1. Executive Summary

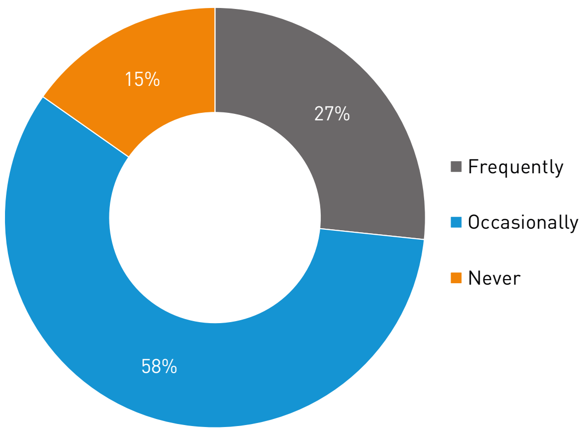
In a bullish fundraising environment, GPs are in a strong position to set the agenda on fund terms and conditions. LPs are paying ever closer attention to fund terms and conditions as a result – and they are walking away if they see terms they dislike. Indeed, the vast majority (85%) of LPs interviewed by Preqin in June 2019 have decided not to invest in a fund because of the terms and conditions proposed by the GP (Fig. 1.1).

But given the opaque nature of the industry, it can be challenging for GPs to determine what terms and conditions are best for their fund. A balance must be struck between GP and LP interests on a wide range of issues, from fee levels and transparency to responsible investment. To get the balance right, GPs need to stay on top of the latest developments in fund terms. And it is essential that they are cognizant of how competing firms are structuring their fund terms as well.

That is why **The Preqin Private Capital Fund Terms Advisor**, now in its 13th edition, compiles data from a broad range of sources – our current databases, historical datasets and LP and GP surveys – to provide the industry's most comprehensive data and intelligence on the private capital fund terms universe. In addition to providing data on key topics, such as fees, governance and transparency, the FTA also features guidance from industry experts on significant developments. This year, the FTA focuses on how environmental, social and governance (ESG) factors are shaping fund terms, with a comment from PRI, a UK-based investor initiative in partnership with UNEP Finance Initiative and UN Global Compact. See **Chapter 15** (In Focus: ESG in Fund Terms) for more.

Some of the highlights from our 2019 edition are outlined in this summary.

Fig. 1.1: Frequency with Which LPs Have Decided Not to Invest in a Fund Due to the Proposed Terms and Conditions



Source: Preqin Investor Survey, June 2019

Management Fees: On the Rise

Thanks to strong performance and buoyant investor demand, particularly in North America, over the past five years some GPs have been able to charge higher management fees for their buyout funds. For vintage 2019 buyout funds or funds in market, the mean management fee is 1.99%, an increase of 15 basis points compared with vintage 2015 funds (Fig. 1.2). That puts current fee levels closer to the 2.02% mean charged for vintage 2010 funds, the peak for the vintage years examined.

No wonder management fees are the chief concern of LPs investing in private equity. In June 2019, Preqin asked LPs across the private capital industry for their views on fund terms and conditions and to what extent they remain a concern. Just over one-third of investors identified management fees as the area they most want fund managers to improve (Fig. 1.3). See **Chapter 8** for more on management fees.

Performance Fees: A Stronger LP Hand

Performance fees is a key area where investors have typically looked to strengthen their hand in the GP-LP relationship. A notable shift in fund terms is that hurdle rates for example are now commonplace across the industry: just 4% of funds on the road or closed in 2018/2019 lack a hurdle rate provision. An insurance company that Preqin interviewed said that "very high fees" and "low hurdle rates for carried interest" was a deal-breaker for them.

That said, most investors we interviewed say they understand that outperformance should be rewarded; for LPs, problems arise when there are "high fees without proper justification," as one family office told Preqin. See **Chapter 9** for more on performance fees.

