

Bloomberg.com

Hedge Fund Fees Firm as LBO Managers Bow to Pensions (Update1)

[Share](#) | [Email](#) | [Print](#) | [A A A](#)

By Katherine Burton

Aug. 3 (Bloomberg) -- **Larry Powell**, deputy investment chief for the \$16 billion **Utah Retirement Systems**, was convinced in January that hedge funds finally would buckle under the pressure of record losses in 2008 and lower their fees.

He figured it was appropriate to insist on a reduction in the standard industry charge of 2 percent of assets and 20 percent of gains on investments as low as \$25 million, according to a memo Powell circulated with hedge funds and investors. Performance fees should be assessed only after a minimum return is exceeded and paid over several years rather than annually, he said.

Powell's plan proved to be wishful thinking. Unlike many private-equity firms which have reduced fees, hedge funds aren't budging without concessions such as longer lock-up periods and commitments of at least \$100 million, according to money managers and consultants. While Powell could crow at a June industry dinner in New York that more than half of Utah's 40 hedge-fund managers agreed to changes in their fees, with four adopting his recommendations, top-performing managers haven't adjusted yesteryear's top-dollar fees.

"There is no wholesale reduction of fees taking place," said **Stewart Massey**, who runs Massey Quick & Co., a consulting firm in Morristown, New Jersey, that caters to wealthy individuals, endowments and foundations.

Relative Returns

Daniel Och's \$20 billion Och-Ziff Capital Management Group LLC, **Steven Cohen's** \$14 billion SAC Capital Advisors LP and Highbridge Capital Management LLC's \$23 billion fund haven't reduced performance fees and are demanding a three-year lock-up in exchange for any cut in management fees.

SAC Capital, which charges 3 percent of assets and takes 50 percent of investment gains, may end up keeping fees where they are because market returns are on the rise again, said a person familiar with the Stamford, Connecticut-based firm, who declined to be identified because the discussions are private.

Private-equity funds are having less success holding the line on management fees, which averaged 2 percent in 2008, according to London-based research firm **Preqin Ltd.** Companies starting new funds this year are seeking an average of 1.8 percent. The figure

is about 1.65 percent for offerings with more than \$1 billion, Preqin reported.

One reason for the difference is investment performance. Buyout funds recorded a 28 percent decline in value last year, according to Preqin. That compares with a 19 percent drop for hedge funds, according to Hedge Fund Research Inc. Hedge funds climbed 9.5 percent this year through June. Comparable figures for buyout firms aren't available.

'Adverse Selection'

Another difference is liquidity. Private-equity funds tie up money for as long as 10 years. Investors can pull out of hedge funds as frequently as once a quarter.

When a hedge-fund manager reduces fees without seeking concessions, "that means they are negotiating from a position of weakness, and that manager must be scrutinized more," said Massey, the consultant. "It's an adverse selection process."

Hedge-fund managers collected fees of about \$55 billion in 2007, when returns averaged 10 percent, according to [Hedge Fund Research](#). Fees shrank to about \$25 billion last year as returns fell the most since the Chicago-based firm began tracking the data in 1990. They will be about \$45 billion in 2009, assuming returns and assets under management are constant for the rest of the year.

Lock-Up Performance

The industry had \$1.43 trillion in assets as of June 30, down from a peak of \$1.9 trillion in mid-2008. Hedge funds are private pools of capital whose managers can buy or sell any assets, bet on rising as well as falling prices and participate in profits from money invested.

Hedge funds considering changes have proposed cutting asset-based management fees by half a percentage point for investors who are willing to put up \$100 million and not touch the money for three years, said people on both sides of the talks. It's a commitment that only institutions with multibillion-dollar hedge-fund holdings can afford to make.

Performance fees, the managers' slice of investment profits, aren't falling. Some funds are talking about instituting a hurdle, or minimum gain, that must be cleared before they can take their cut, and about collecting the payments over the entire lock-up period rather than annually.

"There has been lots of talk, but I haven't seen lower fees except for new funds, which are charging a 1.5 percent management fee now," said [Larry Chiarello](#), director of research at Red Bank, New Jersey-based Riverview Alternative Advisors LLC, which farms out money to hedge funds. "Established managers seem very unwilling to lower fees on existing funds."

Utah to Calpers

[Utah's](#) Powell wouldn't comment, citing the "no press" policy of his Salt Lake City-based employer. The [pension fund](#) tumbled 22 percent in 2008, according to its Web site. Utah doesn't disclose performance for its hedge-fund investments or how much it invests in them.

