

Asset & Wealth Management Benchmarking Insights | Alternatives

Expenses

September 2023

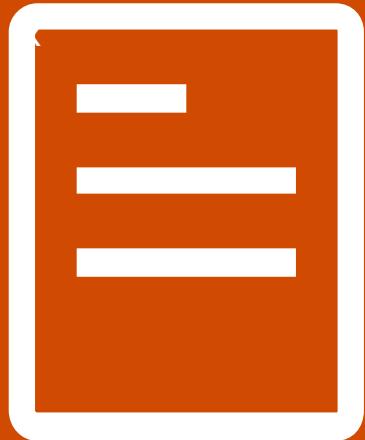


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Overview



Overview

PwC's Asset & Wealth Management practice is pleased to publish the results from our **Asset & Wealth Management Benchmarking Insights Series for Alternatives**.

Our benchmarking series is designed to **gather, analyze and share information** about key industry trends and metrics. This report summarizes industry practices related to **expense trends for funds**. In this report we will explore topics related to expense policies and governance, current trends in fee and incentive structures, and inflationary pressures. Other reports in this series address other industry practices related to valuation, financial reporting, fund of funds, organizational structure, and use of service providers.

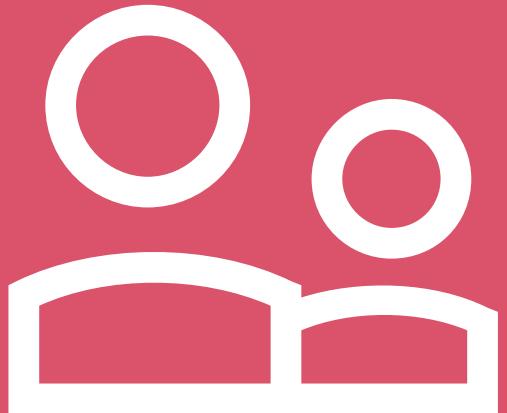
The information reflected in this report leverages the knowledge and experience garnered from providing audit services to leading alternative asset management firms. Our expense policies and procedures report captures information from **over 60 US-based alternative asset management firms** across various product types and strategies representing **over \$2.3 trillion of assets under management (AUM)**. Participants primarily have calendar year ends and include a combination of hedge funds, private equity funds, credit funds and other alternative fund types such as business development companies and real estate funds.

Because of the diverse nature of alternative asset managers, **these results should not be considered representative of all alternative asset management firms**. Furthermore, many of the concepts in this report are influenced by the specific facts and circumstances of each participant. Accordingly, these results should be viewed as directional, rather than authoritative, and do not necessarily represent practices that are applicable in all situations. Lastly, some of the data in this report can be compared to data in previous reports that we have published on the same topic. However, note that there are some survey participants which participated in prior surveys but did not participate in the 2023 survey and vice versa. Therefore, differences should not be interpreted as trends. Should you have any questions about the data herein we encourage you to reach out to our team. Refer to the back of the report for our contact information.

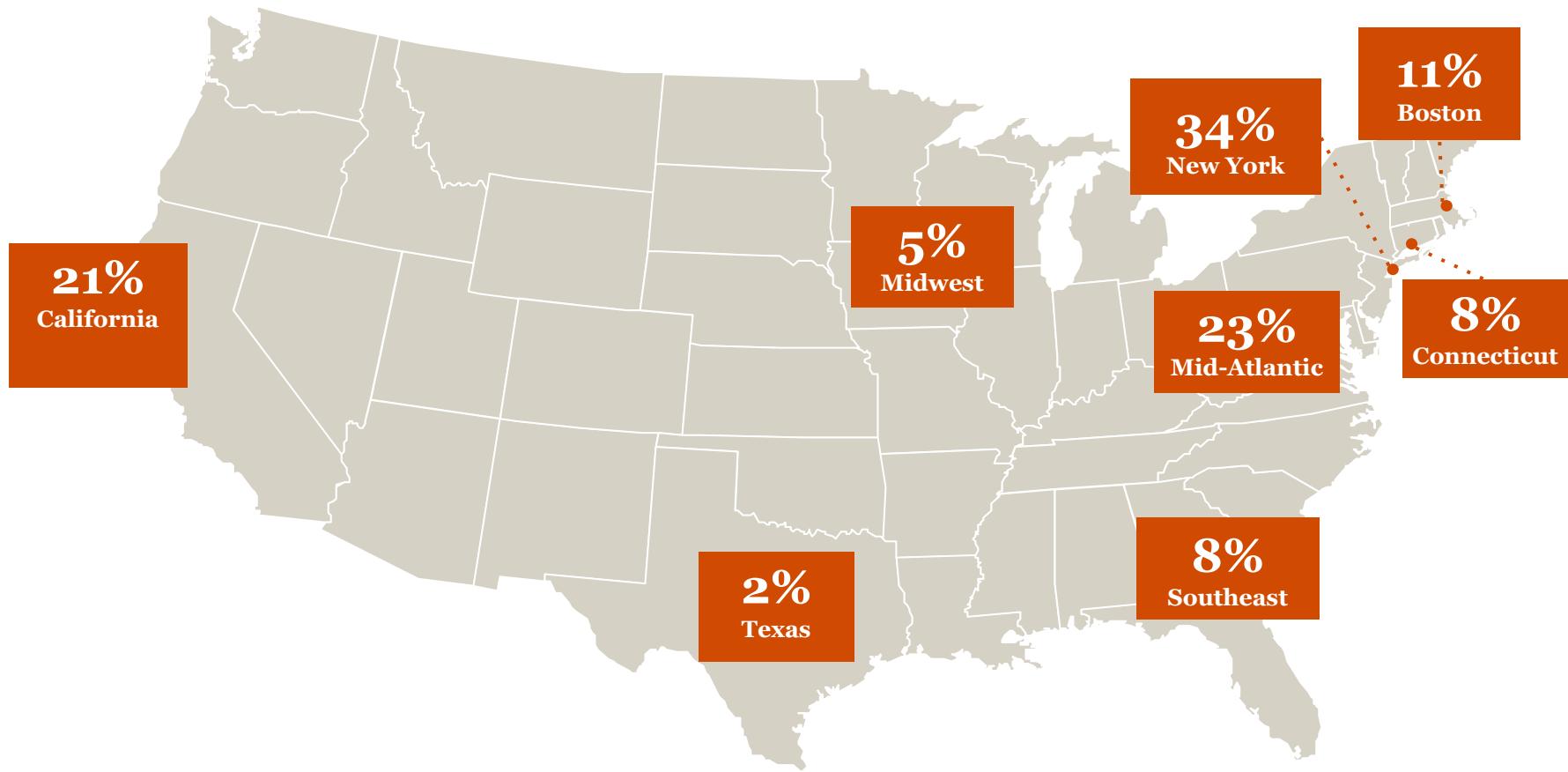
We hope that you find this report interesting and useful as you evaluate your organization on the topics highlighted herein.

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Participant Demographics



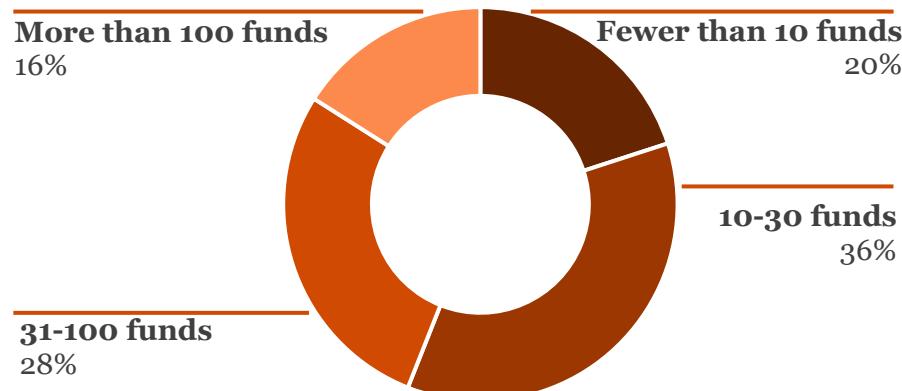
Participant Locations



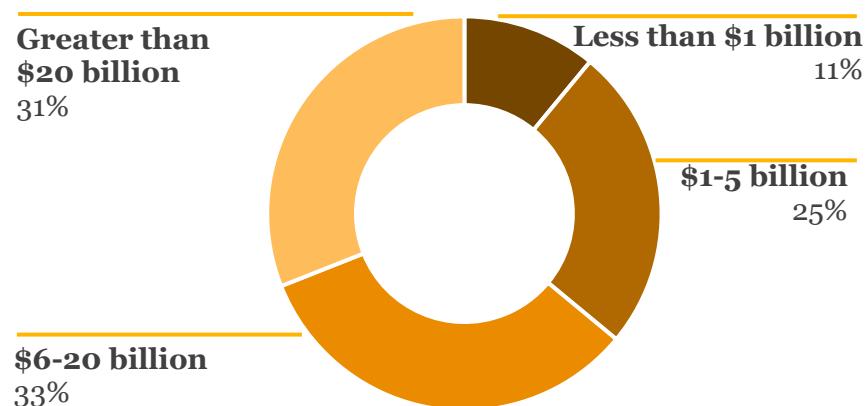
NOTE: Participants were given the option to select multiple locations. Therefore, percentages will not sum to 100%.

Participant Demographics

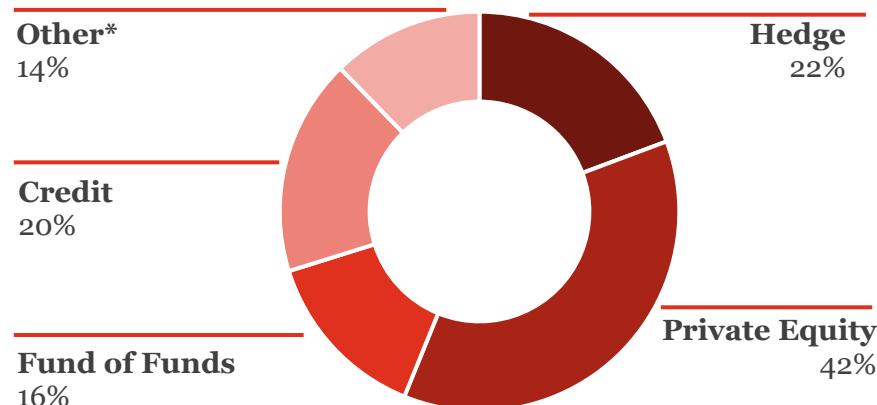
Number of Funds Managed



Assets Under Management



Primary Type of Funds Managed by the Advisor**



*Other represents real estate, middle market, commercial RE, real assets, special situation, venture capital, and long equity mutual funds (note – this participant's portfolio includes alternative fund types in addition to the traditional mutual fund).

