FINANCIAL NEWS
Roundtable discussion
PRIVATE EQUITY NEWS

Developments in the fund administration market

Markets have been buoyant in the last year, and with new funds demonstrating increasing complexity in their structures, there has been a growing need to outsource administration services. There is a changing view of the back office from a basic bookkeeping role to one that is integral to private equity managers' success. Having a strategic presence in new markets is vital to keep up with clients' demands. As the global investment landscape evolves, so too does the fund administration industry and keeping pace is a priority.

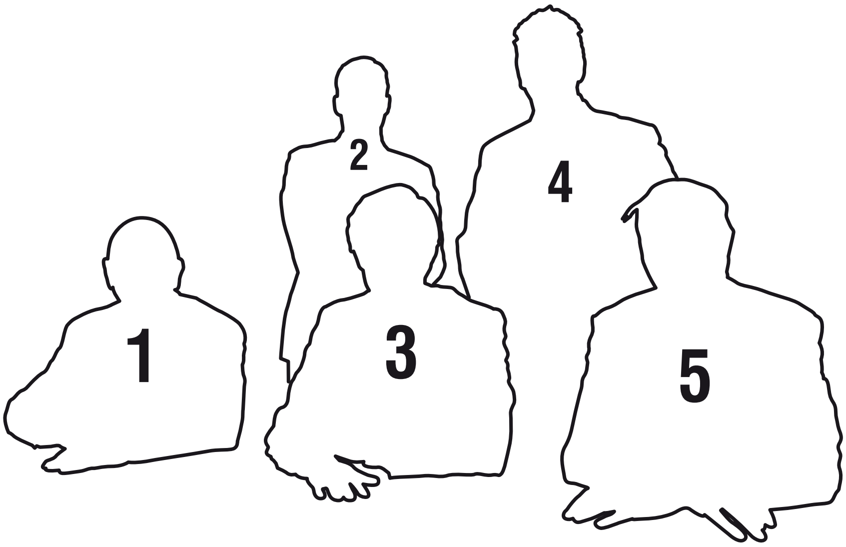
Private equity firms are choosing to outsource much more frequently

Barry Carroll
(Augentius)

GPs will structure the funds to suit the investors. We have to be wherever they need a presence

Matt Wood
(Mourant)

Focus group



1. Huw Jones

Huw 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 and was previously chief financial officer of a UK-based biotechnology venture capital firm. In addition to heading the London office, Jones provides fund administration services to private equity firms in the region.

2. Matt Wood

Matt Wood qualified as a chartered accountant with PricewaterhouseCoopers in Guernsey, specialising in investment funds and banking. He joined Mourant, which has $70bn of private equity commitments under administration, in 2004 to head the private equity accounting team in Guernsey having spent time as a contract accountant on various private equity clients. Wood now runs the business development team in London. Before his financial career, he was an officer in the British Army.

3. James Mawson (Chair)

James Mawson is the editor of Private Equity News

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4. 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 in assets under administration. He became senior managing partner of Augentius on completion of the management buyout in August last year, having joined from Ansbacher Fund Services, where he had worked since April 2002 as global head of the business. Prior to that he worked with Bank of Bermuda, initially as managing director of management international (Guernsey), Bank of Bermuda's Guernsey-based fund administration company, and latterly as vice-president and group private equity product manager based in London. Carroll is a director of offshore fund management companies and investment funds.

5. JP Harrop

JP Harrop is one of four managing partners of Augentius Fund Administration, having assumed the role on completion of the group's management buyout. He is responsible for service delivery from all locations. He joined from Ansbacher Fund Services in January 2002. Prior to this he worked with Bank of Bermuda based in Bermuda, where he was a vice-president responsible for a team of 27 fund accountants and investor relations staff, servicing a private equity, fund of funds and traditional funds client base, providing accounting, administration, share registration, custody and related services. Harrop is a member of the Canadian Institute of Chartered Accountants, having qualified in 1993.

Increasing complexity drives demand

Main points

- Increasing complexity in structure means funds need a sophisticated administrator to cope
- Trend for outsourcing has increased as finance directors' roles have evolved
- Some large firms are better suited to doing the work themselves

James Mawson (Private Equity News)
We ran this roundtable last year, so how have you found the intervening 12 months? Has there been a growing awareness among private equity firms and the alternative asset management industry of the importance of the back office and outsourcing?

Barry Carroll (Augentius)
The last year has been phenomenal. Markets have been buoyant with lots of new fund launches and clients have been upbeat.

