Private Capital 2019 CFO Survey: **All Hands On Deck**

ALTARETURN

Introduction

AltaReturn wanted to examine what private capital CFOs are thinking about the current environment, their concerns, priorities and how they view their back office and operational capabilities.

"If everyone is moving forward together, then success takes care of itself."
Henry Ford

After a torrential pace of fundraising, deal activity and performance over the past few years, the anticipation for a market correction and its effect on the private capital markets is beginning to weigh on both fund managers and LPs alike.

Global growth is undoubtedly slowing across the world, with a number of economic and political headwinds beginning to flex their muscles. How and when this will affect exit opportunities, financing, investor allocations, and ultimately performance, will remain to be seen.

As the industry faces a possible inflection point, AltaReturn wanted to examine what private capital CFOs are thinking about the current environment, their concerns, priorities and how they view their back office and operational capabilities.

Beyond being 'just the number crunchers', the role of the CFO has expanded significantly, much like the private markets have expanded in their own right. These days, there isn't a part of the business that the CFO really doesn't touch, from technology to human capital to compliance.

Given what's on a CFO's plate at any given moment and what's in store for the private markets over the next few years, we felt it appropriate to title this 2019 Private Capital CFO Survey – "All Hands on Deck." As we look ahead in addressing the challenges of a changing market environment, increased regulation, hunt for talent and new technologies being made available, the private capital CFO will need to muster the full resources of his or her team to be able to navigate any rough waters ahead. GPs would do well to take a holistic look at their complete operating picture including technology, service providers and staffing requirements. Operating risks exist with every fund manager – how it is addressed and managed is another question. Optimizing people, processes, technology and support will be an ongoing process.

With that in mind, AltaReturn conducted a survey for Private Equity, Debt, Venture Capital and Real Estate CFOs across the globe to better understand their current thinking in addressing these four key areas:

- Outlook
- Accounting
- Role
- Limited Partners/Investors

As the private capital industry moves into a potentially new market environment, so too will the role of the CFO evolve in order to address these new challenges. "All Hands on Deck" might very well be the captain's order soon.

Finally, we wish to thank everyone who contributed to the survey through their responses as well as interviews conducted. We hope you find the results informative, with the intention that this paper can serve as the foundation for future discussions on best practices and ideas as the private markets continue to expand with both capital and influence.

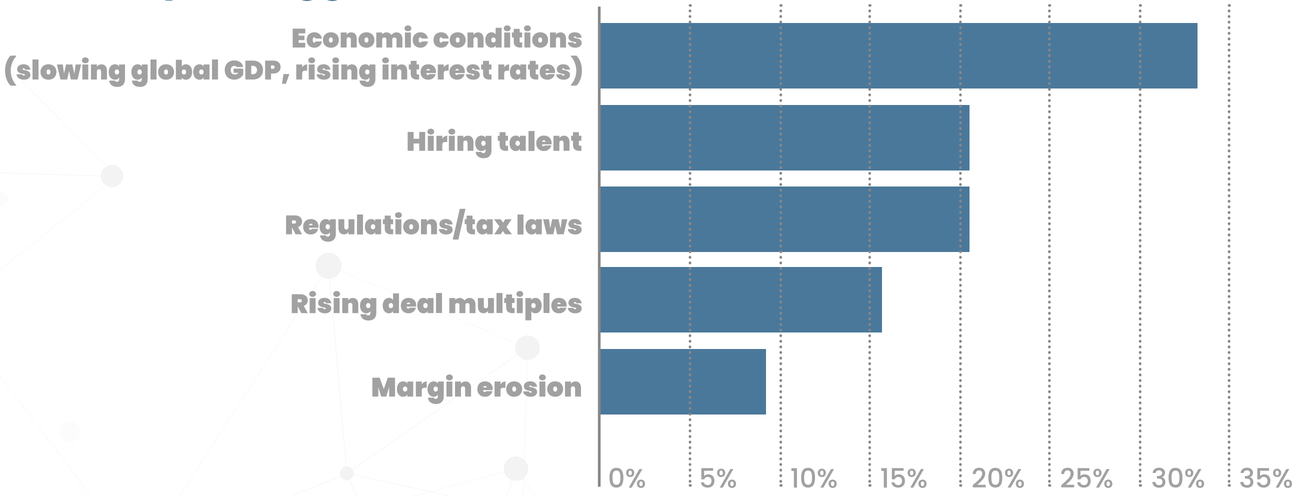
Gratefully yours,
Andre Boreas, Director of Marketing

OUTLOOK

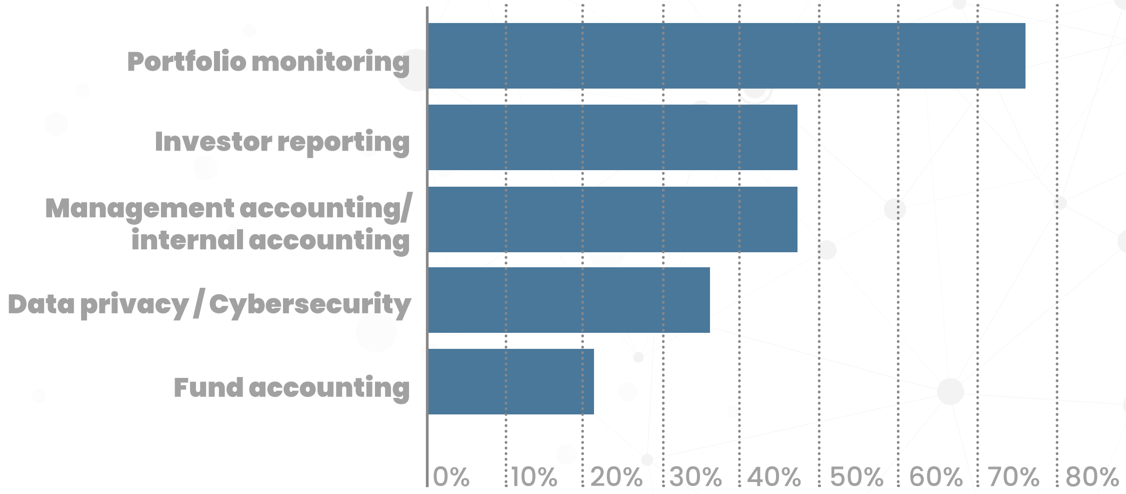
In early 2019, the IMF lowered its global growth outlook from 3.5% to 3.3%, its lowest projected rate since the financial crisis, with downside risks being attributed to "trade tensions, pockets of political instability, mounting debt levels and increasing inequality."[1] This projection has not been lost with our survey respondents, as a third of them ranked 'economic conditions' as their biggest concern going forward. Other dynamics in the private markets, including the challenges of finding experienced talent as well increased scrutinization by regulators, also ranked high in areas of concern.