**Participants were given the option to select multiple types of funds. Therefore, percentages will not sum to 100%.

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Expense Benchmarking



Recent Trends

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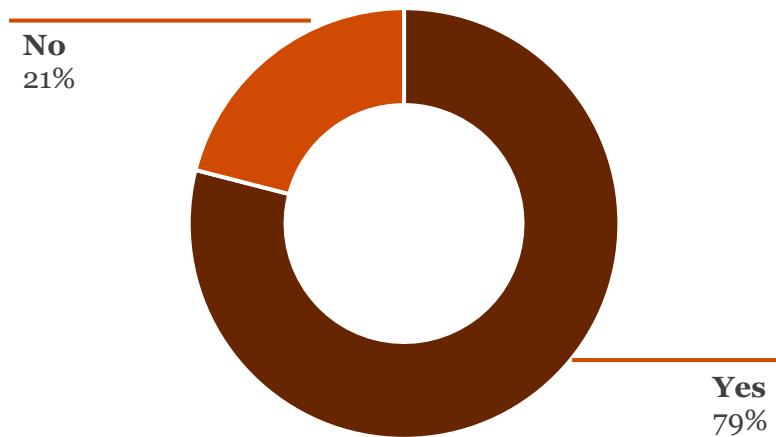
95% of participants have launched new funds in the past two years. Of those participants, 21% charge less fees for the new funds compared to the organization's older funds. Some respondents indicated an increase in side letters have caused a reduction in fees. Further, close ended funds generally are continuing to use committed capital to calculate management fees during the early stages of the funds' life.

A majority of our participants do not have a formal governance mechanism to oversee the allocation of operating expenses amongst funds/product offerings, however, we note that many of these funds consistently apply similar allocation methodologies such as percent of commitments or percent of NAV.

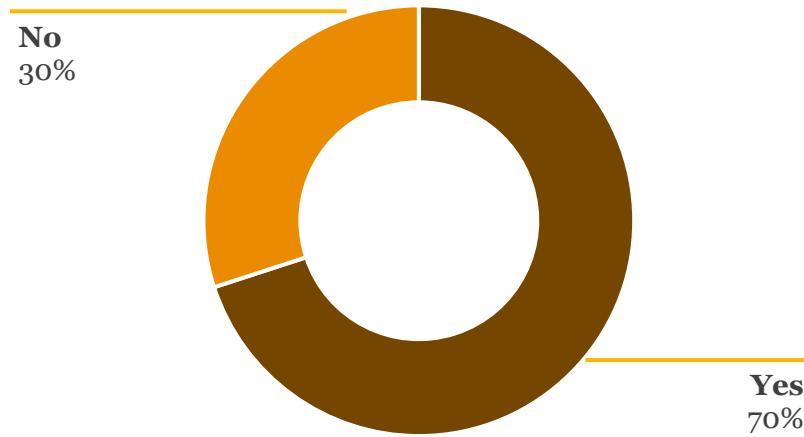
Expenses have been a recent focus of investors, and the industry is responding to that focus and commercial pressure by offering new fee arrangements and increasing transparency into expense allocations. Responses for this survey were collected over a period of several weeks in June and July of 2023. Therefore, the data included herein is reflective of expense policies and trends prior to the finalization of the new rules issued by the SEC surrounding private funds.

Expense Policies

Does the advisor have a written policy governing the identification and allocation of operating expenses between the advisor and the funds?



Does the advisor have a written policy governing the identification and allocation of operating expenses amongst the funds?

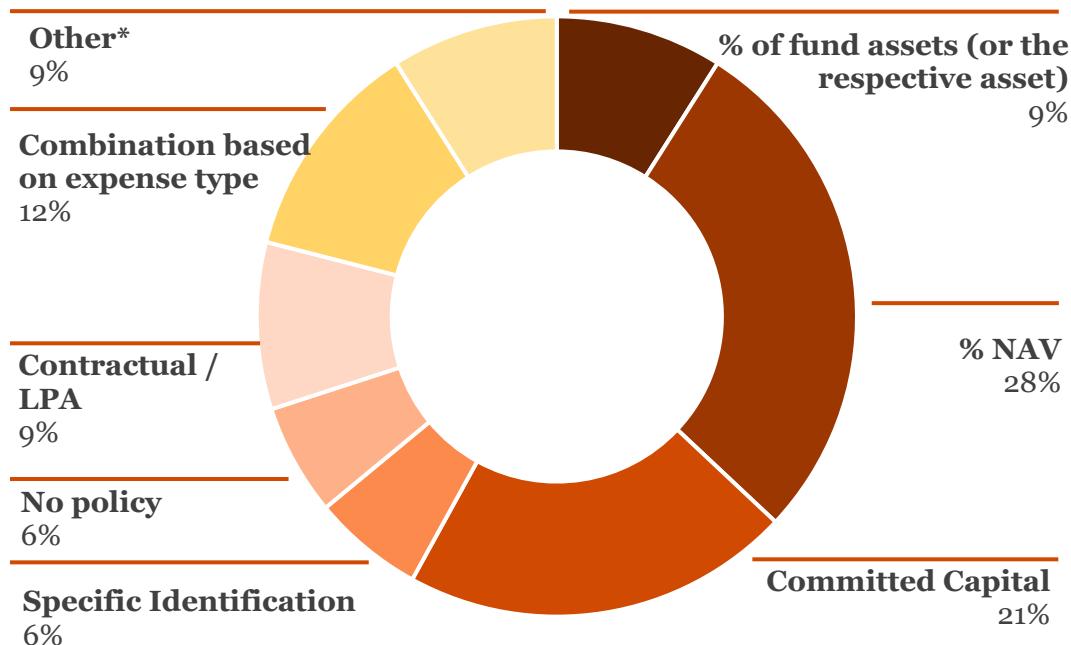


In addition to the data shown above, 77% of participants do not have a formal governance mechanism, such as a committee, overseeing the allocation of expenses. Where such governance mechanisms are in place, the committee generally meets either monthly, quarterly or on an ad hoc basis.

In recent years, there has been an increase in the level of scrutiny from regulators and investors on proper authorization or overall expenses being borne by the fund. Accordingly, ensuring consistency and transparency on the treatment of expenses remains a key focus.

Expense Policies

What is the methodology used to allocate expenses amongst funds?



*Other includes average net assets and weighted average of Partners' Capital.

The majority of respondents indicated that the typical methodology used to allocate expenses amongst funds was percent of NAV. Additional methodologies included an allocation based on committed capital, or a combination dependent on the type of expense.

Expense Policies

84%

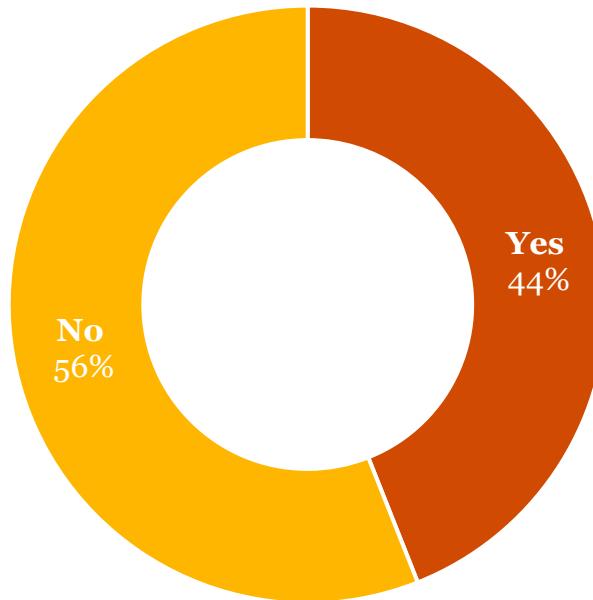
of all participants allocate expenses consistently across all managed funds

16% of participants noted that the method for allocating operating expenses varies across funds. For those participants whose allocation methodologies do vary, the drivers of variations across funds include differences in fund life cycle, size of the fund, and fund type.

The majority of participants indicated that expenses are typically allocated between co-investment vehicles in the same manner that expenses are allocated to any other managed funds.

Expense Policies

Do any of the funds have a cap on expenses?



Among those participants with expense caps, 35% have a variety in practice by fund, while 65% have an explicit threshold for caps stated in the LPA. Many expense caps are limited to certain expenses (e.g., organization costs and offering expenses). Common drivers of these caps include management policy and negotiations with specific investors.

Recent Trends in Fee & Incentive Structures

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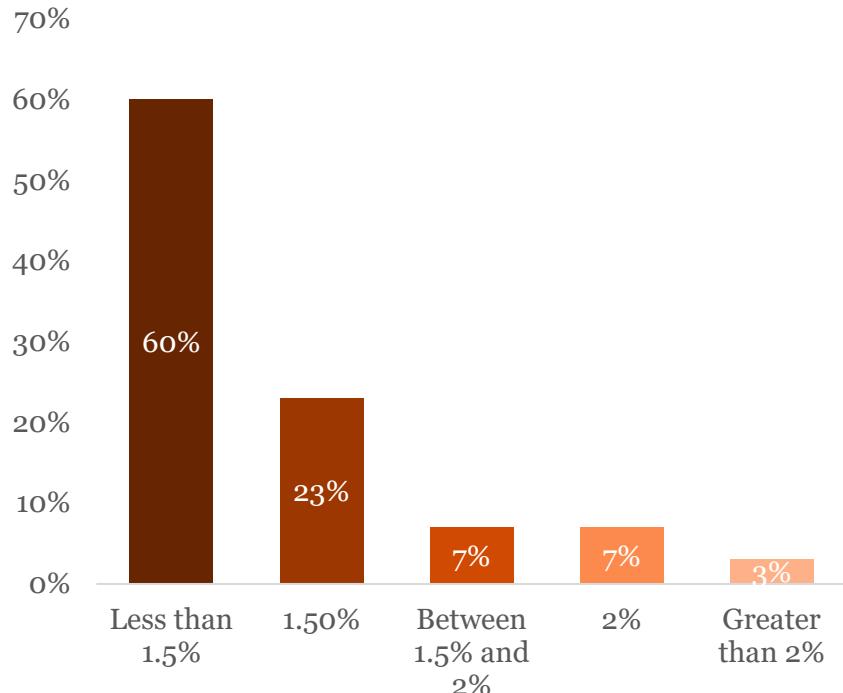
As investors continue to scrutinize fees for alternative products, advisors are leaning away from the 2/20 fee model, as has been the trend for the last several years. The following slides present information on distribution of management fee rates and rates for incentive/performance fees and carried interest.

As the data indicates, the movement away from the 2% management fee and 20% carried interest/incentive fee model has been more prominent with respect to management fees than it has been for incentive/performance fees and carried interest. This may be due to the fact that management fees are viewed in line with broader operating expenses, in that advisors can take advantage of technology, scale, sourcing model or other efficiencies to reduce the cost of the day-to-day operations of advising the fund. In contrast, as incentive/performance fees and carried interest are only earned when returns have surpassed the hurdle rate, if any, there may be less sensitivity around these rates, resulting in fewer instances of these rates being reduced.

