Making the Switch

WHY GENERAL PARTNERS ARE RETHINKING THEIR NEEDS AND REPLACING THEIR FUND ADMINISTRATORS
Fund Administrators Under Pressure

A growing number of General Partners are turning to outsourced fund administration to manage the burden on their back office. But the number of General Partners who are dissatisfied with their current fund administrator relationship and are switching providers is also on the rise. What are the issues, and how can they be avoided the second time around?

The trend towards outsourcing fund administration is on the rise. According to a 2015 eVestment survey of alternative fund administrators, global assets under administration (AUA) grew at a double-digit rate in 2014, increasing from $5.873 trillion to $6.862 trillion.¹ And that growth was predicted to accelerate in the coming years. A 2014 survey of private equity and real estate managers who currently insource found that one in four were planning to outsource at least one back-office function in the next 12 to 24 months.² And while 30% of private equity fund administration was outsourced as of 2016, that figure is predicted to rise to 50% by 2018.³

Clearly, General Partners recognize that outsourcing this back-office function has the potential to help the firm meet regulatory challenges, deliver better service to investors, and gain more time to focus on high-value activities. However, it’s equally clear that not all General Partners are seeing the full complement of benefits from this outsourcing arrangement. In fact, many fund managers are dissatisfied enough with their fund administrator that they are choosing to end the relationship and seek out a new service partner.

According to a Preqin study conducted in 2016, 36% of fund managers had switched fund administrators in the previous 12 months.⁴ While a certain amount of turnover is inevitable, the rate of change was higher for fund administrators than for any other private capital service provider examined, including placement agents, fund auditors, and law firms.

What is the story behind the numbers? Why are so many of these relationships breaking down as fund managers seek out new arrangements?

This white paper looks at some of the key areas of dissatisfaction and examines the ways in which General Partners can make a more informed, successful choice the second time around. The paper also includes two useful tools for firms that are considering making the switch: transition guidelines for smoothing the transition from one fund administrator to another, and an evaluation checklist to help fund managers evaluate prospective fund administration partners.

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New Era, New Expectations

In an era of increased regulatory scrutiny, sophisticated investors, and narrowing margins, General Partners are turning to their fund administrators for solutions. But while some are rising to the challenge, others are falling short.

From mega-buyouts to Dodd Frank to ILPA guidelines to the credit crunch, the private capital market has undergone extraordinary change over the past decade. As part of the strategy to proactively manage that change, many General Partners chose to outsource the administration of their funds to professionals. By placing this function in the hands of a fund administrator, they expected to improve compliance, strengthen investor trust, and streamline back-office operations.

While in many cases the relationship has fulfilled the expectation, in others the reality has failed to live up to the expectation.

What motivates General Partners to seek out a new fund administrator? It comes down to four key factors: service quality, portfolio complexity, regulatory requirements, and cost.

27% SWITCH PROVIDERS BECAUSE OF ISSUES WITH SERVICE QUALITY

Dissatisfaction with service quality was the top reason for switching to a different fund administrator, with 27% of Preqin survey respondents citing this as the main reason behind the switch. Increased regulatory requirements have driven up the cost of operations, and General Partners are looking to their service partners to find innovative ways to achieve greater efficiency and deliver more value. When those partners can't deliver, it's triggering a search for a new provider that can.

While levels of service to the CFO and their back office are key, fund managers also rely on the fund administrator to meet the reporting needs of their investors. As investors' levels of sophistication have increased, so have their reporting requirements, and some fund administrators have not been able to keep pace. Investors expect detailed, customized, and, more frequently, ILPA-compliant reporting for fees and expenses, capital statements and notices, and quarterly reports. And they expect the information to be delivered sooner and to be accessible 24/7.

CONSIDERING A SWITCH BECAUSE OF SERVICE QUALITY ISSUES?

If your firm is dissatisfied with service levels and plans to find a more service oriented fund administrator, make sure you ask the right questions the second time around.

It’s important that your fund administrator be an effective partner with your internal team. Your day-to-day contacts should have experience working with firms similar to yours in structure, strategy, and reporting requirements.

Look for fund administrators that offer formal service-level agreements (SLAs) and are willing to customize your SLA to meet any specific requirements that you or your investors may have. It’s a best practice to have your fund administrator schedule status calls weekly, or every two weeks at minimum, so look for an SLA that covers regular meetings.

If you need to improve levels of service to your investors, look for a fund administrator that, regardless of size, offers investor services and ancillary reporting for Limited Partners, and one that manages and administers an investor portal on your behalf.

