SEWARD & KISSEL LLP

New Hedge Fund Study

2019 Edition

Prepared by the Investment Management Group at Seward & Kissel LLP

Introduction & 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 2019 hedge fund launches of relevant Seward & Kissel clients meeting these criteria. As we have recently been identified by Preqin as the top U.S. law firm based on number of hedge funds serviced, 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 tend to 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:

- 70% of the funds had equity or equity-related strategies, up from 63% in 2018.

- With respect to management fees charged in the standard (i.e., non-founders) classes, the average rate was 1.43% for equity strategies (down slightly from 1.44% in 2018) and 1.68% for non-equity strategies (up from 1.58% in 2018).

- Incentive allocation rates in standard classes increased slightly across all strategies by about 26 basis points from 2018 to an average of 18.98% of annual net profits. In addition, approximately 15% of all funds had an incentive allocation hurdle (down slightly from 2018 but virtually the same as 2017).

- Approximately 47% of the equity funds (down from 63% in 2018) and 38% of the non-equity funds (down from 45% in 2018) offered lower management fee and/or incentive allocation rates through their founders classes.

- 89% of the equity funds (down slightly from 95% in 2018) and 88% of the non-equity funds (up significantly from 55% in 2018) offered quarterly (or less frequent) withdrawals, with the balance allowing for monthly withdrawals.

- Similar to 2018, lock-ups or investor level gates were used by 79% of the equity funds and 75% of the non-equity funds, with 16% of the equity funds including both. Fund level gates have continued to be disfavored by both new managers and investors.

- Sponsors of both U.S. and offshore funds continued to almost exclusively set up master-feeder structures (as opposed to side-by-side structures), and utilized the Section 3(c)(7) exemption 67% of the time.

Introduction & Key Findings (continued…)

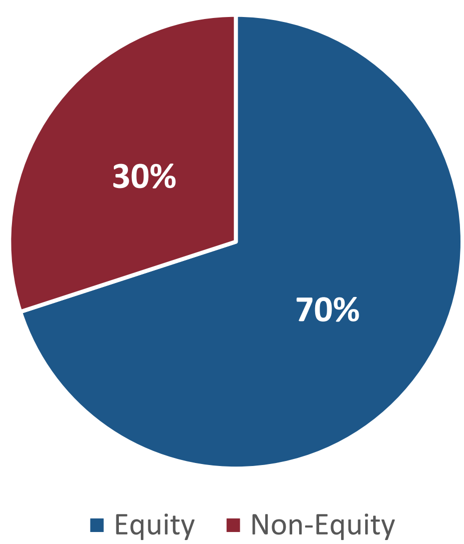
- Overall, seed investment activity was down moderately in 2019. However, the size of seed investment amounts trended higher, with a number of new launches attracting seed investments of well over $100 million.
- Looking back five years to 2014, there have been noticeable changes in both the fee and liquidity terms of newly-formed funds. The table below outlines these findings.

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

	2014	2019
Management Fee	1.70%	1.50%
Incentive Allocation	20%	18.98%
Quarterly or Less Frequent Liquidity	81%	89%
Gate or Lock-up	85%	78%
Founders Capital	65%	44%

Investment Strategies

About 70% 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 up from 63% in 2018, but still down from the 2015 Study's high-water percentage of 80%. The majority of the remaining 30% of funds in the Study (i.e., the non-equity strategies) were split among multi-strategy, quantitative, global macro, credit, cryptocurrency and commodity-related strategies.

