SEWARD & KISSEL LLP

New Hedge Fund Study

2021 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 2021 hedge fund launches of relevant Seward & Kissel clients meeting these criteria. As we have recently been identified by Preqin as a top U.S. law firm based on number of new 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 and liquidity terms distinguished between founders and non-founders (i.e., standard) classes; fund structures; as well as whether any form of 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 COVID-19 pandemic continued to present unique challenges for new managers, investors and allocators. However, we saw managers begin to overcome fundraising challenges prevalent in the early stages of the pandemic. The 2021 hedge fund industry was extremely active as participants were eager to take advantage of recent market opportunities.

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

- 70% of the funds had equity or equity-related strategies, slightly up from 66% in 2020.
- With respect to management fees charged in the standard classes, the average rate was 1.52% for equity strategies (about the same as 1.51% in 2020) and 1.66% for non-equity strategies (up from 1.52% in 2020).
- Incentive allocation rates in standard classes across all strategies averaged 20% of annual net profits (up slightly from 19% in 2020). In addition, approximately 21% of all funds had an incentive allocation hurdle (up from 10% in 2020).
- Approximately 57% of the equity funds (up from 53% in 2020) and 50% of the non-equity funds (down from 60% in 2020) offered lower management fee and/or incentive allocation rates through their founders classes. For purposes of this Study, founders class capital refers to the early investors in a fund who are sometimes granted better fee terms in exchange for their early commitment, however, such investors are not necessarily seed capital, which is discussed elsewhere in the Study.
- 82% of the equity funds (up from 79% in 2020) and 90% of the non-equity funds (up from 80% in 2020) offered quarterly (or less frequent) withdrawals, with the balance allowing for monthly withdrawals.
- Lock-ups or investor level gates were used by approximately 70% of the equity funds (down from 79% in 2020) and, similar to 2020, 70% of the non-equity funds, with 21% of all funds including both (up significantly from 5% in 2020). Fund level gates have continued to be disfavored by both new managers and investors.

Introduction & Key Findings (continued…)

- 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 75% of the time.

- Overall, seed investment activity (i.e., typically, where money is invested by an investor for a locked-up time period in exchange for some sort of revenue share in the fees) was relatively flat in 2021 as compared to 2020, which likely was an effect of the ongoing pandemic. Institutional seeders remained fairly active, representing the majority of observed seeding activity.

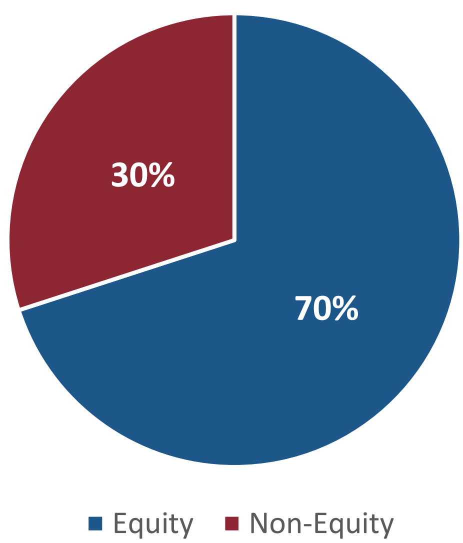
- When comparing the data presented five years ago in the 2016 study to the information set forth in the current Study, there have been noticeable changes in the average fee and liquidity terms of newly-formed funds. The table below outlines these findings across the standard classes issued by such funds:

Average New Hedge Fund Terms -
Standard Class, Across All Strategies

	2016	2021
Management Fee Rate	1.48%	1.56%
Incentive Allocation Rate	20%	20%
Quarterly or Less Frequent Liquidity	94%	85%
Presence of a Gate or a Lock-up	100%	70%
Presence of a Founders Class	61%	52%

