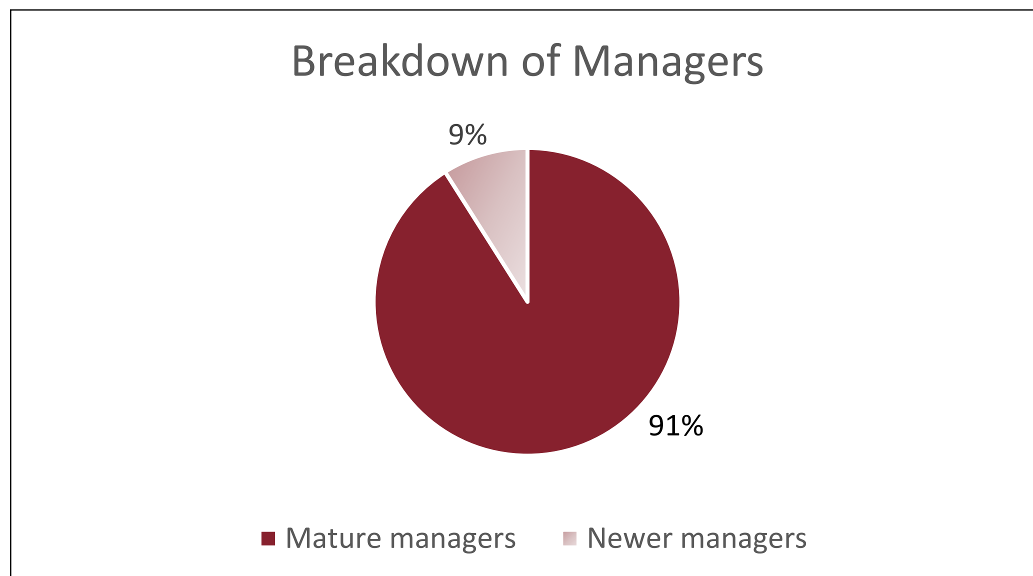
The SMA Snapshot Report

SEWARD & KISSEL LLP

Driven by our ongoing commitment to understanding the alternative investment industry, each year Seward & Kissel conducts various studies of the major trends that impact the industry and our clients. Given the continuing investor demand for more bespoke products, we have seen an increase in the number of managers entering into separately managed account ("SMA") relationships. Accordingly, this year we are excited to release the second edition of The SMA Snapshot Report, which provides insight into the current state of the SMA environment within the hedge fund market over the past 12 months. We believe that the number of SMAs within the Report is large enough to extract important data points that are relevant to the industry. Set forth below are the Report's key findings:



AVERAGE TIME IN BUSINESS FOR MANAGERS:

91% of the hedge fund managers managing SMAs within the Report founded their business over two years ("mature managers") ago, as compared to 82% in last year's Report, and 90% of that group were founded over five years ago (versus a much lower 62% last year). By contrast, just 9% of the managers were founded less than two years ago as opposed to 18% last year ("newer managers"). These figures may demonstrate an investor shift in the SMA space towards mature managers. Nonetheless, our findings in the 2022 Seward & Kissel Alternative Investment Allocator Study indicate that a majority of hedge fund investors continue to allocate to emerging managers (click here to read the full Study). These somewhat inconsistent findings are best reconciled by the results of our annual Hedge Fund Side Letter Study, which consistently shows that newer managers are offering founders classes, thus obviating the need for many newer manager investors to seek out separately managed account arrangements.

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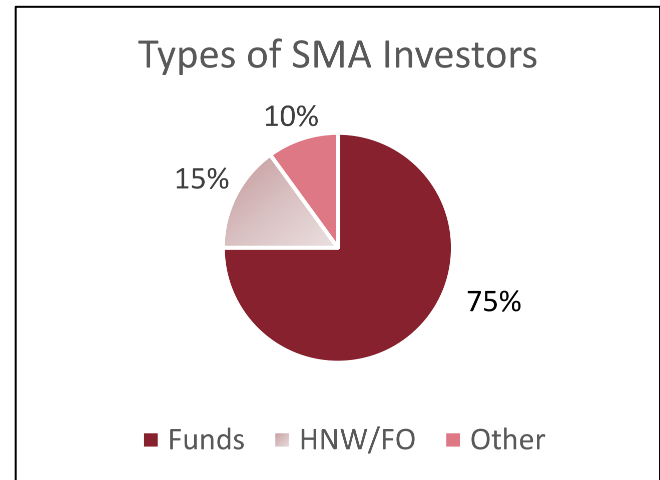
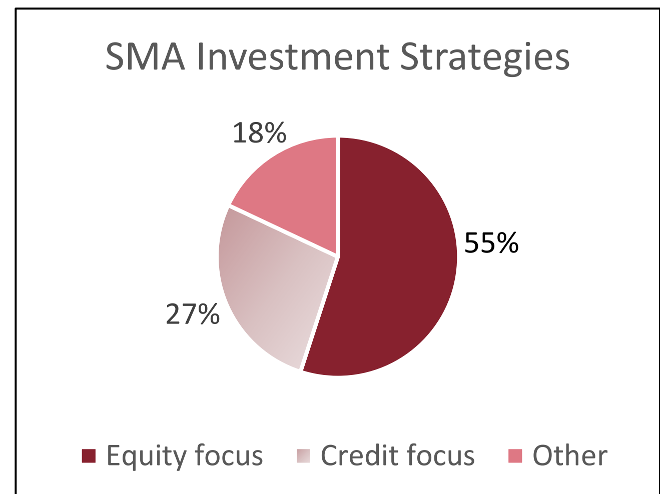
TYPES OF SMA INVESTORS:

