

-
- 01 : Madoff and Private Equity
-
- 02 : Not to be saved for a Rainy Day...
-
- 03 : Maximising return from your
Fund Administrator
-
- 04 : Meet the team – Glyn Thomas
-

TECHNICAL

Madoff and Private Equity



J.P. Harrop
Managing Partner

What on earth has the Madoff fiasco got to do with Private Equity? Madoff was a trader; a Hedge Fund manager of sorts. There are no implications for Private Equity from this scam – PE is different and this sort of thing would never happen.

Well almost right. Scams and losses are not, unfortunately, unknown in the Hedge Fund world – there have been a number over the years. Private Equity has been different. There have not, to date, been any major blow-ups, no managers have run off with the money and disappeared to a Caribbean beach, no traders trying to trade out of black holes – and ending up digging a bigger hole. So Private Equity has gained an untarnished reputation of respectability and long term gains. However numerous Hedge Fund investors are also investors in Private Equity. Many of them have had a torrid time and lost substantial sums in Hedge and other funds/entities. The regulators and politicians have also taken note. How will the market regulators react and what implications will there be, if any, for Private Equity?

Firstly we have to understand how Madoff managed to get away with what he did. This will be examined in length by both the courts and the regulators – indeed the SEC appears to have examined the situation on a fairly regular basis in recent years and not found anything. However the issues appear to lie in the infrastructure (or lack of) surrounding the Madoff entities. Madoff took money in from investors and purported to have invested it in real assets. Indeed he produced

statements to investors on a regular basis, from his own back office, showing what was held on behalf of investors. This is not the first time a money manager has issued false asset statements and valuations.

As any good Fund Administrator or auditor knows – constant reconciliation of real assets with the financial records is a critical part of the job. In a number of historic cases the Fund Manager has either manipulated auditors; used 'tame' auditors or been able to convince reputable firms of the incorrect situation. Madoff was no different – but no one until now has succeeded to the extent of US\$50 billion.

The reality is that investors have had enough and are starting to take action. In December 2008 Union Bancaire Privée commenced a review of its' Hedge Fund portfolio with a view to redeem out of any funds that did not have an independent administrator. This could result in redemptions of a number of billions of dollars from large US Hedge Funds simply because they 'self administer'. Others including a large North American pension fund are reported to be taking similar actions.

As a result of Madoff and others, the Hedge Fund fraternity are waiting for legislation to descend upon them, particularly in the US where there is no regulation of any sort in place – and surprisingly they are waiting in silence. They know there have been errors and have little defence against regulation, which, it is widely expected will require the outsourcing of the back office to an independent third party. This is something that

would currently be accepted by the Hedge Fund world. So where does this leave Private Equity? As was reported very recently, the European Commission has decided to pursue a legislative agenda with respect to alternative investments in which both Private Equity and Venture Capital are included. This could take up to two years to complete and has the potential to be wide ranging. It is likely that credence, as a minimum, will be paid to any legislation that is put in place in the US.

But legislation is one thing – investor attitudes are another. Investors will not wait two years; they will be seeking certainty and security a lot sooner than that.

Augentius is already aware of LPs starting to examine GP back office processes in detail. Self administration is, in the mind of many LPs, a 'distraction' when the priority must be the investment portfolio. This will become a much more important part of LP due diligence in the months and years to come and as a consequence GPs are starting to put a much greater focus on outsourced administration. Indeed a number are already 'promoting' the fact that they have an external administrator.

The Madoff case has focussed the mind of many on the administration of a fund – and LPs want to be sure of security of assets and accuracy of reporting with oversight by third parties. GPs who do not have such arrangements in place (including full and robust disaster recovery facilities) are likely to come under very substantial pressures to change.



TECHNICAL

Not to be saved for a Rainy Day...



Ian White
Compliance Manager

As and when managers make investments they are often asked to make statements or sign declarations to the effect that the funds they are investing are 'Clean' funds for the purposes of Anti-money Laundering (AML) and terrorist financing. Whilst this is a relatively easy statement to make at the beginning of a fund, when all the AML and KYC work has just been completed – the situation of underlying investors does change from time to time and ongoing Anti-Money Laundering checks are an absolute must.

Indeed criminals themselves are becoming more sophisticated by the day – it has almost become a profession – and it would not be beyond the bounds of the imagination to think of professional criminal families setting up a 'Family Office' or Investment Company and making investments into products such as Private Equity. At the time the investment was made everyone appeared above board but unless regular checks are made on the investor and their backgrounds (recommended at least annually), the changed situation may not be discovered by the Investment Manager – resulting in erroneous statements and declarations and to put it bluntly 'an almighty mess'.

Others within the investor community could, during the life of the fund, become Politically Exposed Persons (PEP). The Money Laundering Regulations 2007 (MLR) in the UK and similar regulations in other jurisdictions specifies that Enhanced Due Diligence (EDD) and increased monitoring must be carried out where the customer is a PEP; hasn't been physically present for identification purposes; isn't previously known to the manager or is a resident or business domicile of a high risk country. There is also a need to check companies and associated individuals against worldwide sanctions lists.

