Fee Structures for the AI Era: When Incentive Meet Intelligence

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Private equity is undergoing a structural shift. Once dominated by trac
closed-end partnerships built on the familiar "2 and 20" model, the inc
now experimenting with new vehicles, new economics, and new gover
arrangements. Continuation funds have gone from fringe instruments
mainstream liquidity tools. Evergreen structures promise permanent c
without the friction of capital calls. And now, AI systems are beginning
shape not just how portfolios are managed, but also how fees might be
justified and distributed.

The stakes are high. LPs are demanding lower costs and better alignm
while GPs seek ways to sustain performance fees in a market of slower
and greater scrutiny. At the same time, AI introduces both opportuniti
efficiency and new conflicts of interest, particularly when its recommendations diverge from GP liquidity incentives.

This article examines the emerging contours of fee structures in the A
the rise of continuation vehicles, the economics of evergreen funds, th
growing problem of GP wealth concentration, and the nascent idea of
linked carry. It concludes with a practical governance toolkit for board

LPACs tasked with ensuring fiduciary alignment.

The Scale of Change: Continuation Vehicles on the

A decade ago, continuation funds were niche solutions for secondary r
Today, they represent **$75 billion in 2024 deal flow**, with a pipeline sur
$150 billion. Their appeal is straightforward: they allow GPs to hold on
prized assets while offering LPs a choice between cashing out or rollin
forward. In theory, everyone wins—GPs retain exposure, selling LPs ge
liquidity, and rolling LPs can benefit from further value creation.

Fee Dynamics

The economics of continuation vehicles differ significantly from tradit
blind-pool funds. Management fees average **1% on invested capital**, ra
than 2% on commitments. Carry is increasingly structured in tiers, wit
different rates applying at different performance thresholds. This align
compensation with incremental value creation from seasoned assets ra
than broad portfolio growth.

Governance Risks

While the fee headline suggests cost efficiency, hidden risks abound. R
half of continuation deals in 2023 included **deferred payment mechani
earn-outs**, often designed to reconcile valuation disagreements betwe
buyers and sellers. These mechanisms may smooth negotiations but re
heavily on opaque assumptions about asset performance. Boards must
carefully scrutinize how such terms are modelled, who controls the in
and whether the disclosure to LPs is adequate.

Empirical Case Example

In one anonymized 2024 transaction, AI hold models recommended de
exit by two years to capture additional value. The GP overrode the
recommendation, opting for a sale that crystallized carry immediately.
exit analysis suggested LPs lost ~75 basis points compared to the AI-op
scenario. This case highlights the core governance dilemma: AI may pr
LP outcomes, but GPs—whose personal liquidity is at stake—may choo
differently.

Fee Drag Comparison Across Fund Structures – shows how traditional 2/ funds impose significantly higher annual fee drag compared to continua vehicles and best-in-class evergreen funds. ***Source:*** *Market practice ben from Jefferies (2024), Cliffwater (2024), and pension fund disclosures (Ca CPPIB, WSIB, 2023).* ***Methodology:*** *Estimated annualized fee drag (bps) o fund lifecycles: ~3.5% for traditional closed-end 2/20 funds, ~1.75% for continuation vehicles, and <1% for best-in-class evergreen funds. Values median ranges adjusted for expense layering.* ***As-of Date:*** *2023–2024 da*

Evergreen Funds: The Price of Perpetuity

Evergreen funds offer investors a new value proposition: no capital cal continuous deployment, tax simplicity, and lower minimum commitme They appeal to investors seeking stability and retail access, while offer managers a permanent capital base less exposed to fundraising cycles. 2023, more than **$35 billion** flowed into such structures.

The Fee Spread

Evergreen funds conceal a wide spectrum of costs. SEC filings show to expenses ranging from **0.96% to 5.49%**—a stunning 471% spread. Cruc larger fund size did not equate to lower costs; the dispersion reflected structural choices. Some managers charged fees on gross assets, inclu leveraged amounts, inflating fee income. Others layered acquired fund and expenses (AFFE) on top of base fees, while some passed through le related costs to LPs.

Incentive Challenges

This structure creates fundamental misalignments. Charging fees on g assets incentivizes leverage irrespective of outcomes. Paying carry bas NAV valuations rather than realized distributions risks rewarding mana for paper gains. The result is a set of incentives that can distort behavi with managers effectively rewarded for expanding balance sheets rath compounding long-term value.

