Outsourcing the key to administrators' value-added focus

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Guernsey's fund administration sector is booming, and private equity is its principal driving force. Although the launch of more lightly-regulated fund regimes in the Channel Islands has been popularly associated with the development of the hedge fund industry, and the jurisdiction does have its share, especially funds of hedge funds, in practice much of the new business coming in consists of private equity and to a lesser extent property funds.

This pattern reflects what members of the industry see as an inevitable model for the industry, given the constraints imposed by the island's geographical size and its housing market on its workforce. Guernsey lacks the human resources required to service - at least on its own soil -funds that conduct huge volumes of transactions or have many thousands of investors; but it is well suited to handling vehicles where the number of investments and investors is low, but handling them requires high levels of skill.

'Private equity and property are excellent asset classes for Guernsey,' says Bob Banfield, managing director of Investec Administration Services. 'The technical aspects of those asset classes suit the island's infrastructure and experience very well. Guernsey is no longer a cheap jurisdiction in which to do business, so we need to be looking at higher-value, less process-driven asset classes where typically you would expect quite high margins.'

He is echoed by Ian Burns, group managing director of the Anson Group, who says: 'With its sophisticated and well-trained workforce, Guernsey needs to focus on high-end, low-volume work. Everyone in Guernsey - and Jersey for that matter - will tell you there is pressure on staff resources and accommodation. I for one would not want to be competing with the hedge fund and private equity service providers in Dublin who offer a volume solution.

'In our business, funds of funds, Guernsey is very well placed and offers a good level of knowledge now. But it can't do volume business any more, or rather it can't grow its volume business and doesn't particularly want to. Private equity is exactly what we want to do because the typical fund will have an institutional base of 10 or 20 investors and five or six investments. When I meet managers in the UK with funds that have 1,000 lines of stock, 200 short positions and do 15,000 trades a month, I say: Go to Dublin, that's not what we do.'

Despite the presence of a handful of larger generalist players such as Northern Trust, Guernsey's focus on private equity business is reflected in a preponderance of specialist administrators, whose ranks are being swelled by a steady stream of start-ups. 'A couple of players have said they will do private equity and nothing else, and one or two more will not get involved in hedge funds at all,' says KPMG partner Rob Hutchinson. 'People realise what their skill set is, and quite rightly - you should never go into a business with the wrong skills. The trend is toward sticking to what you know.'

One of the specialists is International Private Equity Administration, founded in Guernsey in 1997, although today, with expansion underway to London, Jersey and beyond, it can no longer be categorised as small. 'We do have other types of related fund, including some real estate, mezzanine and funds of funds, as well as some secondary and venture capital funds, but they're all closed-ended structures,' says executive chairman Connie Helyar. 'We've never looked at diversifying because we've simply been inundated with work on private equity and associated products.

'A lot of fund administrators do all sorts of things, but the difficulty is that you need different types of people to do different types of administration, and it gets more complicated the bigger you get. Many providers service closed-ended funds that invest in liquid securities, or funds that are listed on

Aim, or hedge funds, where the investment process is different. We geared ourselves to what we know best and became a specialised provider, and it's paid off.'

Administration work in Guernsey is not necessarily tied to the domiciliation of funds in the island. Helyar says Ipes services a mixture of Guernsey, UK, Cayman Islands and Delaware structures, mostly limited partnerships. 'A lot of them are UK-based limited partnerships because it is a way of ensuring that the fund has all the advantages of UK statute law,' she says.

'This came about because of one very big US investor who found that Guernsey partnerships had never been challenged, so there wasn't any precedent to prove their limited liability status. To get round this, London law firm SJ Berwin put a UK structure in place and then migrated it offshore, and they have used this model a lot since.'

Specialist private equity administration is far from the sausage-machine procedures that often characterise the servicing of traditional assets. 'It's usually bespoke transactions, frequently involving the establishment of dedicated holding companies and structures,' Banfield says. 'It can involve complex structures in two or three jurisdictions just to hold a single asset - and these structures usually have to be established at fairly short notice.'