Investment Strategies

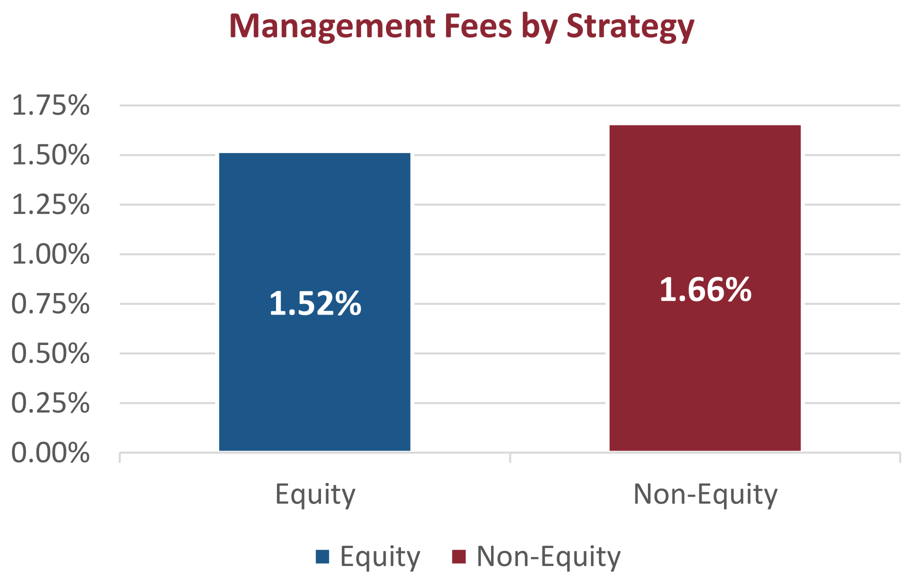
About 70% of the funds included in the Study utilized an equity or equity-related strategy (not including multi-strategy offerings that generally involved both equity-related as well as other strategies). This is up from 66% in 2020, but still below the 80% we found in 2015. The majority of the remaining 30% of funds in the Study (i.e., the non-equity strategies) were split among multi-strategy, global macro, credit, digital assets and commodity-related strategies.



Management Fees and Incentive Allocations; Presence of a Founders Class

From 2020 to 2021, management fee rates in the standard (i.e., non-founders) classes for funds with equity strategies remained nearly the same and management fee rates for funds with non-equity strategies increased by about 9%. The average rate was 1.52% for equity strategies (up from 1.51% in 2020) and 1.66% for non-equity strategies (up from 1.52% in 2020). In a recent shift, funds across all strategies have been resistant to fee compression. This may in part be due to the particularly high demand for alternative investment strategies in 2021. 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 18% (similar to 17% in 2020) of all funds. In 20% (down significantly from 75% in 2020) of those funds that also contained a dual class structure, the tiered rate applied to both founders and standard classes.

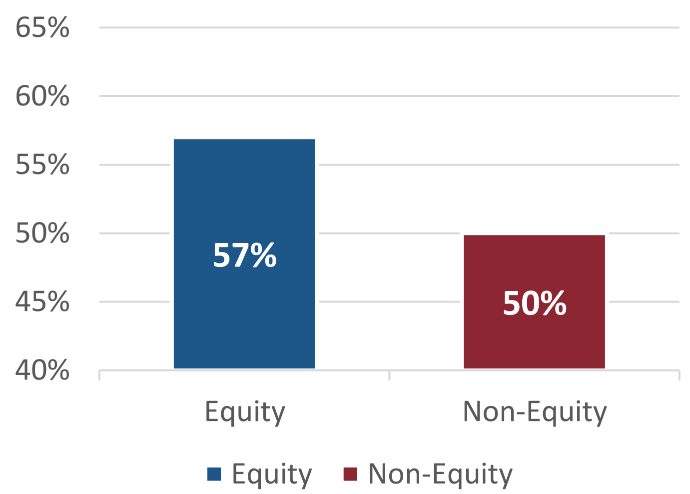
Incentive allocation rates in standard classes across all strategies averaged 20% of annual net profits (up slightly from 19% in 2020). Moreover, every fund that charged an incentive allocation had some type of high-water mark (or loss carryforward) provision. Lastly, while less than 5% of the funds in the Study had a modified high-water mark, approximately 21% of all funds had an incentive allocation hurdle (up from 10% in 2020).



