

# A CHANGING WORLD - THE IMPACT OF UPDATED ILPA REPORTING STANDARDS

Using Technology to Enhance GP-LP Communications

## AN INVESTRAN WHITEPAPER

# A Changing World - The Impact of Updated ILPA Reporting Standards

## Using Technology to Enhance GP-LP Communications

### INVESTSTRAN QUICK FACTS

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- 9 out of the top 10 PEI 300 use Investran
- 45% of Committed Capital on the PEI 300 is supported on Investran
- 1 Trillion USD are managed on Investran directly by GP's
- All 13 members of the Private Equity Council use Investran

### KEY COMPONENTS

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- Front-office portfolio and investor relationship management
- Centralized portfolio and partnership accounting and reporting system
- Web-based investor relations and portfolio monitoring tool

Responding to the changed market conditions following the onset of the global credit crisis, in 2009 the Toronto-based Institutional Limited Partners Association (ILPA), a non-profit group serving limited partner investors in the global private equity industry, released a set of guidelines aimed at streamlining communications between limited partners (LP) and their general partners (GP).

These "Private Equity Principles" called for GPs to boost transparency in areas such as fee and carried-interest calculations and portfolio company financials, while providing greater transparency into company policies and procedures, as well as other pertinent data.

In an effort to further improve LP-GP relations, earlier this year the ILPA issued Version 2.0, which included comprehensive updates to the three main tenets of the Private Equity Principles ("Alignment of Interest", "Governance" and "Transparency"). The ILPA also offered mechanisms designed to help funds process these updates in the most efficient manner possible, including: an appendix on Carry Clawback best-practice guidelines; a more comprehensive overview of the three guiding Principles; as well as expanded context describing the need for the key guidelines.

Additionally, the ILPA issued the first two installments in a series of five Standardized Reporting Templates, covering capital calls and distribution notices (CC&DN). These generic templates – which will subsequently focus on annual and quarterly reporting methodologies as well as portfolio metrics – are part of the ILPA's overall effort to enhance efficiency while reducing the cost of private equity investment administration and monitoring.

What might be the impact on GP-LP relations as a result of these changes? Furthermore, what kind of detail should be expected of GPs in order to meet the objectives of the revised ILPA principles?

## Principle Updates and Standardized Reporting Templates

While certain areas have been modified to reflect a more “GP-friendly” ILPA, on balance the updated principles maintain and add clarity to the long-held position that processes and systems within private equity firms should be capable of providing more accurate and higher levels of reporting detail. These include:

- A rewording of the provision that LPs review partnership expenses annually, to a recommendation that LPs “engage with the GP with regard to the allocation of partnership expenses”
- The condition that all fund extensions not approved by a majority of the LP Advisory Committee should be liquidated by the GP within one year
- Adding the provision that GPs “should not be allowed to co-invest in select underlying deals but rather its whole equity interest shall be via a pooled fund vehicle”
- The recommendation that GPs provide estimates of quarterly projections on capital calls and distributions, as well as immediately disclose to LPs the occurrence of any material contingency or liability arising during the fund’s life and/or any breach of the Limited Partnership Agreement or other fund document
- A recommendation that annual reports include information pertaining to portfolio company risk, well as how such risks are being managed

Developed in cooperation with both LPs and GPs and using third-party providers in a consultancy role, the ILPA’s new generic-reporting templates are intended to improve efficiency in a number of key areas, including the interpretation/accounting of all transactions, LP/GP processing times and monitoring costs, communications to and from LP/GP concerning investment holdings, as well as GP legal compliance with existing documentation. Each template is broken down into sections with step-by-step guidance; for instance, the first set of templates covering capital calls and distribution notices (CC&DN) includes: Capital Call & Distribution Notice Guidelines; Core Business Guidelines; Application of Guidelines; as well as CC&DN cover letter guidelines.

