In the midst of a sea change

Today's fund administrators are a far cry from yesterday's accounting firm spin-offs, offering services from back office outsourcing through to risk management and performance attribution

Millner: fund administrators are providing real-time, fully transparent access

There is a clear trend for private equity firms to outsource their fund administration services as they discover that spreadsheets can't provide enough detailed regulatory information or meet the data requests of limited partners. Despite this, many firms remain reticent about outsourcing, according to Gen II Fund Services managing principal Steven Millner. We spoke to him about the reasons for this and how fund administrators have transformed beyond recognition over the last few years.

Q You've been in fund administration since the early days. What was it like then?

SM: The industry started off in the early 1990s and was very different then. At that time, most fund administrators were either boutique firms spawned from accounting firms or part of the large custodial banks. As part of an emerging industry, I spent a lot of my time educating private equity sponsors about the benefits of fund administration – there were very few funds that outsourced. Fund administrators performed the more mundane accounting work and the technology was not very sophisticated.

Q How would you characterize today's landscape?

SM: It's much more institutional. The big players, on one side, are still the global custodial banks, but you also have large, publicly-traded companies and firms that perform other services in addition to fund administration. Gen II is a big player with over $165 billion of Assets Under Administration, but it's an exception in that we are a large, independent, owner operated player, with a direct focus.

The industry is also set for rapid growth over the next five years. This follows a pattern we're already seeing. Today, about 40 percent of funds use a fund administrator, up from 30 percent a few years ago. Yet when we analyzed the ADV forms filed with the SEC over the past year, the capital attributed to in-house administration remained stable between September 2016 and September 2017. That's despite a significant rise in the amount of capital raised by private equity funds. This implies that the majority of new capital is administered by third parties. Outsourcing is clearly taking hold, with the emerging managers and new funds from established managers out in front.

Q In what respects are emerging managers leading the way?

SM: There is a bifurcation in the market. You have the emerging managers and the legacy managers. The emerging managers, which have raised significant amounts of capital recently, have largely opted to outsource from the start, avoiding large capital expenditures on people and expensive technology. This provides their investors with institutional credibility and enables them to focus on the bigger picture of fundraising and investing their committed capital.

LPs are also increasingly comfortable with the control environment and objectivity that a third party can bring. The services provided by top-tier fund administrators tick all the boxes on LPs' operational due diligence lists – an area in which we frequently engage with LPs.

Q So what's happening with the legacy managers?

SM: Many of the legacy managers are overwhelmed by the amount and complexity of information required by increasingly sophisticated LPs, who are themselves armed with the latest technology. LPs now want not just fund-level information, but also portfolio company data. At the same time, the tide of regulation that the private equity industry faces means that additional reporting is required.

So, while internal teams used to focus on providing information in a set format to LPs, they are now required to provide a variety of formats, not just to investors but also to internal compliance and risk management teams.

ILPA's fee template has increased transparency tremendously, but it is straining internal teams.

Q Are you seeing legacy managers move to outsourcing to keep up with these demands?

SM: We talk to legacy firms and they are interested in outsourcing, but it's not an easy decision. They have outdated systems with high embedded costs. Many still use spreadsheets which do not provide the level of transparency required.

Yet there is a fear of change in many firms, based, in some respects, on how fund administration used to work. Many GPs are concerned that they won't have immediate access to the information they need – they fear they will lose control and access to their data. That would have been the case a few years ago, but today fund administrators can provide clients with real-time access to data in a fully transparent format.

Q High staff turnover has also deterred firms from outsourcing in the past, hasn't it?

SM: Yes, but it's vastly different today. Staff turnover is the Achilles heel of all service providers and it's fair to say that fund administrators used to have higher turnover than many of us would have liked. But there is a real focus on attracting and retaining top talent nowadays – a recognition that human capital is vital to the success of fund administration. That's why we have set up the Gen II Academy, which provides a formal training program that enhances our on-the-job learning. There is also a much clearer career path in fund administration now – the best people don't have to leave; they can enjoy a meaningful career.

Q How has the skillset changed within fund administrators?

SM: It used to be that being a good accountant was a pre-requisite and that was largely it. We still employ accountants, but we also place emphasis on quantitative and risk management skills, including people who can analyze performance. We have much wider servicing capabilities now in addition to accounting skill.

Q Why has that offering broadened?

SM: It's largely because new technology tools enable us to do more for our clients. The market-leading administrators are facing the digital divide head-on. By investing in the latest big data and analytics technology, we can now offer much more than capital call processing and accounting services to enable our clients to dig deeper. Fund administration services now reach into many different areas of a private equity firm. We can now look at performance across different metrics determined by the client, for example, to help them see the source of returns. Our relationship used to be with the CFOs, but now we interact with IR and compliance teams as well as other parts of the firm. Having the right people enables us to manage these relationships, and our technology helps to strengthen them.

Q How can fund administrators manage the greater data protection and cyber risk?

SM: All top-tier fund administrators are investing heavily in this area. It's a hot topic, especially as LPs are inquiring about controls over personal data as the new GDPR regulations come into force in the EU. Large fund administrators, because of our scale and focus, have dedicated resources, including experts who can identify and implement best practices – that's very expensive for a fund manager to do.

Q How is increased regulation in the US and Europe affecting your clients?

SM: Our clients tend to be located in the US, but private equity is a global business, so what happens around the world has an effect here. AIFMD and GDPR requirements are highly relevant to our clients. Their capital comes from global sources, they make investments globally and so firms need an administrator with the capacity to service their funds on a global basis – this will continue to be a significant trend. ■

What are the key trends in fund administration?

"Outsourcing is being embraced by more private equity fund managers and I think we're at the start of a significant uptrend in third party administration. To stay ahead, fund administrators need to invest in their people, process and technology and they can only do this if they have the benefit of scale. The amount of capital needed to run a fund administration business effectively has doubled over the last five years and that creates barriers to entry. As a result, there will be further consolidation and a big gap will emerge between the large players, who can service the needs of large and mid-sized private equity firms, and the smaller ones, who will mainly work with small funds."

Administering over
$175B
in private fund capital

99%
client retention rate

Over
100
sponsors

25
years of fund administratio n experience

Helped launch over
45
Emerging Managers and Spin-out Groups

Service Organization Controls Compliant (SSAE-18 SOC 1, Type 2)

Servicing over
2,100
fund entities

Dedicated service team, led by a Principal

Over
230
professionals

Reporting to over
9,000
investors for our clients

We take this personally.

Fund administration at Gen II is personal. We are trusted partners for our clients, and fully recognize that we are primary fiduciaries of our clients' reputations. We create a customized service model with dedicated teams that work seamlessly with our clients and intimately understand their needs. We are pioneers of industry best practices, employ top talent, and utilize best-of-breed technology. All buttressed by certified processes and cybersecurity compliance to support our clients, their funds and investors. We are dedicated to delivering for our clients at the highest levels and take pride in providing world-class service.

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