

## Carried Interest and Performance Fee Incentives

Link'n Learn – 5 February 2025

# Getting Started

## Here with you today

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## Agenda

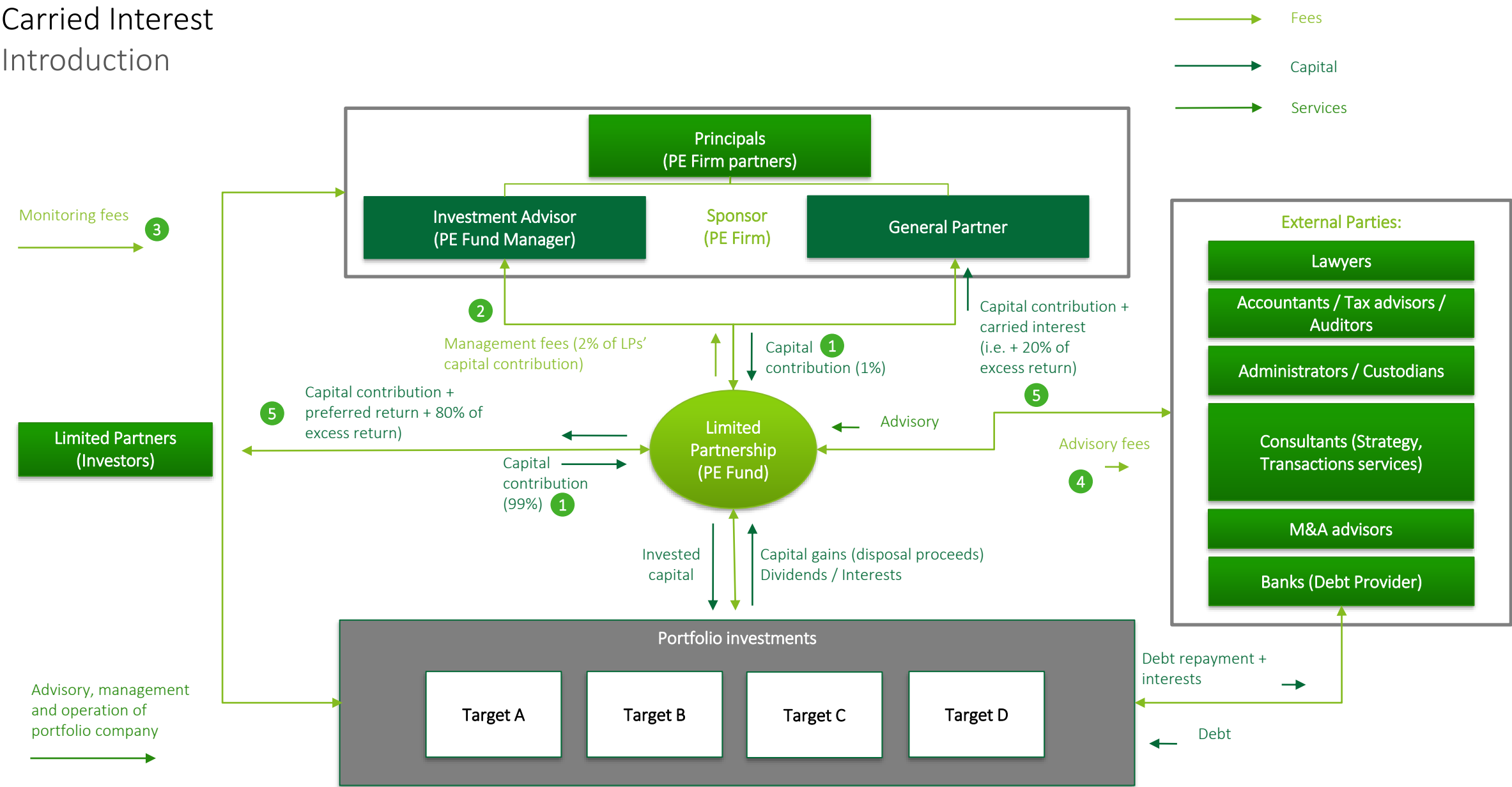
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- 1** Accounting and disclosure of carried interest
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  - Disclosure Requirements
- 2** Economics
  - Waterfall main features
  - Other components
- 3** Valuation
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# Accounting and Disclosure of carried interest

## Introduction & Overview

# Carried Interest Introduction



# Carried Interest

## Introduction

The prospectus of the Fund or the Limited Partnership Agreement defines the set-up of carried interests through the set up a specific class of shares giving right to the allocation of “carried interests”.

*Example of set-up:* The Manager/General Partner of the fund is entitled to receive a carried interest of 20 % of the excess of a performance above 8% (hurdle rate).

In practice this means, the profit of the fund will be first allocated to the investors until these profits reach a cumulative IRR of 8% calculated on the capital amount that have been contributed by the investors, including the General Partner who usually holds a small portion (1% to 5%) interest in the fund. Above 8%, the subsequent profits will be split using a ratio of 20% for the manager and the remaining 80% for the other investors.