## Transparency to the Fore

ILPA 2.0 underscores a now-familiar theme: that investors want their GPs to take the necessary steps to improve overall levels of transparency, even if it means sitting on investment capital until those demands have been met. Polling by London-based research group Preqin found that 58 percent of LPs would be less likely to invest with any partner firm that didn't follow the spirit of the ILPA principles. Recent numbers indicate that LPs are not in any rush to pay; in its 2011 Investor Outlook, Preqin found that the number of noncommittal LPs rose slightly during 2010, with 42 percent opting not to make any new commitments to private equity funds. Such reticence has had an impact on capital raisings; during the first part of 2011, private equity funds accrued an estimated \$42.3 billion, an 11 percent decline from the previous quarter and the lowest level in nearly eight years, according to Preqin.

Of those willing to make new commitments of capital, 71 percent said they would do so in part by seeking new general partnerships. What can GPs do to attract these prospective asset holders? In addition to maintaining a solid performance history and a stable portfolio, adherence to ILPA 2.0 should figure high on a GP's list of attributes.

"With investors having significantly less capital to deploy into new vehicles than in previous years – and with a large number of vehicles still on the road – it is clear that the balance of power has swung towards LPs in fund terms negotiations," notes Preqin in its report. "With over 100 firms already endorsing the Principles, it is important that firms be aware of these best practices."

Despite this, methods used to provide investors with important fund information continue to be a source of concern.

"A good-sized LP might have commitments to upwards of 50 different fund managers, each with perhaps 10-20 portfolio companies across various industries and geographies," states Tony Piper, founder and director of 4vco, a London-based consultancy focused on the private equity business. "Each fund manager compiles all of the portfolio cost and value data for the most recent quarter, then distributes the information using a paper report to all its investors. A significant number of these LPs will then complete a near identical process of disassembling this information in order to figure out what precise business events have occurred in the quarter so this data can subsequently be logged in their own portfolio management systems."

**ILPA 2.0 underscores a now familiar theme:**  
Investors want GPs to take the necessary steps to improve data transparency – even if it means withholding investment capital until those conditions have been met.



“There is a compelling case for making these changes happen now. Rather than having GPs continue to distribute paper reports and asking their investors to just work it out, why not make it easier for them? The bottom line is, with the help of technology, it really shouldn’t be that difficult to accomplish.”

**Tony Piper**, founder and director of 4vco

If the LP’s goal is to achieve greater insight into their exposures and performance attributes, they are going to require reporting mechanisms that can give them a complete snapshot into the inner workings of some 500 different companies, the kind typically associated with quarterly reports distributed by the fund, each one detailing the costs and value of each of those 10 portfolio assets. “Going forward, it is easy to see that there are huge efficiency gains to be made in this regard,” says Piper.

The adoption of universal standards is crucial to strengthening the GP-LP pipeline. “It makes the entire process so much smoother,” says Piper. “Part of the reason for all the difficulty LPs have experienced has been due to the lack of standards around the information flows. If GPs were to adopt these standards and map onto them, the whole process could be reduced to a simple matter of data extraction. Essentially, the idea is to replace physical quarterly reports with a streamlined data flow that can allow GPs to provide business events within a standard format that can be subsequently collated. We’re already seeing this take place in just about every other asset class, and with very good results.”

Change, however, does not always come easy, particularly when it comes to the dissemination of closely held data. In many instances, well-established private equity funds that spent years keeping LPs at arms-length are only now adjusting to a world where negotiation and full disclosure are compulsory elements. Given the extremely dynamic, low-volume and highly complex nature of private equity, such issues may not get resolved overnight. “It is a business that is far more diverse than it was even five years ago. Hence, trying to shoehorn private equity into a finite set of standards can be a very difficult operation,” concurs Piper.

As market conditions have helped keep a damper on private equity growth, LPs have only been required to perform due diligence on a modicum of funds. Should the number of fund launches rise over the near term (as is widely anticipated), LPs will have a much more difficult time keeping tabs on their investments using current due-diligence methodologies.

