KEYNOTE INTERVIEW

Automation and data sophistication signal the future

As the private equity industry faces the peak of the cycle, George Rologis, chief commercial officer and head of strategy and EMEA at Alter Domus, says fund administrators will need to up their game for the benefit of the market

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Q The common consensus in the market is that prices are high and the peak of this cycle is drawing near, or has already been reached. What does that mean for fund administrators?

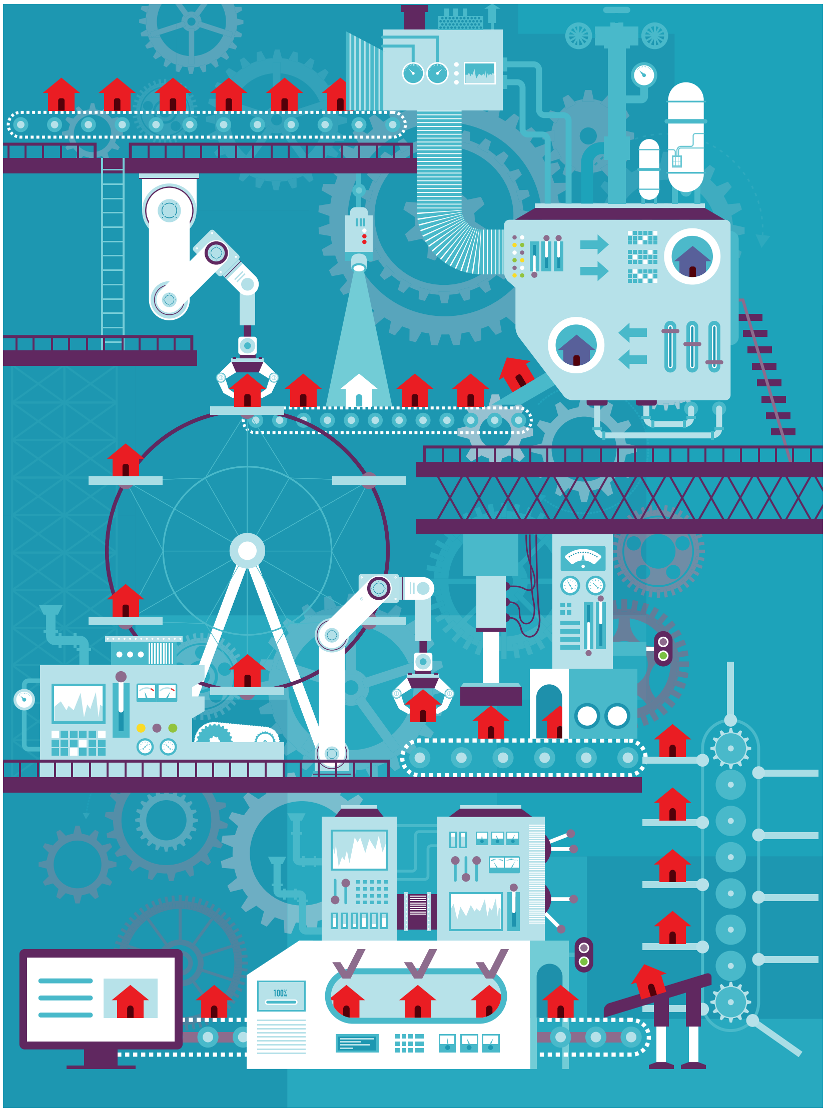
The peak of the cycle, by which we normally mean peak valuations, has come because there is so much demand for private equity and alternative asset products, which leads to even greater demand for our business. We see a lot of the big funds in Europe seeking to follow CVC and raise ever-bigger funds, and we also see the rise of so-called 'super carry', as the big-name firms have begun to push for 30 percent carry structures in new funds, as opposed to the traditional 20 percent.

These changes in the market will oblige us to invest more in our businesses in order to support GPs. On our side, there will be much more focus on automation, introducing advanced data management capabilities or otherwise enhancing the capabilities of GPs to report to LPs in a much more timely and sophisticated manner. Overall the result for our business is very positive, and I expect to continue to see growing demand for our services.

Q How is the traditional role of the fund administrator evolving in the current climate, and what do you see it ultimately becoming in the future?

There is a wave of change sweeping through private equity, which we need to jump onto very quickly. That's not driven by the valuation cycle, but rather by LPs and regulators, and the result is a growing professionalisation in the industry. Things like AIFMD II are driving change for us, as well as increasing competition in our market as more firms get involved in offering the services we offer.

The role of the administrator is definitely evolving into more of a partner to funds, getting closer to chief financial officers and being less of a service provider. At the same time, we are moving into offering not only back-office but also middle-office functions, releasing more of the GPs' valuable time to dedicate to transactions and the portfolio.



The biggest challenge we face is continuing to grow while maintaining the flexibility in our business to become a business partner providing the level of support our clients expect. That means the ability to be flexible, to deliver high quality, to be able to invest next to clients to provide a specific solution that may be required, and the ability to offer human resources to funds that need them – essentially 'loaning' our professionals to our clients – to meet a particular need. Clients are no longer looking for an arms-length relationship; we are moving towards playing an active role on an ongoing basis, observing how funds' needs are changing and looking at how we can bridge the gaps to keep those funds compliant.

