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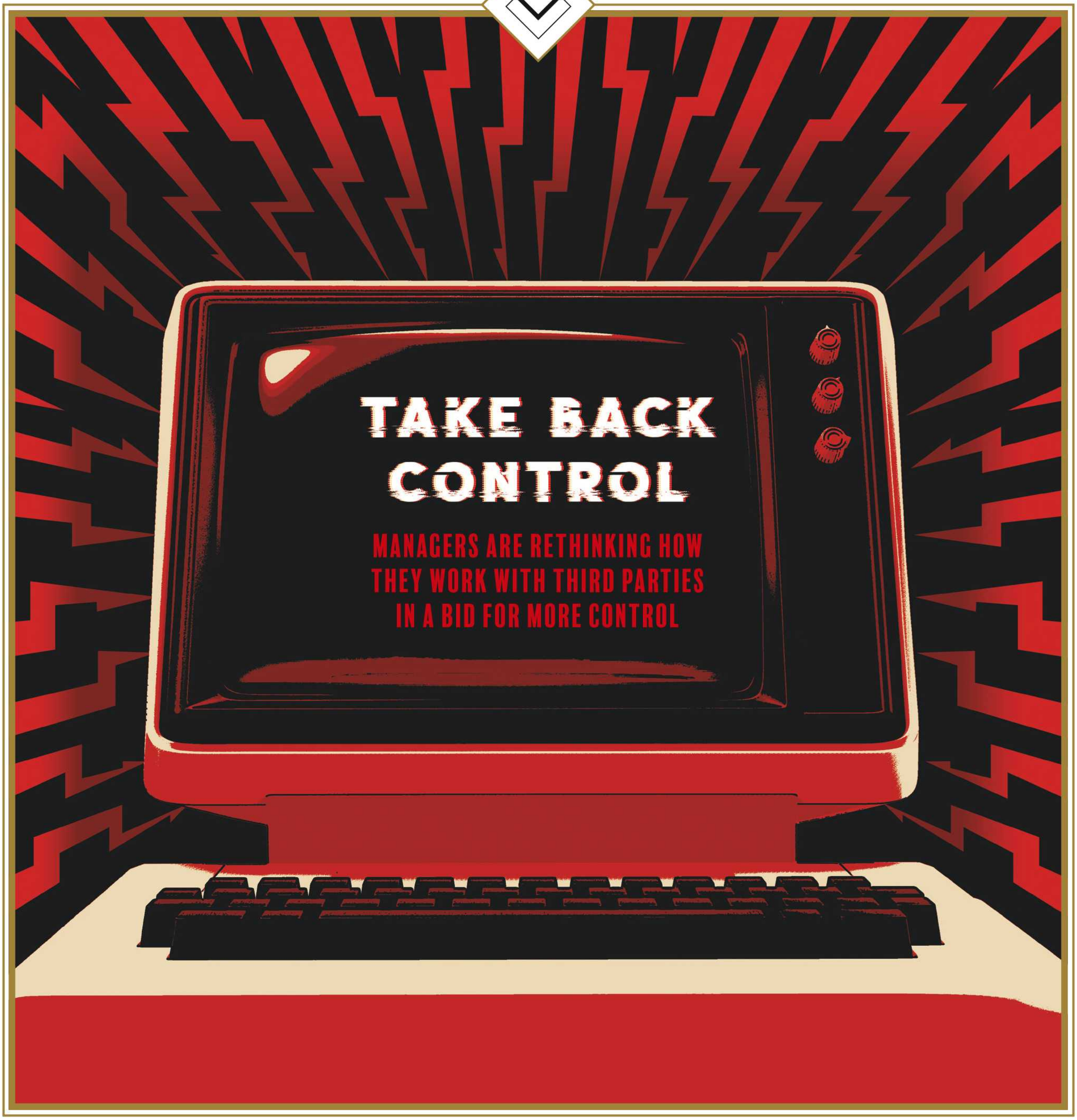

