

Outsourcing rockets in more challenging financial climate

LPs concentrate on fundraising, paving way for sector boom September 2008

Foreword

There has been an increase in the complexity and breadth of funds coming to market. Growth areas have been mezzanine, infrastructure and funds focusing on markets in Asia. This has increased demand for administrators with specialist skills. The growth has fuelled the outsourcing of administration services, particularly to offshore centres such as Guernsey and Luxembourg. However, the rapid expansion has led to a shortage of skills in these jurisdictions.



Clients in the Middle East love the idea of having a London-based administrator

Barry Carroll
(Augentius)

The markets have grown, the allocations have grown, and adjacent sectors are huge

There are more funds being domiciled in places like Mauritius and Singapore

Huw Jones
(JP Morgan)





PHOTOGRAPHY: GRAHAM TONKS

Clockwise from top left

1. Huw Jones

Huw Jones is head of JP Morgan's Private Equity Fund Services business in Europe. He is a chartered accountant who has extensive experience in the private equity industry. In addition to heading the London office, Jones provides fund administration services to private equity firms in the region.

2. David Crawford

David Crawford is financial controller of Bowmark Capital. Prior to joining Bowmark, he was assistant manager for fund accounting at Fidelity Investments. Crawford has over five years' accounting experience in the financial services industry. He is jointly

responsible for Bowmark's accounting with a supporting role in the finance and compliance functions.

3. Barry Carroll

Barry Carroll is chief executive and senior partner of Augentius Fund Administration, a specialist accounting and investor reporting outsource organisation focused on private equity funds, property funds and funds of funds with £50bn under administration. He is a director of offshore fund management companies and investment funds.

4. Oliver Smiddy

Oliver Smiddy is the associate editor of Private Equity News.

5. Simon Brown

Simon Brown has been chief financial officer of Cognetas since 2006. He was previously chief operating officer of Lord Rothschild's family office and finance director of solicitors Lawrence Graham. Simon qualified as a chartered accountant with Deloitte Haskins & Sells.

6. Simon Bliss

Simon has over 12 years' experience of senior finance and administration positions with private equity firms. He joined Nova in 2005, with responsibility for financial management, fund administration and compliance. Before joining Nova he spent five years at Botts & Company, a mid-market private equity firm.

Growth of the industry leads to skills shortage

Main points

- There has been growth in the complexity and breadth of the market
- Luxembourg is growing quickly, particularly for real estate
- There is a dearth of talent in some centres
- Middle East is maturing but not coherent

Oliver Smiddy (Private Equity News)

I'd like to begin by asking the general partners whether they currently outsource the administration of their funds?

Simon Brown (Cognetas)

Yes, we have two funds and we outsource just about everything to Guernsey. There are some things we keep in-house: valuation, corporate report preparation, the sort of thing that needs creative input, but the general admin and accounting we outsource to Guernsey.

David Crawford (Bowmark Capital)

We currently outsource two of our funds to Guernsey and the UK.

Oliver Smiddy (Private Equity News)

What changes have fund administrators noticed over the last year?

Huw Jones (JP Morgan)

A growth in the complexity and breadth of the funds coming into the market.

We've seen a lot more mezzanine, more infrastructure and more funds looking at different markets like the Far East, India and China. The result is a demand for specialist skills within administrators.

Barry Carroll (Augentius Fund Administration)

The growth in the market has been massive: the markets themselves have grown, the allocations to private equity have grown, and the adjacent sectors – like infrastructure – are huge.

The number of people who have outsourced has traditionally been low, so the growth in our businesses has been staggering.

Oliver Smiddy (Private Equity News)

How much has your business grown this year in terms of clients?

Barry Carroll (Augentius Fund Administration)

Over 100%.

Huw Jones (JP Morgan)

Ours has as well, both globally and even more so in Europe.

Oliver Smiddy (Private Equity News)

And on the GP side? Obviously from a deal perspective, conditions have not been what they could be, but in terms of the fundraising environment, how have you found that? And how has having a fund administrator on board helped you free up resources?

Simon Bliss (Nova Capital Management)

We are currently fundraising. We have found the right firm in Guernsey which looks after the majority of our existing structures, and hopefully that will continue.

I take a lot of comfort in what they do, they're very responsive, very co-operative, and they are generally available when you need them.

Simon Brown (Cognetas)

We now have a team of four who look after us exclusively, because things are complex. Our first fund is fully invested, so we are making sure that when we come round to selling something everything is going to be in order.

