Seward & Kissel LLP

# New Hedge Fund Study

2017 Edition



# Introduction

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 2017 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.

# Key Findings

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

- 56% of the funds had equity or equity-related strategies, down from 65% in 2016 (a 9% decline), and down from a peak of 80% as shown in our 2015 Study (a 24% decline). This is also the first time since the inception of our Study in 2011 that the percentage of funds having equity or equity-related strategies is in the 50th decile range.

- With respect to management fees charged in the standard (i.e., non-founders) classes, the average rate was 1.52% for equity strategies and 1.61% for non-equity strategies.

- Incentive allocation rates in standard classes decreased across all strategies by about 75 basis points to an average of around 19.25% of annual net profits in the non-founders classes.

- Approximately 66% of the equity funds (down from 75% in 2016) and 75% of the non-equity funds (up significantly from 36% in 2016) offered lower management fee and/or incentive allocation rates through their founders classes.

- 91% of the equity funds and 67% of the non-equity funds permitted quarterly withdrawals, with the balance allowing for monthly withdrawals.

- Lock-ups or investor level gates were used by 91% of the equity funds and only 66% of the non-equity funds, with 27% of the equity funds possessing 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.

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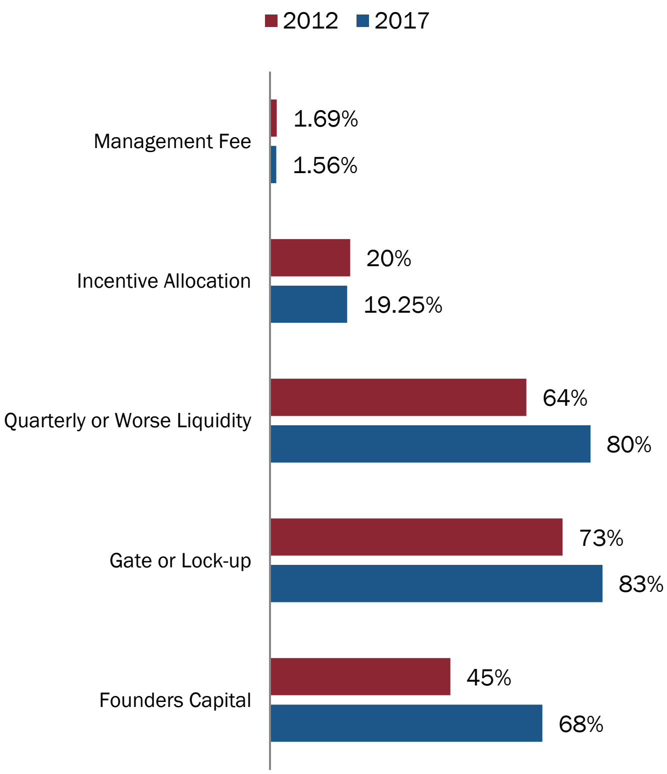
- We estimate that within the entire hedge fund industry, for calendar year 2017, there were approximately 35-40 seed deals consummated (which is roughly in line with our 2016 figures), with a significant percentage of the seeding activity occurring in Q4.
- Looking back to 2012, there have been noticeable changes in both the fee and liquidity terms of newly-formed funds. The table below outlines these findings.

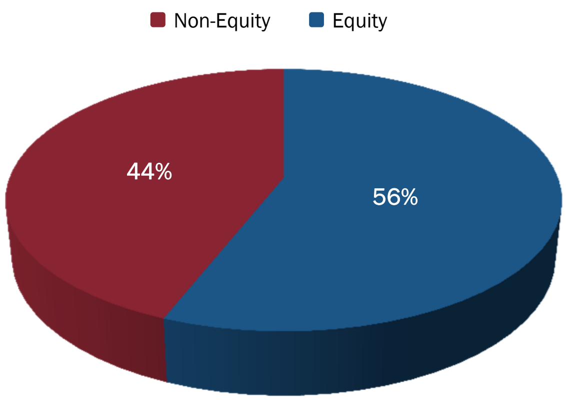
Key Terms for the Average Hedge Fund Standard Class Across All Strategies




# Investment Strategies

Demonstrating a shift we first began to notice last year, only about 56% 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 is down 9% from the 2016 Study's 65% and 24% from the 2015 Study's high water percentage of 80%. This is also the first time that the percentage is somewhere in the 50's range since the inaugural 2011 Study's 50%. Of the remaining 44% of funds in the Study (i.e., the non-equity strategies), about half were multi-strategy, with the rest split fairly equally primarily among credit, quant, commodity, crypto and structured product strategies.

