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Hedge Fund Fees Tighten as '1 or 30' Gains Ground

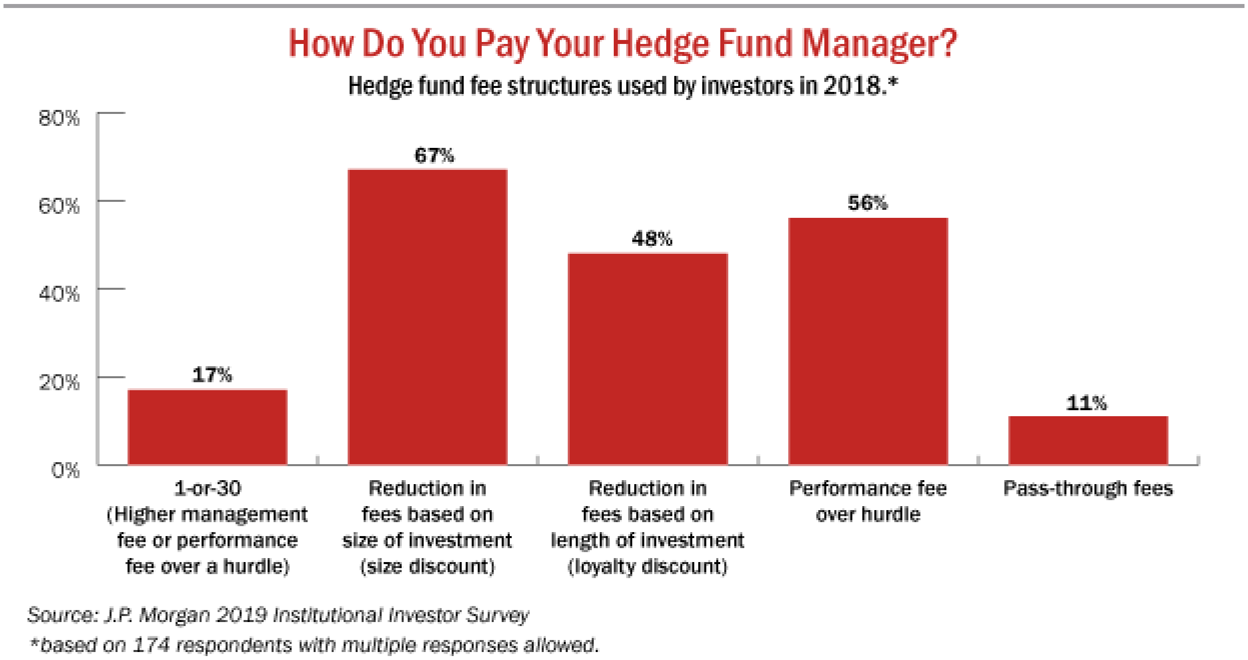
By Lydia Tomkiw April 3, 2019

The hedge fund fee compression push is showing no sign of letting up, as more investors are negotiating fee arrangements and pushing for different models with their managers, including the budding "1 or 30" approach, according to a new survey.

Fifty-four percent of investors are negotiating or planning to negotiate the fees they pay to hedge fund managers, according to a J.P. Morgan Capital Advisory Group survey of 227 investors, including hedge funds of funds and family offices. It's part of a trend seen in recent years as the industry's once standard 2% management fee and 20% performance fee model erodes further.

Nearly half of respondents paid less than 1.5% on average in management fees last year and 40% reported paying less than 17.5% in performance fees, the survey found. And 17% of investors reported using a 1% management or 30% performance fee structure last year, an approach first introduced to the market only a few years ago.

The haggling doesn't stop there, as 67% of respondents reported negotiating a reduction in fees based on the size of their investment, and 56% reported only paying a performance fee once a fund gets over a certain return hurdle with at least one of their managers.



"We were intrigued by the increase in investors using the 1 or 30 fee structure, which is designed to increase the alignment of interests between investors and managers," said **Michael Monforth**, global head of capital advisory at J.P. Morgan, in an email to *FundFire*. "While performance hurdle targets will likely grow in popularity, it's difficult to gauge by how much given the structure may not be suited for certain managers or strategies." As an example, he cited smaller managers that may have a higher cost basis per unit of assets under management than larger shops.

While the 1 or 30 model hasn't "seen broad adoption yet," several other areas of fee negotiating have, says **Jon Hansen**, a managing director at Cambridge Associates. Cambridge has worked with managers on developing founder's share class terms, management fees that scale down as assets under management grow, and having fees scale down over time to reward loyalty.

"We never want to disadvantage our managers," he says. "We want to make sure there is a good balance between the [limited partners] and [general partners]."

There's no downside to exploring new models or negotiating fees, says **Michael Rosen**, principal and CIO at Angeles Investment Advisors, a consultant and advisor that invests in hedge funds. Angeles does so in every case, but it's also important to approach negotiations from the perspective of being a partner with fund managers and forming a long-term relationship, he adds.

"What I've learned over decades is if you're disappointed in the performance or results of a manager, paying a lower fee is not going to ameliorate that disappointment," he says. "It's another way of saying the fee is not the tail that should wag the dog. The most important thing is to get the first decision right – that it's the right manager, right approach for your portfolio."

All of those discussions underscore how the sun is setting on 2 and 20. Only 4% of respondents reported paying an average management fee of 2% or more last year and only 3% reported paying an average performance fee of 20% or more, the survey found.

There are still circumstances where paying the full asking price of a manager is worth it, Rosen adds. "[I]t would be worth it if you really believed that there was a strategy that really could not be accessed any way else or accessed as effectively anywhere else, and/or it's a strategy that's very limited in capacity."

Thirty-three percent of investors remain worried that gutting manager fees could compromise the ability of managers to attract and hire top talent and expand their infrastructure, the survey found.

Fee compression is also causing managers to want to outsource more and implement more robotics into their processes, says **Phil McCabe**, head of SEI's investment manager services division. Real time data with dashboards is also helping with the transparency issues investors still point to.

"It's driving the need for operational efficiency and the need for technology and automation," he says.

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