Fee Structures for Unlisted Closed End Funds

Unlisted closed end funds (CEFs) are an increasingly important part of the alternative investment market. Many of the world's top fund managers have launched tender offer funds and interval funds within the past few years. A wide variety of asset classes and investment strategies are available as a tender offer fund or interval fund. The transparency and convenience offered by unlisted CEFs makes them a preferred way for many investors to access alternative investments.

The relatively high fees for alternative investments, including unlisted CEFs, are a source of ongoing controversy. Fees are an important consideration in any investment, but they must be understood within their proper context. Alternative investments typically offer exposure to asset classes and strategies not available anywhere else. This portfolio diversification benefit improves the overall risk reward tradeoff in an investor's portfolio. Moreover its net returns, not fee levels, that ultimately drive the growth of an investor's wealth.

Market pressures determine the level of fees charged by different fund structures and strategies. This report provides a broad overview of fees across the unlisted CEF market. It covers the different fee structures that fund managers use and contains detailed data on fee levels for different investment strategies for both tender offer funds and interval funds. Topics covered include:

- Management fee structures
- Management fee levels by strategy
- Incentive fees
- Other fund expenses
- Expense limitation and reimbursement agreements

Asset managers considering launching an unlisted CEF can use this report to better understand the competitive landscape for tender offer funds and interval funds. Allocators and investors can use this report in their due diligence process to ensure that they are getting the best value for their money.

Management Fee Structures

Base management fees, also known as advisory fees, are ongoing fees paid out of a fund's assets. The manager uses these fees to support operating costs and seek market opportunities. If a fund has a sub-advisor, then the advisor and sub-advisor will each take a portion of the base management fee. In most cases, the base management fee is the largest direct expense borne by shareholders. Moreover different share classes will have different distribution and servicing expenses, but they will almost always[1] have identical management fees. The

[1] There are a few exceptions in tender offer funds using master feeder structures where different feeder funds have different management fees.

fund's prospectus, and investment advisory agreement (available as an exhibit to the prospectus filed on EDGAR), will provide details on the structure of these fees. Broadly speaking, there are three different methods of calculating base management fees. (1)Net Assets (2) Total Assets (3) Committed Capital.

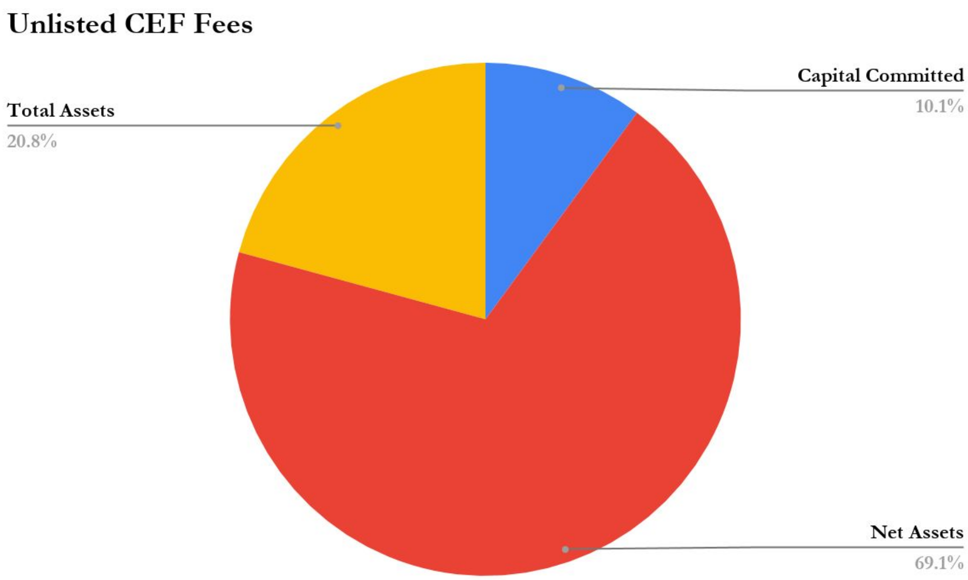
The following table summarizes the three different types of base management fees.

