The Alignment Gap: Rethinking Costs in Private Equity Fund Formation

ILPA recommends the following practical solutions to restore fairness and efficiency in the private equity industry's fund creation process: ***(i) cap organizational expenses at the lower of 5 bps or $10 million, (ii) if this cap is exceeded, implement a 50-50 cost sharing framework for total amount over the cap, and (iii) increase legal fee transparency and legal budget discipline***.

I. Introduction: Misaligned Incentives and Rising Costs

The volume of capital flowing into private equity (PE) has increased dramatically over the last 25 years, growing more than 18-fold from total assets managed of less than $550 billion in 2000[1] to around $10 trillion in 2025,[2] evolving from a niche investment strategy to the global economy's largest alternative asset class and a material contributor to global economic growth. This has resulted in productive long-term partnerships between capital allocators (Limited Partners, LPs) and asset managers (General Partners, GPs). However, the rapid growth and maturation of the PE space have also created inherent structural challenges in the form of spiraling organizational expenses—the legal, administrative, and compliance costs incurred during the formation of a new investment fund—costs that have historically been borne by LPs alone.

What once made economic sense—requiring LPs to cover organizational expenses when the industry was nascent and GPs lacked sufficient capital—has become an outdated practice that now enables systematic cost-shifting by highly profitable asset managers to their investor clients.

The fundamental inequity is clear: LPs bear these expenses, yet GPs control the key decisions that drive these costs that continue to increase significantly, while fund sizes continue to grow exponentially. GPs select outside counsel to the fund, which is also typically outside counsel to the GP itself. GPs both mandate the anticipated organizational expense budget and direct fund counsel in fund negotiations with potential LPs. LPs typically have no visibility into how or why a certain law firm was chosen as fund counsel and typically do not have access to fund counsel billing rates, specific legal budgets, or overall organizational expense budget data. Absent any transparency, LPs cannot be certain—and indeed operate under the assumption based on negotiations with fund counsel—that GPs typically face no financial consequences in the event that budgets are breached or fund counsel exceeds its remit in drafting and negotiating fund terms.

[1] Carlyle, *What the Evolution of Private Equity Means for Investors*, May 30, 2025.
[2] Pitchbook, *2030 Private Market Horizons*, May 1, 2026.

Organizational Expenses are Exploding

This misalignment of interests is exacerbated by recent market trends reflecting troubling cost spirals. Albourne Partners analyzed approximately 1,942 private funds and found an upward trend in median organizational expense caps growing from roughly 20 basis points in 2019-2021 to approximately 25 basis points by 2024-2025.[3]

Legal service providers, which operate on a billable-hours model, have inevitably capitalized on the misalignment. Recent market data[4] reflects law firm billing rates climbing to thousands of dollars per hour, fueling significant profit growth for the global law firms representing GPs and their funds. A recent example illustrates this dynamic: a law firm widely recognized for its strong global fund formation practice made history in 2025 as the first global law firm to reach $10 billion in annual revenue—representing 20% year-over-year growth—and reported average partner profits of $11 million, reflecting an 80% increase in per-partner profits since 2020.[5] This example is not an exception; competitor firms routinely charge similarly high hourly rates.

This environment has materially altered LP cost structures, leading to more complex evaluations of PE allocations and greater scrutiny for some institutional investors when compared with lower-cost alternative asset classes.

II. A Practical Framework for Realignment

Because PE is rooted in long-term partnerships between LPs and GPs, any reasonable solution to the misalignment requires practical mechanisms that preserve flexibility and build trust while introducing greater accountability, transparency, and fairness between fund partners.

In circumstances where well-established global PE firms raise multi-billion dollar pooled vehicles funded by long-term LPs who have entrusted their own constituents' capital over multiple fund strategies, the most equitable solution in today's market would be to assign the cost burden to the party controlling all cost drivers – the GP.

Doing so would obviate the inherent inequity in the information asymmetry regarding the choice of counsel, the ability to set budgets, and to control costs. Interests would be entirely aligned, as any inefficiencies in the fund formation process would result in higher costs not only for the LPs (who already must cover their own cost of counsel) but also for the GP (who would cover fund counsel costs). The reality of private markets in 2026 is that many, if not all, GPs raising large private funds simply do not face the same financial obstacles that existed when the market was new and growing. The industry's own success has resulted in the resolution of the financial barriers that once hindered these now well-established managers from entering the market without LP capital to fund new pools of capital decades ago.

While an entirely GP-borne cost model may result in more equitable outcomes in the case of well-established managers and funds, smaller GPs or emerging/first-time managers still face material barriers to entry without LP capital to at least offset the significant cost of raising a PE fund today.

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[3] Albourne, *Examining the Alignment of Interest in 2025*, ILPA Legal Conference, September 25, 2025.
[4] Wall Street Journal, *Law-Firm Billing Rates Climb Sharply*, December 30, 2025.
[5] LawFuel.com, *The $11 Million Club – BigLaw's Partner Profit Machine Just Broke Another Record – And The 2026 Rankings Haven't Even Dropped Yet*, March 25, 2026.