This is where third-party providers can help. Using updated industry templates as their point of reference (such as those included in ILPA 2.0), providers can craft product offerings that allow GPs to record business events in a manner that is far more transparent to the end user. Says Piper: “It is a great selling point: if the GP incorporates the provider’s system in order to record these business events, then the industry standard extracts will be easily visible to the LP – no extra work required.”

Leading GPs appear to be heeding the call. In a formal endorsement of ILPA 2.0 issued in March 2011, private equity firm Kohlberg Kravis & Roberts (KKR) agreed that both GPs and LPs stand to benefit from the increased clarity of the ILPA guiding principles. “For KKR, we believe the principle of alignment is at our very core, as evidenced by the fact that we have a meaningful amount of capital, more than \$6 billion, from our executives and our balance sheet, at work in our private equity investments,” said KKR co-CEOs and co-founders Henry R. Kravis and George R. Roberts.

## Conclusion

Successfully transitioning from paper-based processes requires a tremendous amount of commitment; however, having universally accepted standards in place will make the job of fine-tuning current methods of data dissemination that much easier for GPs.

Technology can help private equity managers swiftly respond to these ongoing challenges. Once again, this puts the onus on third-party providers to offer high-quality and cost-effective solutions that can deliver the requisite information on demand. The most successful of these vendors will be able to demonstrate a history of crafting practical strategies for enhancing data flow, while identifying and solving opacity-related issues within a private equity context.

Should the markets gain momentum, some believe that LPs may lose their desire to ask the hard questions. Hence, no time like the present—and efforts like the new ILPA standards and templates act as a motivating factor for investors.

“There is a compelling case for making these changes happen now,” says Piper. “Rather than having GPs continue to distribute paper reports and asking their investors to just work it out, why not make it easier for them? The bottom line is, with the help of technology, it really shouldn’t be that difficult to accomplish.”

## How SunGard Investran Can Help

SunGard Investran is a fully integrated solution encompassing front-, middle- and back-offices for private equity and alternative assets firms. Investran supports even the most complex of business models, with workflows matched to meet the needs of each unique business.

With more than 300+ global customers, in 20 countries, collectively managing over \$1 Trillion in assets under management, Investran has one of the largest and most active customer bases of any private equity software solution. As an independent services provider, SunGard Investran is sensitive to both LP and GP needs, with a client base that represents both parties. Over 13 years of experience through up and down cycles has provided the Investran team a unique perspective and ultimately delivered a solution that can answer both parties challenges with full transparency and comprehensive reporting.

SunGard Investran is fully web-enabled, with centralized portfolio and investor accounting and reporting, giving a single entry point for data firm-wide. Investran provides users a with on-demand access to more detailed, granular reports (which include accounting data commitments, capital balances, financial statements, IRR’s and time weighted returns).

Investran’s robust back-office functionality for accounting and reporting maintains a true physical general ledger and embodies an in-depth knowledge of the entire accounting process to increase efficiencies.

For more information on Investran visit [www.sungard.com/investran/learnmore](http://www.sungard.com/investran/learnmore).

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## About SunGard's Investran

SunGard Investran is an integrated application suite that automates front-, middle- and back-office processes for private equity and alternative investment firms. Investran helps improve business efficiencies to facilitate collaboration, support deal flow and automate accounting. Firms rely on Investran's integrated capabilities to help meet their needs in the entire investment life-cycle, including relationship management, reporting, monitoring, accounting, fund raising and deal pipeline management.

[www.sungard.com/investran/learnmore](http://www.sungard.com/investran/learnmore)



Investran awarded **Software Provider of Year**  
2009 and 2010 by Private Equity News

## About SunGard

SunGard is one of the world's leading software and technology services companies. SunGard has more than 20,000 employees and serves 25,000 customers in 70 countries. SunGard provides software and processing solutions for financial services, higher education and the public sector. SunGard also provides disaster recovery services, managed IT services, information availability consulting services and business continuity management software. With annual revenue exceeding \$5 billion, SunGard is ranked 380 on the Fortune 500 and is the largest privately held business software and IT services company.

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