Fee Calculation Method	**Explanation**	**Advantages**	**Disadvantages**
Net Asset(NAV)	Calculated based on net asset value of fund	Typically results in lowest overall fee; no incentive to use leverage	Management has less incentive to expand portfolio with leverage, even if justified by risk/reward tradeoff
Total Assets	Fee charged on all investment assets in the fund, including the impact from margin debt	Provides incentive for managers to devote resources to make full use of fund balance sheet	Can incentivize excessive leverage
Committed Capital	Includes capital committed to fund, whether invested or not	Management compensated for careful underwriting	Investors earn a negative return on idle funds while waiting for a capital call.

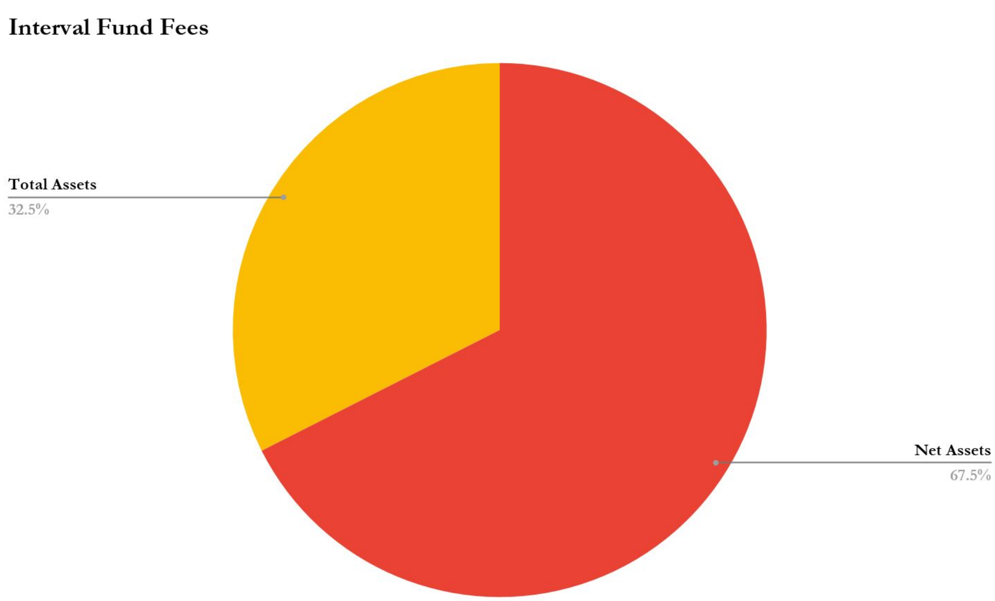
Although there is some variation within these three categories, they are similar enough that we can make reasonable comparisons within them. To compare funds across different categories, an analyst needs to make adjustments by either estimating leverage, or estimating the speed at which committed capital will be invested.

Around 70% of unlisted CEFs use net assets when calculating the base management fee. Total assets is the second most common method of calculating fees, accounting for around 20% of all unlisted CEFs. This method of calculating fees is more common for interval funds than tender offer funds. Approximately 10% of unlisted CEFs use capital committed in calculating base management fees. Note however, that all of these funds are tender offer funds. No currently active interval funds charge fees based on capital commitments.