We're not fundraising yet, but when we are, the administrator will play a key role.



The people who do it right undertake the admin in locations with good access to labour

Barry Carroll
(Augentius)

David Crawford (Bowmark Capital)

We recently had to make the decision between taking admin in-house, staying in Guernsey, or bringing it over to the UK. We're an English GP, so there was really no advantage for us having it in Guernsey. So we decided a UK-based administrator would be beneficial. Having someone down the road that you can go and have a face-to-face conversation with has made it a lot easier to get accounts processed.

Oliver Smiddy (Private Equity News)

On the jurisdictional issue, what has been happening in terms of onshore/offshore jurisdictions? And where is the best place to site your fund?

Barry Carroll (Augentius Fund Administration)

The locus of the fund doesn't have to be the locus of the admin. The people who do it right domicile the fund in one offshore jurisdiction but then undertake the bulk of the admin in locations with access to ample labour. It's important that the offshore central management and controls are handled, for offshore funds, professionally and offshore. Management and control, if it is an offshore fund, must be offshore but the day-to-day administration can be done anywhere.

Guernsey, for example, does not have an unlimited supply of experienced accountants. So you have either got to find one of the small number of good local people yourself, which for a new firm is

difficult, or outsource to a firm like Augentius. The offshore jurisdictions like Guernsey and Jersey don't have the ability to grow without outsourcing from the island what is non-core, which is why firms like Bowmark have chosen to use Augentius. What we are seeing is sometimes people move their new fund business onshore, not because they want to, but because historically they have not had good service.

Huw Jones (JP Morgan)

The jurisdictional elements are the most important. We have an office in Jersey, so for our Jersey-domiciled clients it's very important that we can organise the board meetings and deal with all the regulatory issues there.

Our key team is based in London because that is where we find the best people, and because we're close to the management companies and able to service funds that do not have an offshore need. Luxembourg is growing very quickly, especially for real estate.

Simon Bliss (Nova Capital Management)

We have a Luxembourg administrator who looks after one of our funds and it is not as efficient as our Guernsey relationship. There seems to be a resource problem in Luxembourg.

Barry Carroll (Augentius Fund Administration)

There are, I am told, over 1,200 vacancies for fund administrators in Luxembourg – it

clearly has the same capacity problems of other boutique jurisdictions.

Huw Jones (JP Morgan)

Increasingly European investors see Luxembourg as an important place, traditionally for special purpose vehicles that you can invest in when you invest in mainland Europe, but increasingly for the fund's creation as well. But there's a dearth of skills in that marketplace.

Barry Carroll (Augentius Fund Administration)

Luxembourg has a much bigger labour pool vacuum than Jersey, Guernsey and the UK. A few years ago the Commission de Surveillance du Secteur Financier identified hedge funds and private equity and made efforts in both. They are playing catch-up.

Oliver Smiddy (Private Equity News)

What about Bermuda, Cayman and Delaware?

Barry Carroll (Augentius Fund Administration)

The domicile of the fund is completely different to the domicile of the administrators, but I would say our client book is made up of Delaware, Cayman, Guernsey, Jersey, Bermuda, British Virgin Islands and English/Scottish partnerships. That would be 90% of them.

Oliver Smiddy (Private Equity News)

Do you have a presence in the Middle East?

Barry Carroll (Augentius Fund Administration)

No, we have got seven or eight clients in the Middle East, but we don't have an office there. At this point we don't need to. It's inevitable that we'll have some people on the ground, but there's an even bigger vacuum of expertise there.

Huw Jones (JP Morgan)

The market in the Middle East is maturing. It's a mistake to look at the Middle East as one coherent whole. Dubai is different to Bahrain, which is different to Abu Dhabi, and there are different regulations in each of those locations. We service those clients from London and New York.

Barry Carroll (Augentius Fund Administration)

They like that. We do a client questionnaire every year and clients in the Middle East love the idea of having a London-based administrator. We haven't got a time zone problem. It's just emails on a Sunday but not Friday, which we are getting used to, and a swathe of other cultural adjustments. We are trying our best. We are going to open an operational centre in the north of England next year, and we've short-listed places that have big Arab-speaking populations to set up a Middle East desk.

Oliver Smiddy (Private Equity News)

Are there issues with sharia-compliant funds?

Barry Carroll (Augentius Fund Administration)

Not really. We can do them. The lawyers pull all the paperwork together, and there's a committee to tell you what to do and what not to do. There are a lot of formalities and it's not overly complicated as a fund administrator.