Deal multiples do not seem to be a major concern among the CFOs in our survey with only 16% citing it as their biggest concern. (The same question being asked of the deal team might offer a very different result, though). LPs, for their part, have been quite vocal in their concerns about deal multiples given the amount of dry powder that will need to find a home soon but are still voting with their checkbooks as fundraising continues unabated.[2]

What is your biggest concern over the next 12 - 18 months?

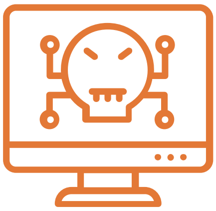


What operational areas are you looking to improve over the next 12 - 18 months?



Many CFOs serve as de facto COOs in their organizations (see next section on Role) so it's no surprise they touch so many parts of the business beyond fund and management accounting. One area of notorious inefficiency is in the collection and management of financials and KPIs from underlying portfolio companies (and properties for Real Estate managers). Often the domain of spreadsheets that get emailed back and forth between company management and fund sponsor, it's an area that has seen marked improvements in efficiency with the advent of cloud-based computing and related technologies.

Investor reporting is often mentioned among operational areas that GPs are constantly looking to improve. Part of the reason for this is that often what LPs want from their GPs is a constantly moving target. Says one CFO at U.S.-based $3 billion fund manager, "Some of our investors, particularly ones that use a consultant, seem to change their reporting requirements every 6 months. I don't know if it's from changes in market dynamics or what's currently fashionable, but it takes a considerable toll on us." One can surmise that if returns begin to head south, the ask for more transparency is only going to go up.



Having separate accounting platforms for fund accounting and management company accounting is often a **source of frustration** for the back office.

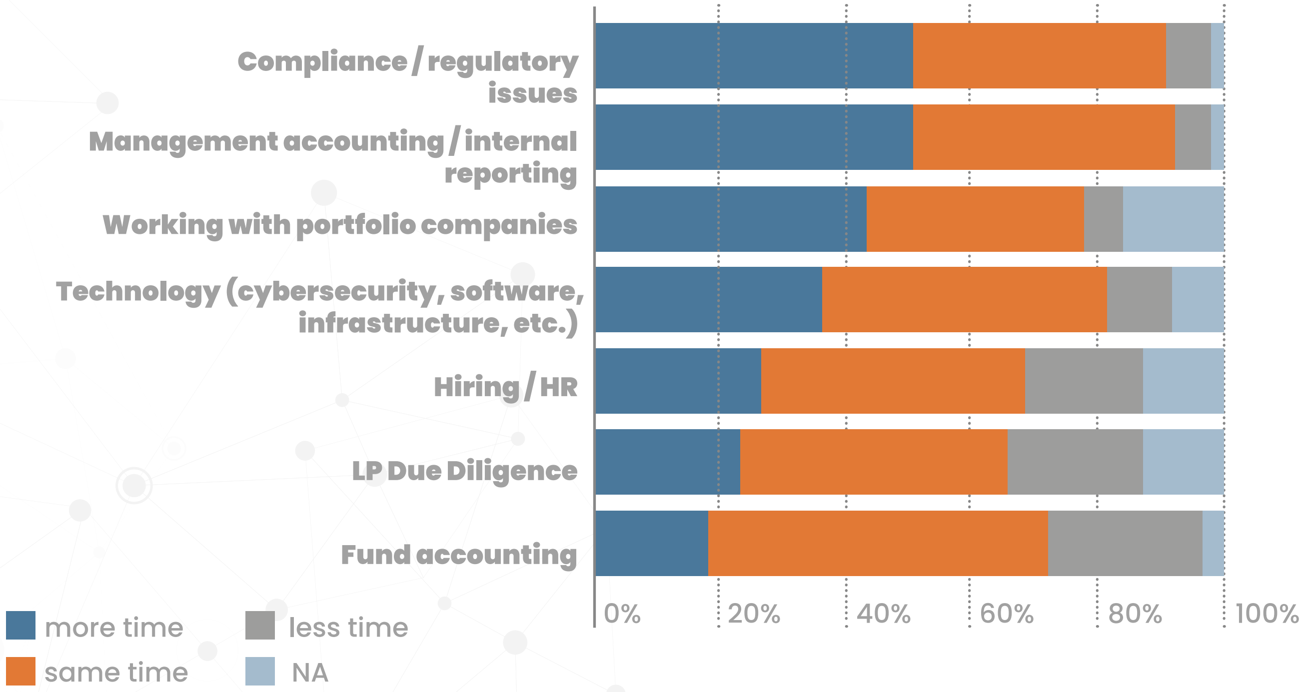
As so many GPs expand the size of their firms (assets, personnel, vehicles), it would seem that the need for better management accounting, processes and internal reporting would follow suit. Almost half of the respondents in our CFO survey seem to think so as well. Part of the issue with management company accounting is that the most widely used tools for this are off the shelf accounting packages such as QuickBooks or Sage. Respectable solutions in their own right, the challenges arise when trying to configure these packages to the very specific requirements of the private capital industry. As one CFO was quoted to say, "It's like putting a square peg into a round hole." Having separate accounting platforms for fund accounting and management company accounting is often a source of frustration for the back office.