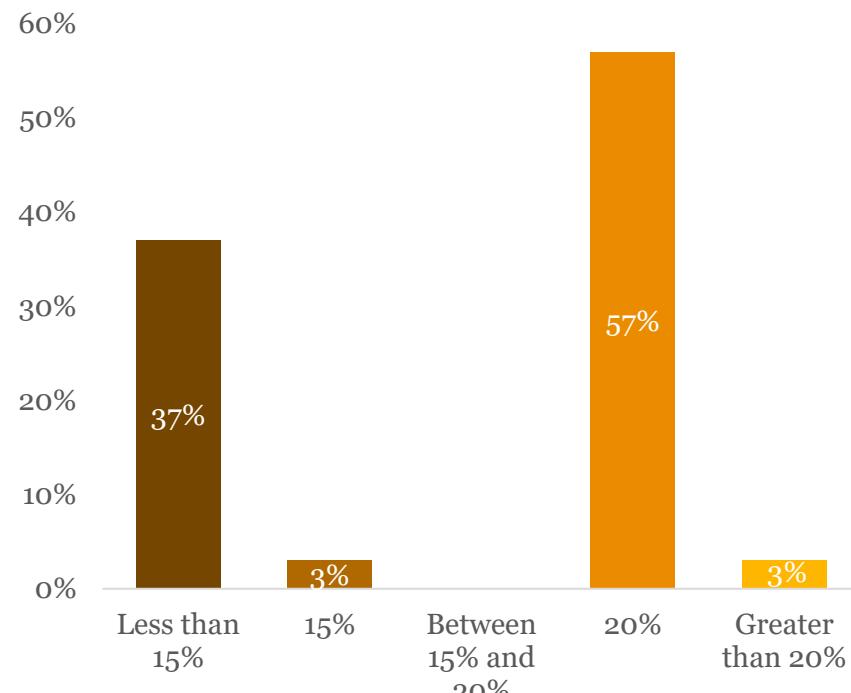
Recent Trends in Fee & Incentive Structures

Management Fees and Incentive/Performance Fees for Open-Ended Funds

What is the annual management fee rate?



What is the incentive/performance fee rate?

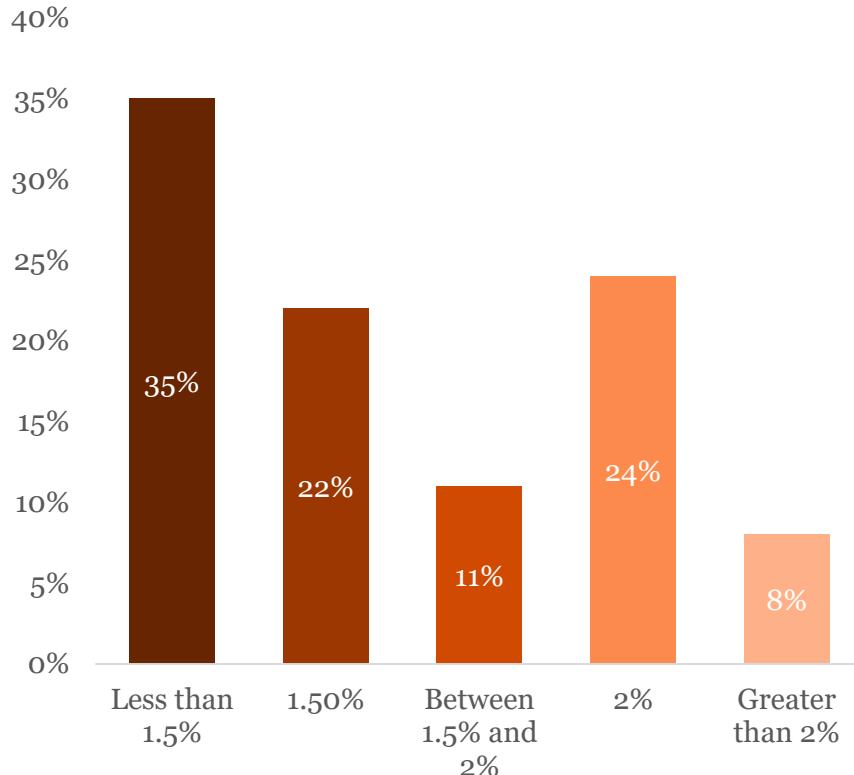


Advisors continue to move away from the 2/20 fee structure, but how has this borne out in practice? Of the participants with open-ended funds, 90% now charge less than 2% for management fees, and 40% charge less than 20% for incentive/performance fees. Comparatively, in 2020 respondents noted that 88% charged less than 2% for management fees, and only 23% charged less than 20% for incentive/performance fees. While the comparative assessment suggests the industry is moving away from the 2/20 fee structure, we note that participants in the 2020 and 2023 surveys are not consistent. Additionally, based on the responses from our participants, the range of annual management fee rates for open-ended funds is 0.35% to 2%.

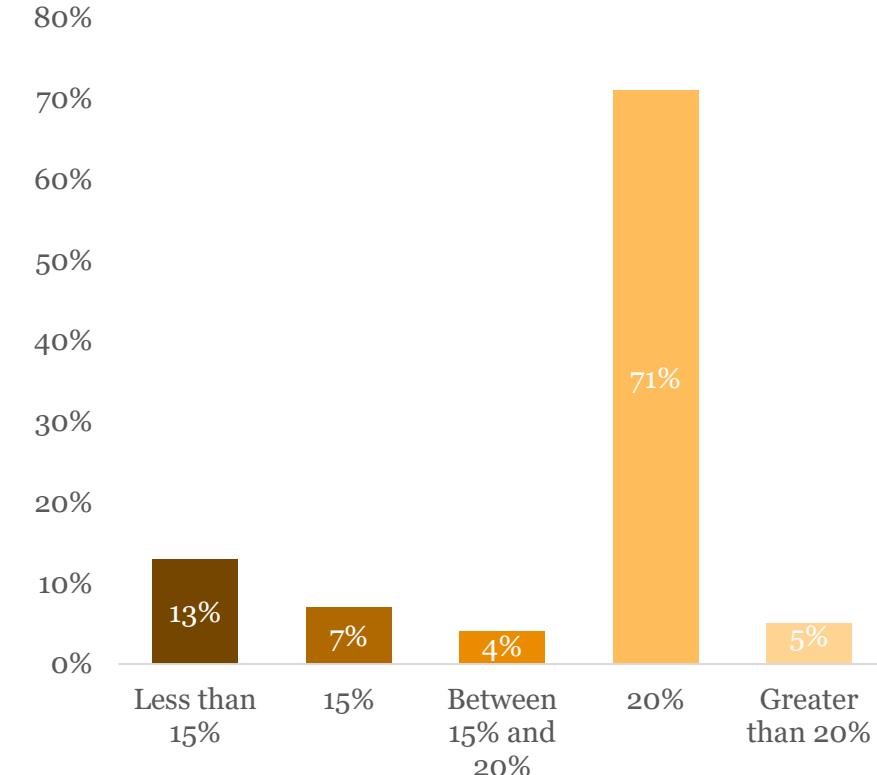
Recent Trends in Fee & Incentive Structures

Management Fees and Carried Interest for Closed-Ended Funds

What is the annual management fee rate?



What is the carried interest rate?



Advisors continue to move away from the 2/20 fee structure, but how has this borne out in practice? Of the participants with closed-ended funds, 68% now charge less than 2% for management fees, but only 24% charge less than 20% for carried interest. Comparatively, in 2020 respondents noted that 68% charged less than 2% for management fees, and only 18% charged less than 20% for carried interest (note all 2020 participants did not participate in our 2023 survey). Additionally, based on the responses from our participants, the range of annual management fee rates for closed-ended funds is 0.25% to 2.5%

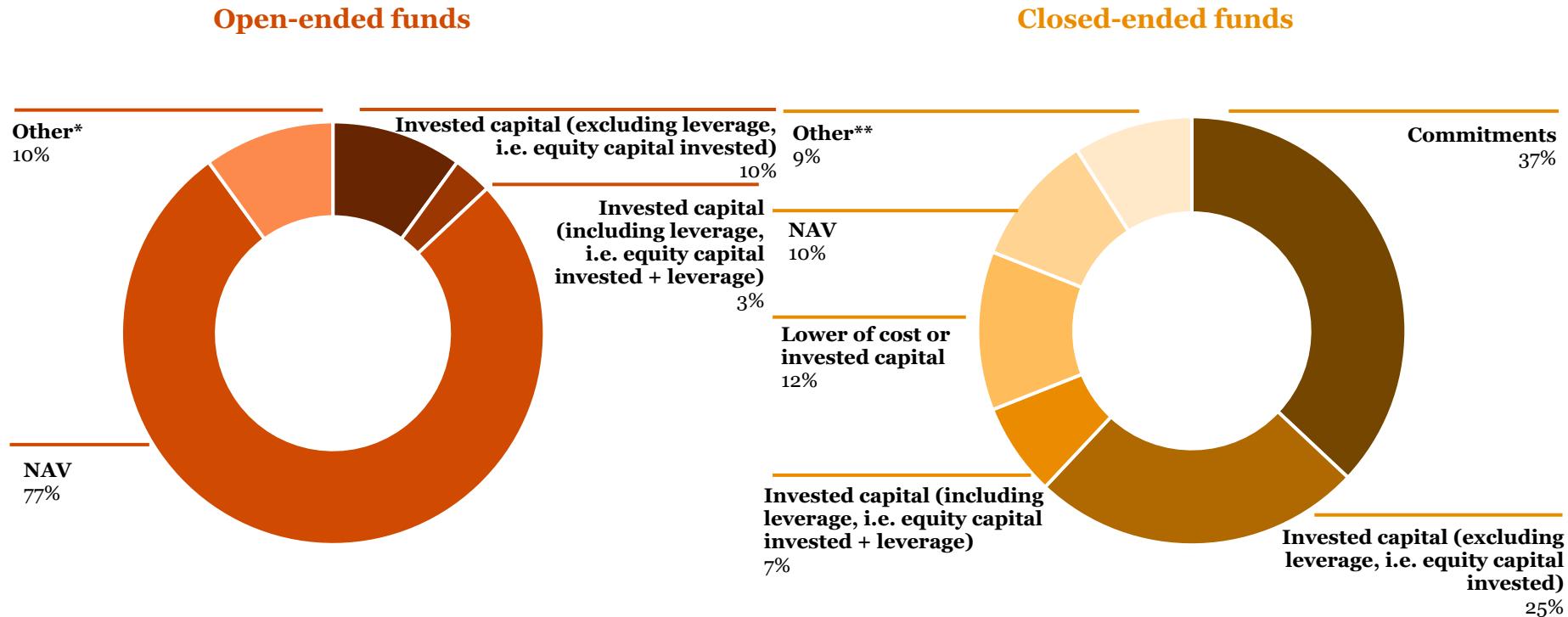
Management Fees

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In addition to updating fee rates, advisors have also moved more towards tailored management fee models. Such models utilize management fee tiers or management fees that vary by share class or tranche, to help alleviate pressure on fee reductions. Furthermore, in recent years some advisors have also sought to manage fund expenses by implementing a unified fee or unitary fee in addition to management fees, whereby the fund is charged a flat rate each year for all operating expenses. Though this model provides more certainty for investors, there may be less transparency into the underlying costs of the fund.

Management Fees

What is the basis upon which management fees are charged to the funds?



*Other includes capital commitment, limited partner's aggregate capital account balance, and lower of cost incurred by the management company to manage the entity or a % of invested capital.

