SEWARD & KISSEL LLP 125 YEARS

THE SEWARD & KISSEL NEW HEDGE FUND STUDY

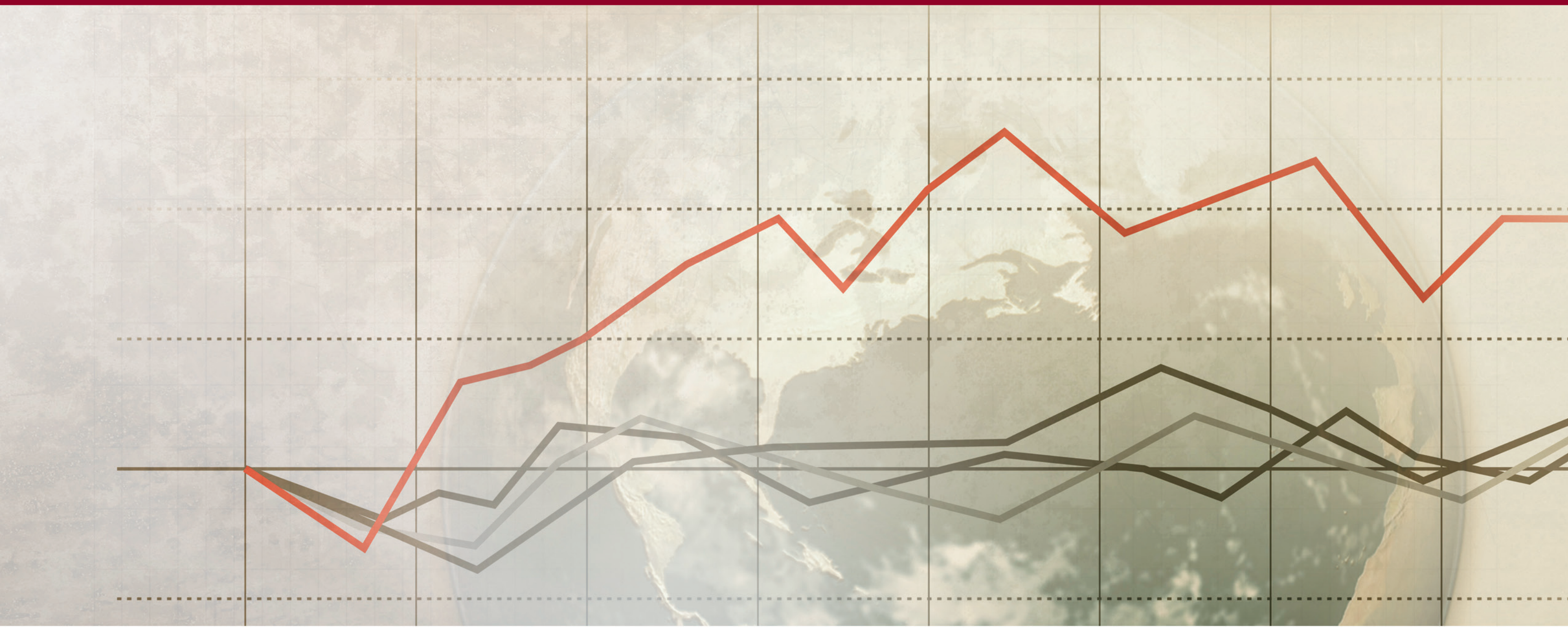
2014 Edition

Introduction & Key Findings

Driven by our ongoing commitment to understanding the dynamics of the hedge fund marketplace, 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 2014 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 analyzed investment strategies, incentive allocations/management fees, liquidity and structures, as well as whether any form of founders or seed capital was raised. The Study did 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:

