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Fund Administration

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Fund Administration

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The relentless growth of outsourcing

Insight

Key trends **LP pressure, new technology and labyrinthine regulation are reshaping the fund administration industry**

1 Fund admin 2.0

Private equity fund administration has been slow to embrace the deluge of new technology on offer compared with adjacent industries, ***writes Amy Carroll***. Until recently, it was not uncommon to find some relying on Excel spreadsheets and basic general ledger software packages.

But as pricing models shifted from billable hours to fixed transaction fees post-financial crisis, a need to maintain margins has led to a drive for efficiency and administrators are now embroiled in a technology arms race.

"If it takes twice as long to perform an action that means you are half as productive," says Neil MacDougall of Silverfleet Capital, former owner of Ipes. "That is why technology is becoming so important."

The approach to technology is twofold. Fund administrators are increasingly automating tasks such as cash movements and reconciliations to meet growing demands without costly team expansion. Second, in response to growing LP pressure, they are investing in data analytics.

2 LP pressure

Limited partners are becoming increasingly sophisticated – and demanding. They are no longer just interested in IRRs. They require a broader range of data points and greater level of detail, as well as the ability to manipulate data according to parameters such as vintage year, geography or sector.

"A significant change that we have seen over the past two years is administrators' willingness to build data feeds straight into our systems," says Michael Robertson of Aberdeen Standard Investments.

And while LP pressure has provoked fund administrators into belated action when it comes to harnessing data, it is also helping drive demand for third-party fund administration services in general.

LPs are placing a growing emphasis on operational due diligence. They are not only concerned with fund performance but with underlying governance and process and this extends to external providers. Indeed, there are increasingly instances of investors insisting that managers outsource fund administration as a condition of commitment.

"I can think of five occasions in the past year where firms have made the decision to outsource because an investor said they wouldn't come in unless they did so," says Melanie Cohen of Apex Fund Services.

3 Increased standardisation

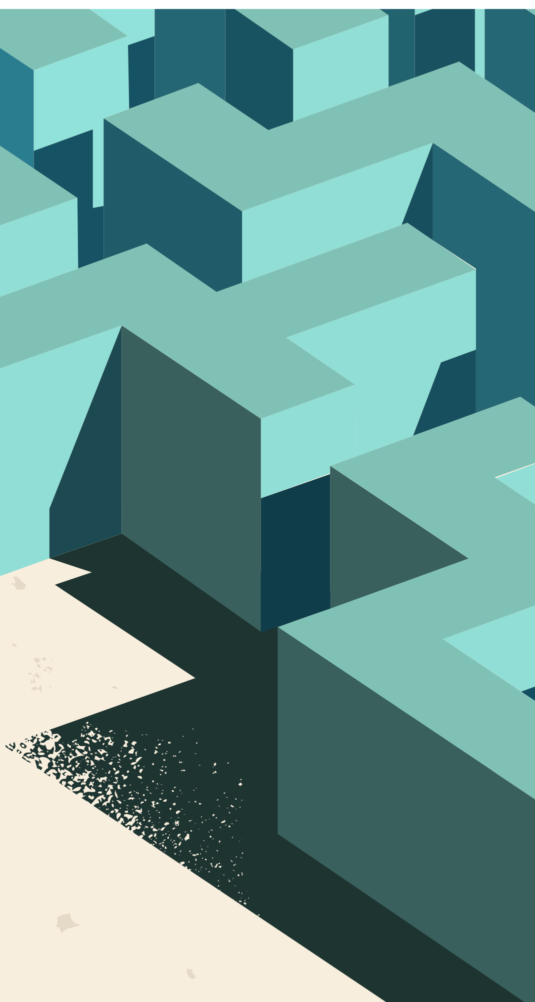
The private equity industry's ability to increase automation and deepen its data analytic capabilities has historically been thwarted by a lack of standardisation in the data available.

However, initiatives such as ILPA's guidelines and templates are beginning to formalise market best practice around managing non-homogenous data in a consistent manner, meaning the potential for further automation is now significant. Some administrators believe as much as 70 percent of labour involved in manual processes can be reduced.

4 The advent of AI

Despite some improvements in standardisation, the use of emerging technologies such as AI is still extremely nascent in the illiquid part of the fund admin industry. Blockchain is in a similar position. An independent record which can be seen by all authorised parties would make sense, but questions remain around who would store that record independently and securely.

However, according to Sam Metland of Citco Fund Services, there have been some strong use-cases of machine learning. "In the AML area, large administrators receive hundreds of scanned passports every day, for example," he says. "There is a tool being shown to the market that learns the standard features and layouts of the variety of passports around the world and then can alert humans to any that seem odd. It can also extract the required data from the scan more efficiently and accurately than humans."



5 Cybersecurity

With more and more data now available – and critically in the cloud rather than on-premises storage facilities – the onus is on fund administrators to ensure the highest standards of cybersecurity. Both managers and the investors that sit behind them are increasingly scrutinising the security credentials of service providers and having basic accreditation in place is the minimum standard expected.

A comprehensive audit trail around data management, password management, multifactor authentication and single sign-on solutions is critical. "We get asked about how data will be held in terms of hosted services, for example, as well as who has access to that data," says Iain Robertson of eFront. "Clients are doing much more stringent due diligence with a view to understanding the security models. Having ISO 27001 is an absolute prerequisite."

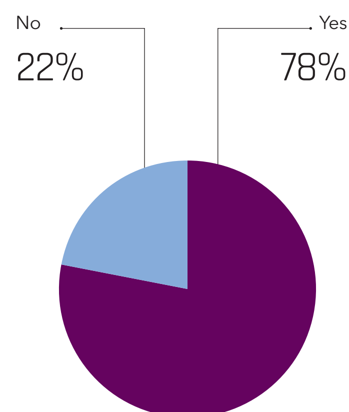
6 Fresh faces

The advent of new technology in the fund administration space has the potential to radically alter the proposition that administrators offer. With more of the mundane being automated, the industry must carve out a new value-added role for itself and this means that staffing requirements are changing.

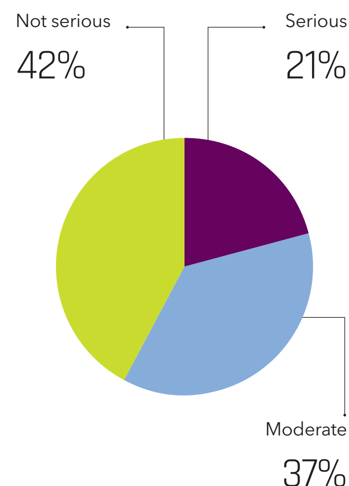
A matter of when, not if

A 2018 survey of private fund managers by EY revealed that more than one in five had been a victim of a cybersecurity breach

Has your firm recently experienced a cybersecurity breach?



If yes, how serious was the breach or incident?



Source: EY 2018 Global Private Equity Survey

Fund administrators are hiring fewer accountants and are, instead, recruiting risk and compliance experts, as well as data analysts. "In a nutshell, we are hiring more technologists," says Justin Partington of IQ-EQ.

Scott Kraemer at Vistra adds: "There has been a change in the types of people we are hiring. We are looking for broader skill sets. Being a great accountant is one thing, but it is just as important that you understand where the inputs are coming from and what the outputs are going to be used for. People have to be technology-focused, for sure."

In addition to the impact of new technology, a proliferation of complex regulation has also led to administrators staffing up their specialist teams in this area, as well as increasing investment in training to maintain accreditations.

7 M&A mayhem

High cash conversion, margins and growth rates have lured investors into the fund administration space for years. As some administrators, such as JTC, successfully make the leap on to public markets, the appeal is only growing. But acquisition activity amongst administrators themselves has really hotted up over the past 24 months.

Recent deals of note include Vistra's acquisition of Radius; IQ-EQ's acquisition of Augentius and Apex's acquisition of IPES.

In addition to jostling for jurisdictional access, fund administrators are chasing scale to facilitate technology investment; to lower overheads, while maintaining margins, and, in some cases, to attract buyers.

For managers and their underlying investors, mergers and integrations can sometimes mean disruption, with both LPs and GPs warning that administrators must work hard to maintain service levels during this period.

Consolidation has also resulted in a pronounced polarisation. "The biggest players are mopping up the market, while a handful of boutiques remain," says Simon Gordon at JTC. "The danger is that the industry giants focus their attentions on mega-cap managers, while the smaller players only have the resources to service the smallest funds. Mid-market firms could find themselves under-served."

8 Regulation, regulation, regulation

Staying one step ahead of the latest regulatory changes is, of course, paramount and the industry is certainly being kept on its toes. The tangled web of single jurisdiction, regional and global regulation is becoming increasingly hard to navigate and this is whipping up demand for fund admin outsourcing.

The base erosion and profit shifting initiative; Common Reporting Standards; rising anti-money laundering standards; GDPR; FATCA; AIFMD II and any number of other ominous anacronyms are all driving GPs into fund administrators' arms.

9 Domiciling decisions

The percentage of private fund managers who plan to use Luxembourg for their next launch has risen, according to PEI's fund manager survey.

One of the most significant impacts of the changing regulatory environment has been the relative dominance of domiciling destinations. Ongoing uncertainty surrounding third country passporting rights – initiated by AIFMD but exacerbated by Brexit indecision – has led to some managers considering relocation. While many are happy to sidestep onerous regulatory overheads by making use of the national private

Fund admin M&A reaches fever pitch

2012

NOVEMBER US Bancorp scoops AIS Fund Administration.

JULY State Street seals deal on Goldman Sachs Administration Services.

JUNE Sumitomo Mitsui buys Daiwa Global Asset Services division.

SS&C completes $897bn GlobeOp bolt-on.

2013

NOVEMBER US Bancorp acquires Quintillion.

JUNE Mitsubishi and Banking Corporation buy Butterfield Fulcrum.

2014

AUGUST Maples buys Vistra's Singapore and HK business.

BNP Paribas acquires Credit Suisse fund admin arm.

Circle Partners swoops for Caledonian Global Fund Services.

MARCH Mitsubishi UFJ Fund Services buys Meridian.

> I can think of five occasions in the past year where firms have made the decision to outsource because an investor said they wouldn't come in unless they did so
>
> Melanie Cohen
> Apex Fund Services

placement regimes offered by offshore jurisdictions, a growing number are heading onshore to secure AIFMD compliance and hedge against Brexit.

Pressure from some LPs to move away from offshore locations for reputational reasons has deepened the trend and Luxembourg has been the overwhelming beneficiary. For fund administrators, it has meant agility in the pursuit of appropriate licences and flexibility of resource. Access to the explosive Luxembourg market has also been a key driver of M&A.

10 Outsourcing soars
Each of these key trends – access to costly technology, rising investor demands, as well as complex regulation – are driving private equity firms to outsource their fund administration in growing numbers.

Indeed, while European uptake of third-party administration has been pervasive for some time, a lower regulatory burden means the US market has historically lagged. This is now changing as US managers wake up to the raft of direct and indirect regulation they are exposed to.

"Europe is at the forefront but it is a global trend," says Emmanuel Raffner at Alter Domus. "Managers are facing regulatory pressure, technology pressure and reporting pressure. They want someone else to take on this pain so they can focus on what they are paid to do – invest and divest." ■

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2015

DECEMBER ALPS adds on Kaufman Rossin Fund Services.

AUGUST SS&C in $425m deal with Citi Alternative Investor Services.

MARCH Carlyle snaps up Conifer Financial Services.

Apex expands with Pinnacle Fund Admin.

2016

NOVEMBER Mainstream buys Isle of Man's Galileo Fund Services.

SEPTEMBER SS&C expands with Wells Fargo Fund Services.

JUNE Intertrust in £435m ($558m; €498m) merger with Elian Group.

MARCH Sanne builds scale with IDS Fund Services deal.

2017

NOVEMBER Link Group gobbles up Capital Asset Services.

OCTOBER Apex buys Deutsche Bank's fund admin business.

SEPTEMBER Sanne takes on Luxembourg investment Solutions.

MAY Apex acquires Equinoxe Alternative Investment Services.

2018

JULY SGG Group buys Augentius.

JUNE Apex adds $165bn AUM with Ipes.

APRIL Centaur bolts-on Luxembourg Capital Partners.

JANUARY Ocorian enters Luxembourg and Mauritius with MAS International.

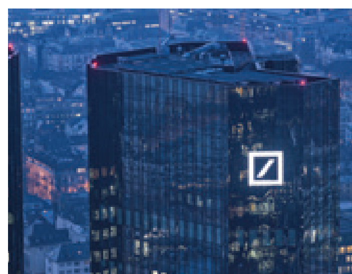
2019

APRIL Oak buys local peer International Administration Group.

MARCH Deal double for Apex with Broadscope and Atlantic Fund Services.

FEBRUARY Apex acquisition frenzy continues with Beacon Fund Services.

JANUARY Apex buys Link's CPCS and Throgmorton.



Editor's letter

Brave new world for fund administrators

Graeme Kerr
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The private equity industry has been notoriously slow to adapt to technological change – especially when it comes to data management.

Even today, some fund managers still default to PDFs. "Investors have to take that data and manually input it. It's completely inefficient," says eFront's Ludovic Legrand.

