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Fundraising in the wake of Covid-19

Peter Naismith and Andrew Mazzarella of Schulte Roth & Zabel outline the ways in whichCovid-19 has altered how funds are raised

Since Covid-19 first began to disrupt the financial markets in February, private fund managers of all stripes, including private equity, hedge, direct lending and credit, have been pursuing opportunities to invest at markdown prices. Many private fund managers have sought or are seeking to raise new capital so as to not miss these opportunities. A wide range of fundraising alternatives are available and certain market trends have developed amid the Covid-19 dislocation.

Of course, Covid-19 has impacted fundraising timelines, as the lack of in-person meetings has slowed inbound activity. However, some larger fundraisings have proceeded in a timely manner and without unusual manager concessions. In particular, managers with large investor relations teams have moved seamlessly to conduct meetings using Zoom and similar platforms, and are still holding closings on schedules set in 2019. Some managers have even accelerated fundraising schedules. Moreover, hedge funds that were previously closed to new investors have reopened and several credit managers have launched or activated dislocation vehicles[1]. Activist, opportunistic, credit, distressed and litigation finance products all remain in demand. Therefore, considering the extent of the market disruption caused by Covid-19 and the tragic human costs of the pandemic, the fundraising environment appears to have held up well and remains promising for many managers.

With respect to new fundraising initiatives, a number of managers are pursuing the 'variation on a flagship fund' model. For example, managers are exploring, marketing and successfully raising capital for more concentrated, 'best ideas' versions of flagship funds pursuing liquid strategies[2], commitment-based sleeves to provide additional capacity for funds that are typically subscription-based and sleeves that have a more limited mandate than the flagship fund, with shorter windows for calling capital for investment and harvesting. Some managers have also successfully closed on co-investment products, including new feeders or classes in existing fund structures, while other managers have offered funds-of-one to anchor investors.

There has also been interest in US-regulated funds, including business development companies and 'interval funds'. Some direct origination platforms are exploring the idea of using private business development companies to target 'retail accredited' investors. Moreover, registered investment adviser channels (for instance, private wealth managers) continue to appear interested in these types of higher-yielding alternative products. Alternative asset managers have also considered 'private' 1940 Act-regulated funds. This type of regulated fund is a means of targeting a broader investment base (for instance, beyond qualified purchasers) and appeals particularly to managers that wish to target less-liquid investment strategies. However, most of those discussions are post-Covid-19 planning at this point (albeit active planning). For managers embarking on new 'private regulated' fund launches, finding creative solutions to manage liquidity mismatches between illiquid investments and quarterly investor redemptions remains a primary focus. In recent years, managers with illiquid investment strategies, particularly on the credit side, have increasingly considered launching registered closed-end investment companies known as 'interval funds' and 'tender offer funds'.

Many GP-led secondary transactions, which had become prevalent in the private equity fund space over the past few years, were placed on hold after the Covid-19 outbreak. However, as industry players predicted, activity in this space has rebounded as markets have stabilised and investors facing

liquidity issues have sought to sell portfolio fund positions in secondary transactions, creating a need for general partner consents.

The private equity fund managers that appear to have been most adversely impacted by the crisis are those that either are at the smaller end of the spectrum or held closings and acquired assets during the marketing period but prior to the outbreak of Covid-19. Smaller private equity managers offering traditional terms may continue to find fundraising to be difficult for some time, as cementing a new investor relationship for a long-term, closed-end product often requires an opportunity for in-person diligence. This is not such an issue for larger, established managers who can rely to a larger degree on repeat business. As a result, some private equity managers have moved to offer 'club' or 'pledge' fund terms to investors. For the latter category (managers that held closings and acquired assets during the marketing period but prior to the outbreak), a potential challenge is that subsequent closing investors may be unwilling to accept the typical trade-off that is the payment of interest equivalent amounts to earlier investors and the manager in return for participation in the existing portfolio as if the investor had invested on day one.

While new fundraising initiatives are a significant priority for many private fund managers, in certain cases the focus has been on re-positioning existing products to weather or profit from the pandemic. For example, for private equity, credit, distressed and other closed-end products, managers have sought investor consents to extend admission periods, extend investment periods or otherwise relax recycling and/or investment limits.

While Covid-19 will continue to provide challenges for private fund managers for some time, we have seen that adversity breeds creativity. The options available to private fund managers seeking to raise capital continue to expand and many managers will continue to do well as the economy slowly reopens and we emerge into a post-Covid-19 fundraising environment.

This publication was authored by Peter Naismith and Andrew Mazzarella and summarises commentary offered in the May 2020 Market Trends Report published by Schulte Roth & Zabel and made available to its clients. The next issue of the Schulte Roth & Zabel Market Trends Report is scheduled for publication in October 2020.

If you have any questions, please contact one of the authors. Please see our other Schulte Roth & Zabel Alerts relevant to investment managers, posted on our Covid-19 Resource Center, available at www.srz.com/resources/emerging-issues/covid-19-resource-center-1.html

[1] See, for example, "Prices Gone Haywire Attract Billions to Dislocated-Debt Funds," April 8, 2020,, and "Investment Funds Bulk Up in Preparation for Crisis Opportunities," April 2, 2020.

[2] Soon after the COVID-19 outbreak, various press outlets reported efforts by managers to pursue this model or otherwise raise new capital. See, for example, "Big hedge funds raise money to capitalize on market turmoil," March 29, 2020, citing plans by several hedge fund managers to selectively reopen or launch new products.