# Carried Interest

## Overview

### Carried Interests / Performance Fees

...Usually GP is granted a fixed percentage (e.g. 25%) of a preferred return (e.g. profit after a hurdle rate of 8% allocated to the LP). The remaining part is usually divided between LP (80%) and GP (20 %)

#### Type of settlement (usually on a whole basis)

- Cash settlement
- Equity settlement

#### Accounting treatment

- Expense (“Service Model”; expense, Contingent Liability, Provision, Accrued Liability)
- NAV Allocation (“Ownership Model”; Adjustment of NAV per Investor; Dilution)

#### Issues

- First Time recognition
- Disclosure Requirements

# Accounting and Disclosure of carried interest Clawback

# Carried Interest Clawback

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## Clawback:

- Limited partners' right to reclaim part of the general partners' carried interest, in cases where subsequent losses mean the general partners received excess compensation
- A look-back to review the total profit distribution at the end of the Fund's term
- Ensures that the LPs received their capital contributions, expenses and any specified preferred return promised in the LPA before the GP receives carried interest
- Recaptures any overpayments made to the GP above their stated carried interest

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## Presentation and disclosure:

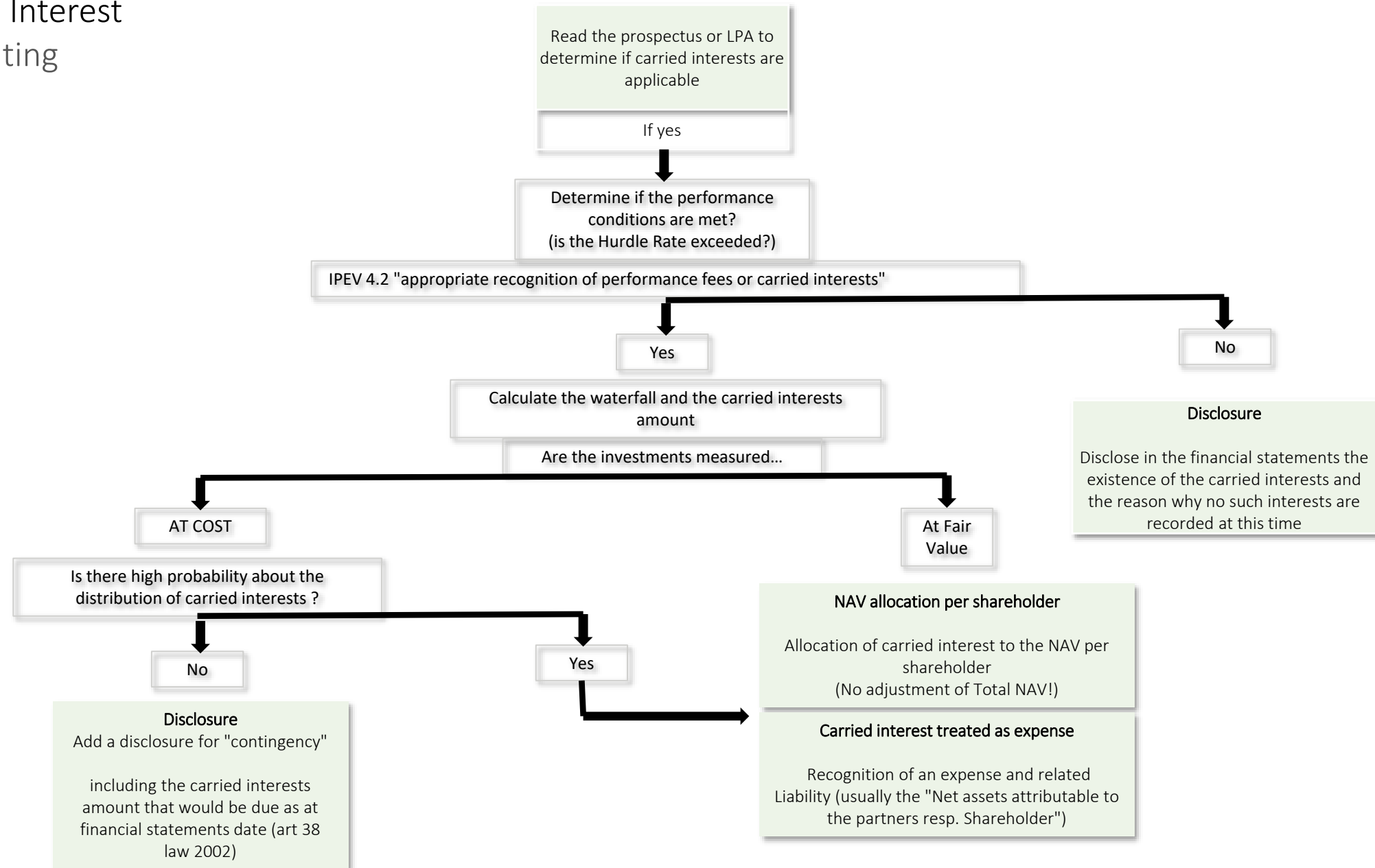
- |                   |    |  |
|-------------------|----|--|
| • Ownership Model | => | Reallocation from GP to LP equity  |
| • Service Model   | => | Recognition of a receivable with corresponding income for the Fund (with appropriate disclosure of the collectability) |



