Seward & Kissel llp

The Seward & Kissel New Hedge Fund Study

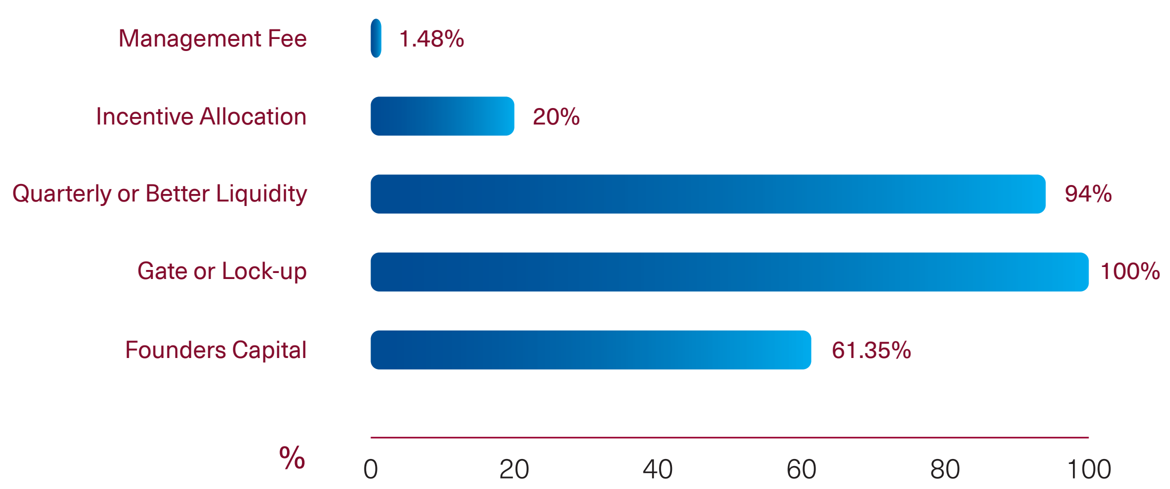
Introduction and Key Findings

Driven by our ongoing commitment to understanding the dynamics of the hedge fund marketplace and bringing the latest industry color to our clients and friends, each year Seward & Kissel conducts The Seward & Kissel New Hedge Fund Study of newly-formed hedge funds sponsored by new U.S.-based managers entering the market. This Study covers the 2016 hedge fund launches of relevant Seward & Kissel clients meeting the above criteria. We believe that the number of funds within the Study is large enough to extract a representative sample of important data points that are relevant to the hedge fund industry. The Study analyzes investment strategies, incentive allocations/management fees, liquidity and structures, as well as whether any form of founders or seed capital was raised. The Study does not cover managed account structures or "funds of one" that may have a wider variation in their fee arrangements and/or other terms.

The Study's key findings, set forth in greater detail below, include the following:

- 65% of the funds had equity or equity-related strategies (down from 80% in the 2015 Study).
- With respect to management fees charged in the standard (i.e., non-founders) classes, there was a relative similarity between equity and non-equity strategies, as the average rate was 1.5125% for equity strategies and 1.43% for non-equity strategies.
- Incentive allocation rates in standard classes generally continued to be set at 20% of net profits across all strategies and no funds had a modified high water mark.
- 75% of the equity funds and just 36% of the non-equity funds offered founders classes.

Key Findings for Average 2016 New Hedge Fund (Standard Class, All Strategies)



- 94% of the funds permitted quarterly or more frequent redemptions, while just 6% of the funds allowed only annual redemptions in 2016. Moreover, all of the funds had lock-ups or investor level gates, and about 5% had both.

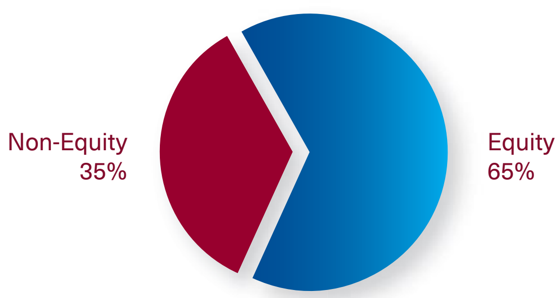
- Sponsors of both U.S. and offshore funds set up master-feeder structures (as opposed to side-by-side structures) over 95% of the time, and utilized the Section 3(c)(7) exemption 75% of the time.

- We estimate, that for calendar year 2016, there were approximately 25-30 seed deals consummated within the industry, which represents about a 25% decline over 2015 deal levels.