As much as corporate cyber-attacks and data breaches grab headlines (seemingly on a daily basis), it's worth noting the relatively lower priority this ranked among CFOs in our survey. This could be from a number of factors including the possibility that most of the GPs in our survey have heeded the cyber-threat warning and have already moved to implement a comprehensive security program. The other possibility is that a number of GPs simply believe they are too small to be the target of any kind of intrusion or cyber-attack. We hope it's the former and not the latter given the highly sensitive nature of data GPs hold. In fact, in a 2017 survey, around half of investors say they will require cyber risk assessments both for GP management companies and for underlying portfolio companies within the next few years.[3]

ROLE

As the private capital markets have grown, so too has the role of the CFO. The two most common themes heard from a number of survey participants is that there is simply more to do, as the role evolves from being accounting-focused to having a broader operational perspective. The other point often made is that the complexity of the job has significantly increased as well. Certainly, a primary driver of these changes is simply the result of growth – people, investors, vehicles, and portfolios. However, the changing regulatory landscape, both in North America and Europe, is requiring a significant amount of attention from the CFO/COO role. In the U.S., the SEC has stepped up oversight and enforcement of private equity firms, including the establishment of a private equity-oriented taskforce in the Office of Compliance Inspections and Examinations. In Europe, the fallout from changes in MiFID II and GDPR is, hopefully, in the rearview mirror. What the ramifications will be from the ongoing Brexit conundrum is still unclear. Changes in AIFMD with regards to “pre-marketing” and reverse solicitation are currently being reviewed, with the potential for major implications in how European investors are approached.

How do you expect to allocate your time in the next 12-18 months?

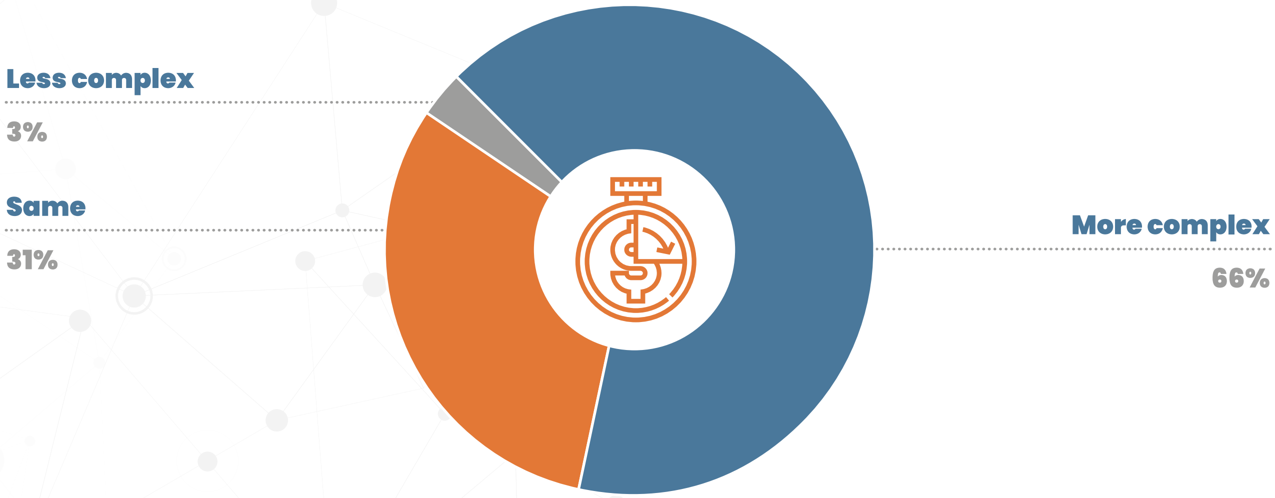


ACCOUNTING

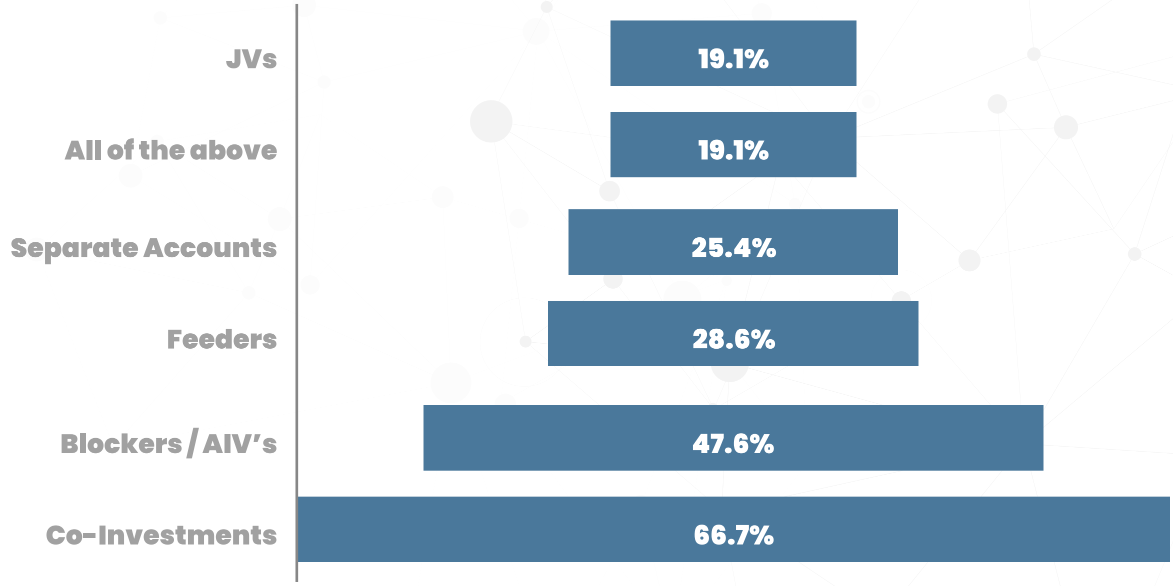
In the course of raising successfully bigger funds, it's inevitable that fund structures will become more complex, as investors from various domiciles, tax structures, and preferred investment vehicles must be taken into account. Allocations, particularly around fees, can be a vexing problem for the back office. With almost two-thirds of CFOs noting that their fund structures were becoming more complex, one can classify this as one of those "good problems to have", but managers still utilizing spreadsheet-based data stores and processes can quickly find themselves mired in errors and undue complexity.

Co-investing, in both Private Equity and Private Real Estate, has seen a marketed increase in use as investors work to deploy capital to meet allocation targets, as well as lower overall fees. Indeed, nearly two-thirds of LPs plan to make a private equity co-investment in the next few months. [4] At the same time, the top 20 private Real Estate managers increased their five-year co-invest totals by $10 billion from 2016 to 2018. [5] Given the popularity of the strategy, its easy to see why a GP that offers co-investment opportunities can see their fund structures' complexity increase quickly. "We tripled the size of our investor base from our last fundraise, bringing on a number of European investors and sovereign wealth funds. We historically ran accounting on (Microsoft) Excel but it's getting really hard managing all the nested relationships with it now," says the CFO of a $3.5 billion PE fund.