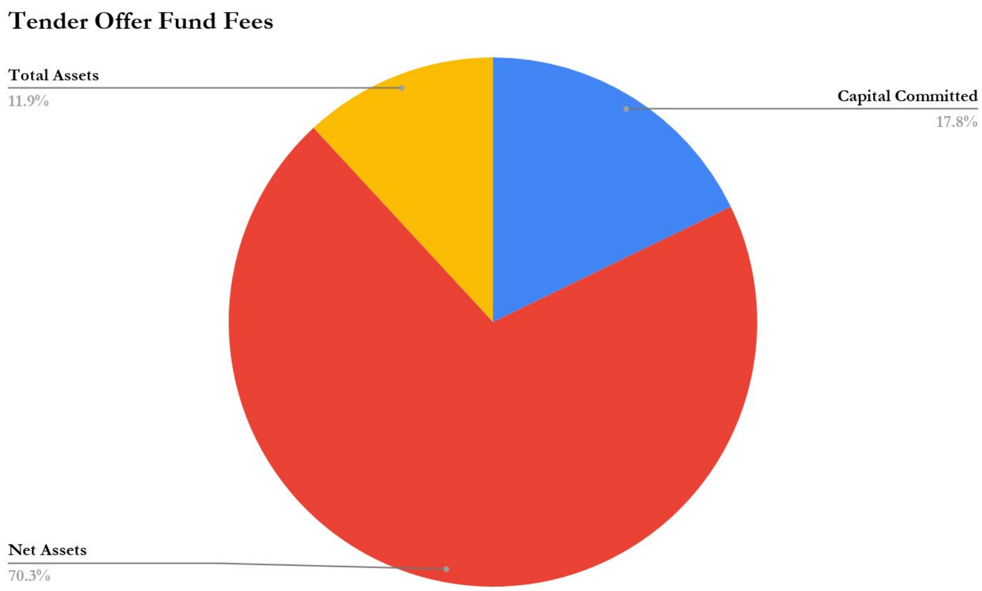
The following chart shows the fee calculation methods for the entire universe of unlisted CEFs.



There are noticeable differences when we disaggregate interval funds and tender offer funds. The following chart shows fee calculation methods for interval funds:



The following chart shows the fee calculation methods for tender offer funds:



Net Assets

A fund might charge a fee based on a percentage of average net assets throughout the year. The level of net assets on which to charge the fee will usually be determined by taking an average of daily, monthly, or quarterly net assets. The fund will generally pay a portion of this fee each month. Due diligence analysts should verify that the fund has a reasonable valuation process and uses a neutral third party in order to calculate the NAV. With a NAV based management fee, there is no incentive to use leverage at all, because it won't increase the amount of fees.

Here is an example of typical prospectus language describing a management fee charged based on net assets, from the ICapital KKR Commitments Master Fund, a tender offer fund with ~$400 million in net assets:

> *In consideration of the advisory and other services provided by the Adviser to the Fund, the Fund pays the Adviser the Management Fee, monthly in arrears, at the rate of 0.10% (1.20% on an annualized basis) of the value of the Fund's month-end net assets. The Management Fee is an expense paid out of the Fund's assets. The Management Fee is computed based on the value of the net assets of the Fund as of the close of business on the last business day of each month (including any assets in respect of Shares that will be repurchased by the Fund as of the end of the month) and is due and payable in arrears within ten business days after the end of the month. The Adviser pays the Sub-Adviser a monthly fee of 0.030833% (0.37% on an annualized basis) of the month-end net asset value of the Fund's investments in Investment Funds and Co-Investment Opportunities.*

In most cases, a fee based on NAV is flat for all levels of assets. In some cases, a NAV based fee will change depending on the total amount of assets in a fund. For example, the Hartford Schroders Opportunistic

Income Fund, an interval fund with~$25 million in net assets, has the following language to describe its management fee:

> *Pursuant to the Investment Management Agreement, and in consideration of the advisory services provided by the Adviser to the Fund, the Adviser is entitled to a Management Fee. The Management Fee is calculated and payable monthly in arrears at the annual rates of 1.15% of the first $1 billion and 1.10% in excess of $1 billion of the average daily value of the Fund's net assets. The Adviser, not the Fund, pays the sub-advisory fees to the Sub-Adviser.*

Total Assets

In some cases, total assets under management (AUM), including the impact of leverage on the investment portfolio, is included in the base on which the management fee is calculated. This will usually be referred to as "total assets", "gross assets", or "managed assets". Charging a management fee based on total assets creates an incentive for the manager to use more leverage than might otherwise be appropriate. On the other hand, there is a real cost to the manager for underwriting a larger portfolio. Most interval funds use relatively small amounts of leverage, so the impact is small. As with NAV based fees, due diligence analysts need to review the valuation procedures, and verify that it uses a neutral third party in the calculation.