Oliver Smiddy (Private Equity News)

You mentioned a dearth of talent in Luxembourg and Guernsey. How do you get round that?

Barry Carroll (Augentius Fund Administration)

You find the best people you can. You

Luxembourg has a much bigger labour pool vacuum than Jersey, Guernsey and the UK

realise that number's going to be small, you pay them well, and you make sure you look after them very well; you don't dump non-core work on them.

You take non-core work out of the domicile – that way clients get a better service and your staff are happier, so your staff retention is excellent.

Huw Jones (JP Morgan)

We offer people a career structure, so that makes us an attractive employer. They can move through our organisation, they can lead teams and they can open new offices.

Oliver Smiddy (Private Equity News)

From the GP perspective, how important is it that you have administrators working on your funds who understand private equity?

David Crawford (Bowmark Capital)

We realised, going from Guernsey to London, that you have to interview the people who will be actually doing the work, not just the senior individuals. They have to be good accountants, because if you know your core aspects of accounting, you can take on almost any set of accounts. When you progress to the latter stages of a fund

and get into more tricky aspects, that is when it is essential to have a detailed understanding of private equity.

Huw Jones (JP Morgan)

Technology is important. You have to be sure the administrator has got systems that can cope with private equity accounting and deal with complex issues such as the commitments, drawdown structures and partnership accounting.

Simon Brown (Cognetas)

We have a firm that only does private equity admin, which helps, but the people we deal with day to day are good accountants and administrators. Would I go to them for advice about an issue about how the fund works or private equity advice? No, probably not, as we have good knowledge in-house and easy access to lawyers if necessary.

Oliver Smiddy (Private Equity News)

Is there an outflow from in-house private equity teams to specialist administrators?

Huw Jones (JP Morgan)

Most of our staff come from the big four accountancy firms, with a background in fund audit, or from other administrators.

Is there an outflow from in-house private equity teams to specialist administrators?

Oliver Smiddy
(Private Equity News)



Early involvement helps eradicate problems

Main points

- Biggest barrier to outsourcing is lack of control
- There is increasing emphasis on due diligence
- Mistakes in the carried interest calculations can be catalyst for change

We are protective of the relationship between the GP and the limited partner

David Crawford
(Bowmark Capital)

Oliver Smiddy (Private Equity News)
It would be good to know precisely the sort of services you provide. Can you give us an overview?

Barry Carroll (Augentius Fund Administration)
We like to work with a potential client from the time they think of setting up a fund. We are less involved before the fund launches and more afterwards, but we have taken over a few funds from other administrators and found we could have prevented a lot of difficulties. We like to get involved before the fund launches and make sure that with the experience that we have got we can prevent or pre-empt things. Afterwards, it's the normal suite of services – closings, drawdowns, banking, quarterly and year-end reporting, web-based investor reporting and communications, and so on.

Simon Bliss (Nova Capital Management)
Barry, when you take on new clients with existing funds, do you carry out a sweep of the legal documentation?



Barry Carroll (Augentius Fund Administration)
We indeed do a review, because we model the fund's financial dynamics, but we are not lawyers so we are just looking at the accounting side. We review every set of documents, unless the client doesn't want us to, but that is not the smartest thing to do because it costs very little to get us to review things and often we can help. After that, every communication with the investors should come through us, so it's like a newsletter, either on the web portal or as an email attachment. The investors get used to getting all the communication from us.

Huw Jones (JP Morgan)
It's important to integrate the administration of the fund with the accounting, integrating the capital call and distribution management with the service that you provide. We have a specialist within our team who provides cash and treasury management.

So the capital call, which for us is a web-based service where limited partners will log on to our system and receive their capital call: we will monitor the cash, we'll move it through the structure, we'll make sure it gets to the right vehicle at the right time. We are also able to provide a foreign exchange service.

Oliver Smiddy (Private Equity News)
Do you find that being part of the JP Morgan stable gives you an advantage over specialist independent administrators?

Huw Jones (JP Morgan)
It enables us to carry out some tasks that some of the other firms are not able to, like



Complexity Made Simple

Augentius specialises in Private Equity Fund Administration. *That's all we do.* Our technology and people ensure our clients don't duplicate the work they pay us to do.



Hugh Stacey

London

Business Development Manager

tel +44 20 7397 5489

hugh.stacey@augentius.com

Kerry-Anne Morley

Guernsey

Managing Director

tel +44 1481 734 302

kerry-anne@augentius.com

David Bailey

London

Managing Partner

tel +44 20 7397 5453

david@augentius.com

www.augentius.com

integrating with the bank and foreign exchange.

