

**Private Funds
CFO**

Fees and Expenses Survey

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Private Funds CFO

Fees and Expenses Survey

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Insight

Seven charts that matter **Our biennial survey reveals the latest developments in fees and expenses, as the power to determine best practice returns to the industry**

The SEC's Private Funds Rules have been vacated, but the regulator will continue to use its enforcement division to pursue transparency in private markets fees and expenses with dogged determination, *writes Amy Carroll*.

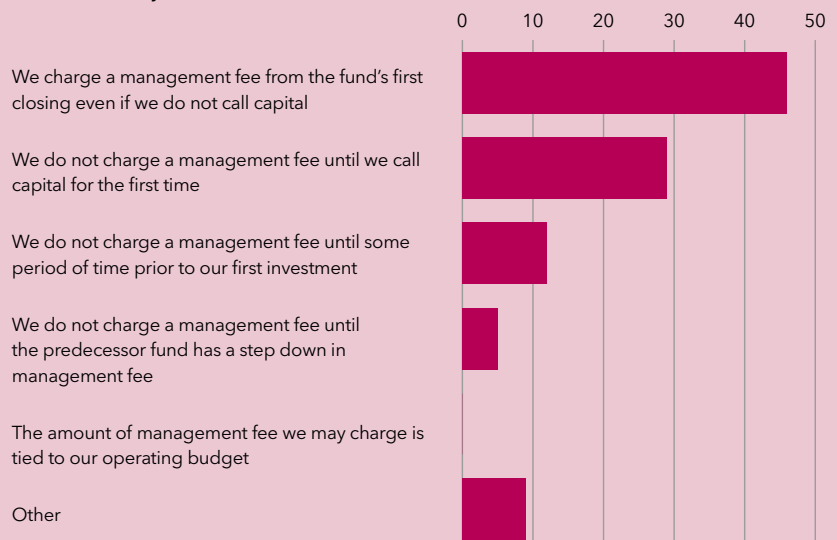
While enhanced quarterly reporting will no longer be mandated, the Institutional Limited Partners Association has rebooted its proposed quarterly reporting template in the hope it will become a voluntary industry standard instead. There is no doubt then that the drive towards disclosure remains

intact. LPs demand it, and GPs must respond. The *Private Funds CFO Fees & Expenses Survey* has again captured the latest evolutions in one of the most sensitive areas of fund negotiations. As the power to define best practice returns to the industry, here are key findings from 2024's survey.

Crossing the starting line

Almost half of survey respondents start charging a management fee at first close, while close to a third wait until they have made their first investment. Negotiations typically center on balancing the need to provide the manager with sufficient capital to run operations, including investor onboarding and deal-sourcing functions, in the early life of the fund with the need to mitigate the J-curve. Other considerations include the need to avoid conflicts of interest, which may occur if two funds are in the fee-earning investment stage at the same time.

Which is true of your most recent fund? (%)



Source: Private Funds CFO Fees & Expenses Survey 2024

Breakdown costs

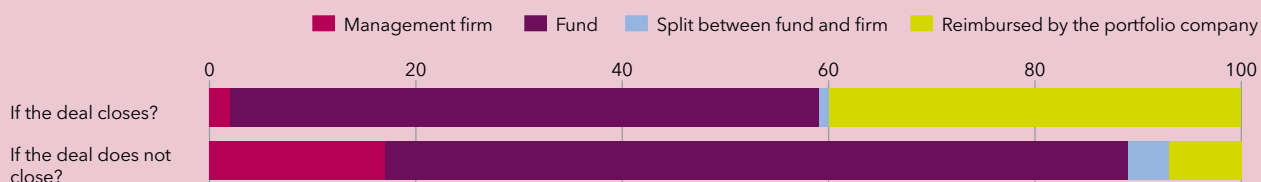
Broken-deal costs remain one of the most contentious points of Limited Partnership Agreement negotiation, with the survey showing that in most cases, funds bear the brunt of the expense, even if a deal falls apart in the early stages.

Managers maintain they are working on behalf of their

limited partners when they kick the tyres on prospective investments. LPs, however, may argue that the costs accrued reflect shortcomings in the due diligence process.

Meanwhile, the situation only becomes more complicated when co-investors enter the mix.

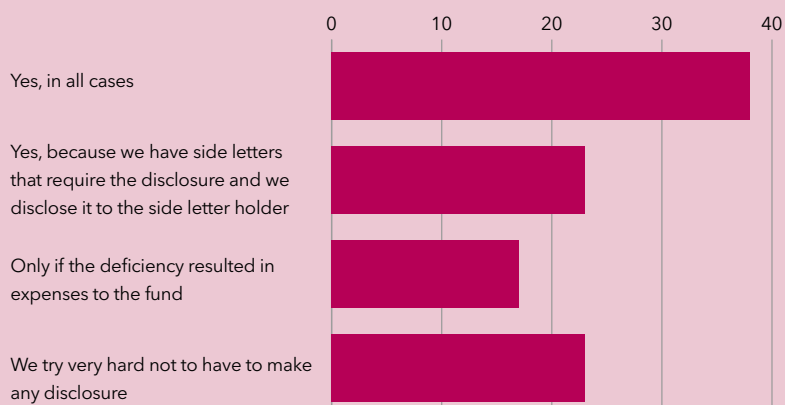
After data room review in an auction deal, a non-binding indication of interest is executed in connection with which you incur legal and accounting expenses. Who pays for these expenses... (%)



Failure to communicate

The entire rationale for the SEC's clampdown on private equity fees and expenses is the need to promote transparency in the asset class and provide investor protection. It is perhaps ironic then, that managers continue to avoid disclosure around SEC examinations themselves. Less than 40 percent of survey respondents routinely report deficiencies highlighted by the SEC to limited partners, while close to a quarter aim to avoid disclosure at all costs.

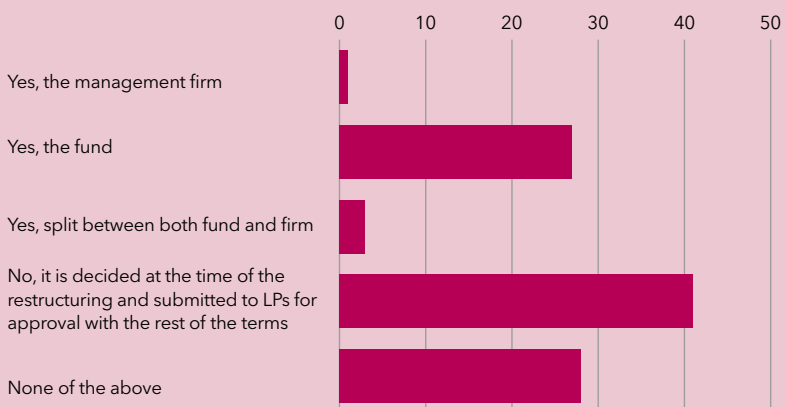
As a result of a routine examination, the SEC highlights deficiencies in the examination report. Do you disclose these deficiencies to your LPs? (%)



Restructuring ripples

Continuation vehicles have risen in prominence in recent years, as traditional exit routes have remained challenged. Yet over 40 percent of respondents do not stipulate in their LPA who should bear the cost of a fund restructure. Of those that do, the majority expect the existing fund to carry the burden. But as LPs become more sophisticated in their understanding of how these vehicles work, there is a growing sense that costs should shift to the continuation vehicle itself.

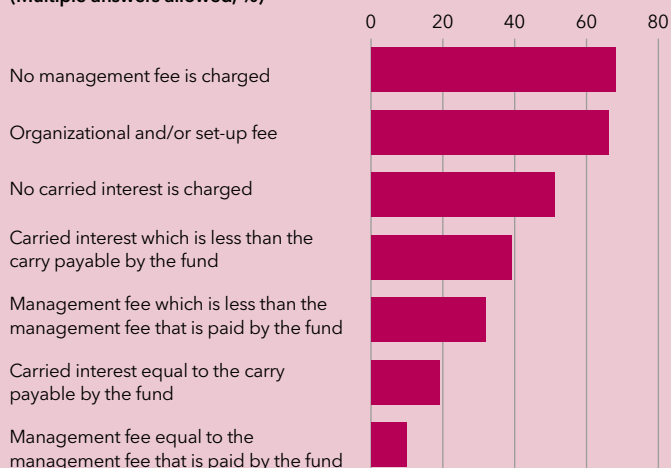
Did you stipulate in your LPA who pays for costs relating to a potential fund restructuring? (%)



Co-investment complexities

A lack of uniformity remains over how fees and carried interest are applied to co-investments. Over two-thirds of respondents charge no management fee, with a nominal organizational or set-up fee commonplace. Others charge a reduced fee, while some charge the same fee as the main fund. Similarly, carry treatment varies significantly and it seems a lot depends on the rationale for the co-investment and the level of criticality it brings to the deal. The co-investment structure also has an impact, with separate fund structures carrying higher costs than direct investment into a holdco.

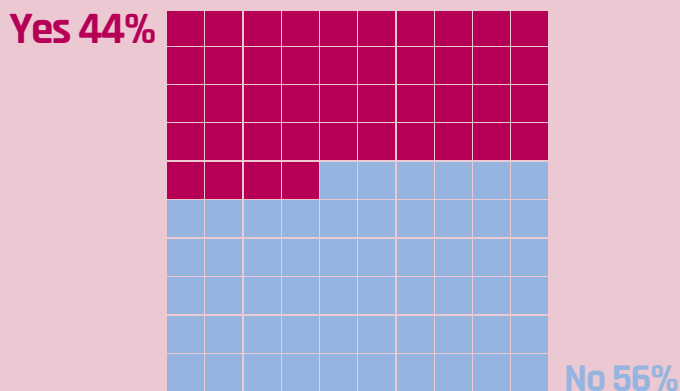
Which of the following do you charge to your co-investment vehicles?
(Multiple answers allowed, %)



Offsetting news

It has increasingly become the norm that transaction and monitoring fees are 100 percent offset against management fees – at least on paper. However, the growing prevalence of co-investment means this is not always the case in practice. Over half of survey respondents said they reduce fees subject to offset by the percentage of investors that are exempt from paying management fees. Critically, this typically includes co-investment provided by the management team itself.

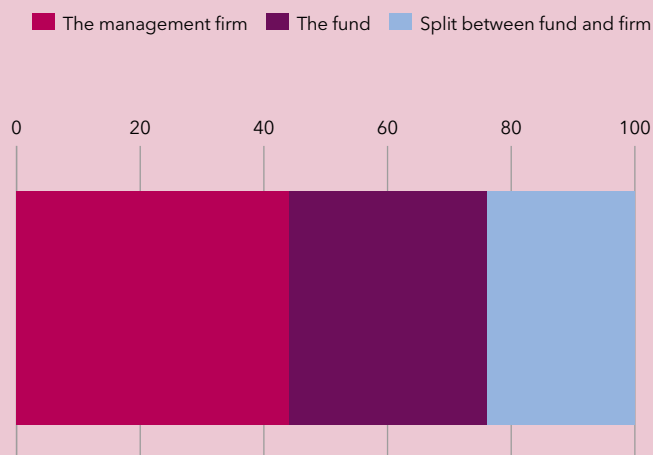
Do you reduce the fees subject to offset by the percentage ownership in the portfolio company that is held by third parties?



ESG expenses

One relatively nascent area of expense involves ESG consultancy and benchmarking. This is an area where no clear market standard has yet emerged regarding who should bear the cost. The survey shows there is a shift toward ESG being deemed a fund expense (32 percent of 2024 respondents compared with 29 percent in the 2022 survey). However, it ultimately depends on who is driving demand. If a manager is promoting ESG as a core component to its strategy, then LPs may argue it should carry the cost. If investors are insisting on ESG ratings to satisfy their own reporting requirements, meanwhile, then the onus is on the fund.

Your firm employs an ESG consultant to advise on a responsible investment policy across your portfolio. Who pays? (%)





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Editor's letter

The disclosure decade



Helen Lewer

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Welcome to the 2024 *Private Funds CFO Fees & Expenses Survey*. Conducted biennially since 2014, the survey is a unique window, and valuable benchmark, on fees and expenses practice in the world's biggest private funds market – the United States.

That first survey coincided with the dawn of a decade marked by acute regulatory oversight by the SEC – revisited on p. 8 by our Washington correspondent Bill Myers. Subsequent iterations have charted a period of unprecedented adjustment by those in charge of private funds' finance and compliance functions.

Perhaps the single biggest story emerging from the past decade, though, is of a sector that has transitioned from one with a reputation for being opaque to one embracing transparency, driven by regulatory necessity, of course, but also by an increasingly inquisitive investor base that expects to know exactly what, and who, they are paying for.

Growing complexity has accompanied this more transparent landscape. "The rulebook has got a lot bigger," muses one expert, with ESG and cybersecurity adding to the cost and compliance burden on CFOs and their teams. So, it must be of some relief that the SEC's latest oversight manoeuvres, the private fund adviser rules, were recently struck down by the law courts.

There's a peculiarity in this year's survey findings, however. Under 40 percent of respondents are disclosing deficiencies unearthed in SEC examinations to their investors; just over 20 percent report avoiding such disclosures at all costs. That signals a transparency and communication issue that needs addressing. Great progress has been achieved to date, certainly, but the transparency journey has not concluded. And *Private Funds CFO* will continue to monitor it with interest.

Helen Lewer

“ The transparency journey has not concluded ”



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How we reached our results

Our survey is one of the most comprehensive insights into fees and expenses in the US private markets industry

The *Private Funds CFO Fees & Expenses Survey* was launched in 2014 in response to fund managers' questions about who should pay for various fees and expenses. The report, which we produce every two years, is intended as a benchmark to compare and review fee-related practices across the private markets industry.

Creating the benchmark

PEI Group's Research & Analytics team surveyed 110 US alternatives fund managers on their fee and expenses practices in May and June 2024. We targeted CFOs because they are most informed of these practices. However, if CFOs were unavailable, we sought responses from other professionals, including CCOs, COOs and IR professionals,

provided they were aware of their firms' practices. The sample covers each region in the US and responses were received across fund size spectrum.

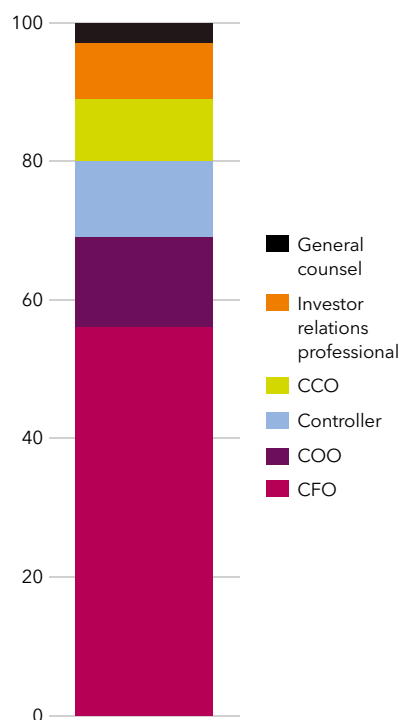
What about confidentiality?

To encourage wide participation, the survey is entirely confidential.

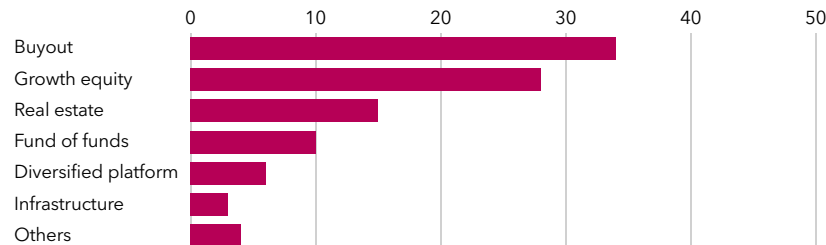
Why alternatives and not just private equity?

While 62 percent of survey respondents manage buyout or growth funds, we included fund managers in other illiquid alternative asset classes such as real estate and infrastructure because much of the scrutiny facing private equity firms is placed equally on those other asset classes. ■

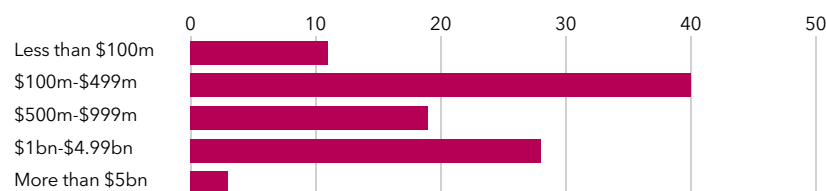
What is your primary job title? (%)



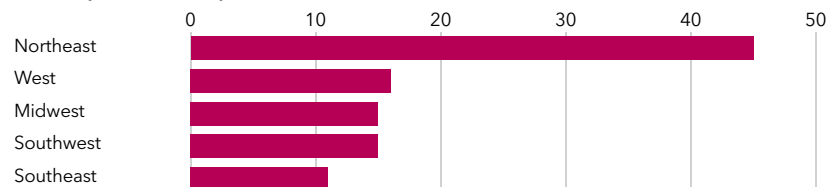
What type of investment strategy best describes your firm? (%)



What is the size of your most recently closed fund (ie, no longer raising capital)? (%)



Where is your firm headquartered in the US? (%)



Source: Private Funds CFO Fees & Expenses Survey 2024

A decade of regulation

Bill Myers charts the evolution of the SEC's thinking on fees & expenses

| Year | Company | Settlement | Comment |
|------|---------------------------------|----------------|---|
| 2010 | | | Congress passes Dodd-Frank, requiring large private equity managers to register as investment advisers with the SEC. Imposes whole suite of elevated fees & expenses disclosure rules and puts funds on regular exam schedule. |
| 2014 | Lincolnshire Management | \$2.3 million | Agrees to settle SEC claims that it misallocated fees and expenses among private fund clients. |
| 2015 | Kohlberg Kravis Roberts | \$47.4 million | Agrees to settle SEC allegations that it did not properly allocate broken deal expenses. |
| 2015 | Blackstone Management Partners | \$39 million | Agrees to settle SEC accusations that it did not properly disclose its accelerated management fees. |
| 2015 | Fenway Partners | \$10.2 million | Agrees to settle SEC accusations that it failed to disclose conflicts of interest "to a fund client and investors when fund and portfolio company assets were used for payments to former firm employees and an affiliated entity." |
| 2015 | Cherokee Investment Partners | \$100,000 | Agrees to settle SEC claims that it improperly allocated consulting, legal and compliance fees to a pair of private equity funds it was advising. |
| 2016 | WL Ross & Co | \$2.3 million | Settles SEC claims that it did not properly disclose its fee allocations. |
| 2017 | Platinum Equity Advisors | \$3.4 million | Agrees to settle SEC allegations that it did not properly disclose broken-deal fees for three private equity funds it advised. |
| 2018 | Aisling Capital | \$200,000 | A venture capital fund manager, agrees to settle SEC accusations that it failed to offset consulting fees it charged against its management fees. |
| 2018 | Beverly Hills Wealth Management | \$100,000 | The firm and Margaret Mulligan Black are censured. Beverly Hills agrees to settle SEC claims that the firm improperly withheld fees from clients that terminated their business with the fund adviser. |
| 2018 | NB Alternatives Advisers | \$2.73 million | Agrees to settle SEC allegations that it improperly charged executive compensation to funds it advised. |
| 2018 | Lightyear Capital | \$400,000 | Agrees to settle SEC accusations that it did not properly allocate expenses and did not properly offset management fees in co-investment vehicles. |
| 2019 | Corinthian Capital Group | \$140,000 | The firm and two of its executives agree to settle SEC claims that the firm and its executives improperly charged "organizational expenses." |
| 2019 | | | The SEC issues a guidance document explaining how regulators see an investment adviser's fiduciary duty, including how he or she discloses fees and expenses. |
| 2019 | Swapnil Rege | \$700,000 | A portfolio manager for a private fund, agrees to accept a three-year ban and to settle SEC charges that he manipulated the price of his funds' investments to goose his bonuses. |

| | | | |
|------|---|---------------|---|
| 2019 | Mitchell Friedman | \$181,000 | A principal at Sharpe 4 Capital settles SEC allegations that he did not properly disclose a conflict of interest in his compensation package from a fund focused on foreclosed real estate. |
| 2020 | Monomoy Capital Management | \$2 million | SEC claims that Monomoy did not properly disclose expenses for operational services provided by staff, and did not properly obtain investor consent to charge those expenses to investors. |
| 2020 | Monsoon Capital | \$100,000 | Founder, Gautam Prakash, agrees to settle SEC accusations that he filed phony expense reports to the fund he and his firm were advising. Monsoon is censured. Prakash is barred from industry. |
| 2020 | SEC examiners release the first-ever risk alert for private fund managers. Among its findings: private fund managers were improperly allocating fees and expenses, charging fees and expenses that were not permitted by fund agreements, failing to comply with caps on expenses, such as legal or placement agent fees, and failing to obey their own travel and entertainment expense policies. | | |
| 2020 | Rialto Capital Management | \$350,000 | SEC claims that it improperly allocated expenses among the funds it advised. |
| 2020 | Finser International Corporation | \$62,000 | Founder, Andrew Jacobus, agrees to settle SEC accusations, including that he and the firm improperly charged performance fees. |
| 2020 | EDG Management Company | \$2.2 million | SEC claims that it failed to reduce management fees after a write-down. |
| 2021 | Global Infrastructure Management | \$9.9 million | Agrees to settle SEC claims that it failed to offset management fees to private equity funds and made false and misleading statements to investors or potential investors about management fee offsets. |
| 2022 | SEC examiners issue the second-ever risk alert for private funds. Among the findings: fund managers are not following the practices in their disclosure documents about post-commitment management fees. | | |
| 2022 | A divided SEC proposes the most sweeping changes to private fund regulation since Dodd-Frank. If adopted as-written, the rules package will ban a raft of fee and expenses for registered and exempt private fund managers. | | |
| 2022 | Alumni Ventures | \$800,000 | Boston-based venture capital firm, and its founder Michael Collins agree to settle SEC claims that it misleadingly advertised its fees. |
| 2022 | Energy Capital Partners Management | \$4.3 million | Agrees to settle SEC allegations that it allocated "undisclosed and disproportionate expenses" to a private equity fund it advised. |
| 2022 | Wave Equity Partners | \$325,000 | Accepts censure and agrees to settle SEC accusations that it did not properly offset its management fees, and did not properly disclose its management fee offsets. |
| 2023 | Insight Venture Management | \$2.4 million | Pays to settle SEC accusations that it charged excess management fees and did not properly disclose a conflict of interest in its fee calculations. |
| 2023 | A divided SEC adopts new private fund adviser rules, in a 3-2 vote. Among other things, it requires private fund managers to distribute audited fee and expense reports every quarter and to obtain informed consent of investors before charging some fees or expenses. Within days, industry challenges the new rules in federal court. | | |
| 2024 | A three-judge panel of the Fifth US Circuit Court of Appeals strikes down the SEC's private fund rules. | | |

Transparency around private equity fees and expenses has been transformed in the decade since *Private Funds CFO* first began carrying out its *Fees & Expenses Survey*. A powerful combination of regulatory oversight and the growing sophistication of the private markets' investor base, harnessed by the Institutional Limited Partners Association, has shone a spotlight on the myriad additional costs that belie the apparent simplicity of private equity's two and 20 model.