The primary challenge for us fund administrators is that a significant segment of private equity managers still view back-office outsourcing as a low-value proposition.

Over time there is a changing view of the back office from a basic bookkeeping task to one that satisfies investors' complex demands for information and is therefore key to the private equity manager's success, and one which can be easily outsourced.

We're seeing infrastructure and real estate funds growing more popular

Huw Jones
(JP Morgan)

Huw Jones (JP Morgan)
The last 12 months have been fantastic. We've opened in London and Sydney. We're seeing increased complexity in the structures of funds being raised, so in order to cope with that, funds increasingly need a sophisticated administrator.

We've also seen a diversification of the asset classes that our clients are investing in. As well as the standard private equity buyout fund, we're seeing infrastructure funds and real estate funds growing more popular, as asset managers diversify away from what many view as an overblown leveraged buyout marketplace

JP Harrop (Augentius)
From the operational side of things, the biggest challenge has been attracting and retaining staff in London. We've opened up a Middle Eastern presence and are setting up an operational centre in the UK to increase capacity.

Matt Wood (Mourant)
It's been a great year for Mourant. We recently opened in Singapore and Hong Kong, as well as opening earlier in the year in San Francisco. It's not just buyout clients either; you've got opportunist funds, mezzanine funds, a whole range of asset classes, many of which are using limited partnership-type structures, others using corporates over a wide variety of jurisdictions.

James Mawson (Private Equity News)
Expansion means moving up the value curve for your clients. What exactly do you count

Firms are choosing outsourcing more frequently. This should equate to enhanced roles and compensation

Barry Carroll (Augentius)

as your service? What do you consider to be a back-office function that you're able to offer? Presumably growth will come from enhancing that offering to clients?

JP Harrop (Augentius)
Our core product is providing a service that makes our clients' finance director's lives easier. The role of the FD has become a lot more complex, with the complexity of the underlying structures and the internal reporting that they're getting asked for from their senior management.

It is beyond simply doing quarterly accounts, drawdown notices, distribution notices and the audit process, it's dealing with the cash management and the treasury side, the tax reporting and the complex investor appetite for information. It's a lot of cash forecasting, getting involved in the VAT and Financial Services Authority returns, and helping setting up the funds.

FD's want, and are expected, to contribute to the deal side and strategy of the business, supporting the firm and the senior deal executives – the trend to outsource therefore has been very much on the increase because of this evolutionary dynamic.

Huw Jones (JP Morgan)
Especially in terms of offshore structures. We recently spoke to a client who was looking to make investments in India from a Cayman-domiciled fund with intermediary structures in Mauritius, all managed out of Hong Kong. Being able to service that type of structure is becoming increasingly more desirable.

Matt Wood (Mourant)
When you meet a prospective client, often they don't realise what they need and want us to do. They might come thinking they just want bookkeeping and accounting, but all of us are offering an integrated service, which may include middle-office services, for instance portfolio analysis, as well as the more traditional back-office services.

Huw Jones (JP Morgan)
The clients are focused towards the deal, and what happens to enable that deal to be done is considered as secondary. So we are very much involved in an eduction process to help our clients understand the value of high-quality administration and reporting.

Barry Carroll (Augentius)
The old-fashioned fund administration business is a dinosaur: it's the low-value proposition arrangement where fund administrators do a small amount of the overall work and the investment adviser does the vast majority.

These days there are credible outsource providers and private equity firms are sensibly choosing outsourcing much more frequently. This should equate to enhanced roles and compensation for FDs in the industry.

James Mawson (Private Equity News)
Do people say, 'If we outsource, we will lose control and become reliant on a third party'? How do you build trust?

Huw Jones (JP Morgan)
We build trust during the on-boarding process, where we're working with clients on a daily basis for a couple of months, making sure we fully understand their requirements and the structure of their funds. We get involved in a lot of other peripheral tasks, and that's when the relationship gets built.

Matt Wood (Mourant)
It is a tight labour market for qualified accountants who understand the work we are doing, and clients are de-risking their own operations by using us. What happens if an accountant goes ill in a general partners' firm? They've got a real problem on their hands; they don't have the backup and the infrastructure that we do. The investment manager is separating operations from performance. They focus on fund performance and let us get on with keeping the car going round the track.

Huw Jones (JP Morgan)
Cost is a factor. They'd rather pay for deal people and originators.