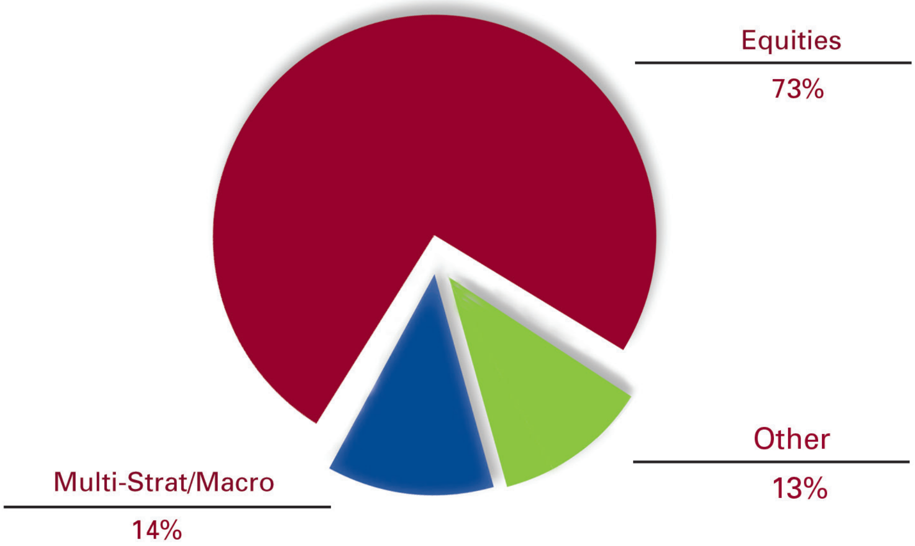
- 73% of the funds had equity or equity-related strategies (up from 65% in the 2013 Study).
- Incentive allocation rates continued to be set at 20% of net profits across all strategies.
- The past disparity in management fee rates between equity and non-equity strategies was essentially eliminated and averaged out at about 1.7%.
- 19% of funds implemented a management fee rate that tiered down to lower rates as assets surpassed certain benchmarks. Of this 19%, all were equity funds.
- 81% of funds permitted quarterly or even less frequent redemptions (as compared to 89% in 2013), while 19% of funds permitted monthly redemptions in 2014 (as compared to 11% in 2013). Moreover, as in 2013, 85% of all funds had some form of lock-up or gate.
- Sponsors of both U.S. and offshore funds set up master-feeder structures over 95% of the time, generally utilizing the Section 3(c)(7) exemption. Most offshore funds were established in the Cayman Islands, although other jurisdictions (e.g., Bermuda) began to reestablish their presences in the industry.
- No fund within the Study chose to go down the path of engaging in general solicitations and advertising as is now permitted under Securities Act Rule 506(c) promulgated pursuant to the JOBS Act.
- 65% of funds within the Study (as compared to 43% in 2013) obtained some form of founders capital and, we estimate, based on conversations with various industry participants, that within the entire hedge fund industry, for calendar year 2014, at least 40% of all launches greater than $75 million (and an estimated 15% of all fund launches) had some form of seed capital.



Investment Strategies

About 73% 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 8% more than the 2013 Study. Of the remaining 27% of funds in the Study (i.e., the non-equity strategies), about 14% of the funds included in the Study were multi-strategy/macro offerings, and the balance consisted of credit, CTA and various other strategies.

Investment Strategies

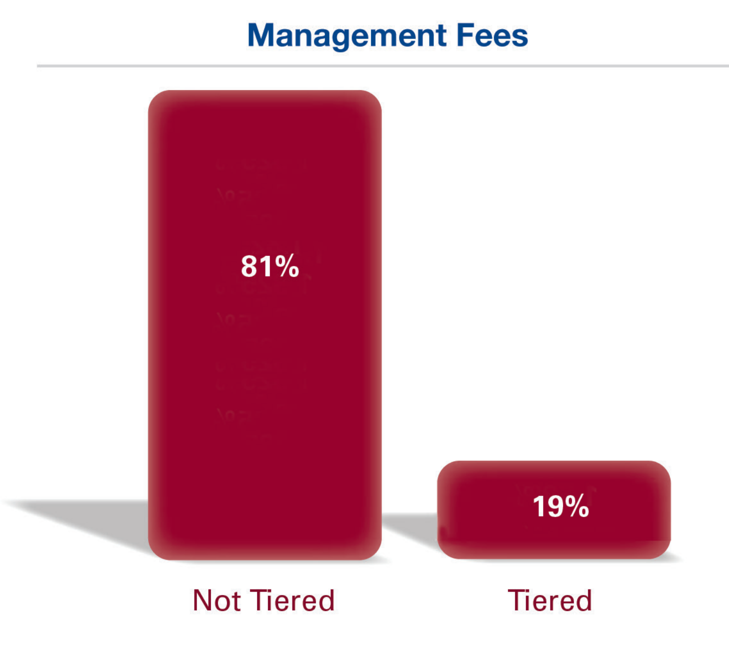


Incentive Allocations/Management Fees

Generally, for hedge fund flagship classes (i.e., the standard classes typically charging a 20% incentive allocation and a 1.5%-2% management fee), incentive allocation rates continued to be set at 20% of annual net profits. Moreover, every fund in the Study had some type of high water mark provision. In total, only 7.4% of the funds in the Study had a modified high water mark provision (with a 200% makeup provision that tiered up to 225-250%, if the loss was not recouped after year one), but none of the funds in the Study had a hurdle rate or an incentive allocation measured over a multi-year period.