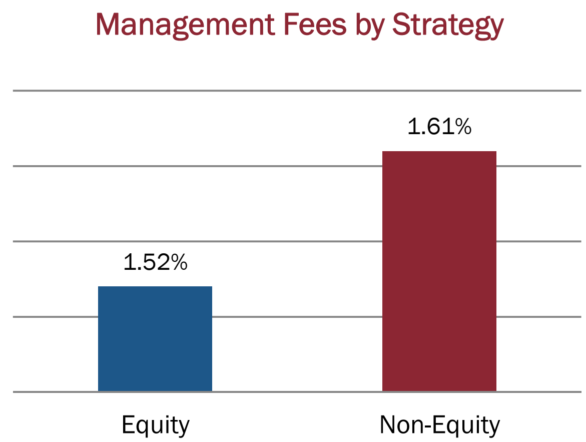
Investment Strategies



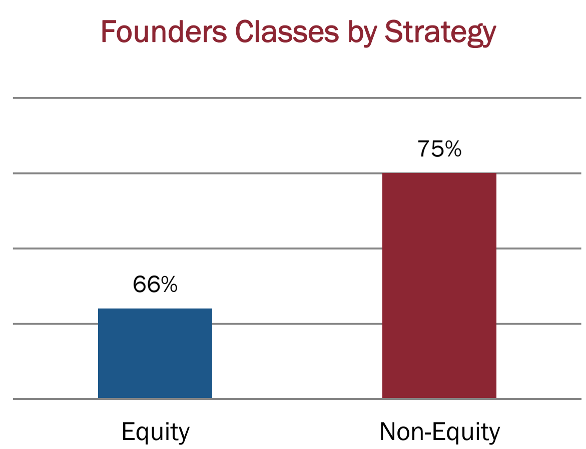


# Management Fees / Incentive Allocations

With respect to management fees charged in the standard (i.e., non-founders) classes, there continued to be a relative similarity between equity and non-equity strategies, as the average rate was 1.52% for equity strategies (virtually the same as in 2016) and 1.61% for non-equity strategies (up from 1.43% in 2016). Note, however, that these averages do not take into account the possible tiering down of management fee rates as assets increase, which was present in 29% (as compared to about 36% in 2016) of all funds (in 57% of those funds it was in both classes and in 43% it was just in the founders classes).




Incentive allocation rates in standard classes decreased across all strategies by about 75 basis points to an average of around 19.25% of annual net profits in the non-founders classes. Moreover, 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, 5% had an incentive allocation measured over a rolling multi-year period and 15% had a hurdle rate.




Approximately 66% of the equity funds (down from 75% in 2016) and 75% of the non-equity funds (up significantly from 36% in 2016) offered lower management fee and/or incentive allocation rates in their founders classes. About 10% of the funds (similar to 2016) offered longer lock-up classes. The average founders class management fee was 1.25% for equity funds (which is similar to the 1.21% average in 2016) and the average for non-equity funds was 1.15% (also similar to the 1.187% number in 2016). The average founders class incentive allocation was 15.5% for equity funds (up from 14.5% in 2016), while the average for non-equity funds was 14.50% (down significantly from 17% in 2016).

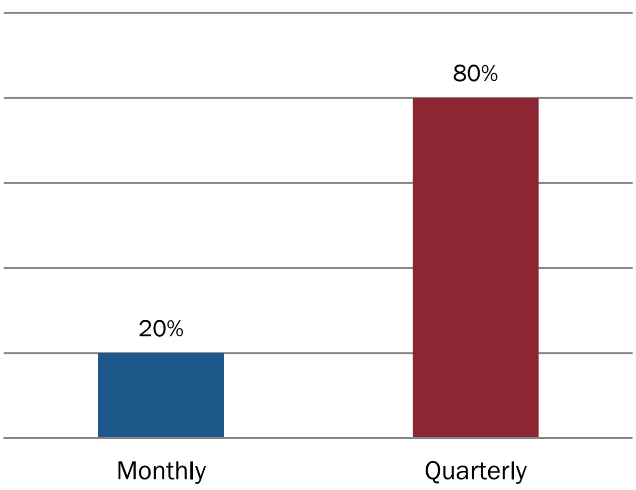


# Liquidity

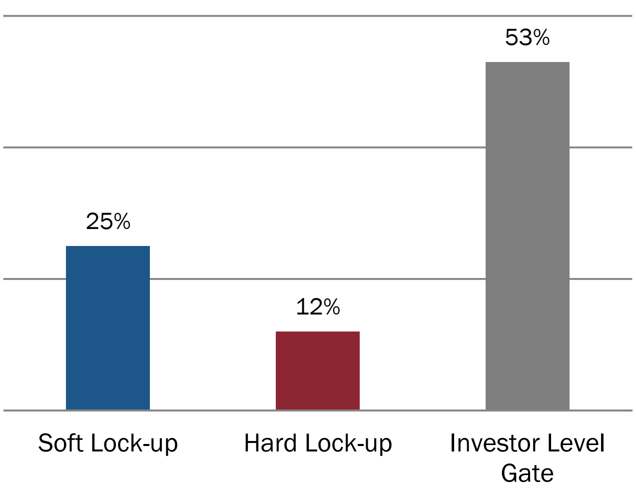
91% of the equity funds and 67% of the non-equity funds in the Study permitted quarterly withdrawals, with the balance allowing for monthly withdrawals.  The notice period for equity funds was 60 days 64% of the time and 45 days 36% of the time, while for non-equity funds it was 60 days 45% of the time, 90 days 33% of the time and 30 days 22% of the time. The average notice period was 58.5% days (up from 52.73 days in 2016) broken down as an average of 54.53 days for equity funds and 63.33 days for non-equity funds.