But that is changing fast. Automation is taking hold in a whole host of accounting areas ranging from waterfall calculations to cash movements, amid a fight by fund administrators for tech leadership.

Data analytics has become a key battleground, as fund managers start to dynamically connect underlying data from portfolio companies to GPs and, eventually, to LPs: "The big trend of 2019," according to Legrand. With financial statements delivered by PDFs being replaced by client dashboards, it is only a matter of time before fund administrators, reacting to demand from investors, provide real-time access through interactive portals.

So far, so good. Technology represents a huge opportunity for the fund administration industry. Fund managers are reluctant to invest the time and money to keep up with the tech advances, creating new outsourcing openings for fund administrators.

> **"Fund administrators are facing competition from the technology they seek to promote"**

The high costs are, though, proving a double-edged sword. The smaller fund administration firms are struggling to build and maintain the technology, leaving them open to being scooped up by the big players as M&A takes hold in the industry.

And with an army of agile platforms and app developers entering the industry, fund administrators are facing competition from the technology they seek to promote.

Costly technology, rising investor demands, complex regulation, M&A mayhem. With all of this bubbling away, the fund administration industry is entering an unpredictable phase.

While it's never easy to predict the future, one thing seems certain. Fund administration will be a very different industry in a decade's time, as the battle for digital supremacy takes its toll.

Graeme Kerr

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KEYNOTE INTERVIEW

Home or away?

LPs are piling pressure on managers to move onshore. But domiciling decisions should never be taken lightly, says Mark Hooton, director at TMF Group

Q To what extent are you seeing private equity managers move their funds onshore?

We have seen a number of managers think very carefully about moving funds onshore. Some of those have done so. Others have chosen not to. Others still have decided to move to an alternative finance centre that is better perceived as being onshore.

I think it is very important, after all, to consider what we mean by onshore. Some would interpret moving a Jersey fund to Luxembourg as moving it onshore. Others have a more purist interpretation. For them, onshoring would mean moving a fund from Jersey to the manager's domestic territory, for example, the UK.

Q What are the most significant drivers behind managers considering a move onshore?

Without doubt, the biggest drivers behind onshoring are LPs. Some managers will have very significant investors in their previous fund that, when it comes to reupping, explain they are under pressure not to invest offshore. Their commitment may be dependent on the move. A lot of the time, there is no good investment rationale behind it. It is very much about politics and perception.

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Q Is regulation, such as AIFMD and associated third-country passporting rights, also a driver?

I would not say AIFMD is a driver in terms of onshoring. If anything, it is reinforcing some people's decisions not to onshore, because whilst you do not avoid AIFMD entirely, you can avoid some of the more challenging aspects of that legislation by remaining offshore.

Regulatory environment, in general, however, plays a very significant role in domicile decision-making. Fund managers are setting up private equity funds that are going to last between 10 and 12 years. They want to establish that fund somewhere that has a relatively stable regulatory and political backdrop, somewhere they can have a level of confidence that the reasons they have chosen to domicile there today will still hold true in 10 years' time.

The traditional offshore territories are highly focused on serving the funds industry and will do everything in their power to keep the regulation as stable and favourable as possible. For onshore territories, on the other hand, the funds industry is unlikely to be a primary focus for political bodies. That means you may see unexpected, and undesirable, changes to regulation during the life of a fund.

Q What is the typical profile of a manager that looks to onshore?

There are really great fund managers, with exceptional track records, that can pretty much dictate to investors how they are set

up and run. Generally those funds will continue with the status quo regardless.

Then you will have managers looking to make a statement, those who use onshoring as a PR coup. Finally, there are the less successful managers, those that find it harder to raise capital and so need to be more receptive to investors' demands. That is where you really start to see LP pressure cause managers to move into onshore territories.

Q What, if anything, are the advantages of onshoring, beyond appeasing investors?

It depends on how you onshore. If you are onshoring in your domestic jurisdiction, you have the advantage of a regulatory and legal environment that you are familiar with. You can hold board meetings locally. There is no need to worry about travelling to an offshore centre, so in terms of day-to-day management, there can be obvious benefits. If you are talking about onshoring in an alternative jurisdiction, of course, you still have the burden of travel, securing local directors, etc.

There are advantages to onshoring, certainly, but you need to go into it with eyes wide open. It is not a panacea and there are compromises to be aware of. Those compromises typically come down to this question of political certainty. Offshore centres will do everything they can to protect fund managers. If you onshore somewhere such as France or Spain, the industry just would not have the same level of priority.

Q Which is why Luxembourg – which marries onshore status with an attractive regulatory environment – is proving so popular. What would you say are the key attractions of that jurisdiction?

Luxembourg has proved a fantastic success story. It is attractively located within continental Europe, with relatively easy travel from most regions. The language is familiar for many. It has a legal and regulatory environment that works to support the fund industry and experienced people to go along with that. They have also been very good at marketing themselves. That is not to say the jurisdiction is without its challenges. Due to their success, resourcing, for example, has become a significant challenge.

Q What are the legal and tax implications of onshoring?

The advantage of offshore vehicles is that investors know how they work. They understand and are familiar with the legal documents. Moving to a new jurisdicition will mean grappling with a new framework, potentially in a foreign language. There is an education process that has to happen that would not necessarily be the case in traditional fund jurisdictions.

But obviously tax is the big issue at the moment. Tax avoidance is a very dirty word. A lot of these structures are not designed for tax avoidance, of course, they are designed to avoid double taxation. But again, the risk with onshore jurisdictions is political. Even where similar structures are available today, tax laws may change and impact those vehicles.

Q How is the onshoring trend impacting the fund administration industry itself?

The biggest impact is that you now need to be in multiple jurisdictions, whereas traditionally, a presence in finance centres such as the Channel Islands, Luxembourg, Ireland and the Cayman Islands, etc would have been sufficient. Today, our client base is more likely to have requirements in the UK, Germany, Scandinavia, etc. That comes with the cost of setting up offices and recruiting teams to look after those vehicles. It is a question of scale. You need enough volume in that jurisdiction to justify the investment.

Q Has that been one of the drivers of all the M&A activity we have seen in the sector?

That is part of it. But M&A is being driven by a number of things. A growing regulatory burden is adding cost for the industry which means it is becoming harder for smaller players to be efficient. As you get bigger, you benefit from economies of scale which mean you can manage processes, invest in technology and have the dedicated compliance functions to react to regulatory changes quickly.

Q What do you think the future holds in terms of private equity fund domiciling?

A lot of this comes down to the political will to ensure all involved in this industry are paying the right amount of tax. But, in reality, we have rules, such as the Common Reporting Standard, which mean the numbers do get reported back to domestic jurisdictions and many significant investors are vehicles such as pension schemes which are non-tax paying anyway. As governments get increasingly comfortable with their access to that data, as they get answers to questions they feel they cannot currently answer, the pressure to move onshore may alleviate. ■

Where should I domicile my fund?

Domestic territory
- Familiar legal and regulatory environment for manager
- Local board meetings, limited travel
- Positive PR, political perception
- Potentially attractive for politically sensitive LPs, a fundraising boom
- Political, fiscal and regulatory risk over life of the fund
- Potentially unfamiliar legal frameworks / language for investors

Alternative onshore finance centre
- Supportive regulatory environment
- Burden of travel and need to source local directors remains
- More attractive for some politically sensitive LPs
- Some stakeholders question onshore status

Offshore
- Supportive regulatory environment
- Familiar legal frameworks/structures for investors
- Travel and operational complexities
- Potential negative PR, political perception
- Unattractive for politically sensitive LPs, could damage fundraising

A technology arms race

Private equity fund administrators are fighting for digital supremacy as investors demand an ever-wider range of data points, writes Amy Carroll

The love affair between private equity and Excel is no secret. From forecasting to financial modelling, there is nothing the finance director of a buyout house likes more than delving into a complex spreadsheet.

But Byzantine regulation, escalating LP demands, security concerns and competitive pressures all mean that Excel no longer suffices. The industry has had to abandon its fondness for formulae in favour of new technology, and nowhere is this more apparent than in fund administration.

"Technology permeates all aspects of modern fund administration," says James Duffield of Aztec Group. "Ranging from day-to-day accounting and financial reporting to the organisation and co-ordination of board meetings and correspondence with investors, not to mention the multitude of task management, file transfer, banking and other systems in play too."

The use of technology in fund administration broadly falls into two camps. First, technology is being used to automate operations that have historically been performed manually.

Fund administrators are developing or buying automated carry waterfall calculations. They are automating SWIFT banking transactions from banks into fund administration software and are streamlining book-keeping by adopting transaction-based accounting flows that move away from double-entry journal accounting. "These may not sound like the most exciting developments," says Justin Partington of IQ-EQ. "But they are genuinely transformative."

Automation is driven by the need for efficiency. The demands placed on the industry are proliferating and pricing pressure means these cannot be met by manpower alone. "You can't just throw bodies at the additional demands being placed on fund administration," says Iain Robertson of eFront.

Meanwhile, Neil MacDougall of Silverfleet Capital adds that in many key fund administration jurisdictions, human resources are, in any case, in short supply.

"I would characterise progress so far as gentle," says Partington. "People are just dipping their toes in the water. But we are seeing new entrants being disruptive with nimble ideas. I think the pace of change and automation will only accelerate."

Data drive

As the heavy lifting subsides, the fund administration industry is having to reposition itself to reimagine the value-add it can bring. And it is here that the second technology push comes into play: data analytics.

LPs are demanding ever-more complex and detailed information about private equity performance and the deals that underly it. "This desire for more granular data is partly driven by regulation – MiFID Key Information Documents, for example, or greater transparency required out of the [Financial Conduct Authority's] institutional disclosure working group," says Michael Robertson of Aberdeen Standard Investments. "It also reflects the wider evolution of the industry – for example, a growing emphasis on ESG."

"The biggest demands of technology that we see are around availability of data itself, as opposed to simple reporting," adds Vistra's Scott Kraemer. "It is about transparency and the ability to delve into different kinds of information on your own terms."

Not only are investors demanding an ever-wider range of data points, but the timeliness and manner in which they demand to receive them are changing too. In the early days, quarterly financial statements used to simply be distributed as a PDF by email.

Gradually, providers started to offer clients dashboards and charts to enrich their reporting, but the information nonetheless remained static. Now investors are demanding real-time access through interactive online portals. They want to be able to interrogate the raw data.

"Investors in private equity funds are becoming more sophisticated," says Melanie Cohen of Apex Fund Services. "They want to drill down, they want detail, they want more look-through reporting. We need to provide that without hiring an army of people, and technology is responding."

"Even today, most players in the industry are still working with PDFs," adds eFront's Ludovic Legrand. "Investors have to take that data and manually input it. It's completely inefficient. The next step is to dynamically connect data from underlying portfolio companies to GPs and ultimately LPs. A few fund administrators have started to do that over the last six months. I think

that will be the big trend of 2019." There is no doubt that the level of technology now in play is radically altering the dynamics of the sector. There is an ever-dwindling number of managers prepared to invest the time and money required to maintain cutting-edge in-house functions. Indeed, even smaller third-party fund administrators are struggling to keep pace, which has been a significant driver of recent M&A.

An army of agile platform vendors and app developers has also grown up around the industry. The growth in cloud-based systems in particular is making implementation and integration easier and cheaper, meaning there is less cost to taking on new technology and less risk of failure.

"More modern development tools mean that it is also much quicker for developers to build for niche markets," says Sam Metland of Citco Fund Services. "That means more systems become available for our industry where it was not considered a big enough market in the past."

Indeed, fund administrators have lapped up the plethora of technology solutions on offer and Excel is fast becoming a relic. The next stage is to consolidate platforms. In recent years, many administrators have accumulated myriad systems focused on different parts of the data lifecycle, as well as on different alternative asset classes. Furthermore, rampant M&A means individual firms have inherited disparate technology bases.

"A handful of players are moving away from silos to a vertically integrated system," says Legrand. "It is where they need to be."

Of course, technology will never entirely replace people in the fund administration space, particularly in private equity, where service levels remain the most significant selling point. Firms are, in fact, placing greater emphasis on the level and breadth of skill they employ in order to support the tech being put in place.

But, nonetheless, the use of technology is increasingly becoming a critical differentiator, and firms are digging deep to fund a wholesale digital transformation. A fund administration technology arms race is well underway. ■

Staying in control

As fund administration systems shift to the cloud and more and more data is shared, questions of access, ownership, security and control are being thrown into the spotlight

"It is difficult to define best practice," says Aztec's James Duffield. "But in our view, intensive education and awareness of phishing and other threats is imperative, as is having the right processes in place, particularly around identity verification and investment in secure technology, such as portals, as well as specialist resources."

IQ-EQ's Justin Partington adds: "We have worked with one of the Big Four to analyse all of our integrations. We have seen what's happened with the Panama Papers, Paradise Papers and Lux Leaks. There are 30 to 40 different parameters that we look at, from physical security to data breaches. Alongside keeping on top of regulatory licences and permissions, it is the critical area that keeps your business."