The \$184 billion California Public Employees' Retirement System, the largest public pension fund in the U.S., told hedge-fund managers in March that it was looking for changes similar to those proposed by Utah. [Clark McKinley](#), a spokesman for Calpers in Sacramento, declined to say which if any of its 30 managers had revised terms. Talks with hedge funds "have been going favorably," he said.

Calpers lost 23 percent in the fiscal year ended June 30. Its hedge-fund holdings fell 15

percent to \$6 billion in the 12 months ended March 30, the most recent data available.

Exits Blocked

Supply and demand has helped hedge funds resist fee erosion. Private-equity firms buy companies, hoping to profit by selling them later at a higher price, as well as invest in real estate, debt, infrastructure and venture-capital startups.

Investors are less inclined in declining markets to lock up their money for five to seven years, said **Brad Alford**, head of Alpha Capital Management LLC in Atlanta and a former managing director of the investment division of Duke University's endowment. With fewer initial public offerings and corporate mergers, private-equity funds aren't able to exit investments and return capital to their limited partners, he said.

More than three-quarters of hedge funds charge between 1.5 percent and 2 percent of assets, Preqin said in a report published last week. Seven out of 10 funds take 20 percent of investment profits. Larger funds tend to have higher management fees because they are more in demand, the report said.

Cutting management fees for a large investment is nothing new, said **Peter Gilbert**, chief investment officer for the endowment of Lehigh University in Bethlehem, Pennsylvania, and former investment head of the Pennsylvania State Employees' Retirement System, where he worked for 14 years.

Fund Liquidations

"There is a long history of certain managers being willing to provide fee concessions in exchange for significant allocations," he said.

Most hedge funds that have reduced fees are new managers or those hoping to keep clients after big losses or redemptions.

Jeffrey Gendell, whose Tontine Associates LLC in Greenwich, Connecticut, liquidated two funds after losing more than 60 percent in 2008, was raising money for a new fund this year that charges 1 percent of assets.

Harbinger Capital Partners, whose assets dropped by about 70 percent between June 2008 and early this year, offered new clients or those adding to their positions the option of investing for two years at a time, in exchange for paying 1.25 percent of assets and 15 percent of investment gains. That compares with 1.5 percent and 20 percent for investors who choose an initial one-year lock up.

Weak vs. Strong

Investors can now pull as much as 25 percent of their assets every quarter and don't pay a performance fee unless the funds return more than 7 percent. The New York-based firm, run by **Philip Falcone**, managed \$7 billion as of March.

Firms with large institutional clients and strong long-term track records are driving a much harder bargain, including some that manage money for Utah, according to people familiar with the state's portfolio.

Highbridge, owned by **JPMorgan Chase & Co.**, has discussed a separate share class for large institutions with a management fee lower than its usual 2 percent. Clients may be asked to commit \$100 million or more and agree to keep their money in the fund for three years, rather than being able to exit quarterly, said people familiar with the New York-based firm.

8/3/2009

Bloomberg Printer-Friendly Page

Its main fund, which has \$7 billion, climbed 27 percent this year through July, the people said.

Stark to Och-Ziff

Stark Investments, with \$8 billion under management, has discussed similar arrangements with investors, said people familiar with the St. Francis, Wisconsin-based firm.

Och-Ziff, whose Master Fund rose 12 percent in the first half of the year, has had talks about cutting management fees by half a percentage point in exchange for a three-year lock-up and a sizable commitment, according to people familiar with the New York-based firm.

Among other managers, **Marc Lasry's** \$17 billion Avenue Capital Group in New York also has talked about cutting management charges in exchange for a large investment, according to a person familiar with the firm. The performance fee wouldn't change.

SAC Capital, which recently told investors in its main fund that they could take money out each quarter instead of waiting three years, is considering an institutional share class with a longer lock-up in exchange for lower fees, according to potential investors with the firm. The main fund has climbed 17 percent this year.

Officials for all the hedge funds declined to comment.

Depends on Performance

With strong performance to draw in new clients, some managers may decide not to offer any breaks at all because that would cut into their revenue for years to come.

"In the previous downturn, a number of managers were forced to lower fees," said Robert Sutton, a partner at New York-based **Kirkland & Ellis LLP**, who advises hedge funds. "It took some time before they could command higher fees for new investments again."

To contact the reporters on this story: Katherine Burton in New York at kburton@bloomberg.net

Last Updated: August 3, 2009 12:09 EDT



©2009 BLOOMBERG L.P. ALL RIGHTS RESERVED. [Terms of Service](#) | [Privacy Policy](#) | [Trademarks](#)