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Carried Away Series — The Fee Table Has Turned

SPEAKERS

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Our “Carried Away” miniseries returns with an insider look at how private fund managers are reimagining fees and carry to win commitments in today’s fiercely competitive fundraising environment. In our second episode, Private Equity Partner Stephanie Pindyck Costantino is joined by fellow PE attorneys Heather Stone and Paul Steffens. They examine how the classic “2 and 20” has evolved into a landscape of fee compression, bespoke arrangements for anchor and strategic LPs, early closer incentives, and even shared carry. Listeners will hear how GPs are using co-investment rights (often on a no-fee, no-carry basis), fee breaks, and other economic levers to launch and scale platforms — and how sophisticated LPs are leveraging early commitments, co-invest access, and long-term relationships to shape GP economics across fund generations.

Transcript

***PE Pathways* — Carried Away Series — The Fee Table Has Turned**

Speakers: Stephanie Pindyck Costantino, Heather Stone, and Paul Steffens

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Stephanie Pindyck Costantino (00:05):

Welcome to *PE Pathways*, our podcast series where experienced dealmakers share their thoughts on current private equity and M&A trends and developments. My name is Stephanie Pindyck Costantino, a partner in Troutman Pepper Locke’s Private Equity Practice, and I am excited to continue our multi-episode miniseries entitled Carried Away. This is a focused podcast series on the economics of private funds, management fees, carry, GP co-investment, and the tax rules that sit behind them. Each episode brings together Troutman lawyers to explore what’s really happening in the market. Listeners will hear candid discussions of current GP fee and carry norms, the way GPs are sharing economics with anchor LPs and strategic partners, how firms are using carry to recruit and retain talent across the organization, and how recent and pending court decisions are reshaping tax planning for management fees. Our first episode covered the current trends we are seeing in GP economics. In this episode, we wanted to continue the conversation by focusing on how today’s GPs are navigating a complex, highly negotiated fee landscape. This includes reduced management fees for large LPs, fee offsets, co-investment economics, and GP-led secondaries that blur the lines entirely. But the real story is how GPs are strategically sharing their management fees and carry with anchor LPs, fund of funds, and strategic investors to build loyalty, secure commitments, and differentiate in a crowded fundraising market. Joining me today are fellow PE attorneys from our Investment Funds and Investment Management Group, Paul Steffens and Heather Stone. Paul, Heather, welcome.

Heather Stone (01:44):

Good to be here.

Paul Steffens (01:44):

Yep, thanks, Steph.

Stephanie Pindyck Costantino (01:46):

Okay, so let's jump in. First, really, what does the current fee negotiation landscape look like? In other words, what are GPs giving up to potentially close anchor investments or, in some cases, to maybe be placed in business?

Heather Stone (02:01):

Well, I think that the historical baseline of the 2 and 20, with maybe an 8% hurdle or something like that, is certainly still the norm, at least the advertised norm. But I think that when you look at anchor LPs or large LPs, there's fewer and fewer of them that I think are actually paying that full freight amount. I think that certainly the smaller investors or investors that aren't perceived as being important to the GP in some way certainly are still paying that. But I think that it's all about fee compression and customization for those larger anchor or strategic LPs. They're certainly more sophisticated as a group. There's more options for them. That creates competition in the marketplace. So I think to close anchor commitments, many GPs now are giving fee breaks on large commitments or fee breaks for people who come into an initial closing or close to an initial closing, whether you call those early adopter discounts or early closer discounts or founder LP discounts. But it's basically some kind of a financial incentive and fee sharing to investors who get to the table early. I think it's becoming more and more common.

Stephanie Pindyck Costantino (03:21):

Paul, are you seeing similar things with respect to the real estate sector?

Paul Steffens (03:25):

I am. We see on the sponsor GP side, we see a fair amount of requests from anchor LPs, larger LPs, some strategic LPs to reduce both the management fee and the carried interest that they pay the general partner. We also see the management fee reduction sometimes when clients are raising capital through the wealth management RIA networks because those wealth managers are already usually paying or collecting a 1% asset management fee from their clients, and so oftentimes they'll ask the fund sponsors for a fee reduction so that the fee load on their clients that are investing in the funds doesn't exceed 2%.

Stephanie Pindyck Costantino (04:16):

So for some managers who are looking to get into the business, so to speak, in your experience, what do you see

maybe being offered by one or more sponsors with respect to that? Either a share of carry or share of management fee or both, or is there something that they're being potentially offered so that they can be incentivized to help the manager get up and running?

