December 2020, 4 min read

Private Equity Fund Terms Research – Sixth Edition- Part I: Economics (management fees and carried interest)

MJ Hudson has today published Part I of the latest edition of its **Private Equity Fund Terms Research**, downloadable here. Now in its sixth edition, the Private Equity Fund Terms Research provides both LPs and GPs with an enhanced understanding of the current strengths and weaknesses of the fundamental economics, alignment and governance terms impacting private equity fund commitments. It relates to buyout funds, venture funds and growth funds.

Included in Part I is an examination of the core economics terms that govern a private fund, as well as economics analysis of the levels and calculation methodologies of management fees (both during and after the investment period). The prevalence and nature of management fee discounts, and the operation of distribution waterfalls and carried interest models (including hurdle rates, ratchets and catch-up) are likewise covered.

Key findings include:

A lower proportion of funds are charging a >2% management fee during the investment period:
2% remains the most commonly seen management fee rate, with 53% of funds in the survey charging a management fee of this level. However, only 15% of funds were charging a management fee in excess of 2%, a decrease on the 21% seen in 2019 and more in line with the 12% seen in 2018.

A lower proportion of capital is commanding a management fee of 1.5% or less:
44% of all capital sought/raised by the funds surveyed had headline management fees of 1.5% or less. This compares with 52% in our 2019 research and 79.5% in our 2018 research.

A higher proportion of U.S. GPs utilised European GPs the whole-fund model:
In this year's economics research, 40% of U.S.-based Managers offered fund-as-a-whole structures, compared with 27% of such Managers in our 2019 research. By contrast, European-based GPs overwhelmingly favoured fund-as-a-whole structures, with 88% of the funds managed by Europe-based GPs surveyed deploying them, the same proportion as that seen in the previous year's research.

There is continued evidence that the 8% hurdle is under challenge:
29% of funds surveyed had (at least initially) no hurdle rate at all, an increase on the numbers seen in our 2019 (23%) and 2018 (12%) surveys.

But the hurdle is far from extinct:
68% of funds surveyed had a hurdle of exactly 8%. This was the most common hurdle rate and a slight increase on the 60% of funds with this hurdle rate seen in our 2019 research. However, the trend over time is downwards, with 76% of funds in our 2017 survey having had an 8% hurdle and 71% in 2018.

It is rare to encounter a fund without a GP clawback:
97% of all funds surveyed in this year's research included a GP clawback mechanism in their fund documentation.

But the market continues to resist the use of escrow arrangements to back GP clawback:
Whilst GP clawback is near universal, only 23% of all funds surveyed had escrow provisions to back clawback in place, a significant reduction on the 44% in the previous year's report. Escrow provisions are even rarer in funds with deal-by-deal waterfall structures. Only 13% of funds with deal-by-deal waterfalls in the surveyed sample had an escrow, a reduction from the 23% seen in the previous year's report.

Eamon Devlin, Partner of MJ Hudson | Law said:

"This proprietary research provides detailed analysis on private equity fund terms and the implications for both LPs and GPs. It includes comparisons with prior years' research and discusses the drivers for any significant changes. As our industry continues to grapple with the disruption caused by COVID, having accurate and insightful data is more important than ever. The experience of our law firm working with both GPs and LPs means MJ Hudson can bring insight from both sides of the GP/LP equation and a consequent 360-degree view on the market".

Part II of the sixth edition of the Private Equity Fund Terms Research will be published in 2021.