

THE  
LONG  
VIEWMARC E. ELOVITZ  
on hedge fund marketing

“THE CHALLENGE FOR MANAGERS IS TO UNDERSTAND NEW REGULATORY REQUIREMENTS AND PREPARE FOR WHAT IS COMING NEXT”

Asset gathering has become more competitive and challenging for hedge fund managers. It has also become more interesting to regulators. The challenge for managers is to understand the new regulatory requirements and prepare for what is coming next.

Hedge fund marketing is one of the focus areas of the SEC's new examination programme. To handle the vast increase in registrants post-Dodd-Frank, the SEC is conducting shorter exams reviewing higher risk areas. So examiners are poring over pitch books, tear-sheets and DDQ responses, looking at the accuracy of disclosures and also for compliance with the specific requirements of the SEC's Advertising Rule.

The director of the SEC's Division of Investment Management also recently announced a formal review of the Advisers Act rules as they apply to private fund managers. We can expect the Advertising Rule to be an area of focus here as well, particularly in light of the increased advertising opportunities created by the JOBS Act.

Incredibly, the SEC's rulemaking to implement the JOBS Act is still unfinished. The deadline for the SEC to lift the ban on general solicitation in private placements is more than nine months passed. Where does that leave us? Some have suggested the ban is now unenforceable but we have not

seen anyone looking to test this proposition. Others have suggested that if trepidation about hedge fund advertising is what's holding up the rulemaking, the SEC should lift the ban to allow small businesses to raise capital while leaving the question of hedge fund marketing for another day. But the JOBS Act itself doesn't provide for treating hedge funds differently. And with a new chairman now installed at the SEC this log-jam may finally break.

US retirement funds are a major focus of marketing efforts by many managers. For these marketing efforts, managers need to take into account all of the regulatory requirements that followed from the 'pay-to-play' scandals. Investigations into pay-to-play payments by consultants to obtain allocations from government pensions culminated in criminal and civil prosecutions. They also led to the adoption of a stringent SEC rule on political contributions by fund managers, and similar rules on the state and local level. Lobbyist registration requirements also apply to many of these situations, such as with California and New York City pensions.

Just last month the SEC pushed another hedge fund marketing issue into the forefront: broker-dealer registration requirements. When managers solicit investors to buy interests in their funds, are the manag-

ers engaged in securities 'brokerage' which would require registration as a broker-dealer? In the past, the SEC brought charges for failure to register as a broker-dealer in Ponzi scheme cases or other scams where investors lost money. But the SEC in March 2013 charged a well-known hedge fund manager in a case where there is no allegation of fraud or investor losses, alleging that the manager used an external marketing consultant that should have been, but was not, registered as a broker-dealer. Obviously, fund managers should review all of their arrangements with external marketing consultants.

Taking this a step further, a senior SEC attorney recently opined that hedge fund managers may not be appropriately evaluating whether their employees who solicit fund investors are engaged in brokerage activity requiring registration. The receipt of 'transaction-based compensation' for marketing securities is the hallmark of brokerage. Managers should review their compensation arrangements to make sure they are not making such payments. They also should consider the full spectrum of responsibilities of each of the employees engaged in soliciting investors.

Marketing hedge funds to investors in the EU is another area in flux. The AIFMD Level 2 implementing measures provided some welcome clarity, and consultation papers by the European Securities and Markets Authority and the regulators in the EU member states may provide additional guidance. It is striking though how much remains unclear under the AIFMD with so little time before 23 July. US managers of non-EU funds do not get the benefit of the one-year transition period available for many EU managers. The scope of 'marketing' under the Directive is not yet specified and the 'pre-investment disclosures' required to continue marketing after 22 July are far from boilerplate. ■

MARC E. ELOVITZ is a partner at Schulte Roth & Zabel.