Forming & Structuring Private Funds

Despite the on-going challenges faced by the private equity sector, the investment funds world seems to be adjusting to its new environment of increased regulation, challenging fundraising and greater investor scrutiny.

Forming a fund and deciding which region and sector to invest in can raise all sorts of considerations. Whether you are a first time sponsor, or an experienced manager, the legal, tax and accounting issues are detailed and complex.

Acquisition International speaks to Henry Bregstein, Global Co-Chair of Financial Services and Member of the Executive Committee and Board of Directors at Katten Muchin Rosenman LLP, to discuss the finer points of forming funds in the USA.

Mr Bregstein attributes the United States' attractiveness to investors to the presence of many highly talented managers of large hedge funds with long, positive track records, along with high-performing start-up and emerging managers.

"The regulatory environment, though possibly somewhat burdensome to managers, results in enhanced transparency, greater legal certainty and reduced risk," he commented. *"The most active sectors currently include: fixed income, structured credit, event driven, distressed, credit opportunity, global macro and infrastructure debt."*

Mr Bregstein believes that larger funds are generally best suited to the current market conditions, noting that a relatively small number of large, established funds continue to attract a disproportionately greater share of capital inflows.

"This trend may be explained, in part, by the risk aversion among all types of investors in alternative assets but especially among public and private pension plans and foundations that have become significant domestic hedge fund investors," he elaborated.

"Though capital flows into larger funds of funds appear to be increasing somewhat, those funds of funds are still receiving a smaller share of the capital flow than was the case prior to 2008. This trend may be partially explained by the increasing importance of pension plans and other institutional investors, who often hire staff or external consultants to identify, provide due diligence on and monitor attractive managers."

Mr Bregstein stated that the dramatically increasing worldwide regulatory burden is a major issue affecting asset managers. He noted that the regulatory focus on hedge funds and their managers has led to the imposition of complex reporting regimes in the US and the EU.

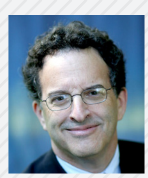
"These reporting regimes substantially increase costs and force asset managers to carefully examine their operating and business models, and are further acting to slow the growth of smaller to medium-sized managers," he continued.

"Additionally, alternative investment strategies are now employed by publicly offered mutual funds. Previously, mutual funds offering exposure to alternative investment strategies were structured as funds of funds or multi-portfolio funds. Increasingly, mutual fund sponsors are seeking to replicate hedge fund strategies directly. It is perhaps a bit too early to determine how much pressure this development will place on hedge fund manager fees, especially in long/short and event driven sectors."

All of the issues outlined by Mr Bregstein represent challenges to finding new sources of capital. Further, in the US, the "push-out" provision of Dodd-Frank has caused banks and their affiliated broker-dealers to exit the business of providing seed or acceleration capital to start-up and smaller hedge fund managers. He believes that this acts as a far more serious barrier to entry, innovation and growth than any of the new regulatory reporting requirements.

In conclusion, Mr Bregstein predicted that the larger funds will continue to attract a disproportionate percentage of capital inflows.

"However, smaller managers with outsized returns will begin to attract attention and capital more in line with the old normal. Further, the increase in the formation of, and capital flows into, so-called insurance dedicated funds that can generally be accessed on a tax-advantaged basis through the purchase of privately placed variable life insurance and annuities will continue on an accelerated pace as US taxable investors increasingly feel the discomfort of higher tax rates."



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