Private equity administration resists market gloom

By *Anonymous*
Created *27/11/2008 - 18:19*

Financial service providers in the Channel Islands are feeling the downdraft of the economic crisis as overall levels of assets under management or administration stagnate or decline slightly, but the evidence so far is that private equity business has held up better so far than hedge funds or property, the other main categories of alternative investment in which Jersey and Guernsey specialise.

To some extent the lower levels of new business this year have offered something of a breathing space to firms that have seen massive inflows over the past few years, and that have now seized on the respite to make process changes and bed in expanded administration teams. And most administrators report that while new entrants into the private equity market and other alternative fund segments are having more difficulty in fundraising, well established general partners with solid records of achievement continue to enjoy the confidence of their investors.

'Promoters that have been in business for a few years are still launching funds and are still able to attract money,' says Chris Hickling, head of fund operations at Investec Administration Services in Guernsey, 'but there are fewer launches from new promoters because it's much more difficult to attract money without a track record. If you already have a fund out there investors may be more wiling to put money into your second fund, perhaps with a slightly different strategy or regional focus.

'We are still receiving plenty of enquiries from both existing promoters with whom we have been working for some time as well as a couple of new ones. Funds aren't coming to launch quite as quickly, but they are moving forward. Guernsey saw around 21 fund launches in the past quarter, a small reduction from the previous quarter.

'In private equity and property, it's still too early to see the full impact on net asset values, whereas it's been more significant so far for hedge funds. It's not unusual for private equity and property funds to have an investment horizon of five or seven years plus two years for the exit period, and if valuations are down that process may be held up. On the other hand, there is a lot of interest in getting back into the market. If you have money, there are a lot of options.'

He is echoed by Horace Camp, an executive director at Anson Group, who notes that there is growth in funds that invest in non-traditional and non-cyclical asset classes, such as timber. 'It's the time now for funds with 'opportunity' in their name,' he says. 'One investor's misfortune becomes another person's gain. The potential gains will move on to another group of investors from those who currently hold the assets.'

Camp believes that Guernsey is well placed to respond to the trickier market conditions because it has the kind of structures that managers require to establish the opportunity and 'vulture' funds that are now in favour. 'The past three or four years were unusual in that the type and size of funds being launched were outside the parameters of those of the previous 30 years,' he says. 'There were a lot of IPOs and those fabulous billion-dollar funds, but they are now few and far between. This year has seen few IPOs and the funds are smaller, but all the lawyers and administrators are still busy.'

They are also being called on to move more speedily - something that has been assisted by the regulatory changes in both islands over the past four years, involving administrators taking on responsibility for due diligence on behalf of the respective regulators, in return for the promise of a rapid authorisation turnaround time (or simple notification in the case of Jersey-domiciled Unregulated Funds).

'We are seeing these opportunistic people going for value and wanting to set things up relatively quickly,' says Graeme McArthur, managing director of Northern Trust International Fund

Administration Services (Jersey). 'Our private equity client base of 57 promoters are being approached by investors that are looking for something, and the promoters is then coming to us to announce they are launching a fund.

'It may not be the same as previous strategies but the opportunities are there. Firms that have expertise in asset management but are less familiar with private equity structuring may be looking to establish a private equity-like vehicle with different asset classes, such as real estate.'

If anything, the increased scrutiny of the alternative investment industry on the part of both investors and regulators is set to increase the workload for administrators and custodians, according to Kevin Mundy, head of client solutions for UK offshore business at BNP Paribas Securities Services.

'With increasing sophistication and variation in the investment model and a wider investor base, it is likely that the need to disclose will drive private equity players to outsource more of their non-core activity to administrators and custodians who can manage data, deliver independence and produce clear and concise reporting on a diverse range of geographically spread investments,' he says.

'Accounting and regulatory changes, along with the development of a voluntary code of practice, will undoubtedly increase the focus on the quality of reporting in respect of financial performance, balance sheet structuring and the valuation methodology, particularly as 'fair value' on exit can lead to greater volatility in the performance of the fund.'

Some administrators that have specialised in areas of the market that are more affected by the economic environment are seeing a switch to other types of business. For example, Kleinwort Benson enjoyed a surge of business in listed closed-ended funds following the establishment in June 2006 of the USD5bn Euronext Amsterdam-listed KKR Private Equity Investors, followed by listed funds from other US private equity firms such as Apollo.

Since then the Guernsey firm has handled a wide range of listed vehicles, including hedge funds, that have been listed in Amsterdam or on the London Stock Exchange, but as the IPO market has dried up over the past year Kleinwort Benson has seen more work from open-ended funds and notably from infrastructure vehicles, according to head of corporate clients Peter Mills.

By contrast, the group's Jersey office has long specialised in mezzanine finance vehicles, an area that has been particularly busy in 2008. 'Jersey took on the administration of Intermediate Capital Group when it was first set up more than 15 years ago, and our team there has built up a particular expertise in mezzanine finance,' Mills says. 'Since ICG is the leading mezzanine finance house in Europe, when anyone wants to do a fund our Jersey office is always one of the names put forward.'

Northern Trust is also benefiting from the growing interest in infrastructure investment, which is seen as comparatively recession-proof and as a generator of substantial cash flows, capable of producing the income streams that corporate dividends or fixed-income instruments can no longer be relied upon to deliver.

'Our teams in both Jersey and Guernsey are doing infrastructure funds, which we bracket together with real estate,' McArthur says. 'Infrastructure funds involve long-term projects to build motorways or other capital installations. You have a restricted number of investors that commit capital and the fund draws it down over a period until the end of the project in seven or eight years' time. In many respects it's similar to traditional private equity. We combine the skills of administering the capital drawdown process with a knowledge of physical property.

'We are seeing more hybrid products coming through, and I think it will be an increasing trend. One of our clients in Jersey is a very large traditional hedge fund manager who is seeing the attraction of a private equity-type structure. You will see an increased mix of strategies and structures as people look for an absolute return of some kind.'

Far from presenting problems to administrators, McArthur says, 'we get to have much more fun. As clients cross from one area to another, we have to combine all these disciplines. Northern Trust is a rare beast in that it embraces everything from money market and traditional long-only funds to real estate, infrastructure, private equity, hedge funds and funds of funds. We have all the expertise we need within our ranks and it's just a question of finding the right combination when someone comes along with something unusual.'

As a director of Louvre Group, Kevin Gilligan belongs to a smaller operation but the Guernsey-based trust company and fund administrator shares Northern Trust's international scope (it has offices in Dubai, Hong Kong and Switzerland) as well as its eclectic range of skills. 'Our promoters are based all around the world and we oversee a wide range of strategies, including commodities, currencies, single-strategy funds of funds, property and private equity,' he says.

'We have the experience to handle anything thrown at us, and we're happy to look at anything weird and wonderful. We can work with promoters to provide tailored solutions even if it doesn't particularly relate to what we're doing already. We're quite interested in getting involved in alternative alternatives such as art, timber or water, which offer significant diversification amid the credit crunch.'

- Articles and Features

Source URL:
http://www.hedgeweek.com/2008/11/27/private-equity-administration-resists-market-gloom