Every time a fund is raised, I'd like to think an FD is considering outsourcing, even if it doesn't suit every scenario

Matt Wood (Mourant)

JP Harrop (Augentius)
The loss of control for financial directors is a difficult point for some to accept, so the challenge is to provide FDs with access to their information, so they can get inside our systems, manipulate their data, and run reports at their leisure. It's down to the technology. We selected the SunGard Investran system, so we have the capabilities that allow our people to access a database for each client. Each client can have their own database and manipulate their own information.

Huw Jones (JP Morgan)
We use SunGard Investran as well. We give all clients online access to their data, and they're able to interrogate that using dynamic reports.

Matt Wood (Mourant)
Chief financial officers of private equity houses have got to move with the markets, and the ultimate client is the investor, who is saying, 'Do you outsource your administration? If not, why not?' Every time a fund is raised, I'd like to think an FD is considering outsourcing, even if it doesn't suit every scenario.

James Mawson (Private Equity News)
What scenarios does it not work for?

Barry Carroll (Augentius)
Some firms are so large and their needs are so ever-changing that it's better for them to do the administration themselves than to outsource, because things can change monumentally from one day to the next. In theory, these are the most suitable situations to partner with an outsource provider who can manage those peaks and troughs for you, but the larger firms will be slower to change over time.

Huw Jones (JP Morgan)
We act for HM Capital Partners, and that is one of those big monsters. Their back office staff are now JP Morgan employees and it's going well.

Matt Wood (Mourant)
It's the people, systems and jurisdictions that you can add. The big guys can replicate that relatively easily; they can go and buy specialist software and hire corporate secretarial people and other experts. As you move down to the mid-size firms, they can't replicate those skills, so they have people with a broad range of skills who possibly don't do it as well as our specialists.

Huw Jones (JP Morgan)
How do those firms provide a career plan for their in-house accounting staff? Usually the FD or the CFO is a senior member of the team who is going to stay put. We provide career paths for our staff. They can move through the system on to areas of higher responsibility.

Finding and retaining staff is problematic

- You have to pay well to attract and retain the best people
- Working in private equity is different to anything else, so many firms train in-house
- Costs can be passed on to clients if they trust the company to do a good job

James Mawson (Private Equity News)
What are the issues when it comes to finding the right people?

Barry Carroll (Augentius)
Organisation culture. You also have to pay people well to attract, retain, stimulate and get good performance out of the best people. We've got to pay what private equity firms are paying. We have seen between 10% and 20% per annum wage inflation of late and so have our clients.

The right clients realise we have to pay people well. The client is less worried whether the administration cost was 30% more or 30% less, but is extremely concerned whether you are a robust, reliable and trustworthy service proposition.

Matt Wood (Mourant)
You've got to look at retention as well, because you don't want to spend your time training people only to lose them to clients. We have to recruit accountants with financial services experience and train them in-house in private equity.

JP Harrop (Augentius)
It is hard to find good calibre people with experience. We do a lot of in-house training because working in private equity means not just a new client base but a new product line, different from anything they've done in the past.

Matt Wood (Mourant)
We as an industry need to put a value proposition out there to potential staff, and say a career in private equity fund administration is potentially exciting and rewarding.

James Mawson (Private Equity News)
Are you able to pass the cost on to clients?

Barry Carroll (Augentius)
The clients will pay if you do a good job. If you're the finance director of a firm and you have to employ an accountant, how much of your time do you spend managing them and training them and mentoring them? And covering for them when they're on holidays or sick leave? And on recruitment costs? We can save you a lot of that cost and related hassle.

Once we explain that fully to clients, they see the benefits. In our experience, an FD that does the work in-house spends 50% or more of his time on staff management matters, where FDs who outsource to a firm like us spend an average 5% or 10% of their time managing the outsourced relationship.

Huw Jones (JP Morgan)
It allows the CFO to focus on the matters that his partners are interested in, so he can take on a role as an active deal person, a financial analyst of any transaction that the firm is doing, and add more value.

It is hard to find good calibre people with experience. We do a lot of in-house training

JP Harrop (Augentius)

Funds diversify but convergence is limited

- Funds will go where their investors want them to be for tax purposes
- Convergence is difficult as different skills needed

What opportunities or pitfalls does diversification bring?

James Mawson, Private Equity News

James Mawson (Private Equity News)
What do people see happening with the onshore/offshore nature of the industry, and where it is good to base the fund administration?

Matt Wood (Mourant)
Funds will go where their investors need the structures and want them to be for tax purposes. It's investor-driven, and the GPs will structure the funds to suit the investors. We have to be wherever they need a presence and now that means having a global presence in the right jurisdictions.

Huw Jones (JP Morgan)
Is there a capacity constraint in Jersey and Guernsey, in terms of getting the trained staff to do the work?

