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The people paradox **GPs should vet service providers with the same care and rigor as any full-time employee**

Businesses have long touted 'people' as their greatest asset. But labor actions in multiple industries across the US show that not everyone is buying it. Against this backdrop, private equity GPs are appreciating the value of culture and workplace satisfaction more than ever, ***writes Rob Kotecki***.

A market as volatile as today's will do that. As financing becomes less accessible and more expensive, value creation becomes the primary route left to generate returns. And who creates value? The right talent, properly deployed. That's why GPs are hunting for human capital experts to cultivate talent at their portfolio companies and firms.

These GPs don't discount the work involved in managing people. If anything, it has them contemplating automation and outsourcing as much of the firm's activities as possible so they can devote their time bringing aboard the highest impact players – as in hiring a CFO instead of a trio of fund accountants. But as GPs outsource basic activities, they still need to treat those service providers as an actual extension of their office to ensure a good culture fit with a genuine rapport.

GPs in the past might have rolled their eyes at the idea of culture as a value driver, or such New Age theories as work-life balance. But they now see human capital issues as one of their core challenges. In the most recent *PE Leadership Survey* from global financial advisory and consulting firm AlixPartners, the war for top talent is one of three key human capital concerns, cited by 41 percent of respondents. In the same survey, 81 percent of portfolio company executives identified recruiting and retaining talent as their biggest challenge.

"Our research shows that private equity firms now see the human capital lever as the number one lever for value creation," says Ted Bililies, partner, managing director and global head of transformative leadership at AlixPartners. "They now know the 'who' matters, and that puts an emphasis on training, development, employee experience

and even succession planning."

As a result, GPs are investing in human capital expertise. "PE firms are hiring a lot more talent acquisition staff at the firm level," says Shawn Cole, president and co-founder of Cowen Partners, which recruits senior executives for portfolio company roles on behalf of PE clients. "These hires are becoming core part of the overall value creation model."

Looking inside

But GPs aren't simply investing in talent at the portfolio companies. "Human capital initiatives were historically devoted to external needs for portfolio companies but now that's an opportunity for the firm's internal staff as well," says Sean Mooney, founder and CEO of BluWave, a PE-focused B2B netork offering access to vetted service providers, consultants and interim executives.

The war for talent isn't anything new for the private equity space, but the current market is having a contradictory impact on that war.

"The competition for talent has slowed some with the inflationary headwinds and the rising cost of debt," says Bililies. But that said, he notes that the tougher the environment, the greater the premium for the talent to navigate those rough waters. As Cole points out: "There's this realization that people are going to drive the next couple of years of growth, especially where turnarounds are necessary."

Bililies also notes that the competition for talent isn't the same across the industry. "The bigger firms, the $15 billion firms and above, are feeling it worse than the smaller ones. At the smaller firms, more of their key roles are covered, and that's just a reflection of the dry powder that the large firms have to put to work."

Hot topic

So what are PE firms doing to win the right people? "They're widening the aperture and looking beyond the same six schools for junior investment professionals. They're paying attention to the employee experience and value proposition," says Bililies. And treating human capital management as its own discipline.

"The number one hottest hire in all of private equity is a head of human capital," says Mooney. "And while they might be tapped initially to look at portcos, eventually they shift their focus to the firm's own staff as well." Bililies finds the competition for CHRO to be quite intense, and its increasingly difficult to fill that role.

This all amounts to a greater appreciation of the time and effort required for recruiting and retaining talent. Little wonder that so many GPs have outsourced tasks like fund administration given the limitations of their own manpower and budgets.

"A private equity firm, in some ways, is a much smaller business than the portfolio companies they own, with that management fee on, say, a billion-dollar fund only amounting to $20 million in revenue," says Mooney. "So that means there's only so many chips on the table, and every bet on internal resources needs to be an educated one."

Outsourcing can be quite an educated bet. "We take the human capital risk of fund administration off our client's plate," says Luis Gutierrez, a managing director at Gen II Fund Services. "Finding, training and developing talent is incredibly time consuming and if that employee leaves, it's back to square one. Not to mention the cost savings of not having to provide a separate salary and benefits package."

> "The number one hottest hire in all of private equity is a head of human capital"
>
> Sean Mooney, BluWave

Even without major savings, there's another asset. "Outsourcing allows a client to have a fixed cost versus a variable cost. That's music to any CFO's ears, since they can now budget for this. I know what to expect. And if there are additional costs, say relating to upskill training of staff, that's the responsibility of the administrator, not the client," says Dautanya Strachan, a managing director with Gen II Fund Services.

However, GPs would do well to evaluate and manage their service providers with the same rigor as their internal staff. "Treat [any outsourced service provider] like a full-time employee," says Mooney. "Outsourcing isn't some magic fairy dust that automatically ensures the provider does the work perfectly."