Are your fund structures becoming more/same/less complex?



What types of entities do you use in your funds?



"We tripled the size of our investor base from our last fundraise, bringing on a number of European investors and sovereign wealth funds. We historically ran accounting on (Microsoft) Excel but it's getting really hard managing all the nested relationships with it now."

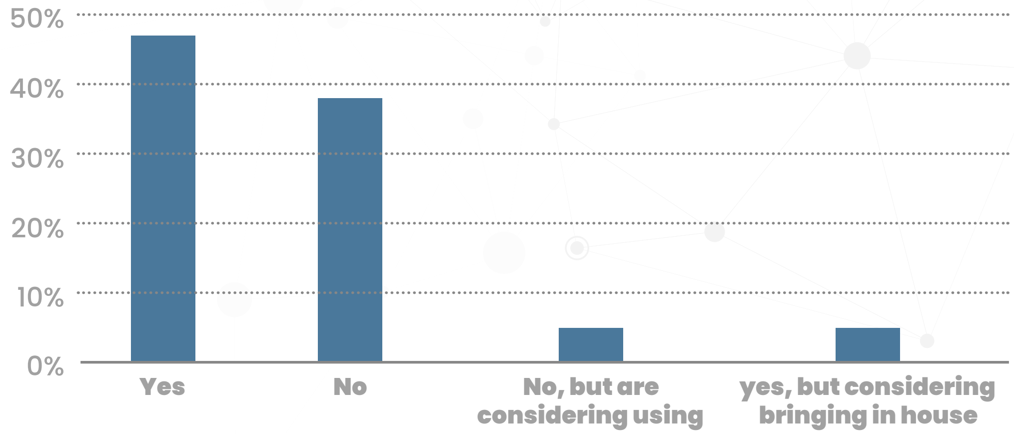
–CFO, $3.5 billion PE Fund

As recently as 2017, it was estimated that approximately 30% of private capital firms used an outside administrator (by contract over 90% of hedge funds use an administrator). With over 55% of CFOs stating they currently use an administrator or are considering it, there has certainly been an uptick in TPA engagement. However, many fund managers still continue to keep the accounting and reporting functions in-house. The most common refrain from this group as to why they don't use a TPA is a lack of control/governance. There is a general reluctance among many GPs in 1) having their data stored on another firm's platform and/or 2) having processes, checks, and controls being managed outside the GPs' control.

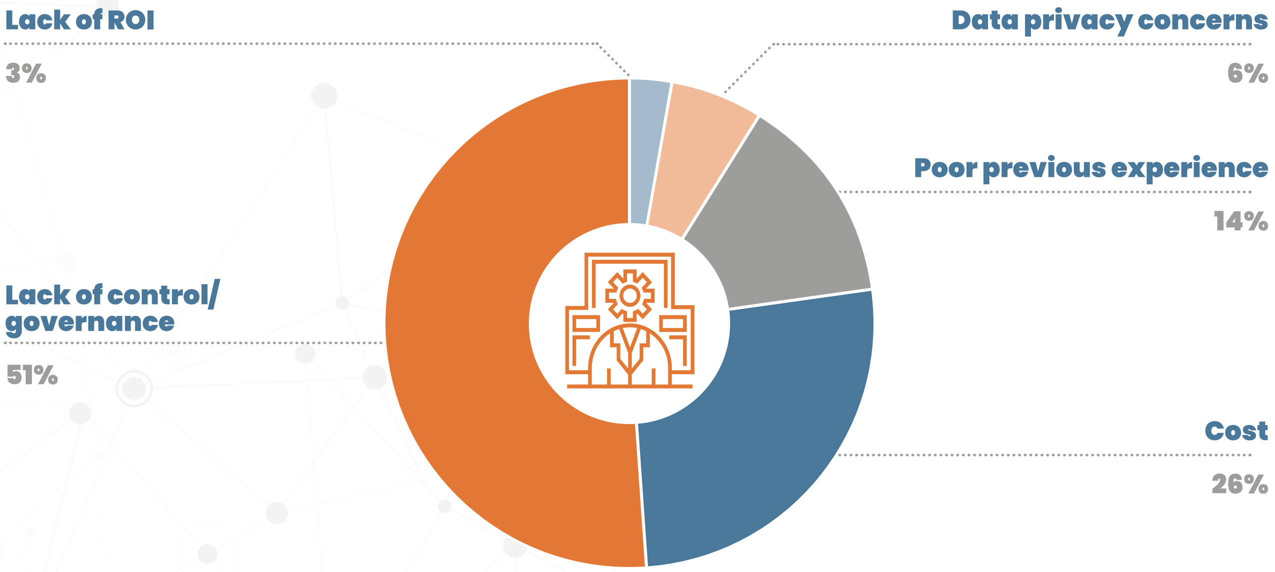
One solution that solves the data governance problem while still taking advantage of the benefits of using a TPA is through a 'reverse outsourcing' model. In this scenario, the GP maintains the technology, data, and processes in-house, and the TPA logs into the GP's system to perform what back office support they are tasked to do. In this way, the TPA acts as a true extension of the GP's back office. The benefits of this model solves two pain points: 1) the GP gets to make use of the expertise and support that comes with using a TPA and 2) the GP maintains 'ownership' of their data and processes

For larger funds with complex fund structures, oftentimes the manager will shadow their administrators' work. As one large GP is quoted as saying: " "We replicate 100% of the administrator work internally, as we cannot rely on third-party work alone given the complexity of our funds." However, many GPs view TPAs as an indispensable addition to their operations. One respondent to our survey was to say, "We put a lot of trust in our admin. We see them as a natural extension of our back office, and they've helped us to scale the business."

Do you use an Administrator?



If you don't use an administrator, what's your primary reason for not doing so?