Here is language from the Blackstone Real Estate Income Fund, a tender offer fund with $470 in net assets, describing a management fee based on total assets:

> *The Master Fund pays the Investment Manager an aggregate fixed management fee (the "Management Fee"), payable quarterly in arrears on the last Business Day of each quarter. The Management Fee accrues monthly at an annual rate of 1.50% of the Master Fund's Managed Assets at the end of such month before giving effect to the Management Fee payment being calculated or any purchases or repurchases of Master Fund shares or any distributions by the Master Fund. The Management Fee will reduce the NAV of the Master Fund (and indirectly, of the Fund) as of the end of the accounting period in which it is payable and after the calculation of the Management Fee. The Investment Manager will charge a pro rata portion of the Management Fee in the event of purchases or repurchases taking place during a given calendar quarter.*

As with NAV based fees, total asset based fees might also be designed to adjust based on the level of AUM. For example, the American Beacon Sound Point Enhanced Income Fund is an interval fund with $10 million in net assets that describes its management fee this way:

> *The Fund pays to the Manager a management fee in consideration of the advisory and other services, including administrative services, provided by the Manager to the Fund. Pursuant to the Management Agreement, the Fund pays the Manager an annualized management fee based on a percentage of the Fund's average daily "managed assets" (as defined below) that is calculated and accrued daily according to the following schedule:*

First $1 billion	*0.40%*
Next $4 billion	*0.375%*
Next $5 billion	*0.35%*
Over $10 billion	*0.325%*

"Managed assets" means the total assets of the Fund (which include assets attributable to the proceeds of leverage) minus accrued liabilities (other than liabilities attributable to such leverage). For purposes of calculating "managed assets," the liquidation preference of any preferred shares outstanding is not considered a liability. In addition, for purposes of calculating "managed assets," the Fund's derivative investments will be valued based on their market value.

Committed Capital

A small segment of tender offer funds function more like traditional private equity funds in that they require an initial capital commitment, and then they call capital from investors as they find investment opportunities. These funds charge a base management fee that the manager calculates based on capital committed, but not yet invested. This fee structure is ubiquitous among private equity funds offered via private placement, but relatively rare for registered funds. When a fund charges a fee based on committed capital, it provides an incentive for the manager to be diligent and careful in selecting investments, since allocating capital quickly will not increase their fees.   On the other hand, it does result in a drag on returns during the investment period.

In most cases, fees based on committed capital will adjust throughout the lifecycle of the fund.[2] During the initial investment phase, they will be relatively low as a portion of commitments, but high as a portion of net assets(since so little of the portfolio is actually invested). Once the portfolio is invested, this fee increases as a percentage of capital committed, or converts to a fee based on net invested capital. Eventually the fee will decline providing an incentive for a manager to wrap up a fund.

Here is an example of a commitments based fee for the CPG Vintage Access Fund III, LLC:

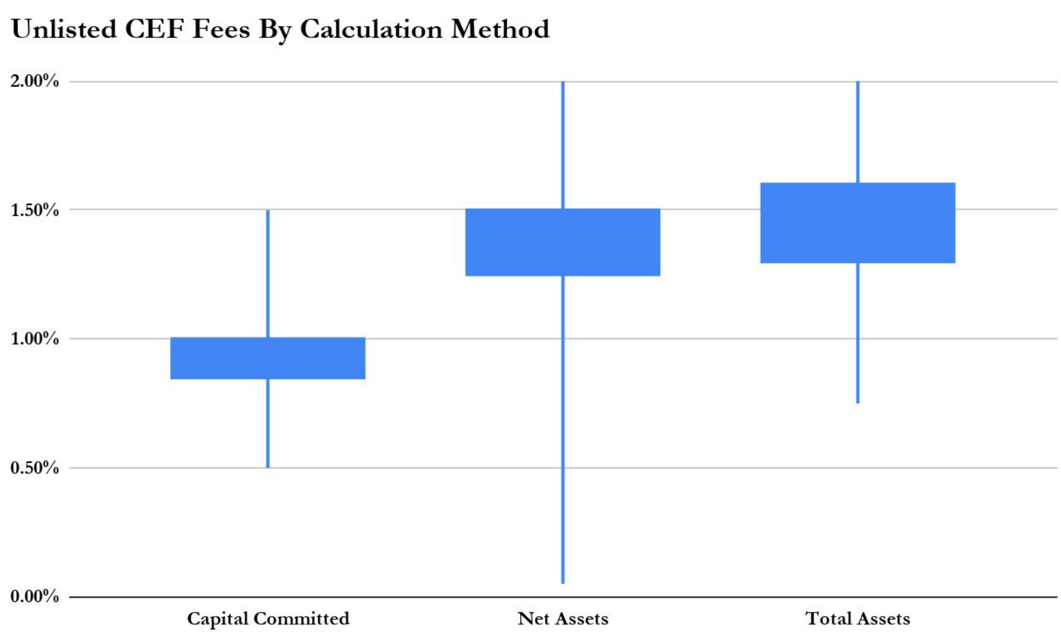
[2] In the database of fund fees available to Premium Plus subscribers, the column labeled *Annual Management Fee* contains a text description of the fee structure, including any changes during the full lifecycle of the fund. The column labeled *Management_fee_num* is formatted as a percent, and in cases where the fee level changes during the lifecycle of the fund will refer to the fee level that will be charged for the longest period of time. Charts in this report also use *Management_fee_num* as input.