"It is hard to say who has driven this change," says Stephanie Pindyck Costantino, a partner at Troutman Pepper. "There have certainly been some key enforcement actions regarding fees and expenses."

ILPA has also played a role, coming out with strong guidelines and recommendations in an attempt to apply a uniform standard, which the industry has taken seriously.

In addition, notes Costantino, the reporting obligations of some of the larger institutional investors have trickled down: "It is hard to say where the circle starts and finishes, but regulations, sophisticated LPs and organizations like ILPA have all played a part in driving transparency around fees and expenses."

SEC mission

Scrutiny of fees and expenses by the US Securities and Exchange Commission has undoubtedly ramped up over the past four years, in particular, since the regulator issued its first risk alert directed at the private funds industry in 2020. A year later, Gary Gensler was appointed as SEC chairman and his sidekick Gurbir Grewal was appointed head of the SEC's enforcement division. Gensler was clear from the outset that tackling opacity in private markets was his top priority.

Indeed, a sweeping raft of reforms that became known as the Private Funds Rules, became the centerpiece

Full disclosure

There has been a profound shift toward greater transparency in the decade since the Private Funds CFO Fees & Expenses Survey was launched. Amy Carroll considers the factors driving the trend



of his tenure. The proposals included a plethora of changes that would have had significant ramifications for the treatment and transparency of fees and expenses, including quarterly reporting, the restriction of certain practices without disclosure or investor consent, the auditing of financial statements and steps to prohibit preferential treatment.

The Private Funds Rules have, of course, now been vacated by the US Court of Appeal, and the negotiation of fees and expenses, and the reporting thereof, has been returned to the investors and managers directly affected – albeit under the auspices of the SEC’s undeterred enforcement division. But the impact of an unprecedented regulatory focus has been felt, nonetheless.

For Troutman Pepper partner Patrick Bianchi, this enhanced scrutiny has been largely positive for the asset class. “The SEC’s focus on fees and expenses has broadly helped the industry. The

emphasis of examinations has been on inadequate disclosure and the improper allocation of fees and expenses. That has caused managers to have stricter compliance with their own fund documents, which in turn has given LPs more confidence in private funds, which is one reason why we are seeing more and more capital flowing into private markets each year.”

For CFOs themselves, it may be harder to appreciate the big picture benefits when in the midst of the nitty gritty of fund negotiations. Saw Mill Capital CFO Blinn Cirella recalls the firm’s first fund, raised 18 years ago. “There was probably around half a page dedicated to partnership expenses in the LPA at that time. In our most recent fund, which we are just about to close, there are at least five pages of expenses language. That is a case of us being more explicit and a reflection of the fact that there are simply more and

more things to spend money on today, from cybersecurity to ESG.”

Cirella suggests there’s no smoke without fire. “Laws get put in place because somebody somewhere did something to necessitate it. Clearly then, there have been managers that have tried to push expenses through under a single label, such as broken-deal expenses. Now, therefore, those broken-deal expenses have to be split out into an entire paragraph.

“For LPs, the SEC’s focus on fees and expenses has created more transparency, while for CFOs it has created more headaches. Fundamentally though, as trained accountants, most of us CFOs are natural rule followers. It is just that the rulebook has got a lot bigger.”

More complex world

The trend toward transparency is not the only factor that has helped shape the fees and expenses landscape over the course of the past decade. The industry itself has experienced significant changes that have had repercussions for the P&Ls of private equity firms, and therefore for the negotiations that underpin the LP/GP relationship.

First and foremost, the cost of regulatory compliance itself has escalated significantly. “While regulation around private funds aims to increase transparency and fairness for investors, it also results in higher operational costs,” says Colleen Fay, financial services practice lead at Withum. “Consequently, these costs may be passed on to investors in the form of increased management fees.”

Other expenses have also entered the fray. The rapid escalation of ESG requirements, for example, has led to significant additional costs, and it is not always straightforward to determine who should pick those costs up.

“ESG ratings and consultancy is a cost line that has dramatically risen in prominence over the past decade,” says Rosemary McCollin, managing director and head of funds for Europe, the

“Regulations, sophisticated LPs and organizations like ILPA have all played a part in driving transparency around fees and expenses”

STEPHANIE PINDYCK COSTANTINO
Troutman Pepper

Opening up to all

Potentially the most transformative trend, the democratization of private markets could herald both significant added expense and added regulatory scrutiny

“The democratization of private equity, characterized by the growing participation of high-net-worth individuals, has led to a broader investor base and growth in the industry,” says Withum’s Colleen Fay. “But this expansion also brings additional costs related to compliance, liquidity provisions and investor education.

“While democratization efforts aim to make private equity more accessible, they could inadvertently raise fees due to the complex nature of managing a diverse investor pool. Overall, while regulation and democratization strive for inclusivity and transparency, they also pose challenges by potentially escalating the costs associated with private equity investments.”

Vistra’s Rosemary McCollin adds: “The onboarding of investors is a time-consuming and costly process. When you move from onboarding 10 big institutions to hundreds and potentially thousands of individuals, that is going to have a real impact.”

Meanwhile, NB Alternatives’ Barry Giarraputo says the SEC and other global regulators are likely to continue to push for enhanced transparency and protections for investors given the increased participation of high-net-worth investors and the proliferation of evergreen structures.



“Most of us CFOs are natural rule followers. It is just that the rulebook has got a lot bigger”

BLINN CIRELLA
Saw Mill Capital

UK and US at Vistra. “Many investors require a positive ESG rating in order to sign up to a fund, and then subsequently require extensive ESG reporting, but depending on the jurisdiction it isn’t necessarily a regulatory requirement. Who then should bear the cost?”

Meanwhile, the growing prevalence of co-investment has added further complexities to the allocation of expenses, with the offsetting of transaction costs against management fees, and broken deal costs, proving

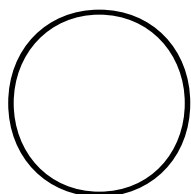
particularly contentious. The rapid rise of the continuation vehicle has also had to be addressed, with LPs in the existing fund increasingly dissatisfied about bearing the cost of fund restructurings.

With the Private Funds Rules now firmly behind us, the onus is back on the asset class to promote its own best practice. Indeed, ILPA is in the process of revising its proposed template for quarterly fees and expenses reporting that it hopes will become the voluntary industry standard.

The agenda is once again being driven by investors. “The reality is that GPs are getting more granular with the information they provide because that is what investors are requesting,” says NB Alternatives CFO Barry Giarraputo. “I don’t know that this yet meets the full magnitude of what the SEC was originally proposing, but it is certainly in the spirit of transparency. There only seems to be one direction of travel and that is towards greater disclosure.” ■

Enforcing change

The Private Funds Rules may have been vacated, but the SEC will continue to pursue its private markets agenda through enforcement actions. By Amy Carroll



In June 5, 2024, a panel of judges on the United States Court of Appeals for the Fifth Circuit unanimously

vacated the sweeping rule changes for private funds advisers that were adopted by the Securities and Exchange Commission almost a year earlier.

In some respects, however, private markets firms had already upped their game in anticipation of the regulation being enacted. “As with any impending regulation, many were addressing areas to be in compliance or were already in compliance with respect to fees and expenses under the Private Funds Rules,” says Colleen Fay, financial services practice leader at Withum.

Meanwhile, just because the rule changes have been reversed, does not mean the SEC is not still laser-focused on identifying and sanctioning firms that violate their own fund agreements. The regulator can and will continue to advance its fees and expenses agenda through its enforcement division.

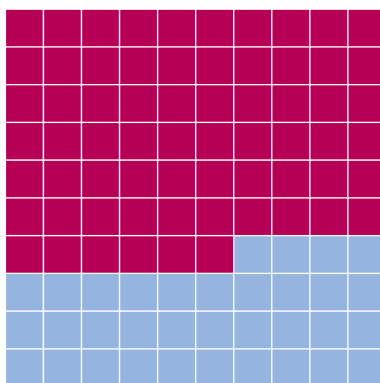
Fixing fees

Indeed, SEC chair, Gary Gensler, and division of enforcement director Gurbir Grewal, who both took up their posts in 2021, have made it their mission to bring ‘enhanced disclosures’ to a private capital industry that represents more than \$18 trillion in gross assets.

The SEC brought eight separate

Is your firm registered with the Securities and Exchange Commission? (%)

Yes 66%



No 34%

“The area that we are seeing the SEC focus on the most at the moment is valuations, rather than fees and expenses specifically”

ROSEMARY MCCOLLIN
Vistra

standalone actions relating to fees in the 2023 fiscal year alone, with a focus primarily on clamping down on disclosure shortfalls and a failure to adhere to Limited Partnership Agreements.

“I don’t think it is so much that the SEC has a position on what should or shouldn’t be being passed through to the fund. The focus is more on ensuring that you are doing what you said you would in your fund documents,” says Blinn Cirella, chief financial officer at Saw Mill Capital. “They are not so much writing the rules as enforcing the rules that LPs and GPs themselves have agreed to.”

Jets and jollies

There are some fees and expenses that remain particularly emotive, of course. One finance director, who asked to remain anonymous, points to private jets and personal entertainment as a source of antagonism.

“The biggest area of enforcement that we continue to see is around private jets,” agrees Cirella. “We do have a private jet that we use, but we always look up the price of a first-class ticket at the time of booking, and that is the expense that gets put through.”

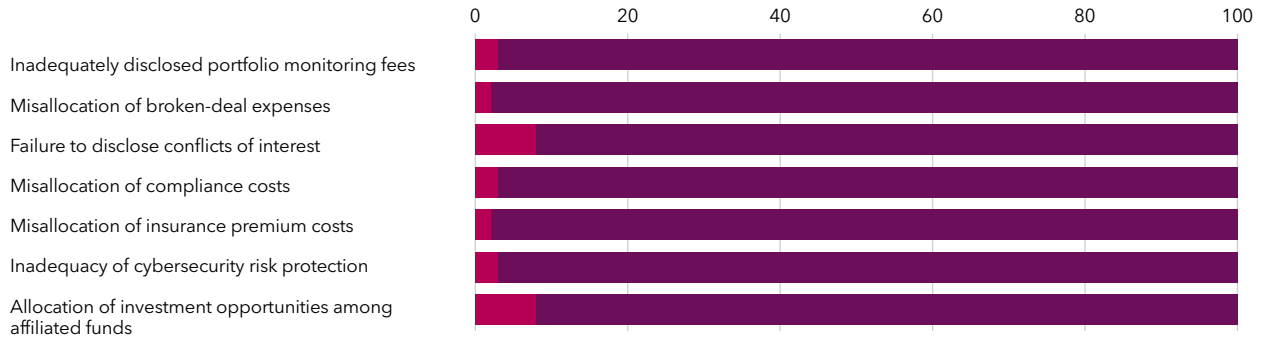
Meanwhile, fees and expenses are not the only area of private markets to be attracting the SEC’s attention. Other recent cases to have been brought against alternative asset managers cover infractions, including failure to comply with books and records rules, which are subject to strict liability. Regulators do

Analysis

Has the SEC raised the below issues with your firm? If they concluded you had a problem and you incurred costs to correct it, who bore the costs? (%)

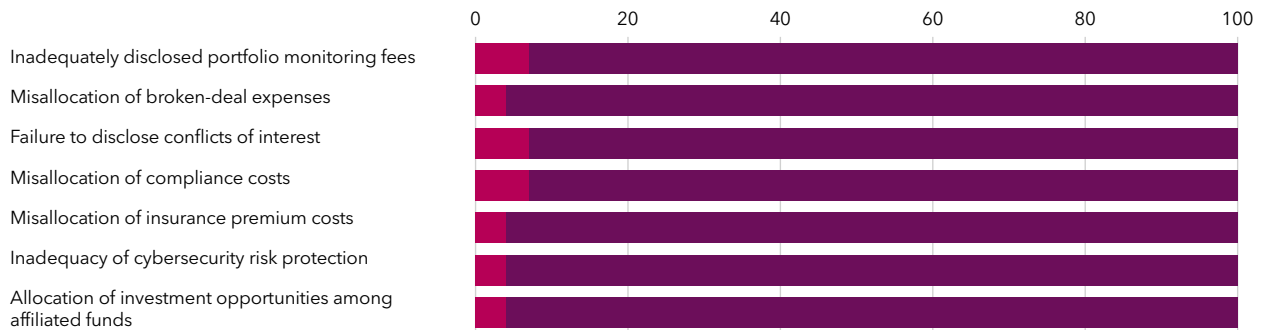
Was this raised?

Yes No



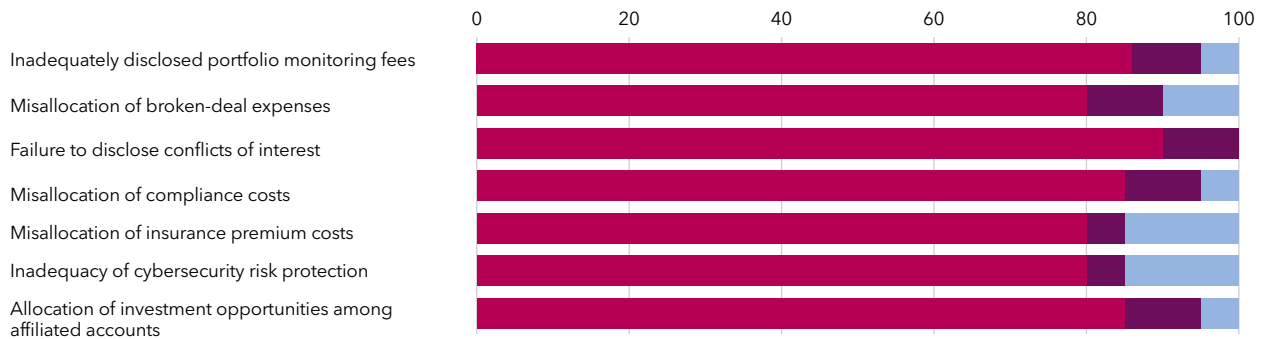
Was the penalty assessed?

Yes No



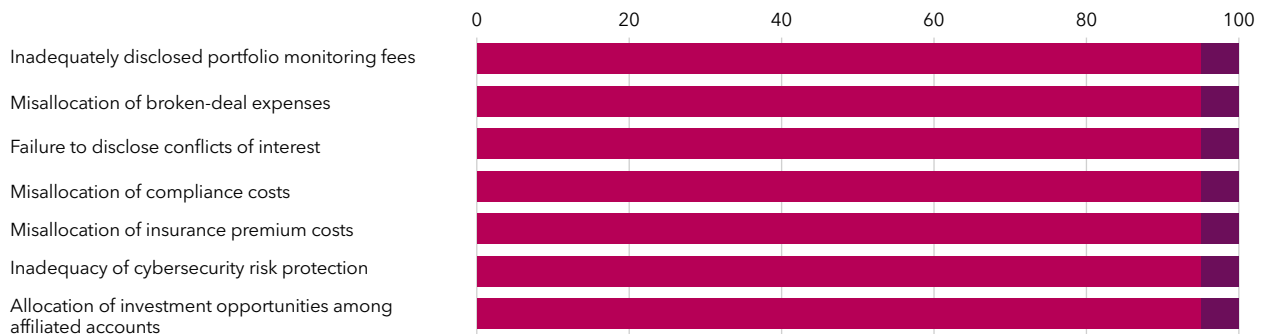
Who pays for the cost of correction?

Management firm Fund Split between fund and firm

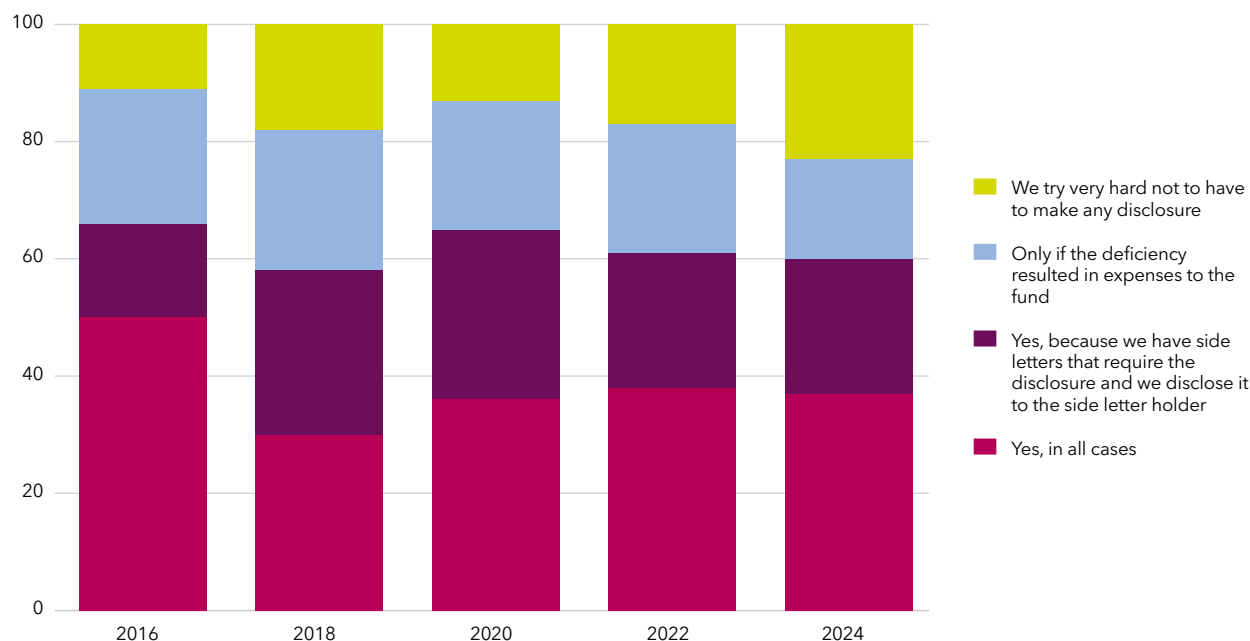


Who pays the penalty?