Most outsourced service providers sell themselves as that extension of the office. But they'll need to be more than just an extension of their clients' culture if they're to continue attracting the talent they need.

"For professionals under 35, compensation is necessary but not sufficient. They will not do what the older generation did so often, which is to say, 'Pay me a lot of money, and I'll kill myself for the firm,'" says Bililies. "They want compensation and culture, and they will make certain individual trade-offs, but by and large, they won't stay at a firm that doesn't understand that, and that's the difference between attracting and retaining talent." And of course, what good is the best talent if it leaves? ■

Gen II View **GPs stay competitive via wise spending and strategic focus**

Expert analysis by **Robert Caporale**, President – Strategic & Digital Solutions, Gen II Fund Services

With increased competition for fundraising, management companies are focusing on aligning their strategies for resource allocation and internal expenses with investor expectations, showcasing a clear value proposition and demonstrating strong track records. As firms manage unrealized capital and navigate the intricacies of regulatory scrutiny, there's a growing expectation for increased transparency.

Internal expense ratios within private equity firms exhibit surprising variability. Benchmarking these expenses becomes crucial for obtaining valuable insights into peers' average expenditures on back- and middle-office capabilities. This information is particularly significant as management companies face increasing scrutiny to enhance efficiency and comply with new regulations while scaling their business.

Talent compensation is a top priority

Gen II's analysis of management company spending segmented firms into three categories based on assets under management, but one thing rang true no matter the size – firms are focused on investing in talent and creating operational efficiencies. As the private equity landscape becomes more complex, there is an increasing demand for skilled professionals. Management companies are investing in talent development, training and attracting individuals with diverse skill sets to meet evolving industry needs.

Respondents across AUM categorizations on average reported 69 percent of their spending expenditures going toward talent compensation. From the $0-$499 million category to the $1 billion-plus category, there was less than a 10-percentage point difference when it came to compensation spending, highlighting that no matter the size of a manager, talent and retention are the top priority.

> “Management companies are investing in training and attracting individuals with diverse skill sets”

Prioritizing internal structure aligns with LPs' expectations

The changing needs of private equity management companies reflect the evolving landscape of the industry, influenced by various factors such as market trends, regulatory changes, technological advancements and investor expectations.

Management companies exhibit a prudent approach in their spending strategies, emphasizing risk avoidance. Even with a marginal uptick in post-pandemic spending on travel and entertainment, the overall percentage allocated to this category has decreased from 5 percent to 3 percent since 2016. This trend underscores the ongoing commitment of fund managers to prioritize internal structure. It serves the dual purpose of satisfying limited partners and aligning the overarching goals of the firm with the activities of general partners. This reflects a continuation of fund managers focusing on strategic alignment and resilience in the face of evolving circumstances.

Strategic focus leads to greater insights

Certainly, a significant number of private equity managers often perceive activities beyond the realms of sourcing new deals, fostering portfolio company growth and executing investments as distractions from their daily priorities. However, amid a progressively competitive environment for fundraising, limited partners are now closely examining back-office capabilities. ILPA's revised version of its standard Due Diligence Questionnaire extensively explores aspects ranging from management company economics to cybersecurity, compliance protocols and the utilization of an independent fund administrator by firms.

Increasingly, management companies are focusing on robust data management and analytics tools to derive valuable insights, improve decision-making and enhance operational efficiency. Adaptability and a proactive approach are crucial for private equity management companies to thrive in the dynamic and competitive landscape of the industry. ■

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Editor's letter

Managers say: 'Help wanted'

Rob Kotecki
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Private equity managers pride themselves on running lean. Even as the cowboy ethos of the industry's early days has given way to process and paperwork, managers aren't eager to bulk up. Instead, they hunt for technology and service providers that complement their internal staff as their funds grow in size and complexity, alongside regulatory demands.

Today, staying in regulators' good graces is a necessity. And that just got harder with the Securities and Exchange Commission's Private Fund Adviser Rules (see p. 10). As these come into effect over the next 18 months, they will unleash a torrent of new prohibited behaviors and increased disclosure demands, including the production of a quarterly report. Even the most optimistic expect managers will need more staff to cope.

> **"That GPs no longer smirk at the word 'culture' is a testament to how long the talent wars have raged"**

However, despite macroeconomic conditions, the talent war goes on. Operational roles have always been hard to fill, and it will not get easier. GPs are prioritizing human capital (p. 2) and hunting for senior executives to manage talent issues, but they're hard to source.

Enter the service providers, eager to tackle the pile of regulatory demands. Fund administrators have been assuming the duties of the management company as well when it becomes too much for veteran and new firms alike.

