PRIVATE CAPITAL INSIGHTS

MARCH 2020

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Over the past 12 months, Institutional investors have continued to increase their investment allocation into private capital asset classes.

While the optimism among General Partners is high in their ability to meet fund raising targets, it will become imperative that digitalization is embraced and leveraged.

Investor and regulator expectations of increased transparency, improvements to the overall customer experience and operational efficiency will continue to rise as the competitive environment intensifies.

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PRIVATE CAPITAL SECTOR EXPLORES DIGITALIZATION

Digitalization is reshaping every aspect of financial services, including the investment styles and operating platforms of private capital managers. In 2019, RBC Investor & Treasury Services moderated a panel, which explored how digitalization is influencing and disrupting the private capital sector.[1]

Generating liquidity and transparency
While private capital assets are generally considered illiquid, blockchain, specifically the use of tokenization, is emerging as a potential opportunity to open these assets to a wider pool of underlying investors.[2]

The panel discussed how this approach could enable illiquid assets, such as a fleet of minicabs or physical buildings, to be separated into smaller component parts, linked through blockchain, and traded individually. In theory, through tokenization and securitization, formerly untradeable instruments could unlock liquidity, reduce transaction costs, and enhance transparency.

This type of financial structure could provide small and medium-sized enterprises (SMEs) that have illiquid assets with easier access to capital, rather than relying on traditional venture capital or private equity funding.

While some managers believe securitization and tokenization could enable them to broaden their investor base away from institutions and tap into the retail market, others are less confident. One panelist cautioned that digitalization of untradeable or illiquid securities could result in the instruments becoming excessively correlated with public markets, adding that many real estate investors put capital in that asset class precisely to diversify away from those correlations.

Big data as a performance enabler
Deeper insights and intelligence can help inform private capital strategies, and private capital managers are increasingly turning to alternative data to complement traditional investment analytics. For example, the integration of unconventional data might include trends pertaining to credit card transactions at significant retailers,[3] as a useful addition to in-depth analysis of retail tenant reports and financial statements. Real estate managers could also consider using anonymized geolocational data sourced from cell phones to track movements which would provide more precise information about foot traffic at their commercial properties, as well as insights on visitor frequency.

Tokenization and securitization could unlock liquidity, reduce transaction costs, and enhance transparency

Alternative data does have drawbacks, however, and it is important that managers conduct due diligence on data providers and sources to make sure the information they are receiving is accurate. For example, poor data due diligence could result in further risks particularly if managers are making investment decisions based on confidential materials.[4] Managers must carefully consider privacy rules, particularly if they use information where individuals may be personally identifiable.[5] Following the introduction of the European Union's General Data Protection Regulation, private capital managers need to pay particular attention to ensure they uphold data privacy provisions.

Producing operational alpha through AI
To remedy these challenges, managers are increasingly utilizing automation tools to streamline aspects of their operations. One speaker said simple coding solutions and programs were already being used by a handful of managers to generate standardized or rule-based legal contracts such as non-disclosure agreements (NDAs).

Private capital managers are increasingly turning to alternative data to complement traditional investment analytics

Adoption of AI across financial services is now becoming increasingly normalized, as firms look to obtain cost savings and efficiencies and improve accuracy. Many private capital managers have found themselves engulfed by regulatory and investor reporting obligations, which may cause financial and operational strain.

Adoption of AI across financial services is now becoming increasingly normalized, as firms look to obtain cost savings and efficiencies and improve accuracy

AI applications such as machine learning are being trialed by some firms to mark up NDAs with their comments. The use of machine learning technologies has expedited the administrative process and negated the need to consult with external counsel for routine issues. Meanwhile, optical character recognition, another form of AI, could help managers convert contracts into machine readable formats, which would allow the process for changing these documents to be fully automated. A panelist acknowledged that such technology would be useful for managers amending legal contracts ahead of their transition away from LIBOR or implementation of contingency plans because of Brexit.

Many of the innovations underway in the private capital industry, whether it be asset securitization, application of big data or adoption of AI, will help the sector identify new sources of investment and potentially produce operational alpha. While these technologies have advantages, their risks may require further clarity before the private capital industry further entrenches such approaches into their business models.

KEY INSIGHTS

- The securitization of illiquid assets could help create new markets and facilitate the retailization of private capital strategies, although the approach introduces new risks
- Alternative data can provide insights that otherwise may not have been available from traditional sources, although the actual process of obtaining this information requires thorough oversight
- The use of Artificial Intelligence (AI) in operational processes has the potential to generate savings for private capital managers and dramatically reduce their administrative workloads

Sources
1 Panel discussion: How is the digital age effecting private equity strategies?
2 Deloitte (November 2018) The Tokenisation of assets is disrupting the financial industry – are you ready?
3 Bloomberg (November 29, 2018) Parking lots don't tell the whole story: The trouble with alternative data
4 Duff & Phelps (April 19, 2018) Alternative data brings different problems
5 Ibid.

PRIVATE CAPITAL INSIGHTS

PEI – RBC I&TS PRIVATE CAPITAL SURVEY RESULTS

Growth forecast is positive

Expectations for growth over the next five years remain positive, with more than two thirds of fund sponsors viewing pensions and other institutional investors the major contributors to fund raising. This was one of the key findings from the RBC Investor & Treasury Services (RBC I&TS) Private Capital Survey 2019 in partnership with PERE, Private Equity International and Private Debt Investor magazines.

The publications surveyed over 80 of the largest private capital managers (by AUM) across the three asset classes. The research covered a variety of topical areas including domiciles, fund raising and potential disrupters.