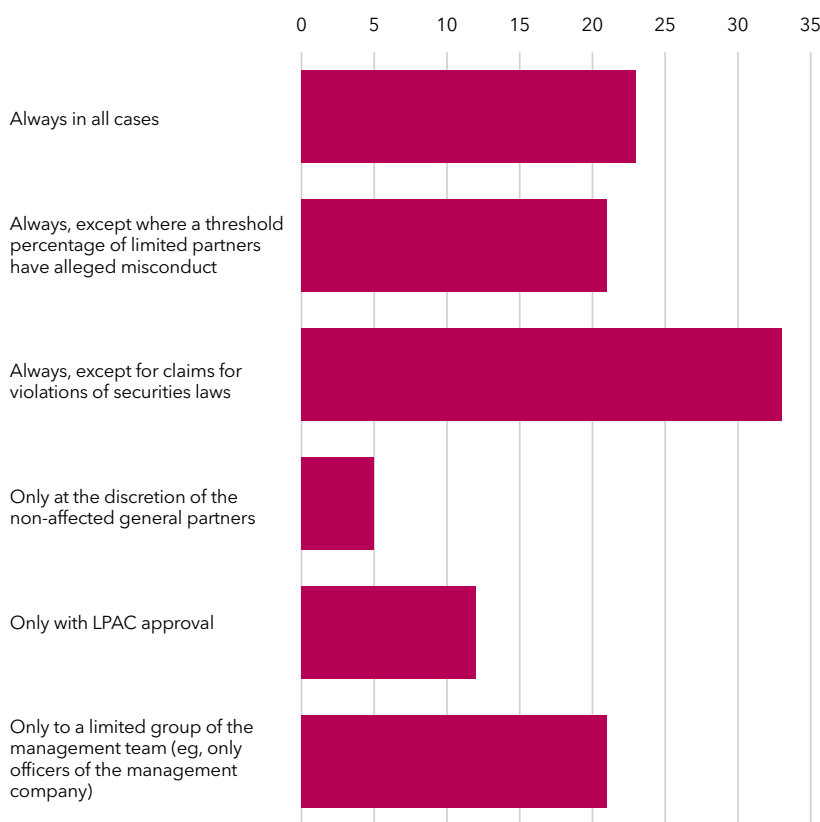
Management firm Fund Split between fund and firm



As a result of a routine examination, the SEC highlights deficiencies in the examination report. Do you disclose these deficiencies to your LPs? (%)



If your LPA provides indemnification of principals serving on the management team, does that indemnity provide for advancement of expenses? (Multiple answers allowed, %)



“We [are] starting to see more precision in the language relating to who bears what costs and in what situations”

STEPHANIE PINDYCK COSTANTINO
Troutman Pepper

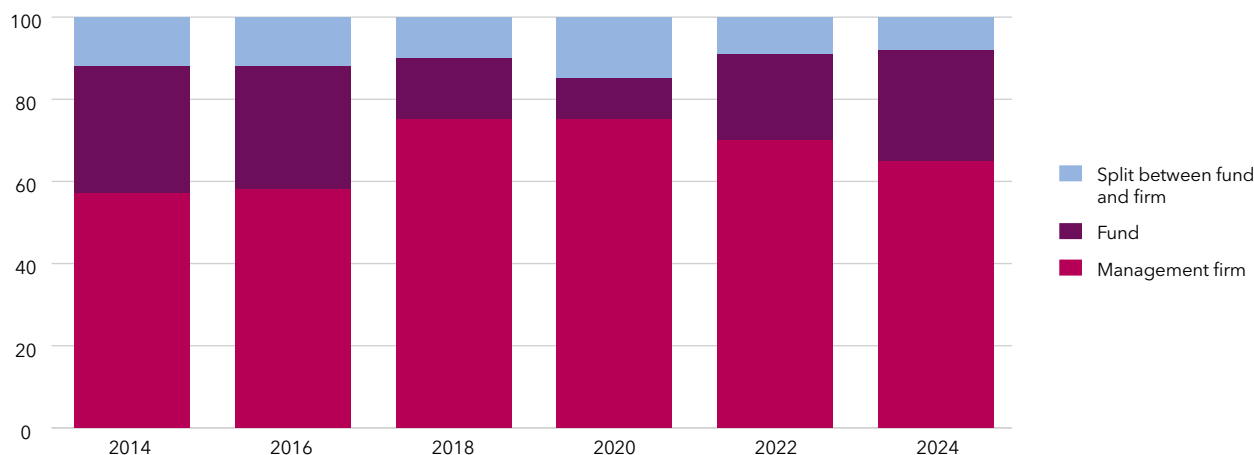
Source for all data: Private Funds CFO Fees & Expenses Survey 2024

Analysis

An individual principal within your firm is the subject of an inquiry from the SEC that involves the firm's activities and the activities of the funds you manage. Do you advance expenses for the principal's defense if... (%)



Your firm is visited by the SEC or state regulator for a routine regulatory examination which leads to a deficiency finding around valuations. You voluntarily decide to redo the last two quarters' reports and deliver the new ones along with an explanatory letter to your LPs. Who pays for the accounting and legal costs in getting through this correction process? (%)



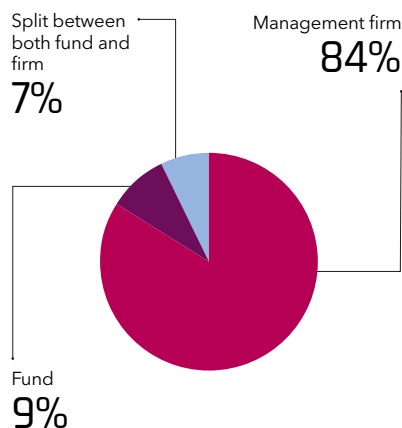
not have to prove intent to file a suit.

Rosemary McCollin, managing director and head of funds for Europe, the UK and US at Vistra, meanwhile, says the SEC is targeting valuation practices, in particular. "The area that we are seeing the SEC focus on the most at the moment is valuations, rather than fees and expenses specifically," she says.

"Although, of course, if there is a move towards having to have an independent valuation from an accredited provider that is not the fund administrator, that would become a significant added expense in itself."

Indeed, dealing with enhanced regulatory scrutiny from the SEC can be a costly business, reigniting the question of who should bear the expense.

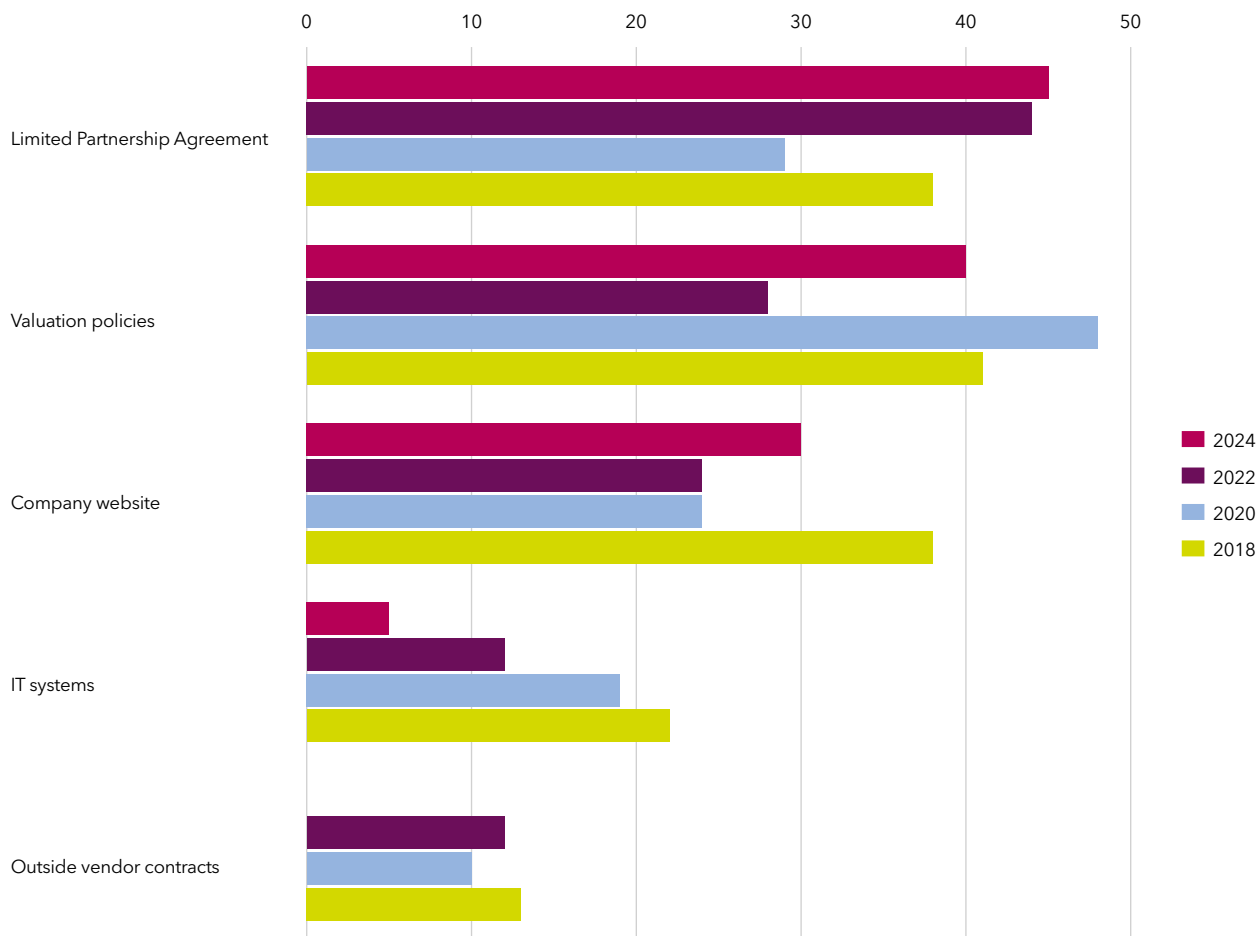
Your firm is visited by the SEC or state regulator for a routine regulatory examination which leads to a deficiency finding around valuations. You voluntarily decide to increase compliance processes and engage a compliance consultant. Who pays for the additional compliance costs on an ongoing basis? (%)



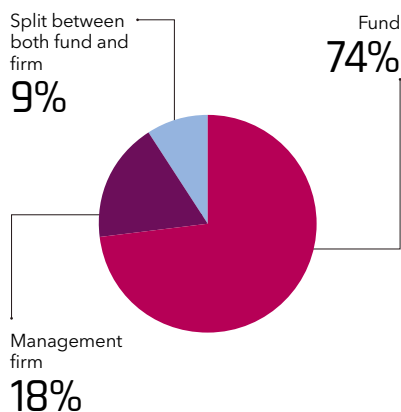
"Costs relating to SEC examinations have not always been front of mind for LPs, but as advisers have come to expect to be examined more frequently, I think LPs have started to pay more attention to the allocation of these expenses," says Stephanie Pindyck Costantino, a partner at Troutman Pepper. "We are, therefore, starting to see more precision in the language relating to who bears what costs and in what situations."

The *Private Funds CFO Fees & Expenses Survey 2024* found that management companies are paying correction costs and penalties in the vast majority of cases, as well as paying the cost of any voluntary compliance measures taken as a result of examinations, unless specifically

If you have made changes to any documentation following an SEC visit, what documentation was updated? (Multiple answers allowed, %)



Your firm is visited by the SEC or state regulator for a routine regulatory examination which leads to a deficiency finding around valuations. You voluntarily decide to enhance reporting to LPs. Who pays for the additional reporting costs on an ongoing basis? (%)



Figures have been rounded
Source for all data: Private Funds CFO Fees & Expenses Survey 2024

involving enhanced reporting to LPs.

Interestingly, however, given the emphasis that the SEC is placing on transparency and disclosure, only 38 percent of respondents will routinely disclose deficiencies highlighted by the SEC in examination reports to investors.

Enforcement agenda

While it seems unlikely the SEC will attempt to introduce any significant new rule changes to private markets in the immediate future, it is clear the regulator will continue to drive for fairness and transparency through enforcement action.

“I don’t think we will see any further rule changes being proposed any time soon. There was a big push with the Private Funds Rule, which has now

been vacated, and the SEC has said it is not going to pursue an appeal,” says Troutman Pepper partner Patrick Bianchi.

“On a practical level, with an election coming up, it is unlikely we will see any new rules for the private funds industry being put forward in the next six months. Instead, the SEC will rely on continued enforcement practices based on examinations of registered advisers.”

“We will potentially see greater scrutiny of particular practices that have been left alone for a period of time,” adds Pindyck Costantino. “SEC staff might not necessarily be considering putting a new formal regime like the Private Funds Rule in place, but I do think they will continue to visit and revisit material topics.” ■

EXPERT COMMENTARY

Colleen Fay, practice leader, financial services, at Withum, highlights six ways that private equity funds are adapting management fee models



Fee flexibility

The private equity sector is characterized by long-term investment horizons. As such, their Limited Partnership Agreements (LPAs) contain a complex interplay of economic and regulatory factors, the preferences and risk tolerance of investors and the specific goals of the fund. One key element influencing the success and performance of private equity funds is the management fees charged.

Management fees play a critical role in private equity funds for striking a balance between what the manager needs to operate effectively, and investor and market demand. On one hand, management fees provide essential compensation to the general partner (GP) for expertise in identifying, evaluating and managing investments. However, excessive management fees can negatively impact the fund's performance by reducing returns, eroding

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investor confidence and creating misaligned incentives.

Balancing the need for adequate compensation with the desire to maximize returns for investors is a critical challenge – and timely topic – in private equity. This article offers an interpretation of what respondents to the *Private Funds CFO Fees & Expenses Survey 2024* shared about management fees, their structure and levels, and how they are perceived in influencing the health and performance of these vehicles.

1 Management fees on successor funds vs in the previous fund

The survey results of the 110 respondents indicate that the vast majority

oppose management fee structures that favor LPs in successor funds compared to those in the previous fund. This includes practices such as offering preferential rates to early investors in the successor fund (70 percent opposed the concept), providing preferential rates to LPs that re-up in the successor fund (only 19 percent replied affirmatively), eliminating/reducing management fees for previous funds once a successor fund hits a hard-cap (86 percent opposed the idea) and/or adjusting management fees on previous funds for LPs that re-up (96 percent showed a clear preference against this practice).

These findings suggest a general reluctance among general partners to accept terms that give preferential treatment. In addition to achieving fairness and equity devoid of an actual or perceived unfair advantage, these results signal an aspiration to achieve

aligned interests, transparency, market competition and compliance. Collectively, these are the dynamics shaping a growing reluctance among investors to accept preferential treatment vis-à-vis management fees in successor funds.

2 Determining the base for management fees post-investment period

Invested capital continues to be the base determinant for management fees in the post-investment period. Since 2020 and the worldwide pandemic that thrust the global economy into a tailspin, invested capital has ticked up from 76 percent to 82 percent (2022) before settling into its current benchmark of 79 percent (2024). In comparison, commitments with step down in rate are currently at the 21 percent milestone. Of this percentage, 38 percent report the step down is not a percentage of the pre-investment rate.

These results for invested capital mirror a multi-year trend fed by the need for transparency relative to actual value of the fund's assets, avoidance of fee payments on capital not yet put to work, GP performance-based incentives (reward for success, reduced fees for underperformance), equitable treatment and transparency. Rounding out invested capital's favorability is, of course, what has become the industry standard for consistency and comparability across different funds.

3 Calculating the post-investment period fee for invested capital

The most common methodology for calculating the post-investment period fee for invested capital is based on the amount invested by the fund, minus any permanent write-downs or -offs, according to 87 percent of survey respondents.

First and foremost, this sound practice reflects the actual economic value of the fund's assets, with the exception of unrecoverable costs. It also connects the GP's compensation to fund

performance as an incentivizing element and ensures all LPs are treated equitably. Additionally, it provides a clearly defined metric for calculating fees. Considering accrued interest on portfolio investments and inclusion on the amount invested, only 18 percent of respondents employ this practice while 39 percent include invested capital based on generally accepted accounting principles fair-market value not to exceed acquisition cost. The subtraction of any permanent write-downs or write-offs is far and away the frontrunner for industry best practices.

“Excessive management fees can negatively impact the fund’s performance by reducing returns, eroding investor confidence and creating misaligned incentives”

4 Number of allowable LPA fund extensions

An important provision in LPAs, fund extensions allow funds to continue their investment activities beyond their initial term. They can be beneficial in certain circumstances, such as when market conditions change. Of course, it is always advisable to carefully consider the terms of any extension to ensure that it aligns with the best interests of the LPs. Survey results indicate two fund extensions are the most favorable (60 percent of respondents), while half of that (30 percent) subscribe to three extensions.

While ‘most favorable’ extension terms can vary depending on specific

circumstances, there are several key factors that play into shaping these roll-overs. Of course, shorter extensions are more advantageous for their ability to minimize risk of prolonged underperformance. Extensions are also especially effective in reducing fees and shaping a clear plan for winding down the fund while distributing the remaining assets.

5 One-year extensions vs multi-year extensions

An overwhelming majority of respondents (91 percent) shared that their fund extensions typically last one year. While each option has its own inherent pros and cons, single-year extensions are appealing for their flexibility and limited LP commitment. In contrast, a one-year duration may also create a level of uncertainty and/or missed chances associated with the inability to capitalize on investment opportunities.

6 What LPAs provide about the management fee charged in an extension period

Since 2020, more than 40 percent of LPAs have reported they provide for management fees with the same rate continuing in the extension period. While the percentage dropped from 51 percent to 41 percent between 2022 and 2024, percentage-point redistributions were recorded in the ‘Provided for in the LPA, no management fee absent approval from LPA/LP’ (+4 percent) and ‘Not provided for in the LPA, expectation is that the same rate will continue’ (+3 percent) categories this survey year.

As the private equity landscape undergoes a significant transformation, funds will keep adapting to evolving market conditions and investor expectations. Once-traditional management fee structures are – and will continue to be – increasingly challenged by more flexible models. This shift reflects a growing recognition that a one-size-fits-all approach is no longer optimal in today's dynamic investment environment. ■

Broken-deal costs

LPs are pushing back on funds bearing the full cost of aborted transactions, while co-investors are let off the hook. Amy Carroll reports

Broken-deal costs have always been one of the more contentious aspects of private equity fees and expenses. The growing prevalence of co-investment in deals is only exacerbating the situation.

“Investors are particularly focused on abort fees, because these can run into the millions,” says one finance director, who asked to remain anonymous. “Over the past 10 years, there has been a marked increase in the level of detail that investors are wanting to see in relation to broken deals.”

Despite increased limited partner scrutiny, funds continue to bear the majority of broken-deal costs, according to the *Private Funds CFO Fees & Expenses Survey 2024*. From a high bar of 73 percent of costs being borne by

the fund at the point of data room review, the share of costs being picked up by limited partners only increases as the deal process progresses further down the line.

The rationale, from the perspective of the manager, is that the investment team and the service providers it instructs are working on behalf of the fund.

“Deals are executed on behalf of LPs, so the fund picks up 100 percent of aborted deal costs,” says the finance director. “That has always been the case because, as the GP, you are investing on behalf of your investors.”

Meanwhile, according to Blinn Cirella, chief financial officer at Saw Mill Capital, it all depends on the language in the LPA. “Our LPA allows us to pass almost all broken-deal costs through to the fund,” she says, adding

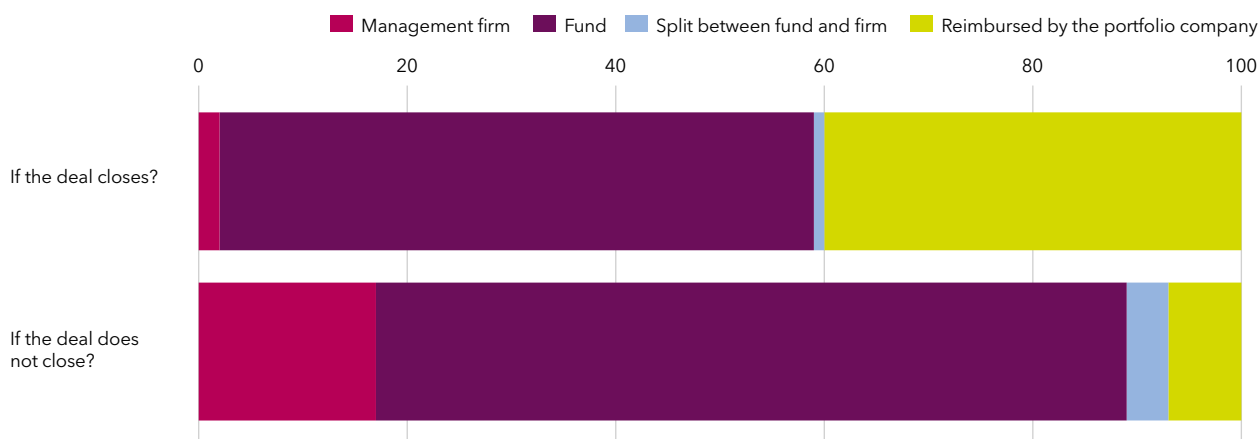
that since covid, the amount of money spent on preliminary investigations has reduced dramatically as rather than flying out to meet people and spend the night in a hotel, everything is done on Zoom.

