

Will IT be one of the biggest hot topics for the private equity and real estate industry in the years to come?

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This article focuses on the IT requirements of asset managers and service providers in the private equity and real estate sectors and appropriate business solutions, taking into account market practice, regulations and legislation, as well as reporting standards—which have already been covered elsewhere in this magazine. It also takes a closer look at the industry challenges from an IT perspective and potential opportunities for software developers and other market players.



The wind of change impacting private equity and real estate

The Private Equity (PE) and Real Estate (RE) sectors, and more generally, the alternative funds market, are now caught in the regulatory spotlight and have not escaped tighter scrutiny and pressures for transparency from regulators and investors alike. In a similar way to the global transformation of the retail fund industry in recent decades; new operating models covering the front/middle to back office operations of PE and RE asset managers and their service providers, have emerged—and these are not just necessary to adapt to current legal and industry guidelines, but are prime requisites for business viability, service marketability and expansion.

Major regulations that have triggered essential change in the asset management industry include the Dodd-Frank Act and FATCA in the United States, and Europe's AIFMD. Many PE and RE structuring vehicles and investment strategies need to make changes to comply with this new wave of laws, directives and their implementation requirements. Moreover, investor and industry standard-setting bodies such as the Institutional Limited Partners Association (ILPA), INREV,

EVCA and IPEV, are likewise influential in clamouring for industry reforms and standardisation of the highly fragmented, inadequately automated and vastly diversified PE and RE sectors.

An aggregated approach is the way forward for portfolio and risk management at GPs and asset managers

The technology supporting investment managers has generally evolved tremendously over the last decade, to offering holistic front to back solutions, mostly for traditional and regulated funds. More and more alternative asset classes are being supported, with geographic spread and local characteristics factored in. In the PE and RE spheres, portfolio and risk analytics and valuation modules are becoming a standard, while to a lesser extent, dedicated tools have been developed or enhanced to accommodate new market demands.

There is no doubt that IT infrastructure, comprising portfolio and risk management, as well as accounting and administration systems, is key to an asset management firm. PE and RE players are facing more and more challenges, which are hard to handle without advanced technology.

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The variety of applications and modules related to portfolio management, risk exposure evaluation, partnership accounting and data administration, deal flow management or due diligence support, require continuous enhancement to be able to cope with traditional PE and RE business requirements, such as deal sourcing, investment due diligence, investment selection and management or investor/partner relationship management, and more particularly, with regulatory and investor-driven reporting needs.

Some of the key issues and challenges in portfolio and risk management for GPs and PE/RE asset managers include:

- **Deal management:** investment pipeline tracking, term sheet reviews, due diligence and investment structuring
- **Fund raising and investor services:** CRM, investment terms, commitments handling and reporting
- **Portfolio analytics and management:** transaction handling, asset maintenance and record-keeping, accounting, revaluations, waterfall calculations, exits and liquidations
- **Risk management:** liquidity assessment, investment restrictions, portfolio concentration and exposure to investment type, geography or structures, leverage calculation and monitoring
- **Reporting:** financial, regulatory and investor specific reporting, which requires consistency of data and various granularity levels

A lot of the time, asset managers struggle to keep up to speed with their obligations and choose the right tools or service providers. These firms have to

manage integration issues, due to legacy systems, and new software implementation offering additional functionalities such as exposure and portfolio return calculations, deal flow management, consolidation of reporting and investor communication. Fragmentation of systems and a lack of interconnectivity, as well as big data related to investment deal opportunities, evaluation and structuring, are taking their toll on the process, adding operational complexity and the need for manual handling of information flows and reporting production, which increases the risks and costs of production.

The increase of systems used, pose additional issues for PE and RE asset managers and GPs, and these relate to the compatibility of data used to evaluate an investment and the differences that often arise due to variations in calculation methodology. For example, marketing teams, accounting and risk departments can obtain different values for the same investment, due to differences in the parameters of their respective systems and a lack of integrated data.

A consolidated and unified view provided in a GP or PE/RE investment firm's reporting to its internal stakeholders, regulators, shareholders and clients is key in order to reduce confusion and misinterpretation of data among the different parties. Many firms experience the negative effects caused by system reporting shortfalls, which mainly relate to additional reconciliation workload. Clarity of reporting is another important factor, especially in view of multi-layered PE and RE structures and their complex valuation methodology.

