

# The Many Problems of Incentive Fees in Semiliquid Funds

## Incentive fees are irregularly disclosed but regularly collected.

### Morningstar

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### Key Takeaways

- ▶ Incentive fee structures in semiliquid funds rarely reward investment skill and often simply incentivize risk-taking.
- ▶ Incentive fees impose material costs on investors, often in similar magnitudes to management fees.
- ▶ Yet, incentive fees are often excluded from prospectus fee tables because asset managers claim they cannot predict whether the fees will be earned or not.
- ▶ In fact, incentive fees are not hard to predict, particularly in private credit, where the structures practically only need base interest rates to be nonzero for the manager to collect its full fee.
- ▶ Private equity semiliquid funds typically charge incentive fees on unrealized gains, an investor-unfriendly practice given the lack of reliable and timely valuations in private markets.
- ▶ Acquired fund fees and expenses also have incentive fee issues, as the underlying funds' incentive fees are sometimes included in the AFFEs, but sometimes not, depending on whether the underlying funds are public or private.
- ▶ All-in cost comparisons are difficult, if not impossible, for the everyday investor, given the different disclosure practices and fee structures.
- ▶ To help make better comparisons, Morningstar is developing a methodology for normalizing fees based on fee structures and gross return assumptions.

### Introduction

Semiliquid funds often materially understate their already-high fees in their prospectuses. Asset managers play coy about incentive fees, obfuscating acquired fund fees (or the fees charged by underlying funds held in a portfolio) as well. Regulatory gray areas allow asset managers to be as candid or as evasive as they wish when disclosing certain fees, creating inconsistencies that make it hard for investors to make true apples-to-apples fee comparisons.

With fund fees, first impressions are everything. Years of fund flow data show that when investors know what they are paying—no matter the vehicle—they tend to migrate to the lower-cost options. Semiliquid fund managers understand that having a lower headline expense ratio in their prospectuses is a key to attracting assets.

Incentive fee structures themselves could use work, beyond just improving disclosure. These fees (also referred to as performance fees) are, in spirit at least, fees that go to a manager for a job well done. They are a percentage of profits above a certain minimum return threshold (the "hurdle rate" or "preferred return"). The concept carries some logic for equity-centric portfolios, but it is much less defensible when it comes to income-driven strategies. Meanwhile, semiliquid fund hurdle rates often aren't that hard to clear, making incentive fee collection a near certainty and begging the question: What is actually being incentivized? The answer, when it comes to income-driven portfolios, is risk.