# Accounting and Disclosure of carried interest

## Accounting

# Carried Interest Accounting



# Accounting and Disclosure of carried interest

## Disclosure Requirements

# Carried Interest

## Disclosure Requirements

### Lux GAAP

- Description of the mechanism (including sufficient information of the calculation) and accounting policy retained (Art. 65 (1))
- Specific disclosure Requirements for AIF, SIF, SICAR, RAIF and SICAR (eg NAV per share)
- In case of expense model Art. 38 might be applicable (Financial Commitments)

### IFRS

- “Useful information” (IAS 1.112)
- IAS 24 “Related Party Disclosures” to be applied in case of Ownership Model
- In Case of Service Model, IFRS 7/IAS 32 or IAS 37 to be applied

# Carried Interest

## Disclosure Example NAV Allocation

### 7.6. Capital Account

#### Statement for all LPs - Capital account since inception to 31 December 2017

Investor	% Ownership	Commitment	Paid in Capital from Investors	Distributions to Investors	Realised portfolio gains/ (losses)	Unrealised portfolio gains/ (losses)	Investment income/ (expense)	Management fees	Non portfolio income/ (expense)	Carried Interest allocation	Capital account at Fair Value
		€000	€000	€000	€000	€000	€000	€000	€000	€000	€000
Investor No. 1	25%	25,000	26,583	(15,684)	4,833	5,554	1,905	(2,188)	(313)	(1,956)	18,734
Investor No. 2	20%	20,000	21,266	(12,547)	3,866	4,443	1,524	(1,750)	(250)	(1,565)	14,987
Investor No. 3	8%	8,000	8,506	(5,019)	1,546	1,777	609	(700)	(100)	(626)	5,995
Investor No. 4	10%	10,000	10,633	(6,274)	1,933	1,208	719	(875)	(125)	(580)	6,640
Investor No. 5	6%	6,000	6,380	(3,764)	1,160	1,333	457	(525)	(75)	(469)	4,496
Investor No. 6	7%	7,000	7,443	(4,392)	1,353	1,555	533	(613)	(88)	(548)	5,245
Investor No. 7	9%	9,000	9,570	(5,646)	1,740	1,999	686	(788)	(113)	(704)	6,744
Investor No. 8	5%	5,000	5,317	(3,137)	967	1,111	381	(438)	(63)	(391)	3,747
Investor No. 9	5%	5,000	5,317	(3,137)	967	1,111	381	(438)	(63)	(391)	3,747
Investor No.10	4%	4,000	4,253	(2,509)	773	889	305	(350)	(50)	(313)	2,997
General partner	1%	1,000	1,063	(627)	193	222	76	(88)	(13)	(78)	749
Total for Investors	100%	100,000	106,331	(62,736)	19,331	21,201	7,575	(8,750)	(1,250)	(7,621)	74,081
Carried interest partner										7,621	7,621
Total	100%	100,000	106,331	(62,736)	19,331	21,201	7,575	(8,750)	(1,250)	-	81,702

