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Current Hedge Fund Fees

The 'standard' 2 & 20 fee fund model may be a thing of the past, but to what extent have managers continued to evolve their approach to fund terms and conditions? Ross Ford examines key trends in headline hedge fund fees and assesses to what extent managers are meeting investors' expectations.

As this month's report on investor sentiment demonstrates, hedge fund managers are still under pressure from institutional investors to offer concessions on their fees. Preqin's monitoring of the changes in fee structures post-2008 provides an interesting framework for evaluating the current fee structure for single-manager hedge funds. The data reported in this article covers terms and conditions statistics for over 4,500 hedge fund vehicles globally.

A 2&20 fee structure used to be synonymous with the hedge fund industry; however, Preqin data shows that only 42% of single-manager hedge funds now use the perceived industry standard. The mean management fee for all single-manager hedge funds tracked by Preqin is 1.60%, 20% lower than the 2% historical 'standard'. Despite 50% of investors interviewed in our recent study stating that they have seen an improvement in management fees over 2012, this mean value is unchanged from 2011. The current mean performance fee for single-manager hedge funds is 18.69%, whereas in 2011 this figure stood at a higher 19.20% – this difference can explain the source of the improvements in performance fees observed by the 50% of investors interviewed.

Breakdown by Fund Structure

When looking at specific fund structures there is a wide variation in fees charged. Commodity trading advisors (CTAs), for example, charge a performance fee that is above the industry standard, but charge a management fee below 2%, as shown in Fig. 1. However, their performance fees are above the 20% level. Alternative UCITS funds, by nature a more retail vehicle, charge a much lower average management fee and performance fee, with 78% of the UCITS-compliant funds charging a management fee below 2%. The mean management fees of funds of funds, meanwhile, has risen slightly over the past year, from 1.35% in 2011 to 1.39% in 2012. Despite this, their performance fees have

Fig. 1: Mean Hedge Fund Fees by Fund Structure

Fund Type	Mean Management Fee	Mean Performance Fee
Single Manager	1.60%	18.69%
CTA	1.76%	20.32%
UCITS	1.45%	16.45%
FoHFs	1.39%	8.43%

Source: Preqin

Fig. 2: Mean Hedge Fund Fees by Fund Manager Location

Region	Mean Management Fee	Mean Performance Fee
Asia-Pacific	1.54%	18.55%
Europe	1.60%	18.84%
North America	1.65%	19.70%
Rest of World	1.76%	19.35%

Source: Preqin

Fig. 3: Mean Hedge Fund Fees by Strategy

Fund Type	Mean Management Fee	Mean Performance Fee
Fixed Income Arbitrage	1.34%	15.14%
Foreign Exchange	1.36%	17.62%
Risk/Merger Arbitrage	1.47%	19.57%
Convertible Arbitrage	1.49%	17.14%
Long Bias	1.57%	17.13%
Special Situations	1.57%	18.92%
Relative Value Arbitrage	1.58%	19.07%
Long/Short Equity	1.62%	19.08%
Long/Short Credit	1.65%	18.79%
Event Driven	1.67%	19.12%
Equity Market Neutral	1.69%	19.44%
Statistical Arbitrage	1.74%	20.98%
Multi-Strategy	1.75%	19.49%
Managed Futures / CTA	1.76%	20.32%
Macro	1.80%	18.73%
Distressed	1.87%	19.42%

Source: Preqin

shown another decline to a mean value of 8.43%, down from over 10% in 2011.

Breakdown by Location and Strategy

Fig. 2 shows the mean management and performance fees charged by single-manager hedge funds based on their location. Preqin found that, on average, Asia-Pacific-based hedge fund managers charged the lowest management and performance fees. Asia remains an emerging hub for hedge fund investments and, as such, Asia-based managers must be relatively flexible on fee structure to ensure that they remain appealing to the institutional market. With many Europe-based fund managers now offering UCITS products, the average management and performance fees charged by Europe-based fund managers are below those charged by managers based in other areas. North America, however, is the traditional home of the hedge fund market and investor base, and the mean performance fee charged by hedge fund managers based in the region continues to exceed those charged elsewhere.

As shown in Fig. 3, fixed income arbitrage funds offer the lowest mean management and performance fees, whereas distressed funds need to post strong returns in order to justify their top tier management and performance fees. Some strategies couple lower management fees with higher performance incentives, risk/merger arbitrage for instance, whereas other strategies such as global macro tend to offer the opposite.

Outlook

Since Preqin's initial study of hedge fund fees in 2009, there have been notable changes in the fees charged by single-manager hedge funds, with 2% management fees and 20% performance fees no longer the accepted industry standard. The changes to management fees have been the most significant, with these fees having come under the most scrutiny from institutional investors in the past four years. After suffering a sharp decline in the initial wake of the events of 2008, the mean management fee for a hedge fund seems to have reached a plateau of around 1.6%, a level which appears to be becoming more palatable for investors and fund managers alike.

Data Source:

This month's article on current hedge fund fees draws on information from Preqin's industry leading Hedge Fund databases, with information on hedge funds, performance, fees, and investor profiles.

For more information on how this useful tool can help you, please contact info@preqin.com.