Fee frustrations

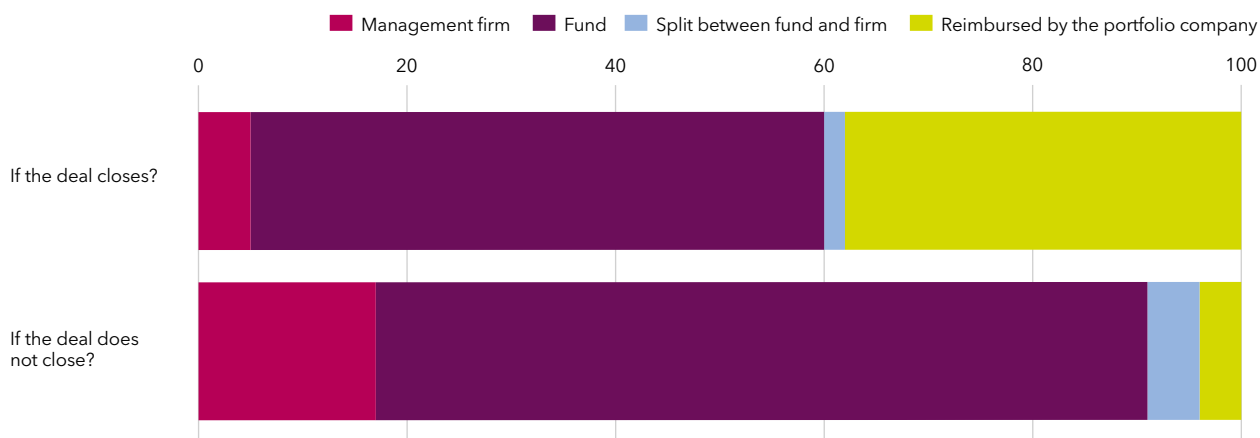
It may have become almost market standard for broken-deal fees to be borne by limited partners, but this is still a source of frustration for many investors, particularly as it may be the case that the transaction falls through due to poor early screening or other shortfalls made by the investment team.

“Broken-deal fees remain contentious because the investment team has to justify not only the time they have spent on the deal, but also the reason why the deal fell apart,” says Rosemary

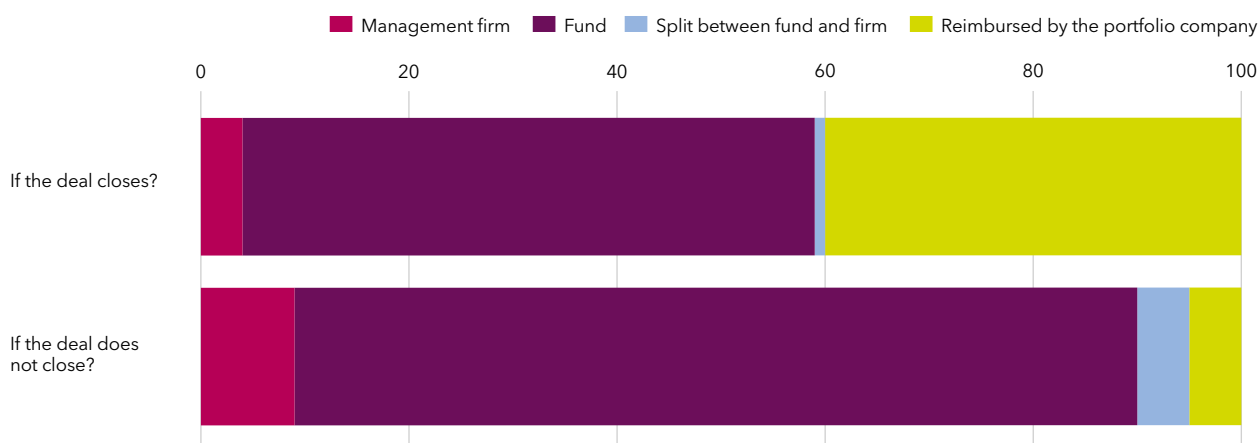
After data room review in an auction deal, a non-binding indication of interest is executed in connection with which you incur legal and accounting expenses. Who pays for these expenses... (%)



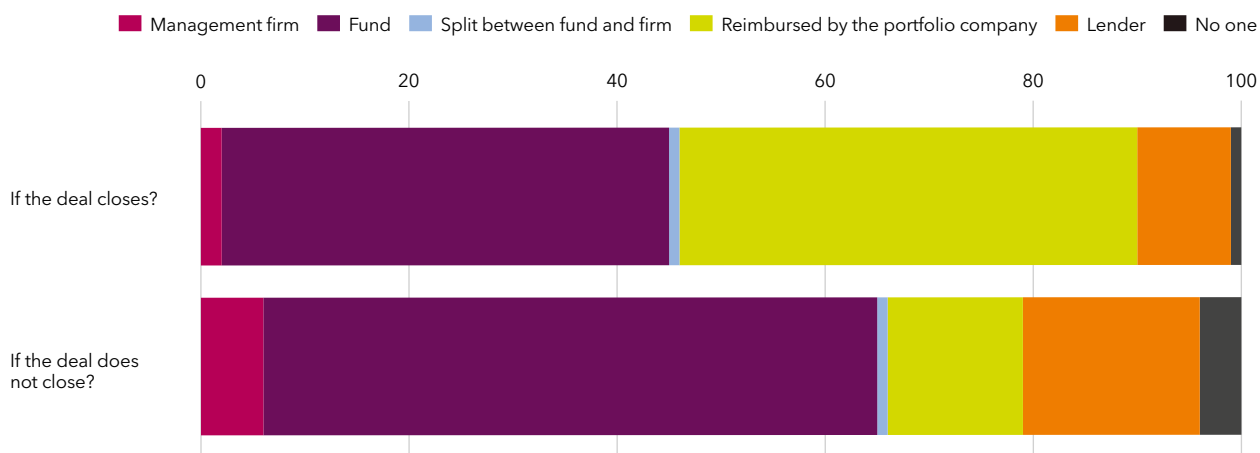
During due diligence and before a formal letter of intent is signed (binding or non-binding), the firm hires lawyers, consultants, accountants and other service providers to work on the transaction. Who pays for these expenses... (%)



After a formal letter of intent is signed, the firm hires lawyers, consultants, accountants and other service providers to begin working on the transaction. Who pays for these expenses... (%)

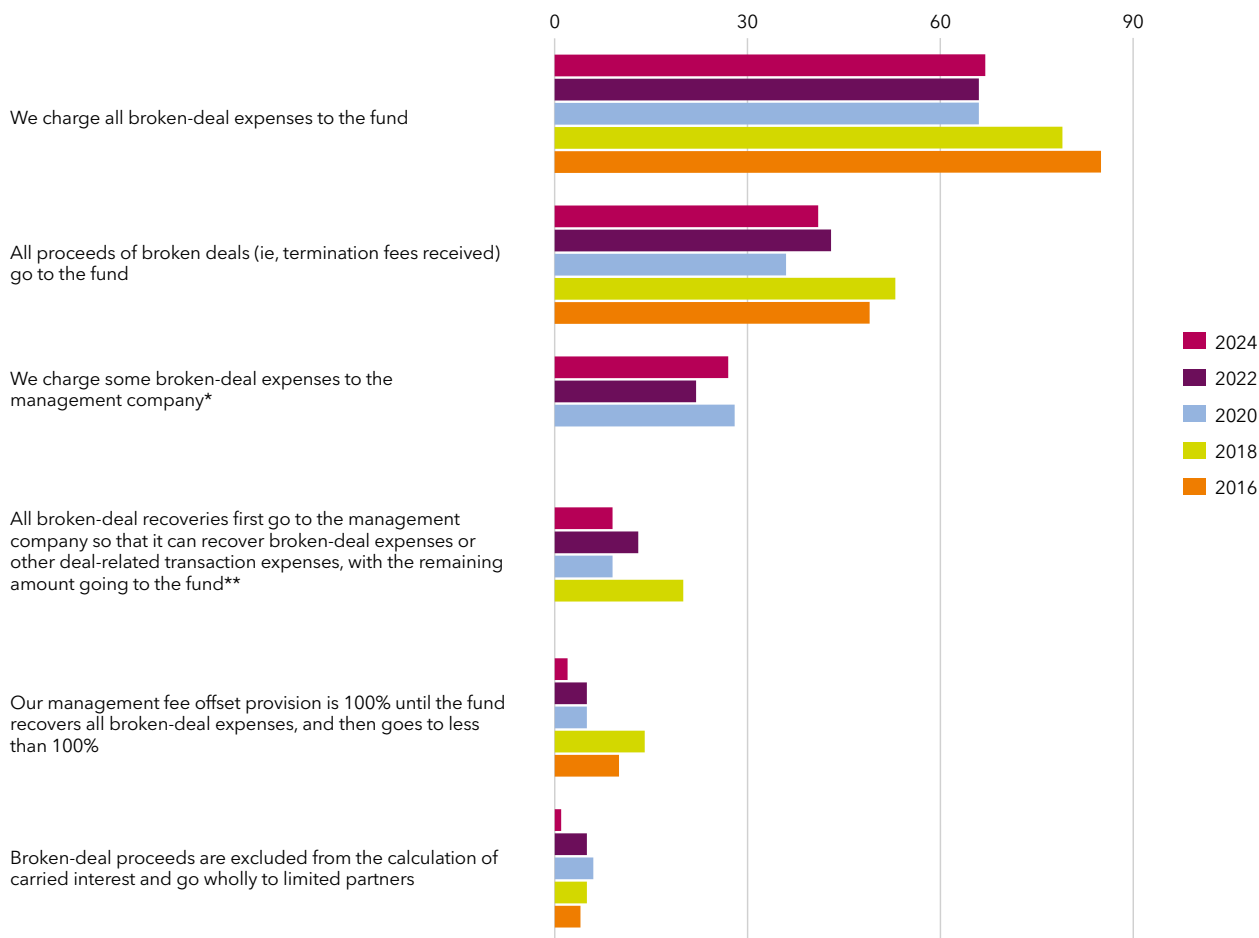


After a definitive agreement is signed, the firm's financing team agree a lending package for the deal. Who pays legal fees incurred by the lender... (%)



Source for all data: Private Funds CFO Fees & Expenses Survey 2024

In terms of broken-deal expenses, which of the following apply to you? (Multiple answers allowed, %)



*Answer not included as an option in the 2016 and 2018 surveys

**Answer not included as an option in the 2016 survey

Source: Private Funds CFO Fees & Expenses Survey 2024

McCollin, managing director and head of funds for Europe, the UK and US at Vistra. “Investors may question whether the manager missed something in early due diligence, for example, and therefore feel that the manager should absorb at least some of those costs.”

Meanwhile, limited partners are particularly incensed by co-investors being let off the hook for their slice of the fees on the aborted deal. “We don’t see a lot of pushback on broken-deal expenses being borne by the fund, but we do see a lot of discussion around co-investment and whether or not the full rate of the broken-deal expenses, including the co-investment portion, is being borne by the fund itself or whether co-investors are expected to

pick up their share,” says Stephanie Pindyck Costantino, partner at Troutman Pepper.

Indeed, fellow Troutman Pepper partner Patrick Bianchi says he is even seeing situations where limited partners are pushing back against paying 100 percent of broken-deal costs where the deal was intended to include a co-investor, even if that co-investor had yet to be identified.

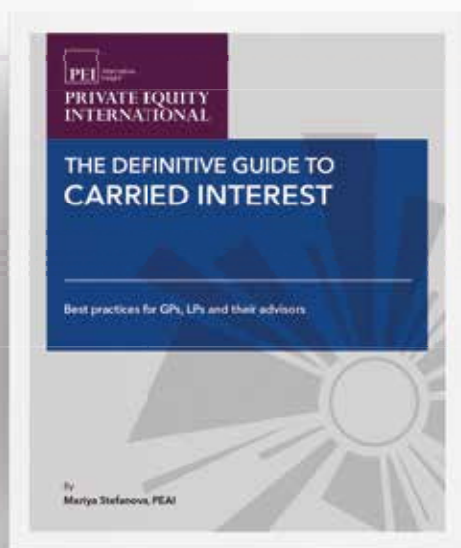
“If it was clear from the outset that the transaction would require co-investment on top of the fund’s allocation, then LPs want to see that the fund is only bearing its pro rata share of the cost,” he says.

Fundamentally, however, provisions related to transaction expenses and

broken-deal costs will continue to be determined by the balance of power between limited partner and GP at the point of Limited Partnership Agreement negotiations.

“Only 2 percent of survey recipients have a management fee offset provision that allows the fund to recover all broken-deal expenses first,” says Colleen Fay, financial services practice leader at Withum.

“With a tough fundraising market, I think you’ll continue to see differences in how this is handled. If a manager is able to set terms the investors will agree to without giving up all of the flexibility when it comes to transaction fees and broken-deal fees, they likely will.” ■



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EXPERT COMMENTARY

*Sponsors that choose to offer co-investment opportunities must be mindful of investor and co-investor dynamics, write partners
Stephanie Pindyck Costantino, Julia Corelli and Patrick Bianchi*



Balancing opportunities with potential conflicts

Co-investments can be a divisive topic, placing investors, sponsors and co-investors on three ends of a complicated and conflict-ridden triangle. For example, who should pay for broken deals or diligence expenses? How should co-investment opportunities be allocated among limited partners, third parties or sponsor personnel?

Co-investments offer sponsors and investors the opportunity to engage in larger transactions they might not be able to pursue independently. According to the *Private Funds CFO Fees & Expenses 2024* survey (the ‘Survey’), offering co-investment is very common, as 82 percent of sponsors afford the opportunity to co-invest in a transaction with one or more of the sponsor’s parties. A

SPONSOR
TROUTMAN PEPPER

co-investment strategy broadens potential investment targets by enabling the sponsor to participate in deals that would otherwise be inaccessible due to required equity size or diversification limits in the sponsor’s governing documents. A well-subscribed co-investment that performs positively may also greatly enhance the sponsor’s market reputation.

A co-investment allows an investor or third party to participate in a transaction that might otherwise be inaccessible due to its size or lack of dealflow. It may also provide an opportunity to

deploy capital in several deals in a sector of particular interest.

Offering opportunities

Co-investment opportunities may be offered in several ways. Sponsors commonly include pro rata participation rights in fund-governing documents or side letters with certain investors. Significant investors often negotiate for larger participation rights. Subject to commitments to existing investors, co-investment opportunities may also be offered to third parties. Savvy co-investors will also negotiate for additional pro rata participation rights within the transaction documents for a co-investment. That is, if another co-investor declines to participate in a follow-on

investment, the savvy co-investor may have an additional participation right.

A sponsor must consider the investor's willingness and ability to support the opportunity, potential strategic benefits and available capital when determining whether to offer co-investment rights. Some sponsors will simply offer pro rata rights to investors in a primary vehicle and afford certain investors first right at any overage.

Other sponsors may not guarantee any co-investment right to investors, opting instead to acknowledge only that the sponsor appreciates the investor's desire to co-invest. Sponsors must clearly disclose co-investment policies and procedures to fund investors, particularly regarding allocation policies between the primary investing vehicle and a co-investment vehicle.

Structure

Appropriately structured co-investment opportunities can be beneficial to all participants. According to the Survey, approximately 57 percent of the 82 percent of sponsors that offer co-investments create a separate entity for a co-investment opportunity. Alternatively, co-investors may invest directly into the portfolio company. These two common approaches differ significantly with respect to sponsor control and influence.

For many reasons, including impact on the track record and execution of exit strategies, sponsors want to retain control over co-invested dollars when it comes to management of the investment. Sponsors therefore prefer to aggregate co-invest capital into a separate entity with the sponsor controlling exercise of the co-invest entity's shareholder rights rather than having multiple investors at the investment level, each able to vote on shareholder matters.

Economics of co-investment vehicles

Separate co-investment vehicles often afford sponsors the ability to charge a

management fee and a carried interest on a deal-by-deal basis. However, the co-investment vehicle may have preferred economics for the sponsor's existing investors, enhancing investor relations.

Most Survey respondents that offer co-investments reported that the economics charged by a separate co-investment vehicle are less than those charged by the fund. In many cases, carried interest is charged to the co-investment vehicle, but no fee is charged. It is important to appreciate that where a fee is not charged, the co-investment vehicle may not contain offset provisions. Therefore, the sponsor parties are entitled to receive transaction fees received in connection with the co-investment that may otherwise be subject to a fee offset in the primary fund vehicle. Apportioning a transaction fee between the fund and any co-investment vehicle often results in a portion of the transaction fees not offsetting the management fee, even if the fund has a 100 percent fee offset.

Broken deals

No one likes a broken deal. Co-investments allow investors to efficiently participate in a deal by leveraging the sponsor's due diligence. Sponsors must address cost allocation in governing documents, covering transaction, operating, compliance and regulatory costs, including expenses for unconsummated deals. According to the Survey, 53 percent of the 82 percent of sponsors that offer co-investments allocate broken deal costs to both the co-investment entity and the sponsor's fund entity. Sponsors who fail to address these costs risk bearing up to the entire expense of a broken deal.

Conflicts

The taking, or not taking, of fees from a co-investment vehicle is just one of many conflicts that may arise when a sponsor offers a co-investment opportunity. Co-investments increase the capital under management for the sponsor,

which in turn could potentially decrease the time and attention to pre-existing vehicles. Many sponsors account for this by developing a dedicated co-investment team. Others account for the increase in necessary time and attention in their general hiring needs. Sponsors that have a dedicated co-investment team charged with raising capital and the oversight of the sponsor's co-investment portfolio rebut the argument from existing investors that co-investments divert attention from managing the primary portfolio due to the need to raise co-investment dollars, structure co-investments and attend to co-investors. But it does not change the fact that co-investments have one investment (usually), and fund entities have a diversified portfolio, which can be another source of conflict for the sponsor. This is particularly acute where the co-investment is a follow-on into an existing portfolio company of the fund.

Providing assurances

Some steps can go a long way to assist the sponsor in navigating what can be a difficult path. For instance, it is critical to appreciate the potential implications co-investments pose to the sponsor's policies and procedures, including allocation of investment opportunities, fee and expense allocations, valuations and conflicts of interest, including use of the fund's advisory board (if formed); utilizing clear and transparent disclosures around co-investment procedures and expenses (including with respect to broken deals and management fee offsets); and understanding the dynamics motivating all constituents (including advisory board members).

Proactively establishing, and making known to investors, robust policies and procedures for all these areas can provide significant assurances to both fund-level and co-investment investors that the sponsor will succeed in achieving its multiple goals of advancing its business, enhancing investor returns and treating investors fairly, equitably and with transparency. ■

Management fees through the cycle

Significant differences remain regarding when management fees commence and how they are stepped down. By Amy Carroll

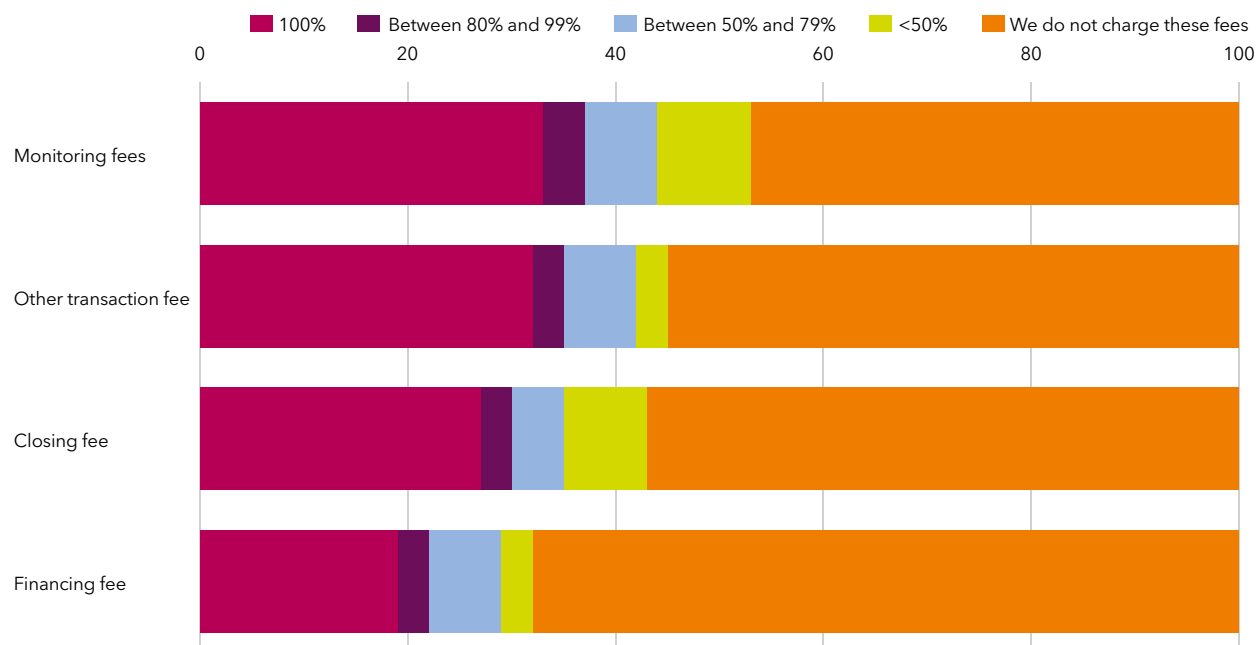
Almost half of respondents to the *Private Funds CFO Funds & Expenses Survey 2024* start charging management fees as soon as they hold a first close, while just under a third wait until they make their first capital call.