Evolving LP Engagement in Private Capital Investment

As the investor universe has grown and become more sophisticated, the methods these institutions use to access alternatives and the involvement they require in the investment process has evolved.

LPs are increasingly seeking more representation on the LP Advisory Committee (LPAC), which is generally used to settle conflicts of interest between LPs and GPs over investment decisions and fund operations. On average, 39% of advisory committees appoint five or six LP representatives, up by three percentage points compared with our 2018 report. LPs are also asking for greater transparency. A North America-based asset manager that Preqin interviewed said a stricter stance on conflict of interest disclosures to the LPAC is one of the most important steps a GP could take to secure LP investment. See **Chapter 10** for more on fund governance.

As LPs look for specific investment exposure to complement their portfolio, separate accounts are being utilized across the investor spectrum. However, the higher capital requirements these vehicles demand, compared to a typical closed-end fund, can prove a barrier to entry for smaller investors. Still, these vehicles can be an effective way for GPs to attract capital. See **Chapter 5** for more on separate accounts.

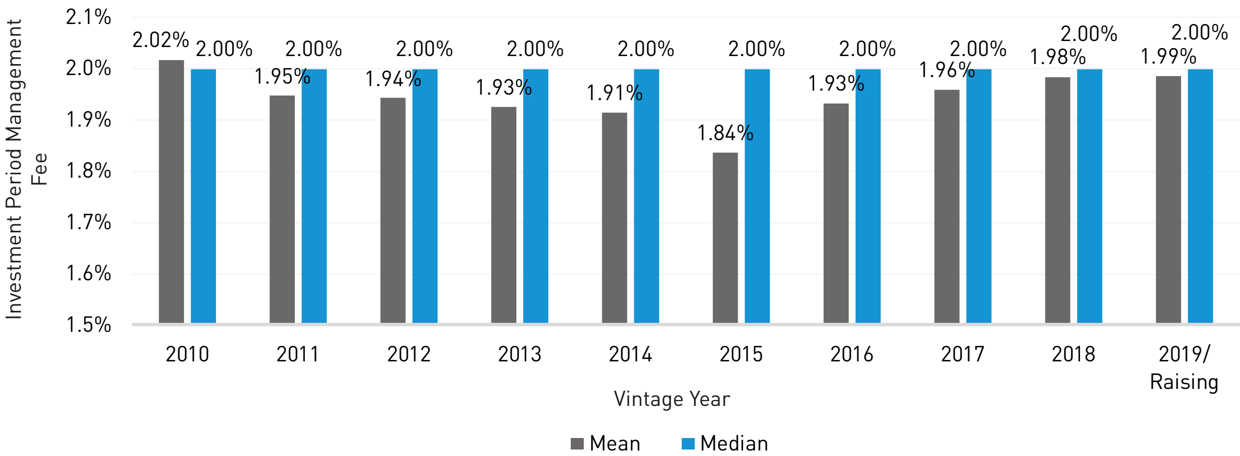
The Rise of ESG

A significant development in fund terms is the growing importance of ESG. As Natasha Buckley, Senior Manager in the Private Equity Programme at PRI, notes, LPs are seeking "a systematic and holistic approach to ESG factors – not just for negative screening purposes, but to unlock investment value." See **In Focus: ESG in Fund Terms** to find out more.

About The Preqin Private Capital Fund Terms Advisor

The 2019 Preqin Private Capital Fund Terms Advisor analyzes the very latest fund terms and conditions information collected by Preqin, providing our readers with the actual terms employed by individual vehicles, as well as benchmark terms. Individual, anonymous fund listings are provided for more than 2,900 funds for all major private capital fund types in an accompanying Excel data pack. The data pack also contains listings of over 1,400 named funds showing the net costs incurred by LPs annually. Another key feature is the detailing

