

JP Morgan Platform Helps Private Equity Move Beyond Spreadsheets

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A new front-end platform from JP Morgan Chase & Co.'s private equity fund administration arm is drawing attention to the growing technology demands in a sector where outsourcing is still relatively young.

JP Morgan's Web-based DealVault system, launched last month, centralizes deal-tracking, allowing private equity managers to store financial data on the companies in which they invest. Funds can use the information to aggregate performance, risk and exposure globally.

"DealVault is the industrial-strength tool the private equity investment industry has been waiting for, particularly given the valuation concerns in today's volatile market," asserted James Hutter, global head of JP Morgan's private equity fund services unit in New York. "Rather than relying on Excel spreadsheets, private equity managers can automatically input information from around the world in a single application."

Portfolio valuations made using DealVault can be fed automatically into JP Morgan's accounting system, reducing the time spent collecting and reconciling data. The platform also generates customized reports for funds' investment professionals, CFOs, investor relations staff and auditors. The reports offer a point-in-time view of financial data, capital structure and non-financial information, offering a consistent valuation process and supporting assessments against initial investment thesis and trends over time.

Clients can use DealVault on a stand-alone basis or in conjunction with the JP Morgan unit's administrative services, which include fund accounting, management reporting, investor-relations support, tax reporting, waterfall and carry administration, capital calls and distribution, treasury, safekeeping and other banking products.

Pension funds, drawn by the potential for strong returns and diversification, are the largest source of capital for private equity funds, followed by funds of hedge funds. As these investors demand increased transparency and more robust systems, some private equity managers are beginning to see the merits of outsourcing.

While offshore-domiciled private equity funds have traditionally used third-party administrators, most domestic funds have not. Only 10 percent to 15 percent of U.S. private equity firms outsource fund administration, according to Hutter. Still, that represents a sizable increase from the 5 percent JP Morgan cited when it opened its administration unit in spring 2005.

Though the unit initially used the technology and operations staff of the bank's venture capital division--JP Morgan Partners--it expanded early last year through a lift-out of the operations of Dallas-based private equity fund HM Capital Partners. It now has more than 160 staffers in New York, Chicago, Dallas, San Francisco, London and Sydney administering over 200 funds with \$55 billion in committed capital.

Specialized Accounting

The structural differences between private equity funds and hedge funds make it necessary for service providers--and their clients--to use a combination of proprietary and third-party platforms such as Wayne, Pa.-based SunGard Data Systems' Investran and FrontVenture from Paris-based eFront. In addition to accounting services, Investran offers front-office portfolio and investor relationship management.

"While both hedge funds and private equity funds have complex investor accounting requirements, their portfolio accounting needs differ," says Shannon Dolan, VP of Investran, which has 250 private equity and fund administration clients.

Simon Radford, finance director of Aztec Group, a private equity fund administrator with offices in London and several offshore centers, says that FrontVenture, installed in 2006, allows his firm to speed up reporting and production of financial information and respond to investor inquiries. "When you consider that many funds have quarterly reporting and the total structure can involve many entities--typically 30--it is not unusual for 100 sets of accounts to be required each year per fund," said Radford.

General partners in a private equity fund manage the investments while the limited partners contribute capital over a specific time frame, typically five to ten years. Unlike in a hedge fund, investors don't hand over cash until the management firm makes a call for it--if they don't send the money in a timely manner, the fund has a cash drag. Software helps administrators and funds reduce the time demands of tracking the capital calls and limited partners.

Chris Schiavo, CFO of Battery Ventures, a Waltham, Mass.-based private equity firm with \$3 billion in committed capital, said that his firm is considering whether to replace its existing system with an application that can better collect, analyze and report profiles on limited partners.

"The software for managing limited partner profiles needs to be very robust," explained Schiavo. "We have hundreds of limited partners, each of which has multiple internal contacts, so when making capital-call or distribution notices we could be communicating with many more individuals. Complicating the process is the need to frequently update the contact lists."

For investor reporting, old-fashioned manual labor may still be the best option, according to Schiavo. "The calculations involved are so varied and what might seem like a low-tech approach really isn't," he said.

Portfolio valuations can be problematic for the funds. Under the fair-value reporting requirements of Financial Accounting Standard 157, private equity funds must keep detailed records of the methodology they use to price their investments, which are often illiquid.

Perhaps the most complex task is determining how to allocate profits to the limited partners, or waterfalling. While all funds return the initial investment, divvying up the profits among limited partners and general partners depends on the terms of the limited partnership. Some contracts require that a minimum rate of return be achieved before general partners can share in the profits through an incentive fee, otherwise known as a carry.

Outsourcing Rivals

Administrators such as JP Morgan predict that private equity funds can cut down operating costs by as much as 50 percent by outsourcing responsibilities. And as investment strategies converge, hedge fund administrators are becoming increasingly active in private equity. Citigroup and State Street Corp. have entered the field through acquisitions of smaller service providers, and Bank of New York Mellon Corp. officials say they are mulling an expansion into private equity administration.

Competing with the big banks are niche specialists including Augentius Fund Administration, International Private Equity Services and Aztec as well as alternative fund service providers such as Mourant and SEI Investments.

Despite the operational benefits, not all funds are eager to outsource. "As we must still do the calculations ourselves we would prefer not to outsource any of our activities," said the CFO of a private equity fund in New York who requested anonymity.

However, many funds are taking a middle road: outsourcing front-office responsibilities such as capital calls and conducting limited partnership reporting on their own; or keeping the front-end duties in-house while farming out valuations work. Fund administrators have had to maintain flexibility. Schroder Administrative Services in Bermuda, for example, allows its private equity fund clients to keep track of their portfolios through a Web-based interface directly into eFront's FrontVenture; for some of those customers, Schroder does the rest of their administrative tasks.

Those funds that opt to do all their own recordkeeping acknowledge that Excel spreadsheets and faxes may be reaching the end of their usefulness, at least for some duties. Anecdotal evidence suggests a large part of the firms' technology spending is going toward managing relationships with limited partners.

Howard Weiss, CFO of New York-based private equity firm Castle Harlan, said that his firm is installing a licensed contact-management system that automates communications with limited partners. The new platform, which also tracks information on each partner and generates capital-call reports notifying investors when they must produce the promised cash, will reduce the support staff's workload by about two-thirds, Weiss estimates. Capital calls will take only a few hours to complete, compared to two days.

"Our volume isn't large enough for us to need to outsource the data required by limited partners, but we do see the advantages of installing a new front-end system," said Weiss. Castle Harlan manages about \$3 billion in committed capital.

The firm is considering adopting a Web-based system for partnership reporting that would allow limited partners to view information online, though they could still choose to receive reports in the mail.