Private Equity International

Fund Administration

June 2020 • privateequityinternational.com

The new wave

Why covid-19 could cause outsourcing levels to rise

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Private Equity International

Fund Administration

ISSN 1474-8800 • JUNE 2020

Insight

Key trends **From accelerated tech adoption to an upswing in outsourcing, here are four fund administration themes making a mark in 2020**

1

Outsourcing demand is on the up

Demand for outsourcing had already been on the rise before the private equity industry had to adjust to new ways of working following the covid-19 outbreak, ***writes Louise Fordham***. A survey by sister title *Private Funds CFO* found a greater interest for outsourcing fund accounting, technology, tax and compliance functions in 2019 than in 2018, with between 24 and 34 percent of respondents planning to increase outsourcing in these areas. The move to remote working and the wider fallout from the pandemic have since accelerated this trend. A surge in demand is not only expected for fund administration, but also areas such as HR and IT.

Outsourcing such functions can enable firms to focus on fundraising and supporting portfolio companies – activities that may prove particularly challenging given the current situation. Even in less unusual times, there are efficiencies to be gained, especially for smaller firms with limited in-house resources.

"Investors increasingly want to work with GPs that are able to focus all of their time on investment decisions and leave the back-office operations to a team of experts," says James Duffield, head of business development at Aztec Group.

2

It's technology's time to shine

With physical distancing measures still in place in many countries around the world, we are all relying on technology more than ever. The crisis has highlighted the role that advanced technologies can play both within portfolio companies and in private equity firms themselves as they navigate this new landscape. As Amit Vij, managing director, private equity at global technology research and advisory firm ISG, says: "Senior executives are looking at ways to leverage automation technology to minimise the human touch and improve business resilience."

Meanwhile, online tools such as e-signatures and cloud-based services are increasingly being embedded into daily workflows. Combined with the already growing demand for data among LPs and GPs, this more widespread adoption of online systems also brings with it a greater need to focus on cybersecurity and data protection.

If private equity firms and their portfolio companies fail to manage cybersecurity risk then they could be exposed to a severe "techlash", point out Ian Bagshaw and Tim Hickman, partners at law firm White & Case. This could come in the form of regulatory sanctions, reputational damage or liabilities to third parties, for example, all of which could potentially impact the value of an investment.

Cybersecurity is a hot topic for LPs – 30 percent always ask about cyberattack readiness policies during due diligence and 58 percent sometimes do, according to *Private Funds CFO* data. And although EY's *2020 Global Private Equity Survey* found most managers feel well prepared to prevent a cybersecurity breach, a worrying 61 percent of investors are not confident that alternative fund managers have adequate cybersecurity policies in place.

> "The ability to collaborate online has been pushed to the top of most people's agenda in these difficult times"
>
> Nikolaos Perros
> Citco

Collaboration is going digital

Perhaps the most ubiquitous use of technology in recent weeks has been for communication. Virtual messaging and document sharing tools are helping GPs, LPs, fund administrators and other service providers to collaborate internally and with each other.

"The ability to collaborate online has been pushed to the top of most people's agenda in these difficult times. Across the board, GPs are looking to do things digitally," says Nikolaos Perros, head of private equity and real estate services at Citco. "Hosting investor presentations via video, a critical need to sign everything digitally, a huge growth in the use of online communication platforms, a reliance on cloud-based document sharing tools. These changes were happening slowly in the industry but, if there is a silver lining to the current situation, it is that we have been forced to move forward to a new digital age."

This may continue for some time to come. According to a survey by *Private Equity International*, 50 percent of GPs intend to hold more online LP meetings once 'normal' business life returns.

There's a new 'business as usual'

The crisis could result in longer-term changes to the way the private equity industry and its service providers operate, especially as remote working and the prevalence of digitally enabled solutions become normalised.

Aided by technology and robust business continuity plans, fund administrators' transitions to the new environment have gone fairly smoothly and they are adapting to meet clients' needs. "BCP has turned very quickly into BAU – business as usual," says Ian Lynch, chief commercial officer at Intertrust. "We are definitely in BAU mode now."

GPs are also demanding more of their service providers, particularly around challenging areas such as liquidity and valuations. While this could open up opportunities for fund administrators, new ways of working during the crisis could also have a longer-lasting effect on service provider and fund relationships.

"I think we'll see greater fungibility between clients and service providers," says Lynch. "There may be specific services where we might, for example, lend our teams to clients." ■

Editor's letter

Relationships prove the linchpin in covid response

Louise Fordham
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With an increasingly complex regulatory landscape to navigate and greater involvement in fundraising and investor relations activities, CFOs at private funds already had their plates full before the covid-19 crisis served up even more challenges.

When *Private Equity International* asked Cloverlay's Omar Hassan – recently named among *PEI*'s 40 under 40: Future Leaders of Private Equity – the most valuable lesson he had learnt as a CFO, the answer was simple: trust. "Surround yourself with people you trust," says Hassan. "Once I found colleagues and service providers I trust, I can lean on that network to help with new challenges."

"Surround yourself with people you trust"

As lockdowns have ushered in remote working practices, private equity firms are communicating with their staff and network of investors and service providers via a range of digital collaboration tools. The fallout from the pandemic is also accelerating the adoption of technologies such as automation and the cloud, as well as driving further demand for outsourced services, including fund administration.

While the crisis has facets unlike any situation the private equity industry had previously encountered, the fundamentals of GP and service provider relationships remain unchanged: people and processes. As Hassan notes: "Fund administrators have grown in sophistication and as long as there is a strong team and sound technology, a fund administrator can provide GPs with much needed scale."

In this supplement, we examine how fund administrators and GPs are moving forward during these unusual times, and what funds' approaches to outsourcing and technology might look like on the other side of the crisis.

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Private Equity International
Published 10 times a year by PEI Media. To find out more about PEI Media visit **thisisPEI.com**

The rising tide of outsourcing

Covid-19 could spark a fresh wave of outsourcing that sees little but fundraising and investment left in house, reports Amy Carroll

The private equity industry may be on the cusp of an outsourcing explosion. Once slow to embrace third-party service provision, the prevalence of outsourced fund administration and investor reporting has soared over the past few years, as complex regulation has proliferated and increasingly sophisticated LPs demand a more streamlined approach.

As an initial reluctance to cede control of operational functions wanes, a desire to get back to the core competencies of raising and investing funds has blossomed. James Yates, CFO at IK Investment Partners, says: "There is a trend to outsource, and not just in fund administration, but also in IT services, regulatory compliance, tax compliance and HR-related matters."

Nikolaos Perros, head of private equity and real estate services at Citco, meanwhile, is seeing greater demand for value-add services, such as accounts payable management, performance fee calculations, investor portals and data integration services.

He believes the next wave of outsourcing will see private equity adopt services that are already being used successfully in other areas of financial services. "For example, online subscription tools have proved very successful in the UCITS and hedge funds industries and are now being implemented by the top private equity managers," he says.

The scale and speed of technological innovation lies at the heart of outsourcing adoption. For all but the very biggest private equity houses, the cost of buying or building in-house tech solutions can be prohibitive.

"We all acknowledge that technology is the way forward, but the ability to buy requires liquidity and the ability to build requires speed, skills and financial capacity," says James Ferguson, head of Americas at Intertrust. "We even see large banking institutions seeking to outsource rather than build given the time and scale it requires."