Negotiations around when the management fee kicks in, typically center around the need to balance investors' J-curve concerns with the need to ensure managers have a sufficient runway of capital to ensure they are performing at the level that they need to perform, says Troutman Pepper partner Stephanie Pindyck Costantino. "With newer

managers, the management fee is likely to be incurred earlier, therefore, while a more established manager may have sufficient capital to defer the management fee until the first investment is made, providing a more attractive J-curve."

Rosemary McCollin, managing director and head of funds for Europe,

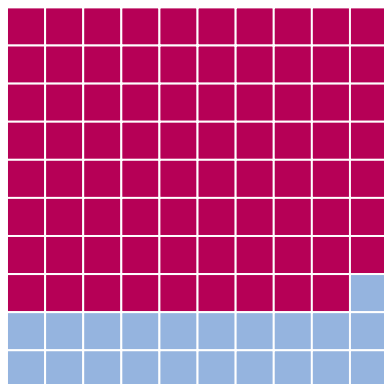
What percentage of your transaction, monitoring or any type of investment-related fee received by an affiliated entity is offset against your management fees? (%)



If your firm charges investment-related fees, do you disclose to investors... (%)

The nature of services being charged?

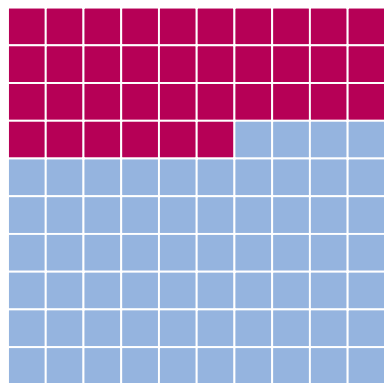
Yes 79%



No 21%

Evidence of the market rate of this fee?

Yes 36%

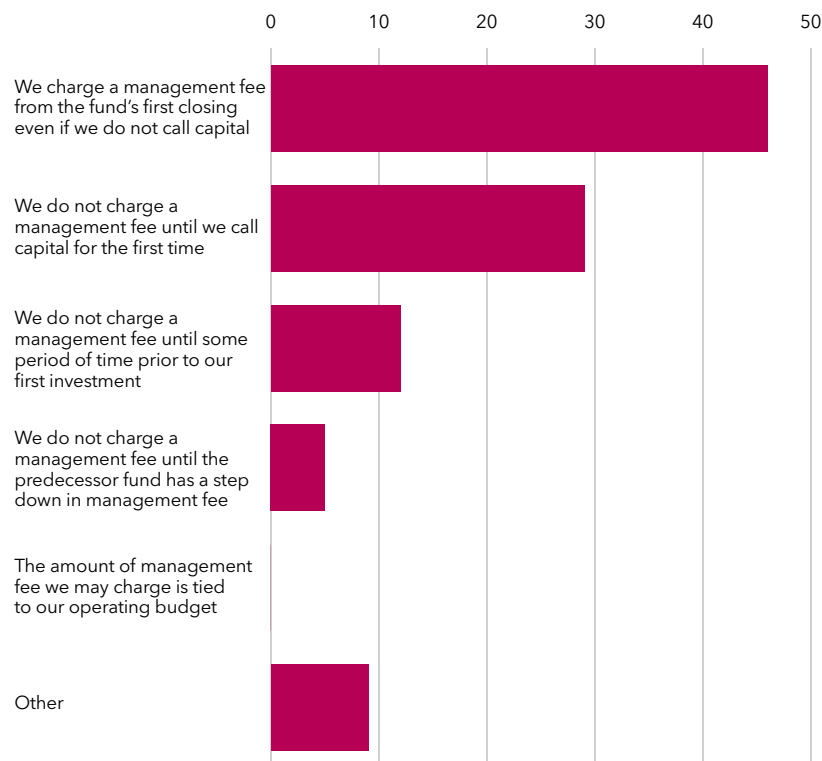


No 64%

“We don’t charge fees until we have either made a first call or drawn on the line of credit”

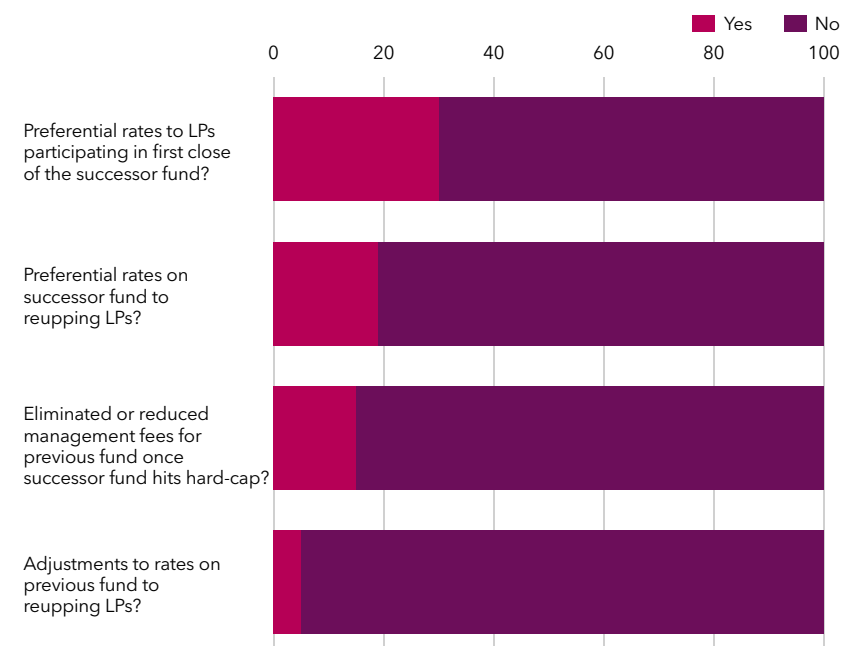
BLINN CIRELLA
Saw Mill Capital

Which is true of your most recent fund? (%)

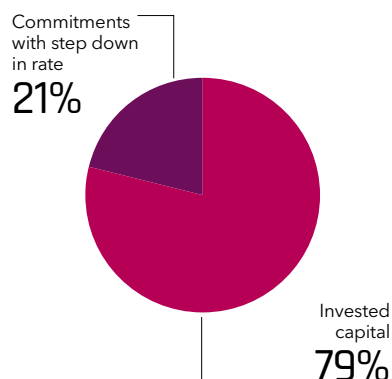


Source for all data: Private Funds CFO Fees & Expenses Survey 2024

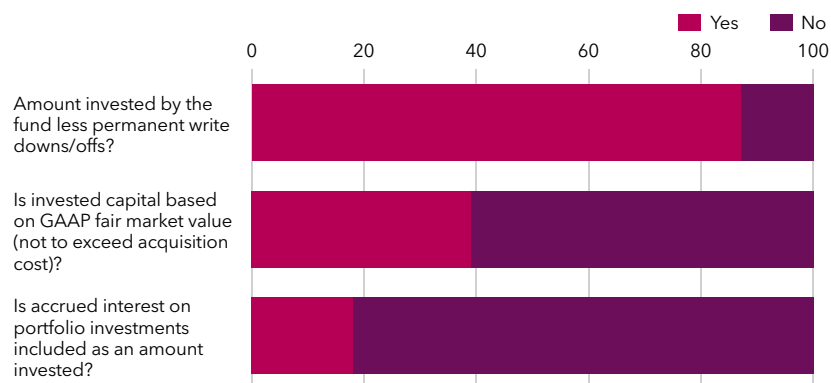
How do management fees on successor funds relate to management fees in the previous fund? (%)



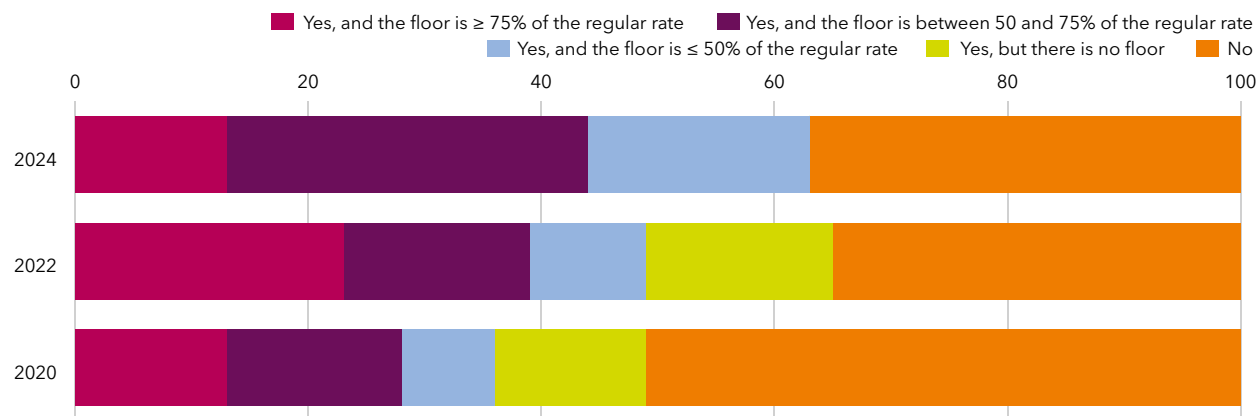
What is the base for management fees post-investment period? (%)



If you answered 'Invested capital,' how is the post-investment period fee base calculated? (%)



If you answered 'Commitments with step down in rate,' is the percentage an annual stepdown of the pre-investment rate? (%)



Source for all data: Private Funds CFO Fees & Expenses Survey 2024

the UK and US at Vistra, adds: “Charging a management fee at first close can help a fund recoup expenses, bearing in mind the fact onboarding investors is a time-consuming and costly process, meaning that this can be a fairly expensive period in a fund’s life.”

“Others may choose to wait until a transaction has been completed. First close would definitely be the CFO’s preference and I think that is the way that the market is moving. A lot depends, however, on the leverage that the anchor investors hold.”

Colleen Fay, financial services practice leader at Withum, agrees. “The pros of early management fees include a steady stream of income for fund managers, ensuring they have the resources

to identify and manage investments effectively,” she says. “However, this can be a con for investors, as fees can erode returns, especially if the fund has not yet begun to generate returns from investments.”

For NB Alternatives, a first close approach makes sense. “We typically see management fees starting at first close, because that is when you start managing the fund – sourcing and making investments,” says Barry Giarraputo, the firm’s chief financial officer.

Saw Mill Capital, however, does not charge management fees until an investment has been made. “We don’t charge fees until we have either made a first call or drawn on the line of credit,” says chief financial officer Blinn Cirella.

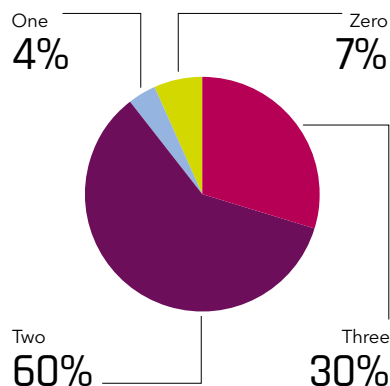
“We also utilize a fee waiver, whereby we waive a lot of the management in the first couple of years. That is because we have one significant investor that is very focused on J-curve mitigation.

“In any case, I personally agree that we shouldn’t be charging management fees for a new fund until we have reached a certain point in its predecessor. Investors want to be sure our attention is not being divided. In our case, our funds have to be 75 percent invested before we can start charging from a new fund.”

Later life

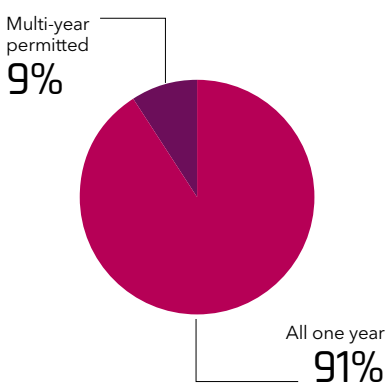
The treatment of management fees at the other end of a fund’s life also differs from manager to manager – 79 percent

What number of fund extensions are allowed under your LPA? (%)

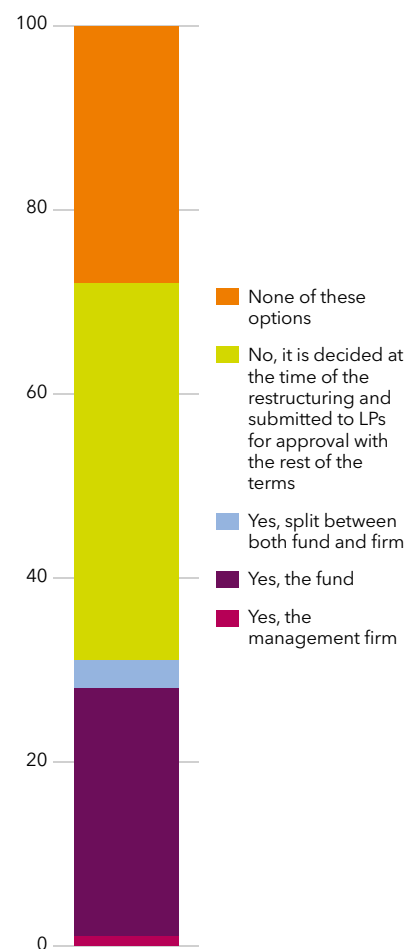


Figures have been rounded

Are they all one-year extensions or are any multi-year extensions permitted? (%)

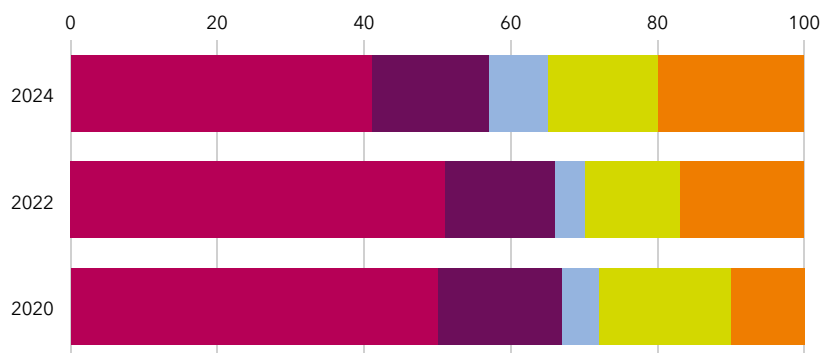


Did you stipulate in your LPA who pays for costs relating to a potential fund restructuring? (%)

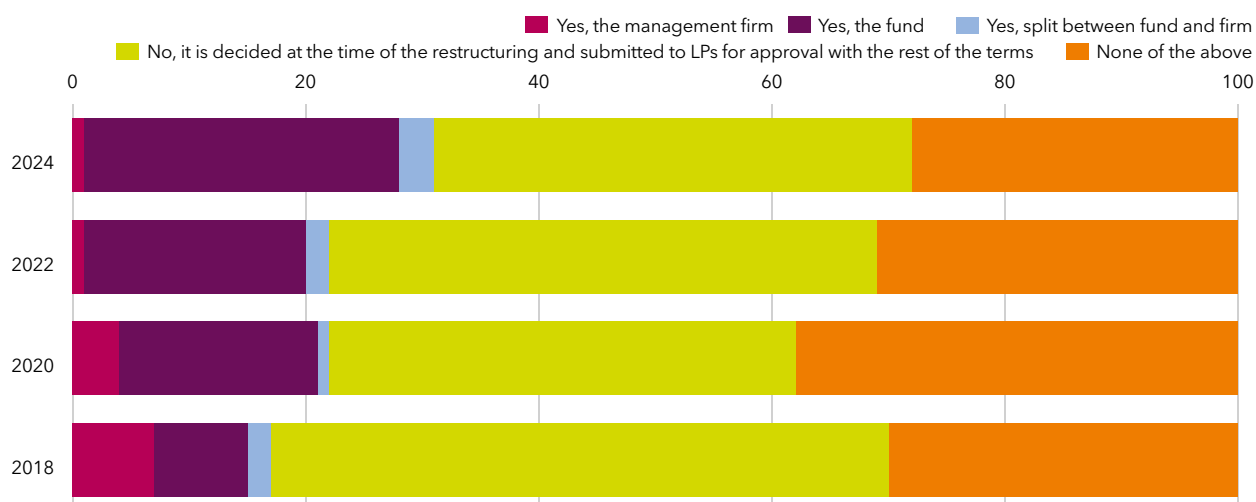


What does your LPA provide about the management fee charged in an extension period? (%)

- Provided for in the LPA, same rate continues
- Provided for in the LPA, reduced rate applies
- Provided for in the LPA, no management fee absent approval from LPA/LP
- Not provided for in the LPA, expectation is that it is negotiated at the time
- Not provided for in the LPA, expectation is that the same rate will continue

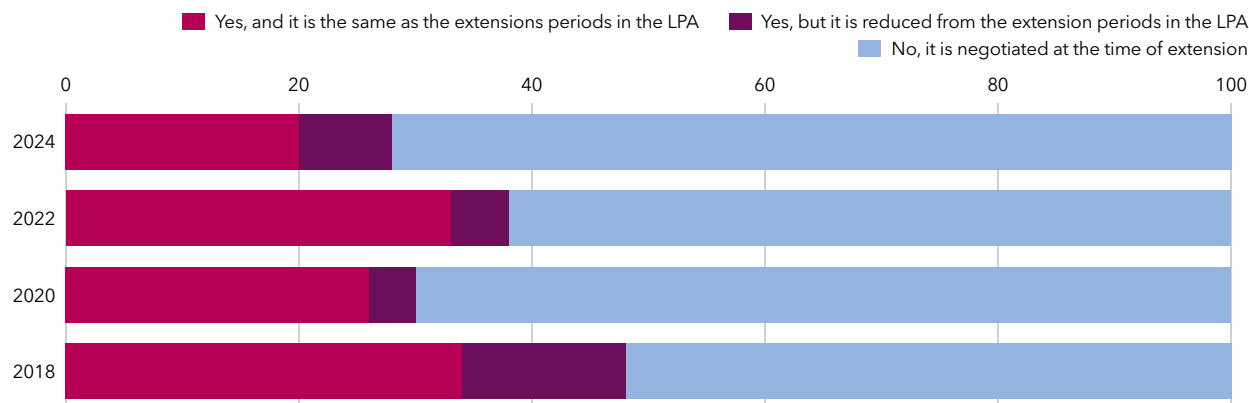


Did you stipulate in your LPA who pays for costs relating to a potential fund restructuring? (%)



Analysis

Did you stipulate in your LPA the fee and expense arrangements if your fund life is extended beyond the extension periods allowed in the LPA? (%)



These questions pertain to how you calculate the amount of management fee that is offset when the manager or its affiliates has 'net fees subject to offset' from a portfolio company (ie, services - or other - fees paid to the manager by a portfolio company that offset the management fee). Do you first apportion the fees subject to offset between... (%)

of respondents charge fees based on invested capital in the post-investment period, while 21 percent impose a step down in rate.

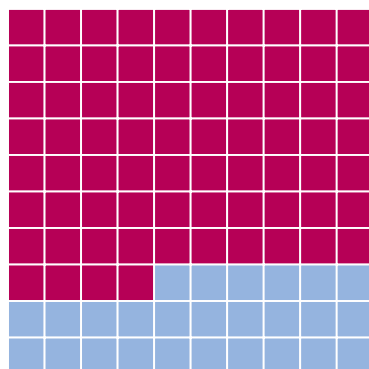
"Towards the end of a fund's life, management fees often continue during the post-investment period and any extensions, although they may be reduced," says Fay. "This is to compensate the fund managers for ongoing activities such as monitoring and exiting remaining investments."

Saw Mill Capital steps down the management fee after the investment period to being a percentage of the cost base of investments on a GAAP cost basis. "Then, at around the 10-year point, the management fee is cut in half," Cirella says. "We have one fund that has been around forever, well past the two natural extensions, where we have stopped charging management fees altogether because it felt like the right thing to do."

Meanwhile, the rise of the continuation vehicle has focused attention on who bears the cost of fund restructurings, although 41 percent of survey respondents say this issue is still not

The fund and its parallel fund(s)?