# Economics

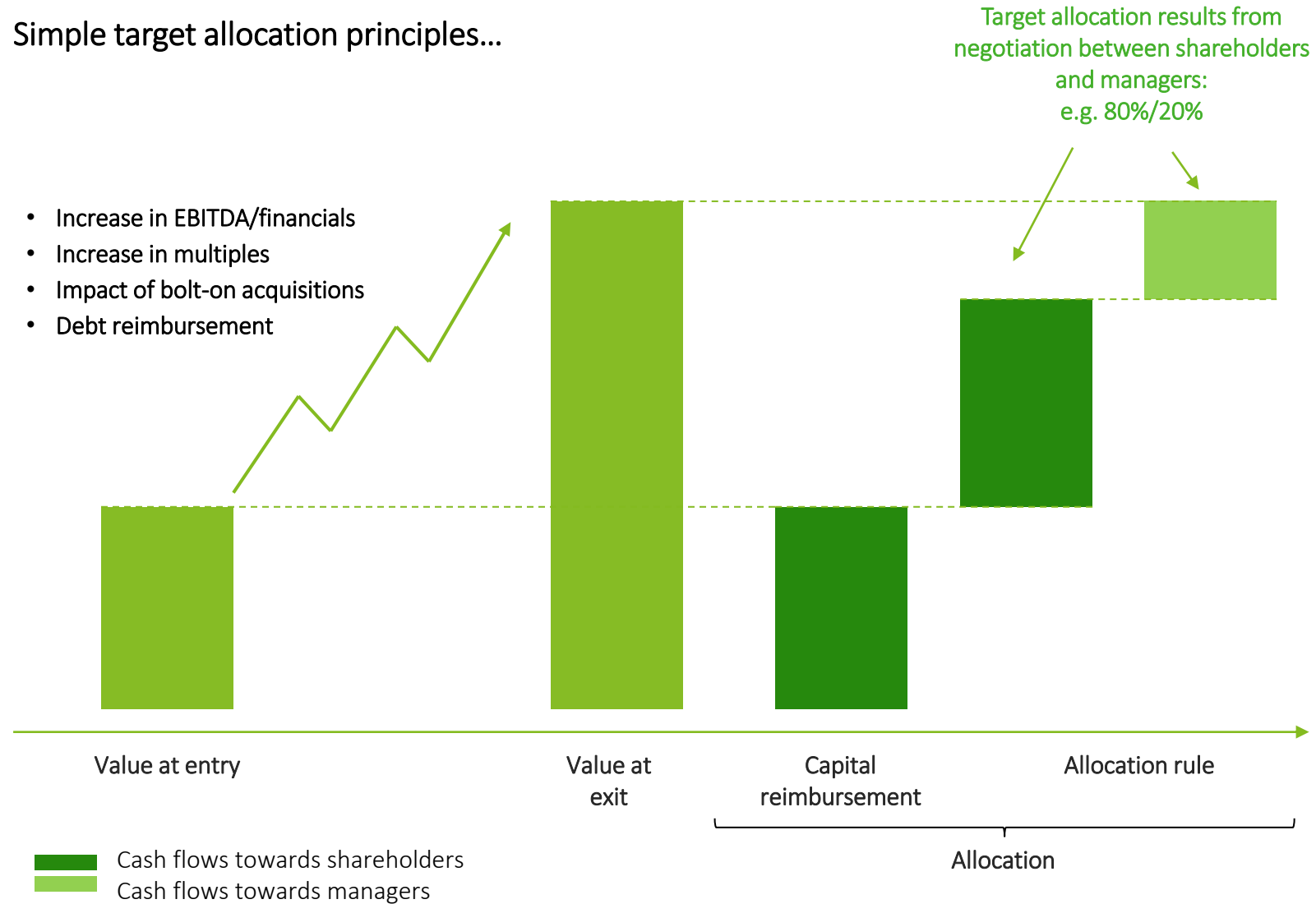
## *Waterfall overview*

# Waterfall economics

## Main features

### Simple target allocation principles...

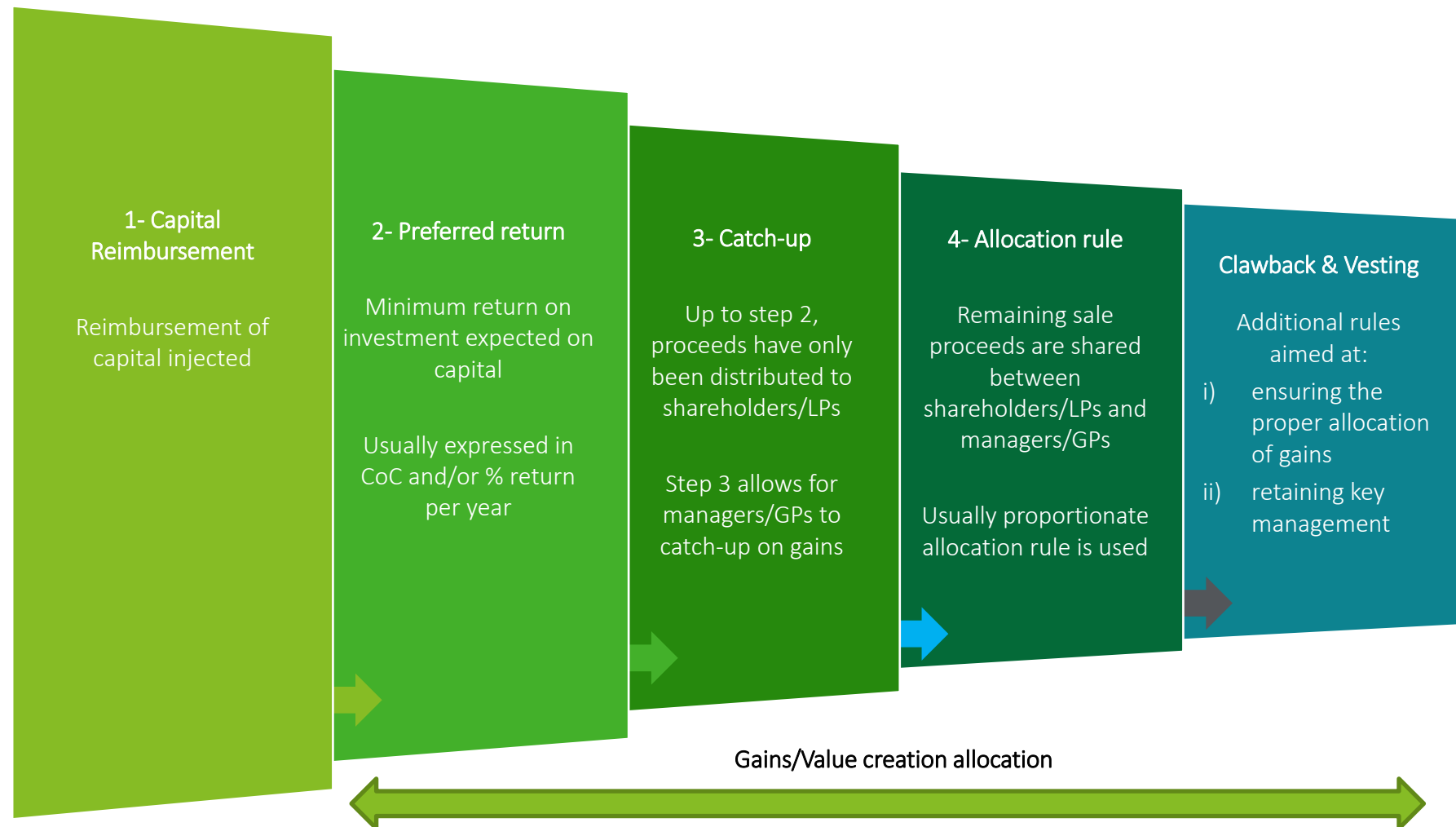
- Increase in EBITDA/financials
- Increase in multiples
- Impact of bolt-on acquisitions
- Debt reimbursement



