

Top Performing Funds Charge Lowest Management Fees

Top quartile private capital funds have lower average management fees, but higher carried interest and hurdle rates

Preqin's 2016 *Private Capital Fund Terms Advisor* finds that top quartile funds favour fee structures that incentivise strong performance, with lower average management fees and a higher rate of carried interest. Across different fund sizes, top quartile private capital funds consistently have low average management fees: funds with less than \$50mn in AUM charge 1.24% on average, while funds with more than \$1bn charge an average of 1.05%. By contrast, third quartile funds with less than \$50mn charge an average of 2.08% in management fees, while those with more than \$1bn charge 1.04%. Overall it is noticeable that the smallest funds have wide variance in their average management fees, while the largest funds all have very similar rates – however, top quartile funds of all sizes have relatively consistent management fees.

However, at the same time it appears that top quartile private capital funds account for a greater proportion of those funds which charge higher carried interest rates, and which apply higher hurdle rates to their funds. More than half (58%) of private capital funds charging more than 20% in carried interest are top and second quartile funds, while bottom quartile funds comprise only 15% of this group. At the same time, the majority (56%) of funds with a hurdle rate greater than 8% are top or second quartile funds, as firms look to further align their interests with those of investors.

Other Key Private Capital Fund Performance and Fees Facts:

- **No Hurdle Rate:** Thirteen percent of recently raised funds have no hurdle rate; **Advent International is one such firm that announced that its eighth flagship fund will not have a hurdle rate**, following a similar approach by Warburg Pincus and Hellman & Friedman.
- **Carry Structure:** Despite investors indicating that they prefer whole fund carried interest structures, **31% of recently raised buyout funds have a deal-by-deal distribution**, with only two-thirds operating on a whole fund basis. This is the lowest proportion of any private capital fund type.
- **Alignment of Interests:** The proportion of private capital investors that report that their interests are aligned with managers' has **risen from 63% in 2014 to 79% in May 2016, the highest proportion Preqin has seen**. Additionally, a third of investors report that fund terms have changed in their favour over the past 12 months.

To access further information and analysis, please see the full report below:

<https://www.preqin.com/docs/reports/Preqin-Special-Report-Private-Capital-Fund-Terms-November-2016.pdf>

Comment:

"Fund terms and conditions remain an integral component of the alignment of interests between fund managers and institutional investors in the private capital industry. Investors want to ensure that they are rewarding strong performance, and fees will inevitably come under the microscope when returns are not matching investor expectations.

While the correlation between fees and performance is not absolute, it is notable that the best performing private capital funds have adopted fee structures which reward them for their performance, while limiting investment period costs to investors. Top and second quartile funds charge consistently lower management fees, but use higher rates of carried interest and higher hurdle rates as firms attempt to align their interests with those of their investors. These managers look to trust in their ability to generate strong returns in order to clear these hurdle rates and gain a higher portion of the profits through their carried interest awards."

Selina Sy – Editor, 2016 Preqin Private Capital Fund Terms Advisor

Note to Editors:

- Preqin is spelled without the letter 'U' after the 'Q', the company name being an amalgamation of the former name, Private Equity Intelligence.

About Preqin:

Preqin is the leading source of information for the alternative assets industry, providing data and analysis via online databases, publications and bespoke data requests.

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