The depositary's role is changing as firms and service providers adapt to shifting regulation and the need to stay ahead of technological developments.

Once a small corner of the fund administration space, depositary services have grown substantially over recent years as they became essential to any alternative asset manager seeking capital from European investors under AIFMD rules. And, as private capital firms become increasingly complex organizations, with more diverse investment strategies and larger pools of different types of investor, depositary services have had to keep up with and, in many instances stay ahead of, the pace of change. PEI Media spoke to RBC I&TS to find out how the depositary role is changing and how providers can help transform the way private capital firms operate.

Q: How has the depositary's role evolved over the past few years?
One of the biggest changes seen was the implementation of AIFMD, which requires managers regulated under the directive to appoint a depositary to provide an oversight and safekeeping function. Yet this has not just driven business toward depositary service providers, it has prompted much more thought and consideration among fund managers and third-party service providers around the extent and type of outsourcing that can be achieved. For example, US managers that have traditionally leveraged Cayman and/or Delaware may not have outsourced much, if any, but may have had to review this operating model given the need for a depositary if they are seeking European capital. That leads to discussions around what services beyond those related to depositary functions might make sense, particularly given the greater need for more sophisticated technologies for reporting and overall running of an efficient firm

Q: How are depositaries responding to this shift?
Private markets have really come of age in the past few years. Fund managers now have scale, increasingly broad investment mandates, wider pools of investors, more structures and, overall, far greater complexity in their businesses than before. For depositaries, that means we need to have a broader understanding of areas such as ownership structures, investor expectations, how structures interact with each other and appropriate reporting needs. We really have to understand individual client strategies. This is not just about looking to deliver the right products and services to them but, as a depositary, taking on the liabilities – we have to develop appropriate risk-adjusted frameworks to serve our clients and, of course, to understand what we as a business are taking on.

Q What are you seeing in private equity in particular?
We are seeing a lot of complexity. For example, North American managers increasingly create parallel structures in Europe and entities are being formed to allow for a range of different investment types. So, in addition to depositary services, they are considering outsourcing beyond fund administration and accounting, and increasingly looking at middle office functions. As they come under pressure for more detailed reporting, they are looking for solutions that work across the fund life cycle. So, beyond the need to meet compliance requirements for institutional investors, GPs are turning to us to provide help with areas such as investor servicing and management, cash management and valuation/reporting – the plumbing of these funds.

Q: And what are you are seeing in private real estate?
Private equity real estate increasingly encompasses a diverse set of investment strategies and that has a bearing on what we as the depositary need to understand. As the asset class diversifies across a range of investment types and geographies, so too does the regulatory requirements, which increases the complexity of remaining compliant. The depositary needs to be able to cater to these variances, which can be subtle but still different. Real estate fund managers are also exploring additional ways of outsourcing their middle as well as back office in order to increase their overall efficiency while combining cost and time savings. Within this industry, the underlying trend is to stay focused on the core business cycle across three key phases: fundraising, investment and divestment. As they come under increasing pressure for more detailed reporting, they are looking for solutions that work across the fund life cycle. So, in addition to the need to meet compliance requirements for institutional investors, managers are turning to us to provide help with areas such as investor servicing and management, cash management and valuation/reporting – the plumbing of these funds.

> "As firms increasingly want to focus on core activities, we see a role for us building long-term partnerships where we have multiple touchpoints with clients"

Q: And what about private debt?
In private debt, a lot of the complexity in our work comes from the fact that funds' investment mandates can vary significantly. There's clearly a lot more activity in the illiquid private debt space as funds fill the void left by the banks, which face regulatory constraints on their lending, yet many also invest in more liquid strategies. We have to ensure we are monitoring these investment types. This requires a high degree of expertize on the part of the depositary because clearly there is a large difference in profile between liquid and illiquid debt strategies.

Q: What are managers looking for in a depositary in today's market?
Clearly, managers need a depositary that understands their business – not just the asset class, but one that understands the firm itself and, importantly, the investment strategy. They are also looking for clarity on what a depositary's risk-adjusted framework approach is. Given that firms are facing a squeeze on margins and fees, managers are looking for a depositary that can provide the most appropriate service at a suitable price. As a consequence, many are no longer just looking for a provider but more of a partner that understands their needs and proactively looks to support their business growth by proposing robust value-add solutions. Pricing naturally reflects the depositary's risk and liability assessment of a client and so if we have a deep understanding of what a fund's investment strategy is, we can arrive at smarter pricing while taking account of the funds' life cycle. We are therefore seeing much greater variation in pricing, which is fine-tuned and bespoke to individual clients. Managers are also focusing much more on ex-ante investment controls – they want more flexibility from depositaries to allow them to invest without delays. Depositaries need to be mindful of how they can facilitate controls to reflect how quickly a client wants to enter the market.

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Regime ratings

Delaware, the Cayman Islands and Luxembourg are the top jurisdictions for private fund managers, according to our survey, with all three domiciles ranking highly in terms of regulatory framework, tax framework and business conditions

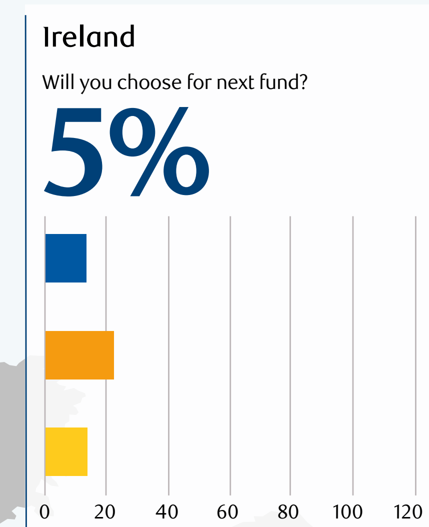
The jurisdictions were rated based on the following questions. Where respondents were asked to give three answers, the first answer was given three points, the second two points and the third one point.

