

# Hedge Fund Terms. An Overhaul.

## **Ideal Hedge Fund Terms:**

For a host of reasons, hedge funds have not offered the most investor friendly terms. The cynical view is that hedge fund managers will get away with as much as they can. The fees are high, the performance fees are charged and cannot be reclaimed if there is a subsequent loss, the manager is drifting into markets and strategies managers are unused to, liquidity is unilaterally suspended just when investors need to exit... the list is endless.

The more charitable view is that hedge fund managers have little idea how a fund should be structured; they are traders and portfolio managers and have little time or attention to spend on fund structure and terms. To be sure this is a major failing since any business needs management of liabilities as much as assets. It is telling that we refer to them as asset managers because liability management often faces neglect. And so, here is my attempt at constructing a set of fund terms and principles which are hopefully fair to manager and to investor.

## **Overriding Principle:**

The money is yours. It is my privilege to manage your money. It is not your privilege to invest with me. Your interests come first. If that was ever violated then I am out of business. I will treat your money better than my own.

## **Side Pockets:**

You may opt out of my side pocket class. If you choose to opt in, I will not charge you management fees on the side pocket assets under management. I will only charge performance fees on side pockets and then only when cash is realized. I will let you know when I side pocket an investment and I will provide details of each investment. If I retroactively side pocket an investment, I will charge you no performance fees. Performance fees are charged only if the investment is designated to a side pocket at inception of the position.

## **Gates and Suspensions:**

Depending on the strategy there may be gates or not. If I run a liquid strategy, I will exclude gating in the PPM. I will restrict the right of the directors or the manager to suspend NAV and redemptions except in specific instances which will be set out in the PPM.

If I suspend redemptions, I will cease to charge management fees. I will exclude

performance fees for the duration of suspension as well. That is, any NAV appreciation during the period of suspension will not be subject to performance fees.

During suspension, you are de facto a senior creditor. I will provide you with total transparency subject to non disclosure agreements.

It is ridiculous and utterly criminal and sinful for me to hold on to money against your will and then charge you management fees for the privilege.

#### **Strategies:**

I will specify my strategy with as much specificity as I can while retaining flexibility to act. This will not be easy to do, but I will to the best of my ability, specify in the PPM, what I can or cannot do. If I want to add a strategy, I will inform you and you will have the opportunity to redeem costlessly before I implement a new strategy. This restricts my ability to act quickly, or to be nimble in taking advantage of any new opportunities, but you know what you get. Alternatively, I may run the new strategy in a side pocket which you can opt into immediately or at a later date. (I am going to have difficulties finding an Administrator who can do this cheaply for all of you.)

#### **Reporting and Transparency:**

I will provide you with timely reporting. Depending on the systems I can afford, I will report to you in real time, otherwise daily, otherwise weekly, otherwise monthly. I will provide you risk and exposure reports. I will provide you position level reports only where it does not endanger the fund. I will provide high level exposure reporting and I will arrange for the fund Administrator to provide independent confirmation to you so that you can perform your own reconciliation.

I will speak to you all once a month in a scheduled investor briefing. I will take questions at the end of the call. The call will be recorded for replay. Beyond this, my head of investor relations will be happy to schedule ad hoc calls, bearing in mind that you want me to dedicate substantially all my time managing your money.

#### **Fees:**

I will charge management fees on a reducing sliding scale just like some mutual funds. I tell you that my management fees are to cover the running costs of my business, well, my costs do not rise as a proportion to my assets under management. As for performance fees, I will reserve half of my performance fees in each period into a subordination reserve. This reserve will vest (be payable to me) on a rolling basis equal to any lock up I may have but in any case no earlier than 2 years. That is, if I lose money for you, 20% of the loss will be taken away from the reserve to repay you.

**Alignment of interest:**

I will invest X USD of my money in the fund. I will pay full fees, and be subject to the worst liquidity terms I offer any investor. Capacity in my fund will be some fixed multiple of my investment. If I redeem from my own fund, I will disclose this and force redeem investors to maintain this fixed multiple. I am not forced to invest any fees I receive into the fund but to the extent that I do, it increases the capacity of the fund. I will be the last man standing. My capital will be the last to leave the fund.

Despite the events of 2008, many managers still violate the overriding principle: that they are looking after other people's money. Fortunately, most managers are not like that. For too long, investors have tolerated asymmetric terms in their contracts with the fund and the fund manager. It's time to change that.

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