> *In consideration of the advisory services provided to the Fund by the Adviser, the Fund will pay the Adviser a quarterly advisory fee at the annual rate of (i) 0.25% of total Commitments for the first 12 months following the Initial Closing, (ii) 0.65% of total Commitments from the one year anniversary of the Initial Closing until the six year anniversary of the Final Closing; (iii) 0.65% of the Fund's net invested capital from the six year anniversary of the Final Closing until the eight year anniversary of the Final Closing and (iv) 0.30% of the Fund's net invested capital thereafter for the remaining life of the Fund (the "Management Fee"). The Management Fee will be determined and accrued as of the last day of each quarter, and will be prorated for any period of less than a quarter based on the number of days in such period.*

Management Fee Levels

In this section we examine the range of fees charged by unlisted CEFs. The level of management fees varies widely depending on the level of cost and skill involved with a particular strategy. For example, a fund that simply invests in US Treasury securities, or follows an index could be profitable for a manager charging as few as 5bps, provided they reach enough scale. On the other hand, a complex middle market lending strategy, or a strategy requiring specialized quantitative skills would justifiably charge higher fees.

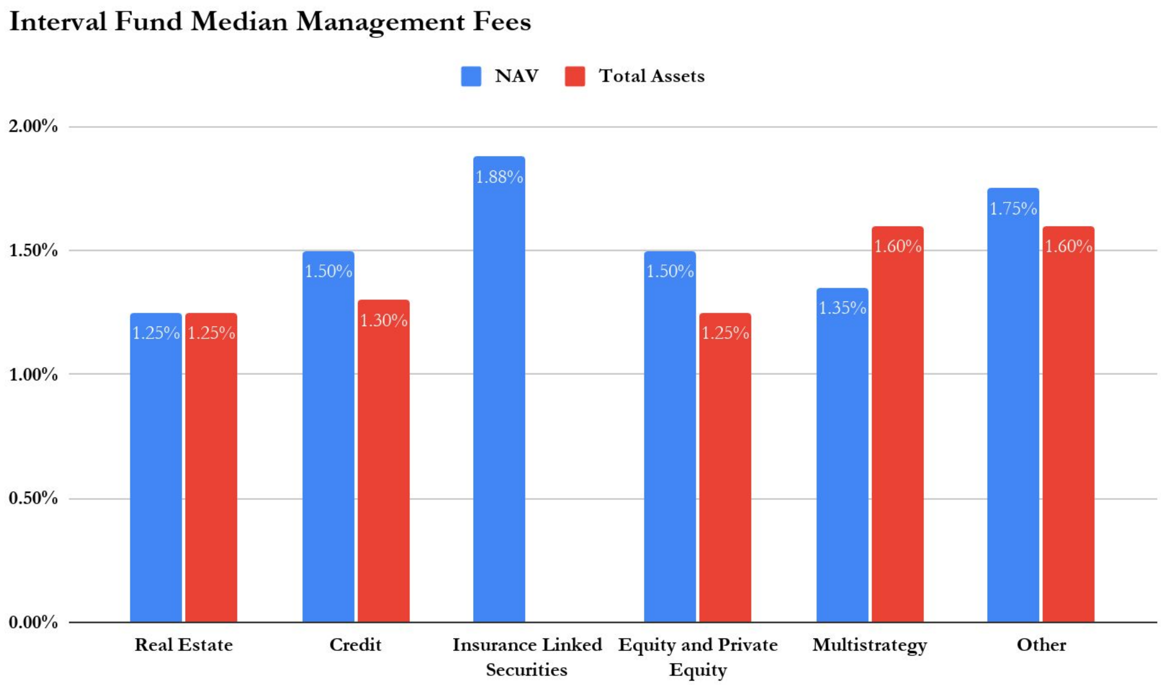
The median NAV based management fee is 1.25%. For total assets the median is 1.30%, and for capital committed its 0.85%. However, as expected there is a wide range in each group. The box plot below shows the range of fees in the current market. Each vertical line shows the full range of fees in the available universe of unlisted CEFs. Each vertical box shows the range from the 25th percentile to 75th percentile.