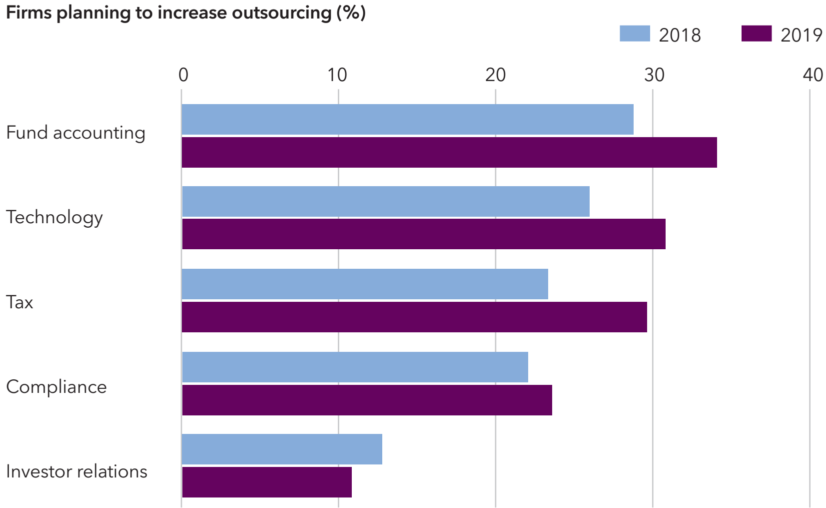
Investor demands are also imperative to the outsourcing process as LPs eye efficiencies. "LPs play a significant role. Investors increasingly want to work with GPs that are able to focus all of their time on investment decisions and leave the back-office operations to a team of experts," says James Duffield, head of business development at Aztec Group. "This approach minimises direct operational costs and the administrator can provide considerable economies of scale across functions, such as accounting, reporting, compliance and AML [anti-money laundering]."

Yates notes that the most sophisticated LPs are looking to make sure outsourced services are clearly segregated between fund and GP in order that costs are borne appropriately. "There can also be a tendency for LPs to want outsourcing where the GP is smaller and may not have the in-house resource or capability to provide a best-in-class service itself," he says.

LPs are also increasingly interested in the efficiencies that automation can bring and have often been a key driver behind private equity firms' tentative steps towards digitisation. "There is inquisitiveness around the large number of technology firms coming to market, some offering a specific product plug, or those with a wider global operating impact," says Ferguson. "LPs are having the discussions around efficiency; should a firm spend on highly paid accountants in New York to do portfolio NAV accounting for example, or explore letting a machine complete the task at a third of the cost? It is definitely something to consider."

Indeed, according to Perros, LPs now expect outsourced administration as the standard. "When that standard is not applied and administration work is done in house, GPs can expect a significant increase in LP due diligence," he says.

Firms planning to increase outsourcing (%)



Source: Private Funds CFO's Insights 2020 Survey

> *"Business continuity plans are being played out, showing that the 'office' may become a thing of the past"*
>
> **JAMES FERGUSON**
> **Intertrust**

Digital acceleration

The impact of the covid-19 pandemic will only accelerate the demand for outsourcing. The outbreak, and subsequent international lockdown, has shone a spotlight on individual firms' – and administrators' – business continuity plans and automation capabilities.

"The top GPs have understood the value of their data and are working to use it to differentiate themselves. They are also starting to expect operational functions to remove the old manual ways of working and move to the new digital world," says Perros.

"The current global pandemic has forced these issues forward at an even greater pace, as everyone is having to rely on the new world order of 100 percent online solutions," he adds, citing Citco's emphasis on providing curated data to GPs systems, which can empower managers to make timely, data-driven decisions in challenging times, as well as putting digital tools into the hands of GPs to help them improve their own operations.

"For example, through the use of an online board pack production and presentation tool, and a digital signing tool, we have been able to fully digitise the processes of preparing a board meeting, hosting it and approving the documentation," he says.

Meanwhile, asked what services are likely to be outsourced in future, Ferguson replies: "The short answer? Everything. We believe the industry is about to go through a shake up, maybe not in a year, but in the next one to three years.

"Business continuity plans are being played out, showing that the 'office' may become a thing of the past. This means home technologies, scanning, printing, signing, links to government and regulatory agencies, auditing, legal work, invoicing and billing, for example, will all need to be accelerated on the technology front by service providers."

Lasting change

It remains to be seen how significant and long-term these changes to the way we work and live will be. But it does seem likely that the international travel and face-to-face meetings that have always been integral to private equity fundraising and deal-making will be drastically cut back for the foreseeable future – and indeed, with a parallel escalation of interest in preserving the planet – perhaps, for good.

For outsourced service providers, this is likely to spell opportunity, with managers eventually adopting fully cloud-based, outsourced operating models where all collaboration between administrators, GPs and LPs takes place online.

Will the current lockdown have lasting impacts on the way private equity firms operate and their willingness to outsource? "That's the million-pound question," says Duffield. "Challenges can be reframed as opportunities, and every LP, GP and administrator will be keeping a close eye on how working practices evolve after lockdown so that they can quickly make the most of opportunities that present themselves.

"It seems likely that an element of home working and remote meetings will continue, with possibly less regional or international travel required," Duffield continues. "If that happens, there will be a knock-on effect for communications and security. Challenges for sure, but also opportunities to be uncovered."

For Perros, the answer to the question of whether the challenges endured during lockdown, and the alternative ways of working that have emerged, will accelerate outsourcing trends, is emphatically "yes".

"The ability to collaborate online has been pushed to the top of most people's agenda in these difficult times. Across the board, GPs are looking to do things digitally," he says.

"Hosting investor presentations via video, a critical need to sign everything digitally, a huge growth in the use of online communication platforms, a reliance on cloud-based document sharing tools.

"These changes were happening slowly in the industry but, if there is a silver lining to the current situation, it is that we have been forced to move forward to a new digital age." ■

Leaders and laggards

Despite an increase in the outsourcing of service provisions, an independent study of the market commissioned by Citco, showed the industry is still only at around a 40 percent saturation point when it comes to third-party administration services. So, which firms are already outsourcing and which have yet to take the plunge?

It can be challenging for established managers to move to an outsourced model. This often happens gradually as their fundraising and investment cycles permit, according to James Duffield at Aztec Group, which typically takes on one or two established managers deciding to outsource for the first time every year. New managers, meanwhile, almost always choose to go down the outsourcing route.

James Yates of IK Investment Partners sees a clear divide based on assets under management and team size. "It is likely there will be more outsourcing of risk management and compliance roles to third-party specialists going forward, particularly for smaller houses struggling with the volume and complexity of reporting requirements," he says. "This may also be the case for tax compliance."

Larger houses are more able to bear the costs of putting in place the infrastructure and resources to provide the relevant services that some smaller houses will need to outsource, Yates adds. "There is also a feeling that US houses are happier to outsource some fundamental services and maintain a streamlined central corporate structure."

For Citco's Nikolaos Perros, however, the real power of data and digital tools is that they are usable from any location or by any size of manager. "It's a given that the largest and most technologically sophisticated managers will build or buy their own platforms, but the rest of the market would still benefit from these solutions and so will search for an outsourced provider who can deliver them ready made," he says.

"We have already experienced different regions accelerating guidelines or implementing different regulatory changes, causing firms to consider their options," adds Duffield. "So, firms, either local or global, will need to determine their revised operating models. It will be more a case of those who do not react finding that they have lost a window of opportunity."

Managing dual roles and curve balls

Guest Q&A by **Omar Hassan**

Cloverlay's CFO and CCO discusses the importance of achieving balance and building a trusted network

Q What is the biggest challenge currently facing CFOs at private equity firms?