Case Insight

Cliffwater's review of 19 evergreen funds found near-identical strategi producing vastly different net returns—diverging by over 300 basis po annually—purely due to fee layering. In one case, administrative and compliance expenses were more than double the peer median, with no observable benefit. This illustrates the difference between fee transpa and fee obfuscation. Boards must benchmark not just performance bu structural efficiency.

*Conflict Map: Distribution Timing Preferences – illustrates how GP liqu interests, AI optimization models, and LP preferences often diverge wher deciding whether to exit earlier, on time, or delay for value maximization.**Source:** Synthesized from empirical case examples (Europ LPAC disclosure, 2023) and governance commentary from Skadden (202 ILPA guidance (2023).**Methodology:** Normalized preference strength (0–1 representing relative incentives: GPs favour earlier exits (liquidity), AI sy favour delayed exits (optimization), LPs balance between tax efficiency a returns. Values are illustrative, based on observed market behaviours.* **As** ***Date:*** *Case and commentary data 2023–2024.*

GP Personal Wealth and the New Structural Conflic

The traditional alignment argument has long been that GPs commit th capital alongside LPs. But the scale of GP wealth concentration has gro dramatically. Between rolled carry, co-investments, and mandatory commitments, many GPs now hold a substantial portion of their net w within their funds.

Liquidity vs. AI Recommendations

This concentration creates new tensions in the AI era. AI models may recommend extended holding periods to maximize value, optimize tax outcomes, or align exits with market cycles. Yet GPs facing liquidity ne personal tax obligations, estate planning, or lifestyle costs—may prefer accelerated distributions. This creates a **structural misalignment**: AI maximizes collective LP benefit, while GPs face private liquidity pressu

Empirical Conflict Example

A European LPAC disclosed that one GP advanced a sale against AI-bas recommendations to meet personal tax deadlines. LPs lost ~100 bps in tax value relative to the modelled alternative. No override disclosure mechanism was in place, leaving LPs unaware until after the fact. This underscores the need for explicit governance around AI overrides—wi personal conflicts can erode trust and value.

Evergreen fund expenses range from 0.96% to 5.49%. Similar strategies deliver net return differentials of 300+ bps annually purely due to fee la **Source:** *Cliffwater Research, The Price of Perpetuity (August 2024), base* SEC Form ADV *filings of 19 evergreen funds.* **Methodology:** *Range of tota expense ratios identified across funds: lowest (0.96%), median (~2.5%), h (5.49%). The chart visualizes dispersion to highlight transparency and fe obfuscation risk.* **As of Date:** SEC *filings as of Q4 2023, Cliffwater analys published in 2024.*

AI-Linked Fee Innovation: Toward Transparent Attribution

Some investors and managers are experimenting with fees that explici
to AI attribution. The idea:

- **Base Carry** compensates for returns tied to market beta.
- **Enhanced Carry** rewards demonstrable AI-driven alpha.
- **Maximum Carry** applies to sustained outperformance validated ov

Auditability and Standards

Such structures cannot succeed without a credible audit. Attribution c
must be independently validated. Boards should require **annual AI attr
audit reports**, analogous to financial audits, conducted by third-party
Techniques include Shapley value decomposition to quantify AI contril
scenario testing to validate robustness, and interpretability framework
explain outputs. Regulators are also moving: the EU AI Act introduces
transparency requirements for high-risk financial systems, while IOSC
OECD have published principles on AI governance. Boards should trea
attribution audits as non-negotiable—if AI is used to justify premium f
value creation must be transparent, explainable, and auditable.

Negotiation Outcomes: The Tiered LP System

Market practice data reveals a stark asymmetry. Public funds such as C
WSIB, and CPPIB disclose continuation vehicles averaging 1–1.5% fees,
carry, and expense caps of $500K–$2M. Yet averages conceal who capt
concessions.

Power Asymmetry

Large LPs routinely negotiate **side letters** that exempt them from fees co-investment rights, and even provide veto powers over continuatior vehicles. Increasingly, they also negotiate attribution transparency, rec disclosure of AI methodologies. Smaller LPs rarely secure these terms. result is a **two-tier market**: mega-LPs gain visibility and control, while investors remain in the dark.

