CARRIED INTEREST AND CO-INVESTMENT PLANS: A PRIMER FOR ASIA-BASED PRIVATE FUND MANAGERS

Date: 27 January 2025

By: Jason R. Nelms, Edward M. Bennett, Scott D. Peterman, Roberta Chang, Charmaine Mok, Yuki Sako

This publication is issued by K&L Gates in conjunction with K&L Gates Straits Law LLC, a Singapore law firm with full Singapore law and representation capacity, and to whom any Singapore law queries should be addressed. K&L Gates Straits Law is the Singapore office of K&L Gates, a fully integrated global law firm with lawyers located on five continents.

Management team participation in the performance of the funds they manage—through carried interest and co-investment plans—has long been a regular feature for private equity, real estate, venture capital, and other private funds in the US funds industry. Increasingly in recent years, many Asia-based private fund managers have implemented similar programs.

Fund manager carried interest and co-investment plans offer several advantages, including (a) attracting and retaining top talent, (b) providing “skin in the game” to align participant interests with the interests of the manager and external investors, (c) maximizing upside potential for participants while reducing the out-of-pocket costs and downside risk of higher fixed compensation, (d) fostering a long-term commitment by participants to the manager, and (e) potential tax efficiencies, as further discussed herein.

This article summarizes the key characteristics of fund manager carried interest and co-investment plans from the perspective of an Asia-based manager, including structuring alternatives, key terms and market practice, and tax and regulatory considerations.

COMPARISON OF CARRIED INTEREST AND CO-INVESTMENT PLAN COMPONENTS

Under a “carried interest plan,” each participant shares in the carried interest (i.e., profit distributions) distributed by one or more of the manager's funds without necessarily needing to make a passive investment. On the other hand, under a “co-investment plan,” the fund manager typically requires each participant to make a passive investment in one or more of the funds managed by the manager, thereby entitling participants to a return of capital and any profits from such investment(s).

Many managers combine the elements of a “co-investment plan” and a “carried interest plan” into a single plan, so that participants would both (a) make a passive investment in one or more of the manager's funds, thereby benefiting from the investment returns; and (b) hold a right to receive a portion of the carried interest distributed in respect of such fund(s).

Participant Co-Investment Plans vs Limited Partner Co-Investment Rights

©2005-2026 K&L Gates LLP. All Rights Reserved.

The term “co-invest” often has a different meaning in the context of a participant plan as compared to a third-party limited partner (LP)'s co-investment right in a fund. A third-party LP's “co-investment right” in a fund typically confers on the LP, which will separately hold exposure to a fund's portfolio investments through its capital commitment to the fund, the option to invest additional capital into specific portfolio investments of the fund. This allows the LP to increase its exposure to certain investments of choice.

In contrast, the term “co-investment” in the context of a participant plan (and as used generally in this article) often refers to a participant's passive investment in a fund (i.e., its capital commitment), which typically exposes the participant to the performance of all of the fund's portfolio investments. Similarly, many managers use the term “GP co-invest” to describe the capital commitment (i.e., the “sponsor commitment”) of a general partner (GP) or its affiliates to a fund. Market practice varies on this point, as further discussed in “Fund-Wide vs Deal-by-Deal Participation” below.

STRUCTURING ALTERNATIVES

A carried interest and co-investment plan could be structured as either (a) an equity arrangement, where participants hold equity in the vehicle that receives carried interest (the Carry Vehicle); or (b) a contractual arrangement, under which participants are contractually entitled to receive payments of cash based on a fund's performance.

In an equity arrangement, a participant would subscribe for an interest in a designated Carry Vehicle, which could be either the GP of the relevant fund or another entity established for the specific purpose of receiving the fund's carried interest and making the team's investment to the fund. Any such specially formed entity typically would invest into the fund as an LP and would be known as a special limited partner (SLP). A participant's co-investment pursuant to an equity arrangement typically would also form a part of the GP's required “sponsor commitment” to the fund.

It can be simpler and less costly to run a carried interest and co-investment plan through the GP entity itself, rather than through an SLP. That being said, using an SLP is more common for established managers because (a) a fund's GP has unlimited liability for the fund's obligations, while an SLP (as an LP of the fund) does not; (b) admitting plan participants into an SLP (rather than the GP) allows the manager to keep the economics of the plan separate from the “control”decision-making rights and function of the GP; (c) a manager may wish to structure the SLP differently (e.g., in a different jurisdiction) from the fund and the GP for administrative or other reasons; and (d) while a new GP should be established for each successive fund, some managers will continue to use the same SLP for multiple funds.