Choosing a service provider requires the same rigor as selecting an internal hire (p. 14). The fact that GPs no longer smirk at the word "culture" is a testament to how long the talent wars have raged. They appreciate that human capital warrants real attention and investment. Which only further argues for making the most of a trusted service provider who can assume that burden.

Even so, GPs should expect to hire extra staff, even if it is to help manage the work of the service providers.

KEYNOTE INTERVIEW

Taking a client-first approach

The best fund administrators truly understand their client's business, but there's real value in understanding their experiences as well, according to Phil Bruno, Gen II's head of management company services

Every fund administrator on the market vows to be an extension of their client's office, with the response times and reliability of an in-house staff. And the industry has exploded largely because most of them do act like they're part of the internal team. But the reality is a little more complicated.

Plenty of service providers can mimic the rigor and pace of their clients, but there is that rapport that takes everything up a notch. If that service provider looks at the world like that GP does, they can help devise solutions for problems that haven't even shown up at their doorstep. It's not merely being aware of the trends and culture of a given asset class. It's often more specific than that, and specific to that particular manager.

The service provider tackling that fast-growing mega-fund brilliantly may forget the reality of that veteran mid-market fund that's stayed faithful to their business model for 30 years. This isn't to say that the same administrator might not be able to serve both kinds of GPs, but chances are their primary client liaison is the same person. And many administrators are very sensitive to the fact that rapport is key and will tap the person best suited to that account.

In the case of Gen II's management company services business, it chose Phil Bruno, the firm's former CFO, to lead the effort. We sat down with Bruno to talk about his career up to this point, and what he thinks is vital to management companies today.

Q How did your career lead you to this corner of the market?

For the last five years, I have been Gen II's CFO, and now I'm shifting over to lead the management company services business. And I think it makes a lot of sense, given my experience. My overall career has focused on accounting and finance starting as a CPA with a

big four accounting firm and then developing a CFO skill set focusing on supporting a business in areas such as performance reporting and analysis, expense management, strategic planning and key initiatives including M&A and financial system implementations.

On the business side, I have focused on the alternative asset management business since 2007. Prior to Gen II, I was with Credit Suisse serving in various senior financial leadership roles supporting their global asset management division with a focus on alternative investment products – private equity, credit, real estate and hedge fund strategies.

During my time at Credit Suisse, the firm was actively building up their private equity business. And I was there to support that initiative from the management company perspective.

We launched a number of different strategies – direct leveraged buyout funds, fund of funds, secondary funds. This required close partnership with our internal fund administration team in the execution of these activities. So my initial exposure to fund administration was on the captive side, doing fund admin for our own business.

While I was there, Credit Suisse did explore outsourcing. We asked if we were better off tapping a third-party administrator that could provide the dedicated skills and know-how along with the technology platform to scale with us versus continuing building the capability on our own.

At Credit Suisse we had the resources of a larger, global organization but were challenged with turnover, evolving technology and the pressures of having to meet the broader firm's financial goals. In this case, we had to meet internal profit targets.

So, we launched a project to outsource, but that began by outsourcing our people to a lower-cost location. It was a first step, but eventually we moved a bunch of our internal products to Gen II, and that's how I got exposed to the firm.

But one of the things that I believe is important to my ability to serve our clients now, is by being a client back then. I've wrestled with so many of the issues around technology, turnover and the growing demands of compliance matters that our clients are wrestling with right now. I've been in their shoes.

Following the financial crisis and the impact on the regulatory regime, Credit Suisse had to rethink its strategy regarding the private equity business so I ended up being heavily involved in spinning out a number of our PE funds. As that wound down, I began looking for my next opportunity that would allow me to be part of the growth story in private equity and ended up landing at Gen II.

Q Given all that time in the trenches, how has the industry changed over time?

This business is people-dependent. Some element of technology has always been involved, but the real challenge was: how do you break the dependency on staff? The story was always, "We're launching a new fund. I need more people." Tech was something that might allow fewer people to do more, but it was only slowing the growth in staff, not halting it. Our big question was: is there any way, any technology, to automate activities to drive greater efficiency gains. And that began back then and still continues, but I still believe that we're in the early digitization phase.

And we're making strides, in the way we're moving away from e-mail to portals and have automated some elements of the reporting process, but we're still not there yet. The first admin to truly automate administration will jump to the head of the pack. However, even as we continue drive innovation to the to the next stage, our tools still do plenty to help lighten the load on clients.

"Our focus is to leverage automation, process improvement and the use of technology coupled with our experiences and expertise to help our clients"

Q Let's say the next big leap in technology manages to automate everything but 25 percent of the work? How does that change the demands on administrators?

It would certainly change the value-add. Administrators will be able to focus on expanding the strategic value of their relationship with their clients rather than just supplementing the client's staff while delivering processing skills and rigor.

They can partner with their clients on structures, provide compliance and regulatory support while identifying and sharing best practices, deliver data analytics and, last, maintain a focus continuous process improvement to deliver their services at a faster pace.