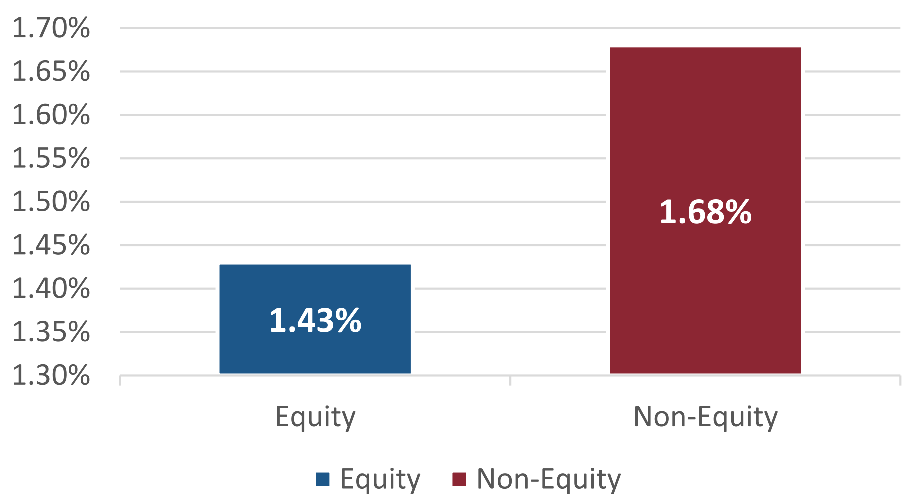


Management Fees / Incentive Allocations

While management fee rates in standard (i.e., non-founders) classes were stable from 2018 to 2019 for funds with equity strategies, rates for funds with non-equity strategies increased by more than 5%. The average rate was 1.43% for equity strategies (down slightly from 1.44% in 2018) and 1.68% for non-equity strategies (up from 1.58% in 2018). Consistent with the Study's findings in the past, funds with non-equity strategies appeared generally more resistant to fee compression. Note, however, that these averages do not take into account the possible tiering down of management fee rates as assets increase or time passes, which was present in 15% (as compared to 20% in 2018) of all funds. In 33% of those funds that also contained a dual class structure, the tiered rate applied to both founders and non-founders classes.

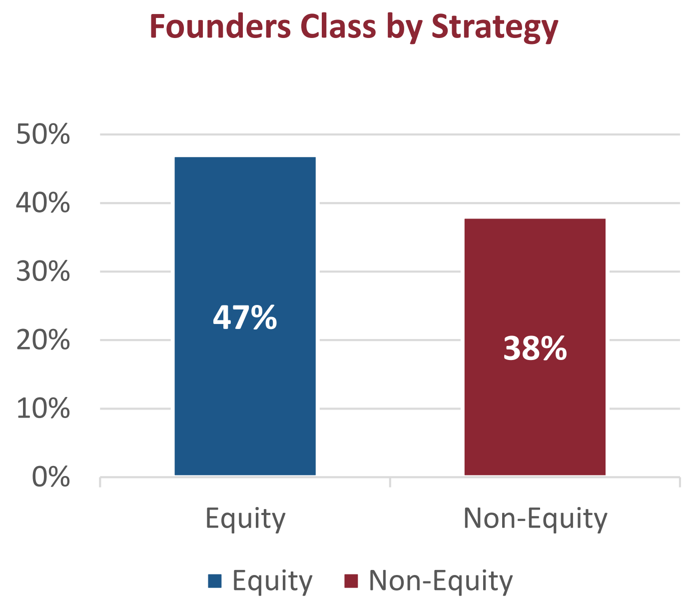
Incentive allocation rates in standard classes stayed fairly constant across all strategies with an average of around 18.98% of annual net profits. Moreover, every fund that charged an incentive allocation had some type of high-water mark (or loss carryforward) provision. Lastly, while less than 5% of the funds in the Study had a modified high-water mark, approximately 15% of all funds had an incentive allocation hurdle (down slightly from 20% in 2018).