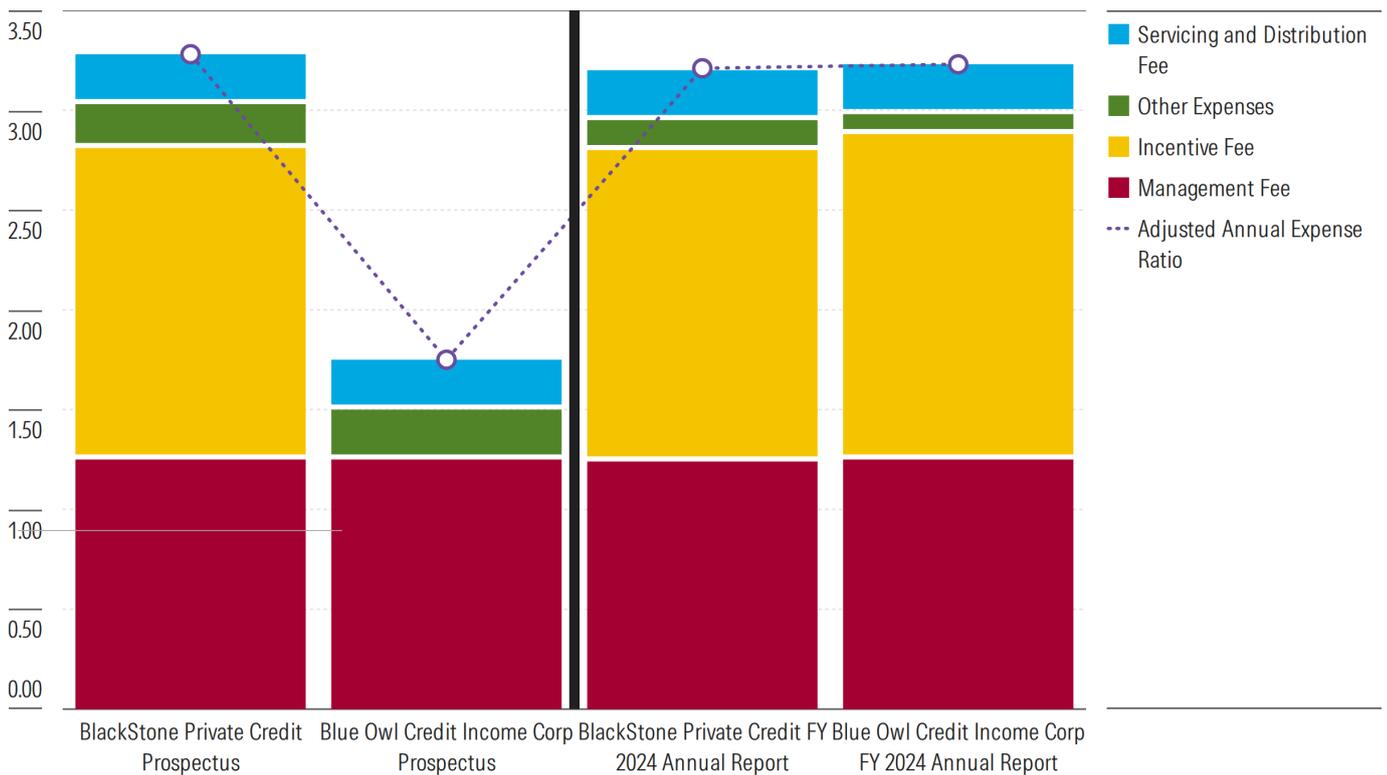
**Problem 1: Nonuniform Disclosure**

Inconsistent disclosure practices are the first problem with incentive fees. Incomprehensibly, many semiliquid funds, particularly unlisted business-development companies, do not include incentive fees in their prospectuses. Why? Almost all of them include boilerplate language that says, “As we cannot predict whether we will meet the necessary performance targets, we have assumed no incentive fee for this chart.”

Yet, plenty of private credit funds do include at least something about incentive fees in their prospectuses. Some offer an estimate based on assumed returns, while others use prior years’ realized results.

Let’s look at two real-world examples: **Blue Owl Credit Income** and **Blackstone Private Credit**. These two unlisted BDCs have the same fee structure. They charge a 1.25% management fee and a 12.5% income-based incentive fee (subject to a full catch-up; see further explanation here) above a 5% hurdle rate.

**Exhibit 1** Identical Fee Structures but Nonidentical Fee Tables



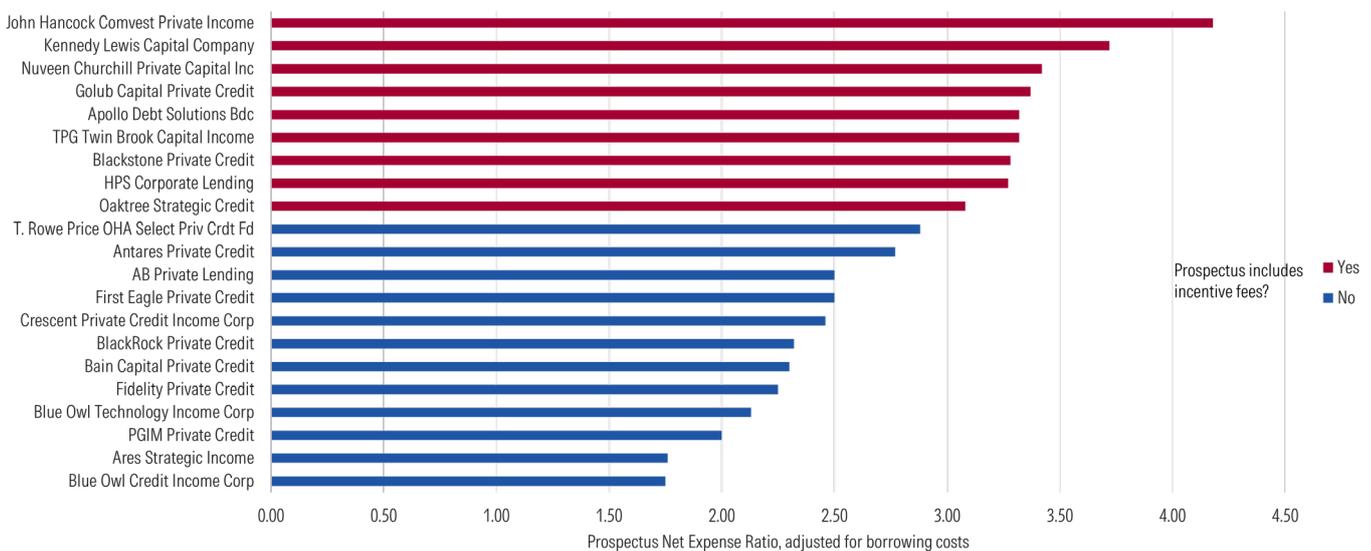
Source: Morningstar Direct, SEC Filings. The adjusted net expense ratio excludes borrowing costs. Annual report fees are based on implied average daily assets in 10-K filings and are subject to small rounding errors.

The above chart shows the adjusted net expense ratios from their latest prospectuses (left) and annual reports (right). If an investor were just to look at the two prospectuses’ fee tables, they could conclude that Blue Owl’s annual expense ratio is a lot lower after backing out borrowing costs (which Morningstar does when adjusting expense ratios). But it only appears that way because Blue Owl pleads ignorance on its ability to predict incentive fees and thus leaves them out, while Blackstone does not (it cites the prior year’s realized number).

What were the actual fees incurred by both strategies in 2024? They were nearly identical on a borrowing-cost-adjusted basis, as should be expected from two funds with identical fee structures that both easily cleared their 5% hurdle rate. The lesson is simple: Looking at prospectus fee ratios alone can lead investors astray.

Blue Owl is not a singular example. Two-thirds of the two dozen or so unlisted BDC managers do not include incentive fees in their prospectuses, even though nearly all of them have identical fee structures.

**Exhibit 2** Despite Highly Similar Fee Structures, Unlisted BDC Prospectus Fees Vary Significantly



Source: Morningstar Direct, SEC Filings. Expenses are based on D share classes.