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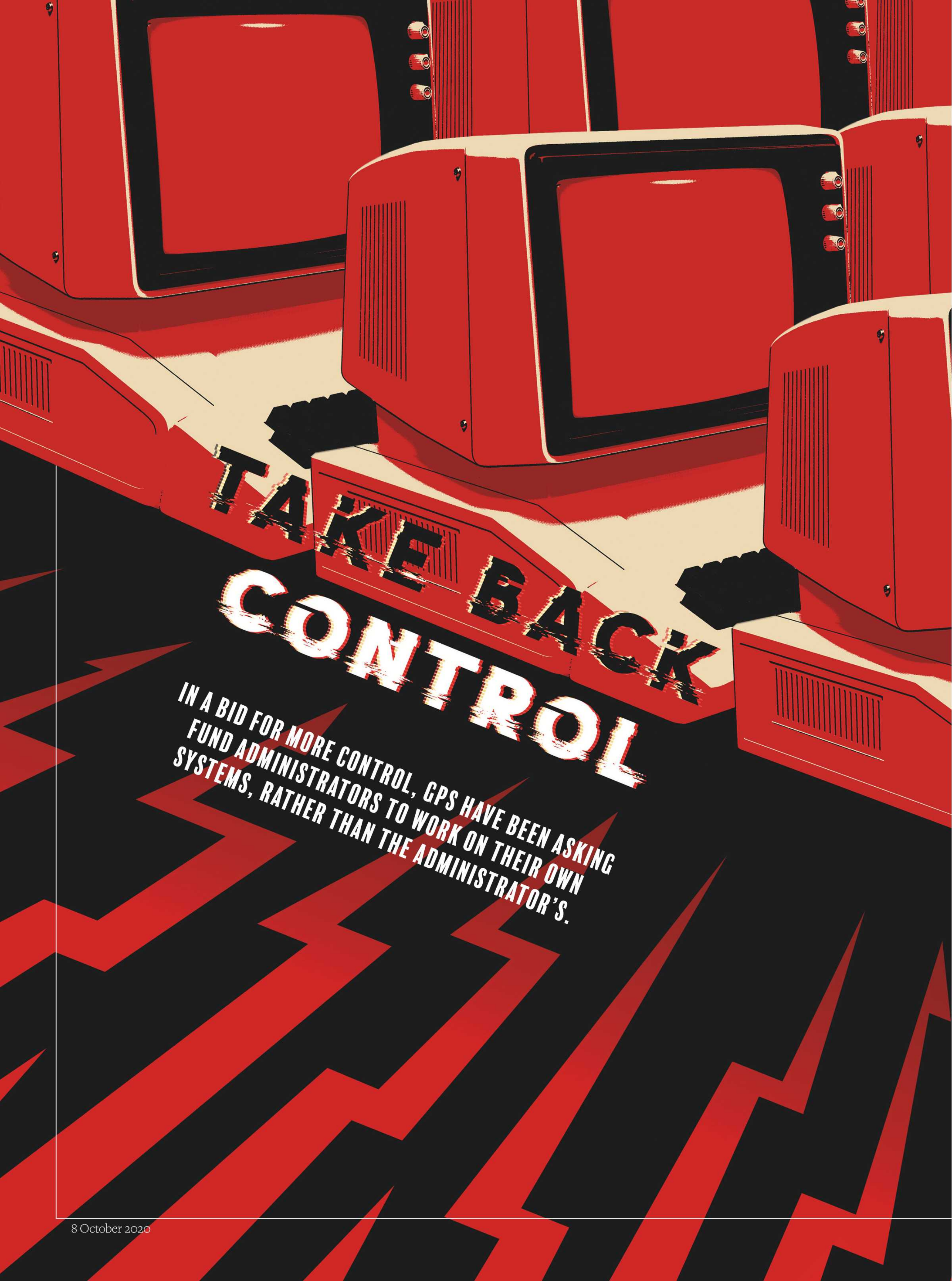
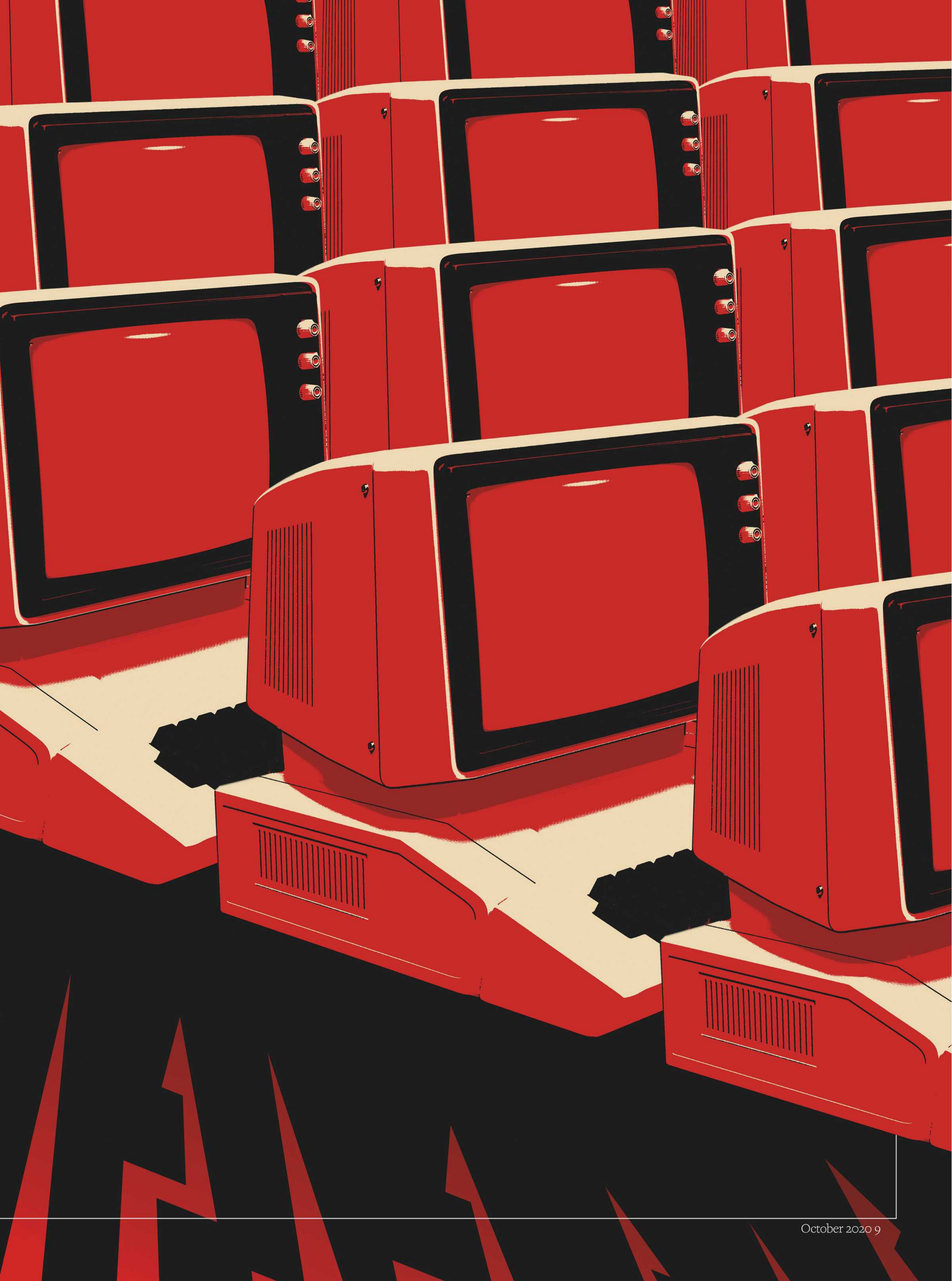


