with the fund, the investment manager, administrator, legal firm, and other key service providers where relevant.

06 Governance and Control

ECONOMIC PARTICIPATION AND VOTING

Open-ended corporate hedge funds often choose one of two paths in terms of corporate governance...or a middle-way between the two. The first is to issue voting shares to investors that are typically linked to the level of financial participation in the fund. The second is to issue, usually to an entity in the manager's group or to an independent third party such as a foundation or trust, a small number of voting shares (with little or no economic rights) (often called "Managing", "Management" or "Founder" Shares) and to issue investors with participating shares that have little or no voting rights but plenty of economic rights. Any voting rights conferred in relation to non-voting shares are typically limited to the class rights attaching to such shares.

The middle-way is to issue, usually to an entity in the manager's group or an independent third party such as a foundation or trust, a small number of shares (with little to no economic rights) that have exclusive voting rights and/or veto rights over certain matters (again, often called "Managing", "Management" or "Founder" Shares) and to issue investors with voting shares (subject to the exclusive voting rights and/or veto rights of the Managing Shares) that effectively have all the economic rights.

In addition to manager and investor preference, there are arguments for and against each of these routes and several considerations that need to be front of mind:

ONSHORE CONTROL

The relevant onshore authorities may wonder who "controls" the fund if an onshore entity has sufficient voting control in an offshore fund. The fund runs the risk of unintentionally becoming subject to an onshore tax regime in such situations.

QUORUM

The possibility that a fund will not be able to meet the necessary quorum at any particular meeting increases as more entities acquire voting rights. The fund's ability to make decisions at crucial times will be hindered if the quorum requirements are not satisfied. The appointment of proxies can help to address this risk and, for example, a proxy clause could be added to the investor's subscription documentation if the fund is only issuing voting shares.

INCREASED FLEXIBILITY

Managers can act more nimbly by having Managing/ Management/Founder shares. It will not always be possible or practical to call an emergency meeting of shareholders or to get the required majority of shareholders to pass a resolution. On a day-to-day level, the same is true. Any system for representing a large shareholder group is likely to be inefficient and may have trouble making decisions, however critical, quickly. It is important to remember that a Managing/Management/ Founder share arrangement does not grant the fund manager the power to do everything. Investor class protection rights, and the "investment contract" between each investor and the fund, will serve as a check on the extent of the fund manager's voting powers.

GOVERNING BODY

Regardless of the structure utilised, it is essential that the fund and all pertinent third parties are under the oversight and supervision of an efficient governing body (this will be the board of directors, in the case of a corporate fund, or the board of directors of the general partner, in the case of a limited partnership fund). Together, the key fund documents and the network that surrounds the management company (**The Fund - Section 3: Principal Documents**, **The Fund - Section 4: Principal Parties** and **The Fund - Section 5: Fund Directors**) should provide a clear framework for, and explanation of, the roles and relationships that make a fund function. The likelihood that a fund will fail to provide investors with the desired outcome is decreased by effective governance.

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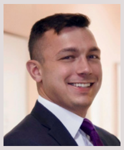

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07

Choosing the Right Auditor

Choosing the right auditor for your fund is essential. It helps to make sure you get the best out of the process. It is a relationship that will provide added value to both the fund and the investment manager.

KPMG in the Cayman Islands has set out the key factors that they believe firms should take into consideration below.

Whilst the audit process is there to make sure your fund is compliant, it's also a chance to take a closer look at your major operational processes and identify any potential weaknesses. It could save you time in the long run, so you need an auditor that understands your business.

IDENTIFYING THE EVALUATION CRITERIA

Consider what you are looking for in your auditor and other professional advisers. This should relate to your current needs and your strategic plans. The factors that are important to you should form the evaluation criteria that you apply.