CFOs quarterback various processes between running the management company, financial reporting, internal reporting, investor relations, fundraising, compliance, tax, etc. It can be a challenge to stay organised with the various balls in the air.

As firms continue to grow and regulations change, more curve balls are thrown, making these processes slightly more difficult to project manage. It is a difficult task without adding overhead, but I have found if you keep workflow clean and processes streamlined, it helps keep things manageable.

Q What is the most important lesson you have learnt during your time as CFO?

Surround yourself with people you trust. I used to spend time second guessing what I had been told and researching or corroborating everything. But once I found colleagues and service providers I trust, I can lean on that network to help with new challenges.

Q You also serve as CCO at Cloverlay; how do you balance the responsibilities of these two roles?

I sometimes have to split my mind in two. For example, when reviewing a piece of marketing material, my CFO/commercial mind will help with number verification and producing content, but later in the process I have to review the same material with the CCO mindset from the perspective of a regulator or independent party.

The separate roles help me appreciate both sides of the coin. Our strong infrastructure and workflow process keeps me well supported on both sides, with service providers and team members to help balance out the workload.

Q How do you use technology to enhance operational efficiency at Cloverlay?

From day one Cloverlay has taken data management very seriously. We spend a lot of time and effort to ensure we have a single source of truth for data. One of my team's goals is to only use Excel for its intended use. As great (and cost effective) as it is, Excel is not a database.

We have built or use databases for high volume data usage (portfolio management, expenses, deal management, investor relations, etc) and then build queries on top of those databases. Our next endeavour is to build a data warehouse to be a single source of truth where all data can reside and be analysed using various calculation and analytical tools sitting on top of it.

Q Which functions benefit most from outsourcing? How does this complement the activities you and your team undertake?

Fund administration by far provides the most benefit as an outsourced service. It complements many facets of the CFO suite such as investor relations, financial reporting, compliance, etc.

Fund administrators have grown in sophistication and as long as there is a strong team and sound technology, a fund administrator can provide GPs with much needed scale. At this point, I do not know any new PE funds launching today without a fund administrator, so PE has come a long way.

Q What is the one piece of advice you would offer a fund administrator?

The most important advice I can give a fund administrator is to continue to build processes and think of efficient ways to build out their infrastructure. I would refrain from saying "yes" to a client for a new project without a thought-out internal workflow and review process. As fund administrators and service providers in general try to take on more services for GPs and CFOs, it is never a good view to seem unprepared after taking on a project they have sold. ■

KEYNOTE INTERVIEW

Due diligence steals the spotlight

Covid-19 will not only impact fundraising, it will also expand the scope and scrutiny of due diligence in the private equity industry, says Jason Bingham, SANNE's chief strategy officer

In the first quarter of this year, private equity funds closed on a total of $124 billion, according to *Private Equity International* data – a remarkable 30 percent increase year-on-year. However, when Q2 numbers are in, the graph is likely to look very different. We spoke to Jason Bingham, chief strategy officer at SANNE, about how the global pandemic has impacted managers' capital raising plans and the due diligence questions it has raised among both GPs and LPs.

Q What are the immediate implications of the global lockdown for GPs marketing and fundraising?

The feedback we are receiving from asset managers on their fundraising is mixed. Many funds which were partly through their fundraising seem to be full steam ahead to first close. Some have exceeded targets, as investors look to place cash in safe havens away from the turmoil in the stock and bond markets.

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LPs also realise there will be some decent returns to be made on the other side of this. Those that backed away from private equity during the global financial crisis lived to regret it when they saw how the industry rebounded during the subsequent recovery. The current shock is unlikely to shake an underlying confidence in private equity.

For some of the smaller and mid-market fund managers, there seems to be a slowdown or delay on fundraising until the covid-19 lockdown is relieved. This is particularly true for managers who are dependent on investors from outside the circle of institutional investors (eg, pension funds), where direct contact and marketing with LPs is critical but currently challenging. For some of our mid-market fund managers we envisage a backlog of fundraisings which will give rise to a substantial number of fundraises occurring once the lockdown ends.

Q What challenges do GPs face as they steer their funds through the current volatility?

Given the degree of uncertainty we have now, portfolio company valuations are currently challenging. GPs are paying particular attention to the valuation provisions in their fund documents to ensure compliance. The changing valuations of portfolio companies may impact the calculation of the management fees, distribution waterfalls and clawbacks. GPs may also come under pressure from LPs to write down the value of existing portfolio investments and any such write-downs would likely have a negative impact on the management fee after the investment period. GPs are also engaging with their portfolio companies, auditors and valuation advisors as to the feasibility of meeting the applicable reporting deadlines.

Q How are managers attempting to mitigate the uncertainty?

As you would expect, the number of additional information requests that we have received from our GP clients on matters such as valuations, financial statements and sign off extensions, has increased significantly. The speed of access to underlying investment data has been critical for these managers. Our role in providing look through reporting for GPs to complete critical tasks like investment risk assessment and cash flow forecasting has been vital during this uncertainty.

GPs have been focusing on their portfolios, supporting investments with liquidity concerns and exploring new opportunities in dislocated markets. The data we are providing is enabling GPs to give LPs better clarity over their cash flow requirements as they schedule their capital calls. In the market generally, there have been some LP liquidity concerns although we have not seen any LPs default, and clearly GPs do not want them to.

Q From a regulatory perspective, are funds working differently?

There are operational challenges, anti-money laundering compliance being a key one. The severe restrictions that we are all under will make it more difficult to perform effective client due diligence. We take a risk-based approach and use information from multiple sources to conduct checks on third parties to support compliance with local regulations. Our fund clients are well known institutions and their LPs invest across multiple managers. There is a lot of information in the public domain that we can source and verify independently. For smaller managers with a less sophisticated investor base, AML compliance will be extremely difficult.

Q Looking forward, will this crisis change how GPs invest?

Sector expertise will become more critical than ever. Post-pandemic, some industries will be changed forever, particularly those reliant on consumer demand, such as retail, hospitality and aviation. If managers are going to place smart bets, they need to understand what will differentiate the winners from the losers in any of the subsectors.

The scope of GP due diligence will also change. No one saw this pandemic coming, but it highlights the importance of modeling a range of scenarios in due diligence and preparing for the worst. Factoring in foreseeable but unpredictable disruption will become a standard part of due diligence in the future. This crisis has drawn attention to several issues, such as resilience to supply-chain weakening and business continuity planning. LPs will continue to focus their questions around business continuity during due diligence, they will want to know that a GP has tested its business continuity plan, and that it will work during an unpredictable disruption, and that portfolio companies are prepared to deal with problems in real time.

Q We are all using technology more in the current crisis. What's the impact on the fund industry?

If firms are not operating on a common platform like we are, or something similar, then they will find life very challenging. We have more than 1,800 employees globally and have been able to conduct virtual communications with all our staff to deliver crucial global covid-19 updates and keep people engaged with our business activities.

For managers seeking to understand their industry exposure and assimilate information quickly, data extraction technology is key. Those GPs that had not set up data architecture pre-covid and were not aware of how important data is to their business are probably struggling operationally in this current environment. Relying on information from several providers using a range of platforms is difficult.

Q What's the solution?

Some of the more sophisticated managers already recognise that dealing with too many counterparties is inefficient and have already lay down the groundwork from which to do analytics. They are reviewing how they ingest information and collate it for their LPs, as well as internal, governance and regulatory reporting purposes. They want a single repository of information, a customised platform, that they can input and extract information from to generate detailed reports.