KEYNOTE INTERVIEW

Automation and data sophistication signal the future

As the private equity industry faces the peak of the cycle, George Rologis, chief commercial officer and head of strategy and EMEA at Alter Domus, says fund administrators will need to up their game for the benefit of the market

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Q The common consensus in the market is that prices are high and the peak of this cycle is drawing near, or has already been reached. What does that mean for fund administrators?

The peak of the cycle, by which we normally mean peak valuations, has come because there is so much demand for private equity and alternative asset products, which leads to even greater demand for our business. We see a lot of the big funds in Europe seeking to follow CVC and raise ever-bigger funds, and we also see the rise of so-called 'super carry', as the big-name firms have begun to push for 30 percent carry structures in new funds, as opposed to the traditional 20 percent.

These changes in the market will oblige us to invest more in our businesses in order to support GPs. On our side, there will be much more focus on automation, introducing advanced data management capabilities or otherwise enhancing the capabilities of GPs to report to LPs in a much more timely and sophisticated manner. Overall the result for our business is very positive, and I expect to continue to see growing demand for our services.

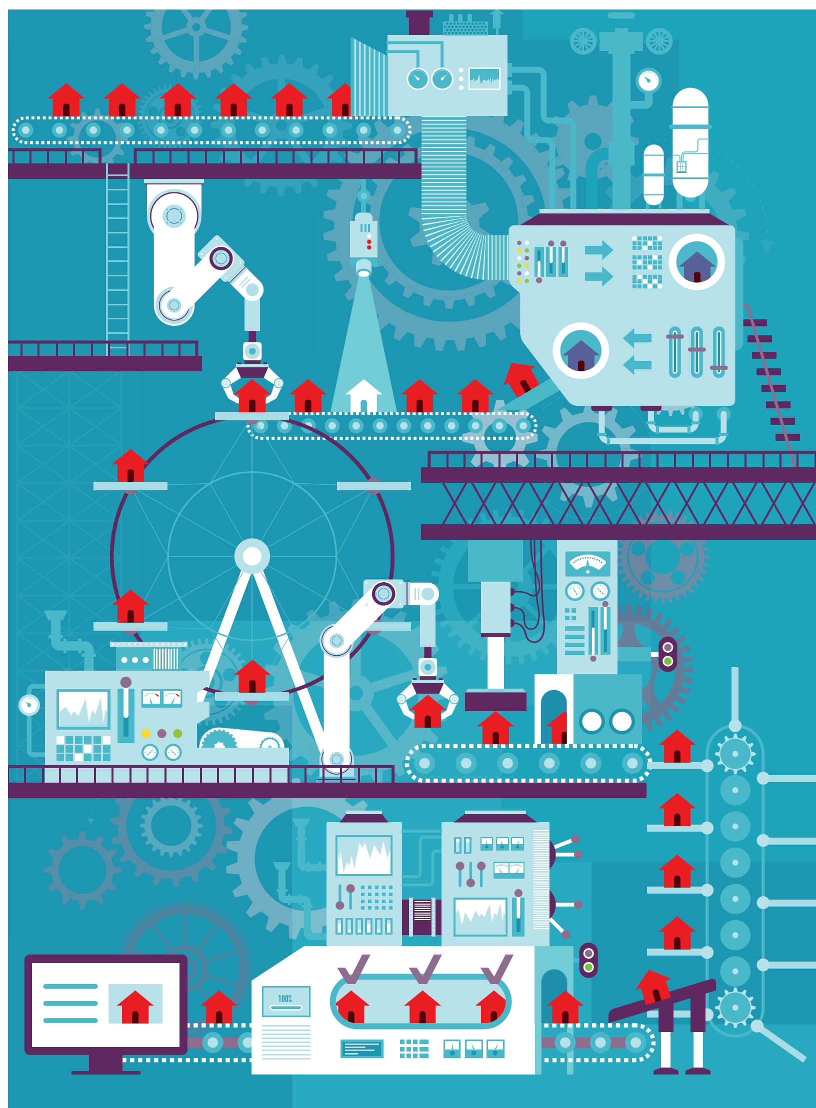
Q How is the traditional role of the fund administrator evolving in the current climate, and what do you see it ultimately becoming in the future?

There is a wave of change sweeping through private equity, which we need to jump onto very quickly. That's not driven by the valuation cycle, but rather by LPs and regulators, and the result is a growing professionalisation in the industry. Things like AIFMD II are driving change for us, as well as increasing competition in our market as more firms get involved in offering the services we offer.

The role of the administrator is definitely evolving into more of a partner to funds, getting closer to chief financial officers and being less of a service provider. At the same time, we are moving into offering not only back-office but also middle-office functions, releasing more of the GPs' valuable time to dedicate to transactions and the portfolio.

The biggest challenge we face is continuing to grow while maintaining the flexibility in our business to become a business partner providing the level of support our clients expect. That means the ability to be flexible, to deliver high quality, to be able to invest next to clients to provide a specific solution that may be required, and the ability to offer human resources to funds that need them – essentially 'loaning' our professionals to our clients – to meet a particular need. Clients are no longer looking for an arms-length relationship; we are moving towards playing an active role on an ongoing basis, observing how funds' needs are changing and looking at how we can bridge the gaps to keep those funds compliant.

Finally, another challenge is the way that the industry recruits its people. There is a fight for resources, globally, in the markets that we are active in, and the traditional way of recruiting accountants, fund professionals, trust experts and so on must evolve because we are now looking at attracting millennials, who are often looking for different things.



Q ESG issues are beginning to permeate fund administration decisions, particularly in other sectors but also increasingly in alternatives. How significant do you think ESG will be in the coming years, and what trends have you already observed?

ESG is definitely growing in significance across the industry generally, both on the client side and on our side. On the client side, we are seeing sizeable ESG-related funds being raised, so LPs are clearly paying serious attention to the issue, and it is also a big part of the due diligence that we are seeing investors conducting on GPs. For traditional buyout funds, ESG issues are now consuming a big chunk of time, as they need to be able to show they are working on these matters, taking them seriously, and producing results.

From our perspective, as a portfolio company of a private equity fund [Permira made a significant investment in 2016], we have seen that pressure coming through. For all businesses like ours this is a matter of growing importance, particularly when it comes to diversity and issues of work-life balance.

When we are recruiting, the younger generations are spending more time looking at ESG. Going forward, I see ESG making a big difference in the way we operate and the way funds are operating.

> *"The role of the administrator is definitely evolving into more of a partner to funds, getting closer to chief financial officers and being less of a service provider"*

Q The EU published some findings in January that give a taste of what might be to come in a potential AIFMD II. Costs for investors and regulatory bodies and the large volume of required data reporting were highlighted. Nevertheless, the feeling among investors is that AIFMD has not deterred them from investing in the EU. What impact have you recognised from AIFMD, and what do you expect from a possible AIFMD II?

There was a lot of fear at the beginning of AIFMD I, if we can call it that, about its potential to slow down business. It has defi-

nitely made doing business in our markets much more process-driven and much more cumbersome, but we have not seen demand for the markets or our services decrease – quite the contrary.

Perhaps AIFMD has split the market between larger funds, who are able to operate in this environment, and smaller asset managers who are now forced to find different solutions – perhaps outside of the EU – to structure their vehicles and look for capital.

AIFMD has allowed the fund administration industry to offer more services and has increased the need for our offering to GPs, as we have moved into depositary services and third-party management to try to meet the demands of the regulations for our clients.

I suspect AIFMD II will make the industry even more accessible for mid-sized and larger funds, and make it even more difficult for the smaller guys. It will probably also increase the need for people such as ourselves to offer services into the market, in turn leading to increased costs for investors.

The fact that the market that we have at the moment is at an all-time peak, with so much demand, suggests that AIFMD had little or no impact on paring back investor demand. If AIFMD II were to come in at a time when the industry was struggling, then it may drive investors to something else, but I doubt the additional requirements as currently suggested will serve to dampen demand.

Q Transparency is the watchword for fund administration right now, and while this makes the market more accessible to investors and grows AUM, it puts huge pressure on fund administrators, and hampers European AIFs in delivering strong returns. Is the industry getting to grips with transparency, or is regulation creating a maze that is scaring off many small to mid-size investment firms?

The industry is trying to get to grips with transparency irrespective of the regulatory environment. It is the name of the game, as something that investors are extremely focused on and have been increasingly committed to over the last three to five years. The fact that this will become official regulation is perhaps not a big issue for the larger funds, who will find it requires only a very small change. It will, however, create a bit of a maze scaring off small and medium-sized investment firms, and may create a barrier for more niche venture capital-type strategies who will perhaps find it much more difficult to operate.

"The challenge for organisations like us in the servicing industry is to try to come up with solutions, through automation and data management, in order to make it viable for any size of asset manager to operate within the rules"

The challenge for organisations like us in the servicing industry is to try to come up with solutions, through automation and data management, in order to make it viable for any size of asset manager to operate within the rules. Somebody has to make the investment in that technology, and that will probably be done by us. That will likely mean extra costs, but most investors will swallow those for the really well-performing funds. Those that are struggling will come under additional pressure.

We may also see a reshuffling of the cards in what might be called a third phase for the industry. A decade ago the major players were not necessarily the same names as they are now, and we have seen some big brands fall by the wayside. I think, once again, we will see some of the mid-performing funds disappear and their high-performing partners will move out and create their own funds. That will, at the end of the day, be a reordering for the benefit of investors. ■

Making waves?

News of Amundi Asset Management's plan to grow its private exposure by over 40 percent was broken at the end of April. Will the entry of such large players into alternatives create turbulence in what has traditionally been a fairly stable environment?

The news is really interesting because it confirms the huge interest in the alternatives market and the continued growth in the asset class for the foreseeable future. The question is which of the two parties will adjust: will Amundi adjust to the traditional '2-and-20' private equity structure, or will the industry have to adjust to Amundi being such a large asset manager and putting capital into the market?

I do believe that any turbulence will be positive, because obviously increased demand for private equity will further fuel demand for services from businesses like ours.

There are quite a few large fund of fund players out there already, and some specialising in this exact area of the market. It's a well mapped-out and well-structured space at the moment, and I see Amundi's move as just much more volume moving in. Other large asset managers, like Aberdeen and BlackRock, are already quite big investors in the sector, so this is perhaps just another huge shift of capital moving into an already established market.

Some mid-cap or other LPs may now miss out on opportunities. What is unclear is whether the market will expand to meet Amundi's demands and pricing expectations, or whether some LPs will now miss out and it will only be the GPs who are already well-established with a good track record that stand to benefit.

The consolidation game

The M&A boom in the fund administration industry is gathering pace, but can these new larger players maintain the same level of service? Rob Kotecki reports on the expansion challenges facing the outsourcing industry

Does bigger mean better? That, in a nutshell, is the challenge facing the fund administration industry where barely a month goes by without a new acquisition or tie-up.

The fact that third-party administrators are flourishing isn't exactly a surprise given the spectacular growth of the alternative assets industry over the last decade. The 2018 eVestment survey of the fund administration industry showed double-digit growth in assets under administration across every asset class.

Even first-time funds are preferring an outsourced option from the beginning now. "We've been around for 10 years now, and finally reached a size where we felt we couldn't manage the process in-house anymore," says Joshua Cherry-Seto, CFO of Blue Wolf Capital. "It's different now. A lot

of firms are outsourcing from their debut funds, as some of the groups spinning out of larger firms already have relationships with administrators."

But the dramatic expansion of the industry isn't just about having more assets to manage – it's an indication of the growing complexity of the tasks they manage. Building and maintaining technology can be hard for smaller players to do profitably, so they are open to being scooped up.

"As managers become larger, they look for partners that can match the breadth and complexity of their businesses," says Rahul Kanwar, the president and COO of SS&C. "This includes asset class coverage, jurisdictional and regulatory requirements and demand for leading technology."

That means that all administrators need to invest in talent and technology to meet their clients' needs. For example, one service provider noted that no matter the size of administrator, they still need to invest in data security software to meet the requirements of institutional LPs, and that costs the same whether they administer $12 billion or $120 billion in assets. The shop managing the latter will be able to spread that cost over a wider customer base.

So when a larger administrator comes knocking to buy a smaller peer, there's good reason to answer the door. The past few years have seen a wave of M&A deals in the industry, as firms like SS&C, Apex and Sanne have been on the hunt for acquisitions and bagging plenty of them to expand their geographic reach and service offerings.

Some suggest the landmark acquisition of the era was in 2015, when SS&C acquired Advent Software. "Advent was a platform that many of SS&C's competitors used, so it was a great strategic move," says Alan Meaney, chief executive of Fund Recs. "It went for a high multiple, but no other deal disrupted the market as much."

Developing technology in-house can be quite costly, so acquiring a tech firm or an administrator with a great tech solution can be more cost effective in the long run.

Smart shopping

"We prefer to acquire companies for a unique capability, a technology or a service we don't currently provide," says Shankar Iyer, CEO of Viteos. Several fund administrators pride themselves on not relying on acquisitions to add customers.

For example, Apex, which has been closing on a slew of deals over the past few months, isn't looking for market share alone. "Our priority is to create the strongest product offering we can, not just growth through acquisition," says Peter Hughes, Apex's CEO and Founder.