From the management company perspective, our focus is to leverage automation, process improvement and the use of technology coupled with our experiences and expertise to help our clients focus on what their expertise and experience should deliver: market-beating returns. ■

Chasing
paper

The SEC's Private Fund Adviser Rules represents a sea change in how the regulator treats the industry and requires mountains of additional paperwork, so GPs would do well to begin their efforts now, writes Rob Kotecki

For over a decade, regulatory complexity has helped shape how private equity firms build and manage their operations. Outsourcing has boomed, as GPs see the value in offloading the regulatory burden and they've institutionalized processes and roles to cast their behavior as rigorous and reliable. But despite all that effort, the SEC has seen fit to further enhance its oversight, with an even stricter regime.

The Private Fund Adviser Rules were finalized in August of this year and will be phased in over the next 12-18 months. Some of the rules impact both registered and unregistered advisers, such as new disclosure rules and some outright prohibitions of preferential treatment for any one LP. And for registered advisers, there are major new changes around quarterly reports, adviser-led secondaries and annual audits.

All these changes guarantee one thing: a windfall of work for GPs, their operational staff, law firms and service providers. GPs would do well to start preparing for compliance now, consulting with their legal counsel and peers, given that the SEC has offered little guidance, so developing a consistent market practice through trade associations and less formal collaboration will be invaluable.

Furthermore, these new rules, by and large, aren't likely to be relaxed. There have been some legal actions filed against the reforms, but none of the lawyers that *Private Funds CFO* spoke to for this story expressed a belief that any GP should count on the courts to rescue them. And these reforms are no mere tweaks of existing laws.

Enforced equality

"A sponsor or management company cannot provide liquidity or grant redemption rights to one LP unless they offer it to all LPs," says Marc Ponchione, a partner at Debevoise & Plimpton. "And they cannot let any LP have access to information [relating to portfolio investments of the fund

in question] that is not also shared with the rest of the LPs. Now, these prohibitions contain certain limited exceptions, but the onus is on the sponsor to demonstrate that they apply and they will be subject to second-guessing by the SEC."

"Some LPs might take a look at the side letters and decide to reopen negotiations," says Brad Caswell, a partner and head of the US Financial Regulation Group at Linklaters. "And think of the technical aspect of sharing side letters. Do they summarize and risk losing a detail? How do they package those side letters? It's a huge undertaking."

Caswell notes one of the major issues with these rules around preferential treatment matters is that it puts the onus on managers to decide what preferential liquidity and transparency terms might have a material negative effect on the rest of the LPs.

"Are certain preferential terms prohibited? Or are they material that need to be disclosed in advance? Or others that can be disclosed after the fact?" says Caswell. "Managers should expect that the SEC will be vetting their decisions around this during an exam, even if they don't offer much guidance at the moment."

For registered advisers there are three other areas that will materially impact operations. First, there are new requirements around adviser-led secondaries. "It's been market practice to do fairness opinions. Now it's a requirement to do either a fairness or valuation opinion and distribute it to LPs prior to the election date," says Caswell. "And GPs are required to disclose any material business relationships with the entity performing the opinion within the previous two years." Like so many of these rules, it codifies certain behavior managers may already do.

Second, registered advisers will have to perform an annual compliance review and provide a written report. "Most investment advisers already put the annual compliance review in writing, but now that report has that the

The end of the disclosure era

The transition from disclosure to regulation and prohibition in handling conflicts of interest and LP treatments

"Historically, until these rules, GPs and sponsors were subject to a disclosure-based regime to deal with conflicts of interest or preferential treatment for some LPs," says Marc Ponchione, a partner at Debevoise & Plimpton. "By law, LPs are required to be sophisticated, and GPs were required to disclose material facts and conflicts, and specific deal terms were handled as part of a bilateral negotiation between sophisticated parties, a practice blessed by the SEC as recently as 2019. Now, the new rules impose prohibitions on actual, specific conduct and certain terms practices are prohibited, or at minimum highly regulated."

Ponchione explains that in many ways, the SEC took the regime that governed retail fund investing and effectively applied it to private funds, which is arguably contrary to Congress's intent in designing the federal securities laws to apply very differently to those two types of investments.

However, some of the new rules from this regime only apply to registered investment advisers, while others govern all. The two key areas that apply to everyone in the industry are restricted activities and the preferential treatment of LPs. The list of new rules in both categories runs long, which is why relying on legal counsel is crucial.

From a bird's eye view, the restricted activities largely center around how to handle fees and expense allocations. Allocations that once only needed to be disclosed to LPs now require their consent and at times, are outright prohibited. "In most cases, GPs can't borrow from the fund without investor consent," says Stephen Mears, a partner in Proskauer's Private Funds Group. "In addition, GPs can't charge the fund for costs related to investigations of the GP, without consent. But what GP wants to call up their LPs and announce they're under investigation and now need to charge the fund? So, in practice, it may turn out to be more of a prohibition."

