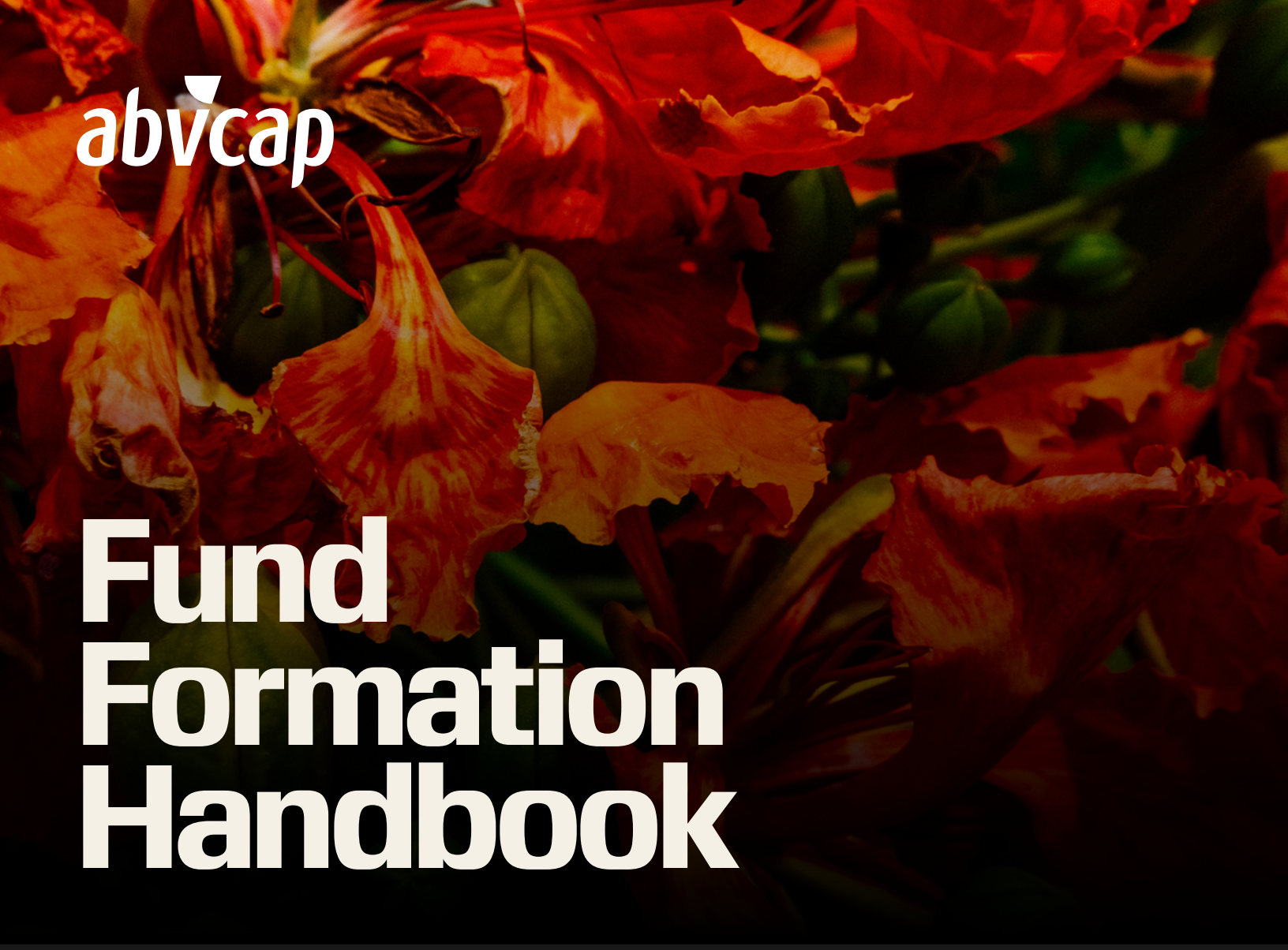


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Fund Formation Handbook

Private Equity and Venture Capital in Brazil and the United States

WINSTON TAYLOR. | MATTOS FILHO

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Introduction

About ABVCAP

ABVCAP is the Brazilian Private Equity and Venture Capital Association, the representative body of the private equity and venture capital industry in Brazil. ABVCAP is dedicated to developing the Brazilian private capital markets and to strengthening the country's alternative investments ecosystem, by fostering dialogue among managers, investors, regulators, and the broader financial community.

About This Publication

ABVCAP published this report with the intent of providing reference content for two complementary audiences: (i) foreign investors seeking to better understand certain legal and regulatory aspects of investing in Brazil through Brazilian private investment funds—please refer to the first part of this publication; and (ii) Brazilian managers considering offshore structures to raise capital from international investors—please refer to the second part of this publication.

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Brazilian Private Investment Fund Formation

This Note provides an overview of Brazilian private investment fund formation, with a focus on Private Equity Investment Funds (*Fundos de Investimento em Participações — FIPs*).

It covers general fund structure, fund economics, fundraising, fund closings and term, managing conflicts, and certain Brazilian regulatory matters. It also examines the principal documents involved in forming such funds.

While historically associated with private equity strategies, FIPs have evolved into flexible vehicles capable of supporting a broad range of private markets strategies, including equity, hybrid, and structured credit investments. In this context, FIPs are increasingly used as versatile private investment vehicles, rather than being limited to traditional buyout or growth equity structures.

Authors

Andre Franco Perdiza
Partner
Mattos Filho

Ana Carolina Lima Nomura
Partner
Mattos Filho

Flávio B. Lugão
Partner
Mattos Filho

Maria Fernanda Fidalgo
Partner
Mattos Filho

Marina Procknor
Partner
Mattos Filho

1. General Fund Structure

1.1. Investment Fund

Brazilian private investment funds (*Fundos de Investimento em Participações — FIPs*) are closed-end investment vehicles structured as a "*condomínio*" of assets — that is, a pool of assets held collectively by investors, which is neither a company nor a partnership under Brazilian law. A FIP does not have legal personality and acts through its Portfolio Manager or its Fiduciary Administrator. A FIP's governing documents generally permit the fund to raise capital commitments during a limited fundraising period, during which the Portfolio Manager and Fiduciary Administrator shall seek investors to subscribe for capital commitments to the fund. The commitment is not usually funded all at once, but in separate capital contributions called by the Portfolio Manager on an as-needed basis to make investments, pay fees and fund expenses.

1.2. Regulatory Framework

FIPs are primarily governed by CVM* Resolution 175 and its Annex IV, which set out specific rules for the formation, operation, and winding up of private equity investment funds. Under this framework, FIPs are generally required to invest in securities that allow for participation in the economic performance of portfolio companies, including shares, debentures, subscription bonuses, and other instruments convertible or exchangeable into equity.

Although FIPs are traditionally understood as private equity vehicles, Brazilian regulation does not limit their investment scope to pure equity instruments. In recent years, the use of FIPs has expanded beyond traditional private equity transactions, reflecting broader global trends in private markets. Brazilian asset managers increasingly rely on FIPs to structure investments that combine equity and credit features, including preferred equity, structured debt, convertible instruments, and special situations strategies. As a result, FIPs are now frequently used as vehicles for private capital deployment more generally, rather than being limited to buyout or growth equity strategies.

It is also worth noting that Annex IV of CVM Resolution 175 is currently under public consultation, and the proposed amendments are expected to further expand the flexibility of FIPs. In particular, the draft regulation contemplates a more permissive approach to investments in non-convertible debentures and other debt instruments, which may significantly broaden the scope of permissible strategies for FIPs. If implemented as proposed, these changes would reinforce the role of FIPs as versatile private investment vehicles capable of supporting a wide range of private market strategies, including credit-oriented and hybrid approaches.

1.3. Fundraising

Fundraising for Brazilian private investment funds may be structured either as a registered public offering under CVM Resolution 160 or, depending on the structure adopted, as a private placement relying on available regulatory safe harbors. In practice, fundraising strategies vary depending on the target investor base, the size of the fund, and the distribution strategy. Prior to launching a formal offering, Portfolio Managers often conduct preliminary investor discussions (*consulta de viabilidade*) to assess market interest.

1.4. Classes and Subclasses

Under CVM Resolution 175, a Brazilian FIP may be organized into one or more Classes of quotas, each of which constitutes a segregated portfolio with its own pool of assets, liabilities, and financial statements. Each Class is economically and legally ring-fenced from the other Classes of the same fund — meaning that the assets and liabilities of one Class are not

* The Brazilian Securities and Exchange Commission (*Comissão de Valores Mobiliários* – CVM) is the federal regulatory agency responsible for overseeing and regulating the Brazilian capital markets. Established in 1976, CVM supervises the activities of participants in the securities market, including publicly held companies, investment funds, portfolio managers, fiduciary administrators, and other market intermediaries. Among its key functions, CVM authorizes and monitors entities engaged in portfolio management and fund administration, sets forth rules for the formation and operation of investment funds—such as Private Equity Investment Funds (*FIPs*) under CVM Resolution 175—and enforces compliance with applicable securities laws to protect investors and ensure market integrity.

available to satisfy the obligations of another Class, and each Class maintains its own separate financial statements prepared in accordance with Brazilian accounting standards applicable to investment funds.

Each Class may in turn be divided into one or more Subclasses of quotas. Subclasses within the same Class share the same pool of assets and liabilities but may differ from one another with respect to their target investor base, economic rights — such as differences in Management Fees, Performance Fee rates, or Preferred Return thresholds — and political rights — such as voting rights at General Meetings or representation on the Investment Committee. The ability to create Subclasses within a single Class provides the Portfolio Manager and investors with a flexible tool for accommodating the distinct economic and governance requirements of different investor categories — such as anchor investors, pension funds, or Development Finance Institutions (DFIs) — within the same fund structure without requiring the establishment of a separate Class with its own segregated portfolio.

All investors within the same Class own all of the assets and bear all of the liabilities of that Class in proportion to their respective share of the total number of quotas of that Class outstanding at any given time. Each investor's economic interest in the Class is therefore determined by the ratio of the number of quotas held by that investor to the total number of quotas of that Class. Where a Class is divided into Subclasses with different fee structures, the pro rata ownership interest of investors in each Subclass is subject to adjustment to reflect the differences in Management Fees, Performance Fees, or other charges borne by each Subclass, so as to ensure that the net economic return to each investor accurately reflects the fees applicable to its specific Subclass.

1.5. Portfolio Manager

The sponsor of a Brazilian FIP is, for practical purposes, its Portfolio Manager (*gestor de recursos*), which is the entity responsible for all investment decisions on behalf of the fund. The Portfolio Manager must be a legal entity duly authorized by the CVM to engage in the activity of managing securities portfolios. The Portfolio Manager sources, evaluates, and executes investment opportunities, manages the fund's portfolio companies, and oversees the divestment of fund assets.

