The evolution of private debt

As the US private debt market has evolved so have managers' fund administration demands. **Maximilien Dambax**, group head of private debt at Alter Domus, and **Michael Trinkaus**, the firm's US country executive, look at the key trends

Since the early 1980s until recently, North America has been the stronghold of the private debt market, setting the pace of the industry globally. In the aftermath of the global financial crisis, however, the private debt market has been transformed, with a growing disintermediation of banks in the wake of a never-ending raft of regulatory measures stemming from the credit crisis. Beyond the US and Europe, Asia is considered the next frontier, even if the shift to non-bank lending has been slower.

The growth and share of private debt funds is no longer considered to be an emerging trend but constitutes a bona fide alternative to traditional financing channels. In recent years, private debt has been moving from a niche to mainstream asset class that can provide value through challenging market cycles.

Operational and structural challenges emerging from post-GFC regulations have shaped the alternative asset management industry as it takes on risks and processes traditionally held by banks.

With this is mind, we look at the seven key trends, from an administration and operation perspective, that will be important to managers looking to face these growing challenges.

1. DEMAND FOR BACK AND MIDDLE OFFICE CAPABILITY

According to a recent survey from bfinance, new entrants are continuing to emerge, especially in the senior debt area on both sides of the Atlantic: 38 percent of vehicles in Europe are first-time funds, compared with 21 percent in the US. Most of these incoming players stem from the private equity industry, capturing the growing opportunities in this space, and allowing them to participate on both sides of the equity-debt fence. Firms that decide to go it alone will need their back and middle offices to take on more diverse instruments with the ability and familiarity to read and interpret documentation in place, understand the complexity of loan agreements and support multi-GAAP accounting, and report data periodically to different stakeholders internally (front and finance teams) and also externally (tax, regulators and investors).

Maximilien Dambax

> "ON-SITE DUE DILIGENCE AND DIRECT DISCUSSIONS AND INTERVIEWS WITH THE ALLOCATED TEAM ARE BECOMING THE NORM"

2. THE IMPORTANCE OF TEAM STABILITY

With more debt funds emerging, there is increasing scrutiny and pressure from investors directed at GP finance teams as they assess their optimal operating model. At Alter Domus, the fund administration teams are at the centre of the operations with the manager they work with. On-site due diligence and direct discussions and interviews with the allocated team are becoming the norm. These visits look to cover the key stages in the loan life cycle and value the team capability, know-how and stability. In reality, the administration team is an extension of the manager's staff. There is no single piece of software or technology which can replace the experience of a trusted team, providing guidance over and above fund administration with full vertical and horizontal integration from the investor down to the individual target investments. In today's environment, operational guidance and assistance are mandatory items to allow sponsors and their finance executives to focus on strategic matters such as structuring, sourcing financing and monitoring deals throughout their lifecycle, and ultimately delivering strong returns to their investors.

3. THE NEED FOR TRANSPARENCY

Initially started by a handful of large LPs, and since enshrined by guidelines set out by the Institutional Limited Partners

Association, there is now a slew of industry standards covering everything from fees and expenses reporting to the use of credit lines by GPs. The overall idea is to allow investors to better understand how a manager budgets and tracks expenses, and allocates those expenses across parallel, co-investment and any other multi-fund structures. At the same time, institutional LPs are asking for personalised formatting and ad-hoc reporting, regardless of the standardised reporting provided by GPs. As a result, there is a need for an efficient and automated data capture process from the source through to an efficient reporting system at the top to feed managers and investors with the type of information and detail they increasingly require.

4. GROWING REGULATORY DEMANDS

Taking into consideration the big three – AIFMD, Dodd-Frank and FATCA – no one will refute that regulatory reporting has growing importance in the alternative assets industry. In the current environment, in-house capabilities and compliance resources at the fund manager level make the monitoring and reporting exercise a daunting task. Regulatory uncertainty and so-called grey zones in interpreting new regulations are another issue requiring regular internal review. Indeed, reports can be requested not only at the fund level but also at the investor level directly by the regulator or by other parties. Failing to comply with such requirements would have a significant impact from both a financial and reputational standpoint.

5. STRUCTURE COMPLEXITY

Fund structures have dramatically evolved over time. Whereas in the past one large main fund was established, today we see an increasing number of asset managers looking to diversify and expand their investor base with parallel fund vehicles. This may include specific feeder vehicles, coupled with co-investment and SPVs to hold the underlying portfolio alongside a main fund structure. From a reporting perspective, this triggers additional complexity as the manager will have to compile and retrieve non-standard data from multiple sources to obtain a consistent and comprehensive view of the overall fund structure.

Michael Trinkaus

6. THE EMERGENCE OF NEW TECHNOLOGY

More data and more complexity in structures and flows are triggering a need for more innovative technology solutions that can integrate and seamlessly combine portfolio, SPV and fund activity with investor and regulatory reporting.

> "A WORLD OF COMPLEX SPREADSHEETS IS NOW MOVING TO SPECIALIST SYSTEMS OPERATED BY TEAMS WITH IN-DEPTH ASSET KNOWLEDGE THAT CAN BETTER SUPPORT THE INCREASING NEEDS OF ASSET MANAGERS"

A world of complex spreadsheets is now moving to specialist systems operated by teams with in-depth asset knowledge that can better support the increasing needs of asset managers. This includes, on the asset side, details of historical loan activity, tracking funded and unfunded positions, automation of the accounting rules per transactions with fee parameters and advanced portfolio construction set-up. Flexibility and customisation are not surprisingly the rule and deemed to be critical.

7. DATA MANAGEMENT AND DIGITALISATION

Data flows from internal and external sources trigger the need for managers to collect, aggregate, compare and store information in order to implement a robust risk management approach. The handling of loan documentation and related compliance and administrative tasks require a robust data management tool to follow the entire loan life cycle including having dashboarding functionalities and access to loan activity level with payment schedules, interest payment dates, loan terms and agent notices. This approach requires a proper digitalisation of documents with "alert me" systems' functionalities to properly cope with the volume of loan documentation.

CONCLUSION

In a maturing industry, private debt managers are facing classic, and strategic, operational challenges as they operate across a growing number of jurisdictions and structures. In this environment, a dedicated specialist outsource partner backed by tailored specialist system infrastructure has become essential for establishing the kind of partnership asset managers need in an increasingly complex environment that is today's private debt fund world. ■