Management Fees and Incentive Allocations; Presence of a Founders Class (continued…)

Approximately 57% of the equity funds (up slightly from 53% in 2020) and 50% of the non-equity funds (down from 60% in 2020) offered lower management fee and/or incentive allocation rates through their founders classes. About 21% of the funds (up from 10% in 2020) conditioned lower management fee and/or incentive allocation rates on longer lock-up terms. The average founders class management fee was 1.31% for equity funds (up from 1.18% in 2020) and the average for non-equity funds was 1.27% (down slightly from 1.28% in 2020). The average founders class incentive allocation was 16% for equity funds (up from 13.86% in 2020), while the average for non-equity funds was 15% (down from 15.39% in 2020).

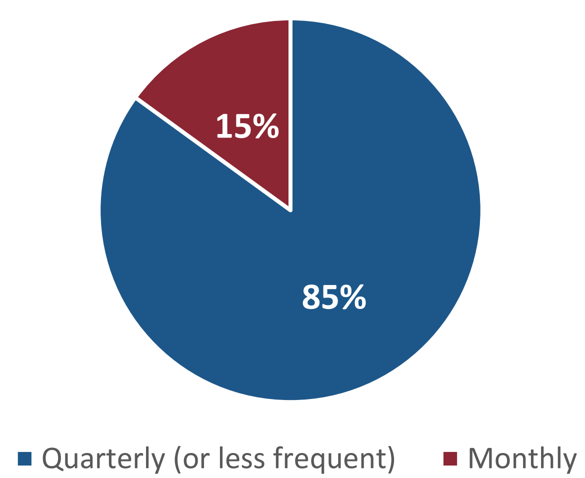
Percentage of New Funds by Strategy that Offered a Founders Class



Liquidity

82% of the equity funds (down from 79% in 2020) and 90% of the non-equity funds (up from 80% in 2020 and 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 in recent years indicates that a larger proportion of non-equity funds pursue less liquid strategies, such as certain credit and debt-focused strategies. The notice period for equity funds was 30 days 30% of the time, 60 days 26% of the time, 90 days 13% of the time, 45 days 17% of the time, and 75 days, 25 days and 7 days each 4% of the time. The notice period for non-equity funds was 60 days 30% of the time, 90 days, 45 days and 30 days each 20% of the time, and 65 days 10% of the time. The average notice period was 50.66 days (down from 58.97 days in 2020) broken down as an average of 47.70 days for equity funds and 57.50 days for non-equity funds.

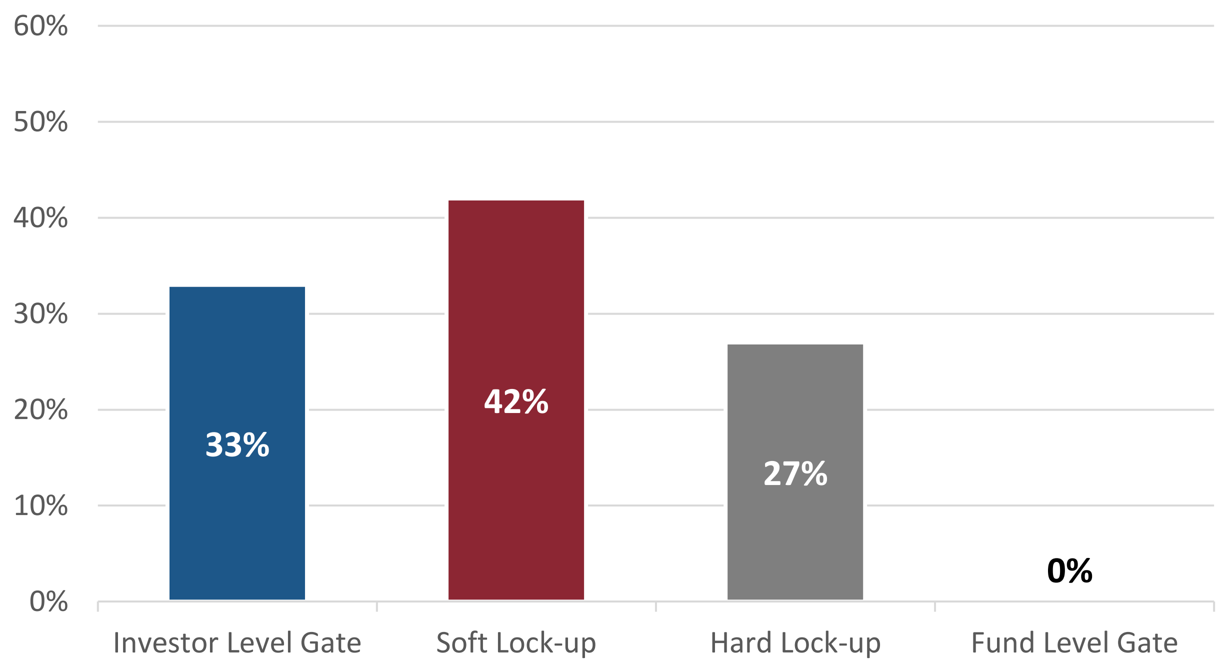
Withdrawal Frequency (All Strategies)



