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1.3% and 16%? As 2 and 20 Fades, Hedge Funds See New Fee Pressure

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By Lydia Tomkiw September 1, 2021

The golden days of the average hedge fund charging a 2% management fee and a 20% performance fee have long passed. Even amid improved returns, the industry continues to drop its fees and see investors pressing for even more concessions.

Over the past five years, both management and performance fees have slowly declined on average across the industry. In 2016, management fees stood at 1.5%, but at the end of the first quarter this year they clocked in at 1.37%, according to data from **HFR**. Performance fees on average declined from 17.61% in 2016 to 16.2% this year, HFR data showed.

A Slow Fee Decline The hedge fund industry has seen fees come down over the last five years. Source: HFR Quarter Management Fee Performance Fee Q2 2016 1.50% 17.61% Q1 2021 1.37% 16.20%
There are notable exceptions among some top-tier managers, which are able to command upwards of a 3% management fee and a 30% performance fee, but they are “few and far in between,” said **Jon Caplis**, CEO at **PivotalPath**. Large institutional investors continue to have a lot of sway and can negotiate for fees much lower than headline numbers, he added.

“The most common fee structure we are seeing right now is between 1% and 1.5% and 15% to 17.5%,” he said. “And that’s especially for new launches that almost always come with founder’s share classes, where you’re not likely seeing anything above 15%.”

Even amid the ongoing decline, many investors are still pushing for more.

Fees are “still too high,” but it’s also a mistake to solely focus on saying “‘we only want to pay x,’” said **Craig Bergstrom**, CIO at **Corbin Capital Partners**, an approximately $9.1 billion alts manager that invests in other funds.

“The high-level issue is fees remain too high and I would look at that as a percentage of the gross return that goes to managers versus what the end investors get,” he said. “It’s institutionally challenging to laser focus on net returns, but it’s what you really want to do.”

Corbin is willing to pay higher fees for the right managers, Bergstrom said, citing an example above the old standard of two-and-20, but added that plenty of managers fall well below that level, even as low as approximately one-and-10.

With many asset managers predicting lower market returns in the next decade, hedge funds that charge high fees and need high returns to justify them face a challenge, said **Michael Rosen**, principal and CIO at **Angeles Investment Advisors**.

“I think any thoughtful investor has to really question the value we are getting for the fees and illiquidity we are paying for," he said. "There always are exceptions to every rule, but this is a structural question we’ve seen demonstrated over the last decade, and I think will only worsen over the coming decade, given lower expected returns in asset classes. It’s simply not justified charging those fees without being able to deliver exceptional performance.”

Angeles began dramatically cutting its exposure to hedge funds this year by about 75%, Rosen said. It is allocating instead to some hedge fund managers that have created long-only versions of their products, as well as to private equity, private credit and other private market products.

“It seems pretty obvious to me the answer for investors is: Get out of these things and find something else or spend the time to find a truly differentiated approach which is not easy or scalable,” he said.

Some creative fee arrangements have cropped up over the years, from consultant **Albourne** promoting a [‘1 or 30’ structure] – where managers earn either a 1% management fee or 30% of the alpha a fund generates – to some managers pursuing structures where [no management fee is charged] for early investors.

But many managers are not pursuing new or esoteric fee structures, said **Kevin Neubauer**, a partner in the investment management law group at **Seward & Kissel**. Managers know they must be thoughtful with how they set fees because “it will be an area of extreme focus from investors,” he added.

“Most funds that launch have relatively traditional fee structures because that’s what institutional investors demand,” he said, adding that with management fees slowly coming down for many years, they may be hitting a floor.

Management Fee Squeeze Average hedge fund management fees by launch year. Source: Eurekahedge Launch Year North America Global 2016 1.34% 1.27% 2017 1.36% 1.17% 2018 1.33% 1.22% 2019 1.31% 1.18% 2020 1.22% 1.17% 2021 YTD 1.18% 1.04%

Hedge funds launching in North America are averaging management fees of approximately 1.18% this year, while performance fees have crept up to 18.02% this year, according to data from **Eurekahedge**. Launches were severely muted last year, as [reported], amid the onset of the global pandemic.

A hedge fund’s brand plays a key role in what investors are willing to pay, said **Donald Steinbrugge**, managing partner at **Agecroft Partners**, a third-party marketer.

Paying for Performance? Average hedge fund performance fees by launch year. Source: Eurekahedge Launch Year North America Global 2016 16.76% 14.33% 2017 17.13% 14.30% 2018 15.97% 14.68% 2019 16.02% 14.11% 2020 17.57% 15.18% 2021 YTD 18.02% 15.39%

“You pay up to invest in one of the top brands. Some of the top hedge funds are closing to new capital. Some are closing because they are really good, others are closing because they have a great brand and institutional investors want to invest with a hedge fund with a great brand," he said. "The ones with a great brand can command 2-and-20, or full fees."

Average industry fee levels will likely continue to decline, Steinbrugge said, while noting that the hedge fund industry has evolved into a two-tiered structure, with large institutional investors able to negotiate significant discounts not available to smaller investors.

"I think the trend is going to continue down," he said. "It's a slow trend. [C]apacity-constrained strategies… can command a high fee, but for most other hedge funds, fee pressure isn't going away."