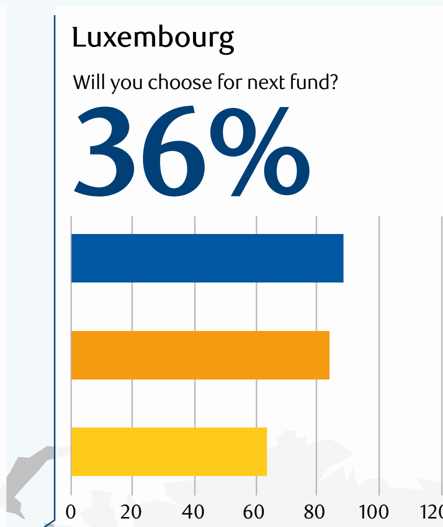
Next fund
Which of the following domiciles will you choose for your next private fund launch/reallocation? (Select all that apply)

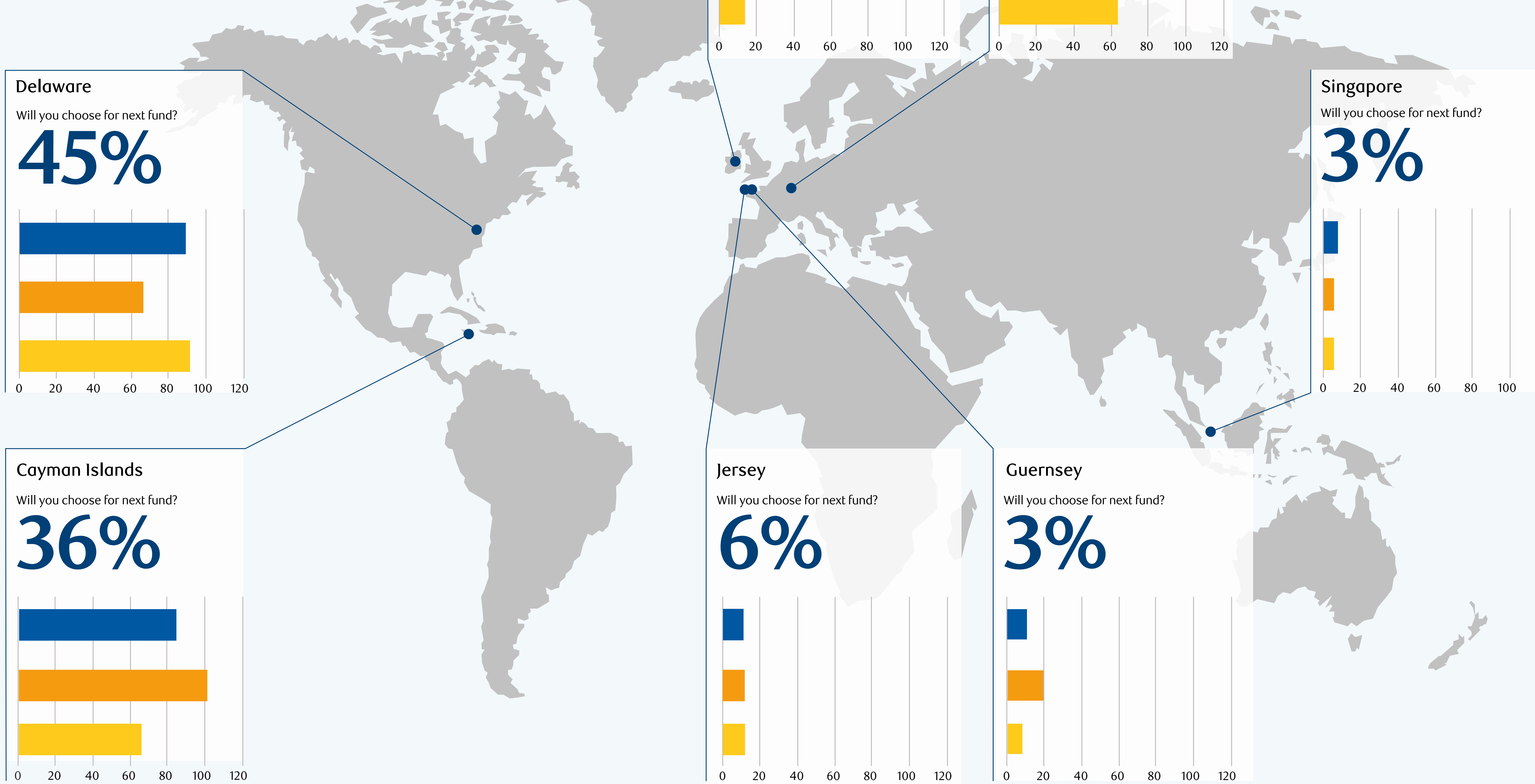
Regulatory framework
Which of the following domiciles offers the optimal regulatory framework in 2019? (Select the top three)

Tax framework
Which of the following domiciles offers the optimal tax framework in 2019? (Select the top three)

Business conditions
Which of the following domiciles offers the optimal conditions for doing business in 2019, such as expertize? (Select the top three)