# Waterfall economics

## Main features

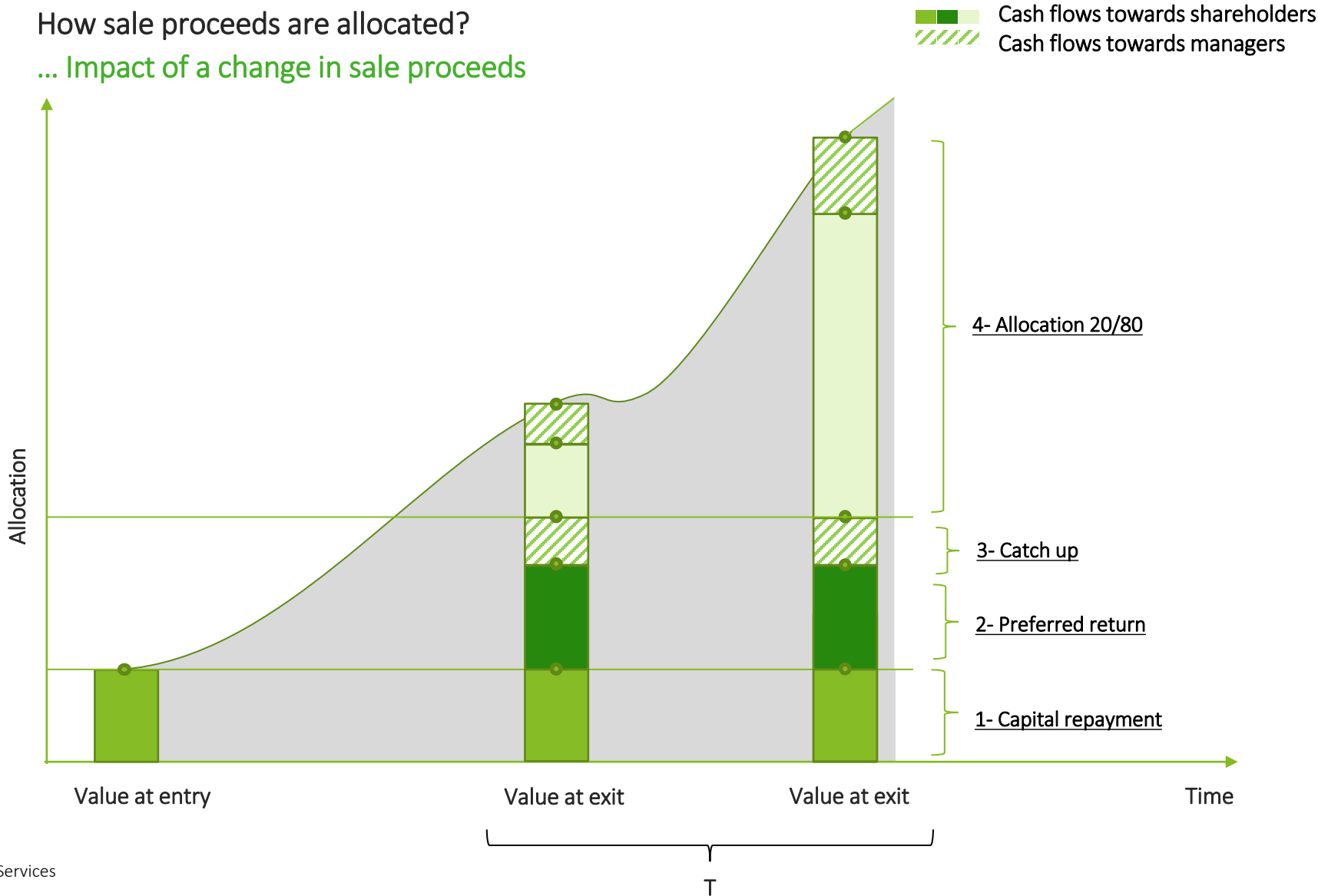
...Slightly more complicated in practice