Liquidity (continued…)

Moreover, across all classes, 70% of the equity funds and 70% of the non-equity funds had lock-ups or investor level gates (with 21% of all funds including both lock-ups and investor level gates). Last year, we saw 79%, 70% and 5%, respectively. In the standard class of the funds, 18% of the equity funds (up from 16% in 2020) and 50% of the non-equity funds (the same as 2020 but up significantly from 25% in 2019 and 27% in 2018) had an investor level gate, 30% of the equity funds (down significantly from 63% in 2020) and 30% of the non-equity funds (the same as in 2020) had a soft lock-up (usually, one year with a 2% - 5% withdrawal fee payable to the fund), and 26% of the equity funds and 30% of the non-equity funds had a hard lock-up. We believe that the flattening out of the proportion of equity funds maintaining an investor level gate or lock-up over recent years demonstrates that institutional investor demand for matching investor liquidity with portfolio liquidity has generally been met. 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 75% of the time. We saw continued growth in the number of master funds established as limited partnerships, as compared to corporations (primarily due to easier administrative and accounting capabilities available in partnerships). In addition, 39% of all managers initially launched just a U.S. stand-alone fund (similar to 38% in 2020 and down from 44% in 2019), primarily to build a track record in order to attract offshore and U.S. tax-exempt investor interest in the future. About 61% (down from 73% in 2020) of the stand-alone funds relied on the Section 3(c)(1) exemption, suggesting that more new managers have been successful in targeting an institutional investor base. The average minimum initial investment for 3(c)(7) funds across all strategies was about $2,100,00 (down slightly from $2,350,000 in 2020). Breaking down the 3(c)(7) fund numbers, the average minimum initial investment for equity funds was about $2,000,000 (up slightly from $1,960,000 in 2020) and $2,500,000 for non-equity strategies (down from $3,140,000 in 2020). With respect to 3(c)(1) funds, the average minimum initial investment was about $450,000 (with equity funds at about $440,00 and non-equity funds at about $475,000). 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

Overall, seed investment activity in 2021 was fairly flat as compared to 2020, which itself was somewhat depressed, likely as a result of the pandemic. Nonetheless, institutional seeders remained fairly active and, based upon our observations, accounted for the vast majority of seed investments in 2021. Terms of seed investments were broadly consistent with historical observations, and seed capital investment sizes were typically +$50mm (consistent with historical practices for institutional seeders). While traditional long/short equity, macro and other strategies with high AUM capacities remained a popular choice for seeders, also observed were a number of seed investments in healthcare focused managers that often had a sizable allocation of their portfolios in illiquid investments – usually these funds were structured as hybrid funds or with unusually large side pocket tolerances.

As in past years, seeding activity was concentrated among several well-known seeders. While this led to a fair amount of competition among seeders for new managers in prior years, the unique circumstances of 2020 and 2021 caused this dynamic to be less apparent.

In 2021, the larger tickets for seed investment deals remained in the $50 million to $100 million range, typically including a two- to three-year lock-up. Our data suggests that deferrals of seeder economics 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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