JP Harrop (Augentius)
There's an enormous issue. We've set up our business to do corporate governance etc from the Channel Islands, but because it's difficult to find accountants in Guernsey and Jersey, we outsource that accounting work back to ourselves in the UK. Traditionally we've done that from London, but we're setting up an operational centre elsewhere in the UK to service that business.

Huw Jones (JP Morgan)
We're adopting a similar solution.

James Mawson (Private Equity News)
And does that have any taxation ramifications?

Huw Jones (JP Morgan)
No, the authorities have approved the arrangements we have in place for clients.

James Mawson (Private Equity News)
What about other hot jurisdictions?

Barry Carroll (Augentius)
Don't underestimate the Middle East. If you looked at the charts of fund launches there, it's rocketed. In percentage terms it's grown quicker than anywhere else in the world, and in absolute terms it can't be ignored. There's a prestige there in having your fund administration done from London, which is why we have been fortunate to secure a number of Middle Eastern clients.

Matt Wood (Mourant)
There is a genuine view that investment managers need us in the Middle East region. The market is awash with capital and institutions that have private equity assets on their balance sheets are now setting up their own funds. When it comes to the administration and accounting, they want best practice.

Huw Jones (JP Morgan)
Luxembourg is competing now with the more traditional areas of the Channel Islands. The authorities are more receptive to private equity-type structures, and we're seeing a lot of hybrid deals coming through Luxembourg. There's a shortage of expertise in how to structure these transactions.

James Mawson (Private Equity News)
Regarding the proliferation and diversification of the alternative industries into structured funds and other types of vehicles, what do people make of the opportunities that brings, or the potential pitfalls?

Huw Jones (JP Morgan)
There are huge opportunities at the cusp of private equity and hedge funds. We see people who are traditionally hedge fund

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Huw Jones
(JP Morgan)

investors looking to get into private equity. Some asset managers are looking to set up a typical hedge fund structure but investing into private equity-type vehicles.

Traditionally we've focused on limited partnership structures, so how do we manage that hedge fund structure where we're looking at open-ended vehicles with a need for complex transfer agency products and redemptions and so on? Somebody is going to make a big win in our industry when we come up with a product that can really address that marketplace.

Barry Carroll (Augentius)
I don't agree. For years people have talked about a convergence between the hedge fund world and the private equity world. They couldn't be more incompatible. Save for the very largest firms, I've yet to see smaller firms successfully sustain a marriage between private equity and hedge fund activities – what the future holds is another question.

We do private equity and property funds and that's all. We do not do hedge funds – never have and never will.

Matt Wood (Mourant)
We're driven by customer demand and we've seen some institutions who want that type of service. There may be hedge fund investors who have a shorter-term horizon, and private equity is a longer-term, more illiquid play so there could be a lot of potential conflicts there.

Barry Carroll (Augentius)
There are institutions out there that are so large that they'll do a bit of both, like say Goldman Sachs. But it's rare. The investment time horizon, the discipline, the culture and the remuneration cycle are vastly different.

Matt Wood (Mourant)
It is a totally different skill set. We have a team of 25 in Jersey who soley do hedge fund administration and they run different systems.

Huw Jones (JP Morgan)
We look at the structure, and if it's corporate, if it's an open-ended vehicle it's a hedge fund, and if it's a limited partnership, closed-type vehicle it's private equity.

Matt Wood (Mourant)
There are going to be more specialist funds, for instance niche players, infrastructure, mezzanine or distressed debt. They will probably fit into the private equity world from an administration perspective, but you have to look at each case and say, 'Is this something we can do?'

JP Harrop (Augentius)
Many clients are envisioning a bigger uptake on co-investment funds. People are getting more involved in co-investments and it opens up other deal opportunities to the GPs. They can diversify a bit or go into slightly larger deals.

The key is people being able to move quickly when these opportunities come up, and there are a few groups in Canada and the US that are good at co-investments because they can get the money agreed in a hurry.

In Europe, a number of our clients are preparing for this as investors get tougher.

James Mawson (Private Equity News)
Do those funds present new administration challenges?

Barry Carroll (Augentius)
It's an example of our basic product getting more complex, because if you're an investment fund and you participate in a co-investment opportunity, then you've got an interest in the fund, which is partly drawn-down, and you've got your interest in your co-investment.

We need to give you one report that says, 'Here's your interest in the fund, here's your interest in co-investment opportunity, here's your total', which is what we do.

James Mawson (Private Equity News)
On that note, thank you all for coming.