The Portfolio Manager's economic interest in the fund's performance is expressed through Performance Fees (*taxa de performance*), which are paid by the fund to the Portfolio Manager as a service fee, rather than as a distribution of profits on an equity stake.

1.6. Fiduciary Administrator

In addition to the Portfolio Manager, Brazilian FIPs require a Fiduciary Administrator (*administrador fiduciário*), which is a legal entity duly authorized by the CVM to perform fund administration activities. The Fiduciary Administrator is responsible for the fund's back-office and operational activities, including: calculating the net asset value (NAV) of the fund's quotas; calling and organizing investor meetings (*Assembleias Gerais de Cotistas*); maintaining the fund's register of investors; acting as the fund's bookkeeper; and ensuring the fund's regulatory compliance with CVM rules.

1.7. Other Service Providers

In addition to the Portfolio Manager and the Fiduciary Administrator, Brazilian FIPs typically engage a number of other service providers whose roles are either required by regulation or customarily adopted in market practice. These include the Custodian, the Independent Auditors, the Distributor, and the Investment Consultant.

It is worth mentioning that the Investment Consultant is an optional service provider that may be engaged by the fund to provide specialized advisory services to the fund in connection with the identification, evaluation, and monitoring of investment opportunities. Unlike the Portfolio Manager, the Investment Consultant does not necessarily require regulatory authorization to perform investment advisory services. This figure is particularly common in fund structures involving foreign Portfolio Managers that rely on a locally established Investment Consultant with on-the-ground knowledge of the Brazilian market, or in funds where a co-sponsor or strategic partner provides deal sourcing and advisory support without assuming a formal management role.

2. Fund Economics

The economic terms of Brazilian FIPs reflect both traditional private equity structures and, increasingly, hybrid private markets strategies. Investors typically commit capital that is drawn over time through capital calls. Returns are generated through investment proceeds and distributed in accordance with a predefined waterfall structure.

Brazilian market practice generally adopts a fund-as-a-whole (European-style) waterfall, under which the Portfolio Manager becomes entitled to performance compensation only after investors have recovered their invested capital and, where applicable, a preferred return.

Management fees are typically calculated based on committed capital during the investment period and may transition to invested capital or NAV thereafter.

2.1. Capital Commitments

An investor generally becomes a participant in a FIP by subscribing for a capital commitment through the fund's subscription documents — which typically include a subscription bulletin (*boletim de subscrição*) and an investment commitment agreement. In most cases, the commitment is not funded at subscription or even all at once, but rather in separate installments that the Portfolio Manager designates through capital calls (*chamadas de capital*) on an as-needed basis to make investments and to pay fees and fund expenses over the life of the fund.

Investors and market practice generally favor a structure in which the Portfolio Manager itself has an economic stake in the fund (skin in the game), demonstrating alignment of interest with the fund's investors. This is typically achieved through a commitment by the Portfolio Manager — or its principals and key personnel — to invest their own capital alongside the fund's investors, whether directly in the main FIP or through a co-investment vehicle. Such commitment by the Portfolio Manager is considered an attractive feature by investors, as it signals that the Portfolio Manager shares in the risks as well as the profits of the fund's investments.

2.2. Recycling of Capital Commitments

The fund's bylaws may permit the fund to recycle capital that is returned to investors. Recycling provisions in the bylaws may cover the following types of capital returns: investments yielding a quick return (for example, investments realized within one year of being made); returns attributable to capital contributions used to satisfy organizational expenses and other fund expenses; and returns on investments made during the investment period.

2.3. Allocations and Distributions

Allocations and distributions in a Brazilian FIP are made at the level of the fund's classes and subclasses as a whole, in accordance with the distribution mechanics set out in the bylaws.

Capital calls and distributions within a Brazilian FIP are generally made on a pro rata basis among all investors within the same Subclass, in proportion to their respective quota holdings. However, the bylaws may provide for capital calls and distributions to be made on a non-pro rata basis among the Subclasses — for example, to reflect differences in the timing or sequencing of capital contributions, to accommodate the specific economic rights, or to implement a distribution waterfall that treats different investor groups differently.

2.4. Distribution Waterfalls

Brazilian FIPs generally distribute excess cash as it is generated, with distributions of investment proceeds made to investors net of fund-level expenses, liabilities, and other required reserves. At each tier of the waterfall, distributions are made in a specific ratio until the current tier is satisfied and the next tier is reached, or until the fund is wound up and the remaining assets are distributed in a manner that reflects the agreed-on economics.

Brazilian FIPs customarily adopt a "European" or fund-as-a-whole waterfall, under which no Performance Fee is paid to the Portfolio Manager until investors have recovered their entire aggregate capital contributions across all investments.

2.5. Return of Capital Contributions and Preferred Return

The first tranche of a FIP waterfall typically provides that all capital contributions made to the fund — including amounts contributed for investments, fund expenses, and Management Fees — must be returned to investors in full, on an aggregate fund-as-a-whole basis, before any Performance Fees are paid to the Portfolio Manager. This means that the Portfolio Manager of a Brazilian FIP is not entitled to receive any Performance Fee until investors have recovered the totality of their contributed capital across all investments — including capital attributable to investments that have not yet been realized or that have been written down.

Following the return of capital contributions, the waterfall next provides a Preferred Return on the capital contributions. The Preferred Return — typically benchmarked against the Brazilian interbank rate (CDI) or the extended national consumer price index (IPCA) plus a fixed spread — accrues from the time capital contributions are made. Although it is still relatively rare, some funds have elected not to include a Preferred Return in their waterfall.

2.6. Performance Fee, Catch-up and Clawback

The Portfolio Manager of a Brazilian FIP is generally entitled to a Performance Fee (*taxa de performance*), which is paid by the fund as a service fee and represents the Portfolio Manager's profit participation in the fund's returns. The Performance Fee is typically set at 20% of profits above the Preferred Return, although rates between 15% and 25% are not uncommon depending on the fund's strategy and the Portfolio Manager's track record.

The Performance Fee in a Brazilian FIP is generally paid as service fee by the fund to the Portfolio Manager. This distinction has important legal and tax implications under Brazilian law.

Brazilian FIPs customarily adopt a fund-as-a-whole approach to Performance Fee calculation, consistent with the European waterfall structure described above. Under this approach, the Portfolio Manager's profit participation is calculated on the basis of the fund's aggregate returns — not on individual investment results — and no Performance Fee is payable until investors have recovered their entire contributed capital and received their full Preferred Return. Accordingly, the need for a clawback mechanism is generally reduced in Brazilian FIPs — though not prohibited — since the fund-as-a-whole structure limits the risk of over-distribution of Performance Fees during the life of the fund.

Under CVM Resolution 175 and its Annex IV, the calculation methodology for Performance Fees and the conditions under which they may be charged must be clearly set forth in the fund's bylaws, and the Performance Fee must be calculated and accrued in a manner that is transparent and consistent with CVM's rules on investor disclosure.

2.7. Investor Givebacks

The bylaws of a Brazilian FIP may require investors to return previously received distributions to meet their share of any fund obligations or liabilities, including indemnification and other obligations relating to the purchase or sale of investments, and other fund liabilities. The obligation to return distributions is often subject to certain caps or limitations, which may be based on the timing of distributions or on the aggregate amount of distributions that may be required to be returned as a proportion of the investor's total commitment.

2.8. Fund Fees

Under CVM Resolution 175, the fees payable to the fund's service providers are typically structured as a Global Fee (*taxa global*), which encompasses the fiduciary administration fee (*Taxa de Administração*), payable to the Fiduciary Administrator, the management fee (*Taxa de Gestão*), payable to the Portfolio Manager, and the distribution fee (*Taxa de Distribuição*), payable to the Distributor. The Global Fee structure allows the fund's bylaws to disclose a single aggregate fee figure to investors, with the allocation of the Global Fee among the various service providers set out separately in each service agreement.

2.9. Management Fees

The standard Management Fee for a Brazilian FIP is typically calculated as a percentage per annum of the fund's net asset value or committed capital, depending on the stage of the fund's life. A common structure provides for a higher fee based on committed capital during the investment period and a reduced fee based on invested capital or net asset value during the divestment period. Management Fees are generally charged to the fund on a monthly or quarterly basis.

2.10. Fund Expenses

There are a variety of expenses associated with a Brazilian FIP, generally falling into the following categories:

- **Organizational Expenses.** The bylaws of a Brazilian FIP typically include provisions requiring the fund, and therefore its investors, to bear the costs of establishing the fund and any related vehicles — including legal, accounting, registration, and other organizational expenses.
- **Operating Expenses.** In addition to organizational expenses, the fund is expected to bear all costs and expenses relating to its operation, including: Management Fees and other service provider fees; expenses relating to the purchase, holding, and disposition of the fund's investments; fees and expenses of third-party service providers such as the Custodian, Independent Auditors, and legal counsel; costs of preparing and distributing reports to investors; insurance, indemnity, and litigation expenses; and taxes and any other governmental fees or charges levied against the fund.
- **Manager Expenses.** The Portfolio Manager and the Fiduciary Administrator are each expected to bear the cost and expenses of their own ordinary administrative and overhead expenses incurred in managing the fund — including employee compensation and benefits, rent, and general overhead — as these are considered the costs of running their own businesses, as distinct from the specific expenses directly related to the operation of the fund and its investments.

3.

Investment Policy; Fund Term; Investment and Divestment Periods

The term of a FIP begins following the first fund closing and generally continues for ten to twelve years, subject to limited extensions when necessary to provide the Portfolio Manager with more time to liquidate the fund's remaining assets, and to early termination triggered by certain events described below. Shorter or longer terms may be required depending on the time it takes to source, acquire, manage, and exit investments in the specific sectors or geographies targeted by the fund. The term of a fund generally consists of an investment period and a divestment period, during which the Portfolio Manager's rights and obligations with respect to new investments and capital calls differ significantly.

Beyond their operational significance, the investment and divestment periods also carry important tax implications under Brazilian law: pursuant to *Conselho Monetário Nacional*— National Monetary Council (CMN) Rule No. 5.111, a FIP must have a clearly defined investment strategy and operate with a genuine cycle of acquisition and divestment of assets in order to be characterized as an "investment entity" — as opposed to a "holding entity" — for Brazilian tax purposes. This characterization is critical, as funds that fail to meet the investment entity criteria may be subject to the come-cotas periodic tax regime, which imposes tax on investors at regular intervals during the life of the fund rather than solely upon the realization of gains or the distribution of proceeds. The tax implications of the investment entity versus holding entity distinction are addressed in further detail in the Regulatory Matters section below.

3.1. Investment Policy

The bylaws of a Brazilian FIP must include a clear description of the fund's investment objectives and investment policy. The investment objectives set out the overarching purpose and strategic goals of the fund — such as the target sectors, geographies, stages of business development, and types of portfolio companies the fund intends to target — while the investment policy describes in greater detail the manner in which those objectives will be pursued, including applicable investment restrictions, diversification and concentration limits, permitted asset classes, and any other parameters that define and constrain the Portfolio Manager's discretionary mandate.