**Problem 2: What Is the Incentive?**

Do the nondisclosers have an argument on incentive fee unpredictability? In equity, perhaps. But in credit—where the bulk of semiliquid fund flows are going—not at all.

For funds that regularly collect their incentive fees to suggest those fees are either zero or unpredictable doesn't even pass the sniff test. This is especially true when it comes to retail semiliquid credit funds' incentive fees on income, which are typically the bulk of the total incentive fee.

Most semiliquid private credit assets are in funds that use 5% return hurdles. There is nothing special about 5%; it became the convention in a period of low interest rates, and most firms simply copied the fee structures of existing funds when launching new semiliquid strategies.

Private credit funds, though, typically lend money at 5% or more above a base interest rate, such as the Secured Overnight Financing Rate. On top of that, they use significant leverage, which boosts their income yield even higher. So, for managers to suggest they don't know if they'll clear the hurdle is tacitly admitting they lack confidence in their underwriting abilities.

The table below shows the percentage of the possible incentive fees collected under different base interest rate and leverage scenarios. It assumes the typical unlisted BDC fee structure and that the fund holds loans with a weighted average spread above base interest rates of 5.5% and borrows at a 2.0% spread. At 40% leverage (meaning 40% of the fund's total investable capital is borrowed by the fund), the fund doesn't need base interest rates to be above zero to earn full incentive fees. That is not asking much, as the typical unlisted BDC operates at 45% leverage, and very few are under 40%. Interval funds cannot exceed 33.3% by law (though they can increase effective leverage by buying leveraged underlying funds like BDCs), but at maximum leverage, even interval funds are close to maxing out their incentive fees, even with zero interest rates. When base interest rates are 2% or higher, clearing the hurdle is a virtual guarantee, no matter the leverage amount.

**Exhibit 3** Percentage of Maximum Possible Incentive Fees Earned Under Different Interest Rate and Leverage Assumptions

|       | Leverage |         | Interval Fund Limit |         |         |         |         |         |         | BDC Average |         |         |         | BDC Limit |         |
|-------|----------|---------|---------------------|---------|---------|---------|---------|---------|---------|-------------|---------|---------|---------|-----------|---------|
|       | 0.00%    | 5.00%   | 10.00%              | 15.00%  | 20.00%  | 25.00%  | 30.00%  | 33.33%  | 35.00%  | 40.00%      | 45.00%  | 50.00%  | 55.00%  | 60.00%    | 66.67%  |
| 0.00% | 0.00%    | 0.00%   | 0.00%               | 0.00%   | 0.00%   | 0.00%   | 0.00%   | 23.30%  | 59.26%  | 77.28%      | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 0.25% | 0.00%    | 0.00%   | 0.00%               | 0.00%   | 0.00%   | 10.53%  | 59.26%  | 92.04%  | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 0.50% | 0.00%    | 0.00%   | 0.00%               | 0.00%   | 3.98%   | 47.65%  | 92.04%  | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 0.75% | 0.00%    | 0.00%   | 0.00%               | 2.81%   | 41.71%  | 81.44%  | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 1.00% | 0.00%    | 0.00%   | 6.17%               | 40.65%  | 76.02%  | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 1.25% | 0.00%    | 13.25%  | 43.70%              | 75.05%  | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 1.50% | 23.30%   | 50.12%  | 77.83%              | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 1.75% | 59.26%   | 83.69%  | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 2.00% | 92.04%   | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 2.25% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 2.50% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 2.75% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 3.00% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 3.25% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 3.50% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 3.75% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 4.00% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 4.25% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 4.50% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 4.75% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 5.00% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 5.25% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 5.50% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 5.75% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 6.00% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 6.25% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |
| 6.50% | 100.00%  | 100.00% | 100.00%             | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00% | 100.00%     | 100.00% | 100.00% | 100.00% | 100.00%   | 100.00% |

Source: Author's calculations. Assumes the typical BDC fee structure (1.25% management fee, 12.5% incentive fee with full catch-up over 5% hurdle) and that funds lend at a 5.5% spread and borrow at a 2.0% spread.

