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US Hedge Fund Startup Guide

SPECIAL REPORT 2020

FUND ADMINISTRATION
Automation key to high quality service

TECH INFRASTRUCTURE
Vision and technology work hand in hand

SOFTWARE SOLUTIONS
Robust systems needed to bolster security

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Don’t underestimate costs and need for planning

Interview with Jeffrey Rosenthal

Despite hedge funds having a good year in 2019, returning over 9 per cent on average, the task of launching a hedge fund remains a challenge.

“Until we have a major correction, it will continue to be difficult for emerging managers to raise capital,” says Jeffrey Rosenthal, Partner-in-Charge of Anchin’s Financial Services Practice at Anchin Block & Anchin LLP, a full-service accounting, tax and advisory firm.

“Some managers lose conviction and may second-guess themselves if the fund starts losing money early on. They worry about retaining capital if they have one or two down months. My advice to startups is ‘Stick with what you know (and what your documents permit). Keep your investors updated and be true to your investment convictions’.”

Launching a hedge fund can be daunting, but not if managers do the necessary preparation and planning, and ask the right questions.

“When I first meet with a startup manager,” says Rosenthal, “I want to understand their business plan, their vision, what their investment objectives are and how much they know about running a fund.

“We seek to guide and educate them on topics such as fund structure, regulatory matters and making sure they understand the tax ramifications; the aim is to make them aware of issues they will encounter and questions their potential investors will likely be asking.”

One important aspect of these early discussions centres on budgeting. Has the individual planned the budget not only for the fund itself but for the cost of running the management company, as well as their personal living expenses as the initial management fee may not cover all of the expenses? Ultimately, can they afford to launch a hedge fund?

Another matter that needs to be addressed early on, says Rosenthal is the manager’s capital raising capabilities. Do they have potential investors lined up? How much do they think they will raise? What are their methods for raising capital? What are their plans if they don’t reach their targeted raise? This is probably the most challenging task for new managers.

“I also ask them to run their pitch presentation by me – tell me your story, what makes you different to other fund managers?” adds Rosenthal.

Failing to budget properly can easily trip up a manager, regardless of how well their investment strategy might be performing. It is expensive to run a hedge fund; not just to cover office rent and payroll but all other ancillary services needed to operate the fund.

“You can’t rely on generating a performance fee,” stresses Rosenthal. “I would advise that any new manager budget for at least two years’ worth of expenses.”

He agrees that outsourcing non-investment functions is worthwhile considering to keep costs down. “Utilising an outsourced CCO, CFO, etc, costs less than hiring your own employees but be cognisant that they aren’t there full time and are not going to be focused on your business 100 per cent of the time.

“That said, investors like seeing it, in fact prefer it. They feel there is an additional safeguard in place to help avoid things potentially going awry.”

Even if the fund is below the SEC registration threshold of USD150 million, it is worth adopting best practices from the start, such as a code of compliance, so that the manager can acclimate themselves to operating under the regulator and appeal to investors.

Additionally a manager should be cognisant of proper tax planning. During the formation stage and before each year end, Rosenthal and his team meet with their clients to discuss what tax strategies may be most beneficial to the fund and its investors.

“At Anchin, we get close to our clients. We are very hands-on and we’ve worked with a significant number of US startups over the last 40 years. We help clients to focus on what is needed to successfully launch a fund,” concludes Rosenthal. ■

Jeffrey Rosenthal
Partner-in-Charge, Financial Services, Anchin Block & Anchin LLP

Jeffrey I. Rosenthal, CPA, CGMA is the Leader of Anchin’s Financial Services Practice. Jeffrey specialises in providing accounting, tax, and business advice to a wide array of financial services entities including broker/dealers, investment partnerships (domestic and offshore), funds-of-funds, mutual funds, private equity funds, and investment advisers. He has extensive experience advising newly formed entities and assisting with startup considerations such as form of practice, structure of agreements, compensation arrangements, compliance, and regulatory matters.