# Waterfall economics

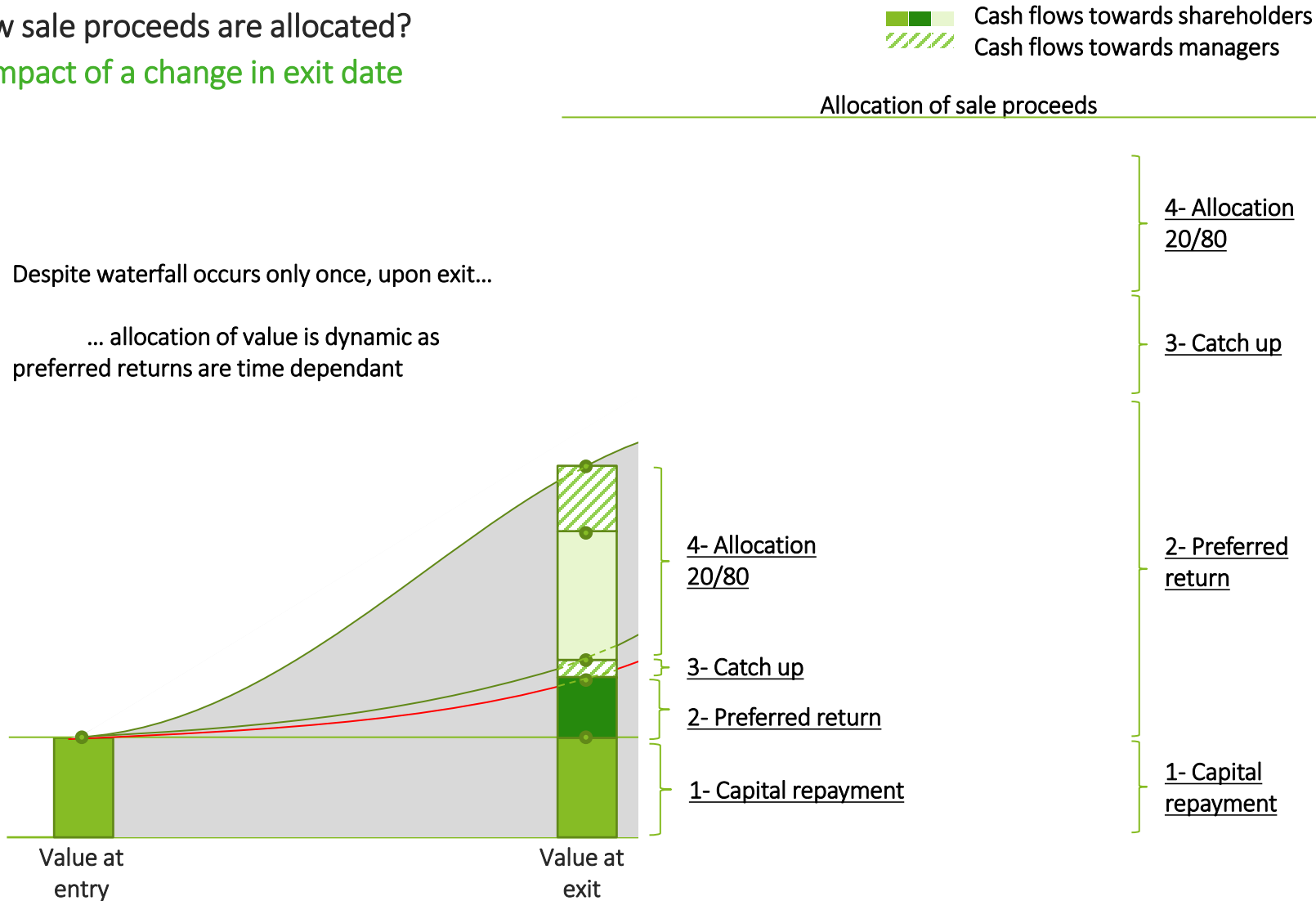
## Main features



# Waterfall economics

## Main features

How sale proceeds are allocated?  
... Impact of a change in exit date



**Economics**

*Other components*

# Waterfall economics

## Other components

### Vesting

Right to share gains is progressively acquired over time, e.g. 20% of the plan vests at each anniversary of the grant date

### Good leaver

Any person who leaves the company because of retirement, disability, death, is dismissed for economic reasons, etc.

### Bad leaver

Any person who resigns, is dismissed (for gross misconduct), etc.

