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Goldman Fund Cuts Fees to Woo Investors After Loss (Update2)

By Christine Harper and Katherine Burton - Aug 15, 2007

Aug. 15 (Bloomberg) -- Goldman Sachs Group Inc. waived fees to draw investors to its Global Equity Opportunities hedge fund after stock-market losses wiped out $1.4 billion of assets this month, according to a person with direct knowledge of the terms.

New participants won't pay the 2 percent management charge and Goldman will cut its performance fee in half, said the person, who declined to be named because the information is private. The New York-based firm and investors including billionaire Maurice ``Hank'' Greenberg agreed to put $3 billion in the fund earlier this week. Goldman spokesman Lucas van Praag confirmed the terms and declined to comment further.

Goldman, the world's most profitable securities firm and second-largest hedge fund manager, needed capital after stock declines worldwide confounded Global Equity's computer-driven bets and threatened to spur withdrawals. The so-called quantitative fund lost 28 percent of its value this month. Other quant funds, including AQR Capital Management LLC and Highbridge Capital Management LLC, also suffered declines.

``In order to lure outside investors, they had to sweeten the deal,'' said Ross Intelisano, a lawyer in New York at Rich & Intelisano LLP, which advises hedge fund clients.

Goldman invested $2 billion of its own money in the fund, which had $3.6 billion in assets after last week's tailspin. Existing stakeholders can get the same revised terms on any money they commit by Aug. 17, the deadline for redemption notices this month.

Not Scaling Back

Goldman won't scale back its own contribution, van Praag said. The company earlier confirmed a report in the Financial Times that it would reduce the commitment according to the amount added by current investors.

``We are talking to existing investors about putting in new money,'' van Praag said.

Until now, Global Equity investors have been paying 2 percent of assets a year as a management fee and 20 percent of profits as a so-called incentive fee. The new arrangement doesn't impose any incentive fees until the fund appreciates by 10 percent. Goldman will keep 10 percent of the fund's profits above that threshold.

Goldman Chief Financial Officer David Viniar said Aug. 13 that the new investment wasn't a ``rescue'' for Global Equity. Instead, the firm and the fund's new backers were taking advantage of an ``investment opportunity.''

With the cash infusion, Global Equity managers Mark Carhart and Raymond Iwanowski would have ``more flexibility to take advantage of the opportunities we believe exist in current market conditions,'' Goldman said.

Six-Month Lockup

Global Equity's existing investors can pull their money monthly with 15 days' notice. The new investors, led by Greenberg's C.V. Starr & Co., billionaire Eli Broad, and Perry Capital LLC, aren't permitted to withdraw their money for six months. The same lockup terms will apply to any money contributed by investors this week.

``It's an astute pricing strategy,'' said Douglas Ciocca, who helps manage $950 million, including Goldman shares, at Renaissance Financial Corp. in Leawood, Kansas. ``It tells me they're looking for people that have the wherewithal and the confidence to commit for a longer period of time, and there should be a reward for that.''

Existing investors wouldn't have been on the hook for the 20 percent performance fee because of Global Equity's decline since July 2006. Instead, they're only paying the 2 percent management fee until the fund's performance surpasses its highest level last year, known as the ``high water mark.''

Quants Confounded

Hedge funds are largely unregistered pools of capital that cater to wealthy individuals and institutions and allow managers to participate substantially in profits from investments.

Quantitative hedge funds began posting steep losses in late July and early August as the subprime mortgage debacle triggered a crisis of confidence in credit markets. Stock-market declines followed. The funds were forced to sell more-liquid stock investments to raise cash and reduce debt, according to a report published by Lehman Brothers Holdings Inc. analyst Matthew Rothman.

The selling undermined the computer models that make investment decisions for the funds. Stocks that the models predicted would decline in price rose, and shares they anticipated would rise instead fell.

Goldman shares have been hurt by the market turmoil and concerns over prospects for its hedge fund fee revenue. The firm booked $700 million from its Global Alpha fund alone in 2006. Global Alpha, a $7.25 billion hedge fund also run by Carhart and Iwanowski, dropped 27 percent this year through Aug. 10, Viniar said this week. The fund also declined last year.

Goldman fell $4.85, or 2.9 percent, to $164.90 in composite trading on the New York Stock Exchange. It's now down 17 percent on the year.

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