Fig. 1.2: Buyout Funds – Average Management Fee by Vintage Year



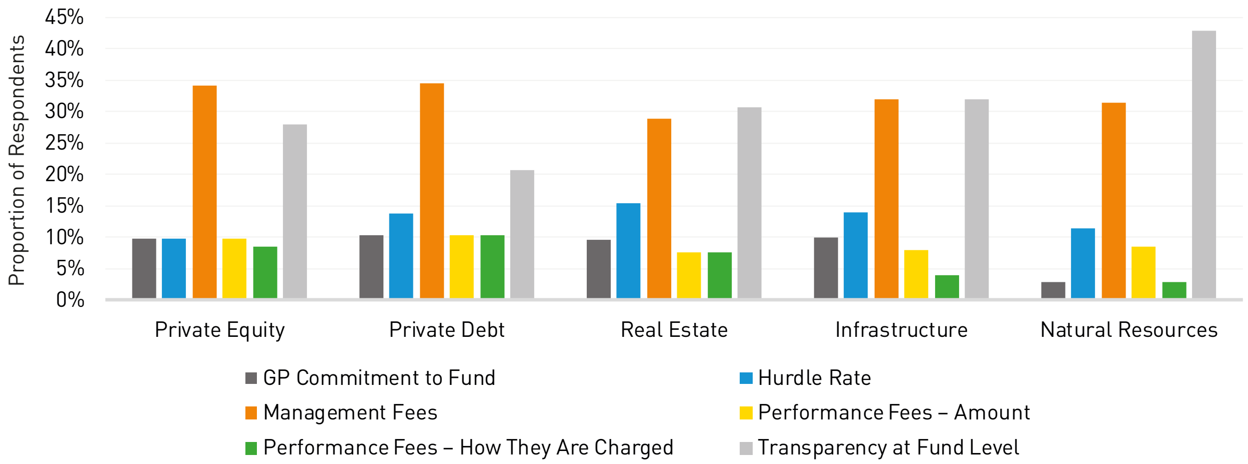
Source: Preqin Pro

of the most active law firms in private capital fund formation, including sample assignments. A larger pool of fund terms data is also accessible via **Preqin Pro**, using the complimentary login received with the purchase of this report.

The 2019 Preqin Private Capital Fund Terms Advisor Data Pack comes as part of your package and will be sent to you separately via email.

Use it to analyze anonymous fund terms listings, net cost listings and leading law firms in fund formation, including their fund formation assignments. All the charts included in this publication can also be found in the data pack.

Fig. 1.3: Key Area in Which LPs Believe the Alignment of GP and LP Interests Can Be Improved



Source: Preqin Investor Survey, June 2019

The 2019 Preqin Private Capital Fund Terms Advisor

A comprehensive guide to private capital fund terms and conditions

Contents

6. LP Attitudes towards Fund Terms

Impact on Investment Decisions

The fund terms and conditions proposed by GPs play a key role in an LP's decision to invest in a fund (Fig. 6.4). Over a quarter (27%) of LPs surveyed in June 2019 said that they frequently decide against investing in a fund because of the proposed terms and conditions. And more than half (58%) said that they are occasionally deterred from making an investment on this basis.

Overall, most LPs say that their interests are aligned with those of their GPs, our survey shows. But they also see room for improvement in key areas, such as management fees and transparency at the fund level.

Below, we take a closer look at how LPs are responding to current fund terms and conditions. These results are drawn from our June 2019 survey.

Alignment of Interest

More than two-thirds (68%) of surveyed LPs agree that GP-LP interests are properly aligned, while close to a third (32%) of LPs either disagree or strongly disagree with that statement.

