

THE
LONG
VIEW

MARC E. ELOVITZ (PICTURED) AND BRAD L. CASWELL describe how hedge fund advertising has been impacted by the JOBS Act



“NEWS MEDIA OUTREACH AND PR CAMPAIGNS ARE STAPLES OF CORPORATE MARKETING. WILL THE JOBS ACT OPEN THE DOOR FOR HEDGE FUNDS IN THESE AREAS?”

Marketing hedge funds to US investors has long been shaped by the ban on “general solicitation” and “general advertising” contained in the private placement regulation commonly relied on by private funds. The Jumpstart Our Business Startups Act, or JOBS Act, enacted 5 April 2012, requires the SEC to modify its regulations to lift the ban.

As the SEC goes ahead with its new regulations, the focus is on the “reasonable steps” hedge fund managers must take to ensure only accredited investors come into their funds. But once these mechanics are worked out, what will the impact be?

One change is that private fund managers will now be able to correct misinformation. The ban on general solicitation has never been clearly defined, so many fund managers have been hesitant to correct inaccurate news stories about their funds.

Another impact will be on industry meetings and conferences. The current ban makes it difficult for managers to speak freely and answer questions even in private settings. The opportunity for a more open dialogue will be welcomed by many.

The bigger question is what will the impact be on hedge funds’ affirmative marketing efforts? Publicly available websites and social media are primary means by which businesses brand themselves. News media outreach and PR campaigns are staples of corporate marketing. Will the JOBS Act open the door for hedge funds in these areas? The answer will be dictated in part by the market, in particular how institutional investors will view hedge fund marketing. But there is a regulatory component as well. Despite all the attention being paid to private placement regulation, there is a whole other set of rules governing hedge fund marketing.

The SEC imposes restrictions on the content and format of marketing materials used by investment advisers. All hedge fund managers – whether registered with the SEC, filing as an “exempt reporting adviser” with the SEC or just marketing to US investors – are subject to a hedge fund anti-fraud rule. Under this rule, a manager may be liable for any misleading statements to prospective investors, even where the manager was simply negligent.

SEC registered hedge fund managers are subject to additional layers of scrutiny with their marketing materials. Under the SEC’s “Advertising Rule”, manag-

ers are prohibited from “cherry picking” profitable investments for inclusion in their pitchbooks, websites and other marketing materials.

Track record is a key component of hedge fund marketing. Both the Advertising Rule and SEC guidance impose stringent requirements on any performance reporting. A portfolio manager who moves from one firm to another may only use his or her track record if the portfolio manager had “primary responsibility” for the investments at issue, the prior firm’s strategy was similar to the new firm and if the new firm has the underlying data to support the performance being presented.

Marketing materials distributed by US registered broker dealers are subject to substantive advertising rules imposed by FINRA, which are, in many respects, more restrictive than those imposed by the SEC. The US Commodity Futures Trading Commission (CFTC) also has rules governing marketing materials.

Broader use of performance reporting may focus attention on various standards, such as the Global Investment Performance Standards (GIPS) promulgated by the CFA Institute, which have not yet been adopted by a majority of the industry. Increased standardisation of hedge fund reporting could also impact more reporting initiatives such as the OPERA (Open Protocol Enabling Risk Aggregation) standard launched last year.

Lifting the ban on general solicitation will create marketing opportunities for hedge fund managers. It will also focus attention on the SEC’s Advertising Rule and other restrictions on the content of marketing materials. ■

MARC E. ELOVITZ is a partner at Schulte Roth & Zabel. BRAD L. CASWELL, special counsel at Schulte Roth & Zabel, co-authored the article.

Schulte Roth & Zabel

Schulte Roth & Zabel LLP
919 Third Avenue, New York, NY 10022
212.756.2000 tel | 212.593.5955 fax | www.srz.com
New York | Washington DC | London