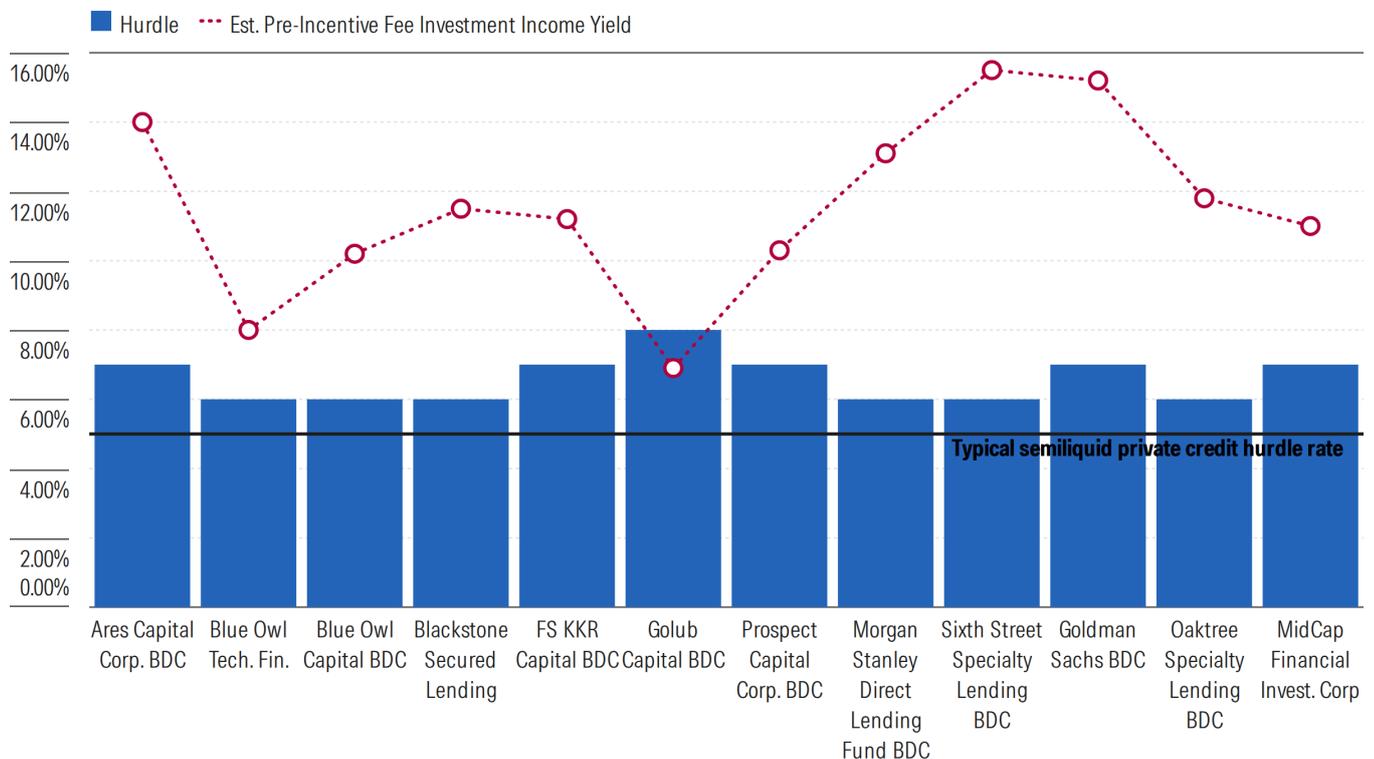
What, then, could prevent a fund from collecting its full incentive fees? Near-zero rates combined with low leverage could do it, or more likely, lower income that is due to credit issues in the portfolio without a concurrent net asset value write-down. Most of these funds market themselves on their high yields, which leverage makes possible, so low leverage is rarely the culprit when a fund misses its hurdle. So, that leaves interest rates and credit as the practical constraints.

What is the "incentive" here? The manager doesn't control base interest rates, so charging investors more or less based on an uncontrollable variable does not reward manager skill. On the underwriting side, with average leverage and nonzero rates, simply not being bad at one's job doesn't seem like that high a standard to earn a bonus.

Below are real-world examples of listed (or publicly traded) BDCs' net investment income yields and hurdle rates in 2021, a year of historically low interest rates. Most semiliquid private credit funds didn't exist in 2021, so the listed BDCs are a good comparison point as they often hold many of the same loans as semiliquid private credit funds.

Almost all these funds easily cleared their hurdles thanks to leverage and would have found the task even easier if they only had to beat the typical 5% hurdle of their younger and aggressively marketed semiliquid cousins. In fact, half of the BDCs in the chart below earned more incentive fees than management fees in 2021. Clearly, even historically low interest rates were hardly a threat to incentive fee collection.

**Exhibit 4** Despite Historically Low Interest Rates in 2021, Listed BDCs Still Easily Cleared Return Hurdles



Source: Author's calculations. Assumes the typical BDC fee structure (1.25% management fee, 12.5% incentive fee with full catch-up over 5% hurdle) and that funds lend at 5.5% spread and borrow at 2.0% spreads.