In the AI era, this imbalance will widen. Attribution audits and explaina reports may be offered as premium services to large LPs, while smaller continue to pay for opacity. This creates not only economic disparity b reputational risk for boards, who must justify why some investors bene from transparency while others bear the costs of obscurity.

Data Gaps and the Call for Empirical Rigour

Despite progress in transparency, three gaps persist:

1. **GP Wealth Concentration**: No reliable database exists to quantify (worth exposure to their funds or their correlation with distributio timing.
2. **AI Attribution**: There is no industry-standard framework for meas AI-driven alpha versus traditional skill.
3. **Override Frequency**: No reporting tracks when GPs override AI recommendations or the financial impact of such decisions.

Boards cannot remain passive. They should commission independent s pool anonymized LP data, and push ILPA to establish disclosure standa

Without systematic data, governance risks remain anecdotal, undermi fiduciary oversight.

From Principles to Practice: Detailed Board Recommendations

Establish Override Authority Frameworks

Boards must formalize the conditions under which GPs can override A recommendations. Without guardrails, overrides risk serving GP liquic LP value. A robust protocol should require written justification, manda independent review above materiality thresholds (e.g., >50 bps impact) log overrides quarterly for LPAC review. Override authority should be transparent, not discretionary.

Demand Attribution Audit Reports

If AI-driven alpha is to justify enhanced carry, boards must require independent audits of attribution claims. These should validate metho assess robustness, and ensure transparency. Audit results should be in in LP reporting, not relegated to appendices. The standard should be s no audit, no AI-linked fee.

Benchmark Fees Rigorously

Boards should benchmark fees against Preqin, Cliffwater, and public p disclosures. Management fees, carry tiers, expense caps, and AFFE mu compared across peers. Any deviation beyond 25% of medians should justification and disclosure. Benchmarking must also measure **fee drag returns** over the fund lifecycle, comparing continuation vehicles, ever funds, and traditional structures.

Monitor GP Wealth Concentration as Fiduciary Risk

GP alignment is healthy, but overconcentration creates fragility. Board should require annual confidential reporting of GP commitments, rolle and co-investments relative to personal net worth. Independent direc LPACs should review this data to assess whether liquidity pressures cc distort distribution decisions. Excessive concentration should trigger additional oversight of exits and distributions.

Push for ILPA and Regulatory Standardization

Fragmented practices across continuation vehicles, evergreen funds, a linked fees leave LPs vulnerable. Boards should advocate through ILPA standardized disclosure templates covering AI attribution, GP overrid reporting, and fee transparency. Regulators such as the SEC and ESM be engaged to integrate AI governance into Form ADV and adviser disc Standardization would level the playing field, reducing reliance on sid and reinforcing fiduciary duties industry-wide.

The Broader Implication: Fees as Governance, Not J Economics

The evidence is clear: fee structures are no longer just economic term are governance instruments.

- **Innovation outpaces oversight**: Continuation and evergreen vehic evolve faster than governance frameworks.
- **Conflicts intensify**: GP wealth concentration clashes with AI-drive

outcomes.

- **Transparency becomes stratified**: Larger LPs secure attribution ri smaller LPs pay for opacity.

The central boardroom question is no longer "what are we paying?" bu **controls the decision—the GP, the AI, or the governance framework?'**

Conclusion: A Governance Inflection Point

The private equity fee model is in flux. Continuation vehicles and everg funds promise efficiency but create new governance complexities. GP concentration embeds structural conflicts. AI attribution offers opport for transparency but also risks becoming a black box.

Boards face a choice: treat fees as narrow economic negotiations, or recognize them as the frontline of fiduciary governance in the AI era. T protect LPs, sustain trust, and harness the benefits of technology, boa must evolve their oversight—establishing override protocols, demandi attribution audits, benchmarking rigorously, monitoring GP wealth, an advocating for standardization.

The future of fees is not just about cost. It is about control, accountabi trust in a world where human judgment and artificial intelligence incre share the stage.

The insights from the Operational Risk Audit article resonate directly w governance frameworks I explore in *Shaping the Next Decade.* Both arg

boards and committees must move beyond pedigree and static benchm
learning to underwrite conviction edges while managing new risks intr
by AI, regulation, and systemic concentration. What begins as a framew
today's investment committees—scoring conviction and networks—bec
tomorrow's blueprint for fiduciary governance in an era where human
algorithmic judgment, and long-horizon policy priorities intersect. Ava
for purchase here.

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