diffusetap
Virtual Event Series

Can SPVs Beat Funds?

Guest Speakers:

Remy Astie
Co-Founder
VAUBAN

Ulric Musset
Co-Founder
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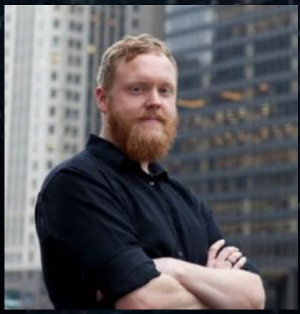

Kenny Estes
CEO & Founder
Diffuse

Ayla Kremb
Chief of Staff
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DiffuseTap: Can SPVs Beat Funds?

Last time on DiffuseTap, **Remy Astie** and **Ulric Musset, Co-Founders of VAUBAN** talked about the coming wave of automated investment vehicles, the practical advantages that SPVs have over traditional funds (and vice versa), and why at some point, fund managers naturally transition from SPVs into full-fledged funds.

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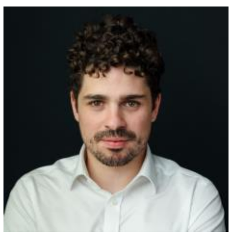
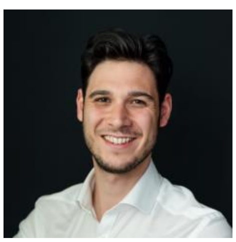
Meet the Speakers



REMY ASTIE is VAUBAN's CEO. Remy was always interested in using technology to reduce friction in the finance industry. In fact, he wrote his master's thesis on custody solutions on Blockchain, specifically for pink sheet stocks. Prior to establishing VAUBAN, he was in charge of Cayman operations for a small Singapore-based company. Remy has a master's degree in financial engineering from ESSCA in Paris and Taiwan National SYS University (where he spent a year learning Chinese). LinkedIn: @remyastie



ULRIC MUSSET is VAUBAN's CTO. Ulric and Remy, both French but living in London, met at school and, in 2013, co-founded their first company, TWEADY, a fashion intelligence app. As a student keen on finance and technology, Ulric spent time at university developing algorithmic trading strategies. He has a bachelor's degree in applied mathematics from Université de Lyon and a master's degree in computer science from ENSIMAG. LinkedIn: @ulricmusset

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We are an alternative fund platform offering differentiated investment products. From digital assets to VC funds and beyond, we identify green field investment opportunities we feel will have market beating returns and turn them into professionally managed funds. For more information, visit www.diffusefunds.com.

KENNY ESTES: Today, we're joined by Urlic Musset and Remy Astie. Do you guys want to talk a little bit about your background and what you do over at VAUBAN?

REMY ASTIE: Yeah. So, I'm Remy. I'm the co-founder of VAUBAN, with my friend Ulric. We met in university. Just to explain what we do in a few words, it's simple. I don't know how much everyone in the audience knows, and these things can have different meanings, but our business is basically about investment vehicles.

An investment vehicle is essentially a special type of company that does only two things: It pulls capital from investors and then it buys something or invests in something or buys and invests in a portfolio, in the case of a fund. It's as simple as that but it's a big deal. Most things have value in the world, like this building here or this Apple logo here. It's a fundamental block of capitalism, and what we're doing here at VAUBAN is engineering the investment vehicle of the future. We call it the "Wealth Container".

Today, dealing with investment vehicles is a very broken process, with work seals and paper certificates. It's very archaic and I'm not exaggerating. So, we really tried to digitize that through end-to-end containers, which means that people don't have to think anymore about banking, legal documents that contain regulatory filings, etc. They can just focus on fundraising and deploying capital.

ULRIC MUSSET: Hi, everyone. I'm Ulric, also co-founder of VAUBAN. Before starting VAUBAN, I worked for an insurance company and a wealth management firm. It's exciting to be here. I can really feel that the venture space is heating up right now. We receive so many messages and inquiries through our website from emerging fund managers that want to set up SPVs, but don't know if they should, or if they should go down the VC fund route instead. It would be a great opportunity for us to share our experience and to discuss with you your questions, and I hope it will clarify your concerns. Thank you for having us.

