

BONUSES FACE THE CRUNCH



As hedge funds are hit by low returns across the industry, bonus season this year will force managers to make strategic decisions about the future of their firms. By Elise Coroneos

The winners and losers of the hedge fund universe have never been separated by such a great divide as they are this year. On one hand, there are those in the short-selling and volatility strategies who have weathered the credit storm; on the other hand, for the first time in years, many hedge fund employees are looking at the very real possibility of taking home little or no bonus at all.

As the industry struggles to come to terms with lower returns – for many, flat is the new up – and shrinking assets, many employees are assessing their options, no longer constrained by the golden handcuffs that traditionally tie employees down to the year end and a substantial bonus cheque.

Typically a slower time in the recruitment business, the fourth quarter has seen a slew of candidates looking for alternative employment, either be-

cause of cut backs or poor performance in their fund, leaving it under the high-water mark.

From the managers' perspective, many have not made their performance fees this year, and are faced with having to cover costs and pay bonuses out of management fees alone.

For those who can't pay bonuses, the silver lining is that the pendulum has swung and they now find themselves in an employer's market.

6 If a firm is big enough to have fees that add to profits, the smarter ones will pay some bonus to hang on to key people

Frank Carr, Centennial Advisory Group

Glocap Search, which has released an annual compensation report on the hedge fund industry for the past seven years, confirms that 2008 is the first time since it began reporting that the industry will experience a substantial reduction in the average compensation.

Total compensation will be down 30-40%, depending on performance and assets, with year-end compensation down in the vicinity of 40-50%, according to Adam Zoia, the chief executive officer of Glocap Search.

The most pessimistic in the industry say that bonuses are likely to be cancelled not only for this year, but for the next two years. "Funds that are down by, say 15%, are unlikely to get performance fees until 2010," said a source from a major prime broker.

However, there are those who believe that negative performance is not a guarantee that no bonus will be forthcoming. "We are seeing that most funds will pay bonuses regardless of performance because they want to keep their good employees, but of course, they will be drastically reduced," said Joshua Crandall, a managing partner at executive search firm, The Wilton Group.

Bigger and leaner is better

At firms that finish the year down, with little or no performance fee income to speak of, the factors likely to impact the size of bonuses or whether they are distributed at all, will depend on the overall size of the firm and the number of staff as a function of the assets managed, says Zoia.

Those at bigger firms have more of a chance of a bonus, as those firms are more likely to have cash pots set aside or savings from which to draw.

Also in with a better chance of receiving a bonus are staff at firms where management fees more than cover costs, where there is a lean complement of staff compared to the level of assets managed or, of course, if you are graded with an owner who is willing to dip into their own pocket.

"Smaller managers who have not put money aside will not pay bonuses. To the extent that a firm is big enough to have management fees that add to profits, the smarter ones will pay some bonus to hang on to key people," says

HEDGE FUND COMPENSATION 2008 Source: Glocap Search 2008 report

AUM	YEARS OF EXPERIENCE			
	1-2 yrs	2-4 yrs	5-9 yrs	10+ yrs
\$0 - \$500m	\$175k	\$231k	\$378k	\$557k
\$500m - \$3bn	\$196k	\$279k	\$538k	\$700k
\$3bn - \$10bn	\$252k	\$327k	\$560k	\$844k
\$10bn +	\$269k	\$360k	\$785k	\$1.46m

Results are estimates for investment professionals at middle performing funds
Includes base and bonus. Excludes compensation from any form of ownership

Frank Carr of Connecticut-based Centennial Advisory Group.

As such, bonuses this year are going to be more strategic, says Zoia. "Those who the owner really wants to retain, he will likely find a way to pay."

Where an employee is at a firm that is struggling to survive, but nevertheless has a contract that guarantees a bonus, industry whispers suggest managers are either negotiating those bonuses downward or selecting not to pay them. Some are even offering non-cash bonuses, like equity stakes in the fund or a new board position.

"I expect contractual payouts of firms that are still in business at the time of distribution, are going to renegotiate," says Robert Olman, founder and president of Alpha Search Advisory Partners.

Aside from key staff, employees are going to have less room to negotiate than in previous years. Managements know that there are few places people can go where they will get paid any better. Furthermore, jobs at proprietary trading desks and investment banks no longer present a lucrative, viable option.

Out of the frying pan

The widespread and uncertain nature of the downturn means that employees face a risk that jumping ship might not necessarily leave them in a better financial situation.

Employees at hedge funds that are struggling would be well served to sit tight until all firms "fess up and lay their cards on the table," according to Lynn Tidd, the head of hedge funds for global executive search firm, Russell Reynolds.

"People are better off holding steady to see where the dust settles in terms of performance and asset size. From

the managers' perspective, they will not know their cost structure for 2009 until they know what assets will look like and investor boards will typically not convene again until the new year," says Tidd.

When they do convene, significant re-allocations and changes are likely to occur which could change the playing field. As a result, those looking for new jobs are not likely to hear from recruiters until the beginning of the second quarter, says Tidd.

Those who do decide to brave the job market should be aware that the ground rules have changed. Recruiters canvassed by *HFMWeek* said that future packages are going to be more along the lines of longer term wealth creation, aligning the interests of employees and employers, with no premiums up front.

Despite the negative outlook for compensation, there are some bright spots where demand for candidates remain and have even strengthened, say recruiters. Nevertheless, offers for new employees are generally way down.

Both Zoia at Glocap Search and Carr at Centennial Advisory Group reported having multiple active searches for asset gatherers. "People are beefing up the asset area in order to retain their assets, or if assets do decline, they need people to get assets back next year," says Carr.

Kyle Ramkissoon, a principal and founding member of LJC Partners, which works with DE Shaw, Fortress and AQR, says it is seeing an increased demand for high-frequency traders and those in quantitative strategies, especially statistical arbitrage.

However, leading the pack at the moment is hiring in credit and traditional distressed debt, says Olman of Alpha Search Advisory Partners. ■