Moreover, across all classes, 91% of the equity funds, but only 66% of the non-equity funds had lock-ups or investor level gates (with 27% of the equity funds possessing both).  In the standard class of the funds, 73% of the equity funds and 18% of the non-equity funds had an investor level gate, 45% of the equity funds and only 11% of the non-equity funds had a soft lock-up (usually, one year with a 2% — 4% withdrawal fee payable to the fund), and 18% of the non-equity funds and none of the equity funds had a hard lock-up.  In addition, continuing an ongoing trend, none of the funds within the Study had a fund level gate.

Withdrawal Frequency
(All Strategies)




Liquidity Terms
(All Strategies)





# 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 compared to corporations (primarily due to easier administrative and accounting capabilities available in partnerships). In addition, following the recent trend, 33% of all managers initially launched just a U.S. stand-alone fund (down from 40% in 2016), primarily to build a track record in order to attract offshore and U.S. tax-exempt investor interest down the road. About 67% (up from 50% in 2016) of the stand-alone funds relied on the Section 3(c)(1) exemption. The average minimum initial investment for 3(c)(7) funds across all strategies was $1,600,000 (down from $2,300,000 in 2016). Breaking down the 3(c)(7) fund numbers, the average minimum initial investment for equity funds was $1,300,000 (half of 2016's $2,600,000 number) and $2,000,000 for non-equity strategies (almost the same as $1,800,000 in 2016). With respect to 3(c)(1) funds, the average minimum initial investment was $825,000 (with equity funds at $550,000 and non-equity funds at $1,100,000). 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.

# Seed Capital

Similar to the general environment for fund-raising, attracting seed investors remained somewhat challenging in 2017, particularly in the first three quarters. However, seeding activity picked up considerably in Q4 of 2017, both due to the re-emergence of existing seeders and a number of new institutional seeders launching pools of money focused on making seed investments. We estimate, based on conversations with various industry participants and our own internal data, that within the entire hedge fund industry, for calendar year 2017, there were approximately 35-40 seed deals consummated (which is roughly in line with our 2016 figures; however, on a Q4 run-rate basis, activity was much higher).

With respect to seed deals, we noted a nearly even mix of institutional seeders (most of which have been active – in one form or another – for a number of years) and opportunistic, one-off seeders who are just entering the space (such as high net worth individuals acting alone or collectively through club deals, as well as family offices). Of the institutional money investing in seed deals, 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 investors, and the trend of fund-of-funds businesses repositioning some part of their business as a seed investment platform continues. The higher end of seed investment deals remained in the $100 million to $200 million range, typically including a two to three year lock-up. Smaller deals generally ranged from $20 million to $50 million, often with a two year lock-up. Our data further suggested that roughly 20% of 2017 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 2016.




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.

**Robert L. Chender**
212.574.1415
chender@sewkis.com

**Joseph M. Morrissey**
212.574.1245
morrissey@sewkis.com

**Keri E. Riemer**
212.574.1598
riemer@sewkis.com

**John J. Cleary**
212.574.1255
cleary@sewkis.com

**David R. Mulle**
212.574.1452
mulle@sewkis.com

**David Tang**
212.574.1260
tang@sewkis.com

**Debra A. Franzese**
212.574.1353
franzese@sewkis.com

**Steven B. Nadel**
212.574.1231
nadel@sewkis.com

**John E. Tavss**
212.574.1261
tavss@sewkis.com

**Maureen R. Hurley**
212.574.1384
hurley@sewkis.com

**Patricia A. Poglinco**
212.574.1247
poglinco@sewkis.com

**Robert B. Van Grover**
212.574.1205
vangrover@sewkis.com

**Paul M. Miller**
202.661.7155
millerp@sewkis.com

**Christopher C. Riccardi**
212.574.1535
riccardi@sewkis.com

Seward & Kissel LLP


| New York | Washington |
|---|---|
| One Battery Park Plaza | 901 K Street, NW |
| New York, NY 10004 | Washington, D.C. 20001 |
| +1-212-574-1200 | +1-202-737-8833 |

www.sewkis.com