

Forex Trader-to- Forex Fund Manager: The Path to Success

Author: Hannah M. Terhune is an attorney with Capital Management Law Group, PLLC, based in Washington, DC. Miss Terhune specializes in setting up hedge funds, incubator funds, master/feeder funds, forex funds, commodity pools and other financial products of interest to the alternative investment community. Miss Terhune and her legal team can be reached at (202) 498-7533 or legal@capitalmanagementlaw.com.

© Copyright 2006 – Hannah Terhune

Forex (or “currency”) funds have enjoyed a huge surge in popularity. From a forex trader’s perspective, it's perfectly clear as to why forex funds are so popular: a skilled forex fund manager can rake in a substantial income and continue to trade his own cash. While starting and managing a forex fund isn't for the inexperienced forex trader, it's not as tough or complicated as it may seem. These funds woo investors who want to participate in the forex markets but who know that they do not have the time or expertise to trade their own accounts.

How does a forex fund work?

Although the name still sounds exotic to some, a forex fund in the United States is typically a private investment partnership set up so as to allow it to remain exempt from the registration requirements federal and state law imposes on publicly traded funds. When set up outside the United States, a forex fund is usually set up as an exempt limited company in a low or zero tax country, such as the Cayman Islands.

As a private fund, a forex fund cannot legally advertise either in the United States or abroad and it can only accept investors “known” to the fund manager. However, a fund manager may have a website to advertise its advisory business in most cases and the fund manager may offer access to the forex fund's daily performance through a password protected website. Many countries have rules similar to those of the United States in this regard.

How much could I earn running a forex fund?

Most forex funds are quite small. Many who start forex funds also keep their “day jobs.” Whatever the size, one real advantage to starting a fund is that the fund manager can legally accept compensation for his services. This compensation may provide a good supplement to the manager’s other income or it may allow him to manage the fund on a full-time basis.

The compensation for a fund manager usually consists of a management fee and a performance allocation, which is a share of the profits. A management fee of 1% and a performance allocation (or performance fee) of 20% is well within global industry standards. Of course, the fund manager also receives the profits on the money he himself has invested in the fund.

Assume the following:

- Management has \$1 million under management in his forex fund;
- A 1% management fee;
- A 20% performance allocation;

- The fund began operating on Jan. 1; and
- Fund has returned 15% YTD.

The forex trader (now forex fund manager) would have gross income of \$40k resulting from a \$10k management fee ($\$1M \times 1\% = \$10k$) and a \$30k performance allocation ($\$1M \times 15\% \text{ return} = \$150k \times 20\% = \$30k$) Using the same assumptions, a fund manager with \$3 million under management would earn \$120k and a fund manager would earn \$400k with \$10 million under management.

Prospective investors in the fund like to see that fund manager has invested his own capital in the fund. Assuming that the fund manager has indeed invested a significant portion of his own cash in the fund (and since the fund manager will not charge fees on his own investment in the fund), he earns an additional money from the 15% return on his investment.

Who would my investors be?

A forex fund investor needs to be a sophisticated investor who understands the risks associated with the fund. Since the media has generally informed the public of the potential advantages (as well as the risks) of forex funds, and since forex funds cannot advertise, there are many investors who would be interested in forex funds if they had the opportunity. A trader may find that in addition to family and close friends, many colleagues and casual acquaintances may be potential investors.

If you are interested in getting investors for your fund, your selling efforts must be personally directed toward investors who are known to you. Advertising and any other non-personal communications are prohibited. For the forex trader who wants to trade for his family and friends, this obviously is no problem at all. The forex fund is an ideal vehicle to pool the resources of a small group of investors.

How do I set up a forex fund?

Starting a forex fund means hiring a lawyer with the proper expertise to prepare all of the required documents and provide you with tax and regulatory advice. The forex trader starting the fund will have to work closely with his lawyer to prepare of some of the documents, especially the private placement memorandum (PPM), which is the description of the fund provided to investors. The whole process can be done in as little as 4 weeks, at a cost of around \$10,000. In some cases, the cost is even less.

For a trader to enjoy such success, he must set up the correct infrastructure. The desire to pool assets in a way that is proper, both from a business and a legal standpoint, has led many forex traders to start their own forex funds. For a successful forex trader, a forex fund is an efficient, legal, and professional way to trade your own money along with the money of those who want to benefit from your expertise.