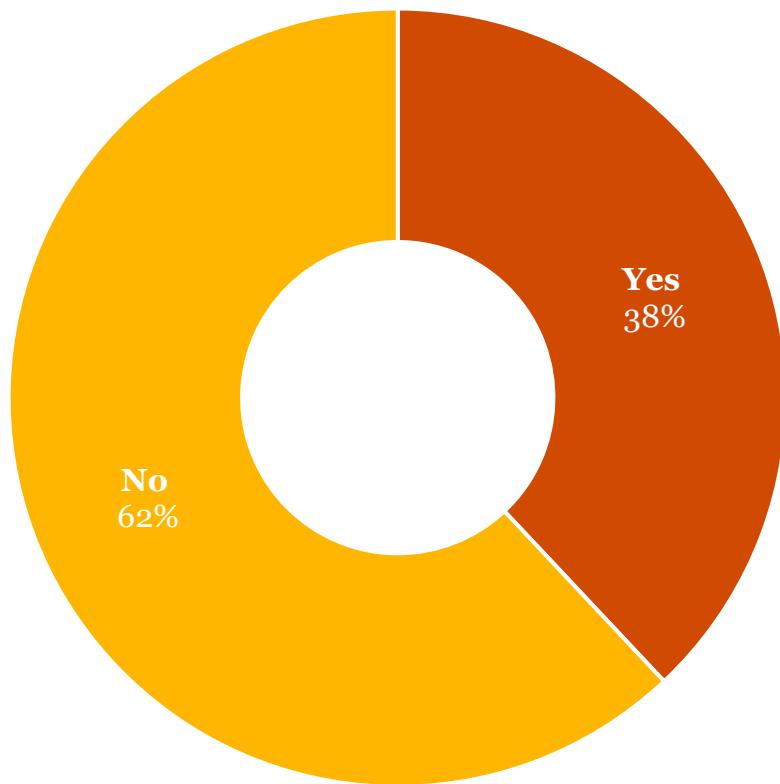
**Other includes GAV, AUM, cost, lower of costs incurred by the management company to manage the entity or a % of committed/invested capital, and aggregate principal balance of all collateral loans.

For 62% of closed-ended funds, the basis upon which management fees are charged changes at a certain point in the fund's life cycle. Such changes are typically triggered by the end of the commitment period, the end of the investment period, or certain anniversaries of the fund.

Management Fees – Co-invest Funds

Based on the responses from our 60+ participants, 43% of advisors surveyed held co-invest funds. Of those advisors with co-invest funds, only 38% charged a management fee.

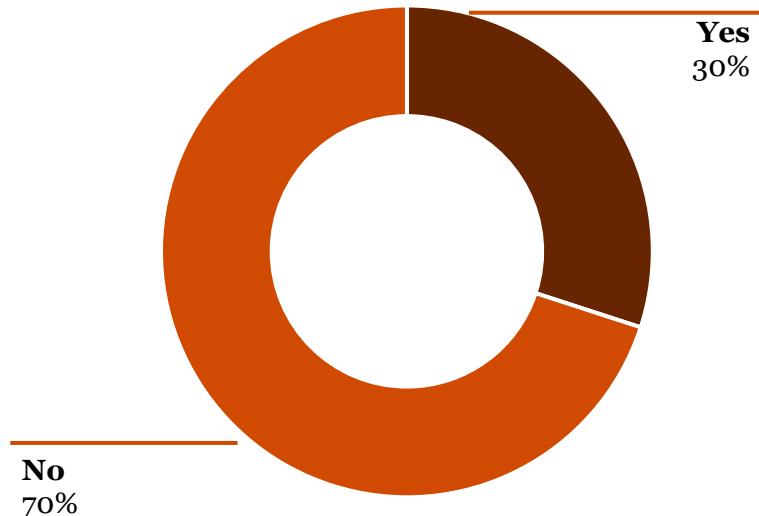
For the Co-invests, is there a management fee charged?



Management Fees

Has the advisor put in place a management fee waiver program?

Open-ended funds



Closed-ended funds

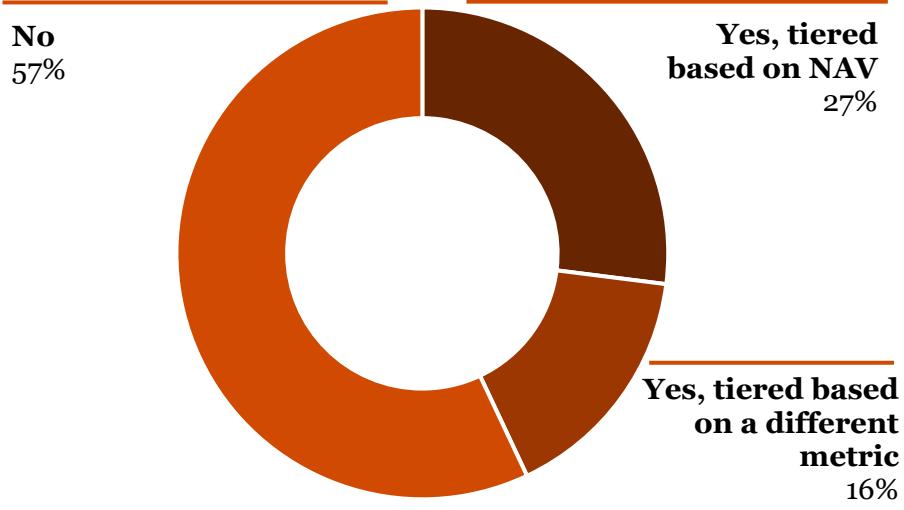


For closed-ended funds, management fee waivers are most commonly put in place at the discretion of the investment manager. Some closed-ended funds also allocate management fee waivers toward funding of GP contributions and profits interest, whereby the amount of the waiver is applied toward a future allocation of profits to the GP beyond its pro-rata share.

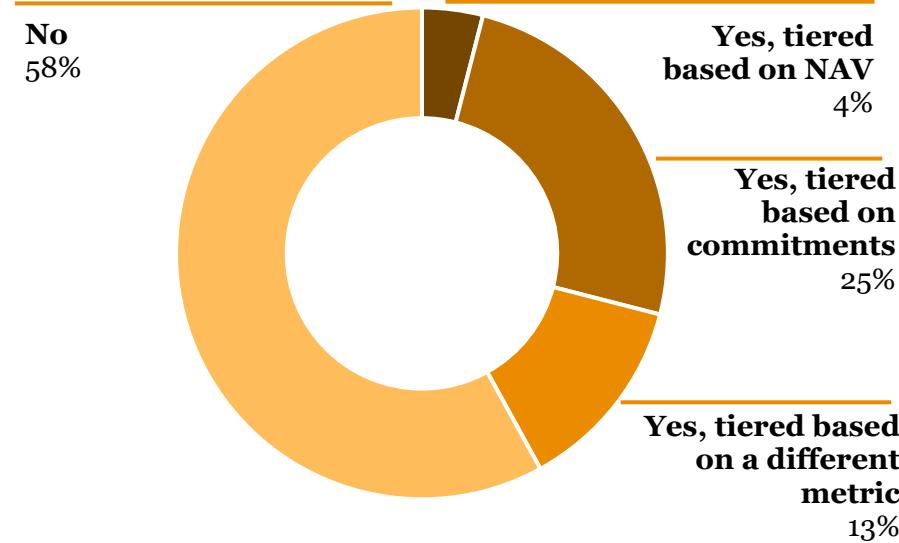
Management Fees

Are management fee rates tiered?

Open-ended funds



Closed-ended funds

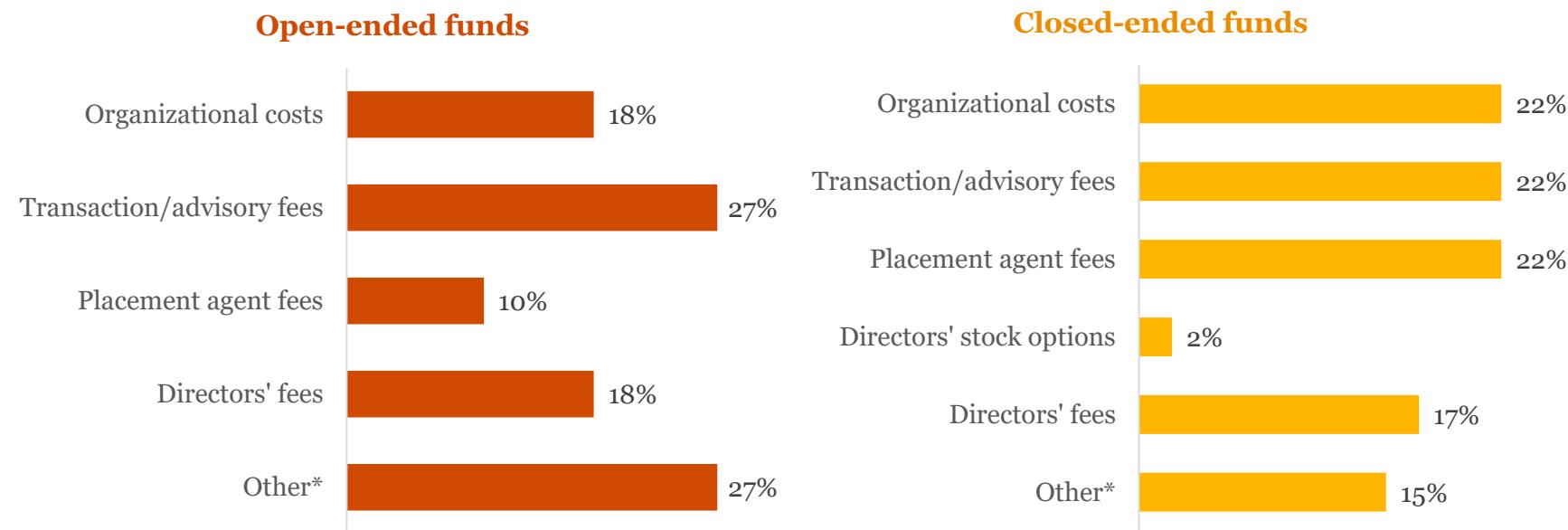


Different metrics used for management fee tiers for open-ended funds include lock-up periods lower than the management fee rate, capital account balance or class of investors. For closed-ended funds, different metrics used include the age of the investor's capital account, and the amount of capital invested/call amount.

Management Fees

What type of other fees earned or incurred by the fund are used to offset management fees?

Note that these %'s should be read in the context of the total of categories presented within the charts below (i.e. respondents indicated that of offsets present in open-ended funds, 18% are due to organizational costs).



*Other includes rebates for investors in multiple funds to avoid duplicative management fees, legal fees, board fees and consulting fees

*Other includes Lux service fees, rebates for investors in multiple funds to avoid duplicative management fees, consulting fees, break-up fees, monitoring or advisory fees, legal fees, and board fees.

Management fee offsets are more common for closed-ended funds, where 47% of participants noted at least one type of fee offset in place, as opposed to only 23% of open-ended fund participants.

Where management fee offsets do exist, typically 100% of the fees are offset (e.g., \$50k of Directors' fees results in a \$50k offset to management fees) rather than some lesser percentage. This applies to all types of fee offsets shown above for both open and closed-ended funds.

Incentive/Performance Fees and Carried Interest

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Similar to current trends in management fee structures, advisors are tailoring incentive/performance fee structures and carried interest structures as well. Tiers and varying rates by share class or tranche are not uncommon, and many advisors continue to reduce or waive incentive/performance fees or carried interest for affiliated investors.