It’s also important to ensure that the fund administrator is SSAE 18 SOC 1 Type 2 certified on an annual basis. The SOC 1, Type 2 audit includes a rigorous analysis of the service organization's processes, systems, and internal controls, and an evaluation of those controls to ensure they are designed to achieve the control objectives and that they operate effectively. The audit also examines the firm's automated and manual processes, related accounting records, the financial reporting process used to prepare financial statements, and information technology systems.

If personalized service is a priority, consider a boutique service provider that is able to provide a deeper level of customization, more direct access to senior-level expertise, and a dedicated, single-point-of-access account manager supported by a wider team.

23% SWITCH PROVIDERS BECAUSE OF ISSUES WITH PORTFOLIO COMPLEXITY

Fund complexity is also a key reason for General Partners to switch fund administrators: according to Preqin, 23% of General Partners cited this as a factor. Many fund administrators are capable of handling relatively simple service requests. However, when complexity increases, the need for a dedicated and experienced team becomes more pronounced.

4 KEY SERVICE BENCHMARKS

When evaluating fund administrators, ensure that they are prepared to meet the following benchmarks:

- **Capital-call processing**: within 48 hours of notification and receipt of required information
- **Distribution processing**: within 48–72 hours of notification and receipt of required information
- **Closing the books**: within 5–15 days of the close of the reporting period (pending valuation adjustments)
- **Financial statement and investor capital statement preparation**: within 30–40 days of quarter end if your reporting deadline to your investors is 45 days after quarter end

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fund strategies, but as a fund manager expands into other, more complex fund strategies, such as private debt/credit or real estate, not every fund administrator has the resources and expertise to develop and maintain the structures required to service these complex fund types. If the fund manager wishes to take advantage of the financial incentives available to SBIC funds, the need for advanced and specialized expertise becomes even more critical.

**CONSIDERING A SWITCH BECAUSE OF PORTFOLIO COMPLEXITY?**

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

**23% SWITCH PROVIDERS BECAUSE OF ISSUES WITH REGULATIONS**

Regulatory pressures loom large for everyone involved in the private capital markets. In a 2017 survey of the global asset management community, nearly a quarter (24.2%) of respondents believed that political and policy (regulatory) changes are the primary disruptive forces in asset management over the next three years, and 50% of respondents identified keeping up with the myriad of changes to global regulation as their top current concern.\(^7\)

Similarly, a 2016 survey of fund administrators found that 51% believe that keeping up with regulations will be the most impactful trend leading into 2020.\(^8\) However, 23% of General Partners are motivated to switch fund administrators because of concerns over regulatory compliance.\(^9\) This suggests that many fund administrators are failing to provide adequate support and leadership in this area.

51% of fund administrators believe that keeping up with regulations will be the most impactful trend leading into 2020.

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7 Linedata, Global Asset Management & Administration Survey 2017 Drivers and Disruptors.
CONSIDERING A SWITCH BECAUSE OF REGULATORY CONCERNS?

If your firm has difficulty meeting regulatory requirements, or if you are not convinced that your fund administrator is doing an adequate job of ensuring compliance, look for the practices and capabilities that signal expertise in this area.

Seek out fund administrators that support ILPA reporting practices. Since its founding in 2002, the Institutional Limited Partners Association has helped General Partners align their reporting and communications to Limited Partners with industry best practices and regulatory requirements, but not every fund administrator is set up to support ILPA guidelines.

In addition to ILPA reporting, look for a service partner with the right expertise on staff. To provide competent support on regulatory issues, your fund administration team should include people who have held senior roles in finance, audit, and accounting environments.

As the industry continues to mature, as regulatory requirements place a bigger burden on the back office, and as Limited Partners demand more time-intensive reporting and communications, General Partners are seeing their margins squeezed. As a result, managing costs has become nearly as important as creating value and generating returns. According to Preqin, 23% of General Partners switched fund administrators because of concerns about cost.\(^\text{10}\)

However, most fund managers recognize that finding the cheapest fund administration partner is not the solution. In the 2014 PwC Alternative Administration Survey, 39% of respondents indicated that when selecting administrators, service levels were the most important factor in their decision-making process, while only 26% indicated that price was the most important factor.\(^\text{11}\)

The concerns over cost likely have more to do with the perception of value for the money, with some General Partners failing to see enough value in the services provided. In these cases, the General Partner is likely to choose one of two courses of action: treat fund administration as a commodity service and find a new service partner that can deliver similar service for less, or seek a fund administrator that is capable of delivering value-added services for a similar fee.

\(^{10}\) Preqin Special Report: Private Capital Service Providers, 2017.