**Problem 3: Earning Cash Bonuses on Noncash Gains**

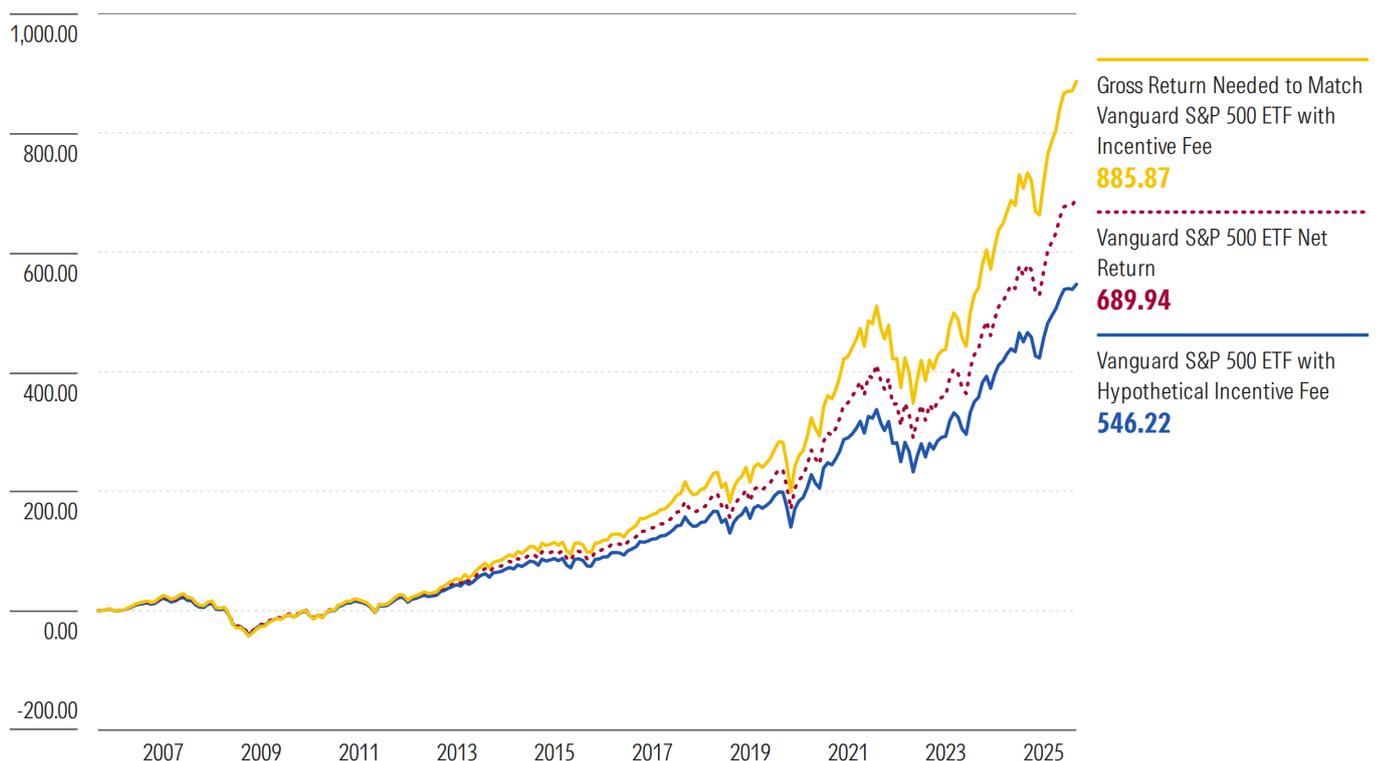
While most of the above is directed at private credit managers, semiliquid private equity funds have their own incentive fee warts. The biggest? Charging incentive fees on unrealized gains.

While not all semiliquid private equity funds charge incentive fees at the fund level, the ones that do generally collect a percentage of the fund's net profit each quarter, often with no hurdle rate and regardless of whether the gains are realized (that is, actual cash was generated on a sale) or unrealized (simple valuation markups). These incentive fee structures are especially unfriendly to investors in secondary-focused funds, which take advantage of an accounting quirk to book one-day gains without any actual cash generation.

The primary problem with charging fees on unrealized gains is that the gains may turn into realized losses in the future. Collecting fees on potentially inflated valuations, especially since private market valuations are known to lag public ones, and then selling the asset for a loss is obviously a poor outcome for investors. Investors cannot recoup prior fees following a future loss. There are some investor protections in place, though. The incentive fees are typically subject to high-water marks, meaning the fund must surpass its previous highs before collecting new incentive fees.

Still, these fees can be meaningful. Below shows **Vanguard S&P 500 ETF's** trailing 20-year returns and what it would have returned if it collected 10% of profits each quarter, subject to a high-water mark. The incentive fee would have resulted in a nearly 20% reduction in ending wealth for the investor, as the actual exchange-traded fund gained 10.89% annualized, which would have been pared to 9.78% if it charged the incentive fee. For context, that is the difference between landing in the top 15th percentile of all surviving large-blend Morningstar Category share classes and the bottom half of the category. To match the S&P 500 ETF's net-of-incentive fees, a fund would have needed to generate a 12.12% annualized gross return, or 1.2% of excess return in addition to its management fees and other fees.

**Exhibit 5** Equity Incentive Fees on Unrealized Gains Can Eat Into Performance Significantly



Source: Morningstar Direct, author's calculations. The incentive fee is 10% of quarterly profits in excess of a loss recovery account, which represents to-date cumulative net losses, if any.

This phenomenon of collecting cash fees on yet-to-be-cash gains can occur in private credit, too. Sometimes, private credit funds will collect their interest payments "in-kind," meaning the borrower doesn't pay interest, and the interest instead gets tacked on to the loan's principal. Funds still count that as income, and thus can collect incentive fees on it, despite the fund not actually earning any cash.

No matter the asset class, collecting incentive fees on yet-to-be-realized gains is a poor, investor-unfriendly practice.

