No Fees Upfront? New Structures Sow Further Doubts

Stockholm (HedgeNordic) – There are further signs the 2-and-20 model (2 per cent management fee and 20 per cent profits) that is the standard in the hedge fund industry may be on its way out. Following a recent Preqin study (reported here) that shows hedge fund managers increasingly viewing investor demands over fees as a key driver of change for 2017 amid lacklustre returns, high-profile redemptions and allocation reassignments throughout last year, Bloomberg is now reporting the emergence of a number of hedge fund startups that are seeking to circumvent the model altogether in a bid to attract investors.

In Singapore, for example, Noviscient plans to start a fund that will charge no management fees at all, and which promises to absorb the first 5% of annual investment losses, a first for the industry. Gordian Capital Singapore Pte will take a performance fee only if returns exceed a certain benchmark. Kit Trading offers to insulate clients from some declines while also taking lower-than-average fees. Among more well-established managers, Winton, Caxton Associates and Tudor Investment Corp. have also cut fees. Others, such as Alan Howard of Brevan Howard, has restructured so as to charge 30% returns from his new hedge fund Brevan Howard AH Master Fund, but with a lower-than-average 0.75% management fee.

“Increasingly these days hedge fund startups have to come up with innovative fee structures in order to attract capital and achieve critical mass,” according to Melvyn Teo, professor of finance at Singapore Management University. “The key is to protect investors from some of the downside while ensuring that the manager shares enough of the upside so that the business remains viable and attractive to the manager.”

Some are doubting fee structure realignments as extreme as those proposed by Noviscient, however, seeing in them the seeds for too high a risk for funds that won’t be able to perform above high benchmark thresholds for extended periods of time. “The marketing strategy plays to a fundamental bias of investors: aversion to low-probability small losses, even when accepting that risk offers a higher expected payoff,” says Bloomberg’s Christopher Langler. “If the new fad catches on, it’s easy to see how hedge funds will start attracting money again. That doesn’t mean they’ll survive, however. Unless every manager is a genius who can always make positive returns, fund closures will only accelerate. It’s right for hedge funds to stop charging investors extraordinary sums for often-ordinary returns. But mortgaging the house to attract investments can’t be the solution either.”

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