BUSINESS

Building a Scalable Closed-End Fund Business

Posted By Jessica Weisman-Pitts

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By Joseph Morrissey and Theo Kaminski, Seward & Kissel LLP

New portfolio managers that enter the closed end private fund space encounter various headwinds that have recently permeated the industry. Accordingly, rather than chasing long-term ambitions, many new portfolio managers choose to pursue short-term strategies that allow them to: (1) build a track record, (2) keep costs down and (3) scale their business when their access to fundraising opportunities improves.

Track Record Considerations

New portfolio managers often seek to enter the closed end private fund space on their own after starting out with another established portfolio manager. Ideally, a new portfolio manager could market to prospective investors, including highly sought-after sources of seed capital, the investment track record that the new portfolio manager developed during time spent working with another portfolio manager. New portfolio managers should, however, be wary of potential regulatory, contractual and intellectual property issues that come with marketing an investment track record. Considerations include:

- If a new portfolio manager intends to register as an investment adviser with the Securities and Exchange Commission (the "SEC") , then under the SEC's new marketing rule, the portfolio manager must, among other things, have been the person primarily responsible for making the investments comprising the track record.
- The new portfolio manager must also maintain original books and records supporting those investments. New portfolio managers are often required to negotiate with their prior firm to obtain original books and records.
- An employment, partnership, separation or other agreement between a new portfolio manager and their prior firm may include restrictions on the use of and/or claim intellectual property rights over performance achieved during the new portfolio manager's time spent at the prior firm. Some contracts preclude such usage entirely; others may have the effect of restricting usage for a period of time or based on the manner in which the portfolio manager left their prior firm.

Structuring Considerations

Given the obstacles to porting a prior investment track record developed at a prior firm, new portfolio managers may wish to develop a new investment track record to kickstart their business. As with any startup business, cost effectiveness in building the infrastructure to pursue investment opportunities is a key consideration. Two attractive options, described below, allow new portfolio managers to offer investment products to investors in a manner that, over time, is increasingly cost effective and cost efficient and reduces lead time to launch, particularly if investors may participate in investment opportunities on the same or substantially similar terms. In addition, rather than soliciting investors for participation in a blind pool, both options offer investors transparency regarding the portfolio investments. To establish a track record, new portfolio managers may create:

- Multiple pooled investment vehicles that are separate legal entities.
  - Investors are required to make separate funding commitments to each entity.
  - For purposes of calculating a portfolio manager's carried interest, performance across investments in which investors participate is typically not netted.
  - Assets and liabilities are segregated between the various entities and are not subject to cross-series liability.
- A single "pledge" or "opt-in" pooled investment vehicle.
  - Investors may make a single funding commitment that is drawn down in respect of investment opportunities in which investors elect to participate. This feature allows the portfolio manager to act quickly because funding commitments are made and subscription documents are submitted at one time.
  - For purposes of calculating a portfolio manager's carried interest, performance across investments in which investors participate is typically netted.
  - Subject to cross-series liability considerations, the portfolio manager may offer multiple series corresponding to various portfolio investments.
  - Subject to statutory requirements to maintain separate books and records, portfolio managers that wish to mitigate cross-series liability risk may form a series entity that segregates the assets and liabilities of each series under state law.

Conclusion

It is important to be strategic and diligent in building and marketing a track record. A lack of careful attention to the various considerations may result in severe consequences and delays in scaling a business. With the right strategy and tools, new portfolio managers can mitigate significant risks in launching an investment advisory business.

Joseph Morrissey is a partner in the Investment Management Group at Seward & Kissel LLP. He works with sponsors and managers of various private investment funds and other pooled investment vehicles, including private equity funds, hedge funds, funds of funds, commodity pools, and various "hybrid" funds. In particular, he focuses on fund formation and structuring, the offering of interests by private investment funds, and the negotiation and documentation of such investments.

Theo Kaminski is an associate in the Investment Management Group at Seward & Kissel LLP. He advises investment managers of hedge funds, private equity funds and commodity pools, and regularly advises clients on private fund formation, structuring and regulatory and compliance matters.

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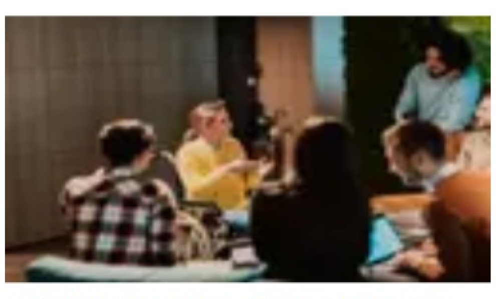

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