PRIVATE EQUITY

A GUIDE TO OUTSOURCING FUND ADMINISTRATION SERVICES

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THE RISE AND ACCEPTANCE OF OUTSOURCING

The trend towards outsourcing fund administration has grown rapidly over the past decade as managers enjoy the benefits of outsourcing through greater efficiencies and improved market knowledge. Recently, as working from home has become the new norm, the fund administration industry has made big changes to adapt and adjust quickly. The industry has proven itself to be robust and the transition to mobile working has been smoother than expected.

General Partners (GPs) have traditionally relied heavily on face to face interactions in an industry that has always been quite conservative. However, with the technology developments and acceptance that has come with the lockdown, General Partners are quickly realizing that technology is a support to them as they adapt and modernize. New technology tools and security protocols are bringing about greater productivity and cost efficiencies, and this has led to an upswing in the outsourcing of administration operations.

Demand for outsourcing had already been on the rise before the private equity industry had to adjust to new ways of working. Regulatory pressures, increasingly complex investment strategies and increased reporting requirements from investors have all influenced the transition of many Private Equity funds to outsourcing. Now, as managers embrace mobile working and digital communications, we are seeing an acceleration in demand.

According to Preqin, global alternative assets under management topped $10 trillion as of June 30th, 2019 which has increased from $3.5 trillion in 2013. In their ‘ Alternatives in 2020’ report, Preqin believes that global AUM is on track to exceed $14 trillion by 2023. According to eInvestment, it is estimated that Private Equity accounts for almost 20% of this total.
Hedge funds were early adaptors to outsourcing their fund administration services. Now private equity managers are enjoying the benefits of outsourcing through greater efficiencies and improved market knowledge.

There is a clear and growing trend for private equity firms to outsource their fund administration as the demands of regulators and LPs make it inefficient and impractical for GPs to continue to administer funds in-house. At Centaur, we are seeing first-hand a growing number of private equity managers making the move to administrators with dedicated technology, expertise and infrastructure to deal with the increasing complexity of the private equity fund business. The benefits of outsourcing are many:

1

**Focus on Core Skills**

Private Equity managers are facing new challenges at work with increased pressure on performance and focus on transparency, compliance and risk management. Outsourcing the administration elements of a PE fund allows the manager to focus more efforts on their core competency i.e. investing their clients’ funds. Fund administrators such as Centaur also provide skillsets that are simply not available internally with PE managers.
2 Regulatory Requirements

AIFMD, FATCA and Dodd Frank are just some examples of highly complex regulations that now impact PE funds. As reporting demands grow, so too does the specialist knowledge which independent third-party administrators are well placed to provide. Additionally, operational risk for PE firms are minimised as continuity of service is ensured by fund administrators.

3 Increasingly Complex Structures

As the regulatory framework increases and GPs seek investors based in a variety of jurisdictions, fund structures have become far more complex than they were ten years ago. Third party fund administrators are able to handle the demands of more complex structures using multiple jurisdictions and legal forms, in a manner which is very difficult for GPs to achieve on their own.

4 Access to Technology

Private Equity firms are realising that excel spreadsheets won’t suffice anymore. Spreadsheet risk is a real concern and GPs are growing more serious about offering the long-term reliability and audit trail that is provided by third party administrators. Leading fund administrators, such as Centaur, invest heavily in their technology platform. This ensures open, transparent, customizable and most importantly, secure reporting, based on client requirements. PE firms can reap the benefits of these systems without the cost and time associated with implementing and maintaining in-house systems.

5 Investor Demands

Investors are demanding operational excellence from their fund and are increasingly demanding third party administration. The trend to outsource is being driven by market pressure on PE firms to deliver tighter accounting processes with greater transparency. Using a third-party administrator adds credibility to firms that move towards outsourcing.

6 Transparency

Investors require improved transparency to protect against investing in questionable funds. This protection is secured by using a third-party outsourced provider to verify the net asset value (NAV) of their funds to validate valuation.

7 Demand for Scalability

Historically, launching a new fund took significant financial and time commitments from PE firms. Now, outsourcing much of the heavy lifting of a new fund to a third party enables PE firms to expand their business in a lower risk environment, making them more flexible and open to market opportunities.

“In-house fund administration is often a misuse of precious resources. Being able to partner with a reliable, independent provider brings many benefits and enables PE managers to focus on their core competency which is investing their clients’ funds.”
CONSIDERATIONS WHEN APPOINTING A FUND ADMINISTRATOR

There is a clear and growing trend for private equity firms to outsource their fund administration as the demands of regulators and Limited Partners (LPs) make it inefficient and impractical for GPs to continue to administer funds in-house. Whether outsourcing administration for the first time or considering moving to an administrator with more experience and focus on the private equity sector, there are four points to consider:

ACCOUNTABILITY

There is no doubt that cost and the ability to service often complex products are important considerations when choosing a fund administrator. However, relationship-based factors such as client service and reputation are also vital to the long-term partnership between a fund, investment manager and administrator.

At Centaur, we believe we are entering an era where administrators must take accountability for their actions. Managers can remove this risk by engaging administrators, like Centaur, that sign up to detailed deliverables in legally binding agreements to ensure that their funds are managed appropriately.

SYSTEM SOPHISTICATION

Savvy fund managers are demanding technology maturity from their fund administrators. Leading-edge technology is critical in helping administrators to deliver their services to clients. Better processes, impregnable security and clients’ needs should always be at the forefront of their thinking. Apart from regulatory events and financial market conditions, the risk of cyber security threats is on the rise and any administrator worth its salt ensures that cyber risk is proactively managed through informed decision making within each level of their organization.

INDEPENDENCE

Independent administrators provide focused and unbiased services to funds and investment managers. As fund administration is Centaur’s core business, we invest constantly in our platform to meet the evolving needs of our clients. With a sole focus on administration, there are no potential conflicts of interest across company divisions. Selecting an independent fund administrator means there are no side businesses or competing services to distract the administrator from its goal of providing clients with the best processes and people.

Also, with independence comes flexibility. Independent administrators such as Centaur respond faster to technology and regulatory changes, which puts them at the forefront of innovative thought.

SEAMLESS TRANSITION PROCESS

If a fund or an investment manager makes the decision to switch administrators, the transition should be as seamless as possible. Dealing with a dedicated transition team is the first step in building the working relationship between a