How many of your investors or principals within your LPs have changed their status

since you last did the relevant checks? Have you any clue that they may have changed? Do you have latest copies of documentation? Are the names checked against sanction lists on a regular basis?

Many of the due diligence requirements set out in the MLR, are regarded simply as a necessary evil and compliance as an increased operating cost. Even the language of regulation is negative. We talk in terms of obligations, duties, and requirements. The word most frequently paired with 'regulatory' is 'burden', and the antithesis of 'regulation' in any discussion of the issue is 'freedom', as though the two terms are mutually exclusive.

However, knowing the beneficial ownership of an investee company and the ownership of any funds must not only be known before entering into a relationship but also on an ongoing basis. Not only must you know who has ownership or control over these funds at the outset – but also throughout the life of the investing relationship. Whilst beneficial ownership of the funds may remain static, there is no doubt whatsoever that the 'controllers' of the funds will change from time to time. The initial verification and ongoing updating must be carried out on a risk-based approach and must take account of the number of individuals, the nature and distribution of their interests in the company and the nature and extent of any business, contractual or family relationship between them.

Many investors operate internet websites, which contain information about them. You should bear in mind that this information, although helpful in providing much of the material that might be needed in relation to the company, its directors and business is not independently verified before being made publicly available. Web research on its' own is not always sufficient and needs to be supported with 'external' evidence.

These processes cannot be considered an optional extra, they must be satisfied as the penalties attached can be particularly harsh. There have been examples recently of severe punishments for not having appropriate risk based procedures in place. The penalties for CDD failures by institutions include severe civil penalties and even cancellation of registration. The penalty for individuals not alerting the authorities to money laundering when there are 'reasonable grounds for suspicion' is up to five years in prison, and an unlimited fine. The reputational impact for either is incalculable.

The emphasis on this aspect of our work will not be going away – indeed it will only become more critical. So when you next make a declaration or sign documentation confirming that the funds you are investing into the portfolio are 'Clean' funds do please consider what evidence you have to make that statement and more to the point when was it last updated?

To 'Know Your Customer' is no longer good enough. You must 'Keep Knowing Your Customer' on a regular basis.

European Commission proposes framework

The Commission published its' well publicised Directive on Alternative Investment Fund Managers on the 29th April 2009.

At the date of writing, the full Directive had yet to be released. There had, however, been much comment from both the BVCA and the EVCA along with other journalists and publications. There is no doubt that the true implications of the Directive are yet to be fully understood and we will keep clients and others advised on this issue as the debate progresses.

Full details can be found on: www.europe.eu Reference IP/09/669



TECHNICAL

Maximising return from your Fund Administrator



Ian Kelly
Partner & Chief Operating Officer (Europe)

The relationship between a GP and their Fund Administrator is a critical relationship – almost akin to a marriage. If the right informed choices are made at the outset, and enough attention is paid, the union will be stronger than the sum of the separate parts.

Selecting the right Administrator in the first place is critical, but how do you ensure that you are making the right choice? And what are the correct questions and due diligence that need to be undertaken?

Selecting a Fund Administrator is not an easy task. At the baseline, Fund Administration consists of two essential materials – state of the art technology supported with good quality people. These are the two areas that should be explored in detail.

Sector specific technology should be guaranteed for anyone serious about Fund Administration – if the prospective Administrator hasn't got it, cross them off the list at an early stage.

But even further, consider that having the technology is one thing – making it work in a manner that fits the client's needs is another. Potential clients should see the technology in use and be able to question the accounting staff (not IT staff) as to how it works and the benefits it can offer.

Modern technology should deliver exactly what the client wants – not what the IT department thinks a client wants, or how the Administrator wants to service a client. If it doesn't deliver, there are plenty of other Administrators able to provide exactly what each client wants, in tailored solutions to fit individual needs.

People are probably the most important asset of any Fund Administrator. The Administrator

should be proud of its people. It should train, develop and fully invest in them. They should be qualified in what they do and, in the case of Fund Accountants given the complexities of Private Equity, be properly qualified.

Meet with your proposed accountant, or the person who would take responsibility for your team. This is the person you will be speaking with at least weekly, if not daily. Do they understand what you want? Do they understand your Fund and how it works? If not, you are off to a bad start with the potential to go enormously wrong.

When appointing an Administrator, key points to consider are:

1. Choose carefully – it's usually a 12 year relationship
2. Seek to match 'Corporate DNA' as opposed to the cheapest price
3. Work only with people you trust
4. Choose people you enjoy working with
5. Don't leave the decision making process to someone who is biased/has a vested interest/a conflict of interest or who is unqualified to make the decision
6. The data the Administrator holds should remain the clients' data
7. Check that you are not locked into the relationship, the Administrator should be proud of their offering and not feel the need for a legal lock in

Get one of the above wrong and you may well regret the result.

