TOPIC TWO – THE EVERGREEN FUND MODEL – THE NEW ALTERNATIVE TO CLOSED FUNDS

Venture funds have historically, and rigidly, operated under a closed-end fund structure with a 10 year life, limiting a fund's ability to continue to support its portfolio companies and forcing pre-mature liquidation of fund holdings.Many VC firms have embraced the open-end "evergreen" fund structures, which offer greater flexibility and a longer-term investment horizon. Although this structure is not new, it appears to be the trend going forward.

In late 2021, Sequoia Capital announced a shift towards an open-end fund structure, which allows the fund to continue funding promising portfolio companies beyond a fixed horizon and to continue maintain a board seat with such companies. This move aims to help portfolio companies achieve sustainable, organic growth and to manage burn instead of pushing for unrealistic scaling for an early exit.
Open-end fund structures have several other advantages over closed-end funds. Instead of the typical 12-18 month subscription window, open-end funds can raise funds continuously according to the needs of their portfolio and as economic conditions permit. They can re-invest funds into new investment opportunities. They have an unlimited lifespan, which means investors can stay invested for as long as they choose. Additionally, they offer greater flexibility to investors, who can buy and sell fund interests as needed.

However, open-end funds are subject to additional regulatory requirements and are more costly to establish. For newer funds that desire the flexibility to shift to an open-end structure, we generally suggest adopting an election approach that allows the manager and the majority of limited partners to elect a closed-end fund to be treated as an open-end fund.

Some criteria that a fund manager must consider before deciding whether an election approach makes sense:

- Regulatory approval: The conversion must be approved by relevant regulatory authorities, such as the Securities and Exchange Commission (SEC). The fund must meet minimum liquidity and diversification requirements.
- Portfolio restructuring: The fund's portfolio may need to be restructured to meet requirements for an open-end fund, such as increasing liquidity or reducing concentration in illiquid assets.
- Redemption: The fund must have provisions in place to allow investors to redeem their interests. This may require changes to the fund's offering documents, such as its prospectus or private placement memorandum. Calculation of net asset values for redemption can be tricky and expensive.
- Fees and expenses: The fund's fees and expenses may need to be adjusted to reflect the costs of managing an open-end fund. Initial fees may be lower, as they are based on funds raised rather than unfunded capital commitments.
- Distribution channels: The fund may need to establish new distribution channels to sell its shares to a wider range of investors, such as through financial advisors or online platforms.

Converting a closed-end fund to an open-end fund can be a complex process that requires careful planning and execution. It may not be appropriate for all funds, depending on their investment strategies and objectives.

Our recommended read: https://www.toptal.com/finance/venture-capital-consultants/evergreen-funds