

Key Insights for Fund Managers on Raising Capital in the Current Climate

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While raising capital for hedge funds has always been a challenge, the COVID-19 pandemic has made doing so even more difficult. New limits on travel and face-to-face contact are making it difficult to reach investors and complete the required due diligence for fundraising. In this article, we look at how investor expectations have changed in this new environment, and what managers can do to meet these challenges.

Due Diligence

Before institutional investors can sign on with new fund managers, they typically require face-to-face meetings and visits as part of their operational due diligence (ODD) guidelines. The COVID-19 travel restrictions have made this nearly impossible and slowed down fundraising.

Given that the COVID-19 crisis has been going on for months, investors are starting to show some flexibility. Some domestic investors are now completing this due diligence requirement through video conference, though international investors are still reluctant to do so.

Without being able to conduct in-person meetings, investors are paying more attention to other parts of due diligence before deciding. On the operations side, they are looking at business continuity plan effectiveness, cybersecurity protections, key person planning and strong references. On the portfolio side, they are concentrating more on cash reserves, use of leverage, volatility positioning and risk of default.

Investor Interest

The COVID-19 outbreak has also impacted the types of funds investors are seeking.

Investors have been prioritizing funds with which they already have a relationship. That way, the lack of face-to-face due diligence is not an issue as they have previously completed this step.

Investors are also showing more interest in top-tier managers with well-tested infrastructure and operations, especially those who have a proven track record with institutional investors. That said, investors are still communicating with each other and making recommendations based on returns, so well-performing emerging fund managers can get attention that way.

Investors are also showing more interest in certain sectors, including: credit/distressed/dislocated, low-net, market-neutral, municipal bonds, CLOs, healthcare/biotechnology, technology and consumer. Both established and emerging managers in these areas have had an easier time raising capital during the COVID-19 era.

Fees and Investor Terms

Established hedge fund managers have not made significant changes to their fee structures or investment terms during the COVID-19 crisis. The only noticeable difference is that some have put additional restrictions on liquidity.

Emerging fund managers and those who have had drawdowns are experimenting with reducing fees on existing contributions and offering discounts for new investors to help them raise capital. There has also been an increase in the use of side letters, especially for larger contributions.

Communication

During these unusual times, managers can help their chances of raising capital by regularly communicating with investors. Even though face-to-face visits might not be an option, calls, webinars and video conferencing are other ways to stay in-touch. Managers can also host virtual tours or even remote roadshows.

If managers need to submit any on-site only documents, presenting the document digitally through shared screen or by uploading the materials, with a watermark, to a document sharing platform then deleting within 24 hours should suffice. Before

using these new approaches, managers should make sure they keep up with cyber- and information-security compliance first.

Raising capital in the current environment is not easy, but by following these tips, fund managers will put themselves in a better position to do so.

As always, please contact your Anchin Relationship Partner or Jeffrey Rosenthal at 212-840-3456 with any questions that you may have.