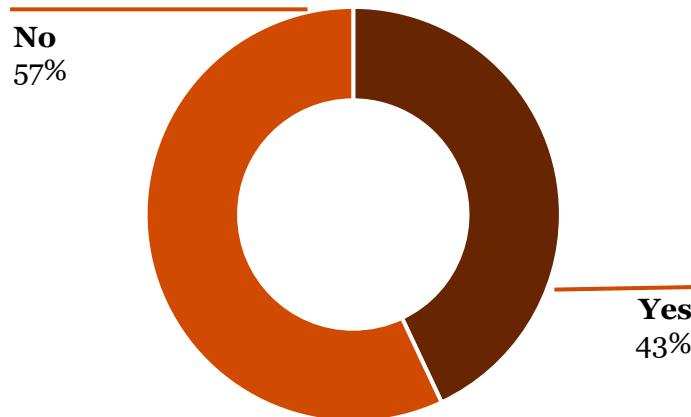
Based on the responses from our 60+ participants, the ranges* of the performance/incentive fee rates for open-ended funds and carried interest rates for closed-ended funds are generally 1% to 22.5% and 10% to 30%, respectively.

*Outliers were excluded from these ranges

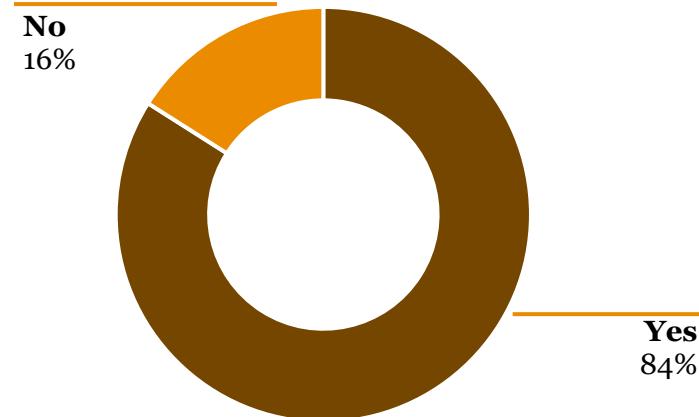
Incentive/Performance Fees and Carried Interest

Is there a hurdle rate/pREFERRED RETURN?

Open-ended funds



Closed-ended funds



For open-ended funds with a hurdle rate indicated, the hurdle is based on an index (with or without a spread) as opposed to a stated percentage return based on contributions.

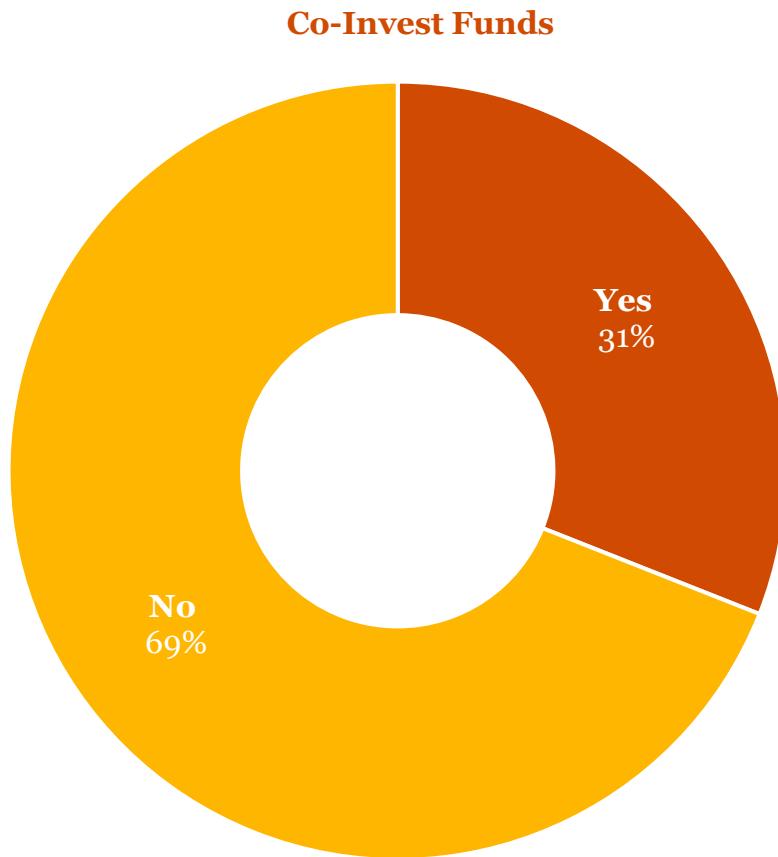
For closed-ended funds with a preferred return, the preferred return is commonly based on unreturned capital contributions or aggregate contributions.

The ranges* of the hurdle/preferred return rates for open-ended funds and closed-ended funds are generally 1% to 8% and 1% to 9%, respectively.

*Outliers were excluded from these ranges.

Incentive/Performance Fees and Carried Interest

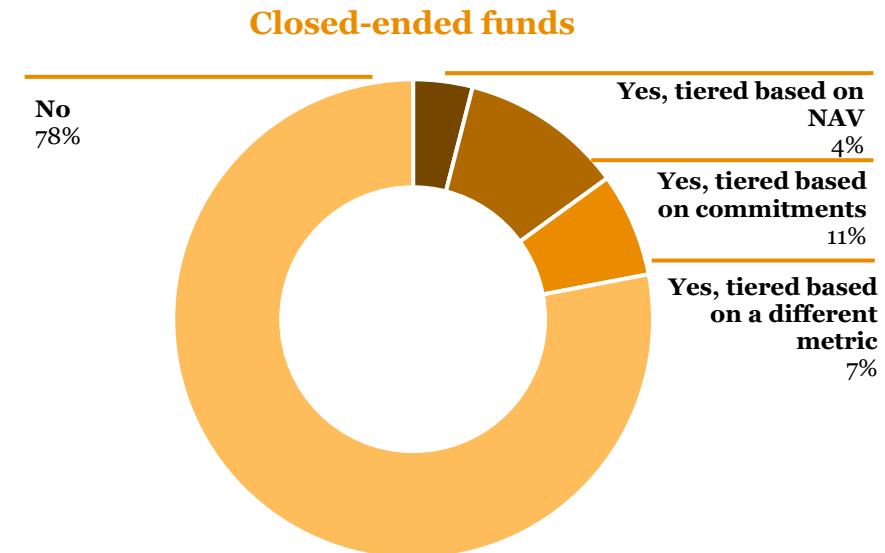
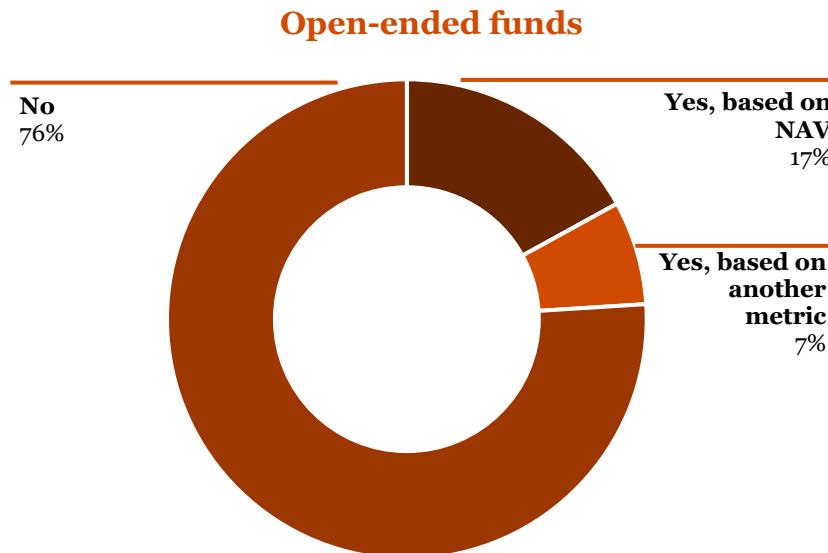
For the co-invests, is there an incentive structure in place?



Of those advisors with co-invest funds, 31% have an incentive structure in place. For the majority of the co-invest funds, the nature of the incentive structure is carried interest.

Incentive/Performance Fees and Carried Interest

Are incentive/performance fee rates or carried interest rates tiered?



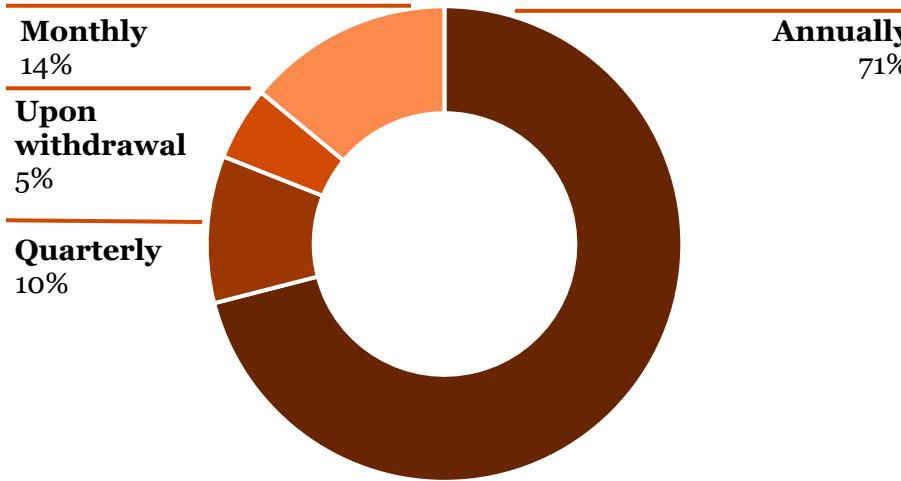
Aside from tiers, incentive/performance fees and carried interest rates often vary by investor. Specifically, affiliated investors' rates are typically lower than non-affiliated investors, and fees sometimes vary by share class or tranche.

Incentive/Performance Fees and Carried Interest

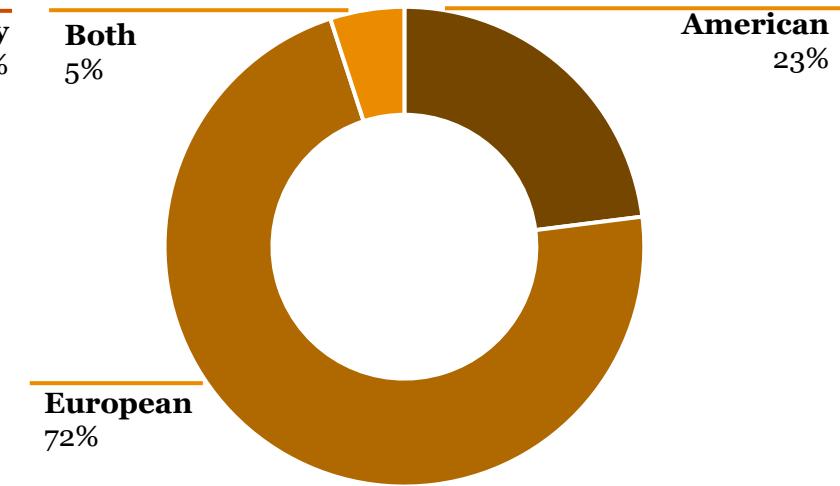
How often do performance/incentive fees crystallize?

Is carried interest charged under the American or European distribution model?

