A dynamic component

Maddie Saghir reports

Private equity continues to grow and evolve amid an increasingly complex environment with new regulations and so the trend for outsourcing is becoming increasingly popular

In the years gone by, private equity has become global and mainstream; managers work internationally with global investors and investments, and across domiciles. In the backdrop, the financial services industry continues to implement complex regulatory structures, which is encouraging partnerships and outsourcing in this area.

Private equity is an alternative form of private financing, away from public markets, in which funds and investors directly invest in companies or engage in buyouts of such companies. As of June 2020, it represented some $4.7 trillion in assets under management, and this figure is expected to continue its rapid growth to $5.8 trillion by 2025.

"The private equity asset class has transformed over the last 30 years into one of the most dynamic parts of the financial services industry, involved in the biggest and most innovative deals in recent decades," says Gareth Smith, head of private equity Europe, Apex Group.

Smith explains: "Assets under management in private equity and dry powder ready to be deployed have built up as institutional investors of all types have been attracted by the compelling track record of strong, uncorrelated returns on offer in the low growth, low interest rate environment that has dominated since the global financial crisis of 2008."

As an administrator of private equity funds, Standish Management has observed a trend towards bigger global funds and smaller specialists. It has been identified that there is less in the middle ground than there used to be, which is mainly driven by limited partners (investors) wanting fewer relationships.

"If they can get good returns by signing a big cheque with a large fund, this is much easier than maintaining lots of relationships with smaller funds. So yes, there is definitely a trend towards bigger global funds. We are also seeing smaller upcoming managers," comments Mark Coppin, director at Standish Management.

He adds: "The private equity world has become much more reactive, it seems very keen to use the structures and the skills to react to economic trends. Looking over the past few years, when banks weren't lending, the private equity world quickly filled the gap with private debt funds, supplying credit to companies for example."

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Private equity trends

Amid growth and evolution, data is one particularly hot topic in the private equity space at the moment. This is in line with advancements in the digitisation of underlying investment and fund data. Experts say general and limited partners expect transparency and real-time access to data.

"Fund administrators have continually adapted systems and portals, so the range and availability of data have also been greatly enhanced," says Paul Woods, regional executive North America, Alter Domus.

Meanwhile, regulations such as the EU's Sustainable Finance Disclosure Regulation (SFDR) are challenging managers to evolve and introduce processes to gather relevant environmental, social and governance (ESG) data.

Woods comments: "It's impossible to talk about data demand without discussing how to deploy integrated and fit-for-purpose technology. Private equity managers understand that advanced and integrated technology empowers managers to focus on what they do best – building relationships with investors and making deals."

Meanwhile, crypto funds are also becoming more prevalent and industry participants are seeing more fundraising activity in the crypto sector as the world continues to get more comfortable with allocating capital to this asset class.

"In Jersey, we continue to embrace fintech including blockchain and distributed ledger technology as a pioneer in fintech regulation and the Jersey Financial Services Commission licensed the world's first Bitcoin-focused, regulated fund (GABI Plc)," notes Alex Smyth, director, Oakbridge Fund Services (Jersey).

In the UK, one prominent trend is managers moving their fund domiciliation to Luxembourg. Due to Brexit, more funds are being set up in Luxembourg rather than the UK because they can use the EU marketing passport there. There is also an increase in the complexity of funds and the terms of them. According to Standish Management's Coppin, this is a reflection of investors getting smarter and negotiating harder to get special terms in side letters and agreements.

Coppin suggests managers have a more global outlook and are willing to look at opportunities in markets they wouldn't have considered in the past. Interest in Ireland as a domiciliation centre is very much on the agenda.

"I'm not seeing a lot of funds being set up in Ireland at the moment but it's certainly an area of very intense interest. A lot of people are keeping their eye on what's happening in Ireland right now because it has a more 'Anglo Saxon' way of doing business, than perhaps Luxembourg, and it's also English speaking. Therefore, it appeals to a lot of the private equity world which comes from an Anglo-American/English speaking background," Coppin says.

To outsource or not to outsource?

As private equity has evolved and become more complex over the years, outsourcing has become an increasingly popular option but experts stress the importance of choosing the right partner for this.

The utilisation and accessibility of data is of paramount importance when it comes to meeting the needs of general and limited partners and this is something that outsourcing partners can help with.