The other area that applies to all managers concerns preferential treatment of LPs, which once again, used to be addressed by a broad disclosure, but now includes hefty new requirements and actual prohibitions. "The new rules around the preferential treatment of LPs are centered around preferential liquidity and information rights as well as material economic terms," says Brad Caswell, a partner and head of the US Financial Regulation Group at Linklaters.

written annual review is required, managers can expect the SEC to test and scrutinize the annual review reports even more closely," says Caswell. But the third area of note is perhaps the most burdensome to managers.

Supersized reporting

"All registered advisers will now have to provide their LPs a quarterly fee, expense and performance statement, where fees and expenses are detailed and divided up by category, and they can't be lumped into a 'miscellaneous' bucket," says Ponchione. "This has to be done by fund and by portfolio company, and the performance details required are incredibly granular, such as gross and net of subscription line financing."

These quarterly reports might be only 10 pages for a new manager, or hundreds of pages for an established one, and must be produced every single quarter. "These rules create major new work streams for managers, so they'll need to allocate resources to comply. Inadequate resources simply won't be an excuse to the SEC for not complying with the new rules," says Caswell.

This burden will change how much GPs need their service providers, from law firms to administrators, and will impact their overall budgets. "All these new requirements will prompt sponsors to add additional staff, even smaller firms," says Jessica Marlin, a partner with Ropes & Gray. "And when coupled with an already onerous SEC registration process, it might cause folks to reconsider if they want to launch a new PE sponsor at all."

One of the rare bits of good news is that the SEC seems quite open to allowing managers to allocate compliance costs to the fund. "Interestingly enough, the SEC is not making it harder to offload those expenses to investors," says Caswell. "In fact, the SEC acknowledges in the final rule they did not want to disincentivize managers from incurring regulatory compliance expenses because that's valuable for investors. So as long as a manager discloses the costs to LPs, they'll be able to bill compliance expenses to the funds."

> *"Managers should expect that the SEC will be vetting their decisions around [preferential treatment] during an exam, even if they don't offer much guidance at the moment"*
>
> **BRAD CASWELL**
> **Linklaters**

Still, the scale of the new workload can't be underestimated. "These rules will demand that the private equity firms invest more in their operational infrastructure to handle these types of issues," says Marlin. And market observers argue that will likely be a mix of outside providers and new hires.

But lawyers agree that the first step managers should pursue is a scoping exercise, where a manager collaborates with outside counsel to determine which rules apply to them, and if there are exemptions. "The SEC acknowledges that these new rules are not applicable to non-US advisers with respect to non-US funds," says Caswell. "So there are exemptions, but if a manager has a large complex global structure with an office in the US, the manager could be pulled back in and the scoping exercise is especially crucial, but every manager should start by determining what these rules mean for them, and what it will take to comply."

Complicating that effort is the lack of guidance from the SEC, which will eventually arrive in the form of exams, when it's essentially too late. "Due to ambiguities in the rules and release, we suggest managers work with industry peers and trade organizations to understand how the market is interpreting certain issues," says Christine Lombardo, a partner with Morgan Lewis. "That doesn't necessarily mean that consensus is how a particular manager will interpret or apply the rules to its business, but there's some value in understanding how the industry is interpreting issues. This helps to ensure no one is an island out there by themselves, because it is unlikely the SEC staff will give guidance and waiting for clarification isn't an option."

Now, not later

One universal bit of advice to managers appears to be, "Don't wait," or not to underestimate the workload involved. "Some managers are looking at the compliance dates and thinking they're 12 months or 18 months from now," says Christine Schleppegrell, a partner with Morgan Lewis. "But some of these rules are already changing managers' day-to-day operations. For example, the side letter negotiations are informed by the new regulations, so it's vital to consider the impact on investor relations and ongoing fundraises."

And once again, it comes down to the workload on the way. "It's true that registered advisers won't need to start producing quarterly reports until March of 2025, but to deliver those properly, they'll need the infrastructure built and the information gathered by January 1," says Schleppegrell. "So, the best plans will work back from the date of compliance."

In short, the compliance dates might be a year or more away, but managers don't have the luxury of dawdling. These changes will no doubt reverberate for years to come, but the countdown has already begun, and the managers would do well to make this a priority so it doesn't become an emergency. ■

Right sourcing is more important than outsourcing

When it comes to the administration of the management company, GPs need to strike a balance between delegating to a service provider and setting up the internal framework to supervise the work, writes Rob Kotecki

So much about the current moment demands that GPs stay budget conscious, not only with their money, but their time as well. The SEC is cracking down on any fee that shouldn't be charged to the fund, and the competition for capital and deals is only rising. The era of cheap money and swift, breezy fundraising drives is over, and GPs are left to up their game, lower their costs and automate or outsource any activity they can.