Management Fees by Strategy



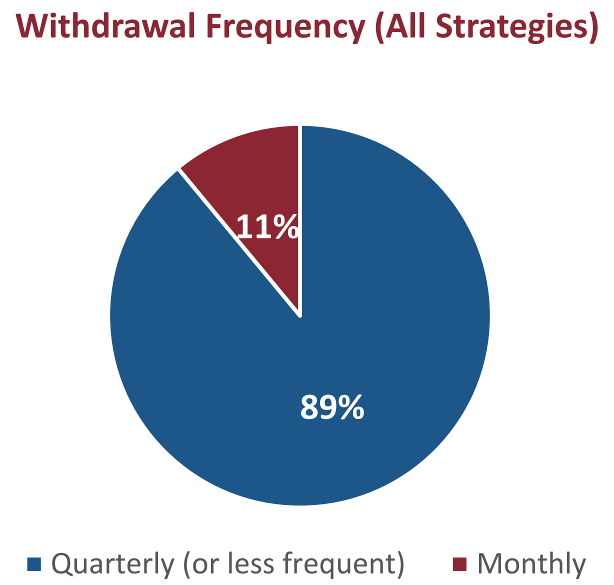
Management Fees / Incentive Allocations (continued…)

Approximately 47% of the equity funds (down from 63% in 2018) and 38% of the non-equity funds (down from 45% in 2018) offered lower management fee and/or incentive allocation rates through their founders classes. About 15% of the funds (up from 10% in 2017 and 2018) conditioned lower management fee and/or incentive allocation rates on longer lock-up terms. The average founders class management fee was 1.23% for equity funds (down from 1.25% in 2018) and the average for non-equity funds was 1.25% (up about 10% from 1.13% in 2018). The average founders class incentive allocation was 15% for equity funds (up from 14.73% in 2018), while the average for non-equity funds was 15.67% (up from 14.50% in 2018). On an aggregate basis, the 2019 Study saw management fee and incentive allocation rates stay fairly constant, which suggests healthy investor demand for new products.



Liquidity

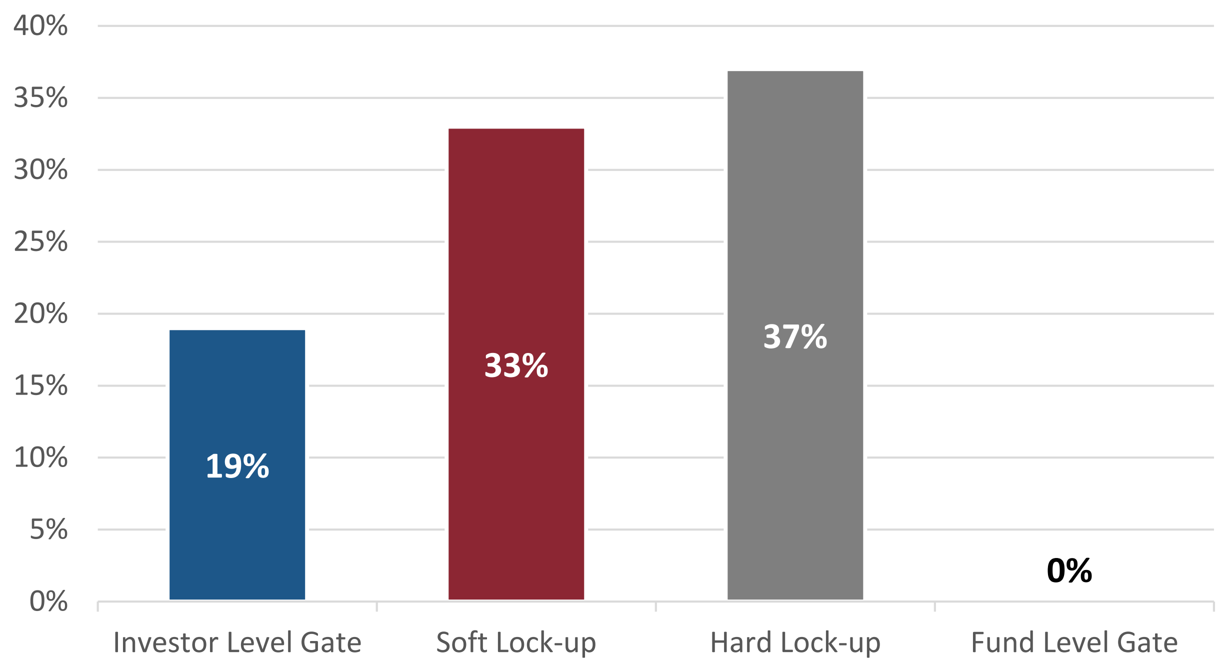
89% of the equity funds (down slightly from 95% in 2018) and 88% of the non-equity funds (up significantly from 55% in 2018) in the Study offered quarterly (or less frequent) withdrawals, with the balance allowing for monthly withdrawals. We believe the increase in non-equity funds offering quarterly or less frequent liquidity indicates that a larger proportion of non-equity funds pursue less liquid strategies, such as macro- and debt-focused strategies. The notice period for equity funds was 45 days 32% of the time, 60 days 26% of the time, 30 days 16% of the time, 90 days 16% of the time and 10 days and 95 days each 5% of the time. The notice period for non-equity funds was 60 days and 30 days each 38% of the time, 5 days 12% of the time and 120 days 12% of the time. The average notice period was 52.96 days (down from 54.35 days in 2018) broken down as an average of 54.47 days for equity funds and 49.38 days for non-equity funds.



