GAARD
CAPITAL LLC

Unfettered Fund Fees

A new trend in fee structure further misaligns incentives

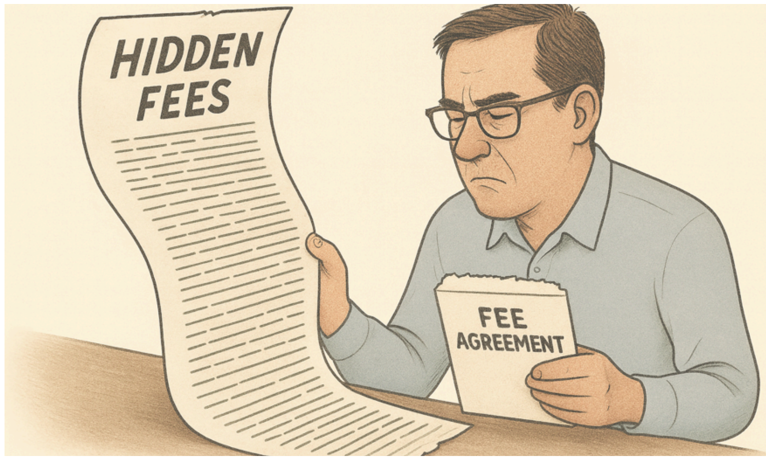
Investment management firms are adopting a new pass-through expense model. The model charges a wide range of business costs directly to investors. Whereas before, firms often used structures such as "2 and 20," which meant investors would pay the investment firm 2% of the assets under management and 20% of gains above some benchmark, a new trend has emerged that foregoes the "2" and simply passes along business expenses. The incentive structure encourages wasteful spending at the expense of the client's performance.

When “Business Expenses” Become *Your* Expenses

Capula Investment Management, a large multi-strategy hedge fund, offers a clear example of how broad pass-through authority can affect investors in ways that go beyond standard fee considerations. In 2021, the firm launched a fund using an uncapped pass-through expense model, giving Capula broad discretion to bill a wide range of operating costs directly to investors rather than covering them through traditional management fees.

Among the expenses charged to the fund were multi-million-dollar compensation packages for portfolio managers, recruiting costs, consulting fees, deferred compensation buyouts, and other overhead typically borne by the management company. According to a subsequent legal complaint, certain discretionary expenses, including artwork purchases and private jet travel, were billed to investors without being clearly disclosed in the offering documents.[1]

When Capula's compliance officer raised concerns that these charges did not meet SEC disclosure requirements, senior leadership allegedly encouraged him to be more "commercial," suggesting that his strict approach to SEC disclosure was out of step with the more flexible norms common in the industry. This episode highlights a broader issue: when fee structures are complex or loosely defined, they shift incentives in ways that can work against investors. When fee arrangements lack clarity, they create room for conflicts of interest and weaken the alignment between managers and their clients.[2]



Gaard Capital: Cutting Through the Complexity

Gaard Capital cuts through complexity. Our fee structure is simple. The fee structures of the investments we use are also simple. We avoid long lockups, multiple layers of management and performance fees, and incentive systems that harm the client. We avoid opacity and structures with governance challenges. If there were a relationship between expense and performance, we might consider more complicated arrangements. However, the evidence clearly shows that higher fees do not lead to higher performance.[3]

We instead focus on building portfolios using low-cost, liquid ETFs and other transparent assets so clients know what they own, what it costs, and why it is in the portfolio. Investors should only pay for the value they receive, not provide a blank check for manager overhead, personnel expenses, and business costs repackaged as "strategy." Costs are one of the few variables investors can control. We want investments that work for the client, not for the manager.

Conclusion

Fee arrangements in modern finance can be complex, and that complexity generally works against investors. The Capula example exemplifies how opaque disclosures can lead to costs that investors never intended to bear. From Gaard Capital's perspective, this underscores the importance of understanding fee arrangements. Transparent, well-defined fee policies reduce uncertainty, strengthen alignment, and help safeguard long-term returns. Maintaining clear and simple fee arrangements is a core part of responsible investment management and a guiding principle of how we partner with clients.

References

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3. Cooper, M. J., Halling, M., & Yang, W. (2021). *The persistence of fee dispersion among mutual funds*. *Review of Finance, 25*(2), 365–402. https://doi.org/10.1093/rof/rfaa023