The good news is that service providers are stepping up with attentive service, great tech and increasingly sophisticated counsel. GPs who have enjoyed outsourced fund administration are now discovering the value of outsourcing the administration of their management company. And more emerging managers are launching firms where both funds and management company are outsourced from day one.

Outsourcing from the debut fund might be ideal, given there are no legacy systems, processes or staff. But even mature firms are finding pain points from their own AUM growth and regulatory complexity that argues for outsourcing that management company. But there is still need for an internal team or team member who can speak the language of the administrators and supervise the effort, because the one thing that no GP can outsource is their responsibility for the final deliverables.

For the first-time managers, service providers today offer a turnkey solution at precisely the moment when time and money are in short supply. "If you're an emerging manager, don't hire an accounting staff and commit to a financial system; focus on hiring your financial executive and we can deliver the support – the staff and the systems," says Phil Bruno, head of management company services at Gen II Fund Services. "The reality is that a lot of managers will spin out from larger firms where the financial administration was handled by the central financial organization, and now,

out on their own, they're left to figure the nuts and bolts of that, when they have more pressing issues requiring their attention."

As part of that blind spot, emerging GPs might also underestimate the work involved in servicing the management company. "A lot of the time, management company accounting isn't top of mind until tax season arrives," says Luis Gutierrez, a managing director at Gen II Fund Services. "And then it's a scramble to get all the financials together in time. That last-minute effort might work at first, but as the firm grows in size and complexity, the management company can't be an afterthought."

Gutierrez also notes that given the current regulatory climate, expenses warrant real attention. "New managers who wait until the end of the year to tackle their expenses might be in for a rude awakening as they realize that this or that item can't be charged to the fund, so while the GP assumed the management company was only fronting the money for fund expenses, they'll actually have to eat those costs."

But with that service provider on hand, no such nasty surprises arrive. Broader compliance matters also argue that small, new teams would be best tapping outside help. "Nowadays, no GP can afford to slip up on compliance issues, but every time a partner is wondering if they can credit this or debit that, that activity runs up against a regulation. That's time and attention taken away from their core business," says Dautanya Strachan, a director at Gen II Fund Services.

Some new managers won't have to bother deciding whether to outsource or not. "More and more emerging GPs are tapping anchor investors to serve as the foundation of their first fundraising drives, and those investors are demanding that the GP brings aboard an administrator," says Bruno. This might be the strongest evidence that service providers have convinced the industry of their value.

Larger, more established players who might have handled their management company activities in-house will often find the workload too much as they reach certain levels of size and complexity. "For larger, veteran firms, it's about pain points," says Bruno. "Maybe they're spending too much time managing staff and wrestling with accounting processes when they should be servicing the business." So, that GP decides to outsource their management company as well.

Most frequently, GPs will outsource the management company administration to the same firm that they outsource their fund administration. "They see the benefit of having the administration of both the funds and the management company in the same platform," says Gutierrez. "At Gen II, the management company servicers are in constant contact with the team servicing the funds so we're always on the same page."

This says nothing of the value of sharing the same technological solutions for both. Onboarding remains the biggest pain point of outsourcing, and it's a major undertaking for funds with the long histories of data to upload, although service providers do all they can to minimize that burden.

Yet, even as these administrators are eager to take more and more off their clients' plate, there's no avoiding the fact that the buck still needs to stop with the GP. This means that there needs to be an internal liaison with the service provider. That may be one of the partners for the first few funds, and then shift to an in-house CFO or controller. "The founders are busy investing, as they should be, but there still needs to be a point person, even if they don't have an accounting background," says Gutierrez. "Our best relationships are where we educate the client about our work, and the client educates us about their work and needs."

> *"As the firm grows in size and complexity, the management company can't be an afterthought"*
>
> **LUIS GUTIERREZ**
> **Gen II Fund Services**

Rising to the challenge

Eventually, GPs may grow out of relying exclusively on their service providers. "Our clients should view our services as the base on which they build their financial function allowing them to focus on hiring the strategic financial roles – a CFO or controller," says Bruno. "The value we bring here is the higher-level hire can join and focus on thinking strategically about the business because we are handling the day-to-day financial operations of the management company."

One of the most common selling points for industry outsourcing is making sure that senior staff gets to focus on matters that only senior staff can tackle.

This is not to say that service providers don't have their own ambitions. Bruno stressed that given the depth and breadth of their experience with so many different GPs of so many sizes and vintages, they can offer higher-level counsel as well. "From what we see, we can be of tremendous help in sharing various industry benchmarks, such as profitability metrics, and even suggesting other vendors for needs not addressed by us, and that's simply because of the everyday expertise and experience of serving our clients," says Bruno.