Investment Strategies

Demonstrating a shift from recent historical trends, only about 65% of the funds included in the Study utilized an equity or equity-related strategy (not including multi-strategy offerings that generally involved both equity-related as well as other strategies). This represents about 15% less than the 2015 Study. Of the remaining 35% of funds in the Study (i.e., the non-equity strategies), about half were multi-strategy, with the rest fairly equally split primarily among credit, quant and structured product strategies.

Investment Strategies

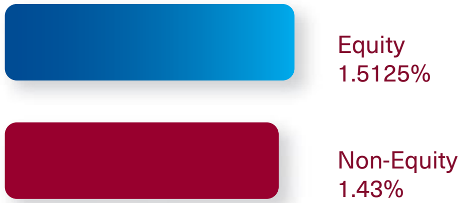


Management Fees / Incentive Allocations

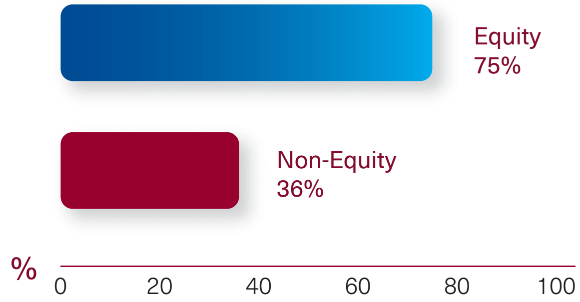
With respect to management fees charged in the standard (i.e., non-founders) classes, there was a relative similarity between equity and non-equity strategies, as the average rate was 1.5125% for equity strategies (down from 1.68% in 2015) and 1.43% for non-equity strategies (down from 1.56% in 2015).

Incentive allocation rates in standard classes continued to remain stable across all strategies at an average of around 20% of annual net profits. Moreover, virtually every fund in the Study had some type of incentive allocation high water mark provision. Lastly, while none of the funds in the Study had a modified high water mark, a small percentage had an incentive allocation measured over a rolling multi-year period and an equally small number had a hurdle rate.

Management Fees by Strategy



Founders Classes by Strategy



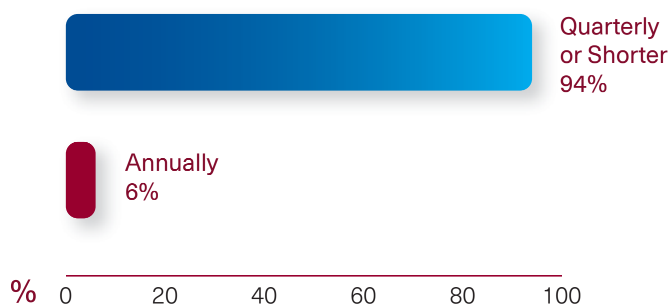
75% of the equity funds and just 36% of the non-equity funds offered founders classes. Somewhat surprisingly, less than 10% of the funds offered longer lock-up classes (as compared to 24% of the funds in the 2015 Study). Typically, the founders classes on average had a management fee rate that was about 50 basis points less than the management fee charged in the standard class for such funds (on average, 1.21% for equity funds and 1.1875% for non-equity funds), and they had an average incentive allocation of 14.5% for equity funds and 17% for non-equity funds. Moreover, the biggest trend that has continued to develop over the past few years is the tiering of fees (i.e., the rate goes down as asset levels increase) in founders classes where, in 2016, 40% of the equity funds issuing founders classes (up from 35% in 2015) and 25% of the non-equity funds issuing founders classes (up from none in 2015) had a tiered management fee in the founders class, and 20% of the equity funds issuing founders classes had a tiered incentive allocation.

Liquidity

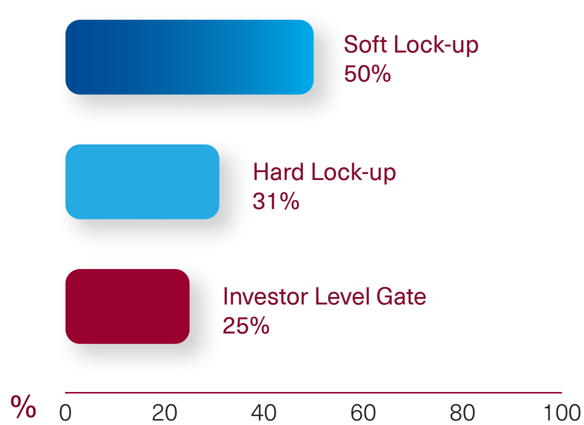
94% of the funds permitted quarterly or more frequent redemptions, while just 6% of the funds allowed only annual redemptions in 2016. Notice periods broke down across the funds as follows: 30 days – 24%, 45 days – 30%, 60 days – 30% and 90 days – 16%, with only 21% of the equity strategies having notice periods of 60 days or longer, but 69% of the non-equity strategies requiring at least 60 days' notice. The average notice period was 52.73 days (virtually the same as 2015's 52.2 days).