These may include:

- **Understanding your business** – how well do the prospective teams understand your investment strategy, the issues you face and the emerging industry trends?
- **People** - are the proposed audit team asset management specialists? Do they have the experience that you're looking for? It is important that the audit team can address complex technical issues as it relates to how accounting and auditing standards are applied to your fund's transactions.
- **Relationship** – is there a personal fit with members of your team? Do the key audit Partners, Directors and Managers have the qualities to establish the type of relationship you prefer? One of the many important relationships is that between the COO/CFO and the audit team. Management needs to be satisfied that the audit team has the appropriate level of staff, with the necessary experience and knowledge.

  In particular, it is important that the audit Partner or Director has an appropriate working relationship with the COO/CFO and Board of Directors, General Partner or Managing Member (the Board) and that the audit Manager has an appropriate working relationship with the key finance staff and the administrator.

  For some offshore funds, these audits may be subject to a "Multi-Firm Arrangement" model, whereby a local firm does the audit work, but another office issues the audit opinion. When operating under this model, it is important to understand to what extent the audit Partner signing the opinion will be involved.

- **Proactivity, ideas and strategies** – to what extent has the potential audit team demonstrated that they will be proactive, bring new ideas and continually enhance their service to you? Throughout the audit Request For Proposal ("***RFP***") process, the level of ideas brought to you will provide you with an indication of the type of performance you can expect in your relationship with the firm. Ideas brought to you upfront in the process also allow you to assess the team's understanding of your business.
- **Organisational fit** – does the firm have the coverage that you need? Do their culture and values fit well with your organisation? The firm needs to be capable of serving the needs of the fund. It also needs to understand your priorities and values and ideally, display these characteristics itself.
- **Commitment** – how committed is the firm to providing you with the service you want? The level of input at Partner or Director level can be an indicator of the level of commitment that the firm has to developing a working relationship with you. How often you will have face-to-face meetings and calls with the lead audit Partner or Director?
- **Approach** – how well does the proposed approach to the work address your needs and provide the added value that you're looking for? To what degree will the audit team involve valuation specialists in the audit process? How will the audit team meet a timeline that meets regulatory deadlines and works for you and the Board? Will they review and provide input on pro-forma financial statements in advance of the period end? How will they work with your administrator? Will they provide a planning and closing presentation to your Board? To what degree will they use technology in the audit process?
- **Independence** – can the firm achieve independence? Prior to providing a proposal, the audit firm should perform certain independence checks to ensure there are no conflicts.
- **Dedicated service professional input** – to what extent do the firms have the dedicated service professional experience that you would like access to? Do they have in-house valuation specialists that can independently value complex investments, or will they need to outsource to other offices or third parties to provide these key valuation skills? Do they have a dedicated asset management tax practice?
- **Fees** – will you get good value for money on an ongoing basis? Management may be keen to demonstrate their tight control over the fund's costs through a reduction in the audit fee, but this may not necessarily be in the interests of the Board, the shareholders, or even of management themselves. A more appropriate measure may be value for money rather than absolute cost.

APPOINTING A FIRM

After you have taken the above into consideration and you have reached a decision, best practice will be to notify all the decision makers and the Board as necessary, then inform all tendering firms. The lawyers may also need to be made aware of your choice of auditor, so that they can include the audit firm's name and address in the fund's offering documents.

AFTER THE AUDITOR SELECTION PROCESS

It is likely that both the winner and losers will ask for a debrief on their RFP performance. This is always a helpful learning exercise from the firms' point of view.

For some jurisdictions, a consent letter from the auditor may be required as part of the regulatory registration process. The firm you have decided on will need to perform acceptance procedures, prior to issuing any such consent letter. These Know Your Client procedures may take 1-2 weeks to complete and should be factored into the timeline to launching your fund. To facilitate the process, it is helpful if you have copies of passports and utility bills ready for each key member of the management team and the Board.

Following completion of the acceptance procedures, an engagement letter will be issued.

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08 Liquidity Management

A foundational part of a shareholder's relationship with a hedge fund is its ability to redeem in part, or the entirety, of its holdings on specified redemption dates within the agreements that manage the relation. Liquidity management is the consequence that flows out of this redemption obligation.

