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GENERATING RETURNS

# Held in trust

## In an increasingly challenging investment environment, limited partners are focusing more on market risk profiles to drive improved investments, say Intertrust's Paul Lawrence and James Ferguson

Private equity managers are under pressure. Globally, their share of the M&A market continues to shrink in the face of competition from corporates and they face increased competition from a record number of other general partners in a crowded market. At the end of 2017, dry powder stood at a towering $1.7 trillion across all private capital asset classes. And at an average of 11.2x, multiples are sky-high. Paul Lawrence, global head of fund services at Intertrust Group, and James Ferguson, managing director Intertrust Americas, describe how GPs are seeking to mitigate risk and generate maximum returns in a challenging investment environment.

**Q The investment environment is competitive and volatile. How are GPs seeking to generate returns?**

**James Ferguson:** GPs are chasing the beta of new capital and balancing that against squeezing existing investments for returns. Private equity, hedge funds and mutual funds are all trying to find different avenues for yield. Asset classes and underlying instruments are diversifying. Asset managers are looking for the next big thing, be it oil and gas, insurance funding, cryptocurrency, blockchain, or fintech. These asset classes are different from traditional equity/fixed income and the underlying investor base is more agile and sophisticated. Those that are ready to accommodate and service new asset types will do well against the competition.

**Q Have President Trump's tax changes had any impact on investing?**

**JF:** The US market will see the beneficial impact of new tax rules in the next six to nine months as the fiscal year ends. This time next year there will likely be more investment activity because the liquidity pools and balance sheets will have increased. Offshore money should start to be repatriated by mid-tier companies where the tax breaks are largest with companies seeking new investment vehicles. Macro investment allocation should increase. There is definitely a hold mentality at the moment, as managers seek the longer term investment vehicles as the administration volatility stabilises.

**Q On the LP side, the industry has seen a trend to consolidate commitments. Why?**

**Paul Lawrence:** Some LPs want to consolidate allocations to a smaller number of GPs to maintain greater control and improve oversight and governance. They don't want to be swept along with all other LPs and be forced to accept what they are given.

**Q Brexit is a massive source of uncertainty in the UK. What does it mean for UK managers?**

**PL:** UK-based managers are scenario planning around various impacts. Some of that depends on where they are investing today and where they plan to invest in the future; how they are fundraising; and where they are in that fund launch cycle. Those in the early stages of investing their funds have probably got a little more breathing space to see how the land lies.

There are a group of UK-based managers who won't do anything. They are raising and investing in the UK or can row back to that situation. Others are already starting to look at what options they might need to explore within Europe. This is where we are engaging a lot more with our clients and managers around planning and support if they want to establish a greater presence for example in Dublin or in Luxembourg. A lot of managers might have exposure to one or both jurisdictions already. Expanding operations links into other regulatory and tax headwinds, like BEPS [base erosion and profit shifting]. We can provide direct support up to and including the point of being a third-party manager of their funds.

**Q And for US-based managers?**

**JF:** Some of the more mature and global players are going into Europe quickly. Some of the bigger asset managers have or are setting up offices and registering with the Central Bank of Ireland, for example, and are hiring people and shifting their organisations. It might be easier to do that now in the noise rather than wait until Brexit is actually implemented. There are managers with current US administration, tax changes, and longer term expansion plan, who are cautious on what their growth strategy may be, so are waiting on an outcome.

*Ferguson: underlying instruments are diversifying*

*Lawrence: smaller GPs lack infrastructure*

Smaller GPs may not have the infrastructure in place to deliver the demanding reporting requirements of larger LPs and may struggle to compete with larger GPs on bigger deals.

However, if you are a smaller LP trying to write the cheques required to get access to some of the mega-funds, it might be a challenge to meet any minimum threshold. On the flip side, LPs want to be a meaningful investor to receive a degree of bespoke treatment, but don't want the GPs to be over reliant on them for the successful launch of the fund.

**Q Another theme LPs are considering more and more is transparency. What are they asking for?**

**PL:** A lot of GPs would argue that they have always been transparent with investors when asked for information. But there is more demand now for upfront transparency, ie, regular reporting that delivers the level of detail that investors want without having to ask. There's a drive toward more consistent reporting and report types across the different funds LPs invest in such as cost allocations and compliance costs. Investors are also starting to request reporting around ESG matters and more detail around portfolio companies.

**JF:** Investors are concerned with risk profile, how quickly managers are reacting to market and macro conditions, and the fee break-out. As asset types change or become illiquid or agile, the short to medium term gain is being challenged against the more stable longer-term strategies. At the same time regulatory compliance, increased knowledge and competition is driving transparency of reporting and objectiveness leading LPs to seek those GPs with more third-party oversight of functions like record keeping and reconciliation services.

The issue with private equity is there are many layers: the LP, the GP, the administrator involved and a depositary and an Intertrust partner on top of that. The underlying investor wants to know: is my money safe? Who is reporting and who holds the books and records? Is the structure so complex that I am losing sight of who has my money at any point in time? GPs that are more in tune with LPs, with better investment strategies and clearer transparency, are the guys that are gaining market share.

**Q How is reporting evolving?**

**JF:** All clients want timely, accurate and complete reporting. The underlying content nature of reporting isn't changing or it may be more finessed; instead, the delivery technology mechanism is becoming more mobile and agile.

**PL:** It's about automated processes, portals and the ability to access information and data 24/7, on the hoof, and manipulating the data to the output that you require. We've invested and continue to upgrade our technology. We've worked closely with our vendors to look at future software developments and prepare for those now.

**Q Is technology driving outsourcing?**

**PL:** Regulation, reporting and transparency demands are all pushing outsourcing. You need to invest in technology to meet these demands. But are you going to become a technology company or are you a fund manager? Our ability to cover everything the manager needs to do except the actual asset management is where we see the most interest in our services. We are assuming the burden of managing that technology platform, which managers don't want to do.

**JF:** Clients seek modular [fund administration] "plug and play" services. They want to keep some functionality and processes and outsource resource intensive processes or functions. The challenge is that there are increasing vendors entering the fintech market with partial solutions. A challenge with fintech is that it doesn't always offer global solutions for end-to-end processing. And there are market challenges in partnering with two or three vendors to get to one solution. Intertrust continues to become technology-savvy so that we can "plug and play" for our clients. ■