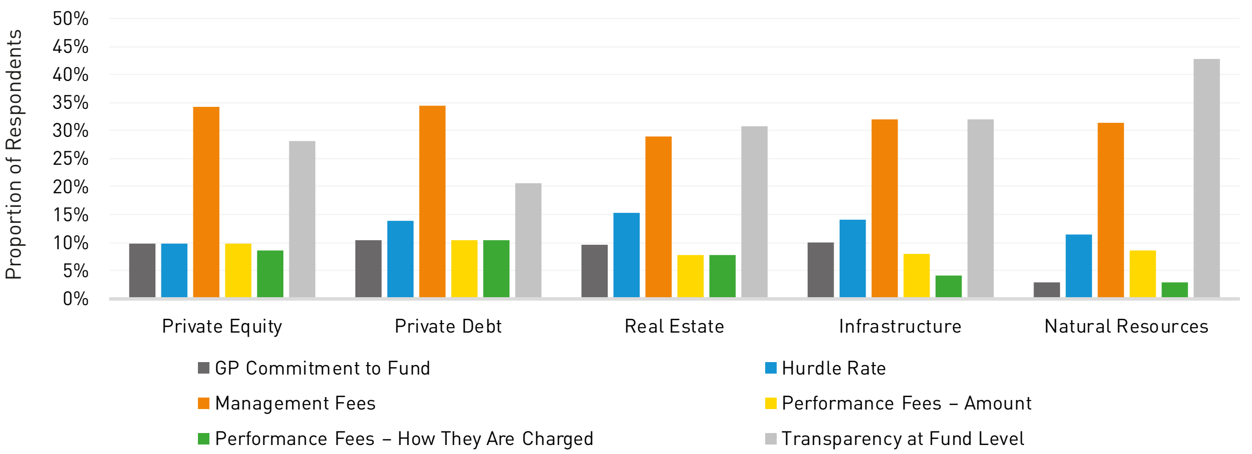
Areas in Which LPs Would Like to See the GP-LP Alignment Improved

Historically, management fees have been a key concern for LPs investing in private capital markets.

This year, we broke down LP responses by asset class (Fig. 6.1). Management fees are the top priority for LPs investing in private equity, selected by around one-third (34%) of respondents. Transparency at the fund level came second, with over a quarter (28%) of private equity LPs selecting this option.

For private debt investors, around a third (34%) of LPs identified management fees as the area they most want fund managers to improve. Transparency had the second highest number of LP votes, with 21% of private debt investors selecting this option.

Fig. 6.1: Main Area in Which LPs Believe the Alignment of LP and GP Interests Can Be Improved



Source: Preqin Investor Survey, June 2019

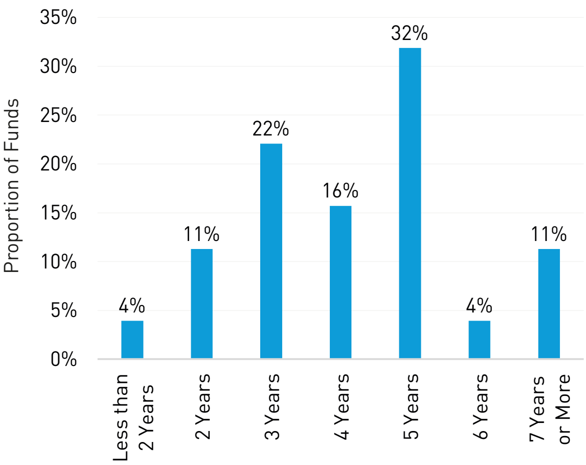
8. Management Fees

In our June 2019 LP survey, just over one-third of investors named management fees as the area they most want fund managers to improve. One European bank told Preqin that "exaggerated fees" were a deal-breaker and said that it had occasionally decided against investing because of the proposed fund terms.

But given strong investor demand, GPs know that they have the upper hand. With an abundance of capital available, funds are closing at a rapid clip. In the private equity space, the largest proportion (41%) of funds closed in H1 2019 were in market for six months or less. This is up two percentage points from the corresponding proportion of funds closed in six months or less in H1 2018.