For us, supporting our clients' data needs is possibly one of the most valuable elements of what we do, given that we sit on a huge amount of robust portfolio company and fund information. Based on what we are hearing in conversations with clients, there's a heavy emphasis on data in terms of security, management and governance across the board. It is not just simply whether we have a policy and procedure but when and how our cybersecurity framework has been tested. Clients want to see details of our insurance provisions around cyberattacks and data security. Given the criticality of technology to the support, sustainability and growth of our business, we have invested heavily in this area. ■

Tech lifts off in lockdown

Technology and legal experts explain how the crisis is changing attitudes towards and adoption of certain tech solutions and protocols, and outline what this means for private equity

Data protection processes

In response to covid-19 and new work-from-home norms, private equity firms are scaling their use of online collaboration tools. Many are pivoting daily operations to the Microsoft Office 365 suite and Microsoft Teams for conference calls, town halls and other needs. These applications have become the standard for managing and protecting sensitive data exchanged between parties.

Firms must adopt a virtual data room for their due diligence needs, one with strong security protocols in place. Some 'straggler' firms still use physical data rooms, which are harder to access, backup and update in real time. Firms should outsource this to a specialist who can act quickly to apply protections, including digital watermarking and access rights management.

Firms should also scrutinise portfolio companies' data privacy and cybersecurity postures. A breach here can impact many stakeholder audiences, including potential consumers whose personal information is heavily regulated. Now is the time to move from passive assessment to more active management across these businesses. This may include contracting a third party to conduct annual risk assessments, test areas of vulnerability and scale these checks closer to the portfolio company's selloff or initial public offering, to protect its valuation.

By Kirk Samuels, executive director of cybersecurity at Agio, a cybersecurity and managed IT organisation

Electronic signatures

During the global lockdown, e-signatures present a welcome solution to one of the challenges of homeworking. Many sectors which were historically sceptical have quickly become comfortable (eg, many UK banks are now accepting e-signatures on finance documents, particularly when they are able to rely on a law firm's legal opinion). The key points to consider are:

Is e-signature suitable for your document? E-signatures are legally valid in most jurisdictions, but you should always check local law requirements. If the document needs to be filed with a registry, check they will accept it.

Will you use an e-signature platform? Under English law simply typing a name or pasting a copy of a signature is sufficient. However, using an e-signature platform gives a greater level of security and in some jurisdictions it may be necessary in order for the signature to be recognised as legally valid.

How will you implement any necessary formalities? Some documents require a greater level of formality than a simple signature. Under English law, where a document needs to be witnessed, the witness must be physically present and not just view the events via video link. The witness must be over the age of 18 and not be a party to the document, or have a personal interest in its provision – so, during periods of self-isolation, although not best practice, it is acceptable for family members to act as a witness. In other jurisdictions, documents need to be notarised and some e-signature platforms are able to facilitate this.

By Madeleine Clark and Alistair Francis, partners at law firm Osborne Clarke

Robotic process automation

Digital transformation is a key part of the value creation plan for most businesses, and intelligent automation plays a crucial role in this journey. Before the crisis, a handful of private equity funds were using RPA within their internal functions to fully understand the nuances before using the technology in their portfolio businesses. Adoption has evolved rapidly since the pandemic started as it has had a negative impact on the front, middle and back-office functions of most businesses, including PE funds.

The response strategies of most businesses triggered significant breaches in operational integrity, especially where there was a dependence on human operations. In response to these new challenges, senior executives are looking at ways to leverage automation technology to minimise the human touch and improve business resilience.

We're seeing PE funds adopting RPA in at least two ways. First, across functions in the PE fund itself (fundraising support, compliance reviews, portfolio performance review, financial accounting, etc). It's not only enabling business resiliency but also enhancing the customer experience (investor relations) at a lower price point and in a secure manner (cybersecurity). Second, in their portfolio businesses, where the drive for cost reduction is now compounded by the need to remove exposure to human operations.

Above all, as we head into a recession, RPA is freeing up time for PE talent to focus on aspects that create value "within their business".

By Amit Vij, managing director, private equity at ISG, a global technology research and advisory firm

Cloud services

Cloud services are transforming how businesses operate and covid-19 will drive more private equity firms to recognise the significant value delivered. As Eze Castle Integration helped clients move from office to remote work models, those operating on a cloud platform were able to smoothly transition their employees to a fully remote environment. Additionally, the flexibility of cloud services allowed firms to easily scale IT resources, ensuring users had access to data and applications without performance or availability concerns.

Beyond infrastructure, the cloud is powering increased collaboration, information sharing and virtual connections at private equity firms across the globe. During this period, more and more firms are embracing tools like Microsoft Teams, SharePoint and OneDrive to give employees the constant connectivity they require while also maintaining a strong security posture.

On the security front, firms must appreciate that the cloud is not secure by design. It is a powerful tool that must be designed, implemented and maintained with a security-first strategy. Looking ahead, we expect the multitude of cloud advantages – from flexibility and collaboration to security and cost optimisation – to drive continued adoption.

By Mary Beth Hamilton, vice-president of marketing at Eze Castle Integration, a global managed service provider to the investment industry

KEYNOTE INTERVIEW

A 'new world' for private equity managers post covid-19

Intertrust Group's CCO, Ian Lynch, talks through the firm's global survey of private equity managers, which signposts what the industry might look like after the pandemic

In early spring, just as the world was driven into lockdown by the covid-19 pandemic, Intertrust Group launched a survey of private equity managers to gauge market sentiment. The timing was fortuitous. As the industry entered an unprecedented period of uncertainty, around 150 managers responded, eager, like everyone, to get a steer on how the crisis would impact their industry. Looking to the immediate future, managers are broadly pessimistic. About 70 percent of respondents anticipate that the investment outlook will deteriorate or deteriorate significantly in the next 12 months. We asked Intertrust Group's chief commercial officer, Ian Lynch, what else the poll tells us about how GPs are feeling and the world they expect to see after coronavirus.

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Q Did any survey responses surprise you?

Yes, how many people thought the investment market would improve over the next 12 months: around 30 percent. I imagine those managers are looking at falling asset valuations and the amount of dry powder they have piled up and expect to see an increase in investment activity. However, negative sentiment is absolutely overriding. Financing markets are effectively closed and that will impact private equity transaction volumes. Across every sector, GPs are going to face challenges within their existing portfolios and will have to inject cash to ensure businesses survive and then thrive when lockdown ends. We forget sometimes that GPs have a host of existing businesses they will always prioritise over new investments.

Q Is it all bad news?

Not at all. The beauty of PE is that investing in closed-end funds mitigates volatility. For GPs, time is on their side and they can manage their assets through the crisis. Operational excellence has always been core for a lot of buyout firms. In a difficult financing market, it will only become more so as the financial engineering piece isn't going to be as easy to execute. Improving margins organically through, for example, technology efficiencies, will be key to sustaining management team and asset performance.

We're seeing several large private equity clients looking at new investment opportunities in countries that are starting to recover post covid-19. For example, an increase in investment activity in China as its financial sector has rapidly opened back up to foreign capital.

Q About three quarters of managers expect an increase in fund term extensions. Is this already happening?

We are not seeing it yet, but it makes sense. Managers, like everyone else, will take a pause as they wait for the global economy to reboot. If I'm a manager in the last year of my fund, this is an awkward time to divest assets. I could try to fold those assets into a new fund or extend my current vehicle to extract most value. The latter is in the interests of LPs too.