> *"As managers become larger, they look for partners that can match the breadth and complexity of their businesses"*
>
> **RAHUL KANWAR**
> **President and COO of SS&C**

Instead, Hughes is focused on whether his firm expands its product offering, and whether Apex can help the acquired company serve its current clients better. Apex is also looking for targets that can blend well with its systems. "If it's a firm in a new geography that also uses complimentary technology, that starts to look attractive to us," says Hughes.

Not just clients anymore

Even with fund managers outsourcing more than ever, not all administrators have the deep pockets or ability to raise sufficient debt to make these acquisitions themselves. Private equity is playing a major role in this wave of M&A activity, not just as new clients, but as investors. Genstar acquired Apex, Permira owns Alter Domus, and Public Pension Capital and FiveW Capital back Viteos, just to name a few.

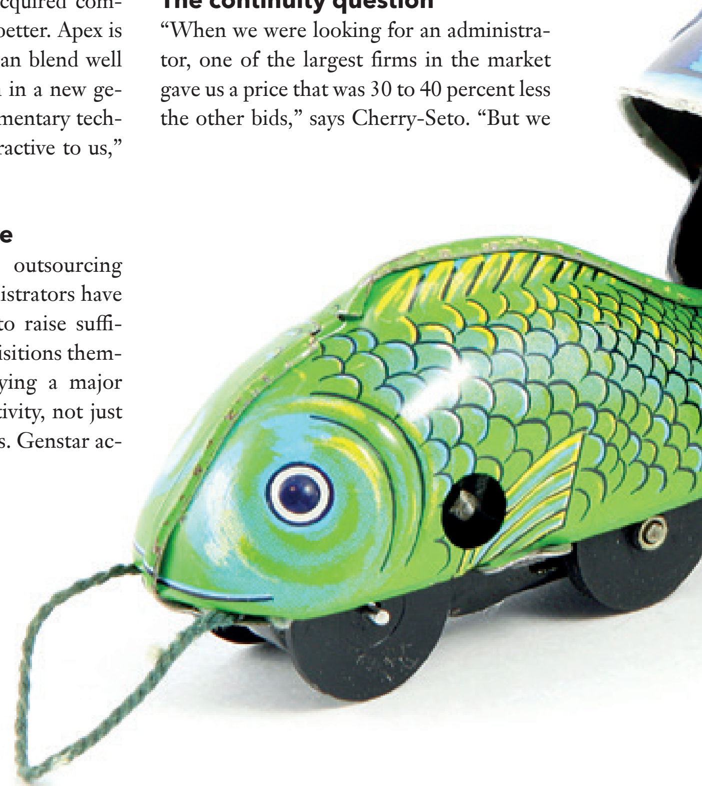
"Our acquisition strategy has been in place since Genstar invested in us in 2017, and it was predicated on building the broadest product mix," says Hughes. "They understand that's what drives organic growth."

And they are bullish on the sector, as one administrator admits getting calls nearly every week from buyout firms asking about their growth plans and looking to invest. The nature of private equity, no matter the era, is to deliver returns after a finite period of ownership. Which begs the question, how much of the current shopping sprees is for the long-term viability of the administrator, and how much of it is part of a roll-up play for short-term growth and a sale?

Of course, fund administrators argue that being able to operate in more jurisdictions and service more asset classes can only better serve clients, and with the benefits of scale, costs stay reasonable. But the nature of fund administration complicates matters.

The continuity question

"When we were looking for an administrator, one of the largest firms in the market gave us a price that was 30 to 40 percent less the other bids," says Cherry-Seto. "But we



were looking for more of a partner, who was truly devoted to the middle market space. Cost is always a factor, but we were able to find that niche firm big enough to have both expertise and scale."

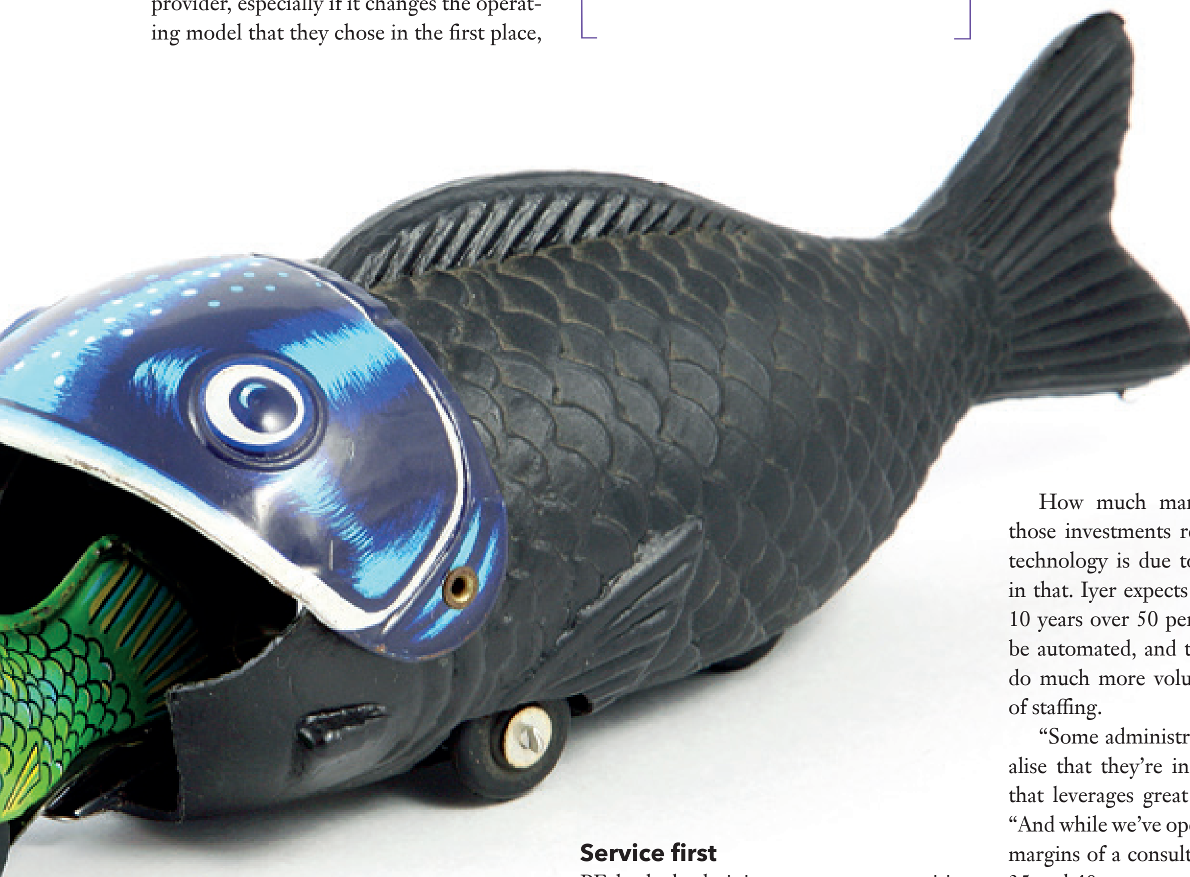
One CFO admits that larger administrators may make sense for the mega-firms that are looking to merely access technology and outsource tasks, but administrators also act as kind of outsourced operational team. In lieu of adding a vice-president of finance, or other more managerial level roles, they require a close collaboration that boutique firms offer as a core value proposition.

And a fund administrator argues that while GPs like exits, they don't always appreciate changes in control at their service provider, especially if it changes the operating model that they chose in the first place, or requires getting a new team up to speed on their own processes.

"We appreciate continuity because there will always be a learning curve when bringing on an administrator," says Cherry-Seto. "Some portion of a firm's business will be unique to their investments or history, and that means outsourcing will make more work before it makes less."

"Some administrators have begun to realise that they're in a technology business that leverages great people"

ALAN MEANEY
CEO of Fund Recs



Service first

PE-backed administrators appear sensitive to the situation. "When we acquire a business, we perform the commercial diligence to ensure that their clients are happy, and we make sure to incentivise client-facing staff to stay," says Hughes. "If we don't force a new technology on them and maintain the same level of service, but with a wider product mix, clients continue to be happy."

Even the largest players are aware of how important service is. "We take a very customer-focused approach to integrating a new acquisition," says SS&C's Kanwar. "We meet a lot of customers, and solicit their feedback to shape our product plans, integration plans and development initiatives. Customers quickly gain access to our broader set of services and improved technology, which improves their overall experience."

The reality is that every administrator is under pressure to keep up with their clients' increasing size and complexity, either by acquisition or by building what they need internally. That takes money, which may favour larger administrators.

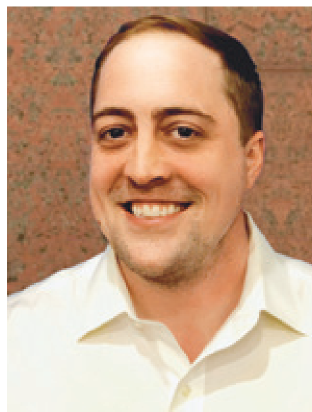
How much margins get squeezed by those investments remains to be seen, but technology is due to play an outsized part in that. Iyer expects that in the next five to 10 years over 50 percent of their work will be automated, and that will mean they can do much more volume with current levels of staffing.

"Some administrators have begun to realise that they're in a technology business that leverages great people," says Meaney. "And while we've operated more at the gross margins of a consultancy business, between 35 and 40 percent, a lot of us are looking at how to evolve closer to a software company, which enjoys margins closer to 85 percent."

That may seem like a moonshot, but given the amount of capital and interest in the industry at the moment, someone might happen upon an innovation that truly revolutionises the space. Until then, they'll be aiming to strike that balance of being large enough to be handle a client's business, and attentive enough to meet their expectations. ■

KEYNOTE INTERVIEW

Finding hidden treasures



Data management does more than lighten a firm's workload. Backstop Solutions' Adam Pinkert and Chris Anderson discuss how the right strategy can uncover hidden insights for a competitive advantage

It is natural for data to feel like a problem to solve. There is so much information coursing through the various systems at any firm that GPs are spending real time and money for technologies to merely manage the basics of due diligence, portfolio analysis and reporting.

But Backstop Solutions' Chris Anderson and Adam Pinkert argue that an optimised data strategy can go well beyond that and upgrade the entire investment operation. As this current boom gets older by the day, it might be more important than ever to look at systemic improvements.

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Q Data strategy is a nebulous term, so what exactly do you mean when you talk about its potential for private funds managers?

Adam Pinkert: Data is all the knowable information at the firm. This includes more than just financial statements, but all the information that drives decisions and explains to investors and other stakeholders why those decisions were made. And by strategy, we mean the three key actions that every firm takes with their data.

First the data is collected, then it is manipulated for both internal and external audiences. Finally, it is delivered to those audiences. An optimised strategy is essentially the best way to do all three tasks.

What is the best way to gather that data? How should they manipulate it for multiple audiences? And then in what format should they deliver it, so it is most effectively consumed? Is it drag and drop reporting? Is it visualisations to make trends apparent? Is it being able to activate alerts for unexpected data? These are the questions that the best data strategy answers.

Q What can this optimised data strategy deliver to firms? Why should they invest the time and money into upgrading their own?

AP: For one, institutional investors like CalPERS are now getting their own data systems in place. They have the appetite to consume this data themselves, essentially executing their own data strategy and will look for GPs to provide them what they need for their own internal and external reporting. There is a consumption demand.

Two, when macroeconomic conditions are benign, growth is easy, but when that changes, LPs will be looking for the data to explain any losses. If some deals went south, there is data that makes those decisions defensible, and it can help the manager make better decisions going forward.

Even if it is smooth sailing, accessible and well-structured data can improve decision-making throughout the firm. The manager can find trends that might have been hidden within their own operations. They can look at their previous investments

closely enough to find out what is making a difference in their performance.

What is contributing to their successes, or those transactions that underperformed? Is it the amount of leverage they are using? Is it their entry multiple, or their operating partners, or the deal source? It allows the manager to mine the data and find where they are creating value, irrespective of the macroeconomic conditions.

Q Doesn't that require an enormous amount of data be uploaded into a single system, that remains accessible in a way that a manager can conduct that kind of analysis?

Chris Anderson: That is the challenge for service providers like us. How can we offer a solution that intuitively brings that data to the forefront, either with notifications, triggers or alerts so the data comes to the manager rather than forcing the manager to go looking for it?

AP: We aim for data systems that are easy to use, accessible and informed. This means that information can be easily inputted and stays agile as the business grows, so it never becomes an administrative burden. And then it can be efficiently downloaded and shared with multiple constituents.

But the data should also be arranged in such a way as to be informative. The manager needs to be able to model their universe, so they can see current portfolio companies, target companies and have key data points available, whether they are meeting with a potential lender or investor. If they are able to cite certain specific stats, they might shave a few points off the financing package or help convince a new LP to come on board.

This is not just about automation, or simply reducing headcount because there is less work to be done.

Q If data administration is not a burden, does that mean the firm frees up time to think about how to use the information more creatively?