Q: How is the debate around full depositary services versus depositary-lite shaping up?
As the interpretation of the rules under AIFMD varies, as too does the comfort depositors are taking on when using these services, often it can be an iterative process with the client. Regulators have taken a different view on this, too. The original interpretation of the rules was that a depositary would offer full-fledged services across different jurisdictions – given that European institutional investors all have similar needs from a depositary – alongside fund administration duties. Yet there are other interpretations which suggest that, as long as you do enough to comply with the regulations, you can have a slimmed-down version of depositary services as a standalone; that is, without fund administration. It is still unclear where we will end up. There is another school of thought that suggests the depositary role will continue to be needed, but it will evolve to include administration services and there is scope for greater value-add to clients as depositaries can help professionalize reporting and data management. I think what we will see is the emergence of multiple models for the different requirements of clients according to their investor base and investment strategies, whether funds are offering co-investment and so on. The role of the depositary will evolve to reflect the variation in requirements and this will be enabled by technological developments.

Q: You mention technology – how are private real estate firms deploying this?
Firms are starting to evolve their platforms to deal with increasing complexity. They are beginning to apply similar operational principles to their own organizations as they apply to their investments. Fundamentally, they are looking at how to optimize their organizations through outsourcing and gain access to new technologies to benefit from digitization and the automation of manual processes. In addition, there is a lot more discussion and implementation of technologies such as blockchain in private equity real estate. They are looking at this as a way of disintermediating multiple parties in the process and creating a single source of truth. That is quite an exciting development.

Q: And how are private equity firms deploying technology?
Private equity firms are looking to apply similar operational principles in their own organisations to those in their portfolio companies. They will outsource areas where they know they can optimise operations through the use of digitisation and automation for more manual tasks. While private equity is a people business and LPs are paying for the discretion exercised by a fund manager, there is much that firms can do to optimise their processes so they can focus on the areas where they add value. For that, they need a strong data management strategy – they need to think about how they are storing data, who has access, and how it is dealt with across jurisdictions. They need to ask themselves what they want their data story to be and what the architecture around it needs to be. We're having a lot of discussions with firms about how they can redesign their client journey through reporting and analysis by providing understandable data that enables investors to continue to invest, including areas such as information on how they source deals.

Q: As a relative newcomer to the market – certainly in Europe and Asia – how are private debt funds approaching outsourcing more broadly?
While we are seeing a shift towards the back and middle office being outsourced in areas such as private equity, the story is slightly different with private debt. Some newer managers are opting for platforms that enable them to launch without building out whole teams. Yet for others, the fact that private debt funds are generally smaller means that outsourcing may not yet be cost-effective. For those that are outsourcing, they are looking for partners with enough knowledge, experience and understanding to help with the plumbing and that can help them create transparency across the liquidity spectrum and deal with the characteristics of where they invest. While in private equity the nature of investments tends to be reasonably similar, in private debt a bilateral SME loan is very different from a large senior leveraged loan that has been syndicated. Debt is a more complex instrument than equity because of where it sits in the capital structure. Private debt managers are having to think about how they provide appropriate reporting to investors that provides transparency across the whole portfolio. It's currently challenging for them to find that perfect solution.

Q: What future developments do you see for depositary services?
As firms increasingly want to focus on core activities, we see a role for us building long-term partnerships where we have multiple touchpoints with clients. As depositaries, we are already collecting and storing large amounts of data on behalf of our clients – we can be creative here. If we can evolve to be a partner to private funds, offering comfort that we are storing their data appropriately, we can start to offer more analytical services to help with a firm's core functions. We can be part of their digital journey and the extent of the arrangement could be quite deep – there are already some large private market players partnering with law firms so that they become almost an extension of their own organization, and there may be scope for this for depositary and fund administration service providers too.

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THE SEARCH FOR STABILITY IN A SHIFTING ENVIRONMENT

In an increasingly complex investment market, managers are sticking with traditional fund domiciles and opting to outsource more of their operational functions, survey findings reveal.

Private fund managers are increasingly opting to domicile funds in Luxembourg, our exclusive survey carried out in conjunction with RBC Investor & Treasury Services reveals. The top three jurisdictions remain consistent with a survey we conducted last year – in which we polled private equity real estate fund managers – with Delaware, Luxembourg and the Cayman Islands well ahead of rivals. However, this year's survey, which includes the views of private equity real estate, private equity and private debt funds managers, suggests the popularity of Luxembourg has risen over the past year to match the Cayman Islands.

When asked which domicile private fund managers would choose for their next private fund launch, Delaware emerges as a clear leader, with 45 percent of respondents choosing this as a jurisdiction, 36 percent opting for Luxembourg, with the same proportion selecting Cayman. All three are highly rated for their optimal conditions for doing business and for their regulatory and tax framework.

This is quite a turnaround in a relatively short space of time. "If you rolled back a few years, the UK and Channel Islands would have appeared among the top jurisdictions for private funds," says Leith Moghli, partner at Reed Smith. "While they are still relevant, Luxembourg's development as a fund center has largely been to their detriment. It has been a key beneficiary of substance requirements under BEPS, the Paradise Papers and Brexit, while also introducing the SCSp, which has made structuring much more straightforward."

Tapping new PE demand

With 74 percent of private equity funds in our survey expecting an increase in AUM of at least 20 percent over the next decade, including more than two-thirds expecting to achieve this within half that time, investor relations and fundraising teams in this part of the alternative assets space are set for a busy time.

There is clearly demand from institutional investors as fund sizes have increasingly crept up over the years since the 2007-08 crisis.