https://www.intervalfundtracker.com

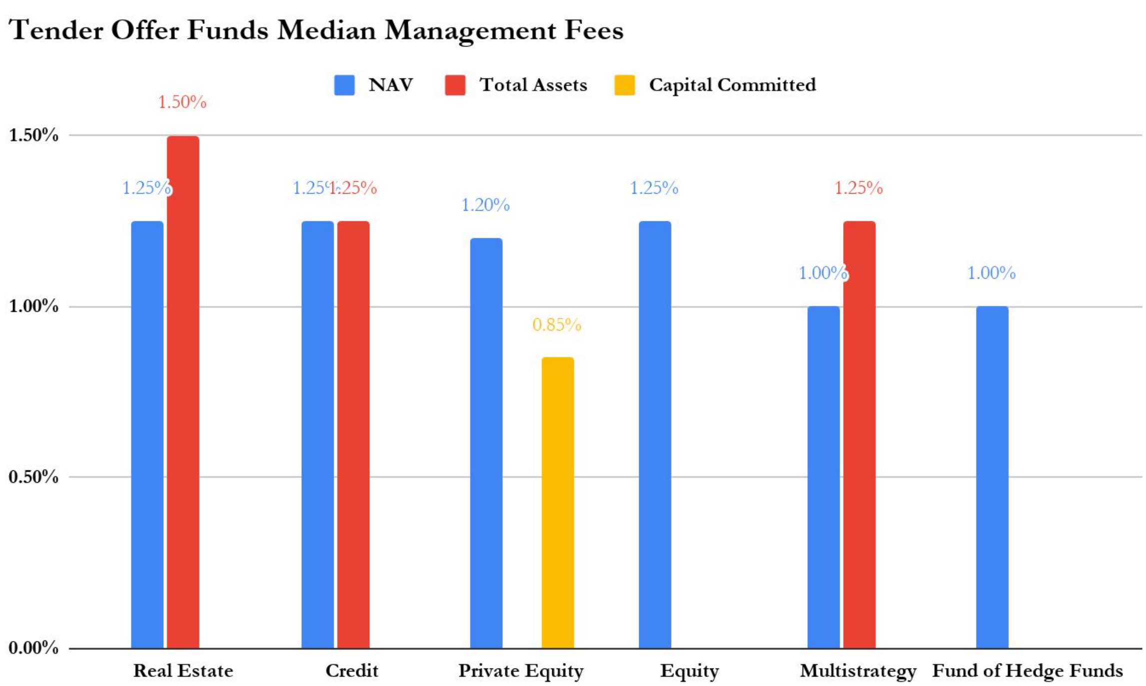
Interval Fund Fees by Strategy

The following chart shows the median base management fee for interval funds based on investment strategy:



Tender Offer Fund Fees By Strategy

This chart shows the median base management fee for tender offer funds based on investment strategy:



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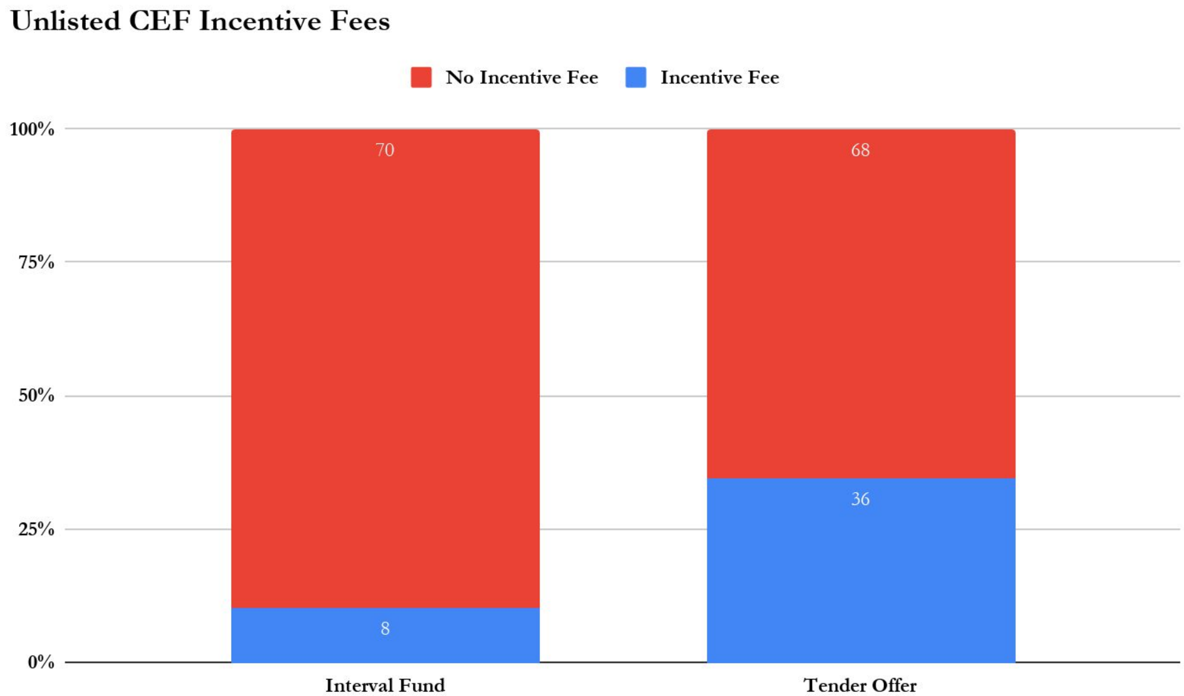
Incentive Fees

An incentive fee, sometimes called a performance fee or carried interest, rewards a fund manager based on performance. A relatively small portion of unlisted CEFs charge incentive fees.



If an unlisted closed end fund wants to charge a traditional hedge fund style performance fee, they must restrict sales to shareholders that are “qualified clients” as defined under the Investment Advisers Act of 1940. Alternatively, funds can charge fulcrum fees, pursuant to section 205(b)(2) of the Advisers Act without restricting sales to qualified clients. A fulcrum fee is a type of performance fee that increases or decreases with investment performance as measured against an appropriate index. A fulcrum fee also requires the adviser to provide for the subtraction of losses when fund performance is less than the performance of the benchmark index. Several law firms have published whitepapers with detailed information on the use of incentive fees in unlisted CEFs.

Interval and Tender Offer Closed-End Funds: Investment Company Alternatives to Traditional Funds (Chapman and Cutler LLP)
Interval funds- At the Intersection of Liquidity, Transparency and Valuation (DLA Piper)
Frequently Asked Questions About Interval Funds (Morrison &Foerster)

Fund sponsors that plan to add an incentive fee to their products should work with counsel to create a structure that is compliant with current regulation and beneficial to all stakeholders. The next section has a few examples.

Sample Fee Performance Fee Structures

The ACAP Strategic Fund, an interval fund offered only to qualified clients, has a relatively simple performance fee in which it charges 20% of net profits.