Moreover, all of the funds had lock-ups or investor level gates and about 5% had both. In the standard class of the funds, similar to the 48% in 2015, 50% of all funds had a soft lock-up (usually, one year with a 2% – 4% redemption fee payable to the fund), consisting of 58% of the equity funds and 38% of the non-equity funds; 31% had a hard lock-up (usually, one year and non-rolling) as compared to a much lower 16% in 2015, consisting of 26% of the equity funds and 38% of the non-equity funds; 25% had an investor level gate (about the same as 2015), consisting of 21% of the equity funds and 31% of the non-equity funds; and somewhat surprisingly none of the funds had no lock-up or gate of any sort (as compared to 12% in 2015). In addition, continuing an ongoing trend, none of the funds within the Study had a fund level gate.

Redemption Frequency (All Strategies)



Liquidity Terms (All Strategies)



Note: All of the funds had a lock-up and/or an investor level gate, but none had a fund level gate.

Structures

Sponsors who offered both U.S. and offshore funds set up master-feeder fund structures (as opposed to side-by-side structures) over 95% of the time, and such structures utilized the Section 3(c)(7) exemption about 75% of the time. Of the master-feeder fund structures, there was continued growth in the number of master funds established as partnerships, as opposed to corporations (primarily due to easier administrative and accounting capabilities available in partnerships). In addition, following the trend we first began to see in 2012, there was a significant increase in the number of managers who initially launched just a U.S. stand-alone fund (approximately 40%, up from 25% in 2015), many of whom were seeking to build a track record in order to attract offshore and U.S. tax-exempt investor interest down the road. About 50% of the stand-alone funds relied on the Section 3(c)(1) exemption. The average minimum initial investment was $2,300,000 for 3(c)(7) funds across all strategies (i.e., $2,600,000 for equity strategies and a lower $1,800,000 for non-equity strategies), while the average minimum initial investment was $974,000 for 3(c)(1) funds (with little difference between the equity and non-equity strategies). Typically, founders classes had a higher minimum investment than the standard classes. Lastly, no fund within the Study chose to go down the path of engaging in general solicitations and advertising as is now permitted under new Securities Act Rule 506(c) promulgated pursuant to the JOBS Act.

Seed Capital

Similar to the regular non-seed investor environment, attracting seed investors also became more challenging in 2016 and, we estimate, based on conversations with various select industry participants and our own internal data, that within the entire hedge fund industry, for calendar year 2016, there were approximately 25 – 30 seed deals consummated (representing about a 25% decline over 2015 figures).

With respect to seed deals, of the funds we studied, the 2016 environment continued a recent trend with an increasing number of opportunistic, one-off investors entering the space (such as certain high net worth individuals acting alone or collectively through club deals, as well as family offices). In addition, several new seed deal-focused private equity funds have been raised (or are in the process of being raised) by a number of well known seeders, and the trend of fund-of-funds businesses repositioning their offerings as seed investment platforms has persisted. The higher end of seed investment deals remained in the $75 million to $200 million range, typically including a two to three year lock-up. For the smaller deals, usually with less well-known managers, the seed amounts generally ranged from $10 million to $50 million, often with a two year lock-up. Our data further suggested that, despite the year over year decrease in seeding activity, roughly 20% of 2016 seed deals contained revenue share sunsets and/or terminations after a number of years (with 10–15 years as a common break-point in those deals), which is roughly in line with our data from 2015.

We hope that you find *The Seward & Kissel New Hedge Fund Study* helpful. If you have additional input that you would like to share with us, or have any questions, please contact your primary attorney in Seward & Kissel's Investment Management Group.

SEWARD & KISSEL LLP

One Battery Park Plaza
New York, NY 10004
212-574-1200
212-480-8421 (fax)

901 K Street, NW
Washington, DC 20001
202-737-8833
202-737-5184 (fax)

www.sewkis.com