

# Who's got your back?

Limited partners have expressed a growing preference for the third-party fund administration model, and general partners' interest in outsourcing is growing faster than ever. What should private equity managers be requiring of their fund administrators?

Each year at the PEI CFO Forum, the topic of third party fund administration is viewed as an increasingly viable option – and in some cases, a requirement. With operations so crucial to the overall performance of a private equity firm, the choice of a fund administrator has never been more important. Indeed, EY made note of this continued trend in their 2018 Global Private Equity Survey.

“Many CFOs see the positive side of outsourcing certain tactical functions. Respondents indicated that using an outsourced provider would increase the ability of their firms to handle more work, and could provide industry leading best practices,” the survey noted. “Leveraging the capacity, industry expertise and capabilities of external parties will allow GPs to shift their team's time to value added activities that will benefit all of their constituents.” And as one CFO remarked, the challenges of attracting and keeping talent that has all the requisite skill sets to support today's operational requirements is a significant issue.

So, as more PE managers are considering the switch to third-party fund administration, how can a GP know that the administrator is the most qualified and can perform all the required tasks with the highest



**Gendel:** Experience matters



**Alecia:** Quality Control is vital

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levels of proficiency and service? The importance of the outsourcing decision is leading many CFOs and firm principals to ask “Who has our back?”

## The imperatives

“Private equity firms are sharply focused on ensuring their administrator can meet mission-critical requirements,” says Gen II Fund Services Principal, Jeff Gendel. “A fund administrator has to be able to instill trust by exhibiting outstanding marks on many key items, like top-tier performance, a highly experienced and long-tenured team, certified processes and procedures, state of the art technology, intimate knowledge of the private equity industry, and a long-term dedication to and focus on private equity fund administration.

Furthermore, the administrator needs to evidence a high client retention rate – with no service related client departures – to be worthy of consideration.”

As GPs commence the administrator diligence process, we reviewed recent GP inquiries on the topic. Some definite trends emerge from the questions GPs ask to make sure the administrator can meet their funds’ demands, and, in turn, the demands of their LPs.

### The processes

Among the first steps every GP and LP will take in reviewing a potential fund administrator is asking whether or not the administrator has an SSAE 18 (Service Organization Control Type 2 (SOC 1) Statement on Standards for Attestation Engagements No. 18 issued by the American Institute of Certified Public Accountants). This certification marks the passage of a crucial independent examination of the administrator’s control environment, and is a must-have for sponsors and their institutional LPs.

The SOC 1 report provides private equity clients and investors with confidence that the fund administrator has adequately described its controls, processes and procedures, and that its controls, processes and procedures are suitably designed and operating effectively to achieve their specified objectives, notes Steven Alecia, Gen II’s Chief Client Officer. With the SEC increasing its oversight role and a more intense focus on recordkeeping for funds, it is understandable that GPs and LPs want to hold their administrator to the highest standards. “GPs want to know that the administrator has certified processes and procedures to do the work that’s required, and as a result, every single

RFP that we see asks about the SSAE 18,” says Alecia. “In fact, it is usually the first question on the RFP, so it’s clear that our GP and LP partners view this as a necessary qualification.” Another important topic GPs and LPs seek to understand is the additional steps taken by the administrator to ensure that client facing items are error-free. Gen II has met this requirement through the establishment of an internal Quality Control department, in order to be sure that there is an extra set of eyes reviewing all sensitive and client-facing transactions. “QC is among the most important parts of our organization,” says Alecia. “Our clients and their LPs take comfort in the additional checks and balances we evidence in our processes.”

And while cybersecurity is a hot topic in the private equity industry of

late, many fund managers are struggling to determine what practical steps they can take to approach the matter. Having a fund administrator who is compliant with both the US Securities and Exchange Commission’s cybersecurity recommendations and the EU’s GDPR is crucial. The fund manager can rest easier knowing their data is in good hands, and they can gain insight from the fund administrator on how to approach cybersecurity.

“Each of these attributes – our SSAE 18, our SEC cybersecurity compliance, our quality control team - is an essential part of our service offering and firm infrastructure,” says Alecia. “We know these elements are required by all investors, fund managers and regulators as the focus intensifies on quality operational procedures, independent recordkeeping, and full transparency.”