Once the documents have been signed, you have entered into a long term relationship with your Administrator. You have purchased a shared service that will bring huge benefits if harnessed properly. Open communication will be key to making the relationship work. Your Fund Administrator is staffed by professionals who will want to get it right

every time. They are not, however, mind readers! Tell them what you are planning to do on an ongoing basis. A good Administrator will want to schedule a weekly call with you – find time to take that call. Use it to keep everyone properly informed and to listen and help with any issues the Administrator may have.

Good quality Administrators agree standards of service and monitor their own performance against Key Performance Indicators (KPIs). They will undoubtedly also seek feedback on what they do, to improve their own service offering and to grow with their clients as their wants and needs change. Share your key delivery points with your Administrator – they should be happy to include them on the list of measurables. In financial services, statistically only 4% of complaints are communicated. Articulate your comments in a supportive manner, be honest and objective, and the service you will receive will improve.

Finally do remember your Administrator is human and will make mistakes – but if they are good, the mistakes will be minor and will not reoccur. Shouting or swearing at your Administrator will not achieve results. Most errors arise because both Administrator and client could have done things better. Remember there will be times when you really need your Administrator to go the extra mile for you. Work together, even when things have gone a little awry, and they will pull out all the stops for you. When they do, recognise it and say thanks once in a while – you will reap the dividends.

Once a great union is forged, the investor will ultimately benefit as they will not only receive independent bespoke best practice servicing at a competitive price but will also benefit as the Fund Manager will be allowed to devote their time to making the optimum investment returns possible.



TECHNICAL

Meet the team – Glyn Thomas

Glyn Thomas, Director, Training & Technical

Glyn heads the Training & Technical function within Augentius, having joined the business six years ago. He has seen the business add over 100 staff in a short space of time.

Joining as Senior Portfolio Accountant to our first Private Equity clients, Glyn was heavily involved in our implementation of the Investran reporting platform. His background of five years with PricewaterhouseCoopers had included audit of Private Equity funds and management entities, as well as time spent with their ABAS Technology group – this helped him to act as 'interpreter' between our two key teams: the accountants and the IT guys! As the teams grew and integrated within the Client Services function, Glyn became a team leader and was affectionately known around the office as 'the Oracle', having worked with so many of our clients and their structures.

Following our MBO, Glyn became a member of the Executive Team in a new role, heading a department focused on technical projects and training. This has included building on the accounting processes and procedures as the business scales up, and the creation of a modular training programme – to share our knowledge of accounting and industry best practices across the growing Client Services teams.



The remit of the Technical Team is wide-ranging, particularly in the take-on of new business, where we assist on migration of data, reporting standards, accounting policies and system processes. Allocation rules and distribution models to fit increasingly complex fund structures must also be bedded down.

The day job includes working with our clients on everything from investor communications to guidance on valuation and impairment issues, as well as supporting the accounting teams with advice in relation to GAAP and the deciphering of legal agreements. The team also provide oversight and counselling for the 20+ staff we are supporting through professional exams, in seven different qualifications.

Augentius launches Consultancy Services

Given its' level of expertise Augentius is being consistently approached by GPs, Managers and others to provide guidance on back and middle office procedures and resources. We have a depth of experience and knowledge in the operational aspects of the business and have now set up a practice to share this knowledge with clients. Headed by Gavin Davies, Managing Partner, Augentius will assist clients in identifying best operational practices, the selection and installation of technology and the ongoing delivery of a quality service to LPs and investors.



Further information can be obtained from Gavin. Email: gavin@augentius.com
Phone: +44 (0) 20 7397 5454



New recruit for Augentius

In the current financial circumstances all employers are looking at different options and Augentius has recently explored the possibility of employing a 'Tea Lady' to both improve the quality of the tea and coffee and reduce costs. It has to be said that both the manner and attitude of the individual concerned left a lot to be desired and the quality of the tea and coffee was not the best. The agency used to find the new tea lady provided the service free of charge for one day and we used this opportunity to raise funds for 'Red Nose Day'. Suffice to say given the costs vs. service levels we have decided to continue to use vending machines.



PS. No prizes for guessing which of the Partners provided the Tea Lady service!!!!



MORE INFO

For further information on Augentius Fund Administration please contact:

Hugh Stacey

Director, Business Development,
Augentius Fund Administration LLP
Tel: +44 (0) 20 7397 5489
Email: hugh.stacey@augentius.com

Kerry-Anne Morley

Managing Director,
Augentius Fund Administration
(Guernsey) Limited
Tel: +44 (0) 1481 734302
Email: kerry-anne@augentius.com

David Bailey

Managing Partner,
Augentius Fund Administration LLP
Tel: +44 (0) 20 7397 5453
Email: david@augentius.com

Barry Carroll

President and CEO,
Augentius Fund Administration
New York Inc.
Tel: +1 (917) 484 8222
Email: barry@augentius.com