Q Are GPs shifting strategy? The biggest area of diversification will be into private debt – around a third of respondents are planning to move into direct lending. And almost all respondents (92 percent) believe there will be an increase in distressed fund transactions over the next 12-24 months. It's a good time for those managers. The largest direct lending firms with distressed situation capabilities will be well placed to capitalise on these conditions. A lot of those managers have the benefit of having survived the global financial crisis and offer in-house expertise. Others will be raising new capital in anticipation of upcoming opportunities.

Q GPs clearly see digitisation as a huge opportunity. How is this evolving?

Portfolio companies have witnessed huge digitisation gains in recent years, whether that is, for instance, the growth of online booking through travel portals or, in financial services, the automation of underlying processes to improve the client experience. By sector, digitisation effects are different, but it's a theme any investor looks for: what can digitisation add to a business, what's the GP's plan, and how does it impact top and bottom lines? It's linked to operational efficiency.

Q For you, as a service provider, what advantages does digitisation bring?

Particularly now, the demand for virtual board meetings and digital signatures is huge and accelerating the digitisation of our business. Historically, corporate services has been a paper-driven industry, but more of our private equity clients are seeking access to digital information. We use a process automation platform to supply that. Instead of sorting through lots of pieces of paper, managers can use the portal to view all documents relating to underlying entities, corporations, director resolutions and so on.

From a fund accounting and portfolio management perspective, GPs are collecting more information from their investments and sharing a portion of it with their LPs. The quality of that portfolio company data is significant as good data allows managers to quickly identify risks and exposures. In future, managers will insist data is provided in a certain format. Data aggregation is a theme. We are investing a huge amount of resources into this area and through our client portal IRIS, we aim to ensure our GP clients have good visibility over their entire portfolio. The last six to eight weeks has proved its usefulness.

Another impact of the lockdown we've seen as a service provider is an increase in client questions regarding team oversight. The use of online business activity monitoring tools will only increase. It's a huge area of opportunity for us. For our clients, it is important we expose our operating procedures, so they know where we are in any given process. We use a programme called Promo across multiple functions to display to clients where we are with, for instance, bank account reconciliations or quarterly NAVs. Internally, our business employs thousands of people worldwide working remotely, and we want to know how they are coordinating and progressing and that they're following policies and procedures.

Q PE has traditionally been a very face-to-face industry. Are you seeing that change during the pandemic?

The first major task was to transition to operating remotely. That has been achieved very successfully and now we've entered the 'business as usual' phase in which people will need to get used to making decisions from their living room. Virtual meetings have been phenomenally effective, more so than many expected. After lockdown, there will be much more virtual engagement, for instance during due diligence, with face-to-face meetings perhaps only at the beginning and end of the process. If not, we won't be able to get through the workload. Air travel will be more complicated and the ability and willingness of people to travel will reduce. The new normal will be to communicate and share documents over online collaboration tools such as Cisco Webex or Microsoft Teams.

Q ESG policies were already high on the industry's agenda. What will this look like post-covid-19?

Over the past several years, climate change has become a critical portfolio issue for LPs, particularly in Europe. Coming out of this crisis there will be a green theme contributing to the economic recovery. I think we'll see the standardisation of environmental, social and governance criteria, as well as reporting, which is currently fragmented across multiple templates. This crisis is going to accelerate that trend. ■

To receive a copy of Intertrust's private equity report, contact: info@intertrustgroup.com

Regulatory relief: Risk, rewards and rope

The pandemic has brought both active relief from regulators and greater unknowns and risks for private funds' compliance teams, writes Bill Myers

Since the crisis began taking on its ghastly dimensions, American regulators have announced new "relief" nearly weekly, and sometimes daily. Over just the month to mid-April, the US Securities and Exchange Commission eased restrictions on intrafund lending, extended the deadline for Form PF and Form ADV filings, and gave permission to hold remote board meetings. But given the pressures to find cash amid the crisis, that regulatory relief means compliance officers have to be even more careful. Here are the issues to be aware of.

1. Anti-money laundering

"This is a time for more customer due diligence, not less," says Ross Delston, a lawyer and consultant in Washington, DC. "It's a tough one, but customer due diligence is always a good idea because customers who are criminals, who are fraudsters, who are involved in illicit activities bring untold problems to financial firms."

Delston has spent most of his career helping firms prevent money laundering. He says he's worried sales teams are going to be more vulnerable to hucksters as the scenery collapses around the world economy. "They're in some ways like the virus – once they attach to you, it's hard to get rid of them," he tells *Private Equity International*'s sister title *Private Funds CFO*. "Unlike the coronavirus, they're not going to kill you, but they're going to be with you a long time. It's better to stop them at the door rather than let them into your institutions."

2. Three tips

It's harder to hear "no" any time, but especially now – and especially because many funds, desperate for liquidity, already see their compliance teams as "cost centres", Delston says. How, then, to convince management to keep their heads while all around are losing theirs and blaming compliance? Delston has three suggestions:

Show executives fraud enforcement cases, even if from different areas of the law or the market.

"Management often pays attention when there are large amounts of money in penalties, or possible criminal prosecution," says Delston.

Remind managers of the "high incidences of fraud that arise in a pandemic", he adds. "All sorts of fraudsters come out of the woodwork during a crisis, and those fraudsters can be clients of the funds" if compliance isn't careful.

Look out for Ponzi schemes. "That's part of the financial landscape," Delston says. As investors are facing liquidity crises, they're likely to try to redeem their funds. When redemptions can't be met, the schemes unravel.

"Looking at sources of funds of clients is as important, or even more important than it's ever been," Delston says.

"That's not to say that compliance won't get overruled by the business. It's a chronic debate that most compliance officers face on a daily basis."

3. 'Significant shift'

If all this isn't enough to focus the minds of compliance then consider pending changes to the SEC's advertising rule, which hasn't been updated since the 1960s. "The definition is going to change," says Kelley Howes, of counsel at law firm Morrison & Foerster. "Things private fund advisors are used to being able to do in a one-on-one context, they may have to rethink. A document that goes to two potential clients instead of just one: that's going to be a significant shift."

This could see tension between compliance and marketing, says Kurt Wolfe, an associate at law firm Troutman Sanders.

"How are [compliance teams] supposed to work that into an actual set of procedures they can deploy?" says Wolfe.

"While all that's going on ... I think the marketing people see it as a win. They can use testimonials, past performance ... in ways they couldn't before, in media they couldn't before."

4. SWOT analysis

Compliance officers should take two steps, Wolfe suggests. First, conduct a SWOT analysis – strengths, weaknesses, opportunities and threats – of current policies and procedures and contrast them against the proposed rules. "Once you have that framework, you start thinking about the particular kind of clients that we deal with. How do my folks use e-mail, Twitter, radio; how do they fit in with my framework?" he asks.

Second, Wolfe urges P&Ps be redrafted as if any future rules will be onerous. "Understanding that different businesses are going to have different risk appetites, I would generally promote a programme around the most restrictive rule, or the most restrictive interpretation of a rule. I think that's going to be the most defensible," he says.

5. 'Have compliance's back'

Given the latent tensions between compliance and marketing/sales, Wolfe suggests compliance officers begin managing up so that top officials at private fund advisors understand how important these changes are. "Whoever is the person at the top, they have got to make it clear that they stand with compliance, that they have compliance's back. You don't want to wait for some sales guy to go rogue on Twitter."

Howes says the proposed rule "will be a significant infrastructure change" for compliance teams "because they're going to have to keep records of all these things".

"If an advertisement includes certain broadcasts, is there a script? Are you reviewing that?" she says. "If there's a public Q&A that you can't control, compliance people will have to put together some kind of training for the people who are out there, and continually update that training."