The specific characteristics of the asset class and the complexity of investment financing, structuring and management impose various challenges for the PE and RE industry especially in terms of reporting. However, these aspects offer software developers an opportunity to enhance their product offering. The urgency to address these needs has been confirmed by the large number of PE/RE asset managers, GPs and asset servicers looking for a comprehensive solution or set of solutions.

However, the platforms need to provide a high degree of flexibility in order to be compatible with the unique success factors of each PE or RE asset management firm and fulfill the reporting challenges e.g.:

- **Deal appraisals**
- **Completeness of portfolios**
- **Portfolio analytics and performance analysis:** tracking of multi-jurisdictional SPVs and subsidiaries, timely reports
- **Risk reporting:** exposure presentation, exceptions handling and escalations
- **Accessibility:** online and real-time reporting, content customisation

PE and RE asset servicers rising up to the challenge

With more GPs and PE and RE firms looking for outsourcing partners in the current business environment, the implications of new regulations has cascaded down to service providers, triggering operating model changes, IT upgrades and business process optimisation projects to accommodate clients' numerous and increasingly complex requirements, while also managing operational risks.

In a recent survey of the largest asset servicing entities in Luxembourg, we asked respondents about their main investments relating to PE and RE services. 'Technology' ranked second in terms of investment priorities for the majority of our respondents, while the top priority was 'staff development and recruitment', which reflects the Luxembourg market's growing interest in this business, following in the footsteps of the more established PE and RE markets in the United States and Europe. The growing number of service providers making technology one of their top business priorities reflects a generally observed global industry shift from manual or limited automation to more sophisticated and integrated systems for asset maintenance, accounting and reporting, much like the current service provider systems for the regulated investment fund industry.

Most PE and RE asset servicers, however, are currently using multiple (at least two) asset servicing systems, either vendor or in-house platforms or platforms



developed for certain activities, which are processed manually using MSExcel. This seems to be the norm—not just in Luxembourg, but across the global PE and RE asset servicing landscape. It also implies that at present, there is no single vendor solution in the market that is able to support the end-to-end processes and complexities of each PE and RE client.

Investor reporting by asset servicers

In the asset servicing value chain, one of the key requirements of asset managers or GPs is investor reporting. Service provider systems must be able to handle specific investor reporting needs ranging from technical requirements—layouts, file formats, and delivery methods either by post, email or web access, to data content such as investment positions, performance data, fee and income allocation, and tax related information. In the PE and RE industry, however, this is still largely performed on a tailor-made basis, as opposed to the more standardised investor reports for regulated retail funds such as UCITS. But with international standards such as INREV, IPEV, EVCA and ILPA increasingly being used by the industry, and with technology providers catching up with investor requirements, more standardised reporting will eventually be achievable.

The key IT-related challenges for PE/RE service providers can be grouped as follows:

- **Limited or costly PE/RE systems and PE/RE IT expertise:** there are very few platforms that cater to PE and RE, and thus are quite costly to acquire, implement and maintain. Developing an in-house platform can also be a massive and costly endeavour given the specific characteristics of PE/RE IT set-ups, which require both operational and industry expertise
- **Limited system flexibility for user-initiated changes:** in general, use of third-party developed platforms is covered by a software licensing fee arrangement between the technology provider and the service provider. Such arrangements usually include a standard number of users, pre-defined parameters and functionalities. Any user-initiated additions or modifications usually entail additional vendor fees. Other costs may include service fees for more intricate parameter set-ups, including carried interest, waterfall calculations, high volume cash flow monitoring, asset valuation, (re)financing and interest calculations or adjustments, customised reporting, consolidations, etc.