TAKE BACK CONTROL

IN A BID FOR MORE CONTROL, GPS HAVE BEEN ASKING FUND ADMINISTRATORS TO WORK ON THEIR OWN SYSTEMS, RATHER THAN THE ADMINISTRATOR'S.



Beyond increased control, other drivers behind exploring this approach include a desire to be more responsive and self-serving, as well as potential cost savings. Furthermore, advances in cloud-based private capital fund software applications make this concept more feasible than it previously has been.

But does it really work? There is a lot of logic behind outsourcing; tapping into expertise, greater investments in technology, systems that can keep up to date with changing regulation, and large, steady teams.

Under pressure

"What's really bringing this conversation to life is Covid," says Ryan Keough, chief revenue officer at Allvue Systems. "When it hit we saw the disruption. LPs started to request information they never had before - they needed to look at their investments through a very different lens, which created huge demand and stress on their infrastructure."

A typical GP tech infrastructure combines various point solutions. When put under the pressure of remote working and increased reporting demands, workflow issues caused by each system having its own data source were exasperated. Some firms are naturally responding by wanting to pull everything into one system, which they control.

"Working from your own system means GPs are more able to self-service and more able to respond to LP information requests," says Tim Friedman, founder and CEO of PE Stack. "The way in which GPs respond to LPs could impact the way investors view them. It makes sense for GPs to report on data themselves and be responsive."