KENNY: Absolutely and thank you guys for coming. I'm joined today by my partner in crime, Ayla Kremb, and for the next 15 minutes or so we'll do a fireside chat, the meat of the session. So, Ayla, do you want to kick it off with the first question?

AYLA KREMB: Yeah. Maybe we'll start with something kind of basic, but massively important. What is the difference between an SPV and a fund, just to make sure we're all on the same page in terms of terminology? Remy?

REMY: Yes. So, it's simple, actually. A fund is a legal entity whose sole purpose is to raise money for, and from investors who invest in a portfolio of things. In the case of venture capital, it's going to be a portfolio of startups. You raise money from LPs, and you buy stakes in 10 to 20 startups generally.

An SPV is exactly the same thing, but instead, an SPV is going to invest in a single deal or a single asset, a single startup. Instead of saying, "Hey, I'm going to raise money to invest in DeFi," SPVs say, "Hey, I'm going to raise money to invest in that specific company." That's really the difference. But essentially, an SPV and a fund are the same thing.

But also, it's important to be careful, because SPV has a different meaning for pretty much everyone in finance. That's because it means special purpose vehicle, and obviously, everything depends on the purpose.

KENNY: Great. On that note, we have a question in the chat from Henry. How do you automate and digitize the structuring and launch of various investment vehicles? So maybe you want to talk about the brass tacks of what VAUBAN does, including what you take out of the hands of the GPs. and how you make their life easier. Ulric?

ULRIC: Our vision is really to automate the infrastructure layer of an investment vehicle. And for us, when we think about infrastructure for an investment vehicle, it's mainly three things that you need to get to structure your vehicle. One, it's the legal document. It's crucial because legal documents are here to determine what you're supposed to do in which situation. That's the first piece. The second thing is the accounting. You need to run the accounting of a vehicle. And the third thing is banking, because you need to be able to collect money from investors, and you need to be able to make a wire transfer as well to the target company.

At VAUBAN, we automate all these things. You just fill in a questionnaire form, and we will generate all the legal documents that you need. We automate the accounting as well, so that when investors subscribe to an SPV or when the GP makes an investment, we generate the corresponding accounting transactions.

KENNY: So, what does that leave the GP to do? Or the fund managers?

ULRIC: GPs don't want to be bored with the legal, the accounting, the back-office, the regulations, the anti-money laundering, etc. Those things are very boring. Fund managers love to invest in great startups and develop relationships with their investors. Those are the two things that they care most about. The vision of VAUBAN is really to allow them to turn their attention towards what they want and need to focus on and spend just 1% or 2% of their time on all the other things.

AYLA: One question then is, at what point should a fund manager choose an SPV over a fund? We're having a lot of conversations about this with general partners who want to launch a fund for the first time, and they often have a few individual investors under their belt ready. At what point does it make sense to just keep going on a single vehicle path, and at what point does it make sense to spin up a fund?

ULRIC: It's very different from a commitment standpoint. I love the analogy that essentially, a fund is like a marriage. Investors are going to lock their money up for the next 10 years, so they need to make sure they can trust you as a general partner. You will go through a lot of meetings with investors, and they need to conduct due diligence on you and your new firm, so it's very heavy. From an operational and fundraising perspective, it takes between 12 to 18 months to raise a fund.

But for an SPV, it's way more flexible. It's like dating. You have a deal that's very time sensitive. You will talk to your potential investors and say, "Okay, I have secured an allocation in SpaceX". You send the pitch deck and talk about the competition, the industry, how great the team is etc. And then you ask, "The deal is closing next month. Are you in or out? Do you want to invest or to pass?" The time element is more sensitive on the SPV side.

I'd say that it mostly depends on your personal situation. For example, if you have a deal that is closing soon, or closing yesterday, like for most of our customers, obviously, you need to do an SPV, because it will take too long to launch a fund.