CA: Exactly. Staff can then focus on leveraging that data to develop new ideas, and new profit streams. PE firms are very concerned about acquiring and retaining talent, and they need to create a space for their employees to use their full range of capabilities.

AP: Human capital management is a soft science, but it is hyper competitive to get great talent in private equity. Having the next generation wasting time on aggregating data leads to burnout. It's not what they signed up for, and it does not leverage their true value, which is to go out and find new ways to grow the business.

Q So, what is the first step a manager can take to improve their data strategy?

AP: A good starting point is to recognise where the data sits today. Do they have a third-party administrator doing partnership and portfolio accounting? If so, how accessible is it? Is it a phone call away with a 24-hour turnaround, or does the admin take the data and deliver it to an internal system that the manager can then manipulate? If so, can they consolidate that data concerning portfolio companies, target companies, lenders, vendors and investors and merge that into a single system to answer questions? That is the goal.

Q To some GPs, that sounds like a Holy Grail of sorts. What is preventing more managers from having that kind of system?

CA: When these firms think about data strategy, they are not thinking holistically. Deal software gets bought by the deal team, the IR team buys a portal for the LPs, and the third-party administrator may use their own system for fund accounting. But how easily do they communicate with one another? They may not ask how a new technology feeds into the systems already in place.

Perhaps previously they have been fine using Excel and adding a few software solutions along the way, but nowadays there is a real cost to not having a data strategy. If staff spend hours to find a data point, they do not have the chance to be creative with what they find. They may make a poor decision without realising that insufficient data was a root cause. Even worse, they will not have the data they need to see what they are doing well, or why something underperformed.

But with a robust and disciplined data strategy, they can course correct quickly. It is not just a data strategy, it is a strategy for understanding what exactly the firm is doing, and how to do it better. Everyone may say they use data-driven insights today, but in the long run, the quality of the data, and the quality of the insights, will show up in that fund's IRR. ■

Domicile head-to-head

As funds continue to weigh up the consequences of Brexit, we talk to managers and agency officials in two European domiciles to gauge the case for and against relocating. By Amy Carroll

Guernsey

The island's advocates argue that its costs are lower and being based there does not inhibit a manager's ability to market funds in Europe.

Guernsey's experience of serving private equity dates back to the early 1980s, when the asset class was in its infancy. Many of the industry's best-known names – such as Apax, BC Partners, Cinven, Coller Capital, KKR, Permira and Inflexion – have a history of using the jurisdiction.

Indeed, Guernsey is one of the largest offshore jurisdictions in the world and is currently home to private equity funds with a net asset value of more than £110 billion ($144 billion; €128 billion). Providing a proportionate, stable and supportive regulatory regime for managers is a priority for the island.

Those in the funds world who are based in the region struggle to see the rationale for the migration from jurisdictions such as Guernsey to onshore territories, and in particular to Luxembourg. While they understand that some LPs are putting pressure on managers to relocate, they question

Luxembourg

The Grand Duchy may be a relative newcomer to the fund world, but it is already the second-most popular domicile for private equity funds, second only to Delaware.

Indeed, Luxembourg is home to 250 alternative investment fund managers and over 600 registered managers. The Association of the Luxembourg Fund Industry estimates that somewhere in the region of €400 billion of private equity funds now reside within its borders.

Those numbers are rising fast as private equity managers come under growing pressure to move their funds onshore. Many LPs, particularly pension

Heart of Europe: Luxembourg aims to be the 'go-to' domicile for private equity

whether moving to Luxembourg would even satisfy those demands. Rather, they argue that only a move to home turf would fully assuage investor concerns and while a small handful of firms such as Altor have genuinely moved onshore, very few managers are prepared to take on the political risk that entails.

It is easy to see where LPs are coming from, however. Tax avoidance is a red-hot issue and investors are concerned about their reputations. Of course, domiciling in a jurisdiction such as Guernsey has nothing to do with tax avoidance. It's about avoiding double taxation. The country adheres to the highest standards of international tax and regulatory principles in accordance with current G20, OECD and EU tax initiatives. Transparency around taxation is, in fact, at an all-time high.

Guernsey advocates find the current spate of relocations to Luxembourg all the more flummoxing in light of the regulatory burden that has befallen EU-domiciled funds since the Alternative Investment Fund Managers Directive was implemented almost six years ago. The cost of a Guernsey structure is around 40 percent lower than one that is AIFMD compliant, they say, and yet, contrary to what the well-oiled Luxembourg PR machine may say, Guernsey domiciliation does not inhibit a manager's ability to market funds in Europe. The fact is, only 3 percent of private equity managers are registered to market in more than three countries, in any case. Switzerland, the UK and Netherlands alone represent two-thirds of private equity fundraising, according to Preqin. Most managers don't require access to every European jurisdiction, greatly diluting the benefits of the vaunted AIFMD passport.

Safe harbour: Guernsey provides easy access to European markets

Guernsey's tried and tested regime enables firms to market into the majority of EU member states on a bilateral agreement basis, without the huge compliance overhead that comes with administering in Luxembourg. It was also one of just five jurisdictions given an "unqualified and positive assessment" by the European Securities and Markets Authority.

The growth of the Luxembourg fund administration market has been explosive over the past few years – to the extent that a lack of available resource is a common complaint – but manager migration is nonsensical, the Guernsey camp claims. Offshore territories such as the Channel Islands offer a light-touch, consistent and cost-effective regulatory regime and make the ideal home for private equity funds.

and government-linked funds, are insisting on relocation as a condition of investment. Blackstone is among the firms that have recently adopted Luxembourg as its European home.

By domiciling in Luxembourg, managers are able to appease investors' reputational concerns, while continuing to operate in a jurisdiction for which the funds industry is of paramount importance. While the ebb and flow of party politics may see punitive changes to tax and regulatory systems during the 10-year life of a private equity fund in many onshore territories, the funds market represents eight per cent of Luxembourg's GDP and is therefore of critical importance to the government and its regulators.

Luxembourg's other key advantage for the private equity industry is that it enables managers to market their funds seamlessly throughout Europe. Private placement regimes may be a workable stop-gap but there are those who believe they do not offer a sustainable approach.

Managers can administer a fund without relocating entirely. For UK-based firms facing ongoing uncertainty over Brexit and third-country passporting, in particular, this is compelling. Delegation rules mean that a Luxembourg AIFM can take responsibility for risk management, while sub-contracting investment and portfolio management back to London, for the best of both worlds.

Indeed, Luxembourg really does have it all, advocates say. It has the talent, the technology and the regulatory regime to provide a long-term home for private equity fund managers. The special limited partnership (*société en commandite spéciale*, or SCSp), launched in 2013, is an internationally recognised fund structure based on the Anglo-Saxon model. Meanwhile, the subsequent reserved alternative investment fund, created after the introduction of AIFMD, is a clear example of how the country's government and regulators are willing to listen to industry concerns and proactively deal with them.

Luxembourg also offers full and unfettered access to Europe's institutional investor capital and is conveniently located for travel from most regions. The growing sense that offshore domiciling is no longer an acceptable option and the impact of AIFMD mean only a continental European base will support global fundraising. Luxembourg provides the core benefits of an offshore location, while residing at the heart of the EU.

KEYNOTE INTERVIEW

The value of a systems check

Private fund managers can win major operational efficiencies from outsourcing, provided that they pay attention to how well data is managed, say eFront's Ludovic Legrand and Iain Robertson

GPs are already bullish on outsourcing, both as clients and investors, largely because their business is not getting any simpler. Contracting a service provider allows them to focus on generating returns, yet the increasing complexity of LP demands and regulatory requirements only ups the stakes for getting this collaboration right.

eFront's Ludovic Legrand and Iain Robertson believe today's asset servicing firms have the talent and technology to significantly improve a firm's operations, but only if managers take the time to create the right system for working with their chosen service provider.

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Q What is creating this boom in asset servicing providers? How attractive is the value proposition for private equity firms?

Ludovic Legrand: Managers are well aware of how much of a difference asset servicers can make in their own business, but a combination of ever-increasing investor demands and pressure on the resources necessary to meet those demands, we think, are the major factors. Asset servicers now have the domain expertise and technology available to help them.

Iain Robertson: I would add that there is still room for the industry to grow. Many GPs continue to periodically send their investor reporting in PDF format, thereby making it difficult and labour-intensive to access the raw data. Also, the granularity and consistency of data that LPs can get varies significantly from one GP to another.

Many LPs want to conduct proper risk and performance analysis, but this usually remains wishful thinking.

In their defence, historically, a number of elements prevented LPs from conducting in-depth analysis that really added value, such as the varying timeliness and quality of data as well as a lack of uniform data definitions to encourage like-for-like comparisons.

Now LPs are looking for a system where all GP data will be centralised and easily exported into their own centralised reporting systems, enabling LPs to conduct in-depth analysis such as cashflow forecasting, performance contribution and Value at Risk.

Q Why not build that centralised reporting system in-house?

LL: They certainly can, but at the moment there are so many qualified asset servicers that they do not need to spend the upfront time and cost to build one from scratch. Today's fund administrators and custody banks sit at the heart of the industry's data. Traditionally, data quality and consistency has been a significant challenge for private equity, largely due to the lack of formalised standard practices to manage non-homogeneous data in a consistent manner.

However, the alternative investment market has really evolved in recent years to meet investor expectations. One example in the private equity market is the increasing adoption of ILPA templates and guidelines, particularly on notices, such as calls and distributions, capital account statements and fees. Many fund administrators and custody banks have helped to push these market best practices to a much higher level.

IR: Furthermore, GPs are expecting that if they do outsource, the service provider will be able to aggregate data from multiple sources into the firm's own in-house system. The best service providers will be able to manage both structured and unstructured data. Although, as the industry matures, the amount of structured data will increase as more and more reporting standards are adopted. And the more predictable, or structured, the data is, the more it will drive an AI revolution in the sector.

Q While that sounds very impressive, how does it address the problems managers face today?

IR: Enhancing data quality is obviously the first necessary milestone needed to improve operational efficiency. The data acquisition process is really complex and cumbersome for both GPs investing directly into underlying companies and/or properties, and LPs, including funds of funds, who have to manage the extra layer of data pertaining to multiple funds and all the underlying investments. As a GP or LP, the quality of the data is really the quality of the decisions being made.

LL: That is why service providers are leveraging their position at the heart of the industry's data to offer a platform like ours, positioning themselves as a partner for managing data between GPs and LPs. They are really looking to go beyond traditional services like fund accounting.

With a platform accessible by all market players (GP, LP and asset servicer) and populated by a rich data set, asset servicers can help GPs to provide timely, quality data to investors. This, in turn, enables investors to drill down into their portfolio and analyse it further.

IR: A centralised platform accessible to all market players provides an excellent way to optimise data exchanges and offer added-value solutions to all GPs, LPs, asset servicers and even regulators.

LL: Speed is no small thing. For any large investor, simply receiving the data in a timely manner will be important. Systems can help to capture, report and interpret that data for LPs, allowing for better analysis. Furthermore, the best systems today offer a robust security framework with controls to facilitate the exchange of data within the regulatory environments that funds tend to operate in. Of course, ownership of data and the responsibility to safeguard data will be increasingly important.

Q What are some ways that clients – GPs and LPs alike – can vet their service provider to ensure they would manage their data effectively?

IR: A lot of the questionnaires for service providers we see are actually quite sophisticated, even in terms of IT issues. But we think it is important that a service provider be able to work with the systems the GP is already using, so that the flow of information is as frictionless as possible. The best asset servicers will be able to work with all of the systems and solutions that a firm uses in order to receive and share data. The biggest challenge that still remains in all of this is how to reconcile the data from various sources and departments.

> *"Data quality and consistency has been a significant challenge for private equity, largely due to the lack of formalised standard practices"*
>
> LUDOVIC LEGRAND

LL: One of the things to be mindful of, especially for managers in multiple asset classes (eg, private equity, private debt, infrastructure and real estate), is whether the service provider is vertically integrated and has a wider geographical presence. Also, many of the larger service groups are arranged so that the private equity system never talks with the private debt system, and neither system talks to the real estate system, and so on.

A single manager juggling a private equity, debt, and real estate vehicle across multiple jurisdictions is looking for a reporting solution containing consistent data delivered in a timely manner. A single manager won't want to have their data managed across three different systems which are, likely, run by three separate teams of their service provider. The objective should be an ecosystem around the data life cycle using technology and based on collaboration.

IR: Outsourcing can help GPs to focus on what they do best, however, just like they need to build a solid rapport with their service representative (in, say, matters of fund accounting, tax or custody), the systems between the client and the provider need to be properly implemented as well. In a perfect world, both sides will be using eFront solutions, but even if they do not, that data needs to flow smoothly back and forth. Ideally, it would reside in a centralised accessible location to maximise its value for all stakeholders. Data collection and distribution can be a burden, but if handled well, can prove to be a competitive advantage. ■

Ludovic Legrand joined eFront in 2014. He is currently heading the asset servicing team for the EMEA region, which is also responsible for the French and Luxembourg markets for all client segments. Prior to eFront, he held different roles in the asset management industry, including as head of international development at Ecofi Investissements.