Open-ended funds



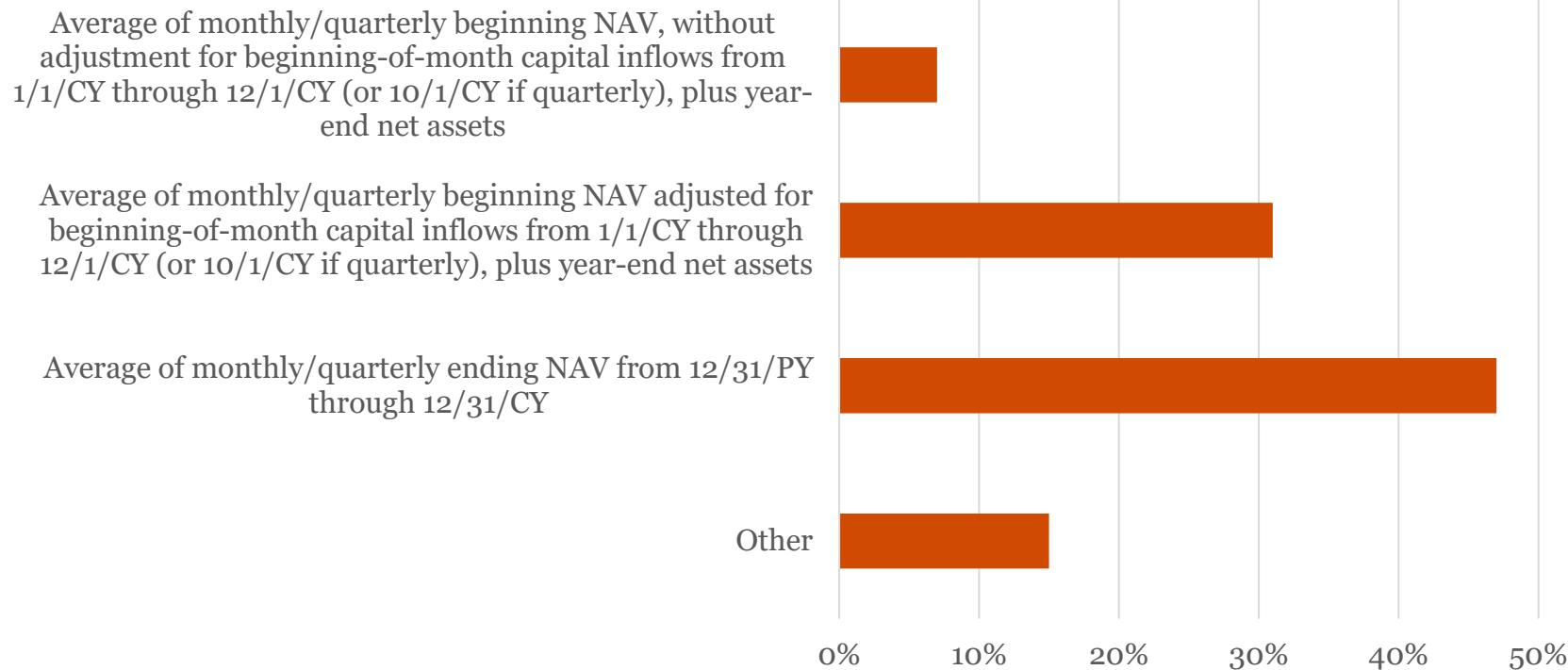
Closed-ended funds



In the American waterfall distribution model, carried interest is assessed on a deal-by-deal basis (and may be subject to clawback at the end of the life of the fund), whereas in the European waterfall distribution model, carried interest is assessed on the returns of the fund as a whole. Additionally, respondents that indicated that they used both models, noted that the approaches were used on a fund by fund basis, as opposed to both approaches being used within one fund.

Expense Ratios

How does the advisor calculate average net assets for the expense ratios in the financial highlights?



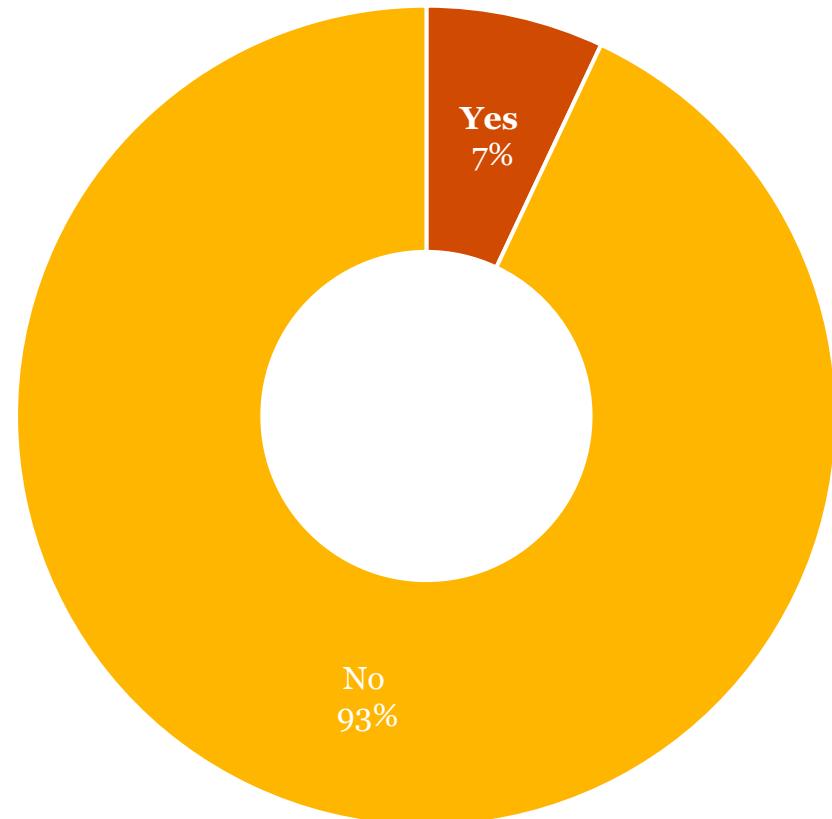
The illustrative examples in the AICPA Audit & Accounting Guide for Investment Companies allows for several methods in calculating the average net assets denominator for expense ratios, provided that the result is reasonable and consistently applied.

Non-Standard Expense Ratios

Does the advisor present any non-standard expense ratios to investors?

For participants that do present non-standard expense ratios, they are typically presented in the notes to the financial statements rather than in separate investor reporting. Common non-standard expense ratios presented are:

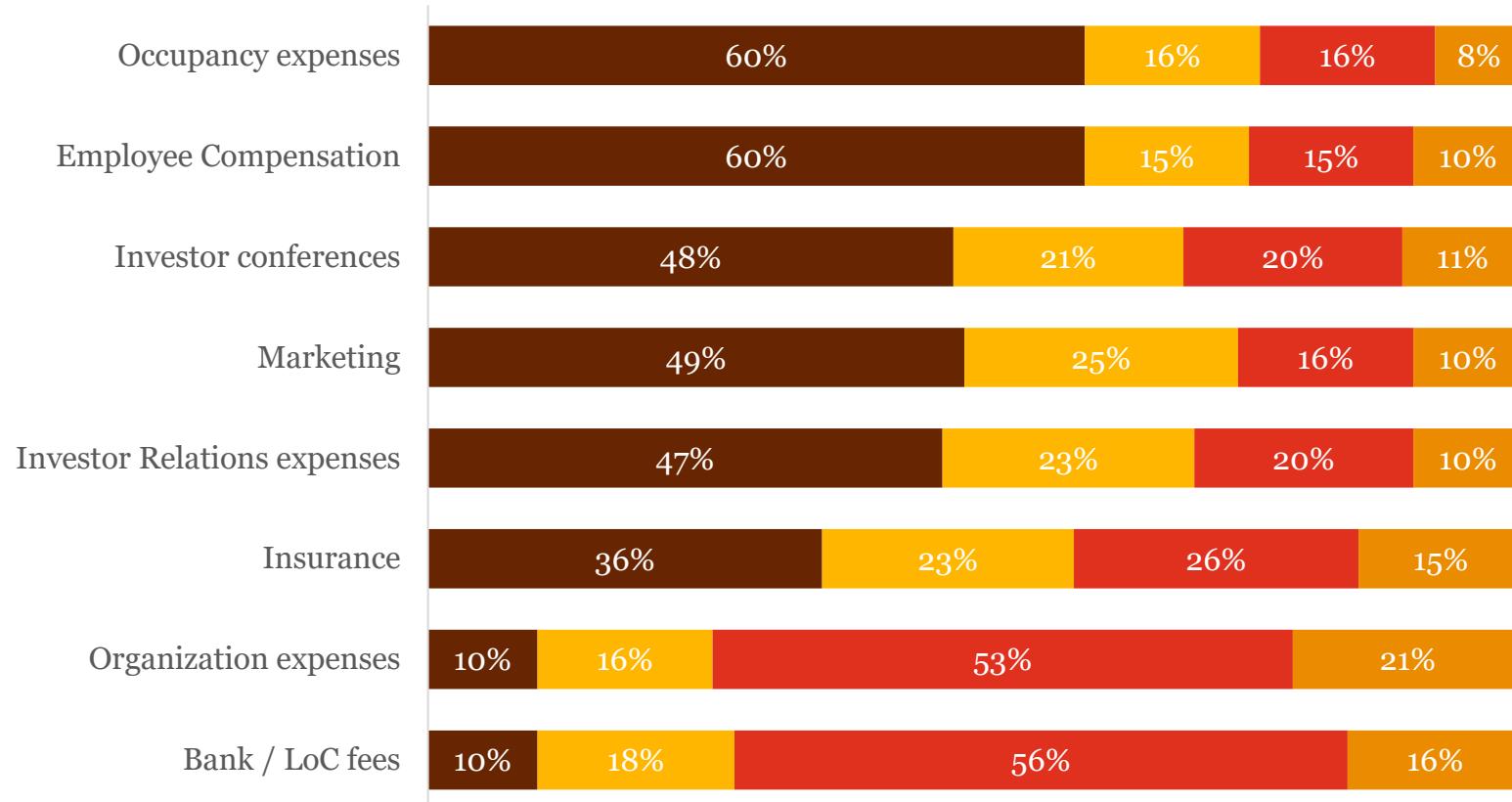
- **Performance carry ratio**
- **Interest expenses**
- **Investment expenses**
- **Operating expenses**
- **Admin fees**
- **Performance allocation shown separately as a percentage of NAV**



Treatment of Expenses

How are expenses charged to the advisor/funds?