**Problem 4: Incentive Fees Distort AFFEs**

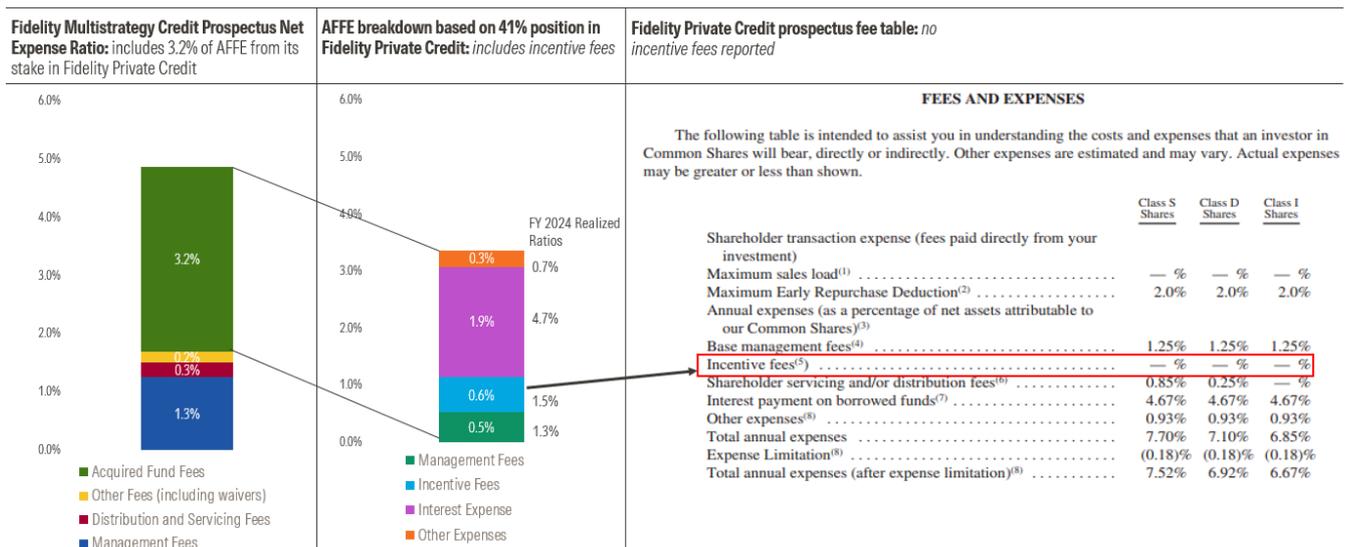
Acquired fund fees and expenses also have an incentive fee problem. When funds own other funds, as many traditional target-date and asset-allocation mutual funds do, investors pay the cost of the parent and underlying funds, and the former has to account for those operating costs.

In practice, though, what counts as a fund’s “operating” expenses is malleable. For registered funds, it includes almost all their costs, such as incentive fees and borrowing costs. Morningstar and others remove borrowing costs at the parent-fund level, but they still appear in AFFE. That’s why some ETFs, like **VanEck BDC Income**, show net expense ratios above 12.8%—only 0.40% reflects management fees, while 12.44% comes from AFFE and 0.02% from other fees. Most of the fund’s AFFE stems from borrowing costs, though a fair percentage still comes from other operating expenses.

To confound matters more, a fund that owns a BDC must report the BDC’s incentive fees in its AFFE, yet the BDC itself can opt not to disclose those same incentive fees in its own prospectus if it considers them too unpredictable to estimate.

For example, **Fidelity Multi-Strategy Credit**, an interval fund, held about 40% of its portfolio in **Fidelity Private Credit**, an unlisted BDC and its only fund position, as of its most recent annual report. That large allocation gives the multistrategy fund a 3.19% AFFE in its prospectus, calculated by multiplying its roughly 41% position by the BDC’s operating-cost ratio, which includes incentive fees. In effect, about 60 basis points of Fidelity Multi-Strategy Credit’s expense ratio comes from Fidelity Private Credit’s incentive fees. Yet, as shown below, Fidelity Private Credit does not include those same incentive fees in its own prospectus.