Barry Carroll (Augentius Fund Administration)

We're more polygamous, so we have a selection of banks that we deal with. We can facilitate the same things, but we have got more than one bank that people can use so the choice is better.

David Crawford (Bowmark Capital)

We have the fund accounting with the administrator. We are protective of the relationship between the GP and the limited partner, so that's something we keep control of. We have arranged that the accounting is done by the administrator, but liaising with the LPs is done via us. We have set up our web portal, and we do all the call-downs and distributions, and distribute the accounts.

Simon Bliss (Nova Capital Management)

David, do you look after the external reporting in-house?

David Crawford (Bowmark Capital)

The reporting is all done externally, so we get a PDF document come in to us and we upload that on to intralinks. Once you have got the format and everything set up, then you are really just talking about the figures being slotted in every quarter, and the odd tweak here and there.

Simon Bliss (Nova Capital Management)

How do you deal with the advisers'/managers' report, and the two-page summaries for each portfolio company? Presumably that is written in-house?

David Crawford (Bowmark Capital)

Yes. The partners produce those because the portfolio of companies is changing and the people that know best are the partners who sit on the boards. We produce that report, it's sent in, it's then merged with all the accounting aspects, signed off, and sent back to us to distribute. We have got a lot more quality control.

One of the things we have seen in the industry is increased rigour in due diligence

Huw Jones
(JP Morgan)



Barry Carroll (Augentius Fund Administration)

The biggest barrier to outsourcing is lack of control, because if we screw up, the clients look bad and they don't want that. We just do whatever tasks the client feels comfortable with, and invariably over time that evolves. We know perfectly well that if we screw up your reputation, our industry will vanish.

Huw Jones (JP Morgan)

One of the things that we have seen in the industry is increased rigour, in terms of due diligence both by LPs and regulatory authorities on systems. It becomes vitally important to have an excellent system that the administrator knows well.

Oliver Smiddy (Private Equity News)

When you've taken on funds that have previously been administered elsewhere, what are the screw-ups that you've encountered?

Barry Carroll (Augentius Fund Administration)

Often people have been simplistic. What we have picked up from clients has been worse than what we have picked up from other fund administrators.

It can be a nightmare, because you get a spreadsheet for each quarter-end, for each investor and for each investment. Even if we picked the best spreadsheet guy in our firm and did that for three years, there would possibly be an error somewhere.

Huw Jones (JP Morgan)

We have found the catalyst for change can be mistakes in the carried interest calculations, because that tends to be emotive for GPs. That usually boils down to an inadequate understanding of the limited partnership agreement, and the result is that the wrong amounts of money have been distributed to managers.

Oliver Smiddy (Private Equity News)

Simon, what are the concerns you have about outsourcing your administration?

Simon Brown (Cognetas)

There are two issues that have recently come up: the relationship with investors and LPs, and quarterly reporting. On quarterly reporting, all we get from the administrator is the draft financial statements for the quarter, and the summary capital account statements, and everything else is generated, created and reviewed by us. We know more about the portfolio companies, the strategies, and what we think about the economic outlook, than they do.

However, on the investor side, the administrator is the first port of call for queries. They do general drawdown notices, distribution notices and general communication.

We are happy to give the administrator responsibility to deal with administrative and general queries from investors, but that is the bit I am sensitive about. You get that wrong, and it's a big black mark.

Reporting systems: their strengths and limitations

Main points

- Spin-outs have gravitated towards more comprehensive reports
- Fundraising has slowed but there is still a lot of work
- Paper versions of reports have merits even though most are online

Oliver Smiddy (Private Equity News)

In terms of reporting to investors, how important is it to have good systems in place? You both use Investran. Can you explain the benefits of that system?

Huw Jones (JP Morgan)

Investran is a strong general ledger system so it can handle the accounting. It is then built into a specialist private equity accounting model, so it copes well with the commitment and drawdown structure and with the partnership accounting.

Simon Bliss (Nova Capital Management)

Do you give any of your clients access to Investran?

Huw Jones (JP Morgan)

We don't give them access to the actual accounting nuts and bolts, because that is fraught with danger. What we have done is develop a number of different reporting modules and they have access to those. Some are interactive, so they can go in, run the reports and do analysis, but the actual accounting, we keep to ourselves.