### The market’s requirements

As EY’s survey of private equity CFOs reveals, outsourced fund administration is becoming a more popular option. In order to meet institutional requirements of private equity firms and investors, GPs and LPs concur that the following attributes are essential for fund administrators:

- Experienced team with long standing private equity fund administration expertise
- Institutional grade infrastructure including:
  - SSAE 18 certification
  - SEC cybersecurity and GDPR compliance
  - Independent quality control
  - Robust, flexible and transparent technology
- Evidence of firm performance at the highest levels
- Low employee turnover across the firm
- A high client retention rate with no service-related client departures
- Ability to customize service approach for each fund
- A long-term dedication to the private equity fund administration industry

## The team

Just as an LP would not commit to a fund because it looks good on paper, GPs should not commit to a fund administrator without researching the team that will service them. That team will work extremely closely with the fund manager's staff, so it is crucial to know and trust the team, Gendel says. "GPs should learn about the members comprising the team, their experience in private equity fund administration and how long they've worked together. Have they seen a multitude of situations that enable them to effectively handle whatever comes up while administering one of your funds?" Gendel notes. It's exactly how an LP would investigate a GP's experience in the industries in which the GP is investing. "LPs would be hesitant to invest with a sponsor that can't evidence a long and successful track record with similar funds or has lagged in performance." Another area of interest for GPs is how long the administrator's senior team has been working together. Turnover is an issue that has the potential to impact fund administrators, notes Gendel, so GPs must be confident their administrator has the proper structure and incentives in place to ensure that key team members stay for the long term. In fact, among the top issues expressed by GPs in EY's survey is concern about turnover at the administrator.

"Team continuity is incredibly important in the fund administration industry, and GPs should be asking detailed questions about the stability of the team that will be servicing their funds. It's analogous to an LP asking a GP to explain how they can ensure that their key team members are incentivized to stay with the firm and how the GP can avoid significant departures from the team. Fund administration is

## Recent Operational Due Diligence Questions

Limited partners are digging deeper into GPs' operations and asking detailed questions. The ability to evidence excellence in operations is now a prerequisite to receiving an LP's commitment. Below are some excerpts from recent LP operational due diligence questionnaires.

- Does the firm's administrator have an annual SSAE 18 (SOC 1) that certifies its operating and control environment? How many years has the administrator received a clean opinion? Please note any instances where the administrator has not achieved a clean opinion or cannot evidence an SSAE 18.
- For the new fund, please describe the structure of the team that will service the operational needs of the fund and how it will differ from existing funds. Include employee tenure with the firm and total industry experience.
- Please discuss the employee turnover rate among your operational staff (and that of your administrator) for the past five years.
- Please describe in detail your cash management procedures and controls, and that of your administrator (if applicable). Who prepares transactions, who reviews transactions, and who executes transactions?
- Please describe in detail the processes and key controls regarding the calculation of both management fees and carried interest and any external auditing or oversight performed.
- Please describe your compliance framework including how you (and your administrator, if applicable) protect LP data.

a service business and people are at the heart of it, and we take great pride in our exceptionally low turnover," notes Gendel.

Equally important, GPs ask about the administrator's knowledge of the private equity industry and experience servicing complex funds. Private equity fund structures become more complex with each passing year. In Gen II's experience, every fund is different, every limited partnership agreement is different, and every organizational structure is different. GPs demand a customized approach for their fund rather than a one size fits all methodology.

Whether a firm is just starting out

with Fund I, moving from one fund administrator to another or as the EY survey predicts, moving their operations from in house to out of house, all of the key attributes that LPs look for when considering a GP's fund will translate into the GP – administrator relationship.

GPs are increasingly focused on the administrator's people, processes, performance, technology, and specific industry expertise. "Sponsors are far more discerning about the skills required of their fund administrator," says Gendel. "General partners gain comfort and confidence when they know that their administrator has their back."

Administering over  
**\$250B**  
in private fund  
capital

**99%**  
client retention  
rate

Over  
**130**  
sponsors

**27**  
years of  
fund administration  
experience

Helped over  
**55**  
Emerging Managers  
and Spin-out Groups  
successfully launch

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

Servicing over  
**2,800**  
fund entities

Dedicated service  
team, led by a  
Partner

Over  
**290**  
professionals

Reporting to over  
**10,000**  
investors for our  
clients

# We take this personally.

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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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