In addition, to raise a fund, you need to demonstrate that you have the skills, as well as a good track record. You need to show that you have done successful angel investments, or that you have worked for a VC firm before. And if you don't have this track record, it can be hard to launch a fund. So, in general, what we see is that SPVs can serve as a steppingstone to launching a fund.

It depends as well on how much free time you have. Maintaining a full-time job and operating a VC fund at the same time is super hard. If you use SPVs, you can go on and off. But with a VC fund, you have this constant pressure of deploying the capital.

And it really depends on your investor base. Some investors prefer to be engaged, and they really love to evaluate investment opportunities. Other investors, they just want to write a check and forget about the money for the next 10 years. It will depend on your investors as well.

KENNY: That makes a lot of sense. And now that we're talking about investors, we'll pick up two questions from the chat. Where do you operate? What type of entities do you form? What jurisdictions are you in, in the US? Remy, maybe you can pick this up?

REMY: Right now, we don't operate in the US. We focus on basically anything non-US, but we offer the typical international jurisdictions like the UK, etc. So that means that most of our customers will be either in Europe, in the UK, in the Middle East, Singapore, Hong Kong, South Korea, etc.

US investors can invest through our SPVs, but if you have 100% of US investors, it's easier to do the structure in the US. But yeah, we tend to get some US investors. It's on the roadmap.

AYLA: One of the other questions was, when it comes to regulatory filings and reporting, what portions of that are you able to automate and simplify for the GP for the lifetime of the SPV? Maybe you can go for that one, Ulric.

ULRIC: Yeah. In terms of regulatory reporting, it really depends on the jurisdiction. In the US, it's completely different than in Europe. And even in Europe, it depends on the country.

However, that's part of our vision as well. We take care of the regulatory reports, which are country specific. For foreign SPVs, you have a lot of stuff to do. You need to do the tax reporting of the SPV, you need to file different reports with the register of the company, etc. I won't go into the details because, but we take care of all that.

KENNY: Gotcha. And then back to you, Remy, with a question from Gabriella [Kusz]. For the funds that you've seen that make that transition from SPV to fund — and I know, you guys have only been around for a few years now, great traction in just a few years, by the way — when do you see them start that transition? When are they successful? When are they not? What are some of the milestones that somebody on that track would be looking for?

REMY: So, I would say, often, they're too early. I would say doing all these SPVs impacts your ability to raise funds like proper LP firms in the future. Obviously, it really depends on your structure, but it's easy to run a succession of SPVs as your track record, where you can say, "Hey everyone that invested through my SPVs. If you would have invested X percent on each of them, then this would have been your IRR."

And that matters a lot, because I think with SPVs, you typically get a carried interest on every single deal, rather than in an investment fund, where it's averaged out to the total performance. And it's easy to be attracted and to become more of a broker, where you just broker bigger allocations, generally in late-stage deals, to smaller investors. And that's fine.

I think it's a very good and lucrative business. But if your goal is to really start a venture fund, at some point, you should stay consistent and thesis-led, and you should really think about branding from day one. (Editor's note: Our DiffuseTap featuring Dave McClure – founder and managing partner at Practical Venture Capital, founder of 500 Startups, and PayPal Mafioso – discusses fund branding strategies in length.)

If you call yourself Velocity, for instance, you should have an entity called Velocity. And in the carry on any deal pushbacks, the name Velocity should be linked to your thesis. So, if it's consumer early stage, you should only push consumer early-stage deals. And then, if you have that consistency, then the LPS in your SPVs will become the anchor LPs in your actual, venture form.

I think the short answer to the question is generally, it should take quite a few years, maybe three to four years, to get a good track record, and to get quite a few significant markups on the portfolio companies in the SPVs, before you can really leverage that good track record and that brand.

And you're going to reach that stage where you will have to tell the investors in your SPVs, "That deal flow I brought you, that's going to be for the LPS in my fund", because you don't want to go over their head. To sum it up, I would say it really depends on how many deals you do, but maybe it will take at least three to five years.