The investment policy of a Brazilian FIP is not merely a contractual disclosure mechanism — it is a regulatory requirement under CVM Resolution 175 and serves as the

foundational reference against which the Portfolio Manager's investment decisions are assessed for compliance throughout the life of the fund.

In addition to setting out its investment objectives and investment policy, a Brazilian FIP must comply with the effective influence and governance requirements set out in Annex IV of CVM Resolution 175. These requirements are composed of two distinct but complementary obligations: the effective influence rule, which governs how the FIP must participate in the management of its portfolio companies, and the governance standards that the FIP must require its portfolio companies to observe as a condition of investment.

The effective influence rule establishes that a FIP must, as a condition of its formation and ongoing operation, actively participate in the management and strategic decisions of its portfolio companies — a defining characteristic that distinguishes FIPs from other categories of Brazilian investment funds that invest passively in securities. Under Annex IV of CVM Resolution 175, a FIP exercises effective influence and governance over its portfolio companies through mechanisms such as: holding shares with voting rights or other instruments that confer participation in the strategic decisions of the portfolio company; execution of shareholders' agreements providing the fund with veto rights or affirmative approval rights over material decisions; appointment of members to the board of directors or supervisory board of the portfolio company; or other contractual or statutory arrangements that ensure the fund has the ability to influence the management and direction of the company in which it invests.

The governance standards, set out in Article 8 of Annex IV of CVM Resolution 175, require that closely-held portfolio companies (*companhias fechadas*) of a FIP observe certain minimum corporate governance practices as a condition of receiving the fund's investment. These requirements are intended to protect the interests of the fund's investors by ensuring that portfolio companies operate in a transparent, accountable, and well-governed manner throughout the period of the fund's investment.

3.2. Investment Period

The Portfolio Manager sources new investments for the fund during an investment period — also referred to as the commitment period — and makes capital calls on a deal-by-deal basis as required to fund new investments or to cover the fund's Management Fees and other fund-related expenses. The fund's bylaws generally permit the fund to enter into new investments only during a limited investment period, often four to six years from the end of the fund's fundraising period or the closing of its first investment.

During the investment period, the Portfolio Manager has the broadest authority to deploy investor capital, subject to the investment restrictions, diversification requirements, and concentration limits set out in the fund's bylaws. At the end of the investment period, the Portfolio Manager's authority to make new investments is curtailed, and the fund transitions into its divestment period. The bylaws of the fund may permit the Portfolio Manager to extend the investment period by a limited amount of time.

3.3. Divestment Period

Fund investments are not generally liquidated all at once, but separately as and when directed by the Portfolio Manager primarily during a divestment period, which typically ends four to six years after the end of the investment period. During the divestment period, the Portfolio Manager focuses on managing and monetizing the fund's existing portfolio — through trade sales, initial public offerings, secondary sales, or other exit strategies — rather than sourcing new investments.

The terms of a Brazilian FIP generally only require investors to contribute capital after the end of the investment period — subject to the amount of their respective unfunded commitments — as and when called by the Portfolio Manager, for the following limited purposes: (a) investments under limited circumstances, including investments for which the fund made a binding commitment before the end of the investment period, follow-on investments in existing portfolio companies, or new investments to the extent expressly permitted under the fund's bylaws; and (b) fund fees and expenses, including Management Fees, to the extent permitted under the bylaws.

At the end of the fund term, the fund's remaining investments must be liquidated and the proceeds distributed to investors in accordance with the distribution waterfall set out in the bylaws. The fund's bylaws may permit limited extensions of the divestment period to allow the Portfolio Manager additional time to complete the orderly liquidation of remaining fund assets in a manner consistent with the investors' economic interests.

3.4. Suspension of the Investment Period

Because Brazilian FIPs require investors to contribute capital as and when called by the Portfolio Manager over a long period, certain protections are typically included in the fund's bylaws that may trigger suspension of its investment period. The most common events in Brazilian FIP practice are key person events, and removal of the Portfolio Manager.

Key Person Events.

Investors commit capital to a Brazilian FIP primarily in reliance on the skill, expertise, and continued involvement of certain key individuals within the Portfolio Manager's organization — typically the senior investment professionals responsible for sourcing, executing, and managing the fund's investments. The fund's bylaws usually identify these individuals as "key persons" and establish a mechanism for addressing their departure or reduced involvement in the fund.

Key person triggering events vary from fund to fund but generally cause an automatic suspension of the fund's investment period upon the occurrence of a specified event — such as the departure, death, disability, or reduced time commitment of one or more key persons below a specified threshold. If triggered, the fund is prevented from making new investments until a sufficient number of replacement key persons are appointed to the satisfaction of investors. If the suspension continues for an extended period, the fund's bylaws often provide that either the investment period is permanently terminated or the investors may elect, at a General Meeting, to liquidate the fund.

Removal for Cause.

The bylaws of a Brazilian FIP may contain provisions allowing investors to remove and replace the Portfolio Manager, or to elect to liquidate the fund, upon the occurrence of certain egregious events constituting "cause." Cause is typically limited to highly material events that call into question the Portfolio Manager's fitness to continue managing the fund, such as fraud, willful misconduct, gross negligence, or material violations of applicable securities laws or CVM regulations. Removal of the Portfolio Manager for cause generally requires the affirmative vote of a qualified majority of investors at a General Meeting, with the quorum and voting thresholds set out in the fund's bylaws.

Removal Other than for Cause.

The bylaws of a Brazilian FIP may also contain provisions permitting a supermajority of investors — often representing 75% or more of the fund's total capital commitments — to remove and replace the Portfolio Manager, or to otherwise dissolve the fund, other than for cause.

Under Brazilian fund regulation, the removal of the Portfolio Manager — whether for cause or otherwise — is a matter expressly reserved for the General Meeting (*Assembleia Geral de Cotistas*).

4. Managing Conflicts

Portfolio Managers of Brazilian FIPs frequently manage multiple investment vehicles or otherwise engage in a number of asset management and related activities that can potentially create conflicts of interest with the fund and its investors. The fund's bylaws typically specify how the Portfolio Manager must address certain conflict situations, and CVM Resolution 175 imposes a baseline set of obligations on the Portfolio Manager and the Fiduciary Administrator with respect to the identification, disclosure, and management of conflicts of interest.

In Brazil, the management of conflicts of interest by Portfolio Managers of FIPs is also subject to specific regulatory requirements enacted by the CVM. CVM Resolution 175 currently requires Portfolio Managers to adopt and maintain a formal conflicts of interest policy, to disclose actual and potential conflicts to investors, and to manage conflicts in a manner that prioritizes the interests of the fund and its investors. These regulatory obligations exist independently of any contractual provisions in the bylaws and cannot be waived by investors.

It is important to note that this approach is currently under review. The draft amendments to Annex IV of CVM Resolution 175, which are under public consultation, propose a shift toward a more principles-based and materially driven framework for the assessment of conflicts of interest.

Under the proposed regime, the characterization of a conflict would no longer depend solely on the formal classification of a transaction within predefined categories. Instead, greater emphasis would be placed on the substantive analysis of the transaction, taking into account its terms, conditions, and overall alignment with the interests of the fund and its investors.

This evolution reflects a broader regulatory trend toward a more nuanced and flexible approach, whereby the Portfolio Manager is expected to exercise judgment in identifying and managing conflicts based on their materiality, rather than relying exclusively on formal triggers.

4.1. Competing Funds

As mentioned above, Portfolio Managers of Brazilian FIPs frequently manage — or intend to manage — multiple funds with overlapping or similar investment strategies. This can create conflicts of interest with respect to the allocation of investment opportunities among the funds managed by the same Portfolio Manager, particularly during the investment period when the fund is actively competing for transactions in its target market.

The bylaws of a Brazilian FIP typically address this conflict by requiring the Portfolio Manager to allocate investment opportunities among the funds it manages in a fair and equitable manner, consistent with the investment policies and strategies of each fund and the allocation methodology set out in the Portfolio Manager's conflicts of interest policy.

In addition, the bylaws of a Brazilian FIP typically contain exclusivity provisions restricting the Portfolio Manager from raising or managing a new fund with substantially the same investment strategy and objectives as the current fund during the fund's investment period, or until a specified percentage of the fund's committed capital has been deployed or reserved for deployment. The scope and duration of the exclusivity restriction is a matter of negotiation between the Portfolio Manager and investors during the fundraising process.

4.2. Committees and Councils

The bylaws of Brazilian private investment funds may provide for the establishment of governance bodies such as councils and committees, including investment committees. The creation, composition, and responsibilities of such bodies are largely a matter of contractual arrangement and may vary significantly from fund to fund.

Brazilian regulation is generally flexible in this regard and does not impose a standardized structure for investment committees. As a result, committees may be composed of representatives of investors, representatives of the Portfolio Manager, independent members, or a combination thereof, depending on the governance model adopted for the fund.

Likewise, the roles and responsibilities assigned to investment committees may differ substantially. In some cases, committees may have decision-making authority in respect of investment approvals; in others, they may perform advisory, monitoring, or oversight functions. Committees may also be tasked with reviewing conflict-of-interest situations or other specific matters defined in the bylaws.

This flexibility allows fund structures to be tailored to the specific characteristics of the investor base, the investment strategy, and the governance preferences of the parties involved.

4.3. CVM Authorization Requirements for Portfolio Managers

Under Brazilian law, the activity of managing securities portfolios (*gestão de recursos de terceiros*) is a regulated activity that requires prior authorization from the CVM, regardless of the type and size of the fund, the number of investors, or the nature of the assets managed.

The CVM authorization process requires the Portfolio Manager to demonstrate, among other things, that it has the technical and operational capacity to manage securities portfolios, that its principals and key investment professionals meet applicable qualification requirements, and that it has in place the compliance, risk management, and internal control policies required by applicable CVM rules. Authorized Portfolio Managers are subject to ongoing regulatory obligations, including periodic reporting to the CVM, compliance with CVM's rules on conflicts of interest and suitability, and the maintenance of minimum capital and organizational requirements.

The fiduciary and conduct obligations of Portfolio Managers of Brazilian FIPs arise under a combination of CVM rules, including CVM Resolution 175, and applicable Brazilian civil and corporate law. CVM Resolution 175 requires Portfolio Managers to act with loyalty, diligence, and in the best interests of the fund and its investors at all times, and imposes specific obligations regarding the avoidance and management of conflicts of interest, the fair allocation of investment opportunities, and the proper disclosure of information to investors.

5. Taxation

5.1. Taxation Applicable to Portfolio Operations

As per current legislation, the portfolio operations of the fund are exempt from Income Tax and are subject to the Financial Transaction Tax at a zero rate.

5.2. Withholding Income Tax of Gains by Quotaholders

The tax treatment applicable to quotaholders of Brazilian private investment funds varies depending on both the characteristics of the fund and the profile of the investor.