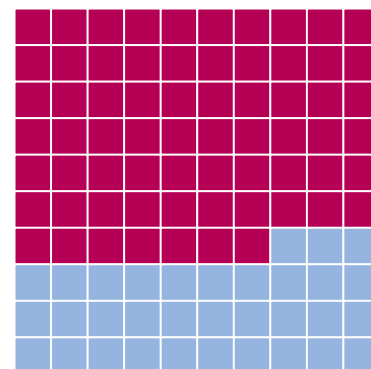
Yes 74%



No 26%

The fund and any co-investment vehicle you manage that is invested in the paying portfolio company?

Yes 67%

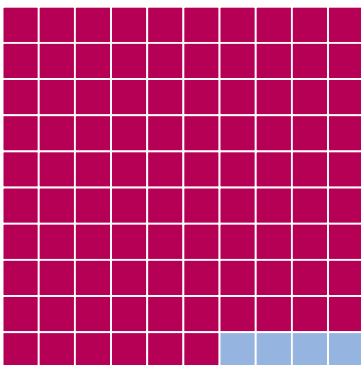


No 33%

If yes, in either case, do you do the apportionment based on... (%)

Invested capital?

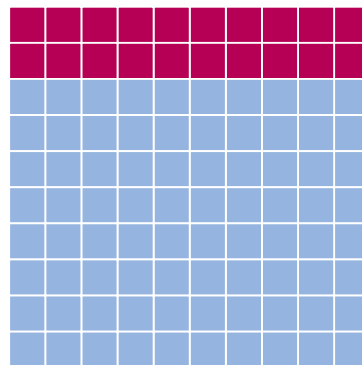
Yes 96%



No 4%

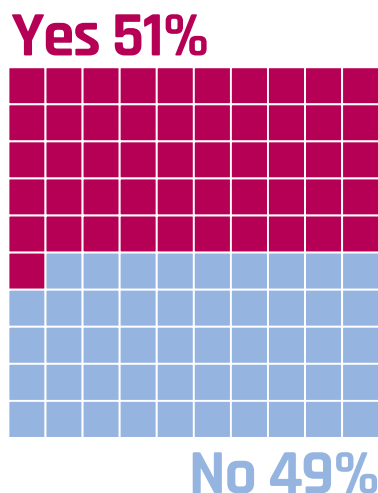
Fair market value?

Yes 20%

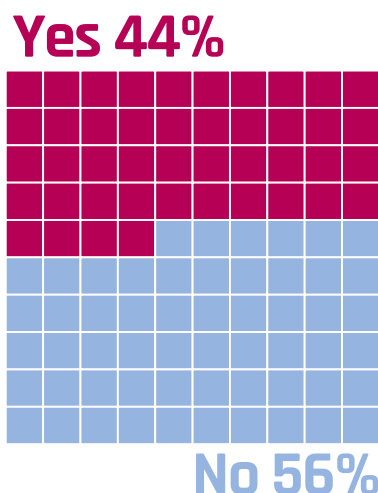


No 80%

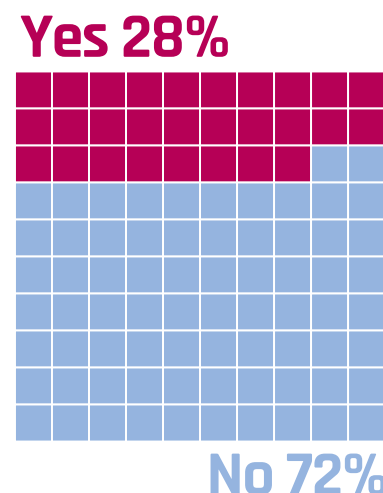
Do you reduce the fees subject to offset by the percentage of investors in the fund that are exempt from paying management fees? (%)



Do you reduce the fees subject to offset by the percentage ownership in the portfolio company that is held by third parties?



If yes, would your answer change if the 30% was owned by the management team of the portfolio company? (%)



Source for all data: Private Funds CFO Fees & Expenses Survey 2024

explicitly catered for in their LPA.

“More recently, we have seen LPAs providing for restructuring costs as fund expenses, but if not, the cost should be borne by the management company,” says Troutman Pepper partner Patrick Bianchi.

Costantino adds: “More and more sophisticated LPs are balking at the idea of the existing fund bearing the cost of restructuring. They are looking for those costs to be borne by the new vehicle. As continuation vehicles become more commonplace and as investors increasingly understand and appreciate how they work, I think the costs will shift more towards the surviving entity.”

Offset upset

The extent to which transaction and monitoring fees are offset against the management fee also continues to court controversy. Although 80 percent of survey respondents claim to offset 100 percent of monitoring fees and 87 percent claiming to offset 100 percent of other transaction fees, this is not always the case.

“The pros of early management fees include a steady stream of income for fund managers, ensuring they have the resources to identify and manage investments effectively”

COLLEEN FAY
Withum

“Transaction fees are still somewhat negotiable. The way we negotiate with our LPs is to be transparent about our budget and what it takes to run our company and produce the kind of performance that our LPs expect us to produce,” says Cirella.

Furthermore, even when there is ostensibly a 100 percent offset, that is not strictly speaking always the case, particularly when co-invest is involved. Indeed, 51 percent of respondents say they reduce fees subject to offset by the percentage of investors that are exempt from paying management fees.

“Some LPs push for a 100 percent offset, but if there is a co-investor in the deal, managers may reduce the portion of the transaction fee that is offset by the percentage of the company that is owned by the co-investor. Furthermore, that isn’t always clearly spelled out in the LPA,” says Bianchi.

“However, as LPs become more sophisticated, we are seeing more questions being asked about how offsets are being applied, including requests for models of those offsets from past practices.” ■

KEYNOTE INTERVIEW

What's shaping fund management costs?



Rosemary McCollin, Vistra's director of funds, analyzes the 2024 CFO Fees & Expenses survey findings, and offers insights into outsourcing practices and the trends shaping the fund management landscape

Q Forty-nine percent of the survey's respondents outsource all legal services and 44 percent outsource all fund administration. What stands out about these numbers?

The high percentage of fund administration outsourcing aligns with industry trends, as many companies are increasingly leveraging third-party expertise, especially with evolving regulatory demands. However, the US-centric focus of the survey might have influenced these numbers, as different regions, like Europe and Asia, have varied regulatory landscapes and operational needs, which could lead to

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different outsourcing strategies.

The relatively lower figure for data management outsourcing (15 percent) could stem from varying definitions of data management or unique sector-specific requirements. Some organizations might have strong in-house capabilities or specific data security concerns that drive their approach in this area.

Q Eighty-seven percent are using use periodic internal reviews to ensure fees

charged by external providers are reasonable. What are the benefits and drawbacks of these methods?

Clients often prioritize service quality over fees, and a decline in service may prompt a review, though not always benchmarked against the market. Our approach focuses on internal reviews to ensure fees align with the services provided, rather than comparing them to market averages, which helps us maintain service quality while ensuring fees meet client needs.

Recently, there has been growing dissatisfaction with traditional assets under management and basis points

fee structures. Clients are frustrated that fees increase as their funds grow, even when the level of service remains the same. This has led to a shift toward more flexible fee structures, where fixed-fee approaches are becoming more popular. Fixed fees offer better budget predictability and prevent fees from rising merely due to fund growth. This trend reflects a broader industry movement toward greater fee transparency and flexibility, ensuring clients feel they're paying for value rather than just the size of their assets.

Q The survey shows that 28 percent of firms run benchmarking reviews of provider fees every three years. What interval would you recommend to balance risk and burden effectively?

Running benchmarking reviews every three years is a common and reasonable interval. It balances staying informed about market trends with avoiding excessive disruption. Firms can reassess provider fees periodically without significant resource drain. The ideal frequency can vary based on a firm's needs. Some may need more frequent reviews due to operational changes, while others may find less frequent reviews sufficient.

For providers, benchmarking reviews offer valuable feedback and ensure services remain competitive. However, they also create pressure to justify fees, which can be demanding. Finding a review interval that mitigates risk and maintains operational efficiency is crucial for a strong provider-client relationship.

Q 'Solution fit' is considered the most important criterion for selecting an external provider by 69 percent of respondents; 6 percent prioritize technology; and 6 percent cite price. How do you define solution fit?

Solution fit means tailoring a provider's

services to a client's unique needs and objectives, which significantly enhances the effectiveness of the partnership. In today's market, there's a clear shift from generic solutions to providers that offer customized approaches that align with clients' specific operational and strategic goals. While technology and cost are still relevant, they often take a back seat to finding a provider whose solutions perfectly match the client's needs. This trend highlights a move towards value-driven partnerships, where service effectiveness is prioritized over technological features or price.

Q Sixteen percent of respondents charge funds for insourced services like data security and fund administration. Does that reflect the real situation, or are there complicating factors?

The consistent figure suggests stability in charging for insourced services like data security and fund administration. However, this may not capture all complexities, as definitions of insourcing versus outsourcing can vary, affecting responses. While the stability is notable, industry trends might be evolving. Some firms may be adjusting their charging models due to changing needs or regulatory shifts, which might not be fully reflected in the survey. Overall, charging for insourced services remains common, but understanding the broader context and specific influencing factors is essential.

"Many companies are increasingly leveraging third-party expertise, especially with evolving regulatory demands"

Q Sixty percent disclose the nature of insourced service charges, but only 40 percent disclose allocation methods, and 33 percent provide evidence of market rates. Does this indicate a transparency issue funds should worry about?

The varying levels of transparency in insourced service charges reveal areas needing improvement. The fact that only 40 percent share allocation methods and just 33 percent provide evidence of market rates suggests gaps in transparency. This lack of detailed information on how fees are allocated and whether they reflect market rates can raise investor concerns about fairness and potential hidden costs, impacting trust and overall satisfaction.

Regulatory trends are moving towards greater transparency and accountability in fee structures, aiming to ensure clear and justifiable fee disclosures, although specific regulations vary by region.

As an external provider, we stress the importance of transparency and encourage clients to adopt clear practices. This approach helps with compliance and fosters investor trust and ensures alignment with industry standards and client expectations.

Q What stands out about who bears the cost of outsourced services, and are you surprised by any findings?

The significant portion of outsourced service costs overall borne by funds is notable. It underscores the need for funds to carefully negotiate and manage these costs to ensure value justifies the expense. However, funds should evaluate these expenses closely and look for ways to optimize their cost structure without compromising quality or compliance. The findings highlight the importance of transparent cost structures and proactive management to align with the fund's financial and operational goals. ■

Co-investment inconsistencies

The fee treatment of co-investment continues to vary dramatically from fund to fund, writes Amy Carroll

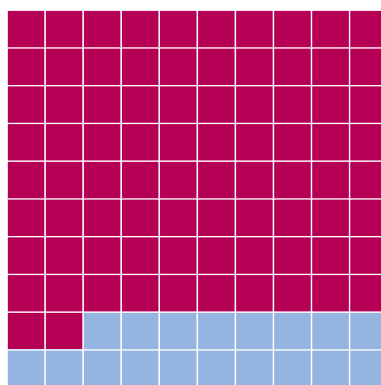
Co-investment has become a critical component of dealmaking in recent years, as credit constraints have led GPs to prioritize capital preservation. Co-investment is also being used to keep limited partners sweet in an undeniably tough fundraising market. Indeed, 82 percent of respondents to the *Private Funds CFO Fees & Expenses Survey 2024* have some sort of co-investment offering, up slightly from the 80 percent and 75 percent reported in the 2022 and 2020 survey findings, respectively.

“Co-investment has become an incredibly popular way to secure investors in a difficult fundraising environment,” says Rosemary McCollin, managing director and head of funds for Europe, the UK and US at Vistra. “Co-investment, alongside continuation vehicles, has also become a useful tool in a challenging exit environment, providing additional firepower to get assets to where they need to be to reach the desired valuation.”

There continues to be a lack of conformity regarding the charges applied to co-investment, however. Over two-thirds of survey respondents do not charge any kind of management fee on co-investments, while a similar figure do charge an organizational or set-up fee. Around a third, meanwhile, charge

Does your firm offer co-investments? (%)

Yes 82%



No 18%

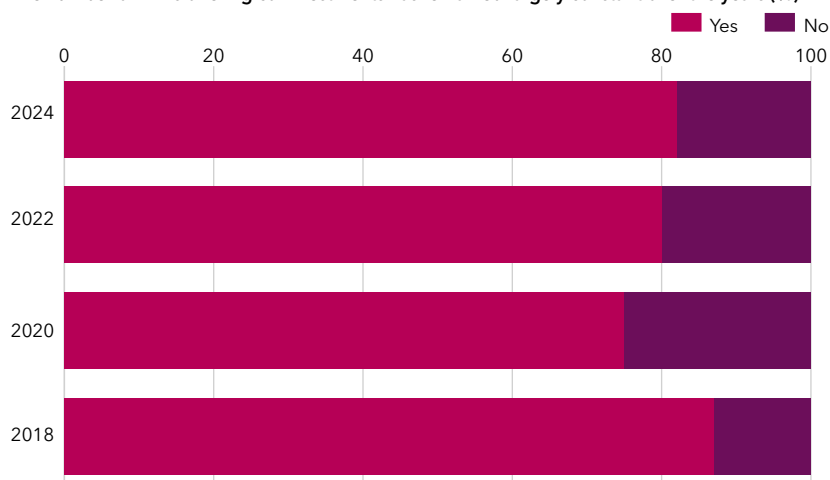
a reduced management fee, while 10 percent charge the same management fee that is charged to the main fund.

Similarly, there is significant variation in how carried interest is applied. Over half of respondents charge no carry, 39 percent charge reduced carry and 19 percent charge the same level of carry as the fund.

“Whether or not fees and carry are charged on co-investment depends a lot on the purpose that the co-investment is serving in relation to the deal,” says Stephanie Pindyck Costantino, partner at Troutman Pepper. “It depends on what the premise of the co-investment vehicle is.”

The way in which the co-investment

The number of firms offering co-investments has remained largely constant over the years (%)

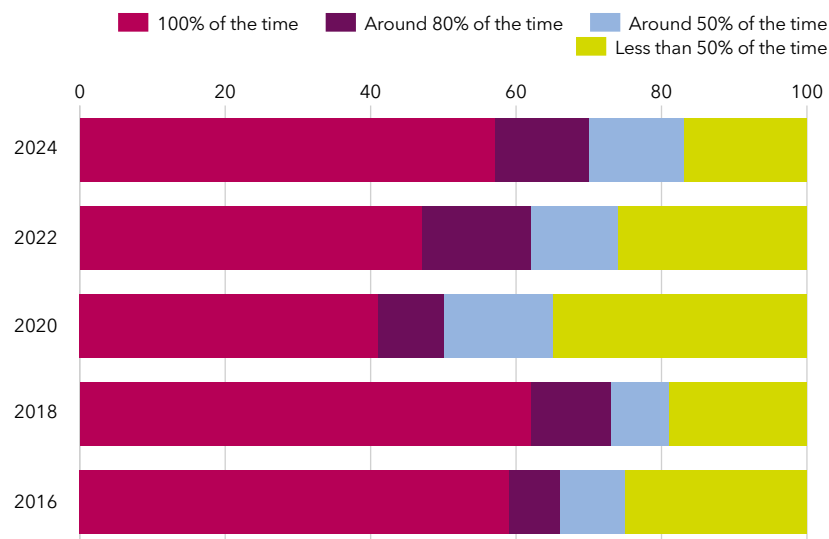


Source for all data: Private Funds CFO Fees & Expenses Survey 2024

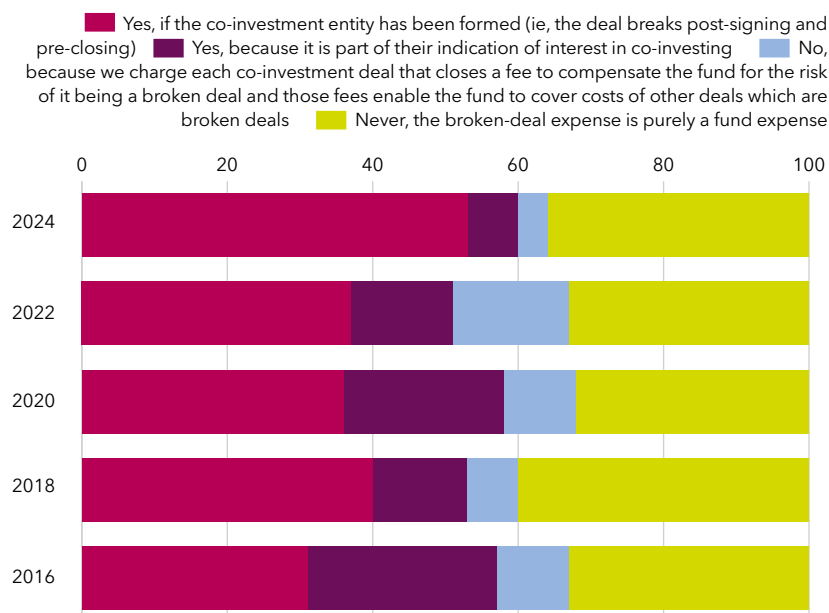
“Co-investment has become an incredibly popular way to secure investors in a difficult fundraising environment”

ROSEMARY MCCOLLIN
Vistra

How often are your co-investments structured as separate entities (as opposed to direct investments in portfolio companies)? (%)



Do the co-investors have any responsibility for broken-deal expenses if the deal does not go forward? (%)



is structured will also have an impact. Seventy percent of survey respondents usually or always structure co-investments as separate entities, rather than having the co-investor invest directly alongside the fund.

“Co-investors can either invest directly into the portfolio company or, these days, a single investor

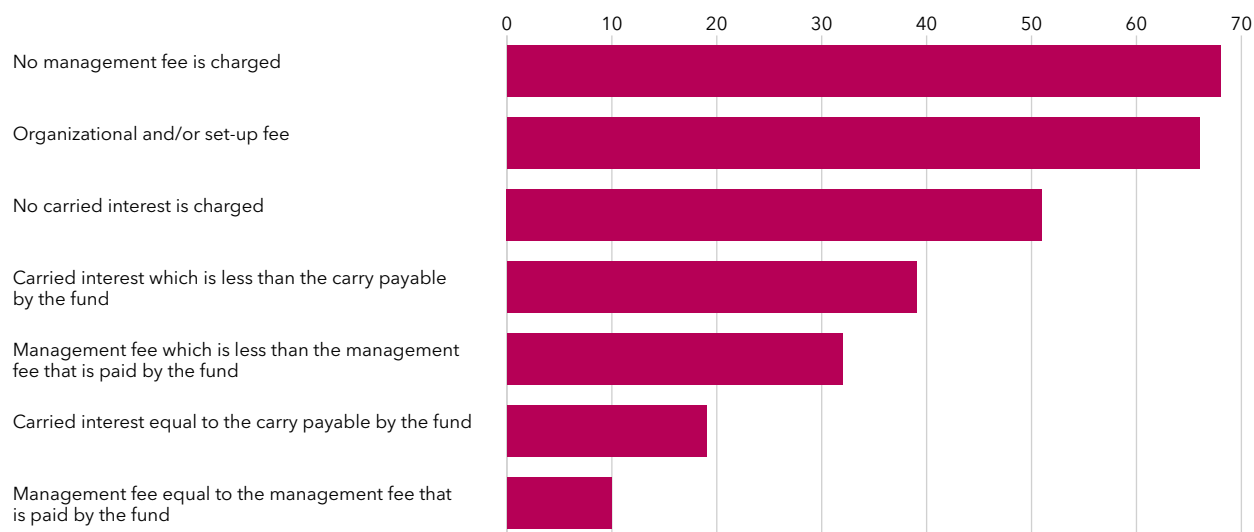
57%

Share of survey respondents that structure co-investments as separate entities, up from 47% in the 2022 survey

co-investment fund tends to be created,” says the finance director of an upper mid-market house who wished to remain anonymous.

“In that scenario, the GP may receive a small admin fee each year. The advantage for the investor is you can hand over the administration of the fund to the GP, rather than administering it

Which of the following do you charge to your co-investment vehicles? (Multiple answers allowed, %)



Source: Private Funds CFO Fees & Expenses Survey 2024

yourself. In addition, the accounting is then usually outsourced to a third-party administrator, which means you get a degree of independent review.”

Saw Mill Capital, meanwhile, does not charge for co-investments at all. But chief financial officer Blinn Cirella acknowledges that firms are increasingly creating co-investment vehicles that are then treated more like a fund. “Those co-investment funds inevitably require work. They have to be audited. You have to file tax returns. So, it makes sense that there is a charge,” she says.

“Our co-investors invest directly alongside us in the holding company where the fund and often a management team entity also invests. That holding company then invests into the portco.”

McCollin adds: “We provide the same services for a co-investment vehicle that we do for a main fund in terms of books and records, reporting and financial statements. There is a cost incurred by having these structures in place and yet it has become the norm for the manager not to charge fees on co-investment, or at least to make any charge incredibly small. I think that is why we are starting to see more co-investment aggregator structures.