No one can be surprised that administrators would eventually aspire to more sophisticated services, as the overall culture of private markets is one devoted to growth and innovation. And in a climate that demands GPs up their game, service providers have little choice but to rise to the challenges of the day. ■

KEYNOTE INTERVIEW

Meet the administrators

The fund administration industry has clearly grown radically in size and sophistication. Gen II's Luis Gutierrez and Dautanya Strachan describe what the era's been like in the trenches and where it might evolve from here

Countless surveys and research reports have shown that outsourcing fund administration is a widely accepted practice, and in many scenarios, even encouraged by LPs. No GP is pining for the days when they had to do it all in-house, and it's a testament to the fine work of service providers that their value proposition was so clear, and so hard to resist. From a distance, fund administration might even look easy.

But a closer look finds those service providers wrestling with the human capital and technology issues, juggling competing LP requests and a myriad of compliance changes. Any internal finance staff that had to handle their funds and management company all by themselves will attest to the burden involved. Still, as outsourcing becomes standard operating procedure, it will be easier for managers to discount the trouble they are keeping off their desk by outsourcing.

So we decided to take the time to check in with two professionals who are doing that work right now: Gen II's managing directors Luis Gutierrez and Dautanya Strachan. They are currently focused on driving the firm's effort in administering to management companies, but their experiences say a lot about how the industry has changed and where it might be going from here. It's also an excellent reminder that outsourcing administration, for all the technology involved, is still a process managed by actual people. For now, anyway.

Q How did both of you land at Gen II? What was your professional experience before?

Luis Gutierrez: I started my accounting career during college at an advertising talent payment agency, where we paid talent for commercials and other similar projects. So I was kind of a junior accountant already while going to

school. I didn't go the traditional audit route.

A lot of recruiters from the Big Four firms at the time come into colleges, and my time working as an accountant allowed me to have more sophisticated conversations with those firms and learn about paths that don't run though audits.

And so after I graduated I joined the financial services division of AIG. And it's there that I got my first taste of management company accounting, which has honestly been the focus of my entire career. This position was an incredible learning experience where I was able to see the full suite of activities, the chart of accounts, trial balances and such. And I was there for roughly five years, which included seeing the company through the challenges of the global financial crisis.

From there I moved on to serve as a corporate accountant for an investment manager called VanEck. That was my first direct experience with fund administration, although it was for mutual fund ETFs, not private equity. But it also exposed me to service providers like the State Streets and SS&Cs of the world. Still, it was a position that kept me learning and executing on management company accounting.

When the opportunity from Gen II came along, I hesitated. I'd not heard of the firm, and only heard of private equity in passing. I argued that I only had management company accounting experience but thought it might be time for something new.

Then in the interview I learned it was to help in the management companies of PE firms, and everything fell into place. Now I'd be able to serve clients, as opposed to staying in that back office for a single enterprise. And working with my clients has made the last six and a half years the most rewarding of my career.

My background ended up serving me well, even if I'd never read an investment management company document for private equity before. In the mutual fund world, funds close every day, instead of every quarter or month, so the pace is so much more hectic. But private equity keeps me on my toes in any number of other ways, and leading a team through the pandemic has helped me grow in countless ways.

Dautanya Strachan: I developed an interest in accounting when I was first introduced to the fundamentals of the subject in high school. I studied accounting in college and worked as an accounting tutor, which helped me to stay in touch with the fundamentals while helping my fellow students.

I landed a role in the field of accounting right out of college in the aviation industry working for a leading global provider of outsourced aircraft and aviation operating services. I moved into the retirement asset management industry working for a provider of retirement plan and fiduciary outsourcing solutions.

These roles provided me with hands-on experience in corporate accounting and financial reporting, and ultimately prepared me for my new life in private equity management company accounting.

I started at Gen II as a senior accountant. Gen II's growth to becoming the largest independent private equity fund administrator provided opportunities for my own growth to advance to my current role as managing director.

Q In your experience, how has management company administration evolved over your tenure?

DS: CFOs want to be much closer to their data. They want to get a real play by play of activities to know the financial position of the business at any given period. Private equity CFOs are tightly managing and monitoring their cash. We see more management companies accepting third-party investors, which creates new reporting requirements and often sparks more auditory requirements for the management company.

Q Technology is becoming a bigger part of everything we do, from accounting to screenwriting, so I have to ask, does that diminish or increase the need for skilled, highly responsive client services?

LG: There is no doubt that I'm spending a great deal of my time exploring the most cutting-edge technologies to automate everything we can. I tell my team, we can't afford to fall behind, or wait for 10 clients to show up on a single day to be aggressive in using tech to manage our workload. But in the same breath, I know cultivating close, open relationships with all our clients is an equal priority.

