Keys to Success with a Third-Party Private Equity Fund Administrator

BY RIVKAH LEWIN

Whether you run a private equity fund or want to start one, you have a lot on your plate—evaluating investments, buying and selling holdings, raising capital, etc. A third-party private equity fund administrator, or "outsourcing firm," can help with the gamut of back-office tasks. If you like to keep an eye on every detail, outsourcing may not be for you. But if freeing up your time for what you do best—managing the fund and nurturing relationships with your investors—appeals to you, hiring an outsourcer might fit the bill.

Is it advantageous for you to engage a third-party fund administrator when you could recruit those positions in-house and watch over them? Bear in mind that if you hire one full-time person for 2,000 hours, he or she is limited to his/her area of expertise. With an outsourcing firm, the cost of those same 2,000 hours might pay for an accountant for 500 hours, a bookkeeper for 500 hours, a controller, and other roles to service your fund.

If you're a new fund, do you want to build a back-office infrastructure? That requires hiring, training, monitoring, and retaining staff, including vacation coverage. You'll also need to invest in technology to get your reports out on a timely basis.

For a budding fund, an advantage of hiring an outsourcer from the outset is that they'll have all your books and records and the history of your fund. Your information will be in their technology platform, and the communications and reporting to limited partners should be done consistently all along.

An existing private equity fund, on the other hand, may experience disruptions as it transitions its current back-office functions to an outsourcer. The fund may have to lay people off and introduce different systems that may initially confuse limited partners.

Avoiding Layoffs and Disruptions

To avoid such commotion, a unique arrangement was recently forged when HM Capital Partners, a Dallas-based investment management firm focusing on private equity, engaged JPMorgan Private Equity Fund Services (JPM PEFS) to administer its portfolio of more than $10 billion in committed capital. Calling the arrangement a "landmark transaction," Robert Caporale, head of JPM PEFS, explained that, in January, his firm hired five back-office employees directly from HM Capital, so "these staff people didn't have to be laid off. They became JPMorgan employees."

Those employees are now paid by JPM PEFS. Over time, they'll transition the HM Capital funds to JPM PEFS's technology platform and work at JPM PEFS's offices. This unique "lift-out" structure wasn't disruptive to HM Capital and was advantageous to JPM PEFS since the five staff members were knowledgeable about their funds and about private equity administration in general.

An Array of Financial Services for Funds

Outsourcing firms provide back-office services for a wide variety of funds. For example, Clark, N.J.-based Northport, Inc., a private equity outsourcing firm, administers funds of "funds, secondary funds, mezzanine funds, real estate funds, venture capital funds, and leveraged buyout funds," says Nancy Farese, managing member.

Discuss your requirements with the principals to make sure they can fulfill them. Outsourcers provide accounting and reporting, maintain the books and records, track historical transaction detail, compute the P&L, do distributions in accordance with fund agreements, and prepare IRR, investor reports, and other internal management reports.

Outsourcers may coordinate the year-end audits with auditors and prepare quarterly and annual financial reports with footnotes, account detail statements, and the remaining commitment schedules. They service investors and coordinate the capital call process, including a fund's distribution of capital call notices and monitoring the receipt of monies. They coordinate distribution of cash and securities to investors and will respond to investor inquiries.

Outsourcers prepare tax filings, including the annual partnership returns and K-1s. They do year-end tax estimates for partners and periodic estimates of income and distributions throughout the year, as well as W-8, W-9, and 83(b) compliance. They may also calculate IRS amounts to withhold for foreign partners and answer general tax questions for fund managers and investors.

"We offer comprehensive fund administration, tax planning, and advisory services, including optimizing your fund's structure for tax purposes," says Marcia Cohen, managing director of Geller & Company, a New York City-based financial services outsourcer. "All our reports are available over a Web-based reporting system, so both fund investors and our clients have access to financial information via the Web, e-mail, PDF, or hard copy."

Ask the Hard Questions

What steps should you take to ensure that you get the best outsourcing firm for your needs? Here are some important items to research when deciding on a firm:

- What are the firm's assets under management? How many funds does it administer, how many clients does it have, and how long has it been in business?
- Meet the specific people who would work on your fund. Assess their experience and abilities to make sure they can deliver what you require. Make sure you'd feel comfortable communicating and working with them.
- Find out about turnover. If a key person assigned to your fund had to leave suddenly, would the absence affect the workings of your fund?
- How many clients has the firm gained and lost over the past few years? Why?
- How does the firm manage the workflow during peak quarterly and annual periods when more work needs to be done?
- Does the firm have enough staff and the ability to take on a new fund?
- What size clients does the firm currently serve? If your fund is larger, make sure that the firm can serve a fund of its size, with its unique needs and delivery requirements. If you're a smaller client, ask if you're too small for them. Will your fund get lost in the shuffle?

Ask for client references, and interview them to find out:

- Is turnover at the outsourcing firm an issue? If so, was the transition disruptive to them, or was it essentially seamless?
- Are they getting their reports on a timely basis? Is the communication working? Are they happy with the staff people? Why or why not?

Ask auditors of the firm about the level of professionalism they see and if the audits go smoothly.

Fees vary widely, so investigate fee agreements. Some firms ask potential clients a standard set of questions to tailor a contract especially for them. They may ask about your fund's metrics, its various requirements and reporting needs, and whether you want Web access for your limited partners. The firm may offer you a multiple-year agreement, and they may hold fees constant for a stated period of time.

Is the fee based on time spent? When the firm discusses its fees with you, you can negotiate, stating that, for example, "We will provide you with items A, B, and C. We expect that these deliverables won't take 10 hours to do; it should take more like five hours."

Help the Outsourcer Serve You

Communication is key to a successful relationship. Be available to talk or meet whenever the outsourcing firm has a need, or assign a point person to do so. Some funds set up a "client communication plan" in advance to proactively discuss the fund. For example, the plan may schedule daily, weekly, or monthly conference calls or weekly conference calls and monthly meetings.

Outline your goals and expectations of the tasks that both the outsourcing firm and you will perform. Set deadlines, and share them with the firm. For example, "Fifteen days after the end of every quarter, I want you to deliver to me a general ledger package that includes the following

continued on next page

[TRENDS] *cont'd from p. 60*

schedules....” Also, send the paperwork and details of your transactions to the outsourcing firm often so they can record your fund's activity. Receiving the data on a timely basis will allow them to administer your fund optimally.

Whether your private equity fund is established or in the planning stages, knowing how to do your due diligence and continually providing what's needed from you will increase your chances of success with a third-party fund administrator. ■