The SMA Snapshot Report

SEWARD & KISSEL LLP

Fall 2023

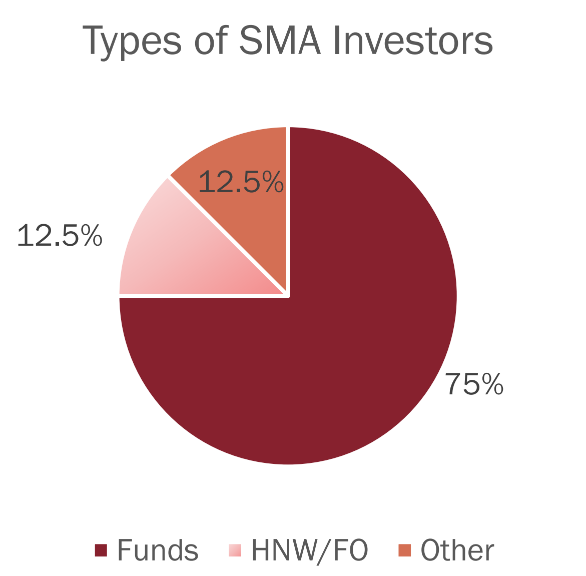
Driven by our ongoing commitment to understanding the alternative investment industry, each year Seward & Kissel conducts various studies of the major trends that impact the industry and our clients. Given the continuing investor demand for more bespoke products, we have seen an increase in the number of managers entering into separately managed account ("SMA") relationships. Accordingly, this year we are excited to release the third edition of The SMA Snapshot Report (the "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

95% of the hedge fund managers managing SMAs within the Report founded their business over two years ago ("mature managers"), as compared to 91% in last year's Report (the "2022 Report"), and approximately 90% of that group were founded over five years ago. By contrast, just 5% of the managers were founded less than two years ago ("newer managers") as opposed to 9% in the 2022 Report. These figures demonstrate a continuing investor shift in the SMA space towards mature managers that we began to observe in the 2022 Report. These findings are parallel to the results of our annual Hedge Fund Side Letter Study, which similarly shows that newer manager investors do not seek out side letters in large numbers because they are accessing hedge fund investments through founders classes which offer better terms.

TYPES OF SMA INVESTORS:

Investors into SMAs broke down into the following categories: 75% - funds (which is the same as in the 2022 Report), 12.5% - High Net Worth Individuals ("HNW")/Family Offices ("FO") (as compared to 15% in the 2022 Report), and other – 12.5%. With respect to newer managers, their SMA arrangements were all with fund investors. The continued dominance of funds as SMA investors may be attributable, in part, to their abilities to best marshal the increased resources necessary to source, diligence and negotiate with SMA managers in the current environment.



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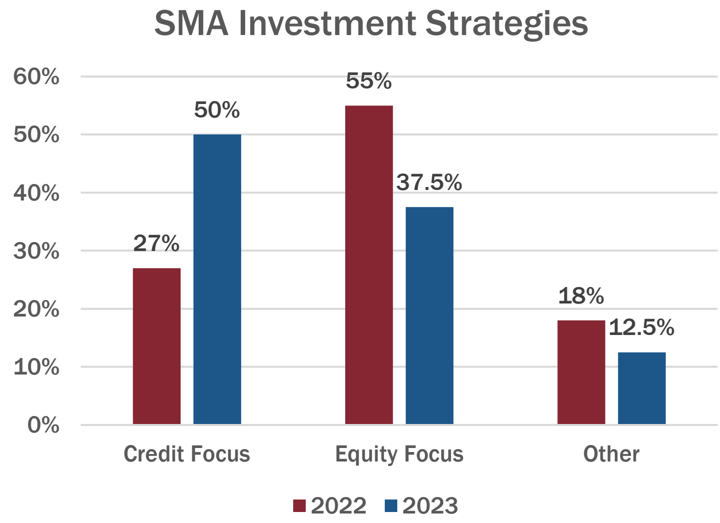
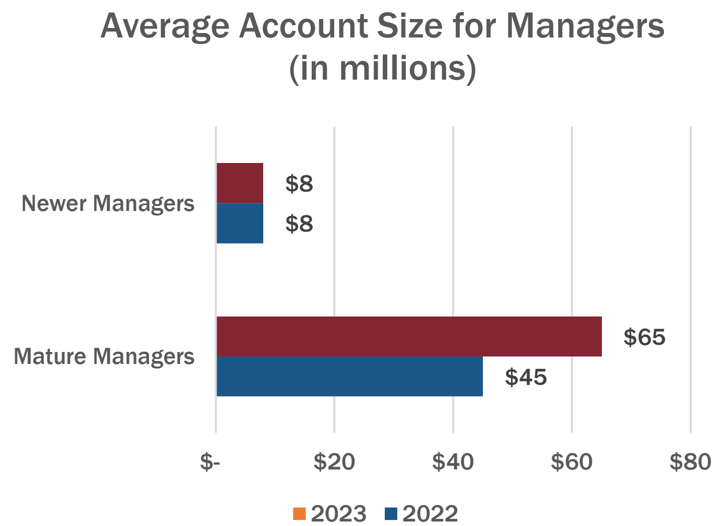
INVESTMENT STRATEGIES:

There was a noticeable shift in strategies as compared to the 2022 Report. Only 37.5% of the SMAs had an equity- focused strategy (versus 55% in 2022), 50% had a credit-focused strategy (as compared to 27% in the 2022 Report) and the remaining 12.5% (down from 18% in 2022) focused on other strategies. 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.



AVERAGE ACCOUNT SIZE:

The size of allocations to mature managers grew dramatically to an average account size of over $65 million (as compared to $45m in 2022) and stayed approximately the same for newer managers at $8 million.



TERMINATION RIGHTS:

Similar to the 2022 Report, in virtually all of the SMA agreements, clients were permitted to terminate on an average of 49 days' notice, although in about 15% of these cases the termination was permitted only on a quarter-end or after an initial lock-up period. Somewhat surprisingly, managers were given far more latitude to terminate under the identical termination rights as their clients over 55% of the time as compared to in 1/3 of the agreements in 2022.

INCENTIVE FEES:

With respect to incentive fees, the SMA agreements broke down as follows: 50% charged no incentive fee (as compared to just 28% in the 2022 Report); 25% charged a 10% incentive fee; and 25% charged a traditional 20% incentive fee. The bulk of the no-incentive fee SMAs were debt-focused, which are often more income-driven and frequently do not charge an incentive fee. By contrast, the flagship hedge funds offered by these managers generally stuck to a traditional two-tier incentive fee model of about 20% on average for the standard class and 15%-18% for the founders class.

MANAGEMENT FEES:

With respect to management fees, the average fee was approximately 1.25% (a bit higher than the 2022 Report's 1%); however, 37.5% of all SMA agreements had some form of tiered management fee structure typically tied to different AUM levels. In addition, 12.5% of the agreements charged no management fee.

STANDARD OF CARE:

Similar to the 2022 findings, 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:

As in the 2022 Report, about 20% of all the agreements contained some form of MFN clause, 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.

If you have any questions regarding the matters covered in this report, please contact any of the partners and counsel listed below or your primary attorney in Seward & Kissel's Investment Management Group.

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