Yet private equity funds also have their eye on the retail market, our survey shows. Nearly half of respondents expect to increase retail investors in their investor base mix, including 19 percent predicting a large increase.

There has been some movement in this space, according to Reed Smith's Moghli. "Over the past 12 months, I've seen the launch of a handful of fully fledged private equity operating platforms aimed at retail investors that provide fully automated administration processes," he says.

"However, they aren't targeting the average person on the street – they generally require minimum income levels of around £100,000 and assume a certain amount of investment sophistication."

Yet major developments look some way off, especially in Europe where regulations are currently not well tailored to the needs of private equity.

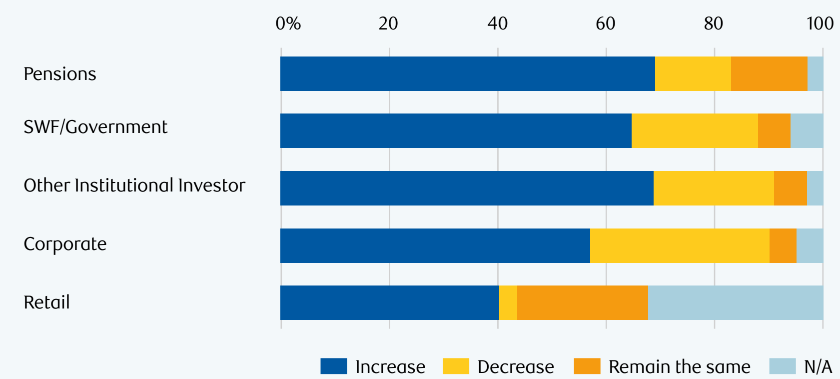
Luxembourg has increasingly become a hub for AIFMD compliance among those seeking capital from European investors. The launch of the SCSp, or special limited partnership, in 2013 – a limited partnership agreement that is effectively a copy and paste of Delaware and UK limited partnership documents – was the start of Luxembourg's rise.

But developments since have boosted its popularity, including the UK's vote to leave the European Union, the implementation of BEPS and increasing LP concerns about using offshore structures following the Panama Papers and Paradise Papers leaks, and the marketing passport available for AIFMD-compliant private funds.

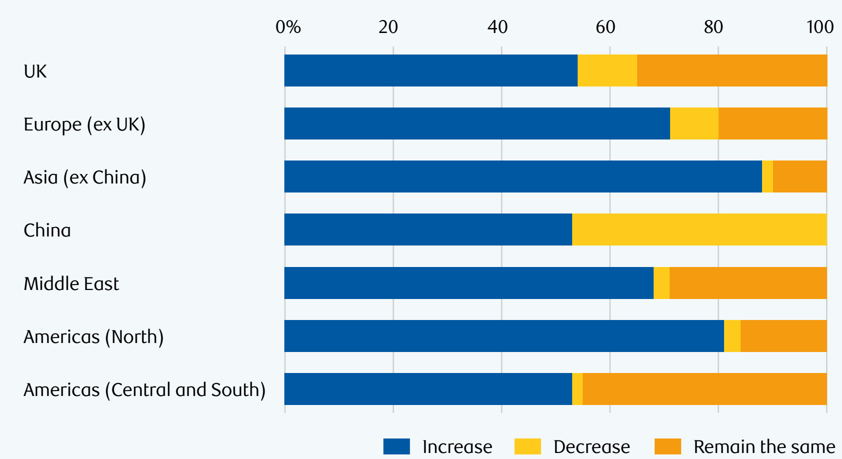
A large part of Luxembourg's growing allure is down to the parallel structures being established by US managers. Proskauer partner Edward Lee points out: "In our own analysis of European funds, we've seen a big shift in Luxembourg's favor over the past 12 months, in particular among UK funds, a move that is clearly Brexit-related. However, we are also seeing a number of US managers establish parallel structures in Luxembourg, where they either establish their own AIFM or use third-party AIFM service providers and delegate back to the US."

"Luxembourg is a relatively easy place for US fund managers to do business," adds Stephen Meli, partner at Proskauer. "In key ways it's becoming the Delaware of Europe for US managers. The entities Luxembourg offers are similar to those available in Delaware and the Cayman Islands for fund structures and the documentation is similar, even down to the way the documents read. There's also a network effect, where every additional US manager that establishes a parallel vehicle there helps attract others."

How do you expect your investor base to change in the next five years, by type of investor?



How do you expect your investor base to change, in the next five years, by location of investor?



Investors are also gaining comfort that Luxembourg's regulatory regime and its requirement for depositary services under AIFMD offer them added protection, a trend also noted by Nicolas Fermaud, head of the New York office at Elvinger Hoss.

"Where firms have had parallel structures for two to three years, we have noticed a disproportionate increase of the commitments collected through the Luxembourg structure," he says.

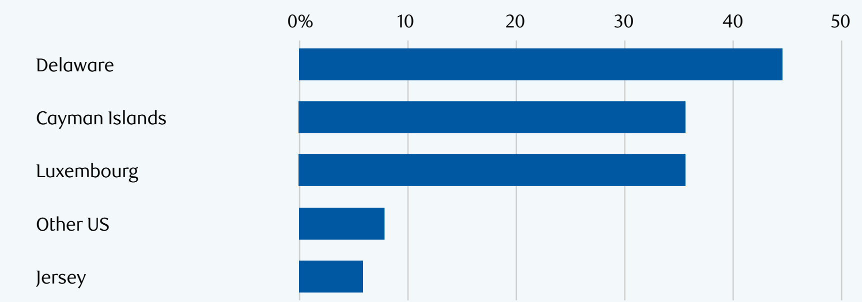
"In part, managers are raising more capital from European investors, but it's also because investors globally are becoming increasingly comfortable with Luxembourg as a jurisdiction. For firms that equalize costs across their platforms, the Luxembourg setup with its depositary and regulatory regime is clearly more attractive for many investors."