“If a co-investor has been part of the deal journey from the beginning, then aborted deal costs will be split between the fund and the co-investor. But, in reality, co-investors only tend to come onboard when there is a high certainty of execution”

MID-MARKET FINANCE DIRECTOR

It creates an element of economies of scale.”

Bone of contention

Perhaps the most contentious aspect of co-investment, however, remains the treatment of broken-deal fees. Over half of survey respondents say co-investors would be responsible for a share of broken-deal expenses if the co-investment entity had been formed, while 7 percent say an indication of interest would be enough for the co-investor to be on the hook for an aborted transaction. A further 37 percent view broken-deal costs as purely a fund expense, however.

“If a co-investor has been part of the deal journey from the beginning, then aborted deal costs will be split between the fund and the co-investor,” the mid-market finance director says. “But, in reality, co-investors only tend to come onboard when there is a high certainty of execution.”

“Co-investments are often theoretical until the last moment,” agrees McCollin. “The investors want to make sure the fund manager is confident in proceeding based on the availability of their capital but, at the same time, they don’t want to be responsible for any failure of the deal.” ■

Splitting the bill

The outsourcing trend continues unabated, but the question of who pays for what, is not always straightforward. By Amy Carroll

As operational and regulatory complexity has proliferated, and tech advances have soared, the trend toward outsourcing has gained momentum. The vast majority – 90 percent – of respondents to the *Private Funds CFO Fees & Expenses Survey 2024* now outsource all or most of their fund administration, while 91 percent outsource all or most of their legal work.

“Outsourcing trends in private equity funds continue to lean towards the adoption of third-party services to navigate certain market demands and support growth,” says Colleen Fay, financial services practice lead at Withum.

“The industry’s focus on being able to digitalize and automate drives outsourcing to achieve operational efficiency and accuracy.”

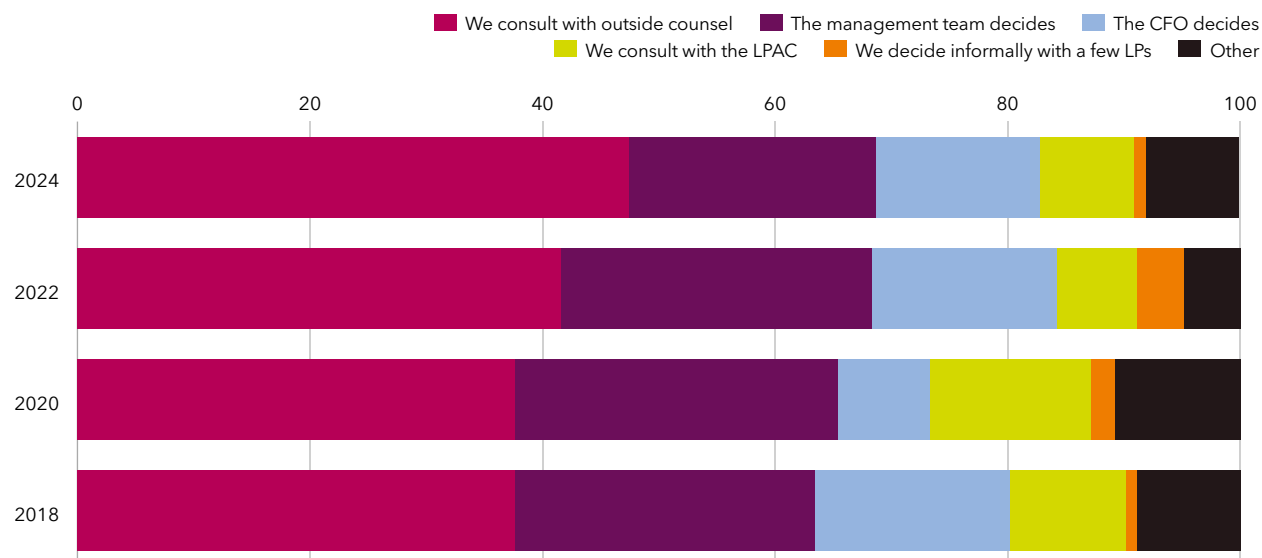
“As a firm, we focus on outsourcing everything that is non-core,” says one mid-market finance director, who wishes to remain anonymous. “In part, that is because technology has moved on so significantly, including cybersecurity. The big administrators have the appropriate resources to invest in the latest and best technology. It is the right thing to do to outsource to a service provider that has both the relevant technology and skill set.”

Saw Mill Capital, meanwhile, has historically insourced most functions, but has recently started to outsource

tax work. “We are also considering outsourcing fund administration, not for the fund we are currently closing, but for the next one,” says chief financial officer Blinn Cirella. “The level of complexity that the accounting team faces is rising at a much greater rate than AUM. Senior management can’t understand why you have this swelling accounting department, and so the only solution is to outsource.”

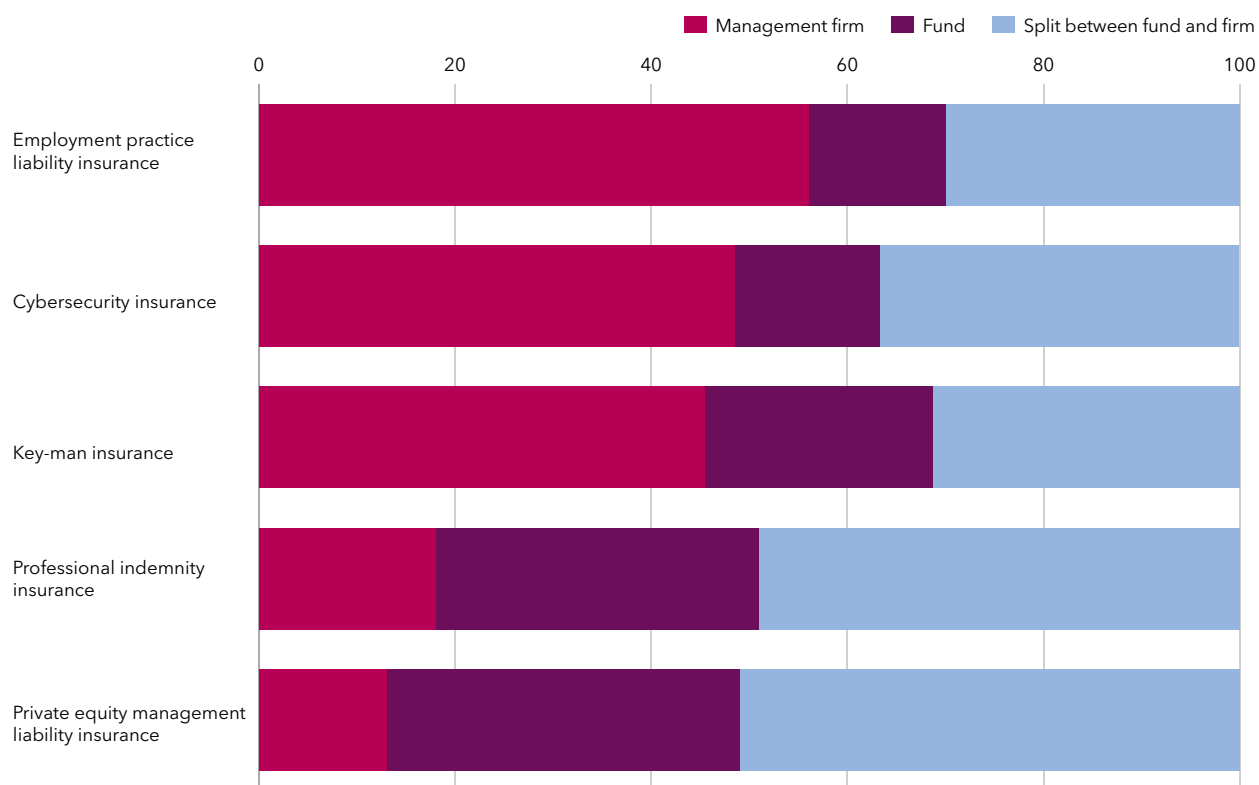
An increasingly complex regulatory environment is undoubtedly having an impact too. “Regulation has been a major driver of outsourcing. Unless managers have reached a certain scale, it can be difficult to ensure you have all the skills and personnel required to perform the myriad functions needed

How do you decide questions about fee and expense allocations that are not addressed in the PPM, LPA or policy documents? (%)

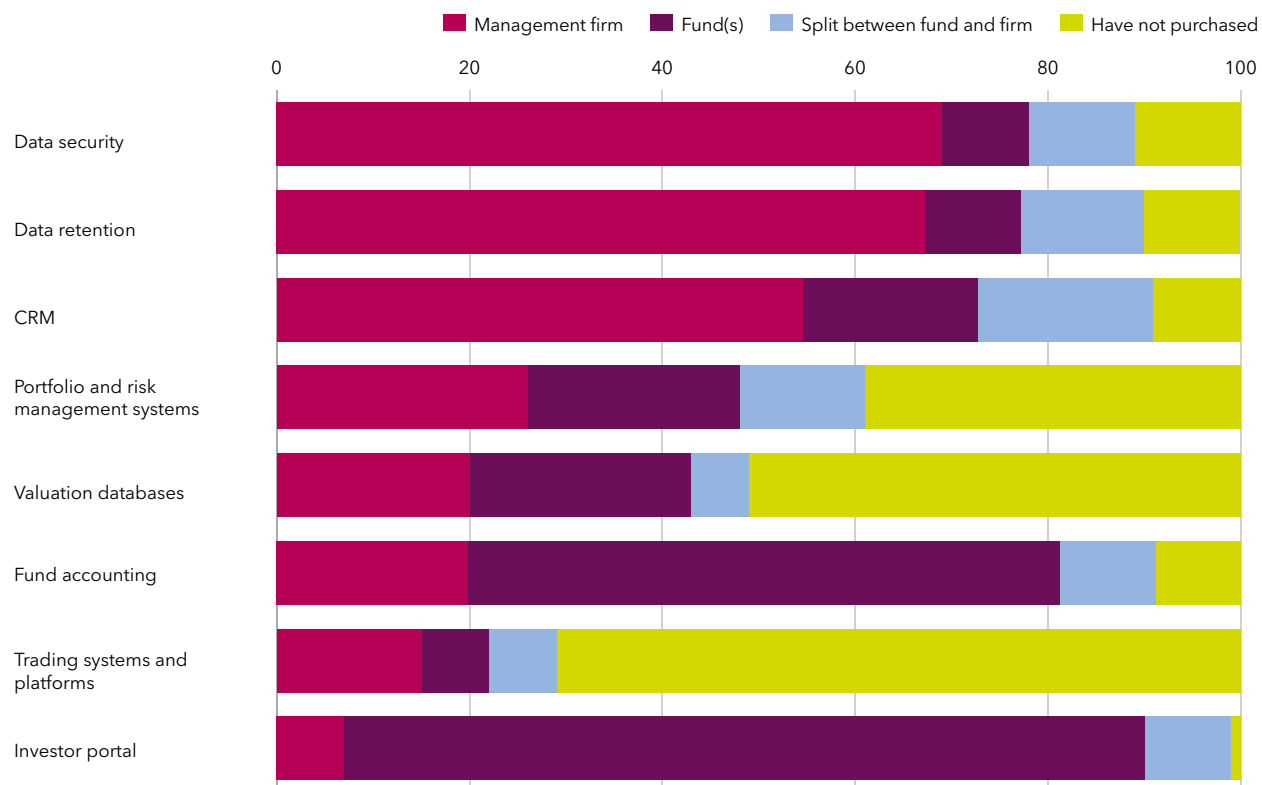


Analysis

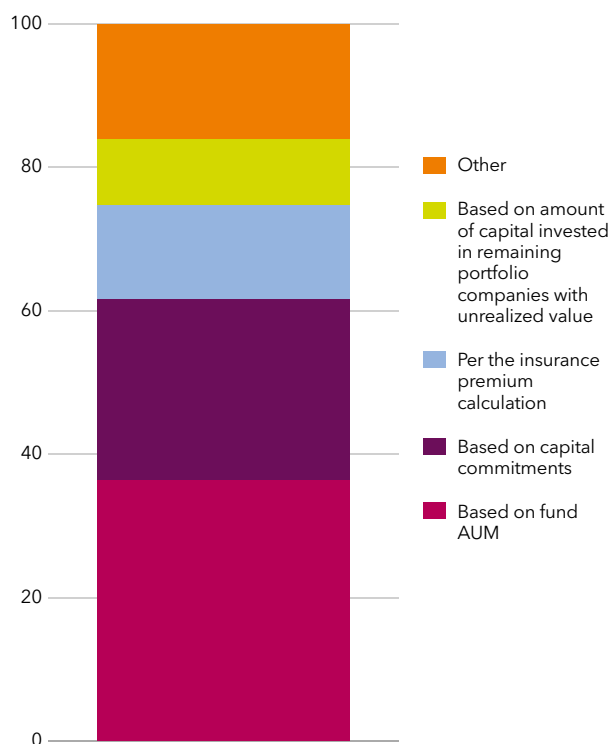
When your firm takes out new insurance policies covering the below, who bears the premium? (%)



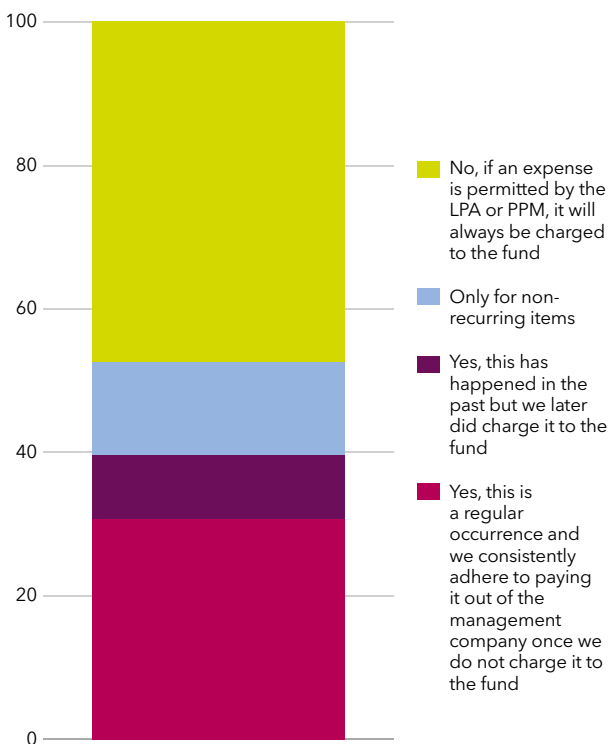
When your firm implements technology-driven systems covering the below, who pays the initial acquisition and ongoing costs? (%)



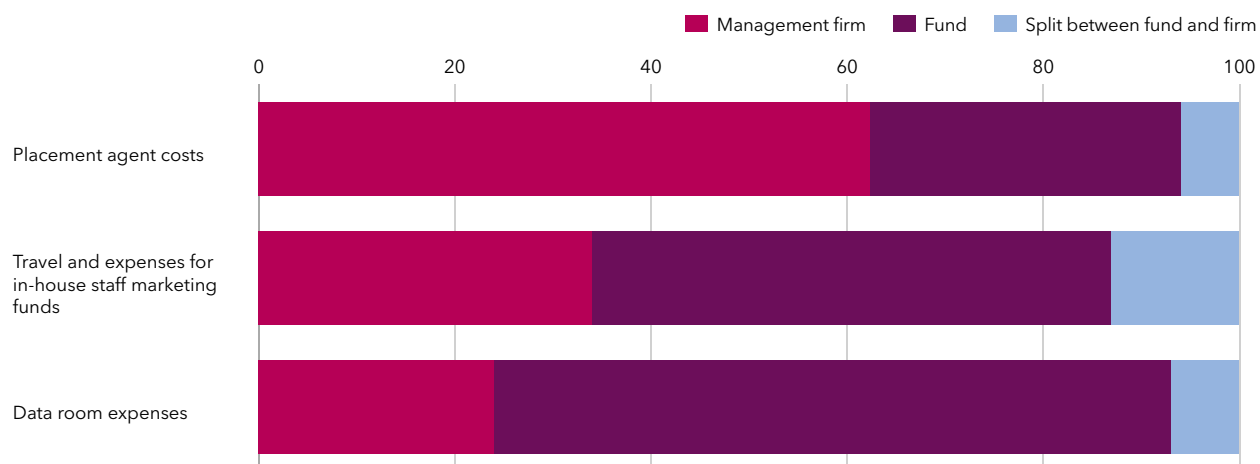
If you allocate these costs across funds, how is this allocation calculated? (%)



Have you ever decided not to charge to the fund an expense that was expressly permitted in the LPA or PPM? (%)



Who pays for the following fund marketing costs? (%)



by the fund without charging a management fee that is off market,” says Stephanie Pindyck Costantino, partner at Troutman Pepper.

Cost advantage

Indeed, cost is undoubtedly among the biggest drivers of outsourcing. Nine out of 10 survey respondents charge

fund administration expenses directly to the fund, while only 16 percent of respondents who choose to insource a given function then charge an additional fee on top of the management fee.

“We outsource fund administration for most of our funds, with that cost allocated to the funds themselves. That is

reflective of a broader trend in the market,” says chief financial officer of NB Alternatives Barry Giarraputo, who adds that some firms across the industry are now employing two different administrators, with one administrator shadowing another.

“It doesn’t make sense for managers to increase headcount in line with

AUM. Outsourcing, augmented by the myriad tech solutions being developed for private markets, are making a real difference to the industry, helping smaller managers, in particular, reduce in-house resource and cost,” says Rosemary McCollin, managing director and head of funds for Europe, the UK and US at Vistra.

“The allocation of expenses is more straightforward in an outsourced model. Managers can find it difficult to quantify fees per project or investment because they are not set up to track those allocations. If you outsource your back office to a third party, they are obliged to give you a clear and transparent breakdown by hour and by entity, allowing the manager to pass expenses on to the appropriate fund or investment in a transparent manner. That typically also means the manager can charge more back to the fund, as costs aren’t being missed because they can’t be allocated properly.”

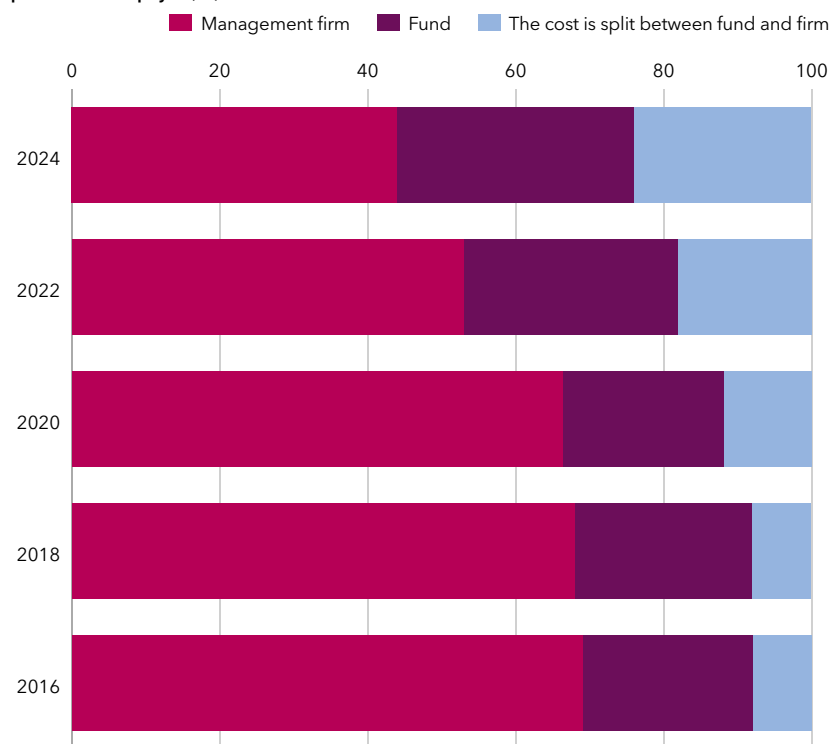
ESG factor

Of course, fund administration is not the only cost that managers must contend with and over the years new areas of expense have risen to prominence, along with haggling over who should pay. Data security, data retention and CRM costs have come to be overwhelmingly borne by the management company. Portfolio valuation costs, by contrast, are more typically borne by the fund.