Data standardisation, transparency, frequency and completeness is key to success

- **Limited functionalities:** most asset servicing systems do not cover the entire PE/RE lifecycle. Additional modules, functionalities and extensive customisations are required but can be very complex, and vendor development or procurement costs can be exorbitant
- **Multi-system management and limited automation and interfaces:** where there is more than one system used and with limited system integration, service providers' IT team budgets and workload could be challenging to manage, given increased client requirements for fast and/or real time reporting

Opportunities and competition among service providers and technology providers

PE and RE service providers recognise that integrated, multi-functional, flexible and customisable systems are critical to their business requirements, which are aligned to client demands ranging from standard balance sheet, income statements and NAV reports, to customised portfolio and risk analytics supporting exception reports and escalations. In addition, clients are increasingly opting for online access to web portals for real-time or on-demand reporting on portfolios, cash flows, etc. Such reports are essential for asset managers or GPs to properly manage their investment fund portfolios, risks and liquidity in a timely manner. The ability of each provider to offer these business solutions using a robust platform is imperative for business expansion as well as client retention, given that systems are one of the key selection criteria for GPs and asset managers when scouting for asset servicing partners.

For PE and RE asset servicing, the competition is intensifying, with smaller vendors offering a vast array of market intelligence and analytical tools for accounting and financial reporting solutions joining the most recognised and dominant platforms catering to these sectors. The business and marketing models of technology providers have also evolved from the traditional practice of selling software under a perpetual licence with an upfront cost and ongoing support fees to the more sophisticated software as a service architecture, and data management and cloud computing services.

The intensifying business competition, along with extensive regulatory reporting requirements, has been a challenge (and an opportunity) for both asset servicers and PE and RE software vendors. Improved data quality and transparent and timely reporting are only a few of the many advances observed in the PE and RE spheres. With more rigorous regulation, more demanding investors and evolving best market practices, these challenges are not expected to ease anytime soon. However, this competition is welcomed by market players as pivotal and necessary for the continued development and overall progress of the industry.

Undoubtedly, technology has become the backbone of new or upgraded operating models at service providers. Having the right platforms is essential for asset servicers to enhance the appeal of their services and optimise their client servicing and delivery models. Some service providers have also acquired or developed tools for an expanded product offering beyond the more mature and traditional domiciliation, accounting, transfer agency and reporting services. They now encompass front office support and middle office functions that could yield higher margins and further commercial influence by having end-to-end, one-stop-shop business solutions.

Speaking the same language—integrated systems are key to efficient data management for PE/RE asset managers and service providers

The main concerns of asset management companies (similar to those of asset servicers) relate to the quality of data required for portfolio and risk management, compliance and reporting needs. Data standardisation, transparency, frequency and completeness is key to success. Continuous upgrading of platforms to improve connectivity, streamline data management and ensure accurate reporting is becoming a must. However, the development of consistent, reliable and efficient data management standards is still a challenge in the PE and RE industry, where a variety of data sources and formats are at the centre of this difficult task.

Fragmentation of systems, whether for legacy reasons, or owing to the complexity of the PE/RE sectors or the geographical complications of having several international jurisdictions for investment structuring and holding company domiciles, is the primary cause of the inability to integrate multi-location and multi-system data. On the other hand, increased reporting obligations, multiple audiences and granularity requirements require additional effort to collect, analyse and consolidate available information.

It comes as no surprise that the majority of PE/RE firms and their service providers are concerned about IT infrastructure, adaptability to changing regulations, its flexibility to expand and its capacity to handle more complex and increased data volume management from

multiple systems in various asset locations. Investments in data quality and management, as well as data warehousing, alongside comprehensive portfolio and risk management systems, are a top priority, which is why appropriate systems offering an integrated and efficient data management approach are highly sought after. Both asset managers and service providers want to limit time spent on data collection and reconciliation by implementing a comprehensive solution that meets their internal, regulatory compliance and client requirements.

Conclusion

- Fully integrated and comprehensive systems are still uncommon in the PE and RE industry, representing significant challenges for PE/RE firms and asset service providers, as well as opportunities for the technology providers that can supply more developed platforms
- Streamlined data management systems are vital for the portfolio and risk management of PE/RE firms
- Automation is increasingly sought after in the PE/RE asset servicing world to meet increased and more complex client requirements
- The capability to support various alternative asset classes and enhanced risk metric functionalities are becoming key criteria for PE/RE asset managers and servicers when selecting new systems
- Increased reporting requirements and a drive for higher transparency require solutions that offer data consistency, the flexibility to handle needs relating to multiple audiences (e.g. management, regulators, shareholders), the application of industry standards and compliance with various regulations