Private fund managers are also eyeing fairly significant growth in assets under management. Over a quarter see an increase of 10-20 percent growth in the next year and over half expect over 20 percent in the coming decade.

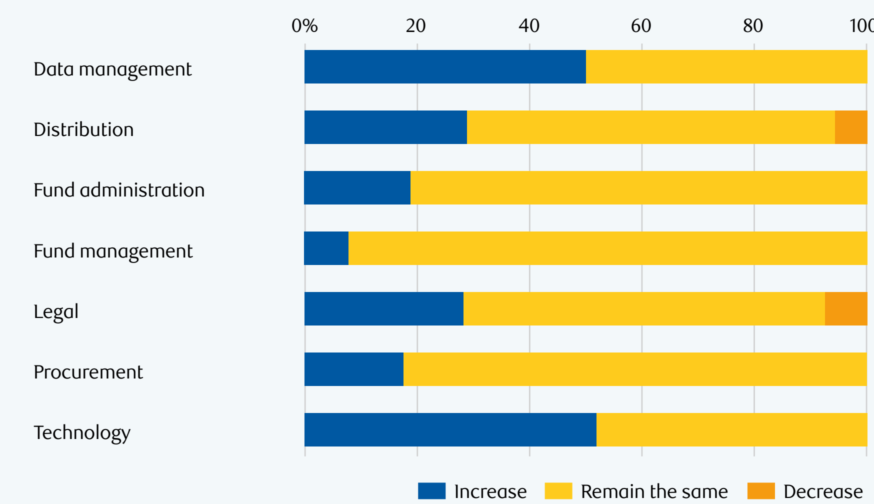
Methodology

PEI Media surveyed 82 private fund managers about a range of fund domicile and regulatory issues. Answers were given on a strictly anonymous basis and the results aggregated.

Which domicile will you choose for your next private fund launch/reallocation?



How will you approach outsourcing of the following areas over the next 12 months?



This increase will come from a wider variety of investors from a broader range of geographies. The majority of respondents (88 percent) expect to increase the proportion of investors from Asia (excluding China), 81 percent anticipate a rise in North American investors and 53 percent predict that capital from Central and South American investors will make up a higher proportion of their AUM.

All this adds up to increased complexity when it comes to managing private fund businesses. Many respondents are looking to outsource parts of their operations: 51 percent of respondents are seeking to outsource at least half of the fund administration part of their business and a third of respondents want to outsource at least 50 percent of their technology function, with 28 percent and 20 percent saying the same about legal and regulatory services, respectively. “Outsourcing among fund managers is clearly being driven by a desire to optimize their operations and focus on what they do best,” says Holz. “It’s also a way for them to manage certain risks, such as regulatory risk, given that it’s challenging to keep up with regulations across the different markets they are operating in.”

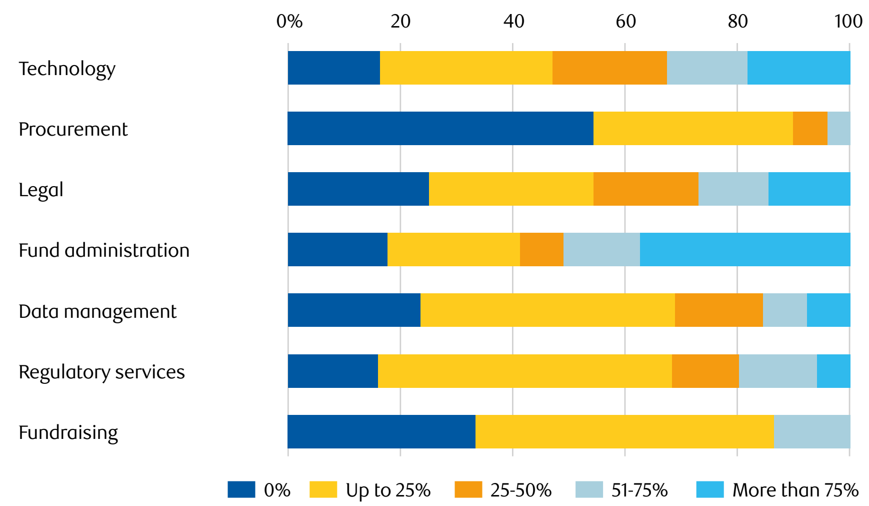
Big data, automation and artificial intelligence rank top among respondents for their potential to disrupt private capital investment in the next three years, yet over a quarter are not planning on implementing these technologies, and many report having little expertise in this area.

Less disruptive technologies could however help private funds streamline their processes without the need for high levels of investment. Smart contracts, for example, can help create base templates where there are a lot of similarities, such as liability frameworks, without the need to have a large element of involvement from lawyers. Regtech has a lot of potential for helping firms monitor regulatory developments globally and ensuring firms can stay ahead of the game – it could streamline passporting, for example, and be applied to AML and KYC compliance.

For those that invest in deploying technologies like big data, the prize could be access to better dealflow. Firms are looking at how they digitize their internal processes at a time when there is a lot of dry powder in the private markets space says. They need to differentiate themselves around how they originate and how they create value in their portfolio.