Heather Stone (04:43):

I think that the most recent time period for—whether you call it walking around money or for a first-time fund, kind of the what-if money or but-for money—I'm seeing that for maybe a collective commitment of a million or \$2 million, somewhere between 5% to 7% of the carry is given to those people. Since it's not really done as a loan, it's kind of that money's not going to be repaid because it's going to be spent to get the manager up and running. But that seems to be the market, somewhere between 5, 7, 10% of the carry for maybe a couple million dollars to really get them going because it takes longer and longer to fundraise now. It could take up to a year, and they need money to do that. So certainly seeing that as being more common with friends and family and other, not necessarily large investors, but people who really want to have an early ground-level stake in a new manager potentially or a new offering.

Stephanie Pindyck Costantino (05:41):

Along those lines, if we look at key investors, for example, and we think about how a general partner is structuring their carry, I think, Paul, the question I would ask is where's the line between smart relationship building and potentially giving away too much of the economics?

Paul Steffens (06:00):

There is a fine line there. So maybe it's a gray line. I don't know how exactly to describe it, but the issue that you have to always keep in mind when you're giving away economics or you're giving very favorable economics to a particular investor, there are a couple of issues. First, if you're giving it to one investor, there will probably be other investors who want similar treatment that may come in to also help sort of get the business off the ground or come in to really get the fundraising going and help the general partner meet their fundraising goals. And so the GP needs to think about that. If I give this break or these special economics to one investor, I may have to do it to another investor, and then that increases the amount that I'm giving away. One other thing they have to consider is once you give the economics away for one fund, the investors typically don't like to give them back for subsequent funds. And so if that investor is going to continue with you, you're probably going to have to give them something similar or maybe the same break on future funds. And these fee breaks that you give, they limit the amount of—if you're giving a share of your carry, for example, to an investor, that limits the amount of carry that you have in order to be able to give to your management team and your investment professionals to incent and retain them. So I think you just have to be careful. I think it is a powerful tool that you can use as a GP or a good incentive to get an investor to increase their commitment and really truly help you get your business off the ground. But there are potential—well, obviously there are costs to it, and they're not just for this particular fund, but those costs usually extend through subsequent funds. You've got to think through that before offering those types of things.

Heather Stone (08:09):

Yeah, absolutely. I would agree with that. It's one thing if you have a \$100 million investor who's going to represent themselves 25% or more of your fund and they are asking for a 10% fee break or 10% of the fees on the whole fund, or a 10% carry break or 10% of the carry on the whole fund, but there's other things that can be added than just the monetary aspects of that. So I've had GPs who have analyzed it in terms of, it's \$100 million and it's 25% of the fund, but more than that, this is a really blue-chip anchor institutional investor and other investors are going to come to this fund and have come to this fund because this is our partner anchor investor. So it actually represents more than \$100 million that does come in at the full fee and carry. They also want to add in, in many cases, some extra things like investment committee observer rights or regular meetings with management, which they market to the anchor LP as being for the benefit of the LP to sort of know what's going on at a higher level at the fund. But it's really important for the GPs too, because if they're, as you had said, just getting started or just getting stood up in the institutional marketplace, it's really important for them to have regular meetings with these big institutional partners to be able to understand that marketplace and learn about that marketplace for subsequent funds and for subsequent conversations they're going to have with other big investors. So it is definitely a tightrope, but in the right situations, it works really well for some people.

Stephanie Pindyck Costantino (09:53):

So when you look at the fee universe holistically, are there any fees that you feel like are not routinely included in any sort of fee-sharing arrangement? If so, what would some examples of those be? I know that I see them in the real estate space, for example. So, Paul, I'd be interested to hear, when you're looking at a vertically integrated real estate investment shop, what is it that you see that might not be actually shared with one or more investors?

Paul Steffens (10:23):

Yeah, typically we would not see the asset management fee shared with investors. The asset management fee at the fund level is typically used to pay for the investment professionals and keeping the lights on at the general partner and the investment manager. So we don't usually see that shared. Also, in the real estate fund context, most of the general partners, or a lot of them, are vertically integrated and they charge property-level fees for services that are provided at the property level. And those are usually development fees, property management fees, construction management fees, and the like. And those fees—or brokerage, leasing and brokerage fees as well—and those types of fees would have to be paid to a third party anyway. So most LPs, at least in my experience, are fine with the fund or its portfolio companies paying those fees to the GP and its affiliates because those fees would have to be paid to somebody else, a third party, to provide the services anyway. They just want to make sure that the fees disclosed are the ones being charged and that those fees that are disclosed to investors in the fund docs are market-rate fees.