6. Know your customers

Wolfe and Howes agree new advertising rules will require a careful look at investors. "In those pooled investment vehicles, you're going to have to know whether you're talking to a retail or non-retail investor," Howes says.

Under the rules, an accredited investor wouldn't necessarily be considered a non-retail investor, she says. "That's a fundamental shift. "

7. New 'normal', new insiders

Covid-19 also widens the risk of insider trading by expanding the pool of potential insiders, says Michael Birnbaum, a former SEC trial lawyer now in private practice with Morrison & Foerster.

That means compliance teams have to look way beyond the C-suite and mid-level management for insider trading. Any number of front-line workers could be sitting on a wealth of wealth-making details, Birnbaum says.

"This is a good time to make sure your employees are reminded of the policies and procedures – and to make sure your contractors are brought up to speed – because a lot of people are going to have access to material non-public information."

KEYNOTE INTERVIEW

Beyond the here and now

The shift to remote working may have posed a short-term challenge to private equity firms, but much of the change stemming from covid-19 has yet to come, says Alter Domus CEO Doug Hart

As the emergence of the coronavirus turned much of the world upside down within the space of just a few weeks, private equity firms have had to adapt – and quickly. While the move to remote working has largely bedded down, it is fast becoming apparent that covid-19 will usher in new ways of working and accelerate existing trends. But what form will these changes take?

We caught up with Doug Hart, CEO of Alter Domus, to find out how private equity firms are coping with the new normal and how the virus is shaping operations, opportunities and future plans.

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Q What challenges have private equity firms faced since the covid-19 outbreak?

Initially, our private equity clients were largely facing logistical challenges stemming from their rapid move to remote working – that meant getting accounts, information and teams from an office to an online environment and enabling real-time access. During the first two weeks of that transition, several of our private equity clients used us as a repository of information – we acted as a central hub for them. Beyond that, there has been the need to put together financial statements and reports, conduct audits, and complete investment memoranda through electronic interfaces – all this at a time when portfolio companies will have experienced dramatic changes almost overnight. As well, there were deals that were already in progress – firms have had to figure out how to run due diligence, comply with Know-Your-Customer requirements and sign and close deals on a remote basis.

We have been able to support our clients in areas such as automation because we have been online for many years now. In some ways, this has helped many GPs overcome inertia or reticence to use technologies for these processes. Private equity was a little behind the curve compared to some parts of the investment community, but they have closed the gap very quickly.

Q What about LP information requests – these must have been significant as the economic outlook shifted?

LPs have understandably wanted to know their positions and exposures as the cycle has turned. GPs were getting a lot of inbound calls from LPs and they needed to be responsive and address open items swiftly. We were able to help with this as GPs were establishing remote operations by answering queries that would normally be dealt with by investor relations teams in areas such as cash positions, reconciliations, rosters of assets and basic holdings of portfolio companies right through to financial statements.

Q How is the current situation affecting fund valuations?

This really varies from sector to sector and even sub-sector to sub-sector. Some companies are performing extremely well, while others have found themselves void of all revenues almost overnight. And then there are those that are somewhere in between. So, you run the gambit from companies that need stabilising through capital injections to others that are raising debt capital to make acquisitions in offensive moves. You will find all or most of these situations in the same fund and so it can be quite challenging to determine how this shifts fund valuations. You also need to work out how this might affect carried interest and, in some cases, clawbacks.

While private valuations are happening all the time, the more formal valuations are quarterly. The Q1 financials feeding into portfolio company valuations at the end of March may only have reflected less than a month of the impact of the crisis and lockdowns. The next quarter will see the biggest impact and there will be some haircutting going on.

> ## Are you seeing any positive changes start to develop from the crisis?
>
> **One of the biggest positives is that the move towards digitalisation and automation has accelerated.**
>
> Firms can no longer rely on spreadsheets and manual inputting, for example. This also plays into a shift in how firms now view their middle-office operations. Historically, these have always been seen as critical to the front office and teams have been co-located in city centres where talent can be hard to find and keep.
>
> For many firms, it has become clear that they can get value from their middle office remotely. Physical location is no longer vital, but the technology required for middle office teams to do their jobs effectively is now much more vital. Private equity houses will look to service providers to help with this.

Q Have any surprises emerged from the situation?

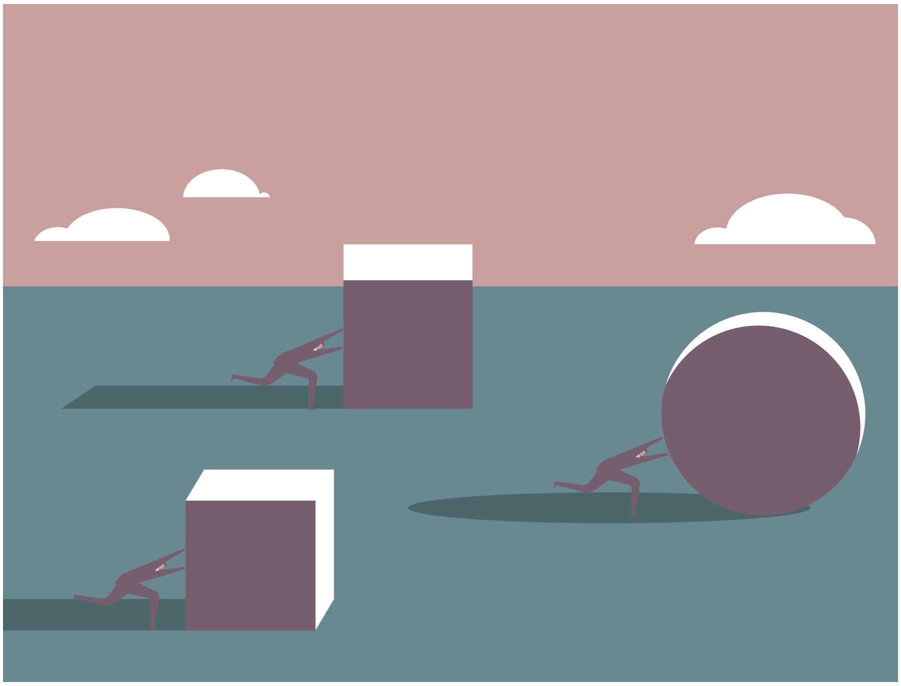
One thing that has really surprised us is that environmental, social and governance issues have remained important throughout this, and have possibly gained more momentum. Due to the practical issues firms were facing, it could have been the case that environmental and social issues didn't get much attention, but I think there is actually more focus on this because the crisis is having such an impact on both. The fact that air has been cleaner through lockdowns has also prompted more thought and discussion around the environment, how managers are reporting on ESG and the extent to which they are meeting their targets.

Q What will be the enduring legacy of the crisis on the private equity industry?

I think it will be technology transformation. Firms now see the importance of self-service for LPs, who want information at their fingertips that is easy to understand and in a digestible format. They want to be able to grab information via portals and get rapid responses to questions through online chat capabilities. We are already seeing interfaces that were previously perceived as for retail only converging with institutional investor platforms – that has happened in the past 90 days. We will be investing significantly more in our portals as a result.

Q Looking beyond covid-19, 2020 will see Cortland rebrand under the Alter Domus umbrella; can you talk us through that?

