Proskauer

Hedge or Hybrid? Terms and Structuring Considerations

Practical Guidance on **April 8, 2022**

This practice note discusses the key differences between hedge fund and hybrid fund structures, and the factors that fund sponsors and their counsel should consider when evaluating the type of fund structure and strategy to pursue.

Traditional Hedge Fund Terms

The term “hedge fund” has been used for decades to describe private, professionally managed investment funds. The traditional hedge fund was based on a “long/short equities” model, taking long positions in stocks thought to be “underpriced” and taking short positions in stocks thought to be “overpriced.” Other common investment strategies include market neutral, event-driven, credit, and global macro. A hedge fund is generally open-ended, in that it permits periodic subscriptions and redemptions at net asset value, has an indefinite life, and pays the investment adviser an asset-based management fee and performance-based compensation. Where hedge funds found themselves holding illiquid assets, or managers came across the occasional illiquid investment opportunity, hedge fund managers were able to create “side pockets” to hold these assets and investments outside the larger liquid fund structure.

The Growth of Hybrid Funds

Hybrid funds gained in popularity after the 2008 financial crisis, and are again becoming increasingly popular, as hedge fund managers seek exposure to credit and other instruments which may be less liquid than equities, and pursue longer-term, more concentrated strategies to supplement their primary investments. With the investor landscape becoming increasingly competitive, and with sophisticated investors expecting the liquidity of their fund investments to match the liquidity of the fund’s underlying investments, hedge fund firms are looking for ways to innovate and offer investors more choice, flexibility, and returns. To that end, an increasing number of firms are launching hybrid funds, which are private investment vehicles that have attributes of both traditional hedge and private equity funds. Where a manager is considering whether to launch a hybrid fund versus a traditional hedge fund, a hybrid fund may be the more appropriate choice when making longer-term, more concentrated investments is a central focus of the manager’s investment strategy.