

# COMMENT

## Strengthening capital administration

*Dean Schaffer and Gary Shelto, managing directors, North America at Alter Domus, discuss why alternatives funds need rules-based technology to support capital administration needs.*

**I**s it really possible to have too much of a good thing? When it comes to the overwhelming volume of data associated with the growing alternatives industry, the answer is clearly yes.

It's estimated that by the end of 2025, the alternatives industry will manage more than \$17trn. That's compared to just \$8.8trn under management in 2017.

To meet the nearly unbridled investor demand, GPs are fast-tracking new funds. In fact, between 2018 and 2021, the number of funds in the market increased threefold, many of them with complex structures. During the same period, the number of LPs increased 4.5 times over the same three-year period.

It's no surprise then that the process of capital administration has grown increasingly complex as well. The fund manager who was efficiently overseeing a couple of funds not long ago, may now be juggling five, six, or seven funds, each with its own terms, investors, and investment strategy. Comparing then and now, the amount of data produced has grown exponentially.

Dean Schaffer

Undoubtedly, data is a valuable tool in fund management, informing decision-making, shedding light on investor behaviour, and enabling regulatory compliance.

But, according to Dean Schaffer and Gary Shelto, managing directors in North America at Alter Domus, as the alternatives industry has grown in scope and sophistication, the ability to wrangle all that data has reached a tipping point. It's almost impossible for human resources to keep pace.

"Ask the CFO of any general partner to consider the number of funds being managed, multiplied by the number of limited partner investors and the number of portfolio companies, and they'll likely admit the amount of data involved is not just substantial, but in many respects terrifying," Shelto said. And unless fund managers institute a rules-based capital administration structure with the automation to support it, things are likely to only get worse.

### Chasing waterfalls

Distribution waterfalls define how the allocation of investment proceeds cascade down a series of capital recoupment tiers, followed by a preferred or priority return to the LPs, then a final sharing of residual profits between the LPs and GP.

On the face of it, that may sound fairly straightforward. In reality, though, the picture is muddled by the fact that there are different waterfall structures, and they're growing more complicated all the time.

Historically, waterfalls fell into one of two categories. They were either the GP-friendly American style or the LP-favouring European style waterfall. Today, though, fund structures can be far more complex (i.e., hybrid structures or evergreen funds) while investor terms are more bespoke, with unique, investor-negotiated agreements. The confluence of fund structures and investor terms add layer upon layer of intricacy.

While it's comforting to think that bringing in an army of Excel-trained staffers will be enough to provide a suitable solution, that's not the case.

"The truth is, in light of the numerous waterfall structures, it's nearly impossible to perform accurate and reliable calculations using traditional methods," Schaffer said. "Basic Excel models can't support the level of complexity and certainly aren't dynamic enough to track and accurately report performance under various scenarios – or fulfil the growing requirements related to information security, transparency, accuracy, and speed."

### No more "making do"

If paper no longer cuts it, what can be done to control the chaos and bring the monumental volume of associated data down to size?

The answer, Schaffer and Shelto said, is to abandon the old ways of working in the back office. No one can afford to "make do" with Excel spreadsheets any longer, they say.

As an alternative, they're seeing firms turning to customised, rules-based technology that can confidently handle even the most overwhelming volume of data – and scale up as GP operations grow.

That includes Alter Domus' secure software platform, CapAssure®, which integrates seamlessly with in-house accounting programs.

CapAssure software is capable of tracking all cash flows moving within multiple fund complexes, managing risk, and simplifying the capital administration process – all while providing a timely flow of information. It allows for the creation of discrete rules that can be followed for every individual LP or investment partner, ensuring that every individual cash flow is accurate. And that's the case no matter how complex the agreement is. Plus, it's fast and leaves a complete data trail.

"Calculations that would have taken weeks to confirm as correct can now be completed in seconds," Shelto said. "All LPA agreements and legal obligations are encoded in the system, along with any relevant accounting and tax rules."

"This provides a complete data and process audit trail that helps make reporting obligations pain-free."

The proof, of course, is how things play out in practice. And if the story

of just one client's performance is any indication, the results associated with CapAssure are compelling.

In the three years since the client began using the platform as part of its service package from Alter Domus, it went from managing two funds with \$1bn of assets to six funds with more than \$8bn in capital. Yet, scaling up was stress-free, at least from a capital administration standpoint. Not only are they processing and distributing large volumes of data across their entire fund range, but they're also doing it significantly faster than ever. They've developed institutionalised procedures to manage capital administration requirements across multiple funds. And though they've eliminated the risk of 'fat finger' errors that can plague Excel calculations, they know they can call on Alter Domus' internal due diligence team to prove carry accuracy.

And, as Shelto noted, the client's finance department now has the time to do what they do best – adding value to the firm – while leaving the capital administration function in safe hands. And that's a good thing you can never have too much of.

Gary Shelto