Alter Domus and Cortland merged two years ago and while our teams have been working together, the Alter Domus brand was not well known in the largest private capital market – the US. Cortland has strong recognition among debt capital markets and real estate fund managers in the US, yet the Alter Domus business covers around a trillion dollars of assets, including private equity, real estate, infrastructure and complex credit. By bringing the whole business together under the single Alter Domus brand we want to demonstrate our scale and capability to clients globally and help them draw the link between what were historically two businesses. ■



Adapting to new terrain

The crisis is presenting a variety of challenges for private equity, but fund administrators are quickly pivoting to the new business as usual, writes Vicky Meek

The spread of covid-19 has ended up being the mother of all tests for business continuity planning for companies and firms across the world. Far from immune have been those providing services to the private funds industry.

Although there will undoubtedly have been headaches, perhaps the biggest surprise across the industry is that the transition has gone rather more smoothly than might have been expected. "Mobile working is not new to our business," says Oliver Morris, global head of private equity at SANNE. "But that means we're used to around 20 percent of employees working remotely at any one time – not 98 percent. However, the current situation has shown us that it is possible. Payments are still made, reporting deadlines met, etc."

For some, the ability to soft test contingency plans helped smooth out potential wrinkles. "We are a globally dispersed organisation," says Srikumar TE, global head of fund solutions at Apex. "So, we had experience of dealing with social distancing measures in Hong Kong and Shanghai as early as January, where we had to put offices into BCP.

"And while BCPs are usually drawn up to be local or zonal, we could see lockdowns were spreading; so we created rotational working from home in the early stages – that really helped test the effectiveness of our plans and systems before we had to shift 95 percent of the workforce out of the office."

Many of the issues were, predictably, IT-related. "Some of the biggest challenges were around ensuring that everyone was using secure connections and that firewalls were in place," says Srikumar TE. "Our ICT people had a lot of heavy lifting to do initially around security. We also did a training programme ahead of the shift around the tactics used in phishing attacks. This meant that this was fresh in employees' minds. It has been worth it because there has been an increase in phishing attempts since home working began."

Yet it wasn't just IT security that needed a boost. "Our technology support teams needed to make sure that various platforms, such as banking and broking applications, could be accessed securely by those that required them," he says.

Staying in contact

Keeping lines of communication open has been vital to ensuring clients' needs can be met and information can keep flowing, and some valuable lessons have been learned from the financial crisis. "One of the biggest frustrations in the last crisis was that information was sometimes slow to emerge," says Morris. "This time, the turnaround on questions is much quicker and our people can be available for calls at odd hours of the day or night."

The development and widespread adoption of a variety of technology-based solutions has enabled a level of business resilience that just wouldn't have been possible even a few years ago.

"Technology has totally changed the way we work," says Laura Brunnen, partner at Reed Smith. "We've had agile working in place for a while and so we already had our home computers set up for working from home. It's also worth bearing in mind that lawyers working on international deals all work remotely with each other in normal times – they're used to conference calls and communicating with teams based in different locations."

In fact, one of the most surprising aspects is how normal the current situation has come to feel.

"BCP has turned very quickly into BAU – business as usual," says Ian Lynch, chief commercial officer at Intertrust. "We are definitely in BAU mode now. We have to make sure that we continue to grow the business even under unusual circumstances because this will likely go on for some time."

> *"The main challenges for our clients currently are around their liquidity positions"*
>
> **OLIVER MORRIS**
> **SANNE**

For the fund administrators, there is, understandably, a significant demand from clients for a whole raft of information and analysis. "The main challenges for our clients currently are around their liquidity positions," says Morris. "They are examining what their portfolio looks like – is there distress or are cashflows going to continue post-lockdown? They are also looking carefully at their LP base; and where funds need to issue capital calls, they are looking at whether LPs can meet them. They are looking at cashflow forecasts for the next nine months and asking, for example, 'if there are no distributions, what does that do?'"

Valuation challenges

Although this information is largely accessible, what's proving rather harder to work through – for market as opposed to operational reasons – is quarterly reporting. The wild swings in public markets and the rapid change in economic outlook brought about by the spread of the virus have made valuing assets with any accuracy an extremely challenging task.

"Valuations are an increasingly difficult issue and they are causing delays for auditor sign-off," says Morris. "The December valuations were less of an issue, but it is going to be highly challenging to complete March sign-offs on time – there is a lot of head-scratching going on."

Meanwhile, for lawyers, there are other considerations as clients work around the current situation to keep fundraising and deals as close to on track as possible. "We continue to be incredibly busy," says a partner at an international law firm. "That's a combination of work in progress that started before the current situation and new work stemming from clients seeking to plug funding gaps and addressing issues in their portfolio companies."

The partner also points to issues around fundraising: "We're working with a client that is raising several billion dollars in aggregate. They have extended their timeframe for doing this and it's a challenge trying to close billions of dollars in fundraising from a laptop at home."

One of the issues is signatures. Although e-signatures are relatively straightforward to arrange for deals, the complexity and multi-jurisdictional nature of fundraising can present problems.

"The UK parliament, for example, has legislated to allow for e-signatures," the partner explains. "Yet that's not the case in all jurisdictions. That means there's quite a bit of due diligence required to ensure contracts are effective and binding."

Brunnen is similarly busy. "We're

still doing pitches and deals are still coming in," she says. "I'm currently working on a joint venture and on an acquisition. Over the Easter weekend, we had a huge team working on a pre-pack administration – that involved video links with clients, the debt providers, lawyers working to the administrators and multiple teams on our side, from employment right through to real estate specialists."

The path ahead

The fact the industry and its service providers have managed to pivot so quickly in highly unusual times is clearly encouraging. Yet it does beg the question of whether we may see more permanent shifts emerge from today's crisis.

"Until now, there had been some resistance in some quarters to staff working from home, but I think this will become more regularised," says Brunnen. "When senior managers and partners go through the numbers at some point in the future and see that work carried on while costs reduced, it will be an eye-opener.

"Many businesses could conclude that they can reduce their floorspace quite dramatically. I'm not sure we'll go back to the old normal – I think a new normal will be created."

The relationship between funds and their service providers may well evolve too. "I think we'll see greater fungibility between clients and service providers," says Lynch. "There may be specific services where we might, for example, lend our teams to clients. There will also be an acceleration of the maturing of operating models so that more firms have all the data they need at their fingertips in a standardised format, from fund right through to portfolio company level in granular detail – fund administrators will increasingly be called on to assist with this."

Proskauer partner Leith Moghli agrees. "The GP-lawyer relationship will be closer as a result of this crisis," he says. "We are going through additional challenges together and it's at times like these that you find out who your valued and trusted partners and counterparties are."

Indeed, those that have managed to stay on the front foot through today's upheaval may be well positioned to benefit over the long term.

"The fact that we're now operating as business as usual presents quite a big opportunity," says Srikumar TE. "That has driven a lot of enquiries from GPs over the past few weeks." ■

"The fact that we're now operating as business as usual presents quite a big opportunity"

SRIKUMAR TE
Apex

A slower period for private equity?

While private equity fundraising figures for Q1 2020 show a strong start to the year, with $124 billion raised across 184 vehicles – the highest first quarter total since 2017, according to *Private Equity International* – the expectations are that the coming period's figures will show a slowdown as many GPs stretch timelines for capital raising.

For many of those raising as the lockdowns started to take effect, fund administrators acted as a linchpin for communications. "We were there to connect networks for firms raising and deploying capital," says Doug Hart, CEO at Alter Domus. "We were a central aggregation point for closing activities to get everyone on the same schedule."

And while fundraising may continue – albeit at slower rates than usual – new deals will likely see a sharper drop-off as private equity houses work to stabilise existing portfolio companies and wait to see how business valuations shake out once the dust has settled somewhat. Indeed, Hart reports his company is administering "fewer capital calls as a result of lower investment levels".