According to Woods, an outsourced partner with the right technology platform, fund administration expertise, service team depth and service commitment can provide a framework for private equity managers to absorb growth and meet investor needs.

Woods also notes that as managers have shifted to remote working, an outsourced model has enabled a greater degree of data integrity and security, while allowing for more flexible and transparent communication with investors.

Meanwhile, one disadvantage of outsourcing is the sacrifice of internal resources. This is why, according to Coppin, it is extremely important to select the right administrator as you need somebody that's going to work in genuine partnership with you and deliver on the things that are really important to you.

Coppin explains there are different models of outsourcing; sometimes you outsource to people and then it is outsourced again to another team that may be remote from the client.

At Standish Management, the focus is on delivering to clients on a local level as local accountability can greatly improve the service. "Our people are based in London so our clients can sit down with them and talk through numbers and issues, you don't have to get on a Zoom call or be reliant on emails in different time zones," states Coppin.

He adds: "There are disadvantages if you get your choice of administrator wrong. You need to get a true partner that's going to work with you and be a part of your team. It is the administrator's role to deliver peace of mind."

Regulation

In the regulatory space, SFDR is aiming to improve consistency and strengthen existing policies on sustainability risks. With regulations, like SFDR, increasingly being introduced and evolving, the emphasis on reporting has been ramped up. Through 2021 and 2022 the reporting obligations increase with, by June 2022 a quantitative report must be published covering 32 mandatory and 18 optional ESG metrics (some jurisdictions are encouraging earlier compliance).

Spencer Goss, director, RBS International Institutional Banking, cites: "General partners are experienced in reporting accurate financial data, however, the variety of ESG metrics needing to be monitored under this new regulation is likely to prove challenging."

Regulation will require firms to have a service provider who spends time working directly with regulators and understands the supervisory environment across multiple jurisdictions to ensure that private equity firms remain competitive and aware of any changes to the regime in advance.

This allows them to adapt more easily and remain in full compliance at all times.

From Oakbridge Fund Services' perspective, Smyth says: "We are seeing the continued development of larger, and some of the smaller bespoke, fund administration software providers to ensure their solutions offer an easier and more flexible approach to being able to extract data from these systems in order to furnish the relevant regulators with the reporting information and formats that they require."

Weighing in on this, Nigel Strachan, head of private equity sales, Europe, Apex Group, highlights that a global fund administrator will have a strong and experienced regulatory team providing a global view of regulation, in addition to understanding local requirements and local relationships.

Strachan comments: "As reporting requirements have increased in recent years, so has the disclosure burden on alternative investment firms. For example, the rising demand for environmental, social and governance (ESG) investing has seen an increase in flow into new strategies in the space and has increased scrutiny of existing funds' credentials.

As such, ESG reporting has become essential for private equity funds and an additional service that managers are expected to provide," he adds.

Challenges and opportunities

As the private equity asset class continues to evolve and grow, both opportunities and challenges have intensified. In line with its growth, experts suggest that regulators and investors are showing greater scrutiny.

As well as this, greater competition is putting pressure on fees and forcing private equity firms to look for more efficient ways to manage their funds and portfolios to cut costs.

Challenges were further amplified by the pandemic which caused immediate and significant disruption in the private equity industry. For example, Smith says fund managers suddenly had to prioritise business continuity, ongoing regulatory compliance and maintaining business as usual while facing practical obstacles like implementing working from home infrastructure, lack of face-to-face meetings and liquidity shortfalls among portfolio companies.

"As such, general partners have become increasingly reliant on their administrators during this time and are continuing to seek out the help of administrators to weather further market turbulence," comments Apex's Smith.

In terms of opportunities, Smyth identifies that with the emergence of a number of innovative tech start-ups, which many have proved to be lucrative investments for private equity houses, such as Deliveroo, Uber and DoorDash, it is expected that there will be more opportunities in this digital age for these type of investments for private equity firms to produce excellent returns for their investors.

Smyth cites: "In particular we at Oakbridge Funds are keeping a close eye on the fintech subsector and the increasing conformity to digital currencies and solutions as increasing opportunities for private equity firms."

Coppin concludes: "The sector itself remains attractive. There are good returns to be had for investors and so the sector continues to grow, and I don't see that letting up anytime soon."

"Generating returns, diversifying your portfolio and adding potential higher returns for your investors will mean the asset class will continue to remain attractive."