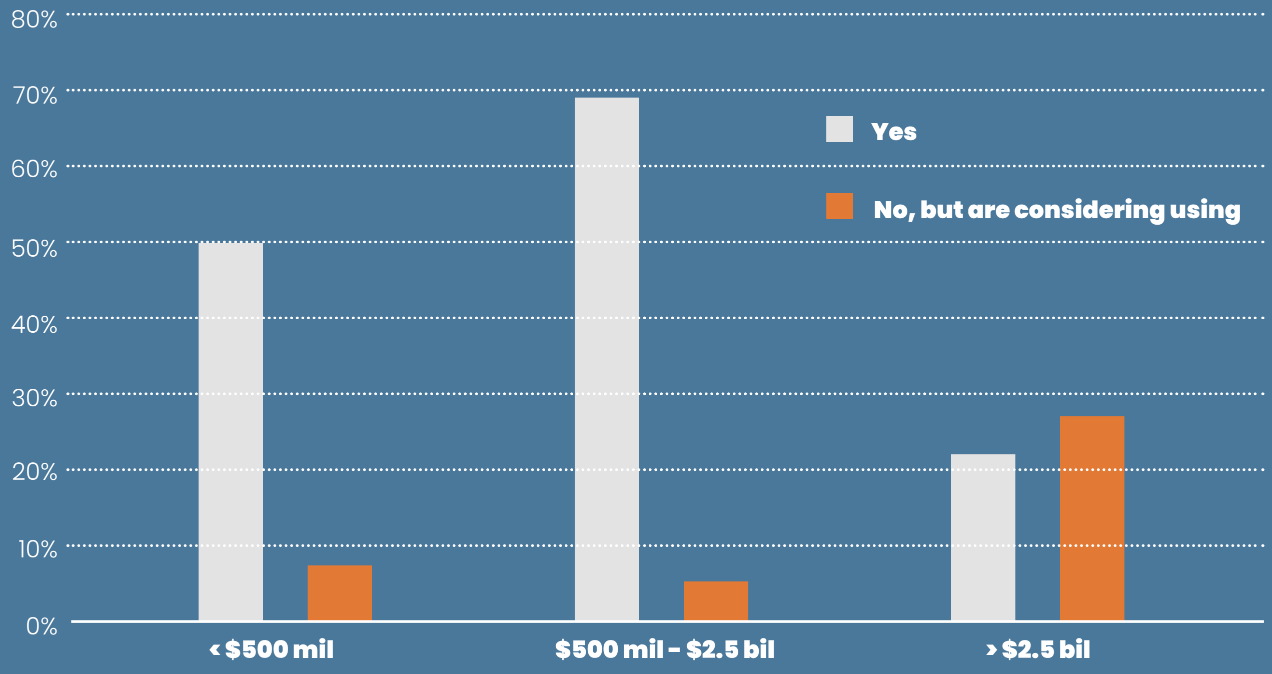


FURTHER ANALYSIS: Does firm size affect the decision to use an Administrator?

When it comes to fund managers and their use of administrators, not all GPs are created equal. When looking at respondents by firm size, there is a considerable drop-off in the number of managers who use an admin once they cross the $2.5 billion AUM mark.

Is there a point of a diminishing ROI in using an outside admin when funds grow to a multi-billion size? With the potential for exponentially complex fund structures and a revenue base with which to hire a dedicated staff, managers at this size seem to favor the in-house approach, particularly when compared to smaller funds who might not have the resources to build their own back office teams. However, with almost 30% of larger funds considering the use of a TPA at some point, attitudes among bigger funds might very well be changing as GPs continue to actively manage their margins.

Do you use an Administrator?



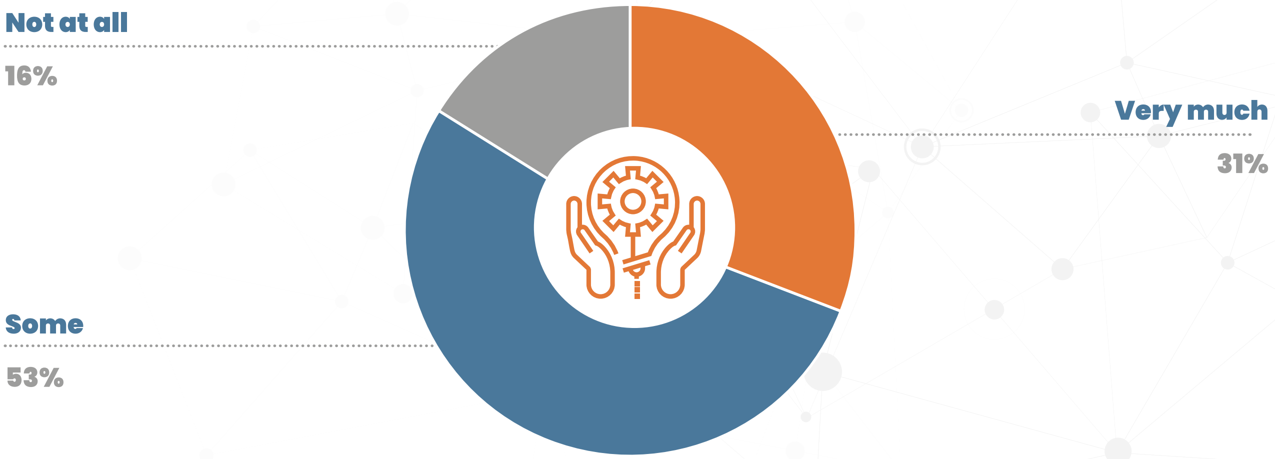
LIMITED PARTNERS/INVESTORS

"We've seen a steady increase of investors asking for property-level information and it's not just the big institutions anymore. It's hard to keep up sometimes."
-CFO, $2.7 billon Real Estate fund