Liquidity (continued…)

Moreover, across all classes, 79% of the equity funds and 75% of the non-equity funds had lock-ups or investor level gates (with 16% of the equity funds including both). Last year, we saw 75%, 73% and 30%, respectively. In the standard class of the funds, 16% of the equity funds (down from 32% in 2018) and 25% of the non-equity funds (down slightly from 27% in 2018) had an investor level gate, 42% of the equity funds and 13% of the non-equity funds had a soft lock-up (usually, one year with a 2% - 6% withdrawal fee payable to the fund), and 37% of the equity funds and 38% of the non-equity funds had a hard lock-up. We believe that the continued decrease in the proportion of equity funds maintaining an investor level gate over recent years demonstrates a continued focus by institutional investors on matching investor liquidity with portfolio liquidity. Fund level gates have continued to be disfavored by both new managers and investors.

Liquidity Terms (All Strategies)



Structures

Sponsors who offered both U.S. and offshore funds continued to almost exclusively set up master-feeder fund structures (as opposed to side-by-side structures), and such structures utilized the Section 3(c)(7) exemption about 67% 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, 44% of all managers initially launched just a U.S. stand-alone fund (up from 37% in 2018), primarily to build a track record in order to attract offshore and U.S. tax-exempt investor interest in the future. About 83% (up significantly from 55% in 2018) 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 about $2,270,000 (down from $2,500,000 in 2018). Breaking down the 3(c)(7) fund numbers, the average minimum initial investment for equity funds was about $2,100,000 (up from $1,800,000 in 2018) and $3,000,000 for non-equity strategies (down from $3,800,000 in 2018). With respect to 3(c)(1) funds, the average minimum initial investment was about $900,000 (with equity funds at about $965,000 and non-equity funds at about $650,000). We believe the minimum initial investment amounts in 2019 suggest that funds are continuing to target an institutional investor base and may have higher operating costs. 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

Overall, seed investment activity was down moderately in 2019. However, the size of seed investment amounts trended higher, with a number of new launches attracting seed investments of well over $100 million. Also active were seed investments in capacity constrained strategies. These investments typically attract a smaller seed investment but often project greater returns. Overall, activity in the mid-range for seed investments (i.e., seed investments of $50 - $75 million) appeared softer than in recent years.

With respect to seed deals, we noted more activity from institutional seeders than from opportunistic, one-off seeders who are just entering the space (such as high net worth individuals and family offices); this represents a bit of a change from prior years where we observed more balanced participation. That being said, a number of smaller seed deals were generated from consortiums of family offices who are planning to make multiple seed investments (albeit at a lower check size than the traditional institutional seeders).

Of the institutional money, several well-known seed deal-focused investment funds generated a large percentage of seeding activity, and we are seeing increased levels of competition to seed premier new managers. In 2019, 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 $10 million to $25 million, often with a two-year lock-up. Our data suggests that modifications or deferrals of the revenue share a seeder typically receives as a means of making more working capital available to new managers continues to be increasingly common in seed deals, which is broadly consistent with what we have been observing for the past several years; however (and perhaps correspondingly), the duration of the revenue share remains perpetual in the vast majority of these investments.

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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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