> *The Fund also pays the Adviser a performance-based incentive fee (the "Incentive Fee") promptly after the end of each fiscal year of the Fund. The Incentive Fee is determined as of the end of the fiscal year in an amount equal to 20% of the amount by which the Fund's net profits for all Fiscal Periods (as defined below) ending within or coterminous with the close of such fiscal year exceed the balance of the loss carryforward account (as described below), without duplication for any Incentive Fees paid during such fiscal year. The Fund also pays the Adviser the Incentive Fee in the event a Fiscal Period is triggered in connection with a share repurchase offer by the Fund, as described below.*

The Hatteras Core Alternatives Fund L.P, a tender offer fund available only to qualified clients, has a performance allocation based on the fund's outperformance of treasury bills:

> *The General Partner of the Master Fund will be allocated a Performance Allocation that is equal to 10% of the excess of the new net profits of the partner interests in the Master Fund (calculated and accrued monthly and payable annually and calculated separately for the Core Alternatives Fund, the TEI Fund and each other fund that serves as a feeder fund to the Master Fund) over the yield-to-maturity of the 90 day U.S. Treasury Bill as reported by the Wall Street Journal for the last business day of the preceding calendar year of the Master Fund. The General Partner makes payments to Portfolio Advisors equal to a percentage of the Performance Allocation the General Partner receives from the Master Fund.*

Private equity focused tender offer funds often have fee structures that are similar to traditional privately offered PE funds. For example the NB Crossroads Private Markets Fund V Holdings LP has the following carried interest provision:

> *After each Investor has received aggregate distributions equal to 125% of all drawn Commitments, a carried interest of 7.0% will be distributed to NB CMP Fund V SM LP, the special limited partner of the Master Fund, only after the fourth anniversary of the final closing, except in respect of an Investor's repurchase of its Interest. While the carried interest will be allocated at the Master Fund level, each feeder fund and its limited partners will indirectly be subject to the Master Fund's carried interest.*

Other Fund Expenses

Although base management and incentive fees are the most significant and direct cost to investors, there are other fund expenses that analysts need to consider as well. Some of these additional expenses are specified ahead of time in a fund's prospectus. For example, some funds pay a separate administration fee to an affiliate of the manager in addition to the base management fee. Some funds have share classes with distribution and servicing fees that can be as high as base management fees. The level of these fees will ultimately be driven by market forces in product distribution channels. Fiduciaries and investors should make sure they are getting the best deal possible.

Additional ongoing expenses vary by investment strategy. For example, funds that invest in esoteric and illiquid assets that may have high trading and operational costs that are ultimately borne by investors. The exact level of expenses will vary depending on market conditions. Analysts can compare a fund's expenses to its peer group to verify they are reasonable. For a fund to be successful, it must generate sufficient gross returns to overcome additional expenses.

Fund of funds strategies have an additional layer of fees known as acquired fund fees. A fund that makes direct investments might actually be a better deal for investors when compared to a fund of funds, even if the headline management fee level is higher. On the other hand, a fund of funds strategy might provide access to top managers that generate consistent alpha, but are inaccessible to most investors due to high investment minimums. Management will provide estimations of acquired fund fees in their prospectus, but the actual acquired fund fees will vary widely depending on the performance of underlying funds.

Investors are able to determine the base management and performance fees prior to making an investment, but other expenses are typically estimated in a prospectus. Ongoing monitoring is necessary to ensure that the expenses are justifiable given a fund's net returns, and overall risk reward tradeoff.

Expense Limitation and Reimbursement Agreements

Many unlisted CEFS that are raising capital have expense limitation agreements in place, so the actual cost borne by investors ends up being less than the headline figure. Under an expense limitation and reimbursement agreement, the manager will waive fees to keep overall operating expenses below a target level. Alternatively, the manager may simply waive their management fee over a certain time period. Typically, managers will keep expense limitation agreements in place until the fund achieves certain performance or capital raising objectives. Usually forgone fees are subject to repayment by the fund in the future once these objectives are achieved.

Due diligence analysts view these agreements favorably because the manager is effectively sharing additional risk with outside investors. Expense limitation agreements can also create certain tax advantages for the manager because it effectively converts ordinary income into long term profit interests.

Although specific terms can vary widely, the vast majority of unlisted CEFs will have some type of expense limitation agreement in place during the early part of a fund's life cycle. Fund managers, directors, and analysts should analyze expense limitation and reimbursement agreements on a case by case basis.