HAZIC INVESTMENTS

Choosing a Fund Administrator

If your firm has decided that outsourcing fund administration is the right choice, you'll want to carefully examine the options available to you.

Fund administrators range from small providers with a handful of staff to larger enterprises or custodial banks with upwards of several hundred employees. Aside from the differences in size, there are differences in the approach to services, the types of services offered, the underlying technologies, and the types and levels of expertise on staff. The breadth of offerings can make it challenging to compare options, but looking at these five key evaluation criteria will help you focus on the elements that are most important in finding the right fit.

1. CAPACITY

When selecting a fund administrator, bigger isn't always better. However, you do need to know that the partner you choose has the bandwidth to meet your needs—today and in the future. To gauge a fund administrator's capacity, many GPs focus on AUA, reasoning that the higher the dollar value, the more resources the firm has available to meet the GP's needs. But AUA fails to take into account the wide variety of service levels required by different fund types.
In fact, a firm that manages a significant multiple of AUA in high-value buyout funds may have fewer resources in place than a firm managing considerably fewer AUA if that lower figure includes mezzanine or debt funds, given the higher level of transaction activity in such funds. If there are additional specialized reporting requirements and/or regulatory reporting elements for some of those funds, the administration process will involve an even greater commitment of technical and human resources, along with a higher level of expertise.

Instead of focusing on AUA alone, ask each fund administrator for a breakdown of the fund types they service, and look for firms with a substantial proportion of funds under administration that require more complex regulatory and compliance processes.

2. EXPERTISE

While bandwidth is a factor, you want to take sure that the fund administrator you choose has a strong and deep bench at the senior level: responsiveness is important, but so is the quality of the information and expertise provided.

A high level of expertise is especially important if your firm manages (or plans to launch) a complex or specialty fund, or has plans to scale significantly. When evaluating staff expertise, make sure that the accounting resources at the senior manager and staff level have direct experience managing private capital fund structures. General accounting experience isn't enough: the complexity of private capital funds requires specific expertise in this area.

In addition to a client services manager who acts as the main point of contact, your service team should include senior and staff accountants with specialized experience in a number of key areas, including fund accounting, financial reporting and compliance, and investor services.

3. CONTROL

If your firm currently administers funds in house, the idea of giving up control over the process can be nerve-wracking. However, a good fund administrator will provide tools and self-service options that enable you to track their progress, check their calculations, and access your fund data, enabling you to retain control and oversight at all times.

Reporting portals are a fairly standard offering, but some fund administrators offer a deeper level of oversight by providing financial statements and data that can be exported in a more granular format to your own environment where you can conduct further analytics. At a minimum, you should expect a fund administrator's system to give you direct access to current and past financial statements and underlying accounting details, including balance sheet, general ledger, trial balance, journals, and P&L statements. The data should be available through a secure online reporting portal in dashboard format and in a raw-data format that can be exported to a spreadsheet or other program that lets you conduct advanced analytics and use the calculations for additional internal reporting.

When evaluating fund administrators, have a checklist of your data requirements ready and always request a live demo of their technology platform so that you can confirm that their offering delivers the level of control, intuitiveness, and transparency you require. Ultimately, outsourcing fund administration should give you the best of both worlds, enabling you to offload the back-office burden to an expert without giving up control over your data.

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3. SERVICE

Levels of service vary considerably among fund administrators, so it's important to clarify the exact nature of the relationship that each fund administrator promises. Terms such as "high-value," "high-touch," or "boutique" are frequently used but poorly defined. At a minimum, the fund administrator should be able to provide a standard service-level agreement (SLA) that defines the onboarding process, sets the ongoing communication cadence, and clarifies the roles and responsibilities for both the fund administration team and the General Partner's back office.

The agreement needs to specify turnaround times, communication frequency, deliverables, special reporting requirements, and any other key service elements. Ideally, it will also specify a standing weekly or bimonthly call, which enables the fund administrator to stay tightly integrated with your team and prepare for upcoming activities.

Within large-scale fund administration firms, the ability to customize the SLA is usually fairly limited, with one level of service applied to every client account. Boutique fund administrators often take a more flexible approach and have the capacity to customize the SLA to align with the GP's specific requirements and preferences.

5. SECURITY

Financial data is at high risk of security breaches, and alternative asset managers are challenged to protect themselves and their investors. Nearly one-quarter of private equity firms (22%) have experienced a cybersecurity breach, and over half (58%) of those breaches were considered at least moderately serious.15

Data security should be top of mind for GPs as they evaluate fund administrators. Check to make sure that the company has SSAE 18 System and Organization Controls (SOC) 1 Type 2 audit standards in place, which means that an independent auditor has reviewed the company's procedures and controls over a period of six months or more. Without this standard in place, your firm can't be sure that the fund administrator is adhering to operational procedures, including multiple review touchpoints that protect the integrity of your data. Additionally, the SOC 1 Type 2 report should be for the entire scope of fund administration services, not just a single component of the service offering.

The fund administrator you choose should also have a documented disaster recovery and business continuity plan for their technology stack. As the holder of your fund data and documentation, it's critical that your fund administrator have procedures in place that enable them to continue delivering service under any adverse circumstances. Their technology should be built on a platform that includes a production site, multiple redundant sites, and automatic daily backups.

15 EY, Operational Excellence: One Path or Many? Key Findings from the 2018 Global Private Equity Survey.

Technology in the Spotlight

If your firm has or is planning to diversify into more complex fund strategies and you need to find a service partner capable of supporting your efforts, look for a fund administrator with specific expertise and active clients in the relevant areas. Ask for references from at least two active clients with fund strategies similar to yours.

23% of GPs switch providers because of issues with regulations

Regulatory Issues

When evaluating fund administrators, technology needs to be as much a part of the conversation as the expertise of the service provider's team or the integrity of its processes.

The technology that underpins a fund administrator's services impacts many factors, including turnaround times, the ease of data access, the quality and integrity of the data, the quality of the investor experience, and resilience to cyber threats. Yet only 21% of fund administrators are fully confident that their technology is where it needs to be.16

Enhanced investor experience. Investors now expect a level of visibility and access to fund data that can't be delivered without state-of-the art technology. A survey conducted in 2016 found that 87% wanted to receive reports through digital portals;17 today, that figure is likely to be even higher.

Look for a fund administrator that offers an investor portal capable of collecting key fund data and a range of performance metrics, including fund strategy, vintage year, unfunded commitment, total commitment, DPI, RVPI, TVPI, fund multiples, and IRR.

Streamlined reporting. Portal technologies can also support your back office by streamlining and organizing the information you need to produce quarterly and annual reports, conduct internal analysis, and prepare external reviews, reports, and audits for various management, tax, and regulatory purposes.

Look for a fund administrator that consolidates fund data on a centralized platform and offers customizable reporting dashboards and report templates.

Improved security. While SOC 1 Type 2 audit standards protect the integrity of your data and documentation, the right technology protects it against cyber threats by keeping sensitive information, including capital calls, distributions, financial statements, K-1s, and other fund-related documents, in a secured digital environment.

Look for a fund administrator whose platform technologies have advanced security features, including two-factor authentication and extended validation SSL certificates for all sensitive data.

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16 The FIS Readiness Report: The Hunt for Growth Across Fund Administration, 2017.
17 EY and Private Equity International, 2016 Global Private Equity Fund and Investor Survey.