Iain Robertson has nearly 25 years working in the offshore finance industry, with the last 14 years at eFront. He now works as part of the dedicated team focused on the asset servicing segment for EMEA. He previously worked at Kleinwort Benson and has a background in technology.

The false economy of complacency

Increased scrutiny has made cybersecurity more important than ever for fund managers, but steps to avoid disaster need not be costly or complex.
David Turner reports

The Securities and Exchange Commission's division of enforcement created its first new unit in eight years in 2017: the cyber unit. This team – about 40-strong, according to regulatory-watchers – deals with all cyber issues, including cybersecurity, computer-based market abuse and cryptocurrencies, the medium for most cyber-criminals trying to extort corporate victims.

The unit is headed by Robert Cohen, a highly respected official, and staffed by "the cream of the crop", according to Sam Waldon, litigation partner at US law firm Proskauer Rose in Washington DC, and former assistant chief counsel in the enforcement division. Within enforcement, he describes the broader topic of cybersecurity as the top equal priority for the chairman, Jay Clayton, along with retail. As a result, in the SEC's rolling system of investment advisor investigations, "cyber has become a big part of the examination".

The SEC's focus on cybersecurity dates to 2014, when it issued a risk alert on the subject. This, and other guidance documents since then, make clear that financial services firms must have a formal programme, with someone responsible for evaluating what the firm is doing to prevent incidents.

Financial regulators in Europe are not taking it lightly, either. Under the EU's General Data Protection Regulation, which came into force in May 2018, a company that suffers a serious breach of data must tell the regulator and any individuals involved within 72 hours or risk a maximum fine of €20 million or 4 percent of global turnover – whichever is greater. It must also disclose the data taken, how sensitive the information is and the volumes involved.

Prompted in part by the new legislation, financial regulators have begun to show much greater interest in cybersecurity. In the UK, lawyers note the joint enthusiasm of three parties – the Information Commissioner's Office, the Bank of England's Prudential Regulation Authority and the Financial Conduct Authority – in stressing the dangers of cyber-crime.

"The FCA has really ramped up its consideration of cyber," says David McIlwaine, partner at London-based law firm Pinsent Masons and specialist in ICT and outsourcing. "It's beginning to send the market the message, 'We are taking cyber very seriously; we don't just leave it as the preserve of the ICO. If we do not think you're taking adequate preparation in relation to your customers, we too will fine you.'"

The FCA also makes clear its view that many firms are not doing a good job in this field. In a review of asset managers' and wholesale banks' practices published in December 2018, it found that most boards did not understand cyber-risks well, and that many risk and compliance departments had limited expertise.

Optimistic fund managers might note there have been few high-profile public examples among their peers of successful hacking: many had information on their clients disclosed in the Panama Papers leak of 2016, but it came from Mossack Fonseca, a now defunct local law firm.

Human error

However, outside the public gaze, lawyers on both sides of the Atlantic say they are aware of successful hacks at fund manager clients. Few of these hacks have relied on state-of-the-art techniques; it is generally much more basic than that.

"Usually the breaches I've seen have not been real technical hacks in the way I imagined hacks happening, where someone was an expert at writing computer codes. Instead they've been cases of human failure," says Waldon, who has seen several instances since leaving the SEC for private practice last year. He cites cases where someone takes an email address purporting to be that

of someone at a client company, but which is in reality slightly different: such as two 'v's instead of a 'w'. The email requests the fund manager to change the wiring details for money from the usual account to another one at a different bank, from where the money is siphoned off. This is a form of "phishing" that involves hoodwinking a person rather than an IT system.

Waldon's experience underscores the importance of maintaining what experts call "basic cyber-hygiene": training staff in good practice, ensuring IT hardware and software are kept up to date, and so on.

James Rounds, associate partner and cybersecurity expert at EY, the professional services firm, says that for the small and mid-sized businesses that account for most fund managers, basic cyber-hygiene provides "the greatest cost-benefit ratio".

This, plus one more practice: spending money on software that automates labour-intensive tasks, such as monitoring security event logs. In other words, smaller fund managers, which make up of the bulk of managers within private debt, need not despair: there is much they can do, even with slender resources.

But training must vary depending on the person, say experts, because canny scammers will tailor cyber-attacks to the person being scammed.

Valerie Abend, managing director of the financial services security practice for North America at professional services company Accenture, gives an example: a scammer might send a CV from a fake female applicant to a female HR manager. An emotionally engaging email says, as Abend imagines it: "My friend told me that your organisation really cares about diversity and inclusion" – a sensitive topic in fund management, where most of the fund managers are men. "I'm a woman seeking to make a change in my career. I would love it if someone could take a look at it."

Embedded in the resume is malware, and the fund manager is breached. ■

KEYNOTE INTERVIEW

It takes a conductor

Private funds technologies can do more than ever before, but it can be hard to choose the right solution and even harder to implement it. We spoke to Apex Group's Srikumar TE about how choosing the right service provider can enable firms to get more out of their systems and software

Today's GPs know that their systems and software are crucial to staying competitive, and are willing to invest the time and money to access the best tools. That means the industry's fintech is booming; with so many vendors, apps and consultants it can be mystifying to figure out the best mix to meet the firm's needs, not just today, but tomorrow.

According to Srikumar TE of Apex Group, there are certain specialists that are well-poised to help clients choose, implement or maximise their systems and software. But this requires a close collaboration between firm, fund administrator and tech provider to best manage these solutions. Like so many challenges with technology, it is not about the tool, so much as how it is used.

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Q How should private equity managers look at technology for their firms?

Today's tech architecture is increasingly defined by external factors. Reporting obligations to investors and other outside stakeholders heavily impact the way in which technology is used and the rise of Big Data only adds to the need to capture and analyse a granular level of data, regardless of the strategy or theme of GP. The swathes of data gathered then needs to be consolidated on a firm-wide basis to satisfy reporting requirements to LPs and regulatory bodies and deliver valuable insights into the factors triggering performance.

Regulations governing the compliance obligations of asset managers particularly around data collection, storage, security, access and usage are developing quickly. GDPR and other data protection regulations have heavily impacted both the flow and organisation of data with respect to processes and controls. The supporting technologies utilised to facilitate GPs are no longer simply shaped by traditional factors such as internal requirements, client service and market competition, but are now influenced by increasingly demanding regulatory requirements as well.

Bringing all of that together, asset managers are faced with a long list of often competing priorities and so an independent administrator helping manage some of those obligations and effectively managing the technology on the manager's behalf can be tremendously useful.

Q What value do fund administrators bring to the task of sorting out the various tech solutions? What makes them useful as a partner?

The role of the fund administrator has evolved. They are now intrinsically linked with technology through the necessity of employing various specialised tech platforms to deliver services. As the asset management

space continues to evolve and diversify to remain competitive, it means that those fund administrators that have the capability to deliver solutions across a wider range of clients and industries are the ones that add real value. We have seen collaboration between fund administrators and third-party tech vendors intensify as a result, so the role of a fund administrator goes beyond traditional reporting and regulatory functions, to a kind of tech-centric discipline.

This is where the fund administrator really enhances its value as a service provider. It's not a case of tech replacing the role of the fund administrator, it's a case of fund administrators exploiting the capabilities of the tech to maximise the benefits for their clients. The depth and breadth of experience allows administrators to better understand the unique dynamic of a given system or app, the pain points and the elements that might need more time and care in the implementation and maintenance.

Administrators are constantly evaluating tech providers and solutions against market standards and best practices, they have economies of scale and are able to discover the most compatible tech platforms for each type of manager or investment strategy. Ultimately they can effectively help GPs balance their information wish-list with the economics involved in implementation and maintenance of their tech architecture.

The other key benefit of the fund administrator sitting between tech and their client is the ability to identify trends as they develop within various corners of the industry. Naturally, due to the fact administrators often work with so many different vendors and GPs, they can help build better interfaces that integrate with a manager's existing system, which makes the upkeep more efficient as well.

Q Given that expertise, how would you describe the competitive landscape for vendors and independent consultants looking to serve the private equity industry?

The landscape has evolved rapidly in recent years, not just in terms of the number of new applications, but in how quickly vendors adapt to the market. The lag time between when a manager discovers a particular need and when the tech solution is deployed to meet the demand has shortened tremendously. This is due to a combination of influencing elements. What we see as one of the key drivers is the fact that these solutions are modular, so they do not require the extensive architecture that perhaps first-generation tech did, which means that evolution is occurring more frequently than before. These plug-and-play options are agile so that they can be all the more responsive to the changing needs of a manager.

Today, in situations where large amounts of data need to be migrated, for example if a firm is switching to a new platform or undergoing a major tech upgrade, there are independent consultants available to assist such projects.

These independent data consultants would not be affiliated with a given application. Instead, they will be pure data managers that specialise in the root applications of technology and can nimbly support data migration between platforms or between clouds and applications. Many of those consultants will be dedicated to the unique needs of private equity, so they will have a shorthand in speaking with managers, to help them over whatever hurdle they face. Naturally the space has become much more competitive, with more service providers, some of which have branched out from the large tech houses that were prevalent few years ago. These new entrants tend to have a sharper geographic or sector focus.

The administrator can play a fulcrum role when such a data consultant is engaged. Administrators are already a data repository for their clients and can work closely with such consultants to ensure the processes and end objectives are appropriately calibrated – at all times ensuring continuity and accuracy of information. Administrators can add value as they have both a deep understanding of the particular needs of their client and a broad view of the many vendors that may fit the bill.

Q Would the role be closer to one of consultant to ensure the manager selects the right fit?

Rather than merely recommending a tech solution, we see our role as affording our clients a choice. Given the range of solutions and applications available, the manager's in-house teams could have a preference for a given application. Perhaps the front office is used to a specific system, even if it is not the cutting edge. Our position in this instance is not to dictate change but to assess the best fit solution for both their current arrangement and future ambitions.

We would not advise them to drop a particular solution for a different platform they are less comfortable working with. For that reason, we have deliberately developed our technology service offering to ensure they have a choice. Our strategy is to find a solution that fits their current arrangement. That solution could be through using a new

Agnosticism's appeal

How important is it that fund administrators be tech agnostic, or is there value in an administrator offering a specialised tech offering of their own?

My sense is that the managers who have spun out from big houses may be looking for a single, specialised solution. They are setting up their own shops for the first time and are much more focused on investor relations, deal sourcing and building out their strategy. These managers require a solution that is as simple and as effective as possible. They do not have the luxury of time or resources for building out an elaborate tech architecture during the initial phases. We do have such a solution which is modular and can be cost-effective. It is designed to scale with a new asset manager's preferences over time.

For more established managers who have a clear preference in their service and technological solution requirements, we have the depth and expertise not only in the skillset familiar with various investment strategies but also the expertise in servicing managers across a broad range of leading applications. This is exactly why we have evolved our business to become tech agnostic. It means we have the ability to support GPs with very specific preferences or those involved with multiple strategies within Apex without the need for them to go shopping for the best solution for each investment.

application that is particularly compatible with one already in use or it could be that a workaround is devised by our technical support team. We have found this approach allows for a seamless data interplay between the investment and operational teams. When a client has a strong preference for a given application, our role is to help facilitate that and make the most of what is already at hand.

It is in instances when the manager is technology agnostic that we play more of a role in drilling down into the technology choices available to them and finding the best fit – effectively helping them balance their information wish-list and an economically efficient solution. This positon drives our strategy to develop our offering into becoming a tech agnostic provider. We have invested in ensuring that our clients have the broadest range of technology platforms in the market available to them so as not to limit them to a single application or solution.

In private equity, we deliver an unrivalled choice to clients, delivering service across eFront, InvestTran, Capital Tracker, AltaReturn, Investment Café and others. Our value comes through the ability to deliver expertise across all of these platforms in order to assist our clients in leveraging the power of the technology most suited to them.

"It's not a case of tech replacing the role of the fund administrator, it's a case of fund administrators exploiting the capabilities of the tech to maximise the benefits for their clients"

SRIKUMAR TE
Apex Group

Q How can administrators help managers moving into new asset classes? If their administrator has no experience in that asset class, do they need to find a service provider that can service both?

If a manager's ambition is to expand into more than one theme of investment strategy it is feasible that they could manage two specialist service providers, though not ideal. The manager must at this inflection point seriously consider selecting a service provider who not only partners with them during their evolution in the new strategy but is also a specialist in every investment strategy the manager may have on their road-map.

The ability to service all asset classes under one roof helps us to share expertise on new strategies and align the GP's new initiative with their overall preferences in information consolidation and reporting. It means we are aware of how the strategy fits in with the firm-wide vision. We get to know the teams working on each strategy and understand their needs so that we can help devise a cohesive tech-supported service solution for the entire business.

Q Given the role fund administrators can play in a firm's technology, how should they look at that skillset when choosing their first, or next, service provider?

A lot of due diligence goes into the administrator selection process, but I would say the theme beyond the standard checklist is to aim for the best combination of tech and expertise. The skillsets required by administration teams today differ from what was required a decade ago. While applications and systems can handle a lot of data-related issues, there will always be a gap between what the tech can do and what a manager needs. It is not enough to simply provide the technology or the skillset in isolation, administrators have the responsibility to deliver skilled resources to get the most out of technology. It's really important that managers vet the team with respect to their technical and technological expertise as well as the administrators' technology offering before making a decision.

