

PRIVATE EQUITY'S STANDARDISATION FRUSTRATION

PRESENTED IN PARTNERSHIP WITH COLMORE

Attempts to standardise fee and cost reporting in private equity has been a Sisyphean endeavour in recent years. The deluge of templates developed in the quest for transparency – from ILPA to Invest Europe's guidelines – have created enough reporting options for GPs that it has to a degree had the opposite effect: standardisation isn't really standardisation if a hundred differing standards are being used.

At *The Drawdown's* recent Breakfast Briefing presented by LP data services provider Colmore, an assembled panel of private equity professionals debated how the challenges faced by the industry in fee transparency and validation, and potential avenues of solution.

On the panel was CIPFA treasury management and pensions advisor Neil Sellstrom; Gareth Parsons, Colmore's head of the product development and fee transparency team, and executive committee member; Neil Cooper, a senior investment manager for the Greater Manchester Pension Fund (GMPF); and IR manager Valerie Auffray of healthcare specialist PE firm Apposite Capital.

The participants quickly found common ground on one subject, standardised reporting templates, with the conclusion being that additional templates to the plethora of current options – such as ILPA's, Invest Europe's, or others – would do little to improve transparency and validation.

"From the investor perspective, I think they don't particularly want another template," said Neil Sellstrom of CIPFA. "They just want to be able to report to their beneficiaries what the costs are. A one-size-fits-all probably won't work, but rather just frustrate the industry even more."

GMPF's Cooper said that any attempt at standardisation would be more successful if it involved fewer templates, because

standardisation implies a single measuring stick. "That might be an unobtainable objective given the global nature of the industry, but it is what you would aspire to," he said, adding "fewer templates would be a good thing".

Templates are not necessarily followed to the letter either, due to the differing demands from LPs and diverse range of investors that can be found in an average private equity fund. Apposite's Valerie Auffray said her firm typically looks at the different guidelines and templates, and adapts them to suit the needs of its investors, rather than fill out a carbon copy.



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"We welcome guidelines, more standardisation, and transparency, but we adapt them to what we believe is relevant to our investors," she said. "We try to be proactive in terms of the information they want, and how they want it presented as well."

Speaking about how it would be possible to make a new template acceptable and effective, Colmore's Gareth Parsons said: "If the existing ones can be consolidated into one that works, then it's minimal effort for

everybody to make those changes. If the industry has already adopted the ILPA template, then it's not a huge jump to something more extensive."

One flaw in the deluge of templates available to private equity managers, as pointed out by the panel, is the fact that they are ultimately voluntary to some degree. Without compulsion from a superior authority, adoption of certain reporting standards will come down to negotiations between GPs and LPs, which puts a substantial hurdle in the way of industry standardisation – especially on a global level.

"What's more interesting is having regulatory backing from the FCA around standardisation," said Parsons. "We've seen a number of standards come through in the past years and adoption hasn't necessarily been great, so I think one of the key challenges is exploring how to ensure adoption of this new template – not just in the UK, but globally."

For its part, the UK's Financial Conduct Authority (FCA) is exploring reporting standards and potential regulation to back it up. It recently appointed outspoken campaigner for cost and fee transparency in institutional investment, professor Christopher Sier as chair of the FCA's Institutional Disclosure Working Group (IDWG), tasked with leading a panel to develop a suite of reporting standards that will encompass private equity. Initial expectations were to publish a draft standard for PE by July 2018, but he told the audience and panel at *The Drawdown's* Breakfast Briefing that it would likely be ready sooner as work had already started.

Sier prefaced his statements by saying he was not speaking on behalf of the FCA, but many of these objectives could be seen in the IDWG Terms of Reference that have been published on the FCA website.

SPEAKERS

Neil Sellstrom

Treasury management & pensions advisor, CIPFA

Neil has been a CIPFA advisor for pensions and treasury management since 2009, running networks on both subjects with over 150 subscribing authorities combined. He represents CIPFA and Local Government Pension Scheme (LGPS) Funds at various key events and also attends CIPFA pensions panels.

Valerie Auffray

Investor relations manager, Apposite Capital

Valerie is responsible for Apposite's marketing, fundraising and investor relations activities. She has around 15 years' experience developing and delivering investor relations programmes within the public and private markets. Before joining Apposite Capital in 2008, Valerie was an Associate Director at Citigate Dewe Rogerson.