In particular, the applicable regime will depend on whether the fund qualifies as an "investment entity" under the regulations issued by the National Monetary Council, as well as on the tax status of the investor — including whether the investor is an individual or a legal entity resident in Brazil, or a non-resident investor and, in the latter case, whether the conditions for favorable tax treatment are met.

Depending on these factors, the applicable taxation may range from a full exemption — as is generally the case for qualifying non-resident investors that meet the applicable requirements — to taxation at a 15% rate. In certain situations, taxation may also follow a regressive regime or be subject to periodic taxation mechanisms, while in others it may occur only upon distributions, amortizations, redemptions, or transfers of quotas.

As a general rule, taxation of quotaholders is triggered upon the realization of income, including through amortization, redemption, liquidation, or sale of quotas.

5.3. Taxation on Financial Operations (IOF)

In addition to income taxation, certain transactions involving fund quotas may be subject to the Tax on Financial Transactions (*Imposto sobre Operações Financeiras — IOF*). IOF may apply, for example, to redemptions, amortizations, or transfers of quotas carried out within short periods following the investment, generally calculated on the amount of the income generated.

Foreign exchange transactions associated with cross-border investments may also be subject to IOF (IOF/Exchange), although such transactions are currently generally subject to a zero rate when related to investments in the Brazilian financial and capital markets.

Applicable IOF rates and conditions may be modified by the Brazilian Executive Branch at any time, within the limits established by law.

6. Main Legal Documents

Certain principal legal documents and other ancillary documents are standard in the formation of a Brazilian private investment funds. The core document governing a Brazilian FIP are the bylaws (*Regulamento*) and the subscription documents, which may be accompanied by an Offering Memorandum (*Prospecto*) and/or other agreements as applicable.

6.1. Fund Bylaws (*Regulamento*)

The bylaws (*Regulamento*) of a Brazilian FIP are the primary governing document of the fund. The bylaws set out the full legal, economic, and governance framework governing the fund and its investors, and are required to be registered with the CVM as part of the fund constitution process under CVM Resolution 175.

The bylaws of a Brazilian FIP are in practice a heavily negotiated document, particularly where the fund's investor base includes anchor investors, development finance institutions (DFIs), or other sophisticated institutional investors with significant bargaining power. These investors routinely negotiate the key economic, governance, and protective provisions of the bylaws prior to the fund's formation, with the agreed terms reflected in the bylaws as registered with the CVM. The degree of negotiation varies significantly depending on the investor's size, strategic importance to the fundraising, and the relative leverage of the Portfolio Amendments to the bylaws after the fund's formation and registration must be approved by investors at a General Meeting, subject to the quorum and voting thresholds set out in the bylaws and applicable CVM rules.

6.2. Subscription Documents

Investors subscribe for a capital commitment in a Brazilian FIP by executing the fund's subscription documents, which typically consist of an investment commitment agreement, a subscription bulletin (*boletim de subscrição*), and a term of acknowledgement of risk and adherence to the bylaws (*termo de ciência de risco e adesão ao regulamento*).

The subscription bulletin and the term of adhesion are standardized forms through which an investor formally subscribes for a specified number of quotas or a specified capital commitment amount. By executing the subscription bulletin and the term of adhesion, the investor adheres to the terms of the fund's bylaws and agrees to be bound by all of the obligations of an investor thereunder. The subscription bulletin also contains representations and warranties by the investor confirming its qualification to invest in the fund under applicable CVM rules — including, where applicable, confirmation of the investor's status as a qualified or professional investor — and any additional representations required by the Portfolio Manager or the Fiduciary Administrator in connection with the fund's offering regime.

The investment commitment agreement supplements the subscription bulletin by setting out the specific terms of the investor's capital commitment — including the total committed amount, the manner and timing of capital calls, the consequences of default, and any specific terms applicable to that investor's participation in the fund.

In practice, the investment commitment agreement often serves as the primary instrument for documenting additional commercial and negotiated terms between the investor and the Portfolio Manager. This may include more detailed provisions relating to matters already addressed in the bylaws, as well as specific rights or arrangements tailored to particular investors.

This approach reflects the structural distinction between the fund's bylaws — which are public documents filed with and made available through the CVM — and the investment commitment agreements, which are private and not publicly disclosed. As a result, it is common market practice for more sensitive or commercially negotiated terms to be documented in the investment commitment agreement rather than in the bylaws.

Private Equity and Venture Capital in the United States

This handbook provides a practical overview of U.S. private equity and venture capital fund formation, covering the core regulatory framework, common fund structures, key economic terms, and principal documents that shape the formation process.

Authors

Scott Naidech
Co-Chair, Private Investment Funds and Co-Chair, Secondaries and Liquidity Solutions
Winston Taylor

Rodrigo Carvalho
Partner, Mergers & Acquisitions/Private Equity
Winston Taylor

Beth Kramer
Partner, Funds and Financial Services
Winston Taylor

Jacqueline Hu
Partner, Funds
Winston Taylor

Basil Godellas
Partner, Funds and Financial Services
Winston Taylor

Olga Loy
Partner, Tax
Winston Taylor

1. General Fund Structure

1.1. Investment Fund

U.S.-based funds typically are formed as "pass-through" entities for U.S. federal income tax purposes (typically limited partnerships (LPs) or limited liability companies (LLCs)) and, therefore, are not subject to corporate income tax. The entity's income, gains, losses, deductions, and credits are passed through to the partners and generally are taxed only once at the investor level. International structures tend to favor forming funds as LPs over LLCs; across a number of non-U.S. jurisdictions, LPs will sometimes provide superior global tax predictability and application of tax treaty benefits.

The structure of a private equity fund generally involves several key entities (with each potentially bringing its own unique layers of complexity and variability of governance and economic issues):

- the investment fund (private fund), which is a pool of capital;
- a general partner (GP) or other managing entity (manager), which has the legal power to act on behalf of the investment fund;
- a management company or investment adviser, which is generally affiliated with the GP or manager and is appointed to provide investment advisory services to the fund — this is the operating entity that employs the investment professionals, evaluates potential investment opportunities, and incurs the expenses associated with day-to-day operations and administration of the fund.

Inherent in this structure is a U.S. regulatory overlay of three key statutes:

- U.S. Securities Act of 1933, as amended (the Securities Act): generally regulating offers and sales of fund securities in the U.S.;
- U.S. Investment Company Act of 1940, as amended (the Investment Company Act): generally regulating companies that engage in investing, reinvesting, and trading in securities of other entities, i.e., the private funds themselves;
- U.S. Investment Advisers Act of 1940, as amended (Advisers Act): generally regulating investment advisers to private funds.

Other regulations will apply, but the above form the regulatory pillars under which U.S. private funds and investment advisers primarily operate.

1.2. U.S. Regulatory Framework

In the U.S., private funds and investment advisers are subject to a variety of regulations under U.S. federal and state laws including the following (depending on the facts and circumstances, other rules may apply).

U.S. Securities Act of 1933 (the Securities Act)

Offers and sales of securities in the United States may only be made pursuant to a registration statement filed with, and declared effective by, the SEC, or in accordance with an exemption from these registration requirements. Alternative funds typically rely on the registration exemption provided by Section 4(a)(2) of the Securities Act, and the "safe harbor" provided by Rule 506 under Regulation D under the Securities Act ("Regulation D"). Section 4(a)(2) is a private placement exemption available to issuers for sales of their securities "not involving any public offering." Section 4(a)(2) does not expressly provide details of what constitutes a valid private placement, so most alternative funds rely on the safe harbor provisions set forth in Regulation D. Also see "Fundraising" below.

U.S. Investment Company Act of 1940 (the Investment Company Act)

The Investment Company Act regulates "investment companies", which are broadly defined as companies that engage primarily in "investing, reinvesting, owning, holding or trading in securities". To avoid being subject to the onerous requirements of operating as a registered investment company under the Investment Company Act, sponsors of private

funds formed in the U.S. or with U.S. investors generally seek to qualify via a number of well-known exemptions from registration (others may apply as well). These include:

- Section 3(c)(1) excludes a private equity fund from the definition of an investment company if it is not making a public offering of its interests and it is beneficially owned by not more than 100 persons.
- Section 3(c)(7) excludes a private equity fund from the definition of investment company if it does not make a public offering of its interests and it is beneficially owned exclusively by qualified purchasers (generally, natural persons, family-owned businesses and family trusts owning at least $5 million of investments; a trust that is not formed for the specific purpose of making investments and whose trustee or settlor is a qualified purchaser; an entity with at least $25 million of investments; or entities solely owned by qualified purchasers).

The Section 3(c)(1) and 3(c)(7) exemptions include a number of rules requiring the fund to look through certain investors to determine their ultimate beneficial owners. Each exemption requires a fund to disregard and look through to the beneficial owners of any entity formed for the purpose of investing in the fund. Section 3(c)(1) requires a fund to look through any investor that is itself an investment company (or would be an investment company but for the Section 3(c)(1) and 3(c)(7) exclusions) and owns more than 10% of the voting securities of the fund. Section 3(c)(1) allows non-U.S. issuers to count only U.S. investors for purposes of counting the total number of beneficial owners. Similarly, Section 3(c)(7) allows non-U.S. issuers to require only that their U.S. investors be qualified purchasers.

U.S. Investment Advisers Act of 1940 (the Advisers Act)

The Advisers Act regulates investment advisers by requiring them to register as an investment adviser with the SEC unless an exemption from registration is available. An investment adviser or management company that falls within the definition of "investment adviser" under the Advisers Act generally must register with the SEC, unless it:

- is prohibited from registering under the Advisers Act because it has less than USD25 million of regulatory assets under management;
- has less than USD100 million of regulatory assets under management and is registered with and subject to examination by a state; or
- qualifies for an exception from the Advisers Act's registration requirement.

Common exemptions from registration as an investment adviser under the Advisers Act are as follows:

- private fund adviser exemption, which applies to advisers who solely manage private funds with less than USD150 million in assets under management in the United States ("exempt reporting advisers");
- venture capital fund adviser exemption, which applies to advisers who advise solely venture capital funds; and
- foreign private adviser exemption, which applies to non-U.S. advisers with limited U.S. client and investor bases (i.e., less than USD25 million in assets under management from U.S. clients and investors, and fewer than 15 such clients and investors).

Depending on the facts, many non-U.S. managers will seek to avoid registration by ensuring that it is not deemed to manage or provide investment advice from a place of business in the U.S. However, as a general matter, under the Advisers Act an investment adviser (whether registered or unregistered) is a fiduciary with respect to all its clients. See below under "Fiduciary Duties and Compliance".