G&A Costs

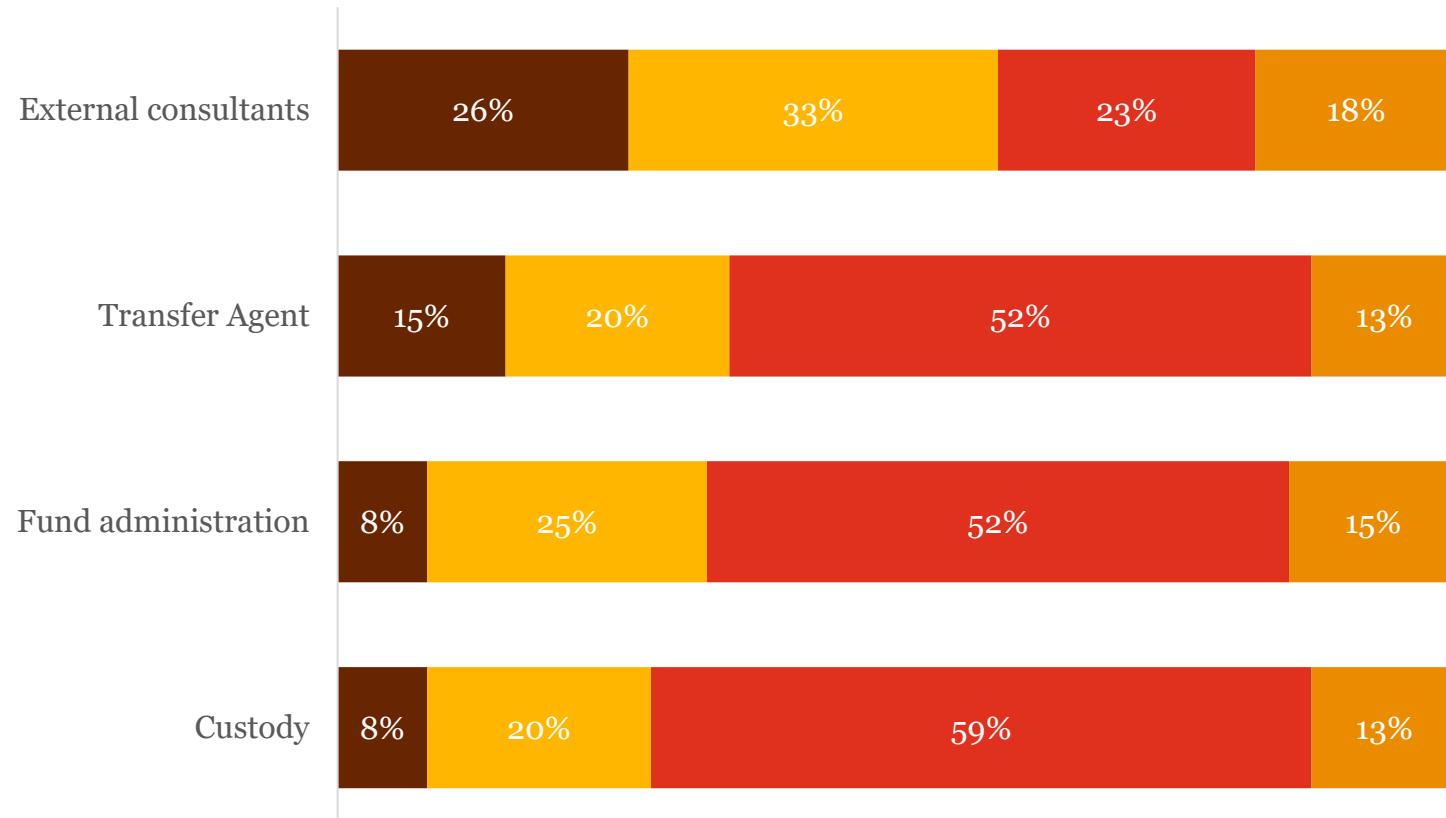


- Borne by the advisor (not passed through to funds)
- Directly charged to fund
- Charged to the advisor and then allocated to funds
- Both allocated and direct

Treatment of Expenses

How are expenses charged to the advisor/funds?

Service Providers

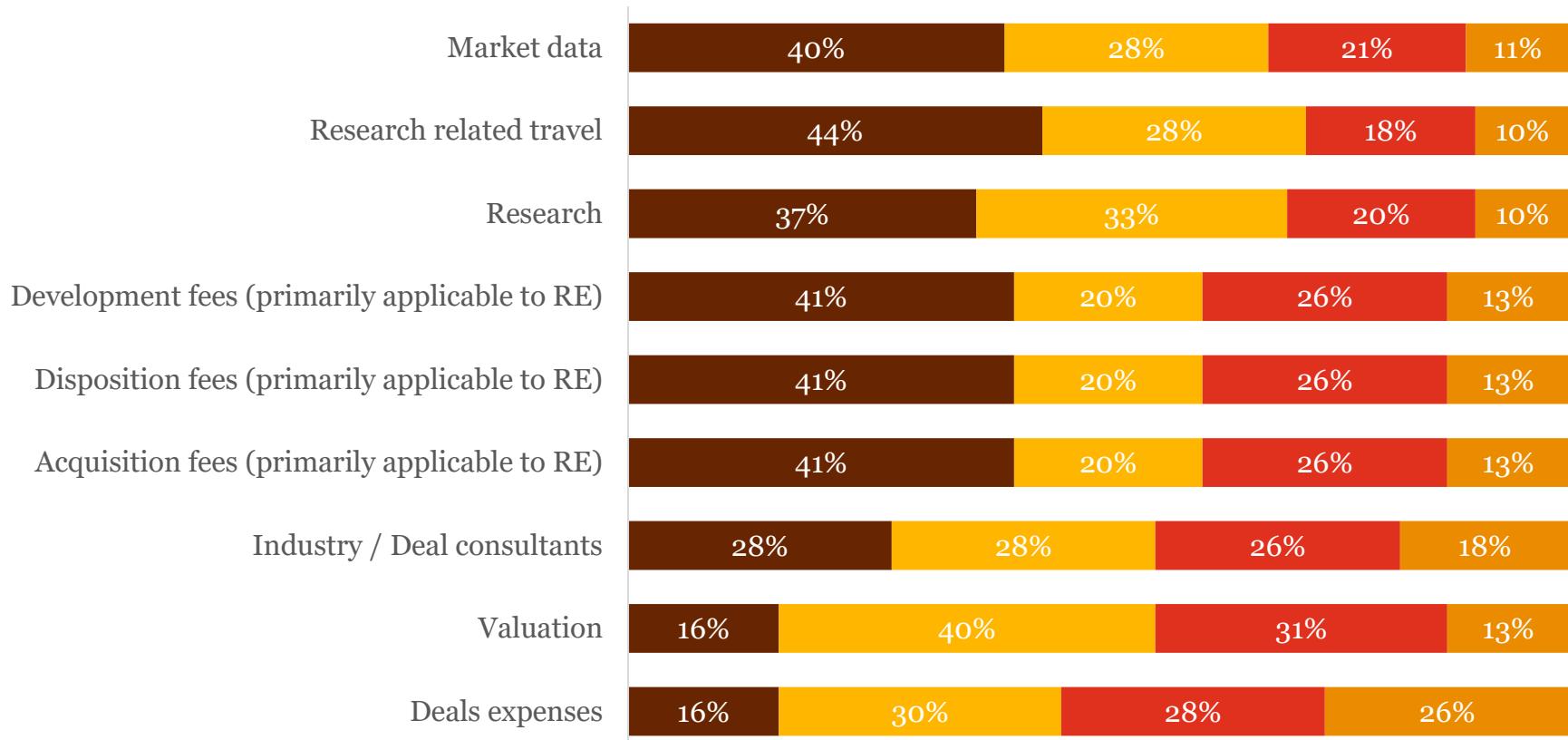


- Borne by the advisor (not passed through to funds)
- Directly charged to fund
- Charged to the advisor and then allocated to funds
- Both allocated and direct

Treatment of Expenses

How are expenses charged to the advisor/funds?

Investment Related Expenses



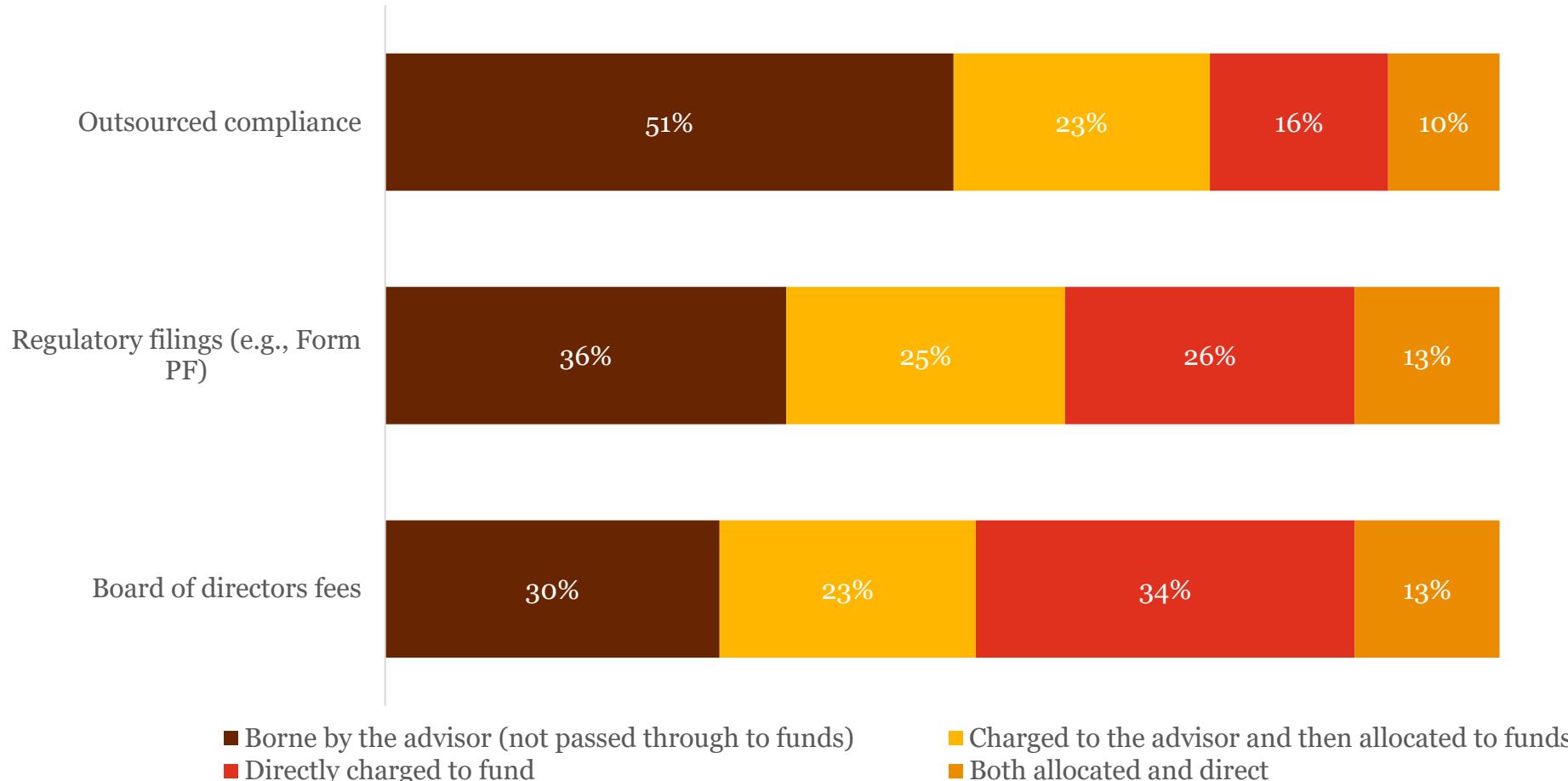
- Borne by the advisor (not passed through to funds)
- Directly charged to fund

- Charged to the advisor and then allocated to funds
- Both allocated and direct

Treatment of Expenses

How are expenses charged to the advisor/funds?

