FAQs On Demand

What does 2 & 20 mean when it comes to fees charged by investment funds?

The term "2 and 20" in private equity refers to the fee structure commonly used by private equity funds. Let's break down the components:

The "2": Management Fee

The "2" in "2 and 20" represents the management fee. This is a percentage of the total assets under management (AUM) that the private equity fund charges its investors annually for the management and operational expenses. It is typically 2% of the committed capital.

For example, if an investor commits $10 million to a private equity fund with a 2% management fee, the annual management fee would be $200,000 (2% of $10 million).

The "20": Carried Interest (Carry)

The "20" in "2 and 20" represents the carried interest, often referred to simply as "carry." Carry is a performance fee that private equity fund managers earn when they generate profits on investments. It is usually calculated as a percentage of the fund's profits.

Example Scenario:

Let's assume a fund has a 20% carried interest (20% carry).

The fund generates a total profit of $50 million from its investments.

Calculation of Carry:

Carried Interest = 20% of $50 million

Carried Interest = $10 million

In this example, the fund managers would receive $10 million as carried interest, and the remaining $40 million would be distributed to the limited partners (investors) in proportion to their capital contributions.

It's important to note that the "2 and 20" fee structure is a common industry standard, but variations exist, and funds may negotiate different fee structures based on factors such as fund size, strategy, and the track record of the fund managers. The carried interest aligns the interests of fund managers with those of the investors, as it rewards managers for achieving profitable returns on investments.