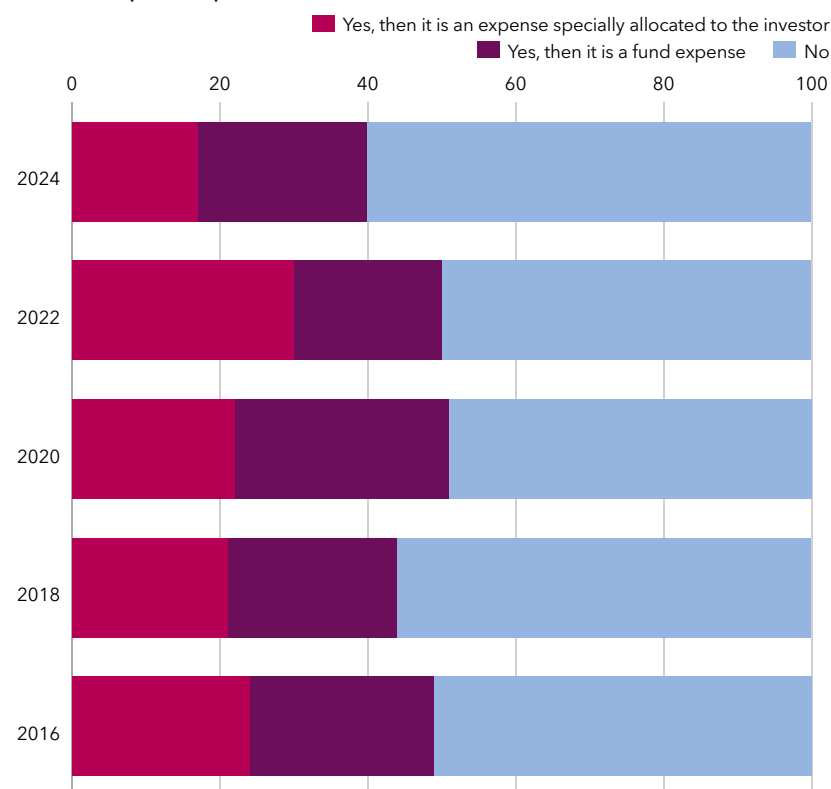
One area that is increasingly a cause of controversy, meanwhile, is ESG consultancy and benchmarking. The survey shows that this cost has shifted from the management company to the fund – or at least is increasingly being split with the fund – but the situation is not straightforward.

“ESG ratings and consultancy is a cost line that has dramatically risen in

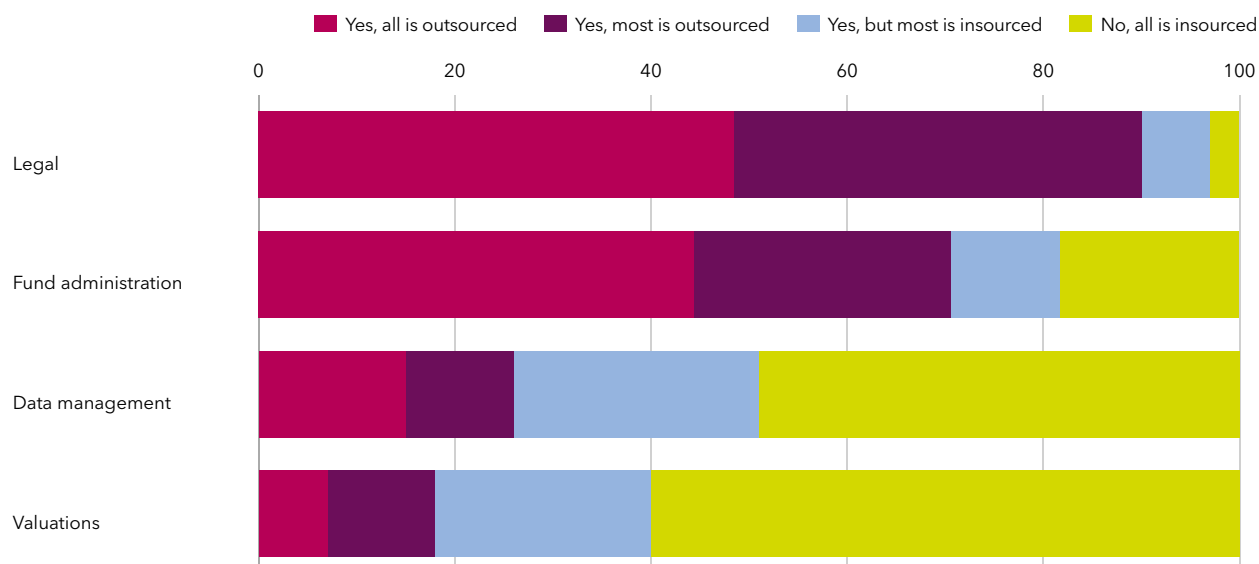
Your firm employs an ESG consultant to advise on a responsible investment policy across your portfolio. Who pays? (%)



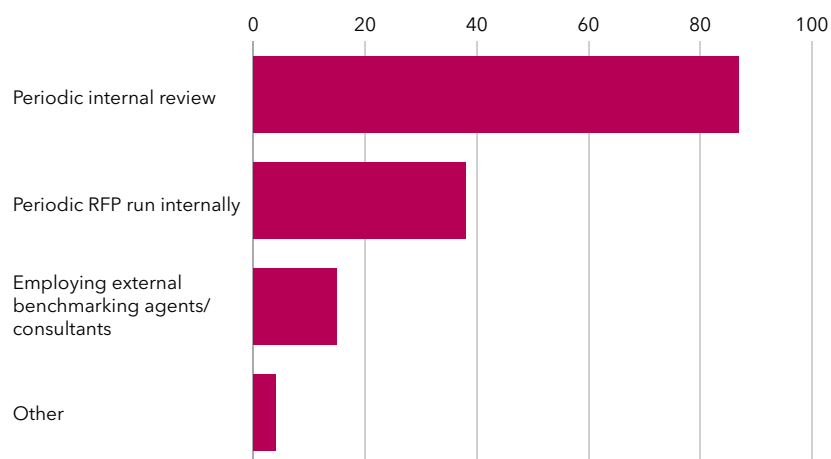
If an ESG consultant is a requirement of a particular limited partner, does this change your answer to the previous question? (%)



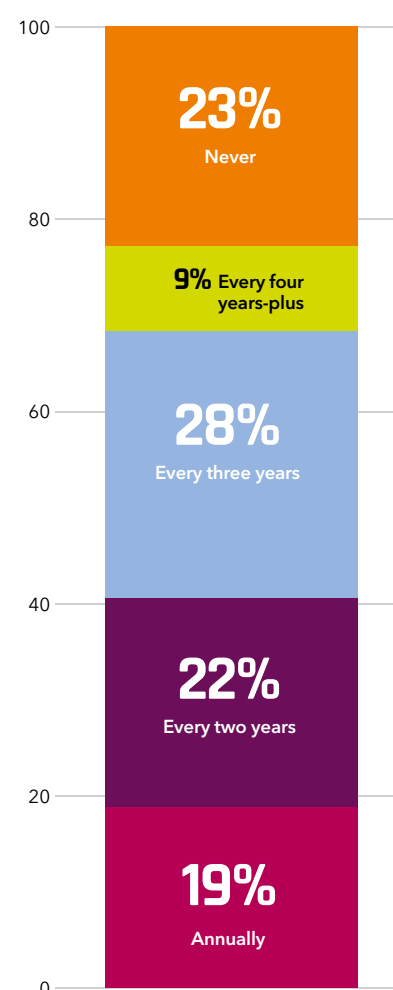
For the following services, do you outsource to third parties? (%)



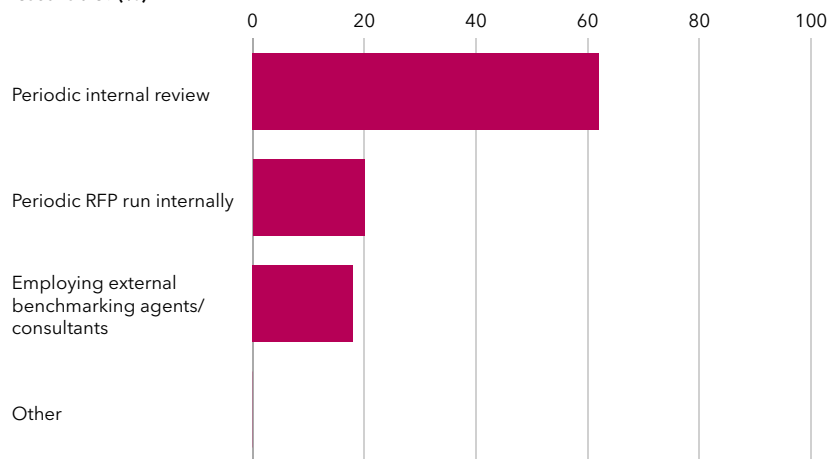
Which of the following methods do you use to ensure the fees charged by external providers are reasonable? (Multiple answers allowed, %)



How often do you run a benchmarking review of your external providers fees? (%)

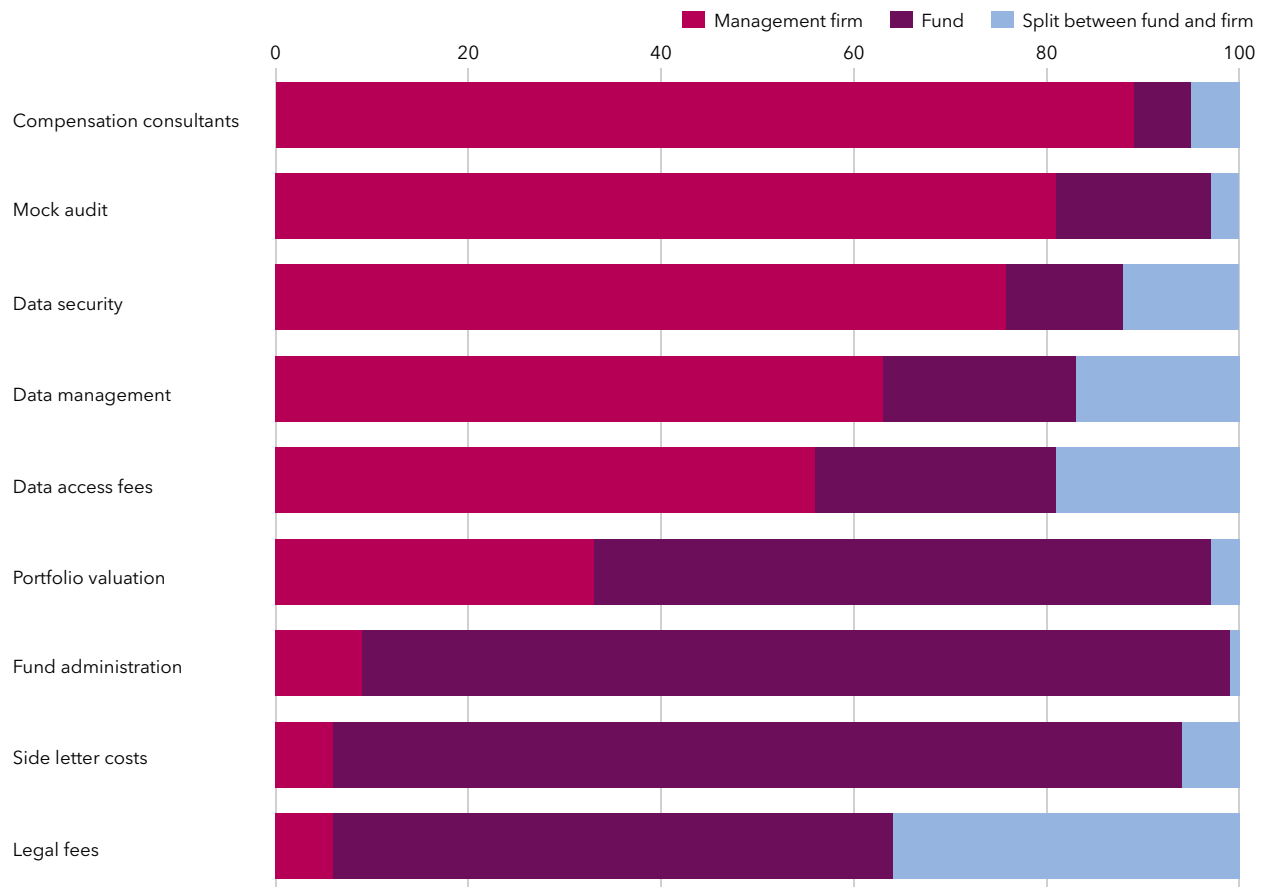


Which of the following methods do you use to ensure the fees charged by internal providers are reasonable? (%)



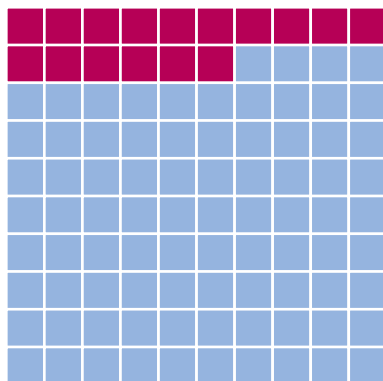
Analysis

Who bears the cost of the following outsourced services? (%)



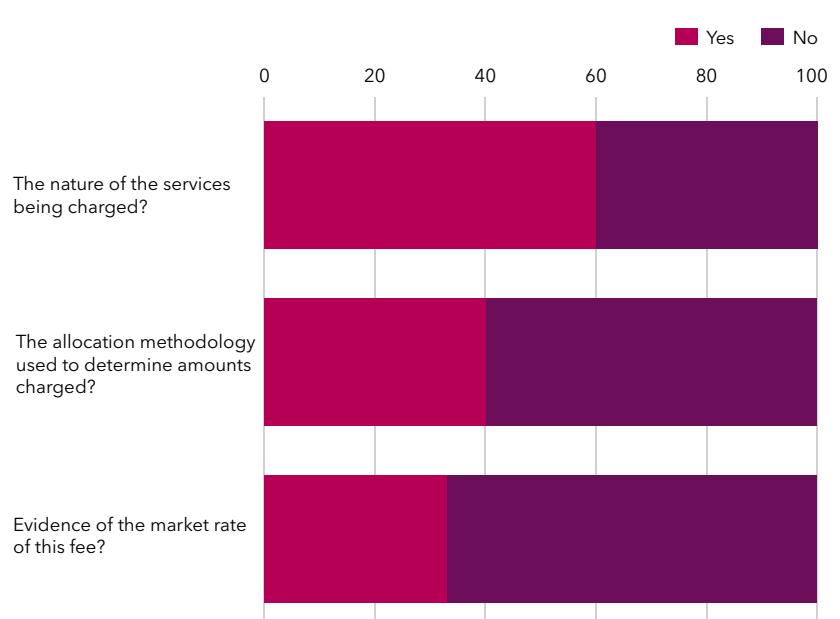
If you are insourcing any of the above services (fund administration, portfolio valuation, data management, data access fees, data security, legal fees, side letter costs, mock audit, compensation consultants), do you charge any of these services to the fund in addition to the management fee? (%)

Yes 16%

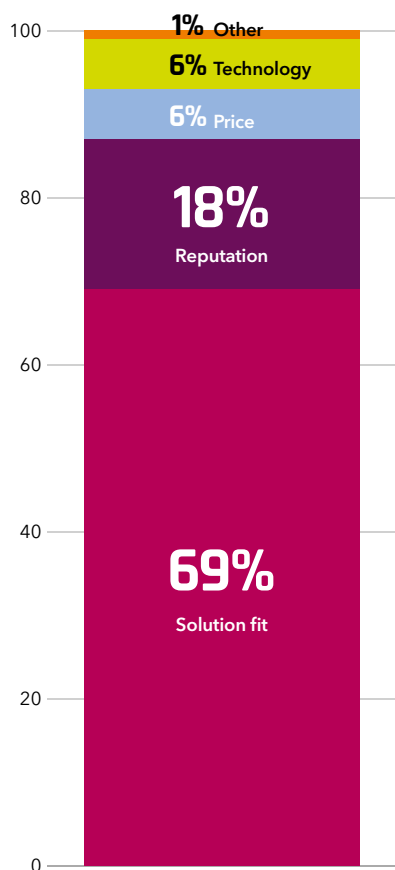


No 84%

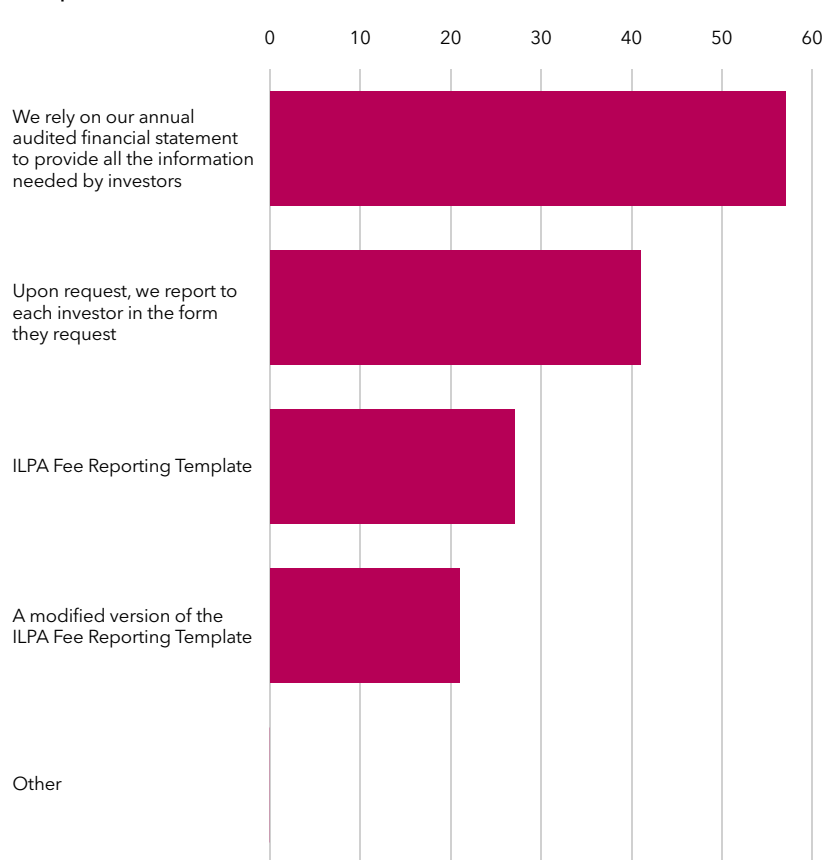
If yes to the question left, do you disclose... (%)



What is the most important criterion in the selection of external providers? (%)

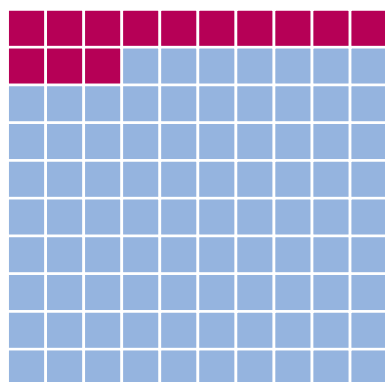


How do you currently report your fees and expenses to investors? (Multiple answers allowed, %)



Do you allow affiliates to loan money to your fund? (%)

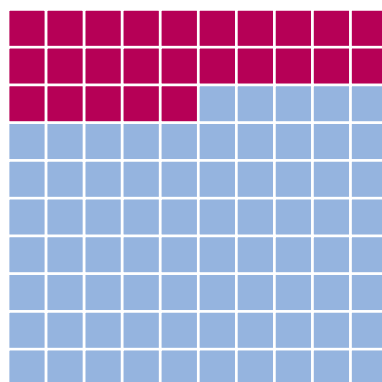
Yes 13%



No 87%

Is the interest rate for such a loan based on a set interest rate or a market interest rate? (%)

Set 25%



Market 75%

prominence over the past decade,” says McCollin. “Many investors require a positive ESG rating to sign up to a fund, and they require extensive ESG reporting, but depending on the jurisdiction it isn’t necessarily a regulatory requirement. Who then should bear the cost? It is a gray area that can be argued either way.”

For Troutman Pepper partner Patrick Bianchi, the key is who is driving the cost incurred. “If the manager is marketing itself as ESG compliant, and that is a major component of what defines them in the marketplace, then they are really just hiring consultants to add to their investment team,” he says. “But if it is the case that there are a handful of investors that want ESG added to the fund’s strategy, then in my view that should be spelled out as a fund expense.” ■

Source all charts: Private Funds CFO Fees & Expenses Survey 2024

“The SEC’s focus on fees and expenses has broadly helped the industry”

PATRICK BIANCHI
Partner, Troutman Pepper

“There are simply more and more things to spend money on today. From cybersecurity to ESG”

BLINN CIRELLA
CFO, Saw Mill Capital

“The significant portion of outsourced service costs overall borne by funds is notable”

ROSEMARY MCCOLLIN
Director of funds, Vistra

Reflections on fees and expenses

Expert perspectives on a changing landscape

“We outsource fund administration for most of our funds, with that cost allocated to the funds themselves. That is reflective of a broader trend in the market”

BARRY GIARRAPUTO
CFO, NB Alternatives

“Investors are particularly focused on abort fees because these can run into millions”

ANONYMOUS
Finance director

“Once-traditional management fee structures are – and will continue to be – increasingly challenged by more flexible models”

COLLEEN FAY
Practice leader, financial services, Withum

“We are starting to see more precision in the language relating to who bears what costs and in what situations”

STEPHANIE PINDYCK COSTANTINO
Partner, Troutman Pepper



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