**Exhibit 6** Registered Funds’ Incentive Fees Can Appear in Another Fund’s AFFE, Yet Vanish in Their Own Prospectus



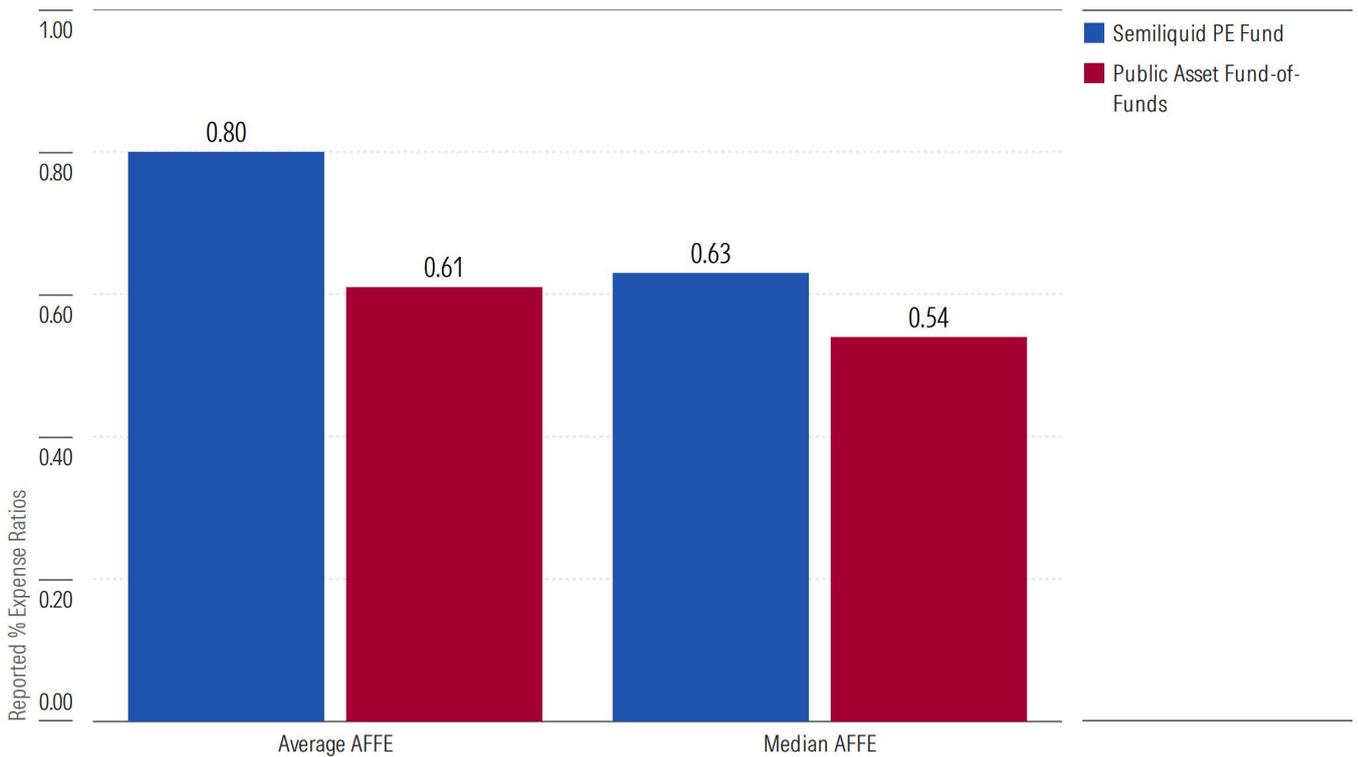
Source: Morningstar Direct, SEC Filings. Data is an approximation that assumes the ETF is fully invested in BDCs.

**Problem 5: Public vs. Private Funds in AFFE**

Private funds introduce yet another wrinkle to AFFE. While incentive fees get lumped into AFFE when the underlying funds are registered vehicles like BDCs, funds that own nonregistered, private funds (such as a traditional private equity drawdown fund) can exclude those underlying private fund incentive fees from their operating costs (and thus AFFE) because of their alleged unpredictability.

If you're confused right now, that is kind of the point. This lack of consistent incentive fee treatment in AFFE produces some head-scratching results. For instance, private equity-focused semiliquid funds, which are almost all funds of private funds, somehow show comparable AFFEs to those of public market funds of funds, such as target-date funds, that invest in cheap share classes of actively managed public mutual funds. Are private equity funds' AFFE really similar, or in some cases cheaper, than public market funds of funds? Of course not, but the ability to exclude incentive fees makes these funds seem cheaper than they are at first glance.

**Exhibit 7** Is It Believable That Private Equity Funds Are of Comparable Cost to Active Public Funds?



Source: Morningstar Direct, SEC Filings. Public asset cohort includes funds with 75% or more of assets in actively managed underlying strategies. Funds with 0.1% AFFE or lower are excluded from each group to account for potentially low fund ownership on the PE side and to account for public funds of funds that own zero-cost share classes to charge fees at the fund level.

Of course, there are nuances. Some semiliquid funds access private equity via co-investments, which sometimes charge fees and sometimes do not. Funds generally do not disclose what proportion of their co-investments comes free of fees, though if it's a material amount, that could justifiably keep AFFE on the lower side.

## How Morningstar Would Improve Incentive Fees

### Create Better Alignment

In a perfectly investor-friendly world, incentive fees should probably be scrapped altogether, or at least a new name should be considered to reflect that these are rarely bonuses for a job well done. It would be more honest to charge a higher management fee than to disguise a separate ongoing fee as an "incentive."

Alas, if incentive fees must exist, the structures could become more shareholder-friendly. On the credit side, wouldn't it make more sense for a floating-rate manager to have a floating hurdle rate? That seems like an obviously better setup for investors, as it would reward better risk-adjusted underwriting. In credit, there is limited upside, so if there is any reward to be had, it should be for protecting capital better than peers. Floating hurdle rates would ensure that capital preservation is rewarded rather than uncontrollable base interest rates.

On the equity side, collecting incentive fees only on realized gains would be a better structure, along with adding some form of a hurdle rate to truly make it an incentive fee. In fact, traditional private equity drawdown funds almost always have those features. Given the lack of clear, reliable valuations in private markets, we do not think collecting incentive fees on unrealized gains is appropriate.

### Improve AFFEs, Don't Hide Them

A proposal moving through Congress would exempt BDCs from AFFE reporting. Excluding BDCs—but not other closed-end funds—is a form of regulatory capture with no economic justification. In truth, neither should be exempt. Private credit interval and tender-offer funds, which lend to many of the same mostly private-equity-owned businesses, would not receive the same relief, even though the reform is framed as support for "small businesses." As asset managers continue launching income-focused funds of funds, this change would likely push them toward BDCs over interval funds simply because of the AFFE advantage. Yet BDCs generally have costlier fee structures, as incentive fees are far more common there than in interval funds.

