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Right on the Money: Calculating Fees for Modern Fund Structures

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This is the first post in a two-part series on the operational complexities of investor accounting.

Modern fund fee structures are far from one-size-fits-all and are becoming more varied, creative, and complex. These structures incorporate multiple variables, such as management compensation, performance metrics, high-water marks, and hurdle rates. The added intricacy of fund structures extends to investor fee agreements and calculations.

Given the complexity, calculating fees for Limited Partners (LPs) is a significant major operational burden. Fee structures are extremely intricate and increasingly unique to every investor – whose confidence is at risk if calculations are inaccurate, opaque, or delayed. Understanding the drivers of fee complexity – notably the increasing intricacy of the underlying fund structures – will guide managers in evaluating the right technology to streamline fee calculation for greater accuracy, transparency, and speed.

Welcome to the Era of Bespoke Fees

Today's fee agreements must account for carried interest and detail complicated waterfall distributions. Slicing fees based on specific deals, forms of liquidity, or side pockets in which different investors participate further complicates the calculations. Further, the size of investor commitments and the length of lockups also come into play.

Coupling the complexity with the competitive environment, fund managers increasingly negotiate more customized, individual terms with different investors. Of course, LPs want lower fees, but they also expect more flexible arrangements. As a result, a single fund may have a variety of side letters and nuanced fee schedules tied to each investor's amount of capital. The valuation of illiquid assets directly affects performance fees and adds to the

challenge to the operations team.

Automation Is the Solution

Is the fee calculation process ripe for automation? Absolutely. However, today, there is not an off-the-shelf solution that can account for all the fee variables, nuances, and individual arrangements with investors. Instead, firms managing bespoke fund structures need an intuitive and customized calculation engine that enables operations teams to:

- Design proprietary fee calculations for its investors
- Build formulas and control calculations based on the fund manager's objectives, with the flexibility to reengineer existing fee constructs
- Operationalize and automate bespoke calculations into your workflow processes

Getting fees right is critical for fund profitability, investor satisfaction, and regulatory compliance. Fund structures are likely to get even more innovative, bringing added operational complexity that calls for sophisticated solutions. Fee customization has become the norm, confronting operations teams with the challenge of ensuring the accuracy of intricate calculations. Moving away from manual, spreadsheet-based calculations and toward automation is a necessary step to drive greater efficiency, accuracy, and, ultimately, investor confidence.

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