Alternatively, a manager could structure the plan as a contractual arrangement (rather than an equity arrangement) between the manager and each participant, whereby each participant holds a contractual right to receive an amount of cash as determined by reference to the timing and amounts of carried interest or other amounts distributed by the fund. A contractual approach is generally lower cost and administratively more convenient, as a participant's contractual rights could be memorialized in the participant's standard employment or consulting agreement, or a simple letter agreement, rather than requiring full-form documentation for an equity interest in a vehicle. However, in certain jurisdictions (including Hong Kong and Singapore), a contractual approach would likely be less tax efficient, as further discussed in “Tax Considerations” below.

©2005-2026 K&L Gates LLP. All Rights Reserved.

KEY TERMS AND MARKET PRACTICE

A manager should consider the following key terms when structuring a carried interest and co-investment plan:

Source of Funding for Co-Investment

A key aspect of a co-investment plan is the source of funding for each participant's co-investment, typically among the following options:

The "Standard" Cash Approach

Each participant funds the co-investment out of pocket in the form of capital contributions over time, in the same manner as other investors in the relevant fund(s). This is the simplest approach, but it also could be burdensome for participants and the manager. For example, for a participant with a modest commitment, it may be inconvenient to fund many small capital calls. With this in mind, a common variation would be for each participant to make periodic cash contributions (e.g., quarterly or annually) independent of the fund's normal capital call schedule.

The "Deemed Loan" Approach

The manager extends a loan to the participant representing all or a portion of the participant's investment amount. Under this approach, the loan is typically repaid to the manager out of future distributions in priority over payments to the participant until the loan is fully repaid. It is also possible for the loan to be "nonrecourse," such that the loan is subject to repayment only out of distributions, and the participant would not be required to pay in any capital, even if distributions are insufficient to pay out the loan. Of course, this nonrecourse approach would add more downside risk to the manager.

The "Free Share" Approach

The manager would fund a participant's co-investment amount on the investor's behalf, potentially representing a key component of the participant's compensation package. This approach could align incentives between a manager and a participant by more efficiently tying compensation to fund performance than cash compensation. In addition, vesting conditions could further incentivize the participant to remain with the firm. However, in addition to manager-funded contributions being taxable to the co-investor, this approach also could reduce the likelihood of favorable tax treatment on the participant's carried interest. See "Tax Considerations" below.

In any case, participants in a co-investment plan will typically be entitled to receive a share of the fund distributions equal to their pro rata interest in the relevant fund(s) in the same manner as other investors, either directly from such fund(s) or indirectly through the Carry Vehicle.

Fund-Wide vs Deal-by-Deal Participation

As noted above, participation in a co-investment plan would typically provide for exposure to the entire portfolio of each relevant fund (i.e., fund-wide exposure) in the same manner as any other passive investor in the fund. However, some co-investment plans—particularly for larger managers—provide participants the option to increase their exposure to specific portfolio investments (i.e., deal-by-deal exposure).

External investors typically would prefer that any participant's co-investments be fund-wide (and not deal by deal) to reduce conflicts of interest and the perception that a participant could "cherry-pick" exposure only to the best

©2005-2026 K&L Gates LLP. All Rights Reserved.

investments. LPs are particularly concerned because the participants typically include the deal team members with the greatest access to information on each investment.

A manager should separately consider whether participation in carried interest would be on a “fund-wide” or “deal-by-deal” basis, though a “fund-wide” approach is much more common for most types of managers. In the case of a fund-wide participation, a participant's share of the carried interest would be based on the aggregate carried interest of the fund, regardless of which investments such participant has been involved with. In the case of a deal-by-deal participation, a participant would share in carried interest that is allocable to specific investments.

Key factors driving this decision include (a) the size of the firm and the depth of its infrastructure, (b) the number of participants in the program, and (c) whether or not participants are responsible for only specific deals or a fund's entire portfolio.