AYLA: One of the questions that we discussed in our prep call was around mistakes or things to think about when structuring SPVs, and we touched on a couple of things. They should be aware of stipulations, provider rights and clauses, allocation management, and things like that. But also, there's IPOs, liquidity events, etc. What are some of the main things that every GP should be aware of when they set out to get an SPV set up? What are some of the key clauses in there that we must have in place when they take off? Ulric, you want to go ahead?

ULRIC: Sure, that's a great question. The first one I can think of, the first mistake, would be to try to do everything by yourself as a GP, and to project manage with lawyers, accountants, and bankers. Because then, you will have to babysit the SPV and the deal, and you will lose a lot of time.

Therefore, I really recommend you use an SPV platform, like VAUBAN, so that you don't have to handle all the back-office stuff, and you don't have to think about all the legals. SPV platforms have done hundreds and hundreds of deals. They know what to include into the legal agreements and how to manage the process.

Because in terms of legal docs, you can find a VC template, like a VC private placement memorandum online, and then simply adapt it to an SPV use case. The problem, however, is that you will have a lot of useless clauses that don't apply at all to an SPV. Like, for example, clawback provision which doesn't make sense in an SPV, because you have just one simple carry, or you will capital call mechanism, which doesn't make sense because in an SPV, you just call everything upfront.

And if you send that to investors, you will look super bad, and investors are your most precious resource, right? So, you really want to get it right, have robust legal docs, and a robust back office as well.

The second thing is to manage your location. When you raise an SPV, it's difficult to gauge investors' interest. You might be able to push a deal to your investor base and raise between 500k to 1 million. But then on the other side, you will have to negotiate with the startup the final investment amount. Plus, sometimes there is the forex element that complexifies the calculation. Let's say you are doing a deal in Europe in pounds, and you are raising from abroad. Your investor base uses USD, Euro, and GBP, so you need to take it into account when closing the deal.

These are some of the practical things you will need to think about before structuring an SPV.

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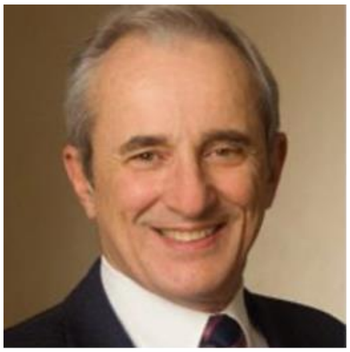
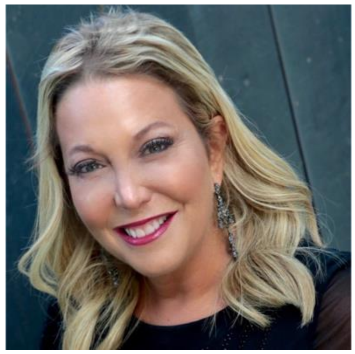


Dennis Chookaszian
Corporate Director, CME Group

DiffuseTap: Institutional Grade Governance

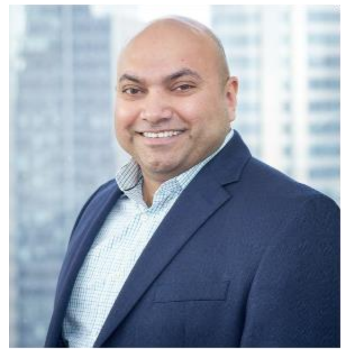
Sharing his decades-long expertise on corporate governance, Dennis discussed how to avoid a co-partnership going sour, the problem with overly idealistic CEOs, and the importance of keeping your board in check. Read on



Susan Brazer
CEO & Founder, LionShare Media

DiffuseTap: Media Metaverse 2022

Susan talked about the 2020 digital media landscape; the evolution of media distribution; how converging, emerging technology points to the metaverse; and the prospect of having an open, decentralized, and free Web 3.0 marketplace. Read on



Raj Mukherjee J.D.
VP/Global Head of Tax, Binance.US

DiffuseTap: Crypto Taxes Decoded with Binance.US

Raj explained the complexities of the US crypto tax landscape, how he built a dynamic tax information system for Coinbase and Binance from scratch, and how investors can profit from crypto without getting caught in a taxation mess. Read on

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