A sponsor that registers with the SEC as an investment adviser will be required to, among other things:

- file a Form ADV with the SEC and keep it current by filing periodic amendments, including an annual amendment;
- comply with the "brochure rule", which requires most advisers to provide clients and prospective clients with information about the adviser's business practices and its principals' educational and business backgrounds;
- maintain accurate and current books and records and be subject to inspection and examination by the SEC staff;
- complete Form PF filings, which contain more detailed information on the funds it manages or advises;
- adopt and maintain written policies and procedures that are reasonably designed to prevent violations of the Advisers Act and related regulations and have a code of ethics governing employee behaviour; comply with the Marketing Rule;
- only charge performance-based fees (i.e., carried interest) to investors that are "qualified clients" as defined in Rule 205-3 under the Advisers Act. Beginning June 29, 2026, a qualified client must have at least $1.4 million (up from $1.1 million) in assets under management with the adviser or net worth greater than $2.7 million (up from $2.2 million).

While exempt reporting advisers avoid the full registration and disclosure requirements applicable to registered investment advisers, they remain subject to a number of Advisers Act requirements including a truncated Form ADV filing (including annual and certain other-than-annual amendments), recordkeeping requirements, Advisers Act anti-fraud provisions, and a requirement to adopt a more limited set of compliance policies and procedures (along with potential state law filings and requirements).

U.S. Commodity Exchange Act (CEA)

A frequently overlooked statute among practitioners, the CEA generally governs the futures and derivatives markets including swaps, hedging transactions and currency exposure. In the United States, securities and futures are subject to separate regulatory regimes. The U.S. Commodity Futures Trading Commission (CFTC) and U.S. National Futures Association (NFA) serve as the derivative industry's regulatory and self-regulatory authorities. If a fund will trade any amount of exchange-traded futures contracts, options on futures contracts or swaps (collectively, "Commodity Interests") as part of its investment strategy, for all practical purposes, the fund will fall within the definition of a "commodity pool".

The operator (i.e., sponsor or general partner) of a commodity pool must register with the CFTC as a commodity pool operator (CPO) and must become a member of the NFA unless it can avail itself of an exemption. The investment manager to a commodity pool generally must register with the CFTC as a commodity trading adviser (CTA) and become an NFA member unless it can avail itself of an exemption. These registration requirements are generally subject to narrowly drawn exceptions or exclusions.

Many managers that only invest in Commodity Interests on a limited basis rely on an exemption from registration as a CPO found in CFTC Regulation 4.13(a)(3). Rule 4.13(a)(3) provides an exemption for managers that operate pools whose interests are exempt from registration under the Securities Act of 1933, restrict participation to accredited investors, certain family trusts formed by accredited investors and "knowledgeable employees" and either (i) the aggregate net notional value of the fund's commodity interest positions does not exceed 100% of the liquidation value of its portfolio, or (ii) the aggregate initial futures margin and options premium needed to establish the fund's commodity interest positions does not exceed 5% of the liquidation value of its portfolio.

CPOs and CTAs have specific filing and reporting requirements under the CEA, the CFTC's rules and the rules of the NFA. Managers registered as CPOs must generally:

- distribute monthly or quarterly account statements to pool participants within 30 days of month-end or quarter-end;
- distribute an annual report to pool participants within 90 days of the pool's fiscal year-end;
- file Form PQR with the NFA on a quarterly basis.

Managers registered as CTAs must generally:

- file Form PR with the NFA within 45 days after the quarters ended in March, June and September;
- file a year-end report within 45 days of the calendar year end.

U.S. Securities Exchange Act of 1934 (the Exchange Act)

The Exchange Act requires an issuer with total assets exceeding $10 million to register any class of equity securities with the SEC if the issuer is not a bank or bank holding company and the securities are held of record by either 2,000 or more persons, or 500 or more persons that are not accredited investors. To avoid registration under the Exchange Act, most U.S. private equity funds try to limit the number of record owners to below the applicable threshold.

Under Rule 10b-5 of the Exchange Act, it is unlawful to make any material misrepresentation or omission of any material fact in the fund's offering materials.

Most importantly, the requirements of the Exchange Act come into play when a person is paid transaction-based compensation for effecting sales of securities (a so-called "salesman's stake" in the deal). The Exchange Act also requires that anyone engaged in the business of effecting transactions in securities for an issuer must be registered as a broker with the SEC. Generally, a broker is a person engaged in the business of effecting transactions in securities for the account of others for a commission, and a dealer is a person engaged in the business of buying and selling securities for such person's own account through a broker or otherwise. For the most part, an issuer of securities (such as a fund) should not be deemed to be a dealer since it is not both buying and selling its securities. Furthermore, an issuer (such as a fund) should not be considered a broker because the securities it is selling are not being sold for the "account of others"; rather, they are being sold by the issuer for its own account. In addition, a new statutory exemption for brokers who specialize in the sale or purchase of private companies was enacted in 2023 to create an exemption from broker registration under the Exchange Act for intermediaries qualifying as "M&A Brokers", subject to specific conditions for transactions involving eligible privately held companies.

Unlike an issuer, however, an issuer's employees or its general partner's employees may be deemed to be selling securities for the account of others for a commission.

U.S. Employee Retirement Income Security Act of 1974 (ERISA)

ERISA may place restrictions on private equity funds if the fund is deemed to hold plan assets under the ERISA plan asset rules. ERISA treats the sponsor, rather than the fund, as directly managing the plan assets of any benefit plan investors unless the fund meets one of the exceptions from the ERISA look-through rules and applicable regulations. Private equity funds usually try to meet one of the three most well-known exceptions to the ERISA look-through rules:

- less than 25% of the value of any class of the fund's equity is held by benefit plan investors (the 25% test);
- the fund qualifies as a venture capital operating company (VCOC);
- the fund qualifies as a real estate operating company (REOC).

If the fund is not exempt from ERISA and is deemed to hold plan assets subject to ERISA, the fund's investment adviser (the sponsor) may be deemed to be a fiduciary with respect to the ERISA plan assets invested by benefit plan investors. A sponsor who breaches its fiduciary duties under ERISA is subject to substantial penalties, including a requirement to restore losses to the investors or to disgorge profits earned by the sponsor as a result of the breach of fiduciary duty, personal liability, equitable remedies such as removal of the sponsor from the fiduciary position, and civil and even criminal penalties.

State Regulation

Private funds and investment advisers will be required to comply with state securities laws (so-called "blue sky" laws) and related regulations, the application of which may (in part) be pre-empted by certain of the federal securities laws mentioned above.

The Advisers Act requires mid-sized investment advisers (with assets under management between $25 million and $100 million, subject to adjustment by the SEC) to register in the U.S. state in which their principal office and place of business is located if the adviser is subject to registration and examination as an investment adviser with that U.S. state.

1.3. Fundraising

Fundraising is the lifeblood of the fund process and often dictates whether the fund is able to achieve optimal size and achieve the fund's investment program. Regulators know this, and regulations are designed with this in mind; a well-conceived marketing plan involves careful preparation in conjunction with skilled counsel.

Regulation D Offerings under the Securities Act

Fund capital raisings in the U.S. are nearly always made as private placements of securities (in accordance with exemptions from the registration requirements of the federal securities laws) under the Securities Act. In particular, Rule 506(b) of Regulation D generally requires that managers take a number of well-known precautions:

- **Limitation on Manner of Offering:** There should be no general advertising or "general solicitation";
- **Limitations on Resale:** (a) offering materials should include special legends regarding U.S. selling and transfer restrictions, and (b) each purchaser should represent in the fund's subscription agreement that it is acquiring the interests for its own account and not with a view to resale or distribution thereof;
- **Nature of and Limitation on Number of Purchasers:** Offers and sales of interests should only be made to institutions and individuals that qualify as "accredited investors" as defined in Regulation D, though Rule 506(b) does allow for offers and sales to up to 35 financially sophisticated investors so long as those non-accredited investors are provided with disclosures similar to what would be required in a public/registered offering;
- **"Bad Actor" Disqualification:** The fund, the general partner or the management company can be subject to disqualification if they have committed "bad acts";
- **SEC Filing:** Form D must be filed with the SEC within 15 days of the fund's first sale of securities, and any annual amendments thereto must be filed while the offering is ongoing.

Rule 506(c) is a separate safe harbour that has no restrictions on the use of general advertising or general solicitation, but all investors must be "verified" as accredited investors. Like Rule 506(b), Rule 506(c) has the same limitations on resale and is subject to "bad actor" disqualification. The overwhelming majority of alternative funds rely on Rule 506(b), as 506(c) offerings typically target retail investors and require a higher volume of investors to achieve scale.

Offerings by U.S. domiciled funds to non-U.S. investors will generally be made in accordance with Regulation D. Offerings by non-U.S. domiciled funds to non-U.S. investors will generally be made in accordance with Regulation S under the Securities Act, which provides that registration under the Securities Act is not required when the offer and sale of a security occurs outside the United States in an offshore transaction and there are no directed selling efforts in the United States with respect to such sale.

Marketing Rule under the Advisers Act

Registered investment advisers are subject to Rule 206(4)-1 under the Advisers Act (the Marketing Rule); in short, the Marketing Rule represents a modernized marketing rule enacted in 2021 that has required managers to revamp the manner in which they advertise new products.

Under the Marketing Rule, an "advertisement" is defined as any direct or indirect communication that promotes advisory services for securities to prospective clients or fund investors, offers new advisory services to current fund investors, or includes an endorsement or testimonial that an adviser paid for with cash, brokerage services or discounted fees.

The SEC Marketing Rule prohibits advisers from engaging in certain activities with respect to advertisements that could be false or misleading. An adviser may not:

- make untrue statements of a material fact, omit material facts or make misleading inferences;
- include a material statement of fact without the ability to substantiate such statements upon further inquiry by the SEC;
- include information with a reasonable likelihood that it will cause an untrue or misleading implication;
- make statements that do not present a fair and balanced treatment of material risks or limitations;
- refer to specific investment advice that is not presented in a fair and balanced manner;
- include or exclude performance results or time periods in a manner that is not fair and balanced;
- display advertisements that are otherwise materially misleading.

Also, the SEC Marketing Rule includes specific restrictions and requirements for certain types of advertisements, such as performance advertising (including by requiring the inclusion of net performance whenever gross performance is presented, and performance data over specified periods), extracted performance, hypothetical performance, testimonials and endorsements, and third-party ratings. The Division of Investment Management of the SEC has issued various frequently asked questions (FAQs) since the implementation of the Marketing Rule providing the industry with interpretations that provide insight into how the SEC evaluates the Marketing Rule.

Broker Dealer Rules under the Exchange Act

Generally, as described above in respect of the Exchange Act, entities that are engaged in brokering the purchase or sale of securities are required to register as broker-dealers under the Exchange Act, and all arrangements with placement agents must also comply with the Marketing Rule.