Stephanie Pindyck Costantino (11:47):

Along those lines, when we think about it, Heather, when you look at all the fees that might be charged, right, oftentimes, there's a discussion about fee offset, management fee waivers. Also, there's a discussion, to your point earlier, about looking at it holistically, co-investment rights and other things that might be offered. When you really take a step back, which of these actually matter in your opinion to sophisticated LPs and which might just be table stakes now?

Heather Stone (12:15):

Well, I think that they tend to focus, I agree with Paul that they're not as interested in the management fee, especially because if we're talking about early Roman numeral funds, they need that money to get their organization set up and pay their people, but they also maybe are collecting transaction fees that are already, as you pointed out, offsetting that management fee. So there's more interest in the carry sharing with anchor investors, I think. And I think that they are the most interested, frankly, in co-investment. That has really undergone a sea change over the last ten years where it used to be half the carry and half the management fee on co-investment has really come down to almost universally being no-fee, no-carry arrangements. And that's really the biggest economic sharing that I think GPs and LPs have now. But it's just such a great benefit for the LPs to be able to average down the cost of their commitment to managers that they really like, and GPs get access to more capital. And also, LPs have very small internal staffs to manage all of the managers that they invest with and to oversee them. And so being able to put more money to work with fewer managers helps them with their own internal people asset management.

Paul Steffens (13:37):

Yeah, I agree with Heather on that. That's what we see as probably one of the most attractive rights. And the economics have changed for co-invest a fair amount as well to where we've got LPs frequently asking for essentially a zero-management fee, zero-carried interest fee structure at the co-invest level. Sometimes we'll have LPs that permit the GP to charge a management fee and a carried interest to non-LP investors that co-invest if they have to go outside of the LPs in the main fund to raise the co-invest vehicle. Sometimes they want a portion of the fees that are earned by or that promote that's earned by the GP from these third-party investors in the co-invest vehicle to go back to the fund to ultimately benefit the LPs in the main fund. And their rationale is, well, but for the main fund, you wouldn't have been able to raise this co-invest fund and be able to do these deals and get the fees from these investors, and so we think you should share some of that with the main fund.

Stephanie Pindyck Costantino (14:42):

So all in all, when you're counseling a sponsor, for example, or you're talking to a limited partner or a potential limited partner or investor, do you find that the one key thing that you routinely say is to take a look at the entire complex as a whole to understand and appreciate what's come before and what's ahead? When you think about counseling them and a couple of key factors they should think about, what is really a driving force in your mind?

Paul Steffens (15:09):

I think that you always have to keep in mind the sponsor. Sponsors a lot of times, particularly if they're just starting and they're really trying to raise their first fund or their second fund and make inroads with investors, they need to always keep in mind how much money they're going to need in order for them to be able to attract and retain the people that they need to make the investments and to source the deals and manage the deals, because they're going to have to pay for that out of their fee income. And then how much it's going to take to retain those folks and incentivize them. And they're going to need to promote in order to provide sort of large back-end incentives, long-term incentives. And they're also going to need some operating income to provide bonuses for someone that did a great job finding really good deals, managing good deals. And so they have to keep that in

mind. And then also keep in mind that for every economic benefit that you sort of give away to investors for the first fund, it's not always that likely you're going to be able to recapture that at fund two, three, four, five from that investor. And once you've given it away, it's really hard to get it back. And just go in knowing that. And then if you go in knowing that, they say it's still worth it to us to do this and we can, yeah, we still will have enough fee income and promote to execute our business plan, then great. But you have to take it all into account when you're creating your budgets and your projections for how you're going to operate your business going forward.

Heather Stone (16:45):

I would agree with that. And I think that from the investor side, it really comes down in a way to access as being the umbrella that covers all of these things. So for managers that they really like their returns and they start out by trying to figure out from a diligence perspective where those returns come from and who's responsible for them and what the next generation looks like and how the GP economics are split internally at the sponsor, to making a big commitment to them is not just about collecting a portion of the carry for themselves or a portion of the fees for themselves or getting a seat at the investment committee table. It's also about having more access to how those things develop into fund two, three, four, and in later funds so that they can have a seat at the table of influencing how the next generation is incentivized and who's the next up-and-coming manager in that firm that is really driving the returns. It's a lot easier to sort of see that information from the inside than it is sometimes trying to get access to it through diligence questionnaires and other third-party arm's-length type of questions.

Stephanie Pindyck Costantino (18:01):

Well, thank you, Heather and Paul. This has been a really great discussion, and I'm looking forward to future installments in our Carried Away series. Also, thank you to our audience for listening today. Please keep your eyes open for future episodes of *PE Pathways*, where we bring experienced dealmakers on to share their thoughts on current private equity and M&A trends and developments. You can find the latest episodes of *PE Pathways* wherever you get your podcasts.

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