Q When picking an administrator, managers will often talk to peers using that service provider for an unbiased assessment. What should they ask that peer about the administrator's tech capabilities?

It is important they dig into the actual systems and apps that are in place at that peer's shop. Sometimes there will be hiccups or quirks to a given solution that have nothing to do with the administrator. That said, it is always good to ask how seamless and swift the implementation and maintenance of solutions has been and the level of understanding of each application the administrator has demonstrated.

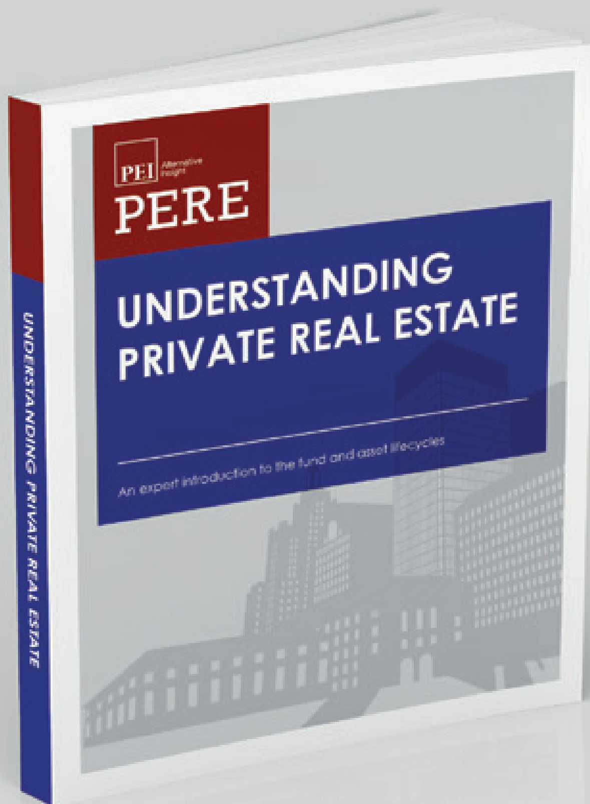
Q It is rare that firms build truly in-house technology solutions for all their needs these days. Is there ever a time or a situation where it makes sense to create a solution from scratch?

There will always be a few managers who simply want that kind of control and are willing to spend the time and resources to develop something truly in-house. But the reality is that reporting obligations to LPs and to regulators are changing at such an accelerated rate that the manager has to develop a system that can evolve rapidly and that is not always as easy. Even if a manager gets a system implemented, it takes an enormous amount of resources to manage and maintain an in-house tech solution, especially one that keeps pace with service providers who specialise in this space.

Most managers want a solution they can define and control, but without being responsible for every byte of data and every line of code. The demands of the industry are evolving constantly and that requires specialised expertise from tech providers and fund administrators to stay on the cutting edge. ■

PERE

Understanding Private Real Estate



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PEI

For effective outsourcing, relationships matter. Blue Wolf Capital's chief financial officer, Joshua Cherry-Seto, offers his insights and regrets.
By Brian Bonilla

Outsourcing has become an important aspect of the private equity industry, but not all firms understand how to pick the right third party and what a successful relationship with them looks like.

Joshua Cherry-Seto, chief financial officer and chief compliance officer of Blue Wolf Capital, a mid-market firm with more than $1.2 billion in assets under management, shares some of his regrets, advice and future outlook on outsourcing.

Q What is your biggest outsourcing regret?

A Not engaging a consultancy to run a formal process. Our time is limited and is worth a decent project manager cost. We will spend half a million [dollars] on a fund administrator, so $30,000-$50,000 for support on the search process is money well spent.

Q What was your most important lesson learned?

A Relationships matter – prior ones and future ones. These are long-term partnerships. Take the time to understand and show we care about what is valuable to them, too.

Q Which outsourcer has been great for you?

A Proskauer – corporate counsel including fund offering/co-invest support and tax structuring – efficiently getting us expertise and, more importantly, a partner to our business to help us think through what we are trying to accomplish.

Q What are your three most important tips on outsourcing?

A Don't shortchange the requirements and search process; bring in a consultant to organise and run the process, just like we pay placement agents to assist with fundraising.

Focus on the relationship and make sure they understand high touch/white glove is required, and they are worth the extra cost to us. Understand their business model and how you add value to your outsourcer – the more you are seen as valuable to them, the more alignment will exist, and the better fit and service you will get.

> "Understand their business model and how you add value to your outsourcer – the more you are seen as valuable to them, the more alignment will exist"

Q What is the next function you are considering outsourcing?

A Portfolio company reporting, as we scale and want to spend more time on analysis than collecting.

Q What would you love to outsource but can't?

A Chief compliance officer! We are definitely looking to do a better job of outsourced support to the CCO function.

Q What do you wish outsourcers did better?

A Understanding us – being in our space more.

Q Explain an experience where you found you were disappointed in a function you outsourced.

A We have had two experiences. On fund tax, it was good for the earlier stage of our life, but as we scaled and expanded in complexity, we did not feel they continued to give us leverage.

On fund administration, we used a very small, niche provider for staff augmentation which was helpful when we were small, but they did not continue to invest in their team, so lost all depth by the time we left. ■

Joshua Cherry-Seto
Chief financial officer
Blue Wolf Capital

KEYNOTE INTERVIEW

Navigating the credit frontier

As more private equity firms launch their first credit vehicles or expand their initial offerings, Jay Cipriano and Chad Longenecker of SEI's Investment Manager Services division caution how complex administering these funds can be

No one can fault a manager for looking to capitalise on the boom in private debt, but like any expansion, the older it gets, the greater the risk of a contraction. Even if growth continues, competitors will crowd the space, requiring greater skill and specialisation to stand out.

According to a recent survey of managers and investors sponsored by SEI, the private debt market is already experiencing these pressures. While the market is still expanding, its scale and increasing competition is creating more covenant-lite structures that favour borrowers and court risks.

While the report, *Private Debt: Preparing for the Unknown*, finds general and limited partners bullish on the sector as a whole, it stresses a note of caution about what comes next, and advises keeping an eye on mitigating risks, especially since LPs are less sanguine about those risks than GPs. Valuations are a top concern, as nearly half of LPs considered assets to be overvalued, and 60 percent expect a market correction within the year.

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Fundraising has slowed in the first three quarters of 2018 as investors prefer the safety of established managers. The five biggest debt funds raised 66 percent of all capital committed in those nine months. That said, the market is expected to double in size by 2023, even after ballooning from $245 billion to $667 billion over the last 10 years.

The report finds both GPs and LPs agree that as the market matures, specialisation will increase, with nearly 71 percent of all respondents expecting more interest in specific sector expertise in the years to come, rooted in the idea that the more a manager understands about the borrower's industry, the savvier a lender they'll be.

And that savvy matters more as the market faces some dark clouds on the horizon. The US Federal Reserve announced that the private debt market may pose a threat to financial stability, while the rate of growth and the number of new entrants has many concerned about dwindling returns.

One way to address the current climate is for managers to place greater focus on expense management and productivity and take advantage of the transformative potential of technology. We sat down with SEI's

Jay Cipriano and Chad Longenecker to discuss how managers should move forward in a time of such uncertainty.

Q The market is expected to double in size by 2023. How should managers think about the private debt landscape?

Jay Cipriano: There's been remarkable growth in the last few years. In 2015 and 2016, the market grew by $100 billion each year and by $120 billion in 2017. That's driven by actual performance data, not just high hopes. Our report cites some impressive statistics. The pooled internal rate of return for all vintages from 2004 to 2016 was 8.1 percent, which included the impact from the financial crisis. Direct lending funds boasted a pooled IRR of 11.8 percent. With little correlation to benchmark indices, those direct lending funds look like smart diversification plays.

Chad Longenecker: But, with that growth comes greater competition. Private equity firms and hedge funds are launching plenty of credit vehicles alongside debt specialists, even as traditional lenders, like banks, may be coming off the sidelines. Most respondents – half of investors and 64 percent of managers – do not expect banks to reshape the private debt market, but can all these players co-exist and thrive?

JC: And while we're not predicting the future or implying a downturn in private debt would cause any sort of systemic risk, no one is making the assumption that some kind of correction isn't on the way.

Q What can managers that are entering the market for the first time, or are expanding their credit offerings, do to prepare for that uncertain future?

CL: A lot of new entrants to the space underestimate the operational burden involved in managing these funds. We've seen some private equity players in particular invest in top-tier front-office personnel for their credit funds, but not bulk up on operational capabilities at the same time.

JC: Those capabilities are available from providers like us that have serviced private equity and credit funds side by side already, and from operational staff at existing credit shops. Just as they comb private debt funds for investing talent, the more successful managers seek out operational talent as well. It's about building out the entire team.

Q What are the key differences private equity managers should be aware of in building that credit operations team?

JC: It's a volume play. The typical private equity systems and processes can't simply be reconfigured for credit. Private debt doesn't just need separate systems for accounting and the investment process, but performance reporting as well. These funds have significantly more events, kick off more income, require more calculations and distributions with that income, and all with multiple structures.

For private funds that administer their funds in-house, Excel won't be able to handle the volume, or if it can, the risks of error are substantial. This drives them to look for automated technologies just to keep up with the pace of transactions. Investing in those systems in-house can be expensive and cumbersome, not just to acquire but to maintain over time.

CL: That also means it can take longer to launch products and once done, slower to calculate performance and produce investor reporting. GPs often realise that they don't always have the time to craft solutions from scratch, so they partner with a third party because it's the most efficient way to get up to speed operationally and in a timely manner.

Q What role does the size of the fund play in tapping these resources?

JC: The larger, sophisticated managers have the staff and technology to handle a large multi-strategy, multi-asset structure, but some of today's biggest funds were early adopters of the outsourcing approach for credit. They understood the nuances and complexity involved in bringing a credit vehicle to market and found outsourcing to be the most efficient way to accomplish that.

CL: Large firms tend to outsource for expertise, while small firms typically do it for resources. Make no mistake, smaller firms may not have a choice but to rely on a combination of technology and outsourcing, given today's competitive landscape. The smaller firms tend to have specialised or niche strategies, which face what we call in our report the 'specialisation paradox'.

On the one hand, managers don't want to be limited to a certain kind of vehicle, but to be seen as experts in a broad array of products, and like having a diversified portfolio in the case of a downturn. However, they face competitive pressures to commit to a sector of expertise, and LPs are looking for a way to categorise the growing field of managers.

JC: Firms of all sizes and sophistication outsource, but this means that the smaller firms are under more pressure to devote their resources and expertise to mastering that niche and not waste the time or internal resources building operational systems and processes.

Q Can technology play a role in improving the operations of firms that are already in the credit space with a fund or two?

JC: Technology can absolutely help streamline processes. For instance, we have a proprietary tool that automates the workflow for investor onboarding, shortening the sign-up and subscription process, and significantly improving the investor experience. Typically onboarding is done by hard copy and driven by the law firms. That could take up to 90 days or more; with a workflow programme like ours that digitises the entire process, it can take as little as a week.

Q As competition heats up in the credit space, adequately nurturing and sustaining investor relationships is even more crucial. What role can technology and outside experts play in satisfying LPs?

CL: One of the primary advantages of partnering with a third-party provider is to take basic blocking and tackling off the plate of in-house staff so they're freed up to focus on sourcing deals and handling LPs' needs and wants. In essence, you're leveraging the expertise of both parties to deliver a better solution to the market and better experience to investors.

JC: Offering an online investor dashboard, for example, allows a GP to grant investors access to statements and other fund data,

60%

of LPs expect a market correction within the year

and enables them to communicate with the LP base in a more timely manner and with more efficiency. They can even upload market commentaries or periodic reports in video format.

As the market matures, LPs are getting more sophisticated and demanding. They want the ability to slice and dice data as they please, but there's a balance to strike. Pure data dumps aren't a shortcut to transparency. Instead, GPs are using technology platforms that ensure the information is meaningful, insightful and appropriate. Doing so then allows the investor relations team and portfolio managers to focus on higher value activities.

Q In a contraction or significant downturn, regulators will be more aggressive in supervising the industry. What can managers do now to be ready when a regulator comes knocking?

CL: This is where a robust workflow platform can make a real difference. Today's systems can map a manager's activity and provide evidence for what a firm did and how it's in line with the policies and procedures found in the fund documents. Additionally, having automated technology and sophisticated data management tools (whether in house or outsourced) enables GPs to produce more accurate and consistent regulatory filings across products, countries and regulatory regimes.

Q There's a lot of discussion about tech advances in the industry and how much the right solution can do. What role will data management and analytics play in how the market evolves?

CL: In our report, we found a slight disconnect between GPs and LPs on how much or how fast data analytics will change the private debt process. LPs were more bullish than GPs on what technology could do.

Half of all investors think better analytics will create more customised investment vehicles. More than half think data analytics will allow more types of investors to participate in the private debt ecosystem.

Still, managers believe there's only so much data can do; at a certain point, a human being has to make a decision. The most likely development in the next few years is the use of alternative data in credit scoring decisions.