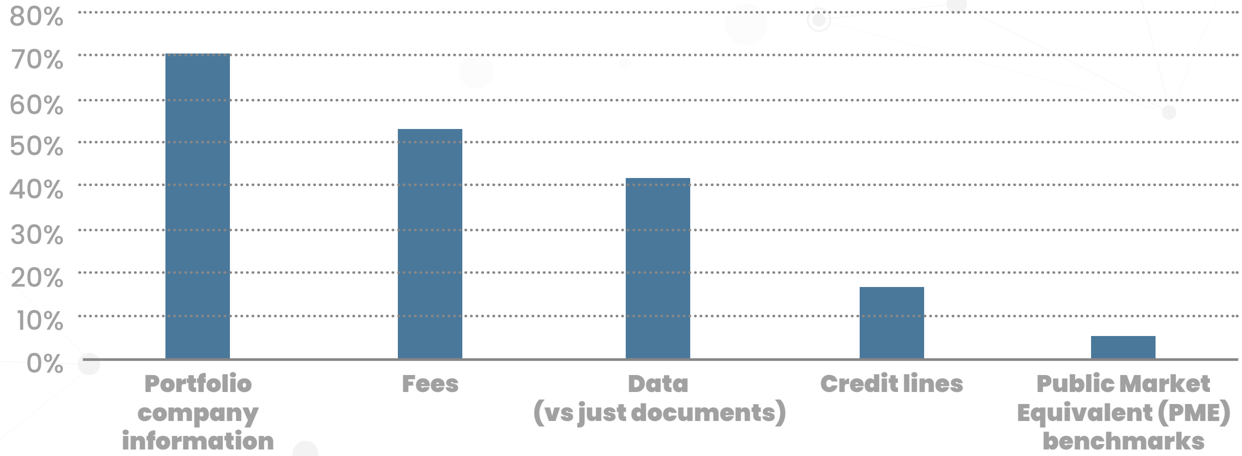
There is an argument to be made that when performance is meeting (or exceeding) investors' expectations, there is a corresponding reduction in information requests of the fund manager (who asks questions when you're up 20% ?) Given that IRRs across just about every private capital strategy is consistently posting mid-teen or higher returns, what does one make of the fact that 84% of CFOs report that their LPs are asking for more customized reporting? With nearly a third stating 'Very Much?' It could be that, even though the financial crisis is nearly 10 years old now, poor returns from vintage years 2005-2008 are still fresh in investors' minds. As LPs look ahead for the next turn in the cycle, allocation adjustments are underway to best position portfolios for any market disruption. LPs want to know where their current managers' bets lie, so future allocations can be intelligently made given the LP's risk parameters, diversification mandate and their view of any opportunity set going forward.

Another area that has seen an increasing amount of attention from investors is with fees. 2018 saw an uptick in SEC enforcement actions against private equity managers related to improper fee allocations - specifically with the application of management fee offset provisions and accelerated fee arrangements. [6] These actions have not been lost on LPs, with the ILPA releasing its fee reporting template in 2016 in an attempt to standardize how fees are calculated and reported on. Scrutiny by both LPs and regulators in this area is not expected to diminish any time soon.

Have LPs been asking for more customized reporting?

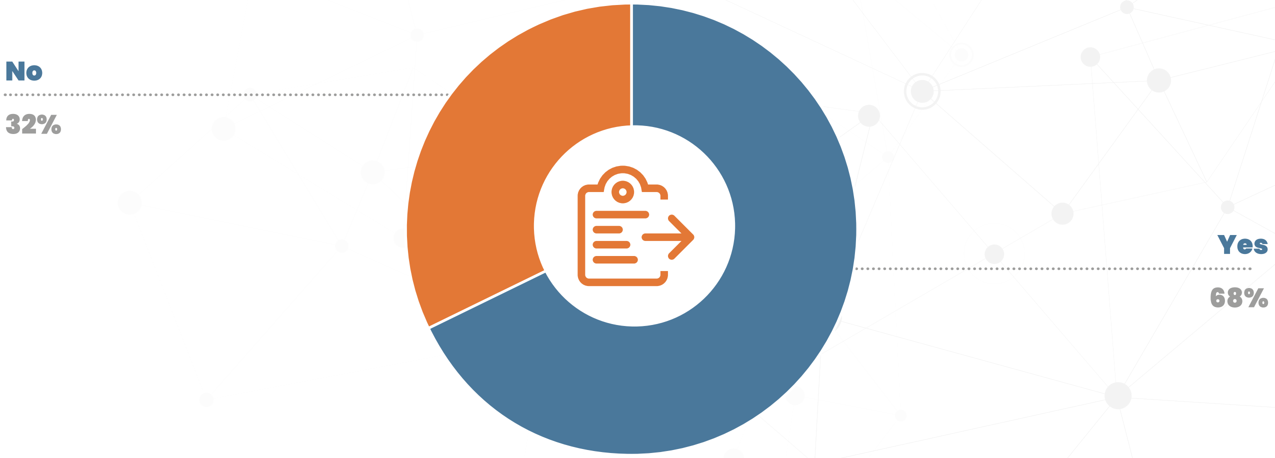


What types of info have LPs been asking more of?

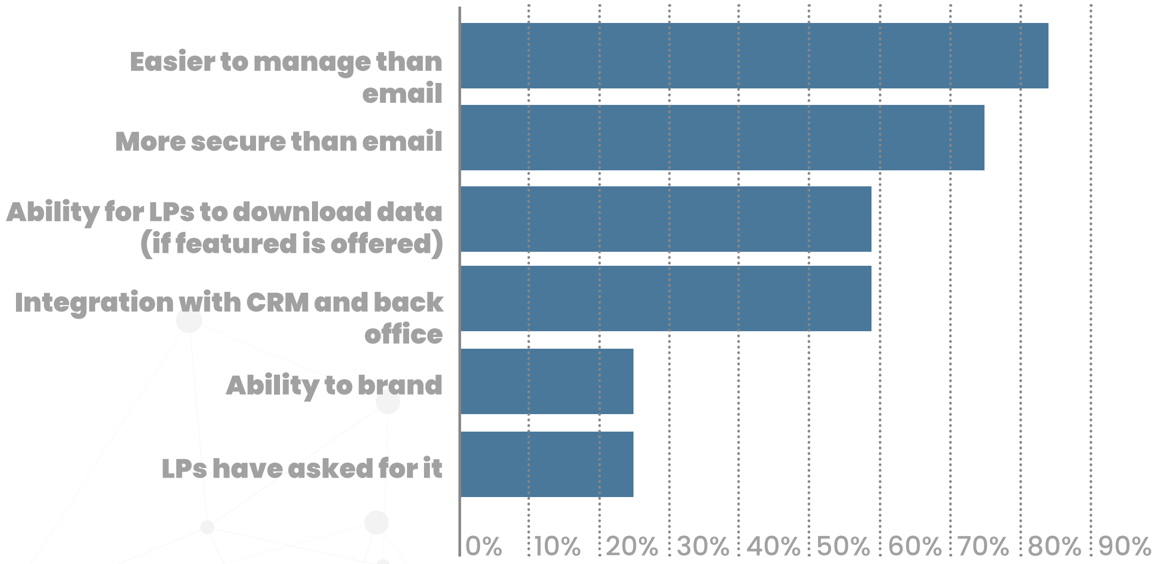


Another key point in looking at the types of information that LP are asking for is the ability for LPs to have access to the actual data underlying their investments beyond documents/PDFs. Indeed, many LPs have taken it upon themselves to perform their own analyses of their investments, positioning, cash flows, etc. at both the manager and aggregate level. Given the increased use of portals to communicate with investors (see next section), fund managers would do well to think about adding dashboard-type technology to their portal solutions. Configured correctly, dashboard technology allows LPs to 'self-serve' their data requests, alleviating the back office and IR of cumbersome, one-off requests that inevitably spike during times of market stress or perceived risk.