In addition, the manner in which an investment adviser compensates its employees in connection with U.S. marketing activities can raise broker-dealer concerns. Determining whether a person is a broker-dealer can be fact intensive. One of the most frequently considered facts is whether such employee receives compensation directly or indirectly related to transactions in securities of the fund or its portfolio companies. Exchange Act Rule 3a4-1 generally provides that an associated person (or employee) of an issuer who participates in the sale of the issuer's securities would not have to register as a broker-dealer if that person at the time of participation:

- is not subject to a "statutory disqualification";
- is not compensated by payment of commissions or other remuneration based directly or indirectly on securities transactions;
- is not an associated person of a broker or dealer;
- limits its sales activities as set forth in the rule.

1.4. Fiduciary Duties and Compliance

Even if not required to register as an investment adviser with the SEC, investment advisers are subject to other requirements under the Advisers Act, including a fiduciary duty to the fund (in addition to any fiduciary duties that exist under U.S. state common law), and a prohibition from engaging in any act or practice that is fraudulent, deceptive, or manipulative with respect to the fund.

In particular, Section 206 of the Advisers Act contains broad "anti-fraud" provisions that make it unlawful for an investment adviser to directly or indirectly engage in the following:

- devices, schemes or artifices to defraud any client or prospective client;
- transactions that operate as a fraud or deceit upon any client or prospective client;
- when acting as principal for its own account, knowingly selling any security to or purchasing any security from a client for its own account, without disclosing to the client in

writing the capacity in which it (or an affiliate) is acting and obtaining the client's consent before the completion of the transaction;

- any act, practice or course of business that is fraudulent, deceptive or manipulative.

Section 206 is the primary anti-fraud provision utilized by the SEC in establishing fiduciary standards and making it unlawful for engaging in (or engaging in what the SEC perceives to be) fraudulent or deceptive practices. Best practices dictate that investment advisers give due care to these principles in drafting marketing materials and investor disclosures, applying their fiduciary standards, SEC exam defensibility, and managing fund conflicts (see below regarding Managing Conflicts).

2. Fund Economics

The economic terms of private equity funds differ widely depending on a number of factors, with certain basic elements of fund economics common to most private equity funds.

2.1. Capital Commitments

Capital commitment in most cases will be funded in separate installments via capital calls on an as-needed basis to make investments and to pay fees and expenses over the life of the fund. In drafting and reviewing terms, key questions include whether the capital commitment includes all capital required to be funded by the investor, or whether certain payments (such as fees or expenses) may be deemed outside of the capital commitment.

2.2. Recycling of Capital Commitments

The fund's operating agreement may permit the fund to recycle capital that is returned to the investor, often by adding back the amount of the capital returns to an investor's remaining commitment. Recycling provisions in the fund's operating agreement may cover capital returns within a certain period (i.e., for example, capital returns from investments within two years after the investment is made); returns attributable to capital contributions used to satisfy fund expenses; and/or returns during the investment period or term. A well-crafted recycling provision, packaged with effective limits on how recycled capital can be used, can allow for efficient and fair management of investor capital.

2.3. Allocations and Distributions

LPs and LLCs are generally pass-through entities treated as partnerships for U.S. federal income tax purposes. As a result, structuring a fund as an LP or an LLC avoids an entity-level layer of income tax, and causes the partners or members to be treated as the recipients of the entity's income, gains, losses, deductions and credits for U.S. federal tax purposes. This flow-through tax treatment occurs whether or not any income is actually distributed and requires the fund to establish rules for both annual allocations among the partners or members of income, loss, and other tax attributes realized by the fund for the year, and the proportion in which partners or members share in cash distributed by the fund. The distribution waterfall provisions in the fund's operating agreement implement the sponsor's and the investors' agreed-on economic arrangement. Allocations and distributions provisions should be appropriately synced in any well-crafted operating agreement.

2.4. Distribution Waterfalls

The fund's distribution waterfall provides that the proceeds from investments are paid in a specified order of tiered priority. This is necessary because private equity funds generally distribute excess cash as it is generated, although the distributions of investment proceeds are made by the fund to its investors net of fund-level expenses, liabilities, and other required reserves. At each tier of the waterfall, distributions are made in a specific ratio (which may be 100% to the sponsor, 100% to the investors, or anywhere in between) until either the

current tier is satisfied and the next tier is reached, or the fund is wound up and the remaining assets distributed in a manner that reflects the agreed-on economics.

2.5. Return of Capital Contributions and Preferred Return

The first tranche of a private equity fund waterfall generally provides that all capital contributed for a particular investment must be returned to the investor who provided it before any other distributions are made from the proceeds of that investment. This tranche is sometimes expanded to require a return of the portion of unrelated investments that have been permanently written down, all unreturned invested capital in previously realized investments, or all unreturned contributed capital.

Following a return of capital contributions, a private equity fund distribution waterfall next provides a preferred return (known as a hurdle) on the capital contributions. The hurdle rate can utilize either a simple interest calculation or, more often, a cumulative compounded rate of return and/or internal rate of return calculation using specific metrics. The purpose of the preferred return is to guarantee investors a minimum return on their invested capital before profits are shared with the sponsor.

2.6. Performance Fee/ Carried Interest

The timing and calculation methodology for payment of carried interest is set out in the distribution waterfall, with the carried interest usually lower in priority to the return of capital contributions and the preferred return to investors. After investors receive their capital contributions and a preferred return, if any, the distribution waterfall provides for distributions of carried interest to the sponsor through a catch-up tranche. The catch-up distribution can be made either 100% to the sponsor or allocated between the sponsor and the investors in a fixed proportion (for example, 80/20 or 50/50, although 100% is more common) and continues until the carry distributions to the sponsor equal the sponsor's negotiated percentage of overall profits. Once this catch-up is fulfilled, the distribution waterfall splits any remaining distribution of profits in accordance with the same agreed-on carried interest split.

In the U.S., carried interest is also a tax-efficient way to compensate principals of the general partner of the fund. Carried interest generally reflects a right to future undetermined profits of the fund above a certain performance threshold, and accordingly is not taxable upon grant by the general partner of the fund. Furthermore, carried interest allocations are not taxed as compensation. Instead, the character (as ordinary income, short-term capital gain or long-term capital gain) of amounts allocated with respect to carried interest is the same as it was when recognized by the partnership, except that long-term capital gain recognized by a partnership on the sale of an asset held for not more than three years is treated as short-term capital gain (which, as at the time of publication, is taxed at the same rate as ordinary income) when allocated to a non-corporate holder of carried interest. In addition, capital gain recognized by a carried-interest holder on the sale of its carried interest is treated as short-term capital gain, rather than long-term capital gain if the carried interest was not held for more than three years prior to being sold.

2.7. Investor Givebacks

Operating agreements for private equity funds require investors to return previously-received distributions to meet their share of any fund obligations or liabilities, including indemnification and other obligations relating to liabilities in connection with the purchase or sale of investments, and other fund liabilities. The requirement to return distributions is often subject to certain caps or limitations, which may be based on the timing of interim or final distributions, or the aggregate amount of distributions that may be required to be returned. A well-crafted provision will balance the need for the fund to satisfy its indemnity and expense obligations over the life of the fund while providing investors with certainty as to their giveback obligations.

2.8. Management Fees

In connection with forming an investment fund, a sponsor usually establishes an entity to act as the investment adviser or management company. The investment adviser generally enters into an investment advisory agreement (or management agreement) with the fund, or its GP or manager, to act as the investment adviser or management company of the fund. Under this arrangement, the fund pays management fees to the investment adviser in exchange for the investment adviser's agreement to employ the investment professionals, evaluate potential investment opportunities, and undertake the day-to-day activities associated with various investment advisory services and activities for the fund.

The investment adviser may also enter into a management services agreement with the portfolio company in connection with each investment transaction, particularly in buyout transactions. The investment adviser generally receives an

ongoing management fee directly from the portfolio company in exchange for providing advisory and consulting services to the portfolio company.

Fund operating agreements usually contain an offset mechanism (i.e., a management fee offset) requiring a dollar-for-dollar adjustment to the fund management fee against a percentage of management services, transaction, and other fees received by the sponsor and its affiliates from the fund's portfolio companies. Generally, investors in funds may seek to receive a share of the sponsor's portfolio company fee income, sometimes requiring that 80%-100% of portfolio company fee income received by the sponsor offset fund management fees.

2.9. Fund Expenses

There are a variety of expenses associated with a private equity fund, including expenses relating to establishing and organizing the fund and its infrastructure (organizational expenses), the operation of the fund (operating expenses), and the fund's general partner or manager (GP expenses). A well-crafted agreement will provide for alignment of interests between the investment adviser and its investors in this respect.

Organizational Expenses. The operating agreement of a private equity fund includes provisions requiring the fund, and therefore its investors, to cover the costs of establishing the fund. The organizational expenses of the fund generally include the out-of-pocket expenses of the sponsor, such as printing, travel, legal, accounting, filing and other organizational expenses incurred in forming the fund and any related vehicles. Organizational expenses are borne by the fund's investors out of their capital commitments but are generally capped in the fund's operating agreement depending primarily on the size and complexity of the fund.

Operating Expenses. In addition to the organizational expenses, the fund bears all other costs and expenses relating to the operation of the fund. These include fees, costs, and expenses relating to management fees, the purchase, holding, and disposition of the fund's investments, third-party service providers to the fund (such as the expenses of any administrators, custodians, counsel, accountants, and auditors), printing and distributing reports to the investors, insurance, indemnity, and litigation expenses, and taxes and any other governmental fees or charges levied against the fund.

General Partner Expenses. The fund's general partner and investment adviser are expected to bear the cost of their own ordinary administrative and overhead expenses incurred in managing the fund. These costs include the costs and expenses associated with running the business of the general partner and investment adviser, as opposed to specific expenses directly related to the operation of the fund and its investments, such as employee compensation and benefits, rent, and general overhead.

3.

Fund Term; Investment and Divestment Periods; Continuation Vehicles

Private equity funds have long lives. The term of a fund begins following the first fund closing and often continues for 10 to 12 years, subject to limited extensions when necessary to provide the sponsor more time to liquidate the fund's remaining assets, and early termination triggered by certain events. Shorter or longer terms may be required depending on the time it takes to source, acquire, harvest, and exit investments. The term of a fund generally consists of an investment period and a divestment period.

3.1. Investment Period

An investor's capital commitment is not usually funded all at once, but in separate capital contributions on an as-needed basis. The provisions of a fund operating agreement generally permit the fund to enter into new investments only during a limited investment period, often four to six years from the end of the fund's fundraising period or the closing of its first investment. After the investment period, the fund is permitted to acquire new investments only to the limited extent set out in its operating agreement. The length of an investment period

should balance the investor's desire for the investment adviser to deploy its commitments with all due care and speed, while giving the manager time to carefully deploy the investment strategy without undue pressure.