These new entrants often offer attractive options to LPs seeking to diversify investment strategies or private market portfolios, and the unintended consequence of hindering new managers' entry into private markets may be avoided by offering an alternative solution.

Based on discussions among market participants and recent industry data, a three-part framework can meaningfully improve alignment, reduce inefficiencies in fund formation, and revitalize the partnerships upon which the industry has been built.

1 – Cap Organizational Expenses at the Lower of 5 Basis Points of Target AUM or $10 Million

As a baseline best practice, costs related to the formation of the fund should be reasonable and capped at an amount appropriate to the fund's size. Increases in organizational cost caps for successor funds should not necessarily be linear with growth in fund sizes but rather clearly aligned with specific cost factors not otherwise rationally covered under the management fee.[6]

To meaningfully constrain cost overruns, **organizational expenses to be borne solely by LPs should be capped at the lower of 5 basis points of a fund's target assets under management (AUM) or $10 million in total**. To the extent formation costs may nonetheless exceed this cap, additional steps to realign incentives should be taken to allow adequate flexibility for complex fund structures under a more equitable cost allocation, as described below through a cost-sharing model.

As part of putting a cap on the organizational expenses, it is important to highlight key expenses that should be captured within this cap. Namely, there have been recent trends to carve out side letter negotiations and the Most Favored Nation (MFN) process from the organizational expenses and instead treat these expenses as partnership expenses, which are not capped. The organizational expenses cap is designed so that these costs are explicitly treated as legal costs covered under organizational expenses. Ongoing transparency is important to ensure these costs—and other expenses that should be treated as organizational expenses—are fully and accurately accounted for.[7]

Large Funds

A $10 million cap would represent 5 basis points on a $20 billion fund. Funds of this size are typically managed by large, well-established GPs pursuing established investment strategies, often successor vintages to existing funds already generating meaningful management fees, which should benefit from standardized documentation and repeat investor relationships. Absent regulatory changes, the need for extensive negotiation should be limited. To the extent that either the GP or outside counsel may seek to materially revise agreements governing a flagship fund strategy that has been successfully executed under prior legacy funds, maintaining a lower of 5 bps or $10 million cap would strongly incentivize all parties to rigorously ensure that new flagship funds do not result in a significant uptick in formation costs. Otherwise, organizational expenses are universally expected to continue to trend upwards across the industry.

Small Funds

At the other end of the market, private funds with anticipated total assets much lower than $20 billion may typically generate organizational expenses totaling much *less than* 5 basis points (and well under

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[6] Organizational costs that are specific to an alternative vehicle, parallel vehicle, co-invest vehicle, etc., should be borne solely by that vehicle. This includes organizational expenses of the GP specific to the GP's commitment to the fund. Please see the ILPA Principles 3.0 for additional detail around industry best practices relating to organization expense allocation and equitable approaches to ensure strong alignment between managers and investors.

[7] *Ibid*.

$10 million), in which case the cap should not adversely impact either GPs or LPs because expenses would in all likelihood remain within the cap.

2 – If Total Expenses Exceed the Cap, Adopt a 50-50 Cost Sharing Framework

To further align incentives, where fund formation costs—as intentionally, conservatively, and pro-actively managed—exceed the lower of 5 basis points on the fund's targeted AUM or $10 million, GPs should bear 50% of total overage organizational expenses, with LPs bearing the remaining half.

This cost-sharing approach reflects a more equitable and fundamentally fair participation structure in PE funds and would ensure that the party controlling key cost drivers shares meaningfully in the economic consequences of inefficiency.

In practice, applying this proposed best practice would result in more equitable cost allocation, which is most acute as funds grow larger and are therefore more likely to be managed by established GPs, as reflected in **Table 1** below.

Table 1: ***Proposed Organizational Expense Cap / Cost Sharing Framework***

Total Capital Committed	ILPA Proposed Cap (lower of 5 bps or $10m)	Example Actual Org Expenses[8]	Total Cost to LP[9]	Total Cost to GP[10]
$ 250,000,000	$ 125,000	$ 125,000	$ 125,000	$ 0
$ 500,000,000	$ 250,000	$ 250,000	$ 250,000	$ 0
$ 1,000,000,000	$ 500,000	**$ 550,000**	**$ 525,000**	**$ 25,000**
$ 5,000,000,000	$ 2,500,000	**$ 3,000,000**	**$ 2,750,000**	**$ 250,000**
$10,000,000,000	$ 5,000,000	**$ 6,500,000**	**$ 5,750,000**	**$ 750,000**
$15,000,000,000	$ 7,500,000	**$ 7,600,000**	**$ 7,550,000**	**$ 50,000**
$20,000,000,000	$ 10,000,000	$ 10,000,000	$ 10,000,000	$ 0
$25,000,000,000	$ 10,000,000	**$ 12,000,000**	**$ 11,000,000**	**$ 1,000,000**

A capped-and-shared-cost model therefore creates incentives for both sides to avoid unnecessary complexity, control legal spend, and streamline negotiations. It also reduces the risk of prolonged negotiations driven primarily by billable-hour incentives.