With respect to management fees charged in flagship classes, there were a number of important takeaways. First, the past disparity between equity and non-equity strategies was essentially eliminated, as the average rate across all strategies converged at about 1.7% (up slightly from the 2013 average rate of 1.663%), with equity strategies moving up 12 basis points from 2013 and non-equity strategies moving down 12 basis points. We believe this may be due, in part, to operational efficiencies implemented by non-equity firms coupled with greater demand for equity strategies. Lastly, and probably the biggest development, was that 19% of all funds within the Study (consisting of 25% of all equity funds and none of the non-equity funds) implemented a management fee rate that tiered down to lower rates as assets surpassed certain benchmarks.

About 72% of the funds (as compared to 62% in 2013) offered lower incentive allocation and/or management fee rates either to investors who agreed to greater than one year lock-ups (typically represented in the offering documents by different fund series, classes or sub-classes, or sometimes evidenced in a side letter) or to "founding" type investors (that may not have necessarily been tied to longer liquidity). Longer lock-up classes were present in 23% of the funds (which was slightly higher than 19% in 2013). Founders classes (about 20% of which also had a longer lock-up provision for founders) were found in 65% of all funds (up significantly from 43% in 2013). As between equity and non-equity strategies, there was a switch in the data as compared to 2013, where 75% of the equity funds had founders classes (as compared to a much lower 35% in 2013), while only about 43% of the non-equity funds had founders classes (as compared to a much higher 65% in 2013). 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 flagship class (which represents 20 basis points more of a differential than in 2013), and they had an average incentive allocation of 15.51% (a slight dip from the 16.1% average in 2013).

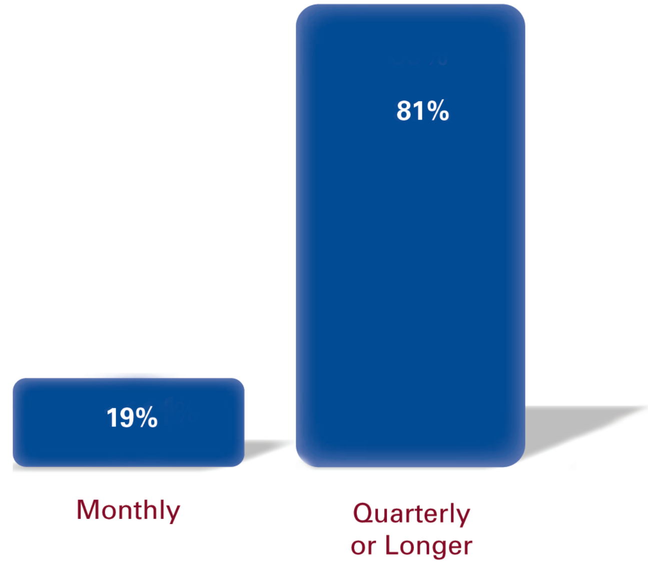


Liquidity

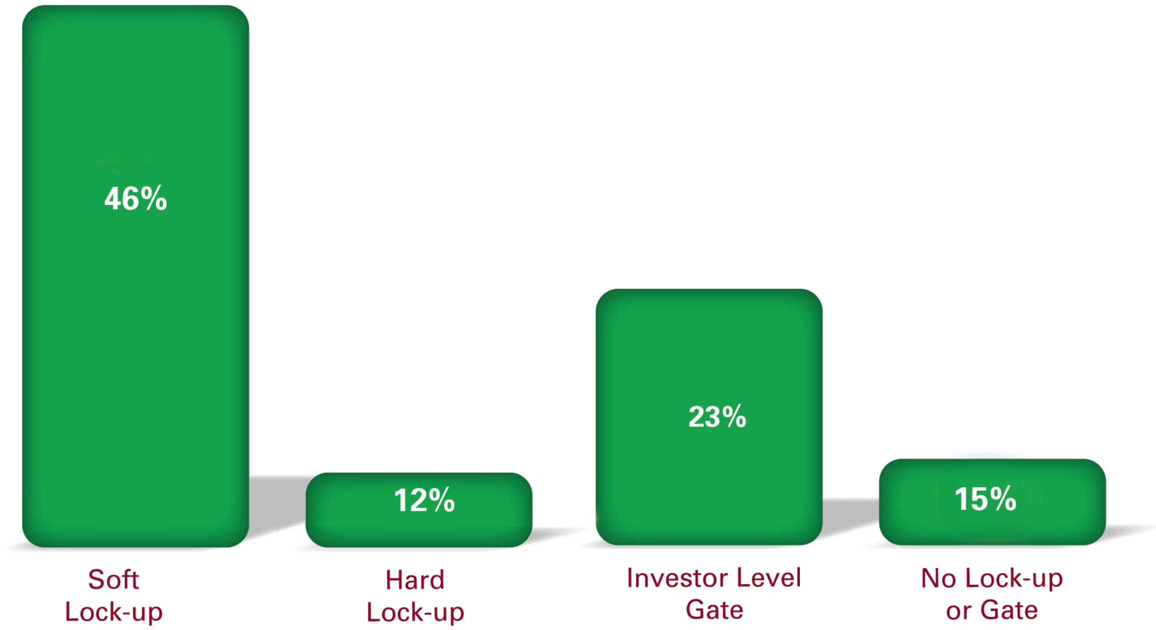
81% of funds permitted quarterly or even less frequent redemptions, while 19% of funds permitted monthly redemptions in 2014 (as compared to 11% of funds in 2013). Note further that some of these funds did have lock-ups or gates, as discussed in further detail below. Notice periods were usually 30, 45 or 60 days, however, about 15% of funds required 90 days' notice.