3.2. Divestment Period

Fund investments are not generally liquidated all at once, but separately as and when directed by the sponsor primarily during a divestment period ending four to six years after the end of the investment period. The terms of the fund generally require investors to contribute capital after the end of the investment period (subject to the amount of their respective commitments), as and when called, only for: investments under limited circumstances, including investments for which the fund made a binding commitment before the end of the investment period, follow-on investments in existing investments, or new investments to the extent permitted under the fund's operating agreement; and fund fees and expenses, including management fees. At the end of the fund's term, the fund's remaining investments must be liquidated, and the proceeds distributed to investors in accordance with the distribution waterfall.

3.3. Suspension of the Investment Period

Because funds require investors to contribute capital as and when called by the manager over a long period, certain protections are often included in the fund operating agreement that trigger an early termination of the fund or its investment period.

Key Person Events

Investors make investments in a fund primarily in reliance on the skill and expertise of certain individuals to manage the fund and its investments. The operation of the fund is often tied to the involvement of these individuals who are deemed to be key persons. Key person triggering events vary from fund to fund, but generally cause a suspension of the fund's investment period. If triggered, the fund is prevented from making new investments until a sufficient number of new key persons are appointed to the satisfaction of the investors. While fund investors will seek the appropriate number of senior personnel required to manage the fund during the most critical stages (i.e., the investment period), sponsors should ensure that such a provision does not unduly restrict their ability to manage their entire investment program.

Removal for Cause

Fund operating agreements may contain early termination events that allow the investors to remove and replace the sponsor or elect to liquidate the fund for cause. Cause is often limited to highly material events calling into question the manager's ability to manage the fund, such as fraud or willful misconduct, gross negligence, or major securities violations.

Removal Other than for Cause

Fund operating agreements may also contain provisions that permit a supermajority (often 75% or more of total capital commitments) of the investors to remove and replace the sponsor or otherwise dissolve the fund other than for cause. The theory behind this kind of provision is that, even if no adverse event has occurred to call into question the manager's ability to operate the fund, investors should not be required to continue to contribute capital to the fund when an overwhelming proportion of the investors do not wish to continue the fund's operations.

3.4. Continuation Vehicles

Over the past decade, GP-led secondaries have grown in popularity as a means of achieving liquidity for investors in private funds. These highly bespoke transactions often take the form of both single and multi-asset continuation vehicles (CVs), which can involve the following features:

- a new CV being formed by the sponsor, which is capitalized by new investors. New investors are typically secondary funds or sophisticated institutional investors; one or more lead investors will typically lead the investment in the CV (and negotiate terms with the sponsor);
- a GP-organized process to proactively offer liquidity to existing fund investors and to secure additional time and/or capital for all or select fund investments;
- an election process in which current fund investors are offered the opportunity to elect to cash out of the existing fund (a "cashout" option) or roll over their interests (a "rollover" option) into the new CV;
- depending on the structure and terms, current fund investors may be offered a status quo (or modified status quo) option (in which they roll over to the CV on the same or similar economic terms).

Because these transactions include the sale of one or more portfolio assets among affiliated entities controlled by the same adviser (or affiliated advisers), conflicts of interest should be disclosed and appropriately consented to (often by the fund's investor advisory board) as part of the transaction process. Moreover, as a general matter it will be important for a fund

sponsor to show a full and fair process by which pricing was achieved, often involving hiring a financial adviser to lead a secondary process. Typically, a fairness opinion or valuation report will be obtained in connection with the transaction (along with disclosure of any conflicts involved with respect to an institution issuing such fairness opinion or valuation report). Overall, these transactions have become an excellent way to achieve liquidity for investors and, when done right, can facilitate price maximization through an arm's length auction process and provide investors with an option to achieve liquidity or maintain their existing stake.

4. Managing Conflicts

4.1. Generally

Sponsors of private equity funds frequently manage multiple investment vehicles or otherwise engage in a number of asset management and other related services that can potentially create conflicts of interest. In order that a manager can abide by its fiduciary duties (see above under Advisers Act), investors should be apprised of not only the risks and merits of an investment in the fund but all material conflicts. The fund operating agreement often specifies how the sponsor must address certain conflict situations that are likely to arise during the fund's term.

4.2. Competing Funds

Fund operating agreements usually require the sponsor to offer suitable investment opportunities it sources to the fund before offering the opportunity to other managed funds or sponsor accounts. During the investment period, the fund may have a right of first look on investments within the fund's target objectives; may not receive priority for certain investments (for example, the operating agreement may list potentially competing funds managed by the sponsor that will either be given priority over the fund or be permitted to co-invest alongside the fund); and may be entitled to a pro rata share of suitable investment opportunities alongside other managed funds of the sponsor as permitted under the fund's operating agreement.

4.3. Exclusivity

Fund operating agreements often contain (subject to appropriate carve outs) exclusivity terms, preventing the sponsor from forming competing funds with the same investment objective until the end of the fund's investment period, or until all or substantially all of the fund's commitments have been deployed or reserved for deployment.

4.4. Transactions with Affiliates

Fund operating agreements typically contain provisions governing affiliated transactions between the sponsor or its affiliates, and the fund or its portfolio investments. Certain affiliated transactions described in the operating agreement must often be brought to the attention of an investor advisory committee for review or approval, or both. The types of transactions requiring approval may include situations in which the sponsor (or one of its affiliates) is engaged to act as a service provider for the fund or one of its portfolio companies, buying an investment from or selling an investment to the fund, acting as a creditor of or lender to the fund or one of its portfolio companies, or otherwise buying assets from or selling assets to the fund or one of its portfolio companies. In addition, Section 206(3) of the Advisers Act specifically prohibits an investment adviser (such as the sponsor) or any of its affiliates from selling any security to its client (such as the fund), or buying any security from its client, without obtaining prior consent for the specific transaction.

5. Taxation

5.1. Taxation Applicable to Fund Operations

No Entity-Level Income Tax on Flow-Through Funds

Typically, U.S.-based funds are established as pass-through entities, such as partnerships or limited liability companies. Generally, a pass-through entity does not pay any entity-level income tax; instead, the beneficial owners of such pass-through entity report their share of the pass-through entity's income, which itself is reported by the pass-through entity to its beneficial owners on an Internal Revenue Service Schedule K-1 (and to the extent the fund has foreign income, on an Internal Revenue Service Schedule K-3), and pay applicable federal income taxes at rates specific to such beneficial owners. However, in certain circumstances, a fund could be deemed to be a "publicly traded partnership", subjecting it to federal income tax at the corporate income tax rate unless the fund satisfies an annual 90% "annual income" test.

Corporate Income Tax

In the unusual circumstance where a U.S. fund is established as a corporation, such fund is subject to U.S. federal income tax (at a 21% rate) and may be subject to state income tax. Additionally, some funds may elect to use a structure involving a below-the-fund or above-the-fund "blocker corporation" that would pay U.S. federal income tax but may help tax-exempt and non-U.S. investors avoid incurring unrelated business taxable income (UBTI) or effectively connected income (ECI), respectively.

Permanent Establishments

If a fund has a U.S.-based general partner or investment manager, such general partner or investment manager's U.S. presence should generally not cause a non-U.S. fund or a non-U.S. investor in a fund to be subject to U.S. federal income tax as long as the activities of the fund consist predominately of passively investing in securities. However, if a fund acts as a dealer in securities, the fund will be deemed to generate ECI for its non-U.S. investors and UBTI for its U.S. tax-exempt investors if such dealing activities occur in the United States. Additionally, activities, such as loan origination and investing in real estate and certain so-called "U.S. real property holding corporations" can also be expected to generate ECI and UBTI for non-U.S. investors.

5.2. Tax Regime for Investors

U.S. Tax-Exempt Investors

U.S. tax-exempt investors, such as charitable organizations, pension funds, private foundations and individual retirement accounts, are generally exempt from U.S. federal income taxation except to the extent that they earn UBTI, which can arise when a fund that is a pass-through entity for U.S. federal income tax purposes borrows money to fund its investments. In addition, UBTI can arise if a fund is itself engaged in a U.S. trade or business or invests in pass-through portfolio companies conducting a U.S. trade or business. Blocker structures or parallel funds can be utilized to minimize UBTI for U.S. tax-exempt investors.

U.S. Taxable Investors

A typical U.S. non-corporate investor is subject to U.S. federal income tax at a maximum rate of 37% plus an additional 3.8% tax applicable to the investor's net investment income. A typical U.S. corporate investor is subject to U.S. federal income tax at a rate of 21%. Various limitations may apply to a U.S. non-corporate investor's ability to deduct certain losses and expenses. Some of these limitations may depend on the activities of the fund. A U.S. corporate investor is typically not subject to such limitations.

Non-U.S. Investors — Withholding Tax

U.S. withholding taxes of 30% generally apply to certain types of non-business income (typically, U.S.-source dividends and certain dividend equivalent income, and limited types of U.S.-source interest income – commonly referred to as Fixed, Determinable, Annual, or Periodical, or "FDAP" income) allocable by a U.S. fund to non-U.S. investors. Certain exemptions or reductions in tax rate may be available under applicable tax treaties. Foreign governments and sovereign wealth funds are not subject to U.S. withholding tax on certain types of U.S.-source income, including dividends and

interest. Capital gains income is also not generally subject to U.S. income or withholding tax unless it is attributable to investments in U.S. real property interests.

Non-U.S. Investors — Income Tax

Non-U.S. investors can also be subject to U.S. federal income tax on income and gains that are ECI. For example, loan origination by a fund may be treated as generating ECI, which would require a non-U.S. investor to pay U.S. federal income tax and file a U.S. income tax return. Domestic funds with non-U.S. investors are required to make quarterly tax payments to the IRS on account of ECI allocable to non-U.S. investors and must withhold U.S. tax from redemption payments to the extent attributable to ECI-generating investments. Additionally, non-U.S. investors may be required to file tax returns and pay taxes in U.S. states where the fund generates ECI.

Double Tax Treaties

Non-U.S. investors in funds may be able to claim tax treaty benefits (typically, a reduction in or complete exemption from the 30% U.S. withholding tax described above) under an income tax treaty between their jurisdiction of residence and the United States. In order to establish eligibility to claim tax treaty benefits, a non-U.S. investor should claim such benefits on an applicable IRS Form W-8 provided to the fund. Certain jurisdictions, such as Germany and the United Kingdom, may limit the availability of tax treaty benefits to a resident of those jurisdictions that invests in a fund organized as an LLC rather than as a limited partnership. For this reason, U.S. funds that are targeting non-U.S. investors may choose to be organized as limited partnerships rather than as LLCs.

5.3. FATCA/CRS and Other Tax Compliance

Under the Foreign Account Tax Compliance Act (FATCA), U.S. funds are generally required to collect and remit a 30% U.S. withholding tax on their payments of U.S.-source dividends and interest to a non-U.S. "foreign financial institution" or "non-financial foreign entity" (each as defined) unless such non-U.S. person makes certain certifications or provides certain information relating to its U.S. owners or qualifies for exemption from FATCA. Typically, a U.S. fund will obtain an appropriate IRS Form W-8 from its foreign investors that will include the requisite FATCA certifications. Different rules may apply to foreign financial institutions located in jurisdictions that have an intergovernmental agreement with the United States governing FATCA.