A fund-wide program can better incentivize each participant's efforts toward the performance of the entire fund, whereas deal-by-deal exposure can allow a manager to incentivize each deal team more efficiently. A fund-wide program is easier to manage administratively than a deal-by-deal program, which requires allocating carried interest (calculated with reference to the entire portfolio across deals) across investments and tracking each participant's exposure separately. Further, actual carried interest distributions are typically backloaded due to a fund's standard “distribution waterfall,” which can make it prohibitively difficult to determine how much carried interest to allocate to early dispositions until later in the fund's life. Some managers will offer a hybrid program whereby participants have exposure to all investments and, in some cases, may have additional exposure to specific investments.

Carry Points

A participant's right to share in carried interest of a fund is typically quantified in terms of “points,” which correspond to a specified percentage of the overall carried interest distributions with respect to the applicable fund(s) or the specific investments in such fund(s).

Market practice varies widely on the portion of the overall carried interest share to be allocated to the pool of participants, on the one hand, and the founder or institutional manager, on the other hand. Key factors typically include the size and type of a firm, the region or country it is based in, and the firm's organizational structure and culture. For example, state-owned firms or larger firms would often adopt a more conservative approach to profit sharing, resulting in a lesser carry share allocated to participants. In many cases, firms that offer lower fixed compensation (e.g., new managers that may not yet generate significant management fees) often would look to carried interest allocation as a significant element of the participant's overall compensation arrangement.

In addition to the founders, carry participants typically include senior officers and investment professionals. Some carried interest plans include a broader range of personnel, such as consultants (e.g., venture partners), junior investment professionals, and potentially even administrative and clerical staff. By carefully considering all available factors, managers can allocate carry points in a manner that incentives peak performance while maintaining a collaborative team environment.

Dilution of Carry Points

Participants in a carried interest plan may be subject to dilution in respect of their share of the carried interest, often subject to limits. Some carried interest plans permit a manager to issue additional points in the future

©2005-2026 K&L Gates LLP. All Rights Reserved.

without limitation (i.e., an unlimited pool), which would allow for limitless dilution. However, it is also common for a carried interest plan to establish a fixed number of carry points, such that (a) a portion would be issued to initial participants, and (b) a "reserve pool" (i.e., a portion of the initial fixed number of carry points) would remain available for the manager to issue to existing or new participants.

Any carried interest distributions attributable to carry points in the reserve pool that have not been allocated to participants would typically be for the benefit of the principal(s). In addition, any carry points that are forfeited (due to failure to vest or other reasons, as described in "Vesting of Carry Points" below) would be added back to the reserve pool.

Some carried interest plans provide for two classes of interests: one for founders and other senior executives, and another for rank-and-file team members. In such cases, carry points that are attributable to rank-and-file team members often would not be subject to dilution.

Key interests to balance when considering dilution are (a) the manager's need for flexibility to scale and bring on new talent, and (b) the participants' desire for certainty as to their percentage interest in the fund's carried interest. As carry points are typically allocated fund by fund, a manager with multiple funds or frequent successor funds may have more flexibility to manage this issue over time.

Vesting of Carry Points

Carry points are often subject to "vesting," permitting participants to retain their points and receive the corresponding carried interest distributions only if they remain involved with the manager or the fund over a particular span of years (i.e., vesting period). Accordingly, vesting arrangements are designed to align participants with the long-term performance of the fund(s) that they manage. While vesting terms (or similar provisions) are standard for carried interest plans, co-investments would not be subject to vesting unless funded by the manager (such that the participant has not put capital at risk).

Vesting provisions are typically structured as follows:

For-Cause Departure

If a participant is required to depart involuntarily and for cause, the participant will typically forfeit all vested and unvested carry points.

Voluntary Departure or Involuntary Departure Without Cause

If a participant departs voluntarily or involuntarily without cause, the participant typically would be entitled to retain any vested carry points but would forfeit any unvested carry points.

Death or Permanent Disability

In the unfortunate event of a participant's death or permanent disability, the participant (or his or her estate) would typically retain all vested carry points, and all or a portion of any unvested carry points might be deemed vested and retained.

The duration and schedule of vesting periods vary significantly across funds. Conceptually, the vesting period should correlate with the time during which a participant contributes meaningfully to the establishment and ongoing operations of the fund and its investments. Arguably, this period often spans from the start of the fund's

©2005-2026 K&L Gates LLP. All Rights Reserved.

marketing activities to its liquidation date. However, many carried interest plans provide for a vesting period commencing at a fund's initial closing and ending around the end of the fund's investment period.

