Ricardo Davidovich in Hedge Fund LCD: Key Considerations for Hedge Fund Managers Working with Outside Sales Consultants (Part One)

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Hedge funds increasingly face headwinds in nearly all aspects of their operations—regulatory scrutiny, investment returns, shrinking profit margins, evolving business practices—but fundraising is perhaps the most challenging. With a growing chorus of institutional investors questioning the benefit of their existing hedge fund allocations, new investors, and the fresh capital they bring, are increasingly harder to come by. The difficult environment has also forced many hedge funds to evaluate fixed expenses and, where possible, employ a more flexible cost structure that bends more readily to changes in revenues.

One of the ways managers are adjusting to these challenges is by hiring outside sales consultants—oftentimes referred to as third party marketers, placement agents or finders—to help them raise assets. Whether targeting a specific market in which an in-house sales team has no experience or faces resource constraints, a start-up fund looking to focus on managing assets and outsourcing the sales function to established experts, or an effort to align costs more directly with fundraising, outside sales consultants can present hedge fund managers with more options to access capital than they would otherwise have.

But utilizing outside consultants is not without risks, in part because there exists a sometimes perplexing bevy of rules and regulations to navigate surrounding the use of outside sales consultants at the federal, state and even local levels when soliciting investment dollars. This article, the first in a two-part series, explores why managers hire third party marketers and outlines the regulatory requirements and prohibitions these firms are subject to and that fund managers must also comply with. The second article will discuss how hedge fund managers select the right third party marketer for their needs and the current market for key terms in engagement contracts ...

Ricardo Davidovich, a partner at Haynes Boone, noted that, “There is probably renewed interest in the use of third party marketers now as assets are harder to raise. On the flip side, when assets are hard to raise, they’re hard to raise for everyone, including third party marketers” ...

As Davidovich explained, “The law hasn’t changed, but the focus of the regulators has become more significant. If you hire someone to raise money for your fund, that party must be a registered broker-dealer. While many people refer to a ‘finder’s exemption,’ there are limited situations in which the exemption is applicable. There is a tremendous misunderstanding about how the exemption works.”

Excerpted from the* Hedge Fund Legal & Compliance Digest. *To read the full article, please click here (subscription required).