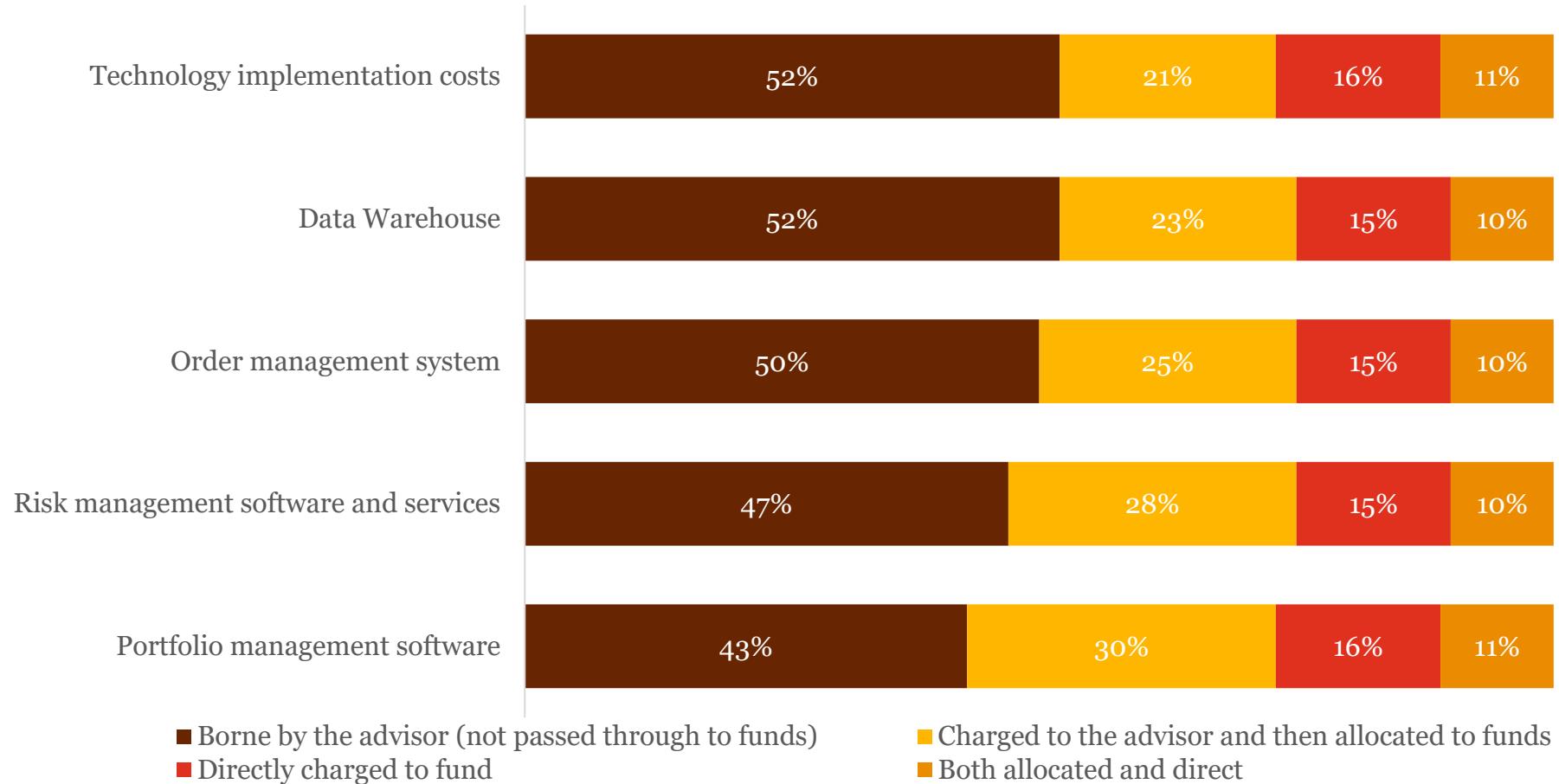
Regulatory and Compliance Fees



Treatment of Expenses

How are expenses charged to the advisor/funds?

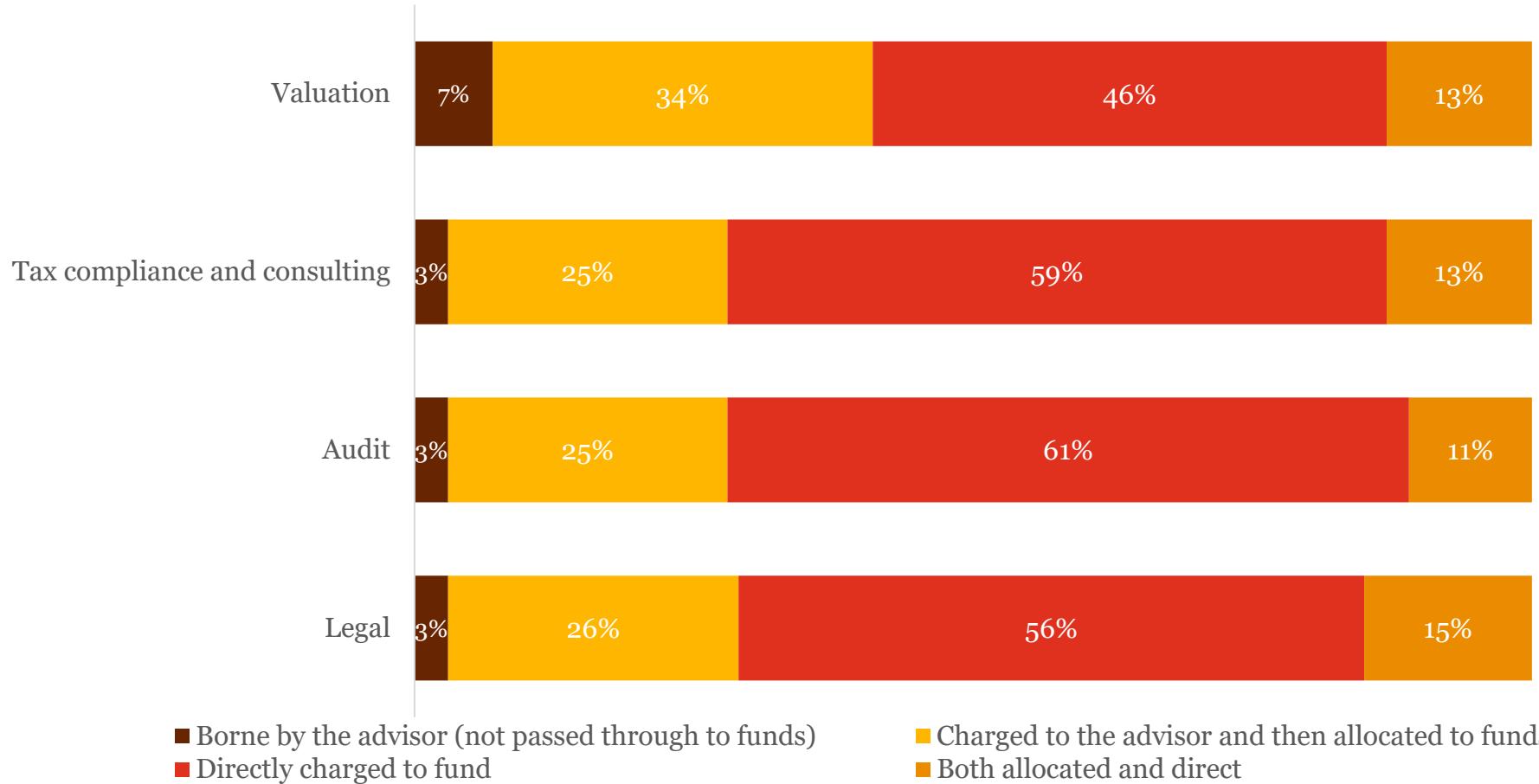
Technology Fees



Treatment of Expenses

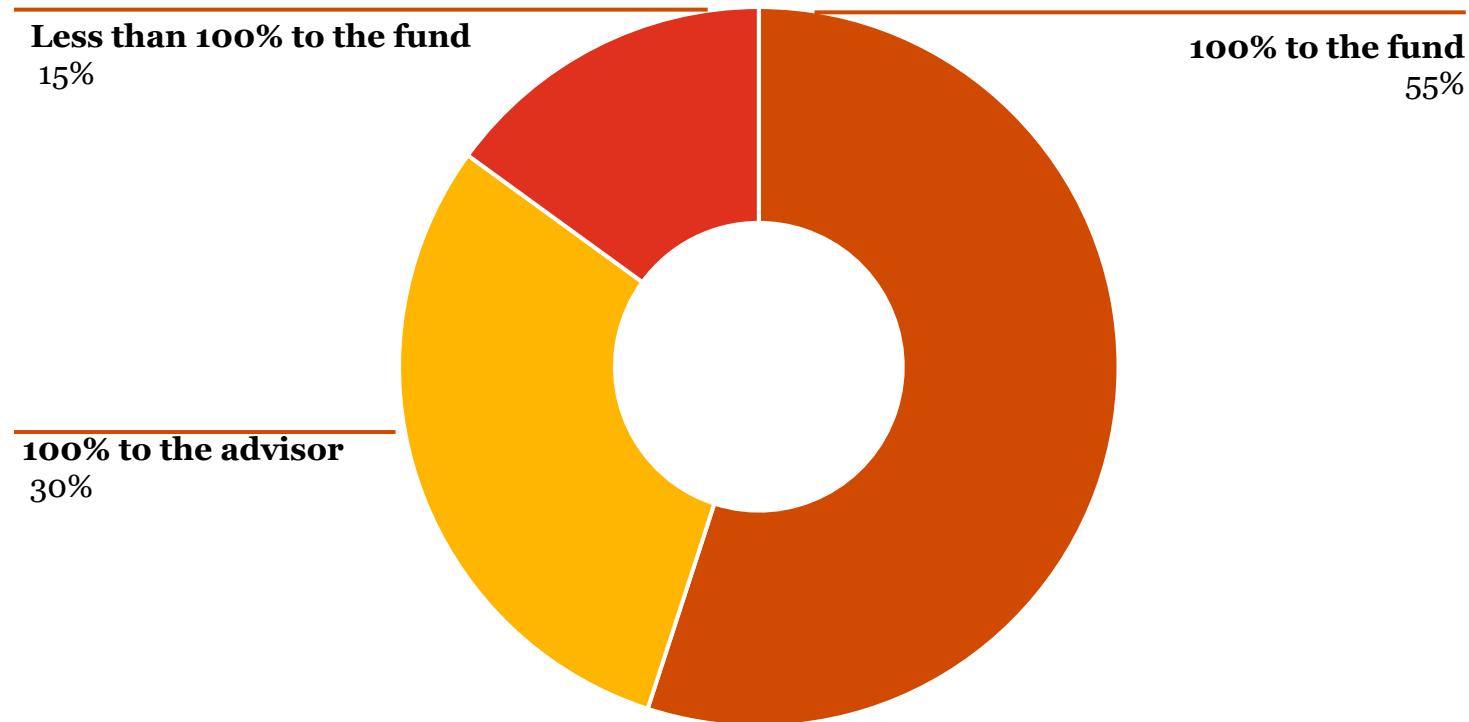
How are expenses charged to the advisor/funds?

Fund-Level Professional Fees



Treatment of Expenses

How are broken deal costs charged to the advisor/funds?



Of participants who noted that broken deal costs are charged to both the advisor and the fund, most indicated that between 10% and 50% of the costs are generally charged to the fund.

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