While some vesting schedules provide for “straight line” vesting, whereby entitlements vest in equal instalments over time, other arrangements (e.g., cliff vesting) are also common. For example, some funds would provide for 15% vesting over the first four years (i.e., 60% total), followed by 20% vesting over each of years five and six (i.e., the remaining 40%).

In lieu of a vesting arrangement, some carried interest plans provide for a buy-back mechanism, giving the manager an option to repurchase a participant's carry points (and, potentially, co-investment) based on a preagreed formulation upon certain triggering events (e.g., the participant ceases to be involved in the management of the relevant portfolio investments).

Restrictive Covenants

Participants in carried interest and co-investment plans are often subject to restrictive covenants that are similar to those commonly included in employment or consulting agreements, typically including (a) noncompete and nonsolicitation provisions, often surviving for six to 12 months following termination of employment; (b) nondisparagement provisions, which prohibit participants from speaking negatively about the firm or its management; and (c) confidentiality obligations. Nondisparagement and confidentiality restrictions often remain in effect for years.

A breach of these restrictive covenants would typically be a “cause” event that, as discussed above, would trigger forfeiture of all vested and unvested carried interest, among other consequences. Even a former participant who had previously ceased to be involved with the manager and the fund on good terms could forfeit any retained carried interest upon subsequent violation of any such restrictive covenant. In addition, such a breach often triggers an option for the manager to repurchase any co-investment interest held by the participant.

Discounts on Management Fee and Carried Interest for Participant Co-Investments

Many managers reduce, or waive entirely, the amount of management fee and carried interest to be borne by the participants in respect of their co-investments, taking the view that it is beneficial for the fund and the manager to have greater team participation. Some larger managers will follow a hybrid approach, offering reduced/waived fees and carried interest for participants for only the funds they are involved in, or only up to a certain investment size.

Compliance With Fund Documents and LP Side Letters

Fund investors will often expect to see provisions in a fund's governing agreement (e.g., a limited partnership agreement (LPA)) or may proactively request side letter provisions, which restrict or otherwise influence certain dynamics of a carried interest and co-investment plan, as follows:

Minimum Sponsor Commitment

A fund's LPA typically will require that the manager and its related persons make capital commitments to the fund of at least a specified percentage of the fund's aggregate commitments. The minimum is often in the range of 1%–5% but could be higher depending on the type of fund and the extent to which the manager is also viewed as

©2005-2026 K&L Gates LLP. All Rights Reserved.

a capital partner. A key benefit of a carried interest and co-investment plan is that participant co-investments typically would count toward this minimum sponsor commitment amount.

Clawback Guarantees

A fund's LPA typically will provide that if the fund receives more carried interest than it should have, measured over the fund's lifespan, the carried interest recipient(s) must return any excess (net of taxes) for distribution to the fund's LPs. Often, the LPA will also require that the fund's GP require each indirect recipient of carried interest to guarantee such recipient's portion of this obligation. Accordingly, many carried interest plans will require each participant to agree to a “back-to-back” guarantee with respect to such participant's share of the carried interest.

Change-of-Control Provisions

Some investors in the market will ask the fund's GP to agree that one or more named persons—or categories of related persons—continue to hold the right to receive a minimum (e.g., 50% or 75%) of the carried interest, in addition to maintaining decision-making control over the GP itself. Such provisions, including whether specific carried interest plan participants would be considered part of this permitted control group, need to be accounted for when budgeting for the future allocation (or transfers) of carried interest rights under the plan.

Anchor Investor Rights

Some investors in the market, in consideration of making a large investment in the fund (e.g., 20% or more of the manager's first fund), will request to share in a portion of the carried interest borne by all of the fund's other investors. Similar to the change-of-control provisions described above, a manager will need to account for any such anchor investor allocation when budgeting for future allocation (or transfers) of carried interest rights under the plan.

TAX CONSIDERATIONS

In many jurisdictions, including Hong Kong and Singapore, the tax treatment of income derived by participants from carried interest and co-investment plans can vary based on the structure of such plans and the specific circumstances.

While income in consideration of services is taxable in Hong Kong and Singapore, capital gains are not taxable in Hong Kong or Singapore (unlike in the United States, where capital gains are taxed at a reduced rate).