6. Main Legal Documents

6.1. Fund Governing Documents (Limited Partnership Agreement/ Operating Agreement)

The fund's operating agreement (either an LP agreement when the fund is formed as an LP or an LLC agreement when the fund is formed as an LLC) is the primary agreement that governs the arrangements among the sponsor (as the GP or managing member) and the investors in the fund. The agreement sets out, among other things: the investment objectives of, and investment restrictions, on the fund; the economic terms, including the allocations of profits and losses, carried interest, and management fees; the payment of the fund's expenses; the manner in which conflicts of interests are administered; the mechanics of issuing capital calls to the investors and any decreases and increases in an investor's capital commitment; the distribution waterfall, tax distributions, and other terms regarding the timing and manner in which the fund may distribute proceeds to its investors; capital commitment default provisions which create severe penalties for a defaulting investor; the delivery of annual and quarterly financial reports and other informational reports to the investors; provisions limiting transfers of interests by the investors unless permitted under the provisions of the operating agreement or with GP consent; provisions relating to tax matters; and other standard legal terms, depending on the form of the vehicle and its jurisdiction of incorporation.

6.2. Subscription Documents and Private Placement Memorandum

Private Placement Memorandum (PPP)

The private placement memorandum is often the primary marketing document through which the fund markets its interests to prospective investors – due care should be given to the Marketing Rule, Securities Act, and other appropriate U.S. regulations as described above. The U.S. federal securities laws do not require PPMs to be delivered to sophisticated investors such as QIBs and accredited investors in connection with a private offering of fund securities, however, general market practice is to provide a PPM (or other marketing document, which can take many forms, subject to appropriate legal review) to all prospective investors where appropriate. The Securities Act and its related rules do not mandate any specific content; however, PPMs generally contain the following information: business sections describing the target investments of the fund, the background of the sponsor and its investment team including its performance track record, and the target industries and geographic regions in which the fund will invest; a summary of terms describing the key legal terms to be contained in the operating agreement of the fund; risk factors and conflicts of interest describing the key risk factors involved in making an investment in the fund; and other key legal and tax considerations.

Subscription Agreement and Investor Questionnaire

An investor subscribes to a fund as a limited partner, member, or other equity holder by executing a subscription agreement, which sets out the investor's capital commitment to the fund. By executing the subscription agreement, the investor also agrees to the rights and obligations of the investors in the fund's operating agreement (by including a joinder signature page to the operating agreement) and makes representations and warranties to the fund, including representations and warranties confirming that it is qualified to invest. In connection with the subscription of interest, investors are typically required to provide tax information (such as on an Internal Revenue Service Form W-9 or applicable Form W-8) and fill out an investor qualification statement or other investor questionnaire confirming that the investor is qualified under applicable laws to invest in the fund and providing other supplemental information and appropriate representations required by the sponsor.

Generally, CFTC regulations require all commodity pools sponsored by registered CPOs to have a "disclosure document" (i.e., a private placement memorandum) that contains certain disclosures prescribed by regulation and which must be reviewed by the NFA, unless an exemption from such requirement is available. If a CPO limits the investors in a fund solely to "qualified eligible persons" (QEPs) as defined in CFTC Rule 4.7, the CPO is exempt from the requirement that its pool have a disclosure document reviewed by the NFA. Generally, QEPs are accredited investors that meet a portfolio requirement (either USD4,000,000 in securities or USD400,000 in futures margin or options on futures premium, or some proportional combination of the foregoing). Qualified purchasers, "knowledgeable employees", certain regulated entities or investment professionals, as well as non-U.S. investors generally, are also deemed to be QEPs.

Investment Management Agreement

The management company or investment adviser of the fund is often retained directly by the fund, or its GP or managing member pursuant to a separate investment management or investment advisory agreement. The agreement contains the general terms under which the investment adviser is authorized to act as the fund's manager or other agent in connection with fund investment in exchange for the fund's management fee.

About the authors and their firms

Mattos Filho

Winston Taylor

About the authors

Mattos Filho



Andre Franco Perdiza
Partner

- São Paulo
- +55 11 98644 5344
- andre.perdiza@mattosfilho.com.br

André Perdiza holds a law degree from Fundação Getulio Vargas (FGV-SP) and is a partner at Mattos Filho. His work focuses on investment fund formation, structuring, fundraising and transactions, with an emphasis on structured funds, private equity, credit and special situations. He is experienced in handling complex and structured transactions (domestic and cross-border), fund financing, securitization and restructuring, and provides customized solutions for transactions involving investment funds and the third-party asset management industry. André previously worked as an international associate in New York.



Ana Carolina Lima Nomura
Partner

- São Paulo
- +55 11 98644 5344
- cnomura@mattosfilho.com.br

Ana Carolina Nomura is a high-level, sophisticated lawyer who specializes in domestic and cross-border transactions involving investment funds. She is one of the co-founding partners of the investment funds practice at Mattos Filho and one of the most prominent specialists in investment funds and asset management in Brazil. Throughout her more than twenty years of professional experience, she has taken part in multiple transactions involving funds, across a wide range of sectors, with deep experience in private equity, infrastructure, credit, special situations and distressed. She has also worked as foreign associate in New York.



Flávio B. Lugão
Partner

- São Paulo
- +55 11 98338 3879
- flavio.lugao@mattosfilho.com.br

Flávio B. Lugão advises asset managers, investment banks, private equity firms and institutional investors on forming, fundraising and transactions involving investment funds across a highly diverse range of classes and strategies, including hedge funds, multimarket funds (FIs), private equity, venture capital, infrastructure, timber and carbon funds (FIPs), real estate and agricultural funds (FIIs and FIAGRO), and exchange-traded funds (ETFs). He also provides regulatory advice to portfolio managers, broker-dealers and other asset management players. Flávio is licensed to practice law in New York and previously worked there for two years.



Maria Fernanda Fidalgo
Partner

- São Paulo
- +55 11 99558 5452
- mariafernanda.fidalgo @mattosfilho.com.br

Maria Fernanda Fidalgo holds a law degree from the Federal University of Bahia (UFBA) and a specialization in Tax Law from Fundação Getulio Vargas (FGV). A partner at Mattos Filho, Maria Fernanda is experienced in advising local and foreign managers, sponsors, and institutional investors on establishing, structuring, fundraising, and conducting transactions involving investment funds – particularly structured funds such as private equity and credit funds. She also advises on complex tax matters involving investment funds and transactions in financial and capital markets linked to the third-party asset management industry.



Marina Procknor
Partner

- São Paulo
- +55 11 98541 9088
- marina.procknor @mattosfilho.com.br

Marina Procknor specializes in private equity, venture capital, and investment funds. Recognized as a pioneer in ESG within the Brazilian legal market, she represents financial institutions, managers, startups, and investors in strategic transactions and fund structuring. She is currently a partner at Mattos Filho. She holds a law degree from PUC-SP and an LL.M. from Northwestern University (USA). Latin Lawyer named her one of the most inspiring women in Latin America, and she is actively involved in pro bono social impact initiatives with Muhammad Yunus. She is also a member of the ABVCAP board.

About Mattos Filho

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About the authors

Winston Taylor



Scott Naidech
Co-Chair, Private Investment Funds and Co-Chair, Secondaries and Liquidity Solutions

- Chicago
- +1 (312) 558-3769
- scott.naidech@winstontaylor.com

Recognized as a leading fund formation attorney by *Legal 500*, *Chambers USA*, *Best Lawyers*, and *Lawdragon 500*, **Scott** advises U.S. and international private fund sponsors on fund formation and operations, including buyout, growth, energy, credit, infrastructure, real estate, and venture capital funds. Scott also advises clients on continuation fund transactions (single and multi-asset) and other liquidity solutions, and counsels on regulatory and compliance matters. He is also recognized by Thomson Reuters as a "Stand Out Lawyer" and Acritas as a "Star Lawyer".



Rodrigo Carvalho
Partner, Mergers & Acquisitions/ Private Equity

- São Paulo, New York
- +55 11 3443 6316
- rodrigo.carvalho@winstontaylor.com

Rodrigo Carvalho concentrates his practice on M&A, private equity, capital markets, and corporate finance matters in Latin America, with a special focus on Brazil. He has extensive transactional experience in Brazil and internationally across a broad spectrum of industries. He advises clients on cross-border M&A, international debt and equity offerings, and finance matters involving Brazil and other parts of Latin America. Before joining Winston, he was Bank of America's Head of Investment Banking (Legal Division) in Brazil. Rodrigo has worked in New York, London and São Paulo during his legal career. He is admitted in New York and Brazil.



Beth Kramer
Partner, Funds and Financial Services

- New York
- +1 (212) 294-6646
- beth.kramer@winstontaylor.com

Beth Kramer focuses her practice on investment management, fund formation, continuation vehicles and regulatory compliance. She advises on the structuring, formation, and ongoing management of funds and US and non-US investment advisers with various investment strategies, ensuring compliance with regulatory requirements. Beth has extensive experience in creating disclosure and offering documents for private investment funds, drafting investment management products, and evaluating fund documents for institutional investors and family offices seeking alternative investments.

About the authors

Winston Taylor



Jacqueline Hu
Partner, Funds

- New York
- +1 (212) 294-5361
- jacqueline.hu@winstontaylor.com

Jacqueline Hu focuses her practice on investment management, fund formation, and regulatory compliance. Her practice includes advising on the structuring, formation, and ongoing management of funds and investment advisors with various investment strategies and on the regulatory and compliance aspects of their businesses. She also has experience with creating disclosure and offering documents for private funds, drafting investment management products, and evaluating fund documents for institutional investors and family offices seeking alternative investments.



Basil Godellas
Partner, Funds and Financial Services

- Chicago
- +1 (312) 558-7237
- basil.godellas@winstontaylor.com

Basil Godellas has over 30 years of experience representing asset management clients in a range of regulatory and transactional matters, including the formation of private investment funds, product development, securities offerings, and acquisitions. He advises on structuring and forming various investment funds, such as hedge funds, private equity, and alternative investments, and has extensive experience with onshore and offshore funds, including “master feeder” and multi-class funds. Basil has represented major financial institutions in significant transactions and advises clients on digital assets and blockchain technology.



Olga Loy
Partner, Tax

- Chicago
- +1 (312) 558-6336
- olga.loy@winstontaylor.com

Olga Loy is chair of Winston’s tax practice. She has over 25 years of experience advising funds and fund sponsors on tax structuring, fund formation, and corporate transactions, including IPOs, SPACs, and debt restructurings. She also represents large public and private corporations, real estate funds, and investors in tax matters across North America, Europe, and Latin America.

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Whatever the challenge, Winston Taylor is in the room with its clients, shoulder to shoulder in the everyday moments, and in the ones that change everything.

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Phone: +1 (312) 558-5600.

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