Pension Bridge conference: Private equity managers stay firm on 20% carried interest

By **ARLEEN JACOBIUS** **July 27, 2016**

Buyout managers might be cutting their management fees some, but they are by and large maintaining 20% carried interest, said speakers at the Pension Bridge Private Equity Exclusive conference in Chicago on Tuesday.

Firms are taking the same share even though private equity managers on a buyouts panel acknowledged expected returns are dropping and they are monitoring their portfolios for recession risk.

Laureen Costa, managing director and portfolio manager of private equity with J.P. Morgan Asset Management (JPM), said: “Not all 2% management fees are evil, especially if you are looking at emerging manager funds.”

At the smaller private equity and emerging manager level, a 2% management fee is needed to “keep the lights on,” she said.

However, Keirsten N. Lawton, co-head U.S. private equity group at consulting firm Cambridge Associates LLC, said fees can make a difference in returns, especially now.

In a market where returns are expected to be lower than in the past, investors can offset that some by lowering fees, she said.

However, when the panel’s moderator Brad Young, co-CEO and head of investments at private equity firm Altius Associates, asked whether the standard 20% carried interest should be cut in light of expected lower returns, the answer was “no.”

Ms. Lawton said she has seen slightly lower carried interest in credit funds where some general partners could go as low as 15%, but in buyouts cutting carried interest is “a negative signal” to limited partners.

A number of speakers on other panels at the conference agreed they expect private equity returns to be lower. Nevertheless, many expect investors to continue to pile into the asset class because its returns still are expected to handily outperform stocks and bonds.

In the past six months, executives at Adams Street Partners LLC reviewed 58 RFPs for private equity managers, compared with 61 RFPs for all of 2015, said T. Bondurant French, executive chairman of the private equity firm, who was speaking on a panel on the state of the private equity market.

Most of the speakers on that panel — including moderator Sam Green, private equity investment officer at the Oregon Investment Council, Tigard, which runs the $68 billion Oregon Public Employees Retirement Fund — were sanguine about a relatively new development in which private equity general partners are taking out lines of credit to leverage their funds.

“There’s some controversy, but I am largely in favor if they (general partners) use credit lines properly,” said Paul R. Yett, managing director of alternative investment money manager Hamilton Lane, who spoke on that panel.

Some managers use lines of credit instead of calling investor capital, thereby easing limited partners’ capital call burden, Mr. Yett said.

“I expect general partners to be good managers of their funds … and subscription line (lines of credit) rates are very attractive right now,” he added.

John Connaughton, co-managing partner and head of global private equity at private equity firm Bain Capital, who spoke on the same panel, said leveraging portfolio companies and then leveraging equity on top of that “could be like the boiling frog.”

“It’s not a good idea,” he said.

That same panel also discussed private equity firms going public.

Bo Ramsey, director of private equity at the $29.9 billion Indiana Public Retirement System, Indianapolis, said he still views publicly traded private equity firms the same way he did when the firms first started going public — around 2007 in the U.S. — “with a heightened degree of skepticism.”

“What business model do they have? Do they generate fees off assets under management,” he queried.

“I have the same concern about backing public general partners with multiple platforms,” Mr. Ramsey said. “We pick our spots with public GPs where they can really add value.”