And being able to differentiate from the competition is uppermost in respondents’ minds. While the biggest barrier they perceive to achieving their objectives in 2019 is the economic environment (mentioned by 72 percent), competition is second for 42 percent of respondents.

What is your target outsourcing level for the following areas?

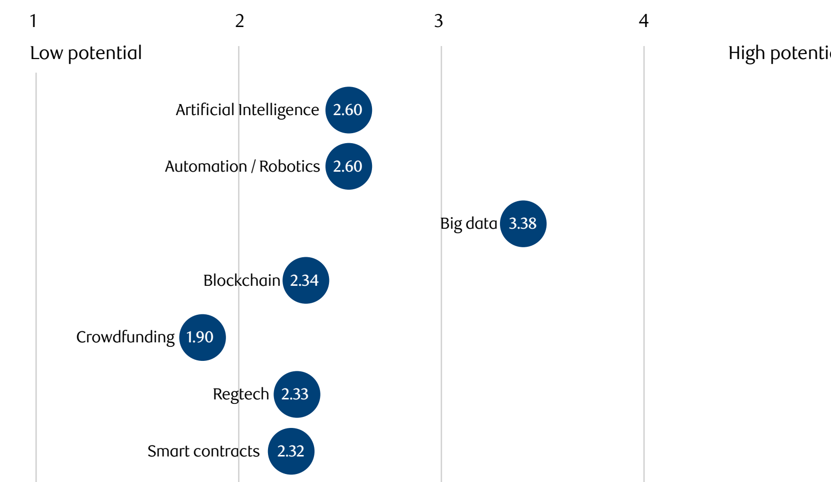


AUM rise may drive need to outsource

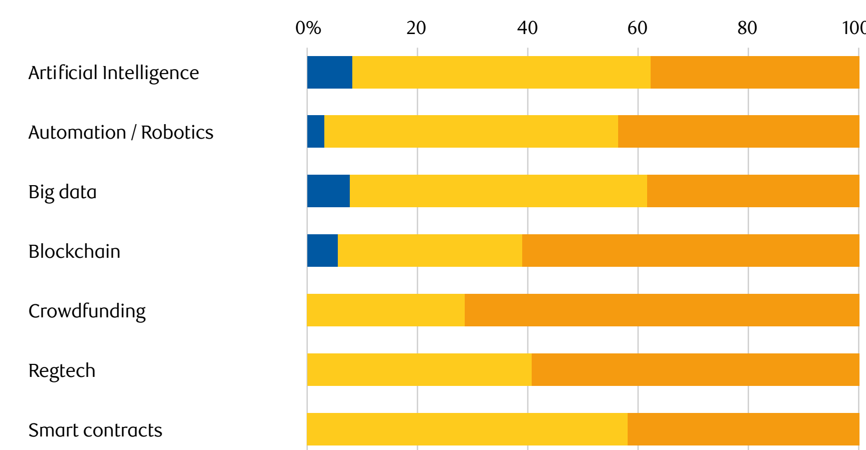
Private real estate managers had the most aggressive expectations for AUM growth among the three main types of private fund, the survey found. A quarter of private real estate funds in the sample anticipate an increase of 20 percent or more within the next year, significantly higher than private equity at 15 percent. To achieve this, private real estate funds will seek more capital from sovereign wealth funds, with 79 percent of respondents expecting an increase from this source compared with 72 percent expecting an increase from pension funds and 50 percent from retail investors. While a similar proportion of private equity funds are expecting an increase in retail investors, this looks rather more achievable for private real estate funds, given the prevalence of REIT structures in the US.

Yet the survey also suggests that private real estate funds may be somewhat behind their private debt and private equity cousins when it comes to outsourcing. Currently, just 27 percent of private real estate fund managers outsource their fund administration and just 13 percent expect to move up to a quarter of this function out of house over the coming 12 months. Private real estate fund managers also manage a far greater proportion of their data management and distribution in-house than either private debt or private equity. However, they have ambitious targets over the longer term, with most functions other than procurement and fundraising largely set for outsourcing.

What is the potential for the following to disrupt the private capital investment and service space in the next three years?



If your organization is not planning to implement any of the following, what is the biggest reason?



CYBER SECURITY FROM A PRIVATE EQUITY PERSPECTIVE

Investing in cyber

Cyber security is a universal concern in the financial sector. As threats and attacks know no boundaries, firms are increasingly focused on approaches to mitigate, protect, and manage cyber risks. And private equity firms are also eyeing opportunities.

At a recent Private Equity event in Paris, hosted by RBC Investor & Treasury Services (RBC I&TS) in partnership with Olivier Younès, Founding CEO at EXPEN, panelists discussed the current cyber environment and response strategies.

Managing against cyber threats

While not all companies are faced with daily cyber attacks, there is a widespread understanding of the value and importance of adopting measures to help protect against cyber risk. "Most firms today acknowledge that it is no longer a question of 'if' an attack will occur, but 'when', says Julie Zanon, Head of Information Technology (IT) for RBC I&TS in France. "The risks are multiplying and can include financial fraud and data theft, and potential reputational risk," she notes.

"It can be hard to recover from an attack, including the reputational impact, which could also result in a loss of clients. In such a competitive business environment, that is certainly an outcome most would want to avoid," says Sébastien Faivre, founding CEO of cyber risk detection software company Brainwave. To mitigate against these undesirable consequences, companies in all sectors are taking action.