### Claw back

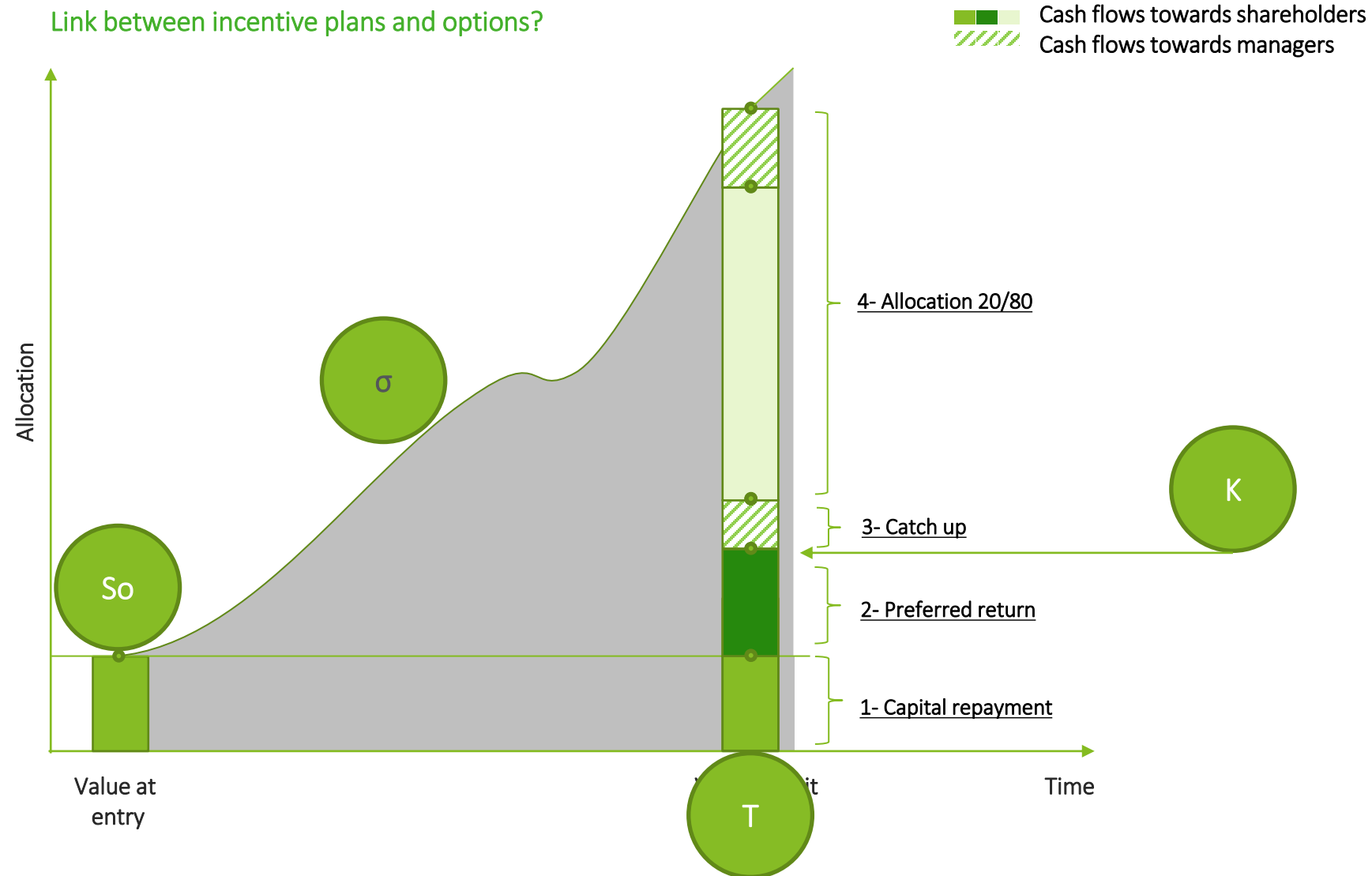
Participants might be obliged to reimburse (part of) their payments upon occurrence of predefined events (e.g. claims from third parties, etc.)

# Valuation

*A brief introduction*

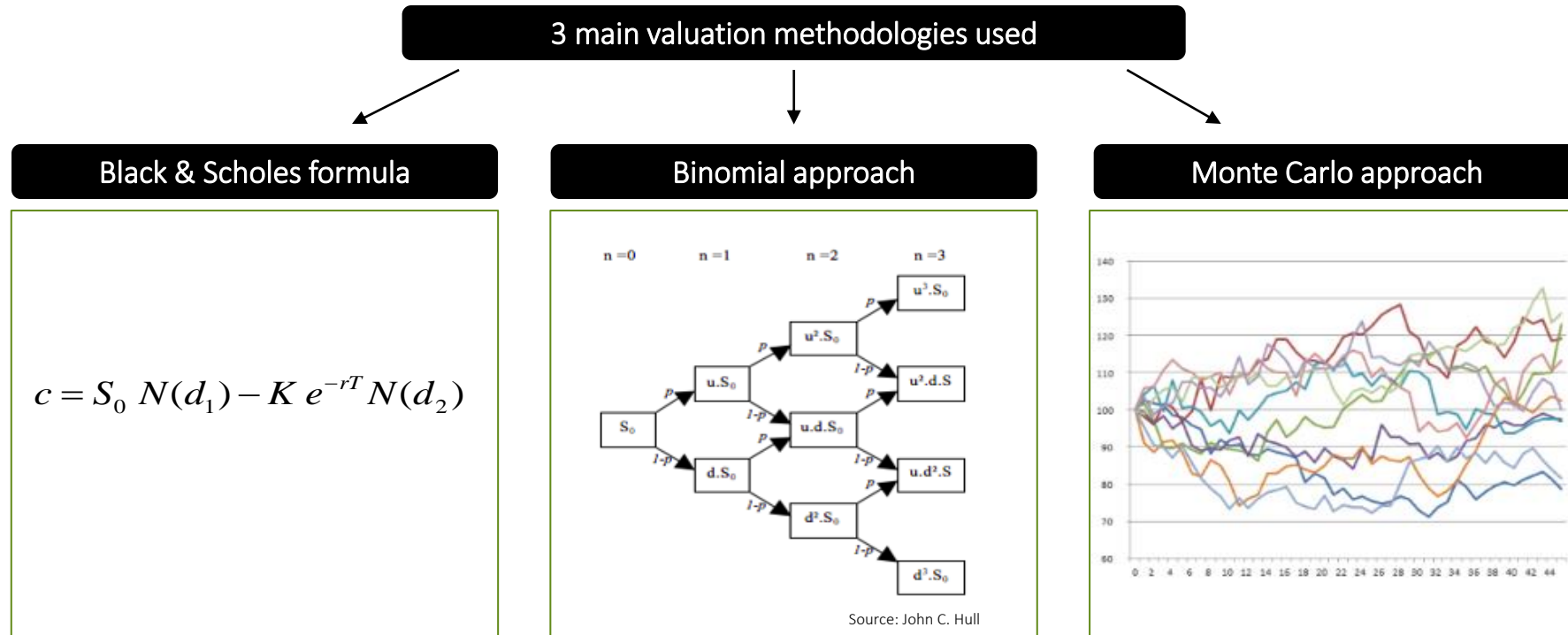
# Valuation

Using financial theory, a carried interest scheme can be assimilated to an option considering its cash flow pattern



# Valuation

Find the appropriate valuation methodology?