3 – Enhance Legal Fee Transparency and Budget Discipline

Another recurring source of friction in the fund formation process is the lack of transparency surrounding legal billing. In most fundraising processes, LPs receive no visibility into the billing rates or expected budgets of fund counsel, despite ultimately bearing the majority of those costs.

[8] Bold font indicates examples where actual costs exceed the proposed cap.
[9] Total cost to LPs would equal the proposed cap amount *plus* 50% of total amount exceeding the proposed cap.
[10] Total cost to GP would equal 50% of the total amount exceeding the proposed cap.

To restore clarity and rebuild trust among private fund partners, reasonable best practices to address this imbalance should be pro-actively adopted by GPs.

Legal Rate Schedules and Budgets Should Be Provided to Those Who Pay Legal Costs

Fund counsel should provide a rate schedule and draft budget for all formation-related services to the partners of the fund. While such information may represent nonpublic information for law firms, the closed universe of parties receiving such information would be comprised of LPs who are already bound by confidentiality agreements, which expressly cover information provided by GP counsel and are entered into prior to receiving any information about the prospective fund. There is no analogous example in which a party obligated to pay for legal services is denied knowledge of billing rates and the anticipated budget or is not provided with full information supporting the actual costs incurred.

Legal Budgets Should Be Realistic, Calibrated to Organizational Expense Caps, and Monitored on an Ongoing Basis

Legal budgets should be set realistically at the outset of a fundraise, aligned with organizational expense caps, and grounded in clear expectations that fund counsel will prioritize efficiency and execution toward closing. GPs should transparently communicate anticipated cost limits and work collaboratively with counsel to implement practical efficiencies as the process evolves. Ongoing, proactive monitoring of legal spend is essential to ensure budget discipline is maintained and that agreed caps are not exceeded.

Counsel to Large Funds Should be Subject to Competition

For funds targeting more than $1 billion in AUM, GPs should be encouraged to conduct competitive bidding processes when selecting fund counsel. Given that partner billing rates among large law firms now routinely exceed $1,500 per hour, introducing competitive discipline into counsel selection can exert meaningful downward pressure on formation costs. It would incentivize firms that represented prior vintage funds to achieve meaningful efficiencies, including avoiding significant revisions to agreements governing a legacy strategy, with long-term partners seeking to continue an investment partnership.

This would particularly benefit the LPs, even where GPs ultimately decide to stay with one law firm through multiple legacy funds. In theory, competitive RFPs should foster (1) consistent documentation requiring little revision through a single investment strategy with largely long-term partners who sign up to next generation funds and (2) deeper institutional knowledge allowing long-term counsel to require less time to provide fund-specific advice than newly engaged counsel may need.

However – and critically – outside counsel's incentives continue to be driven by the reality of today's global legal market, which does not align at all with fund partner priorities. Too often, a sixth, seventh, or eighth generation private fund using the same investment strategy, with many of the same long-term LPs, nevertheless tallies organizational expenses totaling multiples of its first or second generation. This result does not align well with GPs incentivized to find greater efficiency and cost controls. The practice of raising a large fund today using the GP's long-term outside counsel as fund counsel should therefore be intentionally re-examined under the lens of how other fund partners may be adversely impacted by such a decision.

III. Conclusion: Solving What Appears Intractable

The problem of excessive or poorly aligned fund formation costs has long been treated as an unavoidable friction in PE. In reality, it is neither inevitable nor intractable. Industry data clearly shows

that organizational expense caps have steadily increased over the past decade, even as documentation has become more standardized and investment strategies have become well-established.

At the same time, rising legal billing rates—combined with limited transparency and misaligned economic incentives—have generated upward pressure on costs, which have to date been borne by LPs in a fund. Without structural changes, these dynamics are likely to persist, making decisions about whether to allocate constituents' capital to PE funds more complicated and difficult for investors.

A structured and principled approach to cost sharing, transparency, and budgeting can deliver meaningful improvements without sacrificing flexibility. Modest reforms such as reasonable expense caps, shared cost responsibility between GPs and LPs, and greater transparency around legal budgets can significantly improve the efficiency of the fund formation process.

The guidance described herein reflects input from both LP and GP market participants. Additional ideas raised during industry discussions include greater standardization of limited partnership agreement provisions, broader adoption of common side letter language, and incentives for more efficient negotiation processes.

Because the private markets ecosystem includes a diverse range of investors, strategies, and fund structures, no single framework will solve every challenge. Nevertheless, by committing to greater transparency and cost discipline, GPs can signal credibility and alignment, while LPs can participate in a more collaborative and efficient formation process. Ultimately, improving how organizational expenses are managed will not only benefit individual funds—it will strengthen trust and partnership across the PE ecosystem.