Liquidity concerns normally only arise when the number of shareholders exercising their redemption right exceeds the capacity of the fund to honour one or more redemption requests, normally caused by a failure of the investment strategy, adverse market conditions or a combination of both. When this failure to pay occurs, the investor-fund relationship is breached, and the fund may be stuck with just illiquid assets. To mitigate this issue, liquidity management tools are often baked into the fund documentation.

GATES

During periods of high traffic gates provide funds the ability to delay redemptions. Use of the mechanism generally include a redemption threshold (calculated on an aggregate basis) which, when met, the gate is triggered. It is possible to provide different variations for shareholder levels, fund-level or specific share classes. One example of a variation is a 'stacked gate.' This grants existing gated investors a redemption priority over later investors trying to redeem their holdings on the next redemption date. Investor views on gates, and their terms, ebb and flow in different directions.

SUSPENSION

It is common to grant directors of the fund the right to suspend redemptions (along with any determination of the net asset value) for a specified time period. This power can normally only be exercised once a specific set of conditions are met, however, this is something that can vary from fund to fund with the articles of a fund potentially allowing directors more freedom in this regard. Suspension normally allows a fund to delay redemption payments even after a holding has been redeemed. However, this is only delay, once a redemption claim has been approved, it is not possible to retroactively invalidate it.

REDEMPTION IN KIND

If a liquidity crisis occurs, funds may have the option to meet any redemption requests made by transferring to investors underlying assets held by the fund in lieu of cash. The fund documents though must clearly establish the fund's right to issue these 'redemptions in kind'. It should be highlighted that securities issued by the company (such other classes of shares) are not considered eligible assets to form part of a redemption in kind. It is possible that shareholders may consent to part of their redemption be provided in the form of a new share class, but this is something that is to be agreed on a bilateral basis between the individual shareholder and the fund.

LONGER REDEMPTION/HOLDING PERIODS

It is possible to manage liquidity through increasing the notice requirements and period between redemptions to effectively lock investments into the fund for a longer. Commonly, this is employed at the launch of a fund for a limited period of time. This provides the fund's management the ability to focus on raising capital without having to worry about liquidity to the same degree. Longer redemption/holding periods may be made more attractive where used in conjunction with preferential fee rates.

MANAGING ILLIQUID INVESTMENTS

Not all funds employ strategies which focus on liquid investments. Those which invest in assets of a less liquid nature will need to ensure additional measures are in place to protect both the fund and its investors. The types of funds will structure their fund's structures, procedures and documentation accordingly and investors into these funds will be fully aware of the assets types they are investing into. This does not mean managers who typically invest in liquid, assets cannot take advantage of illiquid opportunities as they arise.

- **Side Pockets**

  Where liquid funds are presented the opportunity to invest into illiquid or hard-to-value assets, they may want to take the approach to segregate these from the fund's more liquid portfolio through a 'side pocket', which prevents any redemption occurring until a 'realisation event' occurs. Side pockets often include a selection of investors who have indicated an interest in such assets and have an offer to invest in such baked into the initial fund launch which then bars any further entry of future investors. This provides the fund the ability to continue to accept new subscriptions and redemptions from future investors, while shielding the 'potential value' of the side-pocketed assets from these. Where these opportunities are seen to be an integral part of the fund's strategy, then participating in any side pocket can be made mandatory but will still apply the liquidity benefits mentioned above.

  This is not the say that side pockets are only created at launch. It is possible to create a side pocket after launch although this will generally be more complicated as it will normally require investor consent. Ultimately, this will come down to exactly how flexible the fund's documentation is and its ability to quickly introduce new mechanisms which can take advantage of opportunities as they appear.