Borrowing costs, often a material portion of the AFFE, can inflate AFFE, particularly for funds that own leveraged credit funds. Adjusting AFFE by excluding borrowing costs would, in our opinion, help clarify true costs for investors. Debt costs still matter, as a fund that can borrow cheaper than peers has an advantage, but ultimately, as long as a fund can earn a return on assets above its cost of debt, excluding borrowing costs makes sense. However, the other components in AFFE need to be accounted for, and that includes incentive fees.

### How to Make Fee Comparisons Given These Issues

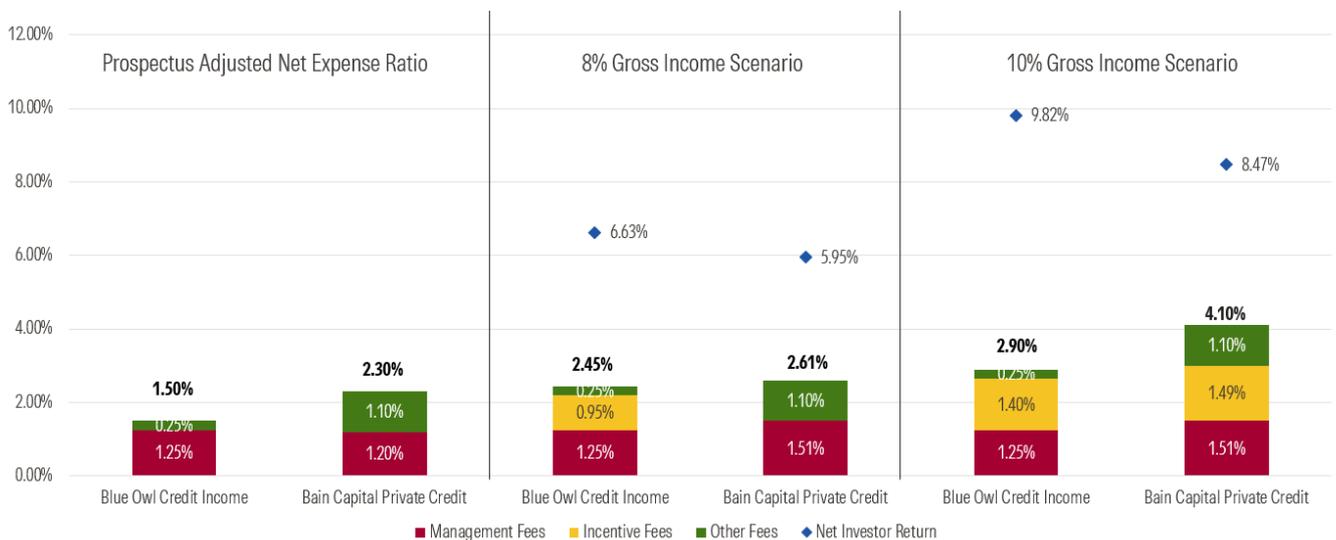
There is a better way to evaluate semiliquid fund fees. Rather than compare their prospectus or annual report expense ratios, one could apply the same assumed gross return to each fund's fee model. Requiring asset managers to do this in their disclosures would give investors a clearer picture of what net returns and total costs would look like across funds and a better idea of what they are paying.

Fund prospectuses are supposed to make fees comparable, but the current framework falls short. Each prospectus includes a table showing hypothetical dollar costs, yet it assumes a 5% return—a level below most funds' hurdle rates—so incentive fees often don't appear in the totals. In the absence of

consistent fee reporting, Morningstar is designing a fee methodology to normalize fees across structures based on common gross return assumptions.

The example below applies the method to Blue Owl Credit Income and **Bain Capital Private Credit**. Blue Owl employs a typical BDC fee structure, while Bain charges a 0.75% management fee on gross assets and a 15% incentive fee over a 7% hurdle. This example shows the fees and net returns under two scenarios: 8% and 10% gross income returns with no capital gains. Whereas there is an 80-basis-point gap in the two funds' prospectus expense ratios, that gap closes to 16 basis points in an 8% gross income scenario but widens to 120 basis points in a 10% gross income scenario. Bain Capital Private Credit's fee structure, in other words, gives it an incentive to take more risk.

**Exhibit 8** Morningstar Fee Normalization: Blue Owl Credit Income vs. Bain Capital Private Credit



Source: Morningstar Direct, SEC Filings. Example uses the D share class for each. Leverage and borrowing rates are based on the latest 10-K filings. Other fees are assumed to be the same as disclosed in the latest prospectus.

**Fees Always Matter**

The price you pay is critical to an investment. Morningstar research has shown time and again that higher-cost products rarely deliver compensatory returns to their investors. Private asset managers will argue that private markets offer an “illiquidity premium,” meaning investors demand (and, in theory, receive) higher returns in exchange for either lower liquidity, lower transparency (and thus, more burdensome due diligence), or some combination of both. These premiums justify the higher fees, so the story goes.

With true expense ratios regularly north of 3.00% annualized, these managers will need to harvest a sizable illiquidity premium to overcome their fee hurdles. How big is that hurdle? Look at public equity funds. Just three out of the nearly 300 surviving large-blend Morningstar Category funds outperformed the S&P 500 by 3% or more on a gross basis over the trailing 10 years through January 2026. An illiquidity premium may exist, but to suggest, as the fees do, that a top 1% public-market performance is simply a structural feature of private markets seems a bit unrealistic. ○

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