In the flagship class of the fund, approximately 46% of the funds had a soft lock-up (usually, one year with a 2%-4% redemption fee payable to the fund) as compared to 58% in 2013; 12% had a hard lock-up (usually, one year and non-rolling) as compared to a much higher 27% in 2013; 23% had an investor level gate (the same as 2013); and 15% had no lock-up or gate of any sort (up from 8% in 2013). In addition, continuing a recent trend, just one fund within the Study had a fund level gate.

Redemption Frequency



Liquidity Terms



Structures

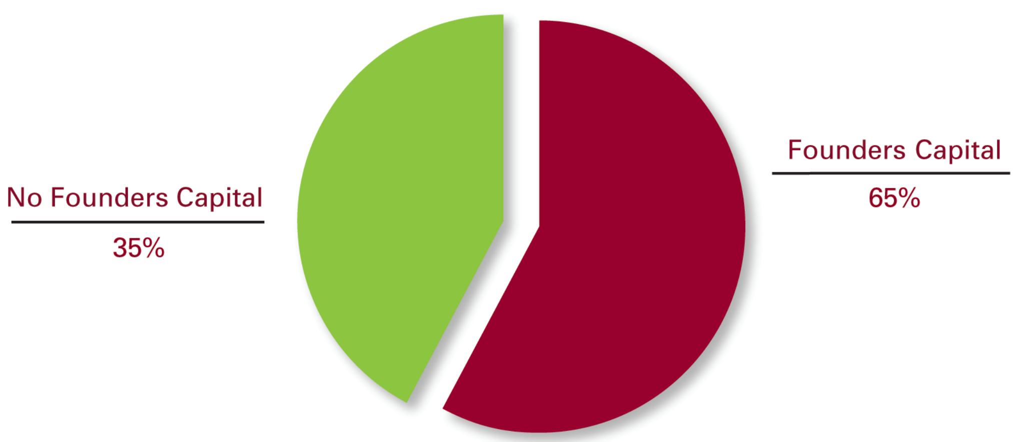
Sponsors who offered both U.S. and offshore funds set up master-feeder fund structures over 95% of the time. Most offshore funds were established in the Cayman Islands, although other jurisdictions (e.g., Bermuda) began to reestablish their presences in the industry. Following the trend we first began to see in 2012, there continued to be a fair number of managers who initially launched just a U.S. stand-alone fund (approximately 30%), 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. Most master-feeder funds continued to opt to rely on the Section 3(c)(7) exemption, however, about half of the stand-alone funds relied on the Section 3(c)(1) exemption. In addition, the stated minimum initial investment was set at $1,000,000 in approximately 70% of the funds, with about 10% of the funds having a minimum of $250,000 and 20% of the funds having a minimum of $5,000,000 or more. Moreover, founders classes often had a higher minimum than the flagship 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 Securities Act Rule 506(c) promulgated pursuant to the JOBS Act.

Founders or Seed Capital

Given the still rather challenging capital raising environment that existed in 2014, it is not surprising that 65% of funds within the Study (significantly higher than the 43% in the 2013 Study) obtained some form of founders capital and, we estimate, based on conversations with various industry participants, that within the entire hedge fund industry for calendar year 2014, at least 40% of all launches greater than $75 million (and an estimated 15% of all fund launches) had some form of seed capital.

With respect to seed deals, of the funds we studied, the 2014 environment saw a number of new prominent firms enter the seeding arena, as well as the emergence of some smaller opportunistic one-off investors such as certain high net worth individuals (acting alone or collectively through club deals) and family offices. For more prominent managers who were in high demand, the increase in the number of seeders sometimes translated into more favorable deal terms such as scaling down or reduced revenue shares, better buyout multiples, more attractive working capital arrangements and other beneficial provisions. Seed investments in many of the bigger 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.

Founders Capital



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.

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