Key questions

The cybersecurity threat landscape is constantly evolving as attackers develop new and creative ways for monetising compromise

Is your fund administrator simply consuming threat intelligence data, or are they actively producing actionable data that allows them to keep pace with or beat the adversary time and again?

Is your fund administrator actively mimicking the behaviours, methods, and tactics used by an adversary to test the effectiveness of the controls in place?

How does your fund administrator handle vulnerability, configuration, and patch management for all devices, including endpoints, servers and network infrastructure?

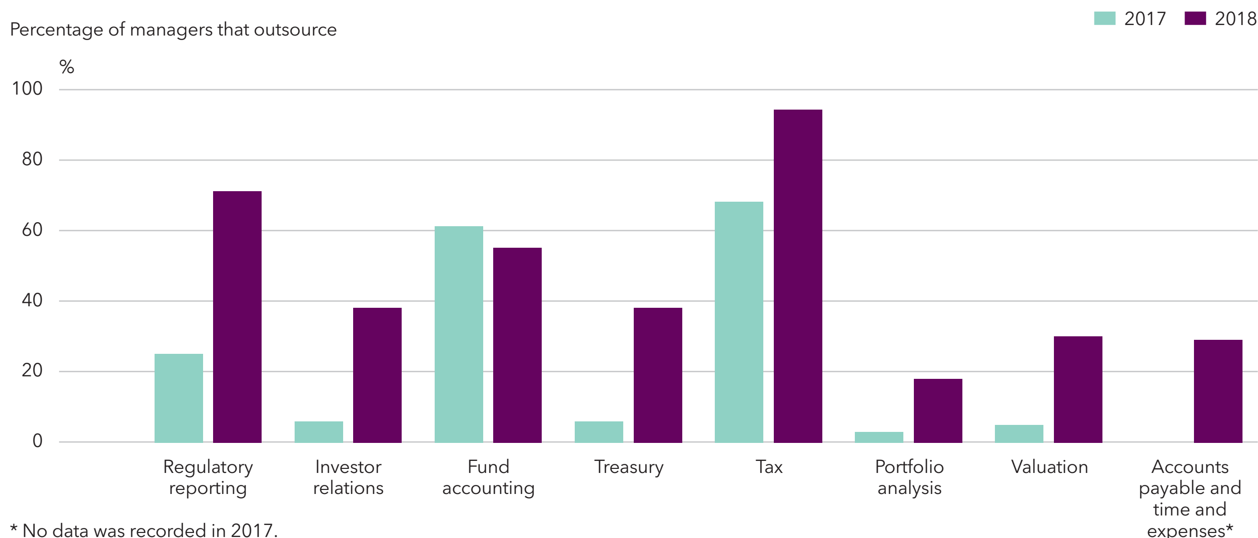
What independent controls testing is performed and does the fund administrator base their controls off a global or federal industry cybersecurity controls framework?

What methods and content are used for staff training and cybersecurity awareness education?

JC: At the end of the day, all of our tools and services are focused on making our GP clients' businesses better and more successful, freeing them up for higher level tasks, like optimising investment decision-making, sourcing and managing investors and finding the best way to explain the firm's tenets and vision. This is still a business built on relationships between the manager and the investor, and we strive to streamline as many tasks as possible to give the manager the time to make the most of those relationships. More than anything else, the health of the GP-LP relationship will be the crux for how a manager weathers whatever comes next. ■

Databank The relentless growth of outsourcing continues with firms looking to cut costs and improve technology, according to recent surveys

Percentage of managers that outsource



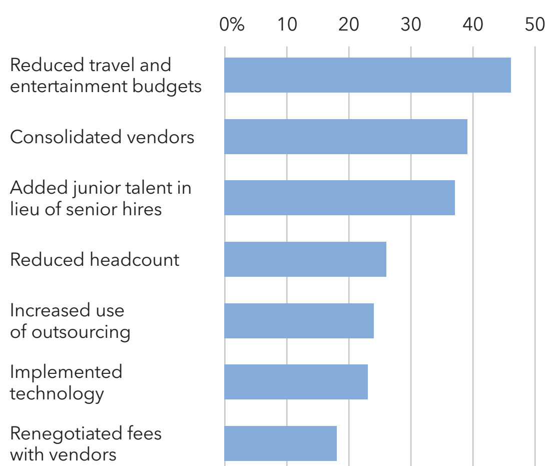
* No data was recorded in 2017.
Source: EY's 2019 Global Private Equity Survey

Change in respondents' level of outsourcing from 2017 to 2018

By AUM	Regulatory reporting	Investor relations	Fund accounting	Treasury	Tax	Portfolio analysis	Valuation	Accounts payable and time and expenses
> $15bn	▲	▲	▲	▲	▲	▲	▲	▲
$2.5bn-$15bn	▲	▲	◀▶	▲	▲	◀▶	▲	▲
< $2.5bn	▲	▲	▲	▲	▲	▲	▲	▲

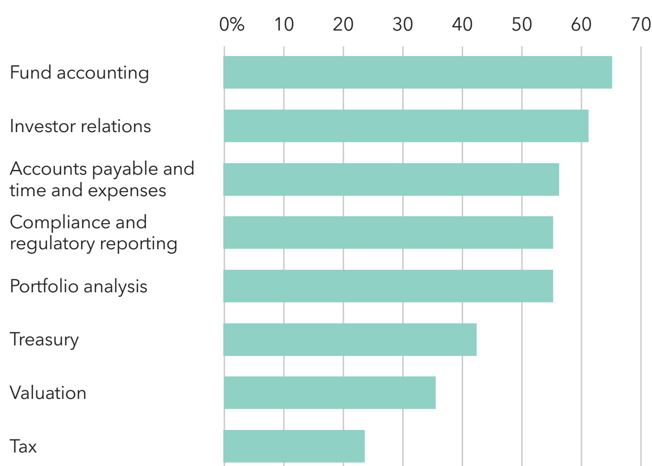
Source: EY's 2019 Global Private Equity Survey

Actions taken to mitigate management company margin erosion



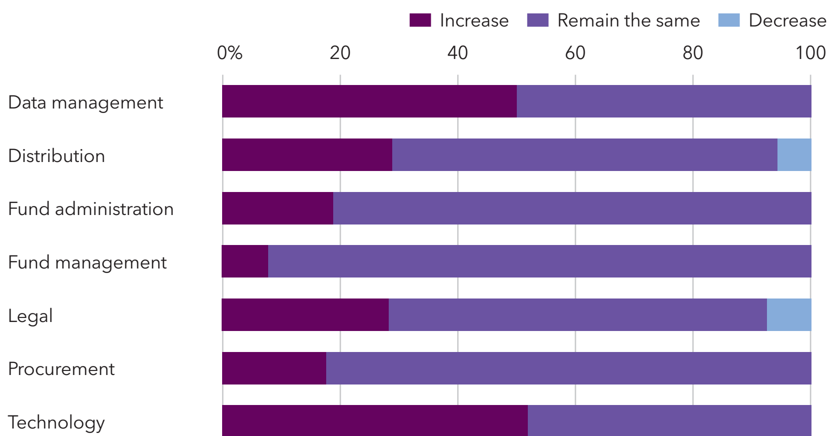
Source: EY's 2019 Global Private Equity Survey

Technology areas in which managers have invested over the past three years



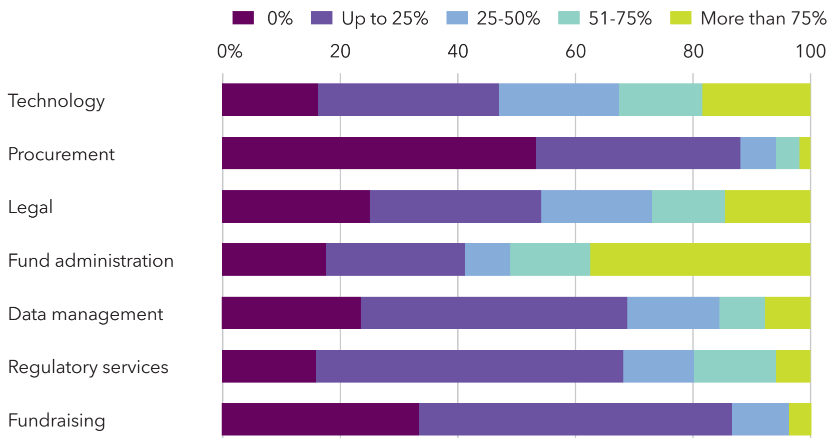
Source: EY's 2019 Global Private Equity Survey

How managers will approach outsourcing over the next 12 months



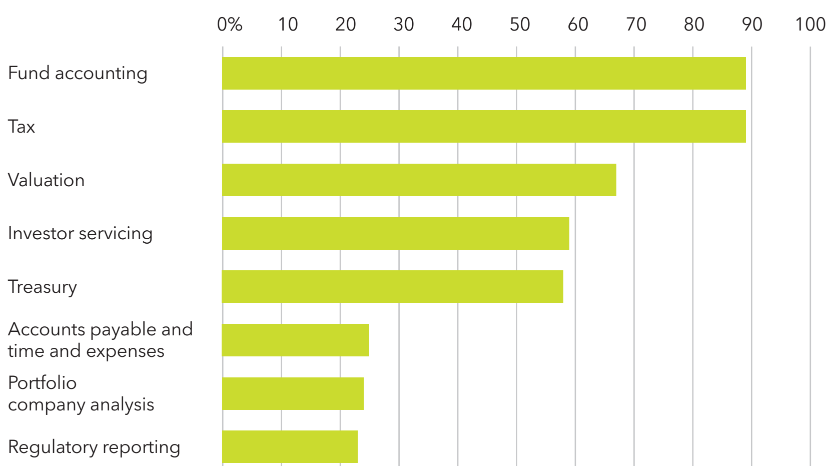
Source: Private Equity International

Target outsourcing levels



Source: Private Equity International

Percentage of managers that pass outsourcing costs related to finance functions on to funds



Source: EY's 2019 Global Private Equity Survey

$2.29trn

PE assets under administration, according to eVestment Alternative Fund Administration 2018 survey

100%

Of fund managers will increase or maintain outsourcing levels over the next 12 months

51%

Of fund managers are seeking to outsource at least half of fund administration

50%

Of fund managers intend to increase data management outsourcing over the next 12 months

32%

Of fund managers want to outsource at least half of their technology needs

28%

Of fund managers will increase legal outsourcing over the next 12 months

Source: PEI

Automated waterfalls **Data gathered for the debut issue of *PEI's* new title *Private Funds CFO* suggest private equity firms have deep-seated doubts about the new technology for calculating distributions**

Private equity firms remain hesitant to adopt an automated system for calculating waterfalls, despite the growing number of service providers offering such products, ***writes Brian Bonilla***.

Of the 15 chief financial officers contacted by *Private Funds CFO* for its inaugural issue, only three said they were using a service provider or software for this purpose. "I'm not sure an automated system buys you much, except as support for the Excel waterfall or maybe vice-versa," one chief finance officer says. The CFOs cite multiple reasons for not hiring a service provider; one issue often raised was the complexity of waterfalls at their firm.

Automated for the people?

- Did not automate their waterfalls
- Automate using a third-party provider

Why not automate?

- It was too expensive
- Our waterfall is too simple
- Our waterfall is too complicated

> "Waterfalls have gotten so complicated that I don't know how you would ever programme all the steps in"
>
> CFO at private fund

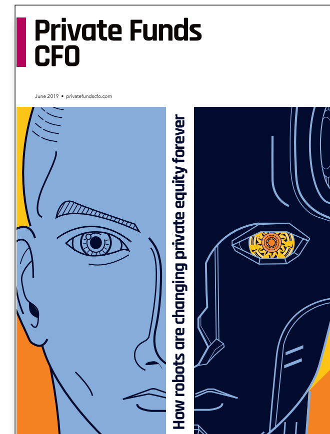
"I would love to find a solution," one CFO says. "However, I have found that the waterfalls have gotten so complicated that I don't know how you would ever programme all the steps in a system. Almost every time we run one in Excel it needs a new tweak. Our current waterfall, besides the routine 'steps,' also has a [minimum] fee giveback test and a waiver giveback test.

"We also have something called a distribution advance, where the GP can forgo its carry distribution and instead distribute to the LPs. And it's been my experience that no accountant ever completely trusts a system, so most likely you would need something in Excel to be sure the system is calculating correctly."

Cost is another factor that firms take into consideration.

The same CFO mentions using an accounting system that was an industry leader three years ago, and says they were interested in working with the same programmers to build a waterfall in the system.

However, they were put off by the fact the cost would have been $40,000, and also because the third party couldn't provide a reference from another firm using their waterfall system.



In the first issue of Private Funds CFO

- **Cover story: What robotic process automation means for your job**
- **Abraaj Group: The trial of Arif Naqvi will shine ever-brighter light on operational due diligence**
- **GIPS 2020: Will CFA Institute's guidelines catch on with PE?**

Cost can also affect the decision of a private equity firm when it comes to even considering automated waterfalls as a solution.

"This is something we can do on our own, and if it were inexpensive it would be something I would then consider," another CFO says. ■

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