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New funds, beware of how the rules are written.

They constitute a contract between manager and investor. And if the vehicle is Italian, the Bank of Italy's approval is required.

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When preparing to commence fundraising for a new fund, great attention must be paid to drafting the rules for the management of the fund, which: govern the economic and organizational relationships between sponsor (manager) and investors, delineate the investment area and outline the general investment strategy of the fund. The rules are a contract accepted by the manager and by the individual investors and, in the case of an Italian fund, approved by the Bank of Italy. We have set out below a description of certain key aspects and contents typical of the rules for the management of an Italian private equity closed-end fund.

Negotiation with Investors. The fund rules are subject to specific and often prolonged negotiations between the sponsor and the investors, which examine the rules only once they have reached a certain level of confidence as to the investment's merit. This negotiation is what differentiates the rules from the summary of key terms included in the private placement memorandum, since this termsheet is usually only subject to generic observations by those who, at that moment, are still only potential investors.

Investors in private equity funds are often institutions that regularly and systematically invest in this type of funds, and it is part of each of their investment systems to make investments under standard conditions, regardless of the strategy and geographical focus of the fund. Negotiations may concern various aspects of the investment terms and conditions. In certain cases, focus is placed on the distribution mechanism of the fund proceeds. Other times, it is directed to ensuring the alignment of the manager's perspective with that of the investors by eliminating conflicts of interest or introducing incentives. Furthermore, negotiation may aim to subject certain key decisions of the manager to the opinion or approval of the investors, often at a committee meeting.

In international practice, each investor negotiates its own specific investment conditions with the sponsor, which coordinates each investor's requests so that the result of each negotiation is reflected in the fund rules. Sometimes, the sponsor will provide individual investors with "side letters", which accompany the rules and add or specify certain provisions.

In Italian practice, the necessary supervision of the Bank of Italy in approving the rules, limits the possibility of using "side letters", above all in cases where their contents conflict with the rules officially approved by the Bank of Italy. Furthermore, participation of the Bank of Italy means that significant effort is required of the fund sponsor in coordinating negotiation with investors and the Bank of Italy's administrative procedures.

Investment Areas and Guidelines. The fund rules outlines the investment sectors and the guidelines to be adhered to by the manager. This outline is, again, the result of complex and delicate negotiation between sponsor and investors, which typically have conflicting interests. Indeed, on the one hand, the manager will seek maximum flexibility in both the sectors to invest in and the investment tools, so as to be able to modulate the fund's strategy during the investment period without the need to activate the procedures to modify the fund rules.

On the other hand, the investors require the maximum precision possible in drafting the goals and strategies of the fund, so that they may be certain that these effectively match the best abilities of the manager and take into account certain non-negotiable limitations investors may be subject to. These limitations often include the diversification obligations, prohibitions based on geography, investment sectors or certain kind of transactions (*e.g.*, real-estate development for non-specialized funds or investment in other closed-end funds).

Investment Period and Duration of the Fund. There are two main aspects to the timeline in the rules of a closed-end fund. The first is the investment period, usually of around 5 years, which indicates the time in which the manager will have to use the amounts made available by the investors. The second is the duration of the fund, generally of a further 5-6 years, which defines the maximum term within which the manager must liquidate the investments and distribute the proceeds to investors. In both cases, short extensions are admissible, although the investors' approval is almost always required, as sometimes is, in the case of Italian funds, that of the Bank of Italy.

In recent years, we have observed a trend wherein investors insist on a reduction of at least the investment period (which, in venture capital funds, can be as short as 2 years). This reduction, accompanied by a strong demand for limitation of the size of the funds, is increasing the sponsors' frequency in turning to the market in order to raise new funds and thus allows investors to more regularly evaluate the performance of sponsors.

In most cases, the complete cycle of the fund remains nevertheless rather long (between 8 to 13 years), even if a partial disposition of investment commitments is ensured by the peculiar mechanisms of waterfall distributions, typical of private equity funds.

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