Investors into separately managed accounts broke down into the following categories: 75% - funds (which is significantly higher than last year's 52%), 15% - High Net Worth Individuals ("HNW")/Family Offices ("FO") (as compared to 25% last year), and other – just 10%. With respect to newer managers, their SMA arrangements were all with fund investors. The significant rise in the percentage of fund investors may be indicative of their abilities to best marshal the increased resources necessary to source, diligence and negotiate with SMA managers in the current environment.



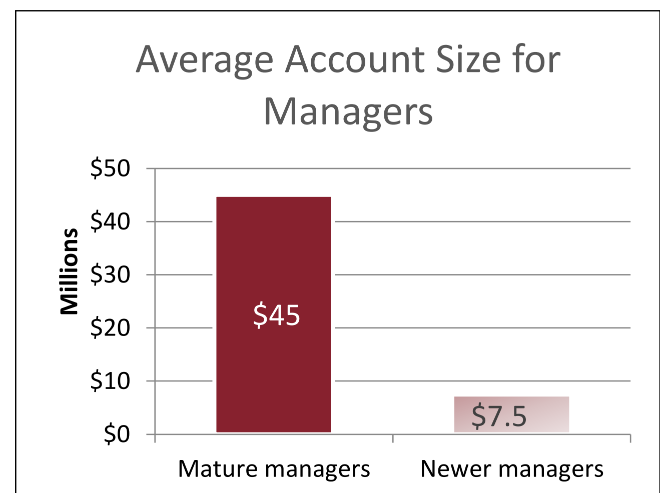
INVESTMENT STRATEGIES:

There was a somewhat wider dispersion in the types of strategies as compared to last year's Report. About 55% of the SMAs had an equity-focused strategy (versus 65% last year), 27% had a credit-focused strategy (which was the same as last year) and the remaining 18% (up from 8% last year) focused on other strategies (e.g., single name, commodities, etc.). Approximately half of the strategies implemented deviated from the manager's flagship hedge fund strategy due to mandates primarily related to: long-only exposure; higher position concentrations; greater leverage; ESG considerations; or tax efficiency.



ACCOUNT SIZE:

The average account size was over $45 million for mature managers and less than $7.5 million for the newer managers.



TERMINATION RIGHTS:

In virtually all of the SMA agreements, clients were permitted to terminate on an average of 45 days' notice, although in approximately 30% of these cases the termination was permitted only on a quarter-end or after an initial lock-up period. By contrast, managers were afforded identical termination rights in only about 1/3 of the agreements (as compared to 45% last year).

INCENTIVE FEES:

With respect to incentive fees, the SMA agreements broke down as follows: 28% charged no incentive fee (quite a bit lower than last year's 40%); 54% charged between 15%-18% (up from only 32% of the agreements last year); 9% charged a tiered incentive fee structure; and only 9% charged a traditional 20% incentive fee. By contrast, the flagship hedge funds offered by these managers generally stuck to a traditional two-tier incentive allocation model of about 20% on average for the standard class and 15%-18% for the founders class. These latest findings appear to show a demonstrable move towards more managers requiring incentive fees in their SMA arrangements, which may in part be due to the seniority of the managers in the Report.

MANAGEMENT FEES:

With respect to management fees, the average fee was approximately 1% (lower than last year's 1.5%); however, 27%% of all SMA agreements had some form of tiered management fee structure typically tied to different AUM levels. In addition, 9% of the agreements charged no management fee.

STANDARD OF CARE:

Except for SMAs with ERISA clients, all of the remaining agreements contained a gross negligence standard of care (which is consistent with what we see in hedge funds).

MOST FAVORED NATIONS ("MFN") PROVISION:

About 20% of all the agreements contained some form of MFN clause (which was a decrease from the prior Report's 33%), each of those clauses contained carveouts for insiders and larger investors, and usually those clauses only applied to other agreements in respect of substantially similar investment strategies.

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