Indeed, a desire to be agile is an important factor here. "Thinking about the reason why GPs might be looking at this is because, firstly, they're not getting information from administrators quickly enough. And secondly, they can't absorb information quickly enough. They might think using an internal system is a way around it," explains Barnaby Piggott, founder and CEO of Holland Mountain.

According to Friedman, this approach could reduce errors. "If you think about all the different areas where mistakes could arise, if everything is all on one platform - wherever that is - there's arguably less scope for error. Or errors are easier to spot."

Could another motivation be an attempt to reduce costs? "There are funds that will look at their expenses and try and push them down if they're already using software that's full front to back and they're paying for it. Or the cost of taking on new models and then going to a fund administrator, then price sensitivity does play a part," says Friedman.

And perhaps there are cost savings for the fund administrator

working in this way as well. Fund administrators are the largest clients for the major software platforms; an ability to service clients without taking on additional licences could create cost efficiencies.

Leave it to the professionals

The counterargument to this approach is that fund administrators are experts. And while Covid may have some GPs wanting more control over their data and workflows, for others it has only strengthened the case for having an expert third party looking after an entire business function.

"Some of the reasons GPs outsource is because of factors such as staff turnover, advanced technology and an increasingly complex regulatory environment," argues Piggott. "GPs use fund administrators because they invest in technology, robust processes and steady teams."

Furthermore, fund administrators are often seen as a safe pair of hands, providing LPs an additional layer of comfort. "The reason why LPs are happy with third parties is because it's exactly that. If a third party is logging in to use your systems, all the things you pay a fund administrator for have gone out the window," adds Piggott.

Friedman disagrees. "I wouldn't say having a fund administrator is a proxy for quality. LPs are responsible for making sure that firms are compliant, they're not relying on there being a fund administrator for that. Ensuring GPs are compliant and reporting properly is why we have auditors and regulations. LPs are looking at all of these things."

But, given the rapid changes in working conditions over recent months, with GPs facing new pressures and demands, old ways of working are facing increased scrutiny.

"If you think of a GP's workflow; managing investments, funds and assets - you want to manage them holistically and understand their performance and potential risks. You need a data strategy to be able to look at what's happening and also provide the proper transparency and reports to LPs. This is more challenging if you're operating from stitched together point solutions that can sometimes end up being a Frankenstein's monster, and a nightmare to manage," says Keough.

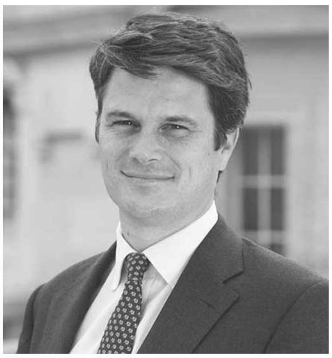
Under new management

In response to this, software modules are being designed with a better understanding of how they need to be fitted together to other point solutions.

Meanwhile, entrants to the market are taking a different approach to the traditional players. "If you're a newer player you can design a coherent front to back office suite that is fully integrated from the outset," adds Friedman.

One of these newer players is Allvue Systems. Could the use of this software be more appropriate for GPs asking fund administrators

THE CASE FOR PRIVATE CREDIT FUNDS



ROB SHAW, APERA CFO

Given the complex nature of loan reconciliation and strong demand for these funds, are they better suited to keeping systems in-house?

HOW ARE YOU CURRENTLY SET UP?

There are two parts to our set up; the fund part, which handles the drawdowns, distributions and so on, which runs on Investran, which SEI then uses Geneva as a loan accounting tool. Then we take the information on loans in Allvue and reconcile that with Geneva.

We've kicked around the idea to remove the reconciliation process from Geneva and feed it into Investran / SEI in order to avoid the duplication.

IS THERE A GREATER ARGUMENT FOR CREDIT FUNDS RUNNING EVERYTHING FROM ONE SYSTEM?

Credit as an asset class is a growth area. But the demand is aimed at lots of different parts within it. For example, a loan of $20m can be split in many ways. We have some loan positions allocated in six different pools of capital. It isn't just held by one fund, it's more likely to be a fund, an SMA [separately managed account], a co-investment and other separate pockets of capital - and that's where the slicing and dicing takes place. It's making sure we can manage the performance of one loan across these six different pockets of capital. On top of that, we might need to hedge currencies across those different pockets.