Do you use an investor portal to send information (K-1s, statements, etc.) to LPs?



If you DO use an investor portal, what are your reasons for doing so?



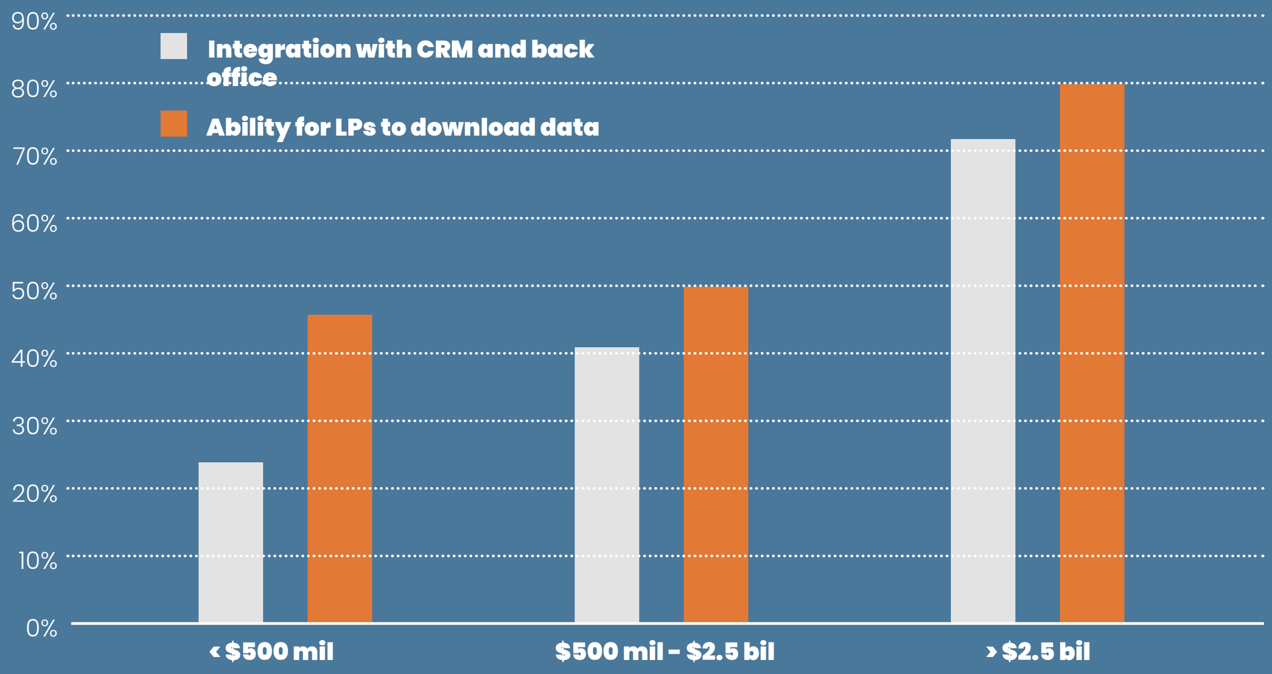
In the history of the private capital markets, it's not all that long ago that end-of-the-quarter reporting consisted of stuffing envelopes with hard copies of capital account statements, printing mailing labels and heading down to the local post office to send them on their way. Of course, email changed all that. But, just like snail mail, email is beginning to see its utility in this function begin to fade away. With the advent of cloud computing and related technical advancements, establishing an investor portal to share information, documents and data with investors (and prospective investors) is quickly becoming the norm. According to survey responses, the two most important benefits to fund managers are that portals are considered more secure than email (which has increasingly been targeted by cyber-attacks) and that getting the right information to the right person is more efficient than stand-alone email programs. Also, as previously noted, the right portal technology also allows for LPs to directly access the data underpinning their investments, a growing request particularly among institutional investors.

FURTHER ANALYSIS: What do different size managers think about the functionality of their investor portal?

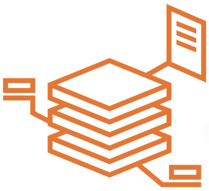
While ease of use and security are top of mind when a GP considers implementing an investor portal, a closer look at other functional areas of portal technology is warranted, especially in the context of AUM.

As a GP grows and begins to incorporate more sophisticated technologies into their organization, having applications and processes integrated (fund accounting, CRM, portal) becomes more important. With a higher proportion of institutional investors (and the reporting requirements that they command) as investors, developing efficiencies around reporting and communication becomes a priority if a manager is to scale their operations properly. Integrating technologies, across the back, middle and front office, significantly increases in importance as the complexity of fund structures increases.

If you DO use an investor portal, what are your reasons for doing so?