And even if all parties can agree on valuations and investments can get over the line, there may be some delays during the process. In the UK, one issue, for example, is creating newcos, says Reed Smith's Brunnen. "You used to be able to do this very quickly online, but that's no longer possible," she explains. "The lead time has increased on this and on some searches, plus there are practical points around signatures and certification, so there are a few wrinkles you have to work through. That said, in many respects, our work is business as usual."

184
Number of funds closed in Q1 2020

$681m
Average fund size in Q1 2020

Avoiding a 'techlash'


Guest comment by: **Ian Bagshaw** and **Tim Hickman**

Ian Bagshaw and Tim Hickman, partners at law firm White & Case, outline the key cybersecurity risk management considerations for private equity firms

The accelerated digital transition businesses are being forced to undergo will likely be one of the longer-lasting consequences of the covid-19 pandemic. As the private equity industry adapts its focus towards digital-enabled, investors in data-fuelled companies will need to make data and cybersecurity risk management a key pillar of their strategy.

Data-heavy businesses need to be keenly aware of data protection obligations that arise from legislation and regulation, yet many companies neglect to consider their legal exposure to other participators within the data chain. Failing to manage cybersecurity risk may lead to regulatory enforcement and claims under contract brought by third parties for not protecting their data assets. Private individuals who have had their data disclosed in a cyber breach may also seek compensation.

Data privacy and cybersecurity are critical considerations for any business that relies on the internet handshake model. This allows customers to access digital services free of charge and in return the company can harvest and monetise their data. It is implicit within this model that the company protects users' data. A severe 'techlash' will be experienced if there is a failure to manage cybersecurity risk. Consumers are increasingly untrusting of firms with a poor data protection reputation.

The impacts of the 'techlash' will also be felt in seismic changes to the regulatory landscape. Rising cybersecurity risk brought on by accelerated digitisation may bring with it increased legislation and regulation. The private equity sector needs to understand that data protection has become a major regulatory focus and investors must adjust their investment thesis accordingly.

The upcoming cash crunch will inevitably divert management focus towards the short-term goals of survivability and profitability. However, underinvestment in cybersecurity and data protection will increase the damage a cybersecurity failure could have on the value of a business. The typical five-to-seven-year length of a private equity investment leaves sufficient time for a risk to come to fruition and reduce the value of an investment through regulatory sanction, liability to third parties and reputational damage.

> *"Operationally, the starting point is technical security"*

A proactive approach

Businesses must manage cybersecurity risk from an operational and legal perspective. Operationally, the starting point is technical security. Companies must hire technically competent staff who can constantly monitor systems and have a strong voice in management to empower them to rectify any issues identified. The absence of a credible chief security officer will increasingly be viewed as a due diligence red flag.

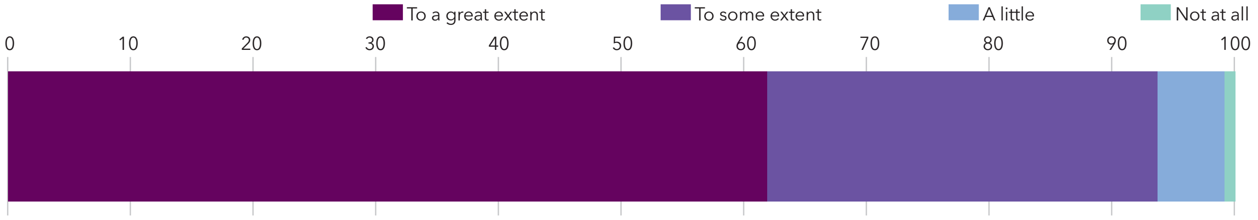
Cybersecurity insurance, effective due diligence and contractual protections are key legal tools for managing risk. Firms seeking to rely upon insurance must understand its limitations; in particular, it is unlikely a policy would cover the quantum of any regulatory penalties. Firms must look to take preventative and not just curative actions.

Contractual protections are common in agreements governing data usage; however, firms need to examine the counterparty's financial and operational abilities to meet their obligations. If a contract requires a counterparty to take certain risk management actions, audits and other tools should be used to monitor compliance. ■

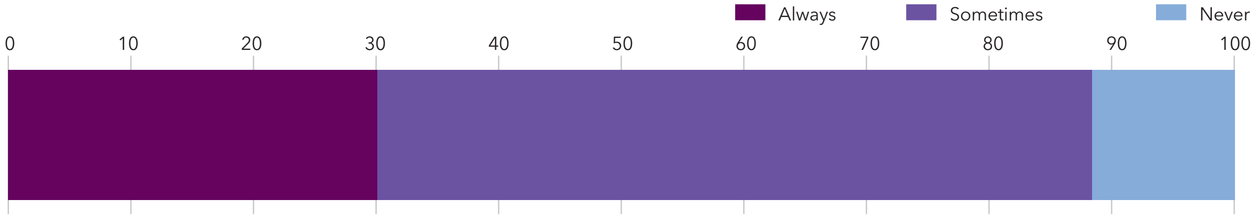
The cybersecurity perception gap

Although robust cybersecurity policies hold heavy weight with LPs and GPs alike, there appears to be a mismatch in confidence levels

Are strong cybersecurity protocols viewed as a back office 'must-have' by investors? (%)

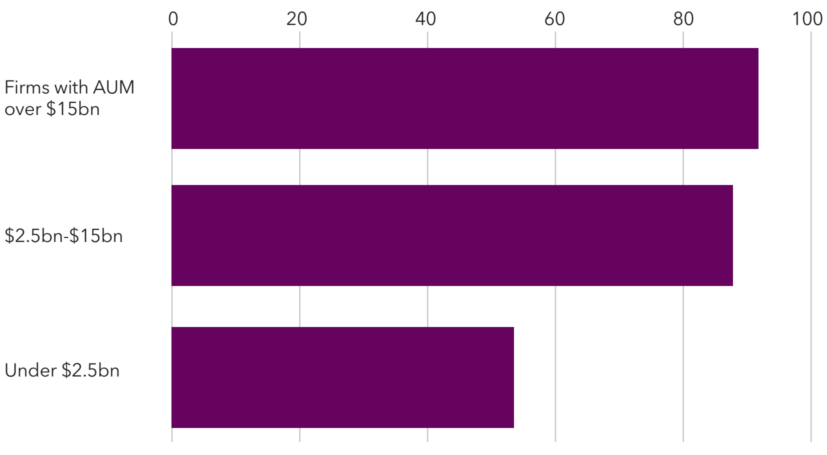


The extent to which LPs ask the following question during due diligence: Do you have a readiness for a cyberattack policy? (%)

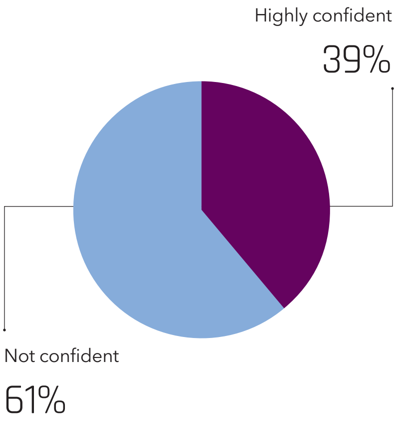


Source: Private Funds CFO's Insights 2020 Survey

Do private equity firms feel well prepared to prevent a cybersecurity breach? (% that replied Yes)



How confident are investors that alternative fund managers have adequate cybersecurity policies and procedures?



Source: EY's 2020 Global Private Equity Survey