While valuations can often be a slow process, he says, the pace can suddenly accelerate. 'Our private equity clients are particularly looking for responsiveness, especially if a deal needs to be done. When the fund's board votes to follow the manager's recommendation to do the deal, it's down to the administrator to deliver on the nuts and bolts and make sure everything is in place to complete the transaction without delay.

'As administrators we put a lot of effort into trying to understand our investment managers' needs in terms of timeframes and reporting, so that we can try to match their expectations. It means sitting down with them on day one to understand what they expect of us. When there's a clear understanding on both sides of what the deliverables are, things can work smoothly the first time you're operating under pressure.'

In some ways, the principles underlying the servicing of private equity funds are the same as with any alternative asset class, according to Iain Stokes, head of European private equity at Mourant International Finance Administration. 'Sophisticated investors are committing significant amounts of money to an asset class that enables them to diversify their risk profiles and can potentially earn higher returns, with higher risk as the trade-off,' he says.

'The private equity industry is maturing and the profile of limited partners has changed significantly, from smaller investors who don't have their own investment community to which they need to report, to big pension funds and banks selling products on to their institutional or private client base. As a consequence, general partner reporting is of huge importance. The decision to invest or otherwise can sometimes come down to the quality and transparency of the reporting that the investor can expect from the fund, because the investor needs to manage its own risk profile and report to its own investor base.'

The change in the industry's public profile is also significant, Stokes argues. 'Some leveraged buyout funds are close to being household names,' he says. 'The industry is under public scrutiny from interested parties ranging from trade unions to governments because of the range of its financial firepower. Private equity now accounts for a quarter of all private sector employment in the UK, and directly or indirectly generates tax revenues of some GBP30bn. This is a niche industry that's gone mainstream, and that means transparency and accountability.'

It's tempting but too simplistic to suggest that private equity houses prefer to deal with niche administrators that can offer personalised service, Hutchinson argues; sometimes bigger can be better. 'It depends on the private equity house and what they want,' he says. 'If you want a close relationship, you have to be sure the people you're involved with can provide that, whether they are big or small. It may be a smaller player, but then again the private equity house may want the comfort of a big organisation that can pull the resources in the event of a big deal.

'There's a tension for the administrator between being able to understand fully and being closely involved with the client, and being able to respond as the client grows. If the manager sticks with a small player, it won't be small very much longer. They may be two or three people when they're set up, but they grow rapidly and the closeness of the relationship will gradually diminish.'

As in every area of administration, technology has an important role to play in private equity, Hutchinson says, but it is less of a holy grail than in, say, hedge fund servicing. 'You can't do business without the technology to run the basic accounting functions or the investor relations database, but it can only go so far,' he says. 'There's no point in having the biggest and best database in the world if you have no-one to run it, take the reports off and satisfy the investors' needs. You can do private equity without having the best technology in the world, as long as you have people who know what they're doing.'

In Guernsey, such people are not in unlimited supply. Says Stokes: 'We all deal with it in our own way, but Guernsey is likely to remain a restrictive environment simply because of its geography. It's done an incredible job in terms of building a credible industry to service a global market, but at the same time the stresses and the demands of investors are becoming more complex.

'We're in a marketplace where competition is driving down revenue and where there will always be competition for resources, of which the most important is your staff. That inevitably adds inflationary pressures, so whether you want to or not, you are forced to look at your operating model. That's why we are seeing an upsurge in administrators' use of outsourcing, either to a third party or to an in-house operation in another jurisdiction.'

Stokes argues that the biggest challenge is to make it 'invisible to the client where the work is performed. From the client's perspective, you have to ensure the integrity of the structure remains intact, particularly if you're dealing with an offshore fund - there are all these issues around management control and decision-making. But ultimately the responsibility lies in Guernsey, and that's where the greatest value is being added.'

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