SUMMARY



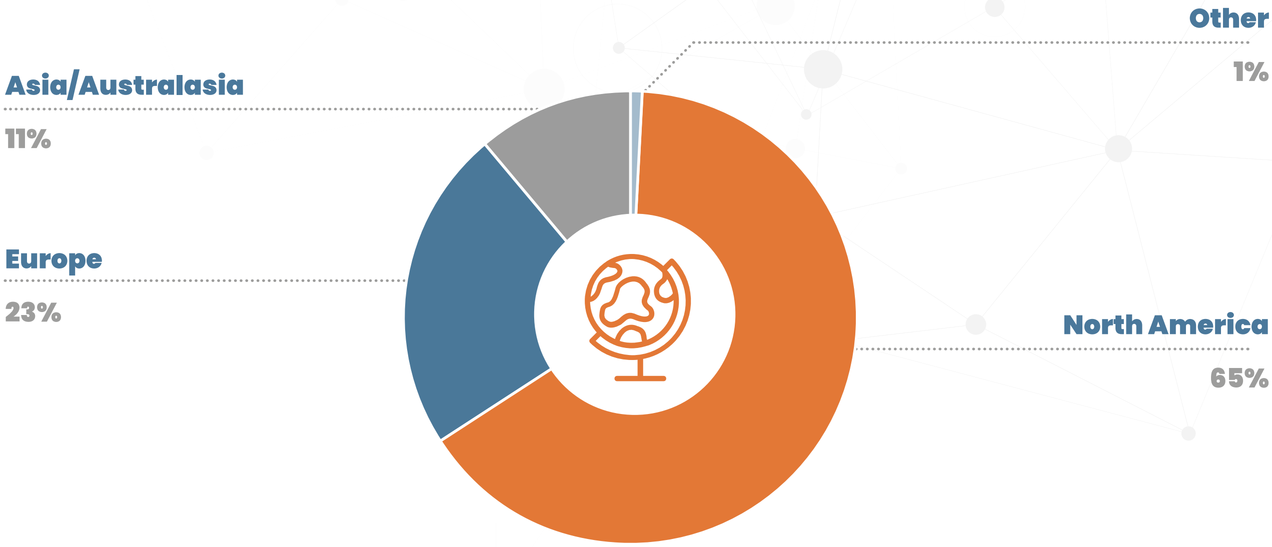
The private capital markets – Private Equity, Debt, Venture Capital and Real Estate - still represents but a small fraction of investible assets in the world. However, it is also one of the fastest growing and best performing – a fact well recognized by the investment community as allocations remain firm. (It's also a fact not lost on regulators, as many CFOs can attest to).

So, what does this mean for today's CFO? An expansion of duties, more complexity, and greater demands, both internally and externally, is what is driving the CFO's agenda. As previously mentioned, the title of this paper, ***All Hands on Deck***, represents the fact that CFOs will be hard pressed to address these challenges by themselves. A combination of a dedicated internal staff, support from external vendors (TPAs, legal, compliance), owner/partner buy-in, and investments in technology to support the decision-making processes are what's going to be needed to take on whatever headwinds the markets might bring over the next few years.

Respondent demographics

AltaReturn wishes to thank the many CFOs who took part in this project. Seventy four CFOs responded to this survey, with wide representation across geography, size, strategy and, of course, opinion.

By location:



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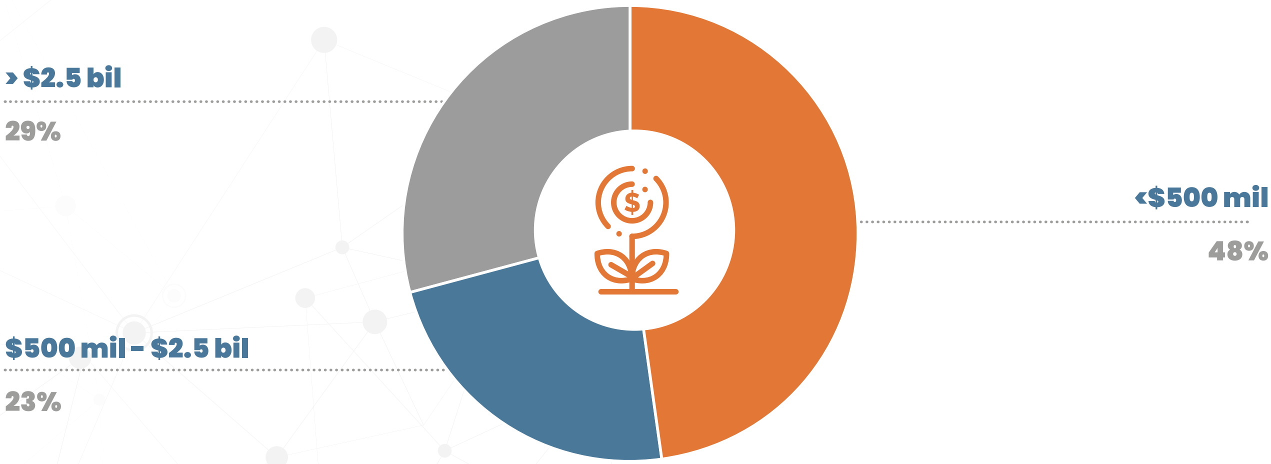

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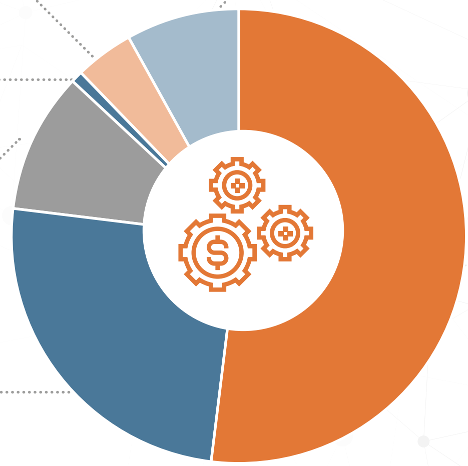

Footnotes

1. https://www.bloomberg.com/news/articles/2019-04-09/imf-cuts-global-growth-outlook-to-lowest-since-financial-crisis

2. https://www.privateequityinternational.com/lps-bearish-pe-returns-competition-becomes-top-concern/

3. https://www.collercapital.com/coller-capital-global-pe-barometer-summer-2017

4. https://www.privateequityinternational.com/lp-perspectives-2019/

5. https://www.perenews.com/the-art-of-co-investing-in-private-real-estate/

6. http://www.mondaq.com/unitedstates/x/777720/Securities/The+SEC+Continues+to+Spread+Sunshine+on+Private+Equity+Reflections+on+Two+Recent+Enforcement+Actions

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AltaReturn offers a modern suite of solutions for private capital fund managers, administrators and family offices including Fund /Corporate Accounting, CRM, Portfolio Monitoring, Business Intelligence and Investor Portals. Built within a Microsoft-based framework, these solutions are available as an integrated end-to-end suite or as independently licensed applications. Over $500 billion in assets is managed using the AltaReturn platform.

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