\(^{11}\) PwC, Alternative Administration Survey, 2014.
CONSIDERING A SWITCH BECAUSE OF CONCERNS ABOUT COST?

If your firm is concerned about paying too much for the services received, look at your existing fee structure. Does your current service provider base their pricing on the total AUM to be administered? This fee structure can result in costs that exceed the value of the services rendered, particularly when the AUM are primarily in an easy-to-administer fund strategy.

Instead, look for a fund administrator who calculates their fees based on the amount of work required. Basing costs on considerations such as the number of capital calls and distributions processed, complexity of the portfolio and volume of transactions and the complexity of the required reporting ensures that your firm sees tangible value for the fees paid.

You can also ensure value by choosing a fund administrator that can customize the service proposal to your needs by eliminating unnecessary services and either replacing them with any additional services required or reducing the overall cost of service.

You may also wish to evaluate potential new partners based on their ability to support your firm’s high-value or mission-critical activities. A 2016 survey indicated that 39% of fund administrators believe that the need to offer value-added services will be the most impactful trend leading into 2020.12

For example, a fund administrator that can deliver secure reporting directly to the investor using an investor portal and field questions from investors can help your firm strengthen its reputation while giving your back office more time to focus on strategic endeavors. Service partners that offer services beyond basic fund administration can also deliver more value for the money. Examples of these value-added services include AML/KYC investor services, wind-down or end-of-life fund services, guidance on navigating investor situations that happen over the life of the fund, and other areas requiring complex analysis.

23% switch providers because of issues with cost.

The Tech Factor

While proven processes, expertise, and fair pricing structures are key elements of a successful partnership with a fund administrator, technology is the elephant in the room. Without an ongoing investment in technology, no fund administrator, no matter how seasoned and competent, can support their clients effectively.

With the right technology, fund administrators can manage costs by automating key elements of the process, improve compliance by enhancing transparency, and improve service levels to both the firm’s back office and their investors by maintaining secure, self-service information portals that meet the need for fresh, accessible data and documentation.

In addition, fund administrators with advanced technology platforms are able to migrate your historical data into their applications using automated processes, making the transition to a new fund administrator a smoother, more efficient process. This historical data must be migrated seamlessly to enable the firm to report IRRs and other metrics.

However, technology adoption is uneven among fund administrators. While some have embraced automation and online portals, others continue to rely on manual processes. According to “A 2020 Vision of Fund Administration,” a survey of 57 global fund operations executives, 40% of fund administrators anticipate significant changes to their systems and technology between now and 2020 in order to cope with regulatory demands. Yet a full 27% currently have no data analysis tools in place.

General Partners need to bring greater rigor to the task of evaluating the technological capabilities of their service partners so that they can choose a partner that invests in the technology platforms and proficiencies that help fund managers gain a competitive edge. This includes ensuring that the fund administrator has a formal business continuity and disaster recovery plan in place that enables them to minimize service interruptions in the event of a disaster or a technology breach.

If you plan to switch fund administrators, conduct a detailed technology demo as part of the evaluation process. Look for ease of use, ensure that all required data points are available, and make sure that the data is accessible in a format that fits the way your firm works, whether that’s an online portal, an Excel export, or some other method.

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**THE RIGHT TECHNOLOGY ENABLES:**

- Enhanced transparency
- Improved service levels
- Advanced analytics
- Greater efficiency
- Lower costs

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Smoothing the Transition

Change is never easy, but when the General Partner and fund administrator follow best practices for the transition, the potential for disruption and downtime can be minimized or even eliminated.

Apprehension about transitioning from one fund administrator to another can cause General Partners to delay the process, even when the current solution is clearly not working. But a well-planned and detailed transition can ease the migration and ensure that back-office processes and investor services experience minimal disruption.

These checklists for General Partners and their fund administrators are designed to smooth the transition and address some of the most common onboarding issues.

### YOUR ONBOARDING CHECKLIST

**Ensure you do this:**

- Review the service-level agreement (SLA) and provide any feedback and changes.
- Organize all records and convert them from paper to electronic format.
- Consider the need for backfilling historical documents such as K-1s, capital statements, call/distribution notices, financial statements, etc.
- Consider backfilling inception-to-date vs. year-to-date information, including ITD investor and investment cash flows for IRR calculations.
- Consider having your current fund administrator maintain shadow records for up to one quarter or at least a month to address any potential lag in record-keeping during the transition period.
- Review migrated data to ensure accuracy and completeness.
- Familiarize yourself with the fund administrator’s reporting format.