Human resources play a key role

"Cyber security is a corporate governance matter," says Pierre Meignen, Managing Director and Member of Eurazeo PME Executive Board. "It has to be visibly supported by the company's top management to be taken seriously by employees." This approach, however, is not yet firmly imbedded. According to a study conducted in February 2019 by Deloitte[1] with IT managers across 850 companies, only 25 percent of companies have their security team directly tied to the executive committee. According to Philippe Legrand, Managing Director at RBC I&TS in France, this highlights the need for a focused multi-pronged approach. "Cyber security is a vast and evolving domain, which includes both technological challenges as well as human ones," he says.

The risks are multiplying and can include financial fraud and data theft, and potential reputational risk

Cyber criminals use the potential for human error as a point of attack and are employing increasingly sophisticated methods to gain entry. To address this threat, many firms, including RBC, are establishing robust training programs that include phishing simulation tests throughout the year to educate employees and raise awareness about cyber risks. "The purpose of these tests is to make sure everyone is engaged and has a clear understanding of their role in helping to prevent and thwart cyber threats," says RBC I&TS' Zanon.

New business models emerge

IT and risk departments are now working more collaboratively and the chief information security officer (CISO) role is becoming prevalent across all industry sectors. In response to the rising sophistication of fraudsters, cyber security solutions have also become more advanced, thanks to technologies such as artificial intelligence (AI). For this reason the search for talent is even more critical. "Recruitment and training of qualified personnel is a strategic imperative, and it is challenging," says Folliet.

In response to the rising sophistication of fraudsters, cyber security solutions have also become more advanced

According to figures released by the Ponemon Institute, 62 percent of heads of IT and CISOs say that neither automation nor AI will reduce their need for qualified personnel[2]. It is incumbent on firms to work to ensure that the relevant resources and internal training programs are in place to act as a strong defence against cyber threats. Widely published data breaches should not be the trigger for change.

The existence of a solid plan can potentially influence investment activities. "Today, IT and cyber audits are systematically conducted when we are considering an investment, along with strategic, legal, and financial audits," says Meignen.

Faivre also sees opportunity. From a business perspective, he notes, "If some obstacles remain, our solutions to overcome these challenges help us become a more desirable investment."

Investors look to leverage investment potential

Increased awareness and spending on cyber security has resulted in private equity investors exploring the sector for investment opportunities. Bertrand Folliet, Managing Partner at Entrepreneur Venture, is aware of several funds that became more actively engaged in establishing a more robust cyber mitigation program after experiencing cyber fraud attempts. From a private equity perspective, that interest is then being converted to identifying investments in the fintech sector with firms that focus on cyber security.

Sources

1 https://www2.deloitte.com/fr/fr/pages/risque-compliance-et-controle-interne/articles/enjeux-cyber.html

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PRIVATE CAPITAL INSIGHTS

FIVE MINUTE FOCUS

Enhancing the private capital client experience

As allocations into private capital continue to grow, the demand for detailed reporting, analytics and solutions that streamline complex operational processes is also increasing. How can fund managers scale-up their operations through automation to more effectively manage these complex asset classes and help simplify administrative burdens?

RBC Investor & Treasury Services (RBC I&TS), discusses the current private capital environment and the path forward.

1. What is driving the demand for more sophisticated private capital reporting solutions?

Institutional investors have become accustomed to a certain reporting standard for their liquid assets, and expect that level of consistency and transparency across their portfolio, including private capital holdings. From a regulatory standpoint, Europe's introduction of the Alternative Investment Fund Managers Directive (AIFMD) in 2013 helped satisfy investment policy requirements for independent oversight from a depositary. However, limited automation and digitization capabilities have influenced the level of detail and reporting flexibility required by investors.

2. What are the main private capital data challenges that exist today?

The need for a streamlined, integrated technology and operations infrastructure is becoming a priority. One of the common challenges limiting a manager's ability to provide a digitized experience to their investor clients is that data generally needs to be gathered from multiple sources, which then needs to be structured and analyzed before it is delivered on to clients. Much of the reporting today requires considerable manual intervention, which adds significant time, and is more prone to inaccuracies. Asset owners are looking for direct digital access to data and documentation, online banking capabilities to manage investments and income, plus advanced analytical based portfolio management tools.

Assets under management of private capital and other alternative asset classes are expected to total USD 14 trillion by 2023 as institutional investors continue to seek higher yields[1]

The complexities of reporting private capital assets also explains in part why this market segment is falling behind others in terms of client experience. For example, many managers have fund structures, investments and investors located across multiple jurisdictions, which makes standardized reporting a challenge.

As allocations into private capital continue to increase, we should expect that more scrutiny from regulators into the type, detail and frequency of reporting that end investors receive will inevitably follow.

3. How can service providers facilitate this transition?

Fund managers are definitely looking to their service providers for solutions and support. In our role as depositary and fund administrator, providers have a significant amount of the required data that can help improve the underlying client experience. However, it's not as simple as a plug and play scenario.

For data to be more impactful and insightful, we collaborate with fund managers to understand what is required, identify the appropriate data sources and look to package it in a way that meet the needs of the manager and their end clients. Based on our experience, our clients generally prefer to be the sole contact for their investors. So we want to ensure that data delivery is seamless and provided in formats that can be easily ingested, managed and interpreted.

We recommend a consultative partnership between the fund manager and service provider to ensure transparency across digital platforms. Understanding investor reporting expectations, objectives and benefits to the end client is the key starting point. These criteria ultimately guide what type of data is required, where the data is coming from and the most appropriate distribution channel. It's about providing an enhanced client experience and adding value with insights. We need to work towards developing approaches that provide more consistency across all asset classes.

Sources
[1] Preqin The future of alternatives

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