As we offer co-investment opportunities to our LPs, we want to be a solution provider and work in a way that is beneficial to them. We can't do that from Excel. And this is the crux of it, when companies borrow from us we look like one lender, but the economics behind that loan can be split in lots of different ways.

YOU MENTIONED THAT YOUR CURRENT SETUP CREATES A DUPLICATION, IS THAT GOOD OR BAD?

It works and it doesn't. I don't really like duplication as a principle, but on the other hand it is part of a robust reconciliation process.

For example, in Allvue there's an IRR functionality. I could run IRRs for all instruments immediately. But for it to work I need to know the cash flows are the same as those hitting the bank account. In order to do that, I need to make sure it matches what's on SEI.

This is where duplication helps. I can work out where the differences are, know the single source of truth and ultimately what the IRR is.

From an LP perspective, the administrator is reporting on positions provided by the manager. LPs probably like that separation; it's good to have a third party view. Furthermore, the administrator needs to check our information anyway and the only way to do that is through a parallel system, so you end up where you started. To say to investors that the reporting positions are coming from us, I'm not sure that's the best thing.

to use their own system? "Yes, it would work, given that it is designed from the ground up in that it is an all in one platform for PE," says Friedman.

Allvue's Keough (unsurprisingly) supports this view. "We are the only player in the market that can address the credit and PE space with one solution from investment to LPs. Looking at most players, they only address part of the workflow, such as accounting, monitoring or portals. We do the whole life cycle as well as across strategies. We're unique in having a full end-to-end product."

Hybrid theory

But it's not just the software players that are adapting to demands for control and flexibility. Linnovate Partners describes itself as a technology-enabled asset servicer. "Linnovate has good software and a good service, it's a hybrid," notes Friedman. "The future of fund administration has to be more of a tech play, and a good service."

When it comes to facilitating new approaches to workflows and partnerships, Linnovate's fintech-based delivery gives it the necessary flexibility. Says Redmond Lee, Linnovate's managing director: "We will leverage a client's tech where it makes sense to do so, but we will connect it into ours because GPs aren't always set up to be full administrators. Instead, we integrate and connect their tech with our systems. In this hybrid model we're not only offering an outsourced service, but we can also do the tech part."

Lee makes an interesting point when it comes to working on a GP's system: "If you look at where the world is going, we're moving into a sharing economy. To win the client's trust you will do as much as you can to make them comfortable. Our approach is to enable and enhance."

As ever, working out the best operating model depends entirely on the size and maturity of the GP. But for those interested in a new approach, it must be done in the right way.

Better together

"If a fund administrator was offering this model and they would help with set up, then there's a tighter partnership and you're set up to scale," explains Friedman. "A riskier approach would be to buy the software and implement it, and then ask an administrator to deal with it. Then you're setting yourself up for potential issues."

Piggott agrees, "Putting in your own systems and having an administrator work on it really doesn't make a lot of sense. What you're paying for in theory is using high-quality tech and standardised processes. The people providing this service will not be used to doing their jobs on firm-specific installations of fund administration systems. Why take all the core reasons for outsourcing and chuck them in the bin and buy your own systems? It doesn't make a lot of practical or financial sense."

Piggott's view is based on first hand experience. "We have seen firms try this in the past and few have been successful. It's not a scalable model. It doesn't make a lot of sense."

Another vital consideration for adopting this model is internal skills and knowhow. It is no secret private equity firms have some way to go in upgrading their tech talent. "Many GPs don't have the tech skills to make it all work. It would be up to them to get systems to work together," says Keough.

The pandemic has undoubtedly been a major driver in digital transformation for the majority of sectors, but perhaps none more so than the private capital funds industry. The asset class had been behind the curve in terms of technological adoption for many understandable reasons. With continued uncertainty stretching ahead, a unified and efficient tech infrastructure can make the difference between winners and losers.

Fund administrators will always provide much needed financial knowledge, tax and regulatory expertise as well as steady reliable teams to the partnership. But, new demands on data, workflows and systems require all parties to innovate and develop new approaches to create efficiencies and ultimately, to better serve LPs.

However, in deciding one's optimal model, GPs would be wise not to let the desire for control or cost reductions lead them. The decision also asks for GPs to move away from their traditional fixing approach: to hire someone in.

This is a decision dependent on a firm's size and maturity. It cannot be influenced by one's peers. It's about stepping back and really understanding the firm's needs, skills and future. ◆