### SERVICE PARTNER ONBOARDING CHECKLIST

**Ensure your fund administrator does this:**

- Prepare a service-level agreement that details responsibilities, timelines, and required documentation for each service.
- Develop an implementation timeline that includes ample time for preparation, review, and approval steps.
- Review all documents and confirm understanding of all pertinent provisions (allocations, waterfall, allowable expenses, cap call provision, reporting timelines, etc.).
- Use Excel-based migration templates that are flexible and migrate data efficiently.
- Perform data validation during migration to avoid “garbage in, garbage out” quality issues.
- Transition all data and documentation to the new system, including setup of allocations and waterfall distributions.
- Conduct weekly calls or meetings to discuss the transition and troubleshoot issues proactively.
Making the Switch

As outsourced fund administration matures as a service offering, General Partners have more options to choose from, and a better chance of finding the perfect service partner.

The trend towards outsourced fund administration is on the rise, but so are the expectations among General Partners who are increasingly reluctant to compromise on service quality, expertise, or value. Those that are in the process of rethinking their options and exploring new options are doing so at the perfect time. Fund administration has entered a "golden age" as the service category matures and supports a wider selection of more sophisticated service providers. Today, it's possible to find examples of both boutique and enterprise fund administrators who offer deeper levels of expertise, better technology, and more streamlined, rigorous processes to support their clients.

The information in this guide is intended to identify the new benchmarks for fund administration services and support your search for a partner capable of meeting your firm's administration, compliance, and reporting requirements. The checklist on the following page includes a list of questions and considerations to help you evaluate potential service providers more thoroughly and ensure that the providers under consideration have the experience, infrastructure, and technology to deliver optimal service.

For more information and insights into fund administration, visit the PEF Services Thought Leadership section (pefservices.com/thought-leadership).

ABOUT PEF
Since 2002, PEF has helped some of the most complex fund types meet stringent regulatory and investor requirements. We are nationally recognized as one of the top boutique fund administrators and back-office specialists for General Partners, Limited Partners, and management companies in the alternative asset space.
FUND ADMINISTRATION

Evaluation Checklist

This list of questions can help your firm collect the information you need to ensure that your next fund administration partner is capable of meeting your needs and supporting the engagement with the right technology.

SERVICE

☐ Do you have a System and Organization Controls (SOC) 1, Type 2 exam performed on an annual basis?

☐ What is your Net Promoter Score (NPS) and/or customer satisfaction level?

☐ What's the average length of time that your clients stay with you?

☐ Which fund types do you support [debt/credit, SBIC, buyout, venture, real estate, fund of funds, etc.]? Please specify.

☐ Do you have clients in the same fund strategy as my firm? Can I speak to them?

☐ Do you offer value-added services such as AML/KYC, management company bookkeeping, startup consulting, wind-down consulting, books and reports for GPs, and tax support?

☐ Do you attend annual meetings for clients?

☐ Do you respond to investor DDQs?

☐ What is the average turnover rate among client service personnel at your firm?

☐ How many people will be assigned to my account and what is their background/level of experience?

☐ How is coverage and service continuity addressed when team members take time off?

☐ Do you have a discovery process for determining the service levels required by the client?

☐ Do you have a documented onboarding process for new clients?

☐ Do you have a documented Service Level Agreement (SLA)?

☐ On average, how frequently do you communicate with your clients?

REPORTING

☐ Is the reporting you offer standard, or can it be customized?

☐ Do you support ILPA reporting?

☐ Do you provide a portal where investors can access reports and documentation 24/7? Is the reporting customizable?

COST

☐ Do you structure your fees based on assets under administration (AUA) or fund complexity and work required?

☐ Do you charge a fixed fee or variable fee, and are there any incremental or hidden costs associated with your services?

☐ What is the cost for onboarding and migrating our historical data?
FUND ADMINISTRATION

Evaluation Checklist

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TECHNOLOGY

☐ What accounting platform do you use?

☐ How would you migrate my historical data (including static and transactional data for investors, investments, and other accounting transactions) onto your systems?

☐ Is the accounting platform integrated with all processes and systems? If not, what processes are manual? What information is maintained outside of the core system in spreadsheets and other formats?

☐ How do you ensure data security?

☐ Do you maintain an online portal for Limited Partner reporting and communications?

☐ Do you provide a CFO portal that provides access to financial data at all times?

☐ Which technologies are your Limited Partner and CFO portals built on?

☐ How do you ensure platform performance?

☐ What type of technical support do you offer to support your technology platform?

☐ What types of business continuity precautions do you have in place?

☐ Do you have a documented disaster recovery process in place?

☐ Does your platform include a production site, multiple redundant sites, and automatic daily backups?

☐ Do you manage and maintain your technology with an in-house IT team?