Neil Cooper

Senior investment manager, Greater Manchester Pension Fund

Neil is a senior investment manager with GMPF, which he joined in 2014. Prior to joining GMPF, he spent more than six years as a senior investment analyst with The Cooperative Asset Management, and a combined eight years as an investment manager with James Breailey & Sons and Nelson Money Managers.

Gareth Parsons

Executive committee & head of the product development and fee transparency team, Colmore

Gareth is a director, member of the Executive Committee and heads the accounting unit at Colmore. Prior to joining Colmore, Gareth was a director at Capital Dynamics where he held a similar function. Previously, he worked in the finance department at Select Service Partner UK.

He said the IDWG's job is not to re-invent the wheel, but rather improve it or adopt it if already works. Any cost applied to the asset owner – either directly or indirectly – and anything representing a significant impact on gross performance of the AuM will likely be included in the working group's cost collection standard.

With Sier's eventual proposal having the FCA's backing and a £250bn asset base, it will be one lever to force adoption in the UK. Sier said the Committee on Workers' Capital (CWC) is in the process of forming a workstream to look at transparency, costs and charges on the funds managed by its members. Bringing the £15-20trn of assets managed by CWC members to bear on a standardisation effort would likely affect global change, and Sier said it is entirely possible that the CWC will adopt the most sensible and comprehensive standards available. "Hopefully, these will be the ones on which the IDWG is working as these will be agreed by the FCA, adopted by the LGPS and supported by the person who first presented the issue to the LGPS... who is the same person who presented the issue to the CWC."

Validation vexation

Sier's comments and work with the IDWG spoke to the heart of what the Breakfast Briefing panel repeatedly held up as a key challenge: cost and fee validation.

Even if there was a completely standardised, working template for the whole industry, the internal cost of analysing that data could be prohibitive for LPs without the resources needed. Colmore's Parsons said

that in his experience the act of compiling the data can, in itself, be a huge undertaking before any validation is even started.

"There's a huge internal cost for these firms to do this work. We manage about 1,500 funds through Colmore, collecting largely unstructured data and trying to turn it into something that's usable, and then apply a validation level on top of that," he said.

"Getting more information is great, but then it's about what you do with it and best use it on a cost effective basis with a pragmatic approach to validate that information that doesn't mean you're growing a team internally that is just adding to that layer of cost you're reporting out."

While management fees and carry are typically detailed in the LPA and easy to validate, expenses mark a serious challenge to accurately evaluate for most LPs. Without complete granularity in the allocation and calculation of expenses, it is difficult for an LP to validate accurately.

"All you can do is give the numbers a good sense check to see whether they are sensible in the context of where a particular investment is in its lifecycle," said Cooper. "The more granular information we can be given by a GP, the better it will be. The expenses piece is difficult, because without climbing inside the GP and sitting on the accountant's shoulder, you can't know for sure if everything that's supposed to be in there is there."

However, addressing granularity through forensic accounting can have negative side-effects, according to Parsons: "The forensic approach is very intrusive, where you

have to go into a manager's office and have your team go through everything they've done, which isn't necessarily great for a relationship."

Benchmarking was floated by the panellists as one way of tackling some of the complexities around expenses, as it can help to identify funds that are outliers in terms of costs, without a forensic approach to gathering and validating expenses by the LP, but even that has its drawbacks and can often be an imprecise science.

Apposite's Auffray pointed out that different LPs often ask for different information and levels of detail, and GPs vary in how they approach validation and reporting, adding complexity to the equation. "There are some elements of funds that are similar and can be standardised, but private equity funds can be very different in a lot of ways. That's why trying to standardise everything would be challenging. It's about trying to find the right balance," she said. However, the panel generally agreed that increased transparency would help in LPs' validation efforts, and could improve GP/LP relationships over time.

"Transparency helps build trust and standardisation just allows for the transfer of additional information to facilitate the transparency and reporting of the GP," said Colmore's Parsons. "I don't need think we need to take away the uniqueness or brand of a manager, it's just being able to add an additional layer to facilitate the needs of LPs." ↓



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