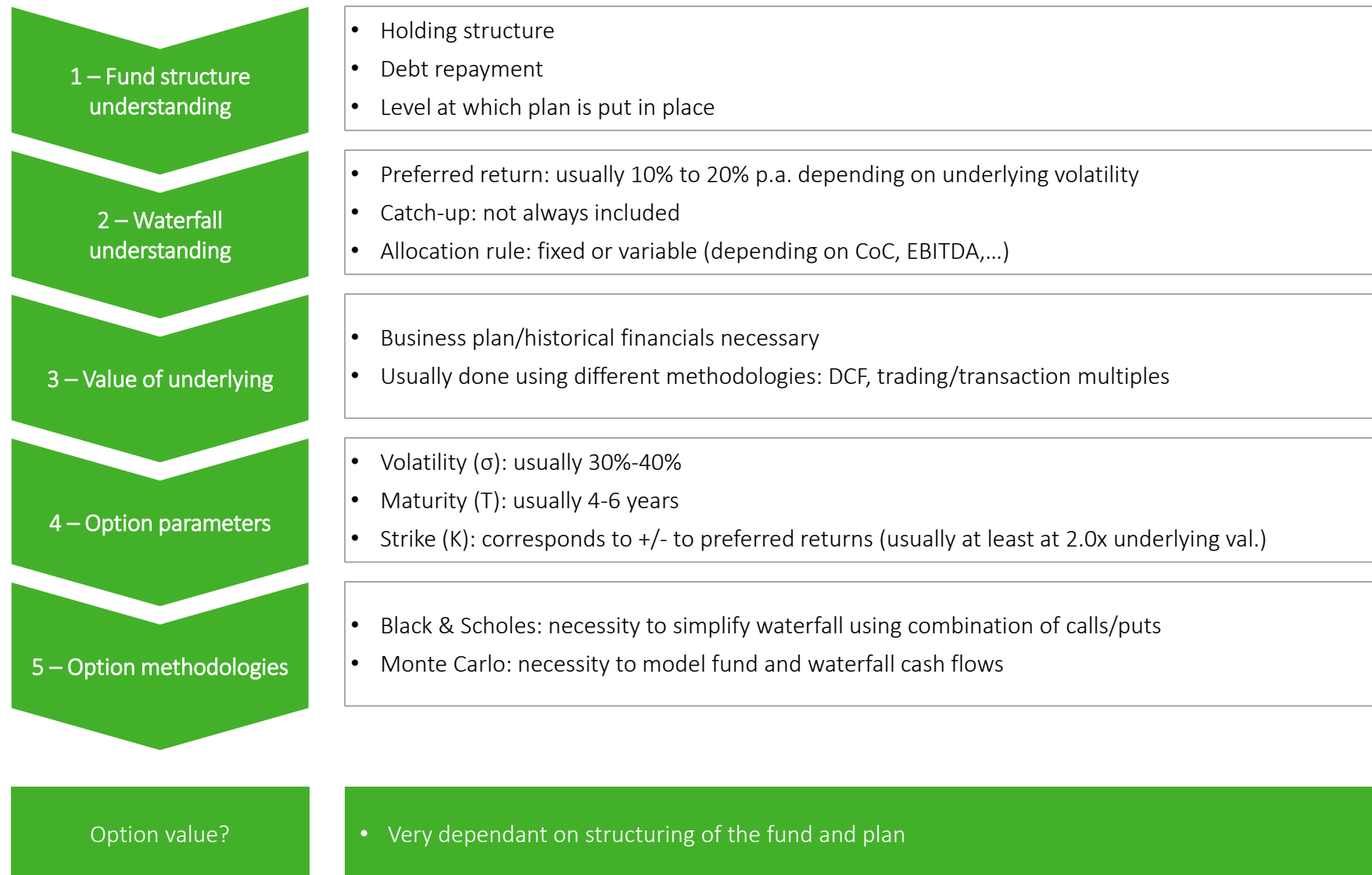
Increased Tailoring/Increased Flexibility



Increased Simplicity

# Valuation

## Valuation process





# Management Fees & Performance Fees

# Management Fees & Performance Fees

## General Overview

Portfolio Manager / General Partner receives a remuneration for services rendered – Split between:



Both fixed and variable remuneration need to be disclosed in the pre-contractual documents - Investors need to be aware of and agree to:

1. Fixed and variable fee structure;
2. Calculation mechanism („translation“ of legal wording into mathematical model)

# Management Fees & Performance Fees

## Performance Measurement

Return on  
Investment (RoI)

Multiple on  
Invested Capital  
(MoIC)

Internal Rate of  
Return

ESG Targets

- Driven by the new EU Regulation (SFDR / Taxonomy)
- Can be set-up either as
  1. Remuneration for achieving ESG targets
  2. Penalty for not achieving ESG targets

# Next Link'n Learn webinar

*Date: 19/02/2025*

**Topic: Alternative Investments |  
Accounting for Alternative  
funds: reporting aspects of  
different GAAPs and NAVs**





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