- **Separately Managed Accounts**

  If Side Pockets are seen to be too complicated there are other options that can be used. Opening SMAs is an alternative option which allows managers to make investments on behalf of specific individual clients. More information can be found in **The Fund - Section 9: An Alternative Approach: The Separately Managed Account.**

- **Stand-Alone Funds**

  Where an illiquid asset presents an attractive opportunity but lies beyond a manager's typical activities, it might be worth establishing a new dedicated closed-end fund which focuses solely on these opportunities. Stand-alone funds with their own capital and a structure designed for such investments are normally best placed to take advantage of the specific opportunity rather than bolting them onto existing investment funds. As can be expected, this will raise issues around the manager's focus. Depending on the size of the manager, it may struggle to allocate time between two funds sufficiently, and any perceived 'distraction' has the potential to be concerning to existing investors while off-putting and prospective investors alike.

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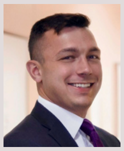

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09 An alternative approach: the Separately Managed Account

Separately Managed Accounts ("***SMA***s") came to real prominence in the wake of the 2008 financial crisis, and the transparency of the structure now has a proven track record of being attractive to potential investors in the years since. SMAs allow investors to benefit from the expertise of the hedge fund manager to invest on their own terms, while remaining in control of their assets.

HOW THEY WORK

An SMA (also referred to as an 'dedicated managed account') essentially comprises an account established with a third-party service provider and an investment management agreement. The account is established for the single investor and managed by the investment manager in accordance with the terms of the underlying agreement. As the account is in the name of the investor, they are able to maintain notional control of the account and can gain access to it at any time. SMA's normally take about three months (though timings vary) to open. These accounts are not normally available to all investors due to the relatively high minimum capital requirements imposed to ensure the structure is economically viable, though these requirements may be waived if the SMA is being used as a proof of concept and track record.

SMAs are commonly established so that they sit alongside the primary fund to accommodate the specific needs of particular investors. These will typically track the investment strategy to the primary fund but may have some caveats due to investment restrictions.

The term "SMA" can also include more complicated structures, whilst still being for a single investor (e.g. funds-of-one and other single investor structures).

BENEFITS

One of the biggest selling points of an SMA is the high degree of control it provides. This can help alleviate concerns about potential fraud, transparency and liquidity issues, especially where the investment manager is either unproven or unknown. Under an SMA arrangement, the separation of powers are clear; the manager handles only handles the asset trading and has no responsibility for valuation, accounting or custody of the assets. A secondary benefit of this control is that the SMA will typically offer a better liquidity profile than a mutual fund with the account holders generally having a greater ability to replace/remove the manager or liquidate the portfolio in emergency situations.

SMA accountholders also benefit from the ability to use notional funding to leverage their investments for greater returns. Managed accounts with 'notional funding' provide investors the ability to only fund a proportion of the minimal capital requirements (normally somewhere between 25-75%). The extent to which this can be considered a 'benefit' is debatable as employing this mechanism is generally inadvisable with it significantly increasing the risks associated with running an SMA. Investors wishing to employ this strategy should be required to sign a disclosure agreement acknowledging they properly understand the risks with notional funding.

DRAWBACKS

SMAs have a high barrier to entry with sizable minimum capital requirements in order to even set one up. SMA structure's may be created to alleviate investor concerns but they come with their set of risks. Accounts established alongside the primary fund may suffer from tracking errors, often caused by different policies in place for each, a failure to synchronise the launch of both, and a plethora of other potential operational setbacks. While the delegation of account holder responsibilities may make this model attractive, it does require certain level of understanding on the investor side. Direct control does not naturally translate into informed and effective oversight and without active control taking place, it could lead to greater risks. SMA-tracker arrangements also only suit certain investment strategies, commonly those which focus more on liquid assets rather than illiquid ones.

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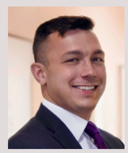

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Customised structures can also provide many a headache for investment managers. Regulatory issues may also arise for managers with SMAs that track primary funds due to the likely inclusion of 'most favoured nation' clauses inserted into SMA investment management agreements. Such clauses can create double standards between SMA investors and primary fund investors which may give rise to the impression of unfair treatment, which in turn may become a regulatory headache later down the line.

> The term "SMA" can also include more complicated structures, whilst still being for a single investor (e.g. funds-of-one and other single investor structures).