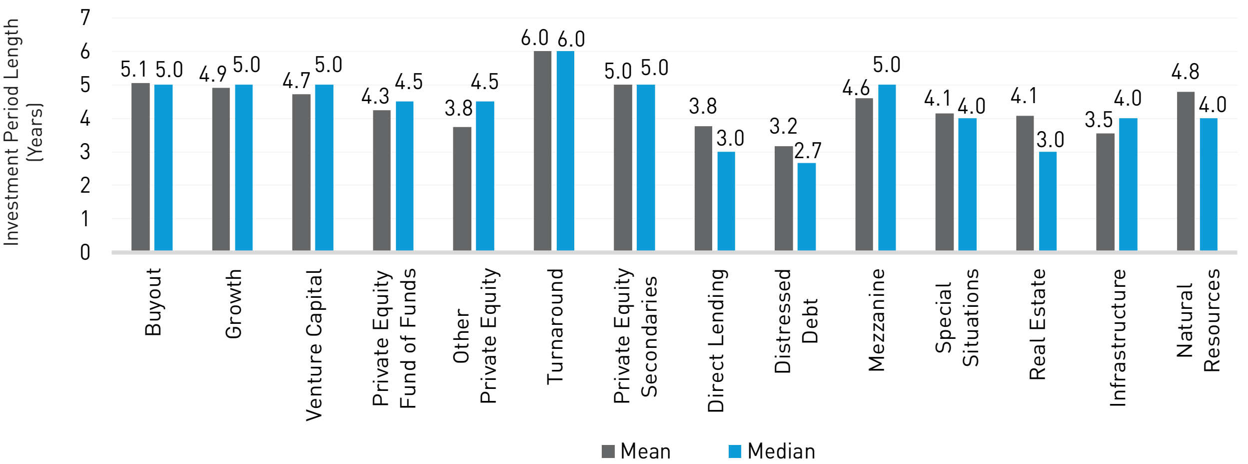
To better understand the evolution of management fees across the alternative assets universe, we consider the average fees charged for different fund types. We then take a deep dive into each fund type, breaking down

Fig. 8.1: Length of Investment Period – All Private Capital Funds (Funds Raising & Vintage 2018/2019 Funds Closed)



Source: Preqin Pro

Fig. 8.2: Average Length of Investment Period by Fund Type (Funds Raising & Vintage 2018/2019 Funds Closed)



Source: Preqin Pro

11. Fund Formation and Costs

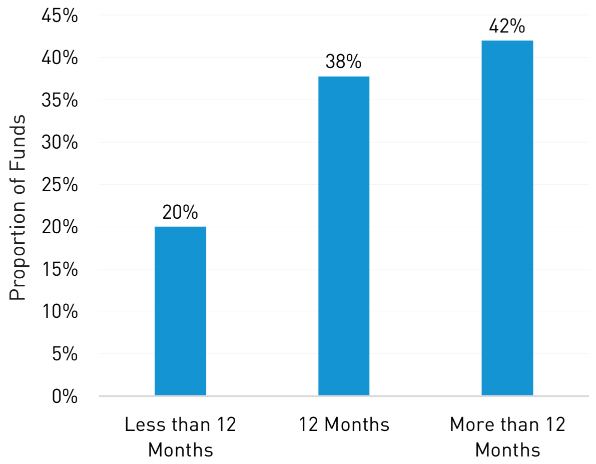
This chapter examines the key terms and conditions associated with establishing a private capital fund. These include the time limit on final close, interest rates payable by LPs committing to the fund after the initial close, GP commitments to the fund, minimum LP commitments to the fund and fund organizational expenses.

Time Limit on Final Close

Limited partnership agreements typically include a time limit on how long after the first close, or when the fund starts investing, that the fund can remain open to new investors and continue to fundraise. This is an important consideration for LPs, as they would prefer that fund managers focus their attention on identifying investment opportunities and putting capital to work instead of spending time on a prolonged fundraising period. Time limits can be extended with the consent of the LPs investing in the fund.