Let me give you an example. I had a flight canceled this summer, at midnight the night before it's due to take off. So I hop on the service line trying to find out what's happening and noticing all these other flights are getting canceled as well. Can I even find another flight? And who am I talking to at 1am? A chatbot. That only added to the stress, when a live person could have walked me through my options and left me prepared to find that plan B or C.

So much of our job is ensuring that for our clients, there is a human voice on that line. Think about it. The more we rely on our tech solutions, the less equipped we are when they falter. That's when a human being can step in and help give context for the situation and devise alternatives.

I can't tell you what the next big leap in AI or machine learning will be, but it's certainly going to still take a real person, who went to college, and is trying to get a flight, to step in, pick up the phone when it rings and apply everything they learned to fixing that problem. That's our job. And that's why we've enjoyed the success we've had so far. ■

Company Overview

Gen II Fund Services, LLC is the largest independent, U.S. based, private equity fund administrator, administering over $1T+ of private capital. The Gen II team is the longest-tenured, most experienced team in the fund administration industry. Our senior management team has more than 30 years of experience and are recognized as leaders in private equity fund administration. Our dedicated client service teams, led by a Principal with an average of 15 years of fund administration experience, provide our clients with world class service and expert guidance.

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Steven Alecia
President

Founded 2009

Well-run funds.

Gen II

Gen II is the largest private equity fund administrator in the United States by AUA.

source: Convergence

Administering
$1T+
Private Fund Capital

Client Retention
99%

30+YRS
Fund Administration Experience

Transitioned
200+
From Inhouse or Other Administrator

Reporting to
50,000+
Investors for Our Clients

Servicing
8,000+
Fund Entities

Boston | Dallas | Denver
New York | San Francisco | Stamford
Luxembourg | Vancouver

Gen II | Well-run funds.

Q&A

For firms outsourcing the administration of both funds and management companies, it's best to use one provider and build strong internal resources to manage the process, according to Knox Lane CFO Ivor van Esch

Q Knox Lane is a relatively new firm. When did you join the team?

A I joined as head of finance in 2021, but Knox Lane had begun raising its first fund in 2019 with a team that had worked together for quite a long time at TPG Growth and its portfolio companies.

That debut fund closed at $610 million, with a focus on mid-market buyout investments in the consumer and services sectors. By 2022, I was made chief finance and compliance officer, my current role.

Q Was the firm already outsourcing its management company?

A We were. The firm previously had one service provider responsible for management company administration and another for fund administration.

I soon realized, we might gain some real efficiencies if we used one service provider for both, so after a diligence process, we decided to transfer the management company finance work to Gen II, the firm that was handling our fund administration.

> *"It's vital to have a system that can evolve with industry's demands"*

Q How was the onboarding process around moving the management company activities to Gen II?

A I have to say it was fairly smooth. We intentionally took a longer approach to transitioning, by having both firms still operate together and slowly transitioning the pieces over to the new Gen II team. The accounting system integration was probably the most cumbersome part of the process, but it was critical to get it right. I'd say it took us three to four months to complete, so basically a quarter. We simply didn't want to risk any errors around historical records, mapping accounts and the systems involved.

Q Do you have advice for your peers as they look at outsourcing their management company?

A We've found this approach to work very well, especially given the new regulatory requirements from the US Securities and Exchange Commission. There's just so much work to be done that we're being very proactive in developing the process to make sure we're ready when we need to be. Given the workload, outsourcing makes a lot of sense.

I'd be sensitive to team turnover at service providers because this model works best when it's the same staff who know our needs and our individual processes. And I'd take a good hard look at the technological capabilities of that administrator. It's vital to have a system that can evolve with industry's demands. Six months ago, I added a new internal hire to be the key liaison with Gen II, because as much as they do for us, we still need to supervise that work and are responsible to our stakeholders for the data we deliver. ■

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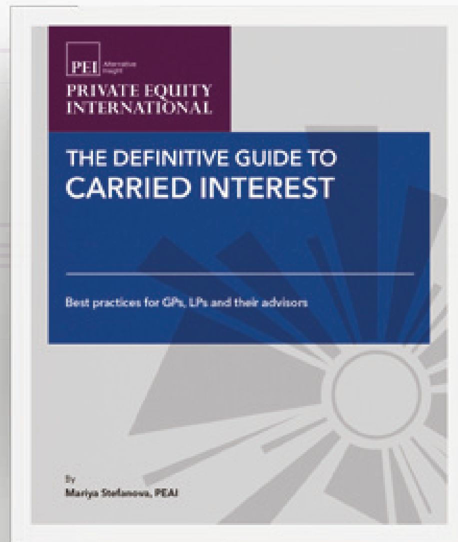

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