Accordingly, returns derived from a Hong Kong or Singapore participant's passive investment (i.e., co-investments funded by the participant) generally should not be taxable in Hong Kong or Singapore (as applicable), though co-investments funded by the manager rather than by the participant (via a deemed loan or free share approach) could raise unique tax issues. Similarly, carried interest often takes the form of a return on investment, the income of which could potentially be treated as capital gains.

Under a contractual approach where a participant holds a contractual right to share in the carried interest, any such distributions would likely be deemed income constituting compensation for services—rather than as return on investment—which would be taxable in Hong Kong and Singapore. An exception for Hong Kong participants is that carry returns allocated to them may be exempt from salaries tax under Hong Kong's tax concession regime for carried interest, provided the relevant conditions are met. Singapore, however, does not have any similar tax concession regime.

©2005-2026 K&L Gates LLP. All Rights Reserved.

In addition, the timing of granting carried interest rights to a participant (e.g., before or after (a) the fund has made investments, (b) appreciation in value of investments, and (c) distributions) can affect the tax analysis. Managers and participants should also consider the relationship between any vesting provisions and the relevant tax treatment.

The considerations described above similarly impact how carried interest is taxed in Japan, although a manager should discuss any specific Japan tax issues with its Japan tax advisor.

In any case, it is important for both managers and participants to consult with their tax advisors to ensure compliance with local regulations while maximizing the tax efficiency of their carried interest and co-investment plans, taking into account the applicable jurisdiction(s) and the specific facts and circumstances.

REGULATORY CONSIDERATIONS

Depending on the structure of the carried interest and co-investment plan, regulations governing the licensing of fund managers and the offering of plan interests may apply in certain jurisdictions. For example, each of Hong Kong, Singapore, and Japan have licensing rules and investor suitability tests that can apply with respect to carried interest and co-investment plan participants depending on the specific circumstances. These rules would not necessarily limit a manager from inviting participants into a plan, but they should be considered on a case-by-case basis with advisors.

CONCLUSION

As the private funds sector in Asia continues to grow, understanding the nuances of structuring carried interest and co-investment plans is crucial for managers to implement effective team incentive programs. By navigating key terms and tax considerations effectively, managers can establish robust incentive structures to retain top talent, align participant interests with the manager's long-term goals, and drive growth in an increasingly competitive market.

©2005-2026 K&L Gates LLP. All Rights Reserved.

KEY CONTACTS



JASON R. NELMS
PARTNER AND DIRECTOR OF K&L GATES STRAITS LAW LLC
K&L GATES STRAITS LAW LLC
SINGAPORE
+65.6713.0299
JASON.NELMS@KLGATES.COM



SCOTT D. PETERMAN
PARTNER

HONG KONG
+852.2230.3598
SCOTT.PETERMAN@KLGATES.COM



JOEL D. ALMQUIST
PARTNER

BOSTON
+1.617.261.3104
JOEL.ALMQUIST@KLGATES.COM



ANSON CHAN
ASSOCIATE

HONG KONG
+852.2230.3554
ANSON.CHAN@KLGATES.COM



CHARMAINE MOK
ASSOCIATE

HONG KONG
+852.2230.3579
CHARMAINE.MOK@KLGATES.COM



EDWARD M. BENNETT
PARTNER AND DIRECTOR OF K&L GATES STRAITS LAW LLC
K&L GATES STRAITS LAW LLC
SINGAPORE
+65.6507.8109
EDWARD.BENNETT@KLGATES.COM



ROBERTA CHANG
PARTNER

SHANGHAI
+86.21.2211.2086
ROBERTA.CHANG@KLGATES.COM



SOOK YOUNG YEU
OF COUNSEL

HONG KONG
+852.2230.3591
SOOK.YEU@KLGATES.COM



ANU L. JOSE
SENIOR ASSOCIATE
K&L GATES STRAITS LAW LLC
SINGAPORE
+65.6713.0259
ANU.JOSE@KLGATES.COM



YUKI SAKO
OF COUNSEL

WASHINGTON, DC, TOKYO
+1.202.778.9061
YUKI.SAKO@KLGATES.COM

This publication/newsletter is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer. Any views expressed herein are those of the author(s) and not necessarily those of the law firm's clients.

©2005-2026 K&L Gates LLP. All Rights Reserved.