Finally, another challenge is the way that the industry recruits its people. There is a fight for resources, globally, in the markets that we are active in, and the traditional way of recruiting accountants, fund professionals, trust experts and so on must evolve because we are now looking at attracting millennials, who are often looking for different things.

Q ESG issues are beginning to permeate fund administration decisions, particularly in other sectors but also increasingly in alternatives. How significant do you think ESG will be in the coming years, and what trends have you already observed?

ESG is definitely growing in significance across the industry generally, both on the client side and on our side. On the client side, we are seeing sizeable ESG-related funds being raised, so LPs are clearly paying serious attention to the issue, and it is also a big part of the due diligence that we are seeing investors conducting on GPs. For traditional buyout funds, ESG issues are now consuming a big chunk of time, as they need to be able to show they are working on these matters, taking them seriously, and producing results.

From our perspective, as a portfolio company of a private equity fund [Permira made a significant investment in 2016], we have seen that pressure coming through. For all businesses like ours this is a matter of growing importance, particularly when it comes to diversity and issues of work-life balance.

When we are recruiting, the younger generations are spending more time looking at ESG. Going forward, I see ESG making a big difference in the way we operate and the way funds are operating.

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Q The EU published some findings in January that give a taste of what might be to come in a potential AIFMD II. Costs for investors and regulatory bodies and the large volume of required data reporting were highlighted. Nevertheless, the feeling among investors is that AIFMD has not deterred them from investing in the EU. What impact have you recognised from AIFMD, and what do you expect from a possible AIFMD II?

There was a lot of fear at the beginning of AIFMD I, if we can call it that, about its potential to slow down business. It has definitely made doing business in our markets much more process-driven and much more cumbersome, but we have not seen demand for the markets or our services decrease – quite the contrary.

Perhaps AIFMD has split the market between larger funds, who are able to operate in this environment, and smaller asset managers who are now forced to find different solutions – perhaps outside of the EU – to structure their vehicles and look for capital.

AIFMD has allowed the fund administration industry to offer more services and has increased the need for our offering to GPs, as we have moved into depositary services and third-party management to try to meet the demands of the regulations for our clients.

I suspect AIFMD II will make the industry even more accessible for mid-sized and larger funds, and make it even more difficult for the smaller guys. It will probably also increase the need for people such as ourselves to offer services into the market, in turn leading to increased costs for investors.

The fact that the market that we have at the moment is at an all-time peak, with so much demand, suggests that AIFMD had little or no impact on paring back investor demand. If AIFMD II were to come in at a time when the industry was struggling, then it may drive investors to something else, but I doubt the additional requirements as currently suggested will serve to dampen demand.

Q Transparency is the watchword for fund administration right now, and while this makes the market more accessible to investors and grows AUM, it puts huge pressure on fund administrators, and hampers European AIFs in delivering strong returns. Is the industry getting to grips with transparency, or is regulation creating a maze that is scaring off many small to mid-size investment firms?

The industry is trying to get to grips with transparency irrespective of the regulatory environment. It is the name of the game, as something that investors are extremely focused on and have been increasingly committed to over the last three to five years. The fact that this will become official regulation is perhaps not a big issue for the larger funds, who will find it requires only a very small change. It will, however, create a bit of a maze scaring off small and medium-sized investment firms, and may create a barrier for more niche venture capital-type strategies who will perhaps find it much more difficult to operate.

The challenge for organisations like us in the servicing industry is to try to come up with solutions, through automation and data management, in order to make it viable for any size of asset manager to operate within the rules. Somebody has to make the investment in that technology, and that will probably be done by us. That will likely mean extra costs, but most investors will swallow those for the really well-performing funds. Those that are struggling will come under additional pressure.

We may also see a reshuffling of the cards in what might be called a third phase for the industry. A decade ago the major players were not necessarily the same names as they are now, and we have seen some big brands fall by the wayside. I think, once again, we will see some of the mid-performing funds disappear and their high-performing partners will move out and create their own funds. That will, at the end of the day, be a reordering for the benefit of investors. ■

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Making waves?

News of Amundi Asset Management's plan to grow its private exposure by over 40 percent was broken at the end of April. Will the entry of such large players into alternatives create turbulence in what has traditionally been a fairly stable environment?

The news is really interesting because it confirms the huge interest in the alternatives market and the continued growth in the asset class for the foreseeable future. The question is which of the two parties will adjust: will Amundi adjust to the traditional '2-and-20' private equity structure, or will the industry have to adjust to Amundi being such a large asset manager and putting capital into the market?

I do believe that any turbulence will be positive, because obviously increased demand for private equity will further fuel demand for services from businesses like ours.

There are quite a few large fund of fund players out there already, and some specialising in this exact area of the market. It's a well mapped-out and well-structured space at the moment, and I see Amundi's move as just much more volume moving in. Other large asset managers, like Aberdeen and BlackRock, are already quite big investors in the sector, so this is perhaps just another huge shift of capital moving into an already established market.

Some mid-cap or other LPs may now miss out on opportunities. What is unclear is whether the market will expand to meet Amundi's demands and pricing expectations, or whether some LPs will now miss out and it will only be the GPs who are already well-established with a good track record that stand to benefit.