Barry Carroll (Augentius Fund Administration)

We are one of the beta testing partners that Investran has. We are rolling out version six, which is a more web user-friendly version of the system, and allows funds like Bowmark to log in and see a direct mirror image of all the live data that we maintain for it and run reports on it.

David Crawford (Bowmark Capital)

That sounds good, especially for the offshore aspect. If we could do that with the information we had in Guernsey that would be superb, but at the moment I prefer to do the other option, go and see a physical folder.

Barry Carroll (Augentius Fund Administration)

If there is one tip I can give you, still do that, or send someone to review quarter-end files, once a quarter.

Simon Bliss (Nova Capital Management)

I am at the stage now where I'm looking to develop and expand the role of our administrator. However, from a control perspective, I plan to keep the production of the quarterly reports in-house. It works for us, and it makes the whole process more efficient. Late changes are a good example. They are managed more effectively by us. We also like pressing the send button on the emails to investors.

Huw Jones (JP Morgan)

The way I see it, a quarterly report is very much a front end and a back end, and most of our clients do the front end. We will do the back end, and we will put the two together.

Barry Carroll (Augentius Fund Administration)



We spend time talking to our investors and we have an investor relations partner

Simon Brown
(Cognetas)

The only thing we never do, and we occasionally get asked, is when funds say: “I want you to be the fund administrator, but I’m going to do everything and then I’ll send it to you to send out”. We don’t do that – that is deceiving the investors that an administrator is doing a role that in reality he is not, and we will not accept that.

David Crawford (Bowmark Capital)

We are very early on in the relationship, but we will be mirroring the accounts, we will be doing everything in-house as well. We will keep monitoring everything and making sure that everything we receive matches what we have got. It’s like a bit of protection for the LPs, they have a third-party audit.

Oliver Smiddy (Private Equity News)

In terms of your level of reporting, has that changed much over the last year?

Simon Bliss (Nova Capital Management)

We look after the investor relations in-house. Generally, we receive very little feedback from our investors, which I view as a positive. I assume that the reports we produce each quarter are providing pretty much everything they need.

Barry Carroll (Augentius Fund Administration)

We have noticed that the spin-out firms, the new start-ups, have gravitated towards more comprehensive reports and there have been far fewer queries from investors because you bombard them with detail.

Simon Brown (Cognetas)

We have some investors whose reporting deadlines are earlier than ours, so they want an early view on valuation. If you have an investor who wants to know a good estimate of figures at the end of January, you have to include lots of caveats.

We spend time talking to our investors and we have an investor relations partner. He finds out what they are interested in, what they need, what they are looking at, what sort of things they are going to be focusing on in the reports. That gets fed back to us, and we make sure that information is there.

People want private equity fund structures to be invisible for tax purposes

Oliver Smiddy (Private Equity News)

Have you been looking at different fund structures for future vehicles?

Simon Brown (Cognetas)

In terms of fund structures, we will look at market practice when we are trying to raise a fund. We are always thinking about what is happening in the market, other things that the skill-set that we have in-house might enable us to do.

Oliver Smiddy (Private Equity News)

And from the administrator’s view, have you seen different fund types coming through your doors?

Huw Jones (JP Morgan)

Limited partnership structures are still most popular. We have seen a few refugees from the hedge fund world looking to invest in unquoted companies with hedge fund structures, but I don’t think that it works to have a liquid investment vehicle investing in illiquid investments.

Our systems are very much set up to deal with closed-ended structures, but we are able to leverage other systems across the banks that are dealing with hedge funds.

Barry Carroll (Augentius Fund Administration)

Limited partnerships are by far the best structure, because people want private equity fund structures to be invisible for tax purposes, and they are the easiest ones to do that. The fundraising cycle seems a bit slower, but there is still work out there; we are seeing tons of start-ups and tons of firms doing repeat funds. The growth in the Middle East and Asia is interesting, because there are more funds being domiciled in places like Mauritius and Singapore.

Oliver Smiddy (Private Equity News)

And in terms of the growth of your businesses?

Barry Carroll (Augentius Fund Administration)

Our focus for the next 12 months is Jersey, which is close to being off the ground, and our New York office will launch on December 1 with 11 people, and then Luxembourg after that.

Huw Jones (JP Morgan)

Our focus in the next four months will be getting Luxembourg up and running. We also have plans for Hong Kong.



Generally, we receive very little feedback from our investors, which I view as a positive

Simon Bliss (Nova Capital Management)