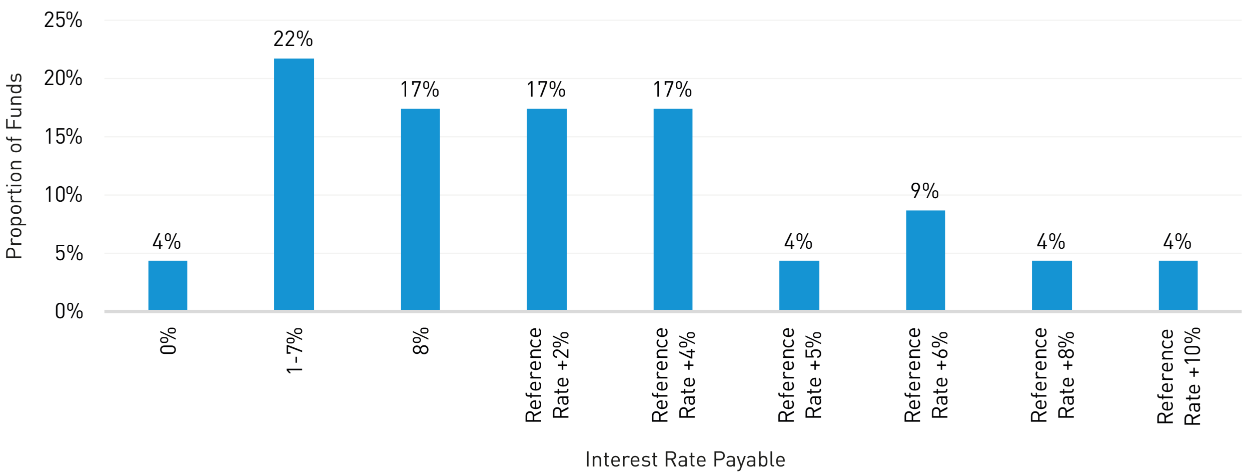
According to Fig. 11.1, the most common time limit on a final close is more than 12 months after the first close. The largest share (42%) of recent funds – funds with a 2018/2019 vintage or those yet to start investing

Fig. 11.1: Time Limit on Final Close after First Close (Funds Raising & Vintage 2018/2019 Funds Closed)



Source: Preqin Pro

Fig. 11.2: Interest Rate Payable on Contributions Made by LPs Joining Fund after First Close (Funds Raising & Vintage 2018/2019 Funds Closed)



Source: Preqin Pro

Fig. 12.2: Venture Capital (Funds Raising & Vintage 2018/2019 Funds Closed)

Key Terms		Median Benchmark Average		Variations/Comments
Management Fee	Investment Period	Funds below $500mn:	1.95%	
		Funds $500mn or above:	2.50%	
	Post-Investment Period	Same rate; charged on invested capital		
Carried Interest	Basis for Distribution	Whole fund		
	Percentage	20%		
	Hurdle Rate	7%		
Transaction Fee Rebate		0%		
GP Commitment		2.0%		Mean 3.5%
Minimum LP Commitment		0.5%		
No-Fault Divorce Clause		No		Of the funds with a no-fault divorce clause, a 75% LP majority is needed
Key-Man Clause		Yes; 1 level		
Investment Period		5 years		

Fig. 12.3: All Private Debt (Direct Lending, Distressed Debt, Mezzanine and Other Private Debt) (Funds Raising and Vintage 2018/2019 Funds Closed)

Key Terms		Median Benchmark Average		Variations/Comments
Management Fee	Investment Period	Private Debt:	1.75%	Mode 2.00%
		Direct Lending:	1.50%	
		Distressed Debt:	1.75%	
		Mezzanine:	2.00%	
		Other Private Debt:	1.75%	
	Post-Investment Period	Same rate; charged on invested capital		
Carried Interest	Basis for Distribution	Whole fund		17% elect deal-by-deal
	Percentage	20%		
	Hurdle Rate	8%		
Transaction Fee Rebate		0%		
GP Commitment		3.5%		Mean 7.6%
Minimum LP Commitment		1.1%		Mean 0.70%
No-Fault Divorce Clause		Yes; 75% LP majority needed		
Key-Man Clause		Yes; 1 level		
Investment Period		4 years		Mode 5 years