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OUTSOURCING TRENDS

Time to declutter?

Increased complexity in fund management and the rise of technological solutions are leading private equity firms to take a long, hard look at their back and middle office functions, says Emmanuel Raffner of Alter Domus

Raffner: technology is a big driver

Private equity firms are at a crossroads today. More established firms have built out large back and middle office teams to remain compliant in the face of increased regulation, with the Alternative Investment Fund Managers Directive in Europe creating a significant amount of additional workload. Meanwhile, LPs require much more granular information and are increasingly seeking independent verification in areas such as valuations. At the same time, managers have branched out into new asset classes and are managing multiple funds and co-investment vehicles.

All this adds up to greater operational complexity and more headaches for those in charge – the CFOs, many of whom are still having to grapple with all these challenges using outdated technology.

Against this backdrop, we spoke to Emmanuel Raffner, head of private equity, infrastructure and corporates at fund and corporate services provider Alter Domus, about how outsourcing providers are developing to meet the industry's challenges.

Q It's clear that the private equity industry needs to find solutions to a variety of pressures today. Where are you seeing most interest?

We are having conversations with clients – both current and prospective – across the spectrum of services we provide, but also across the different fund manager sizes and maturity. So, for example, with first-time managers, the conversations are very much around us providing a fully integrated solution from corporate services right through to fund administration, accounting and reporting with a fully integrated third-party management company (Manco). These managers may not have much expertise in back or middle office functions and, in any case, would be reluctant to invest heavily in these areas when they need to focus on building a track record.

At the other end of the spectrum, we're seeing many of the larger, non-EU managers looking to use third-party AIFM services so they can continue to promote funds in the European Union, and for many it is too time-consuming and costly to set up licences on their own.

Q And what about the more established, mid-market players? What are they looking for today?

Often, these clients come to us because they've made the decision to outsource part of their operations, for example, to administer their fund and/or SPVs, or help them manage regulatory compliance. They have often reached this decision after looking at whether they want to hire more middle or back office staff, or whether they would be better off investing in front office professionals.

With these clients, it's often a case of building trust with one type of service in one geography and then extending those services and geographies over time. You have to build a relationship with clients so that, when it comes to launching a new fund or extending into a new asset class, you are well positioned to help them design or redesign their middle and back office functions, or you can help with a move into new regions. But to do this effectively, you need to be able to follow your clients to wherever they operate and offer them services from the fund level right through to the holdco and SPV levels. Overall, we are finding that outsourcing is often a gradual process, but with European managers moving faster than their US counterparts.

Q And how much of a role is technology playing in these decisions?

Technology is a big driver. The industry is in a transition phase and that is one of the key reasons GPs are looking to outsource. In the US, for example, we are having a lot of conversations around this as managers have started to take a step back and look at their IT. What they often see is a mosaic of different systems, none of them integrated, and they realise that they are going to have to invest significantly to streamline their processes and automate data capture, analysis and reporting.

Q One of the big concerns about outsourcing among GPs is retaining control over data. How can firms mitigate against this risk?

Yes, control over data is often the first question clients ask us when we meet them for the first time. To a certain extent, technological developments have already mitigated this as clients can now have more data accessible – there is not the same lag now in the way there used to be.

Yet it also comes down to the design of systems and processes. GPs sit down with us and we define with them what their process is, what their internal staff do and how we can work with them. The outsourcer shouldn't be a layer in between GPs and their data or, indeed, their LPs – there is no need for disruption to processes. GPs should also expect there to be dedicated team members at the third-party provider they can talk to. Our team is their team.

Q How do you think outsourcing will evolve in the future?

Technology and integration will continue to develop. However, if you look at what third parties do beyond regulatory compliance matters, we are already gathering, verifying and aggregating data on our clients' behalf. Yet data is not the end objective – quality reporting and useful information is what third parties should be providing. Increasingly, we are able to help clients focus on their key investment decisions, ensuring they don't have to spend time benchmarking and by providing them with more value-added reporting.

We can increasingly help alternative investment managers focus on their core business by giving them the relevant information that they need. We are continually moving towards more value-added services. ■

Q Why is there this disparity between US managers and European ones?

There is a clear lag for US managers. Around 30 percent of US managers currently outsource, while the European rate is now close to 70 percent, with a real increase over the last few years. One of the drivers in Europe has been the AIFMD and the ever-increasing regulatory compliance pressures, which has created a need for depository services and a pressure to become compliant.

Nevertheless, we are seeing more US managers look towards outsourcing. Part of this has to do with increased demands from LPs for greater transparency across a range of areas, with many pushing for firms to adopt the ILPA template.

In the US we are seeing a new generation of CFOs who as new incumbents are often prepared to rethink or redesign their firm's existing operational model. Managers in the US are increasingly recognising the value that specialist third-parties can bring, and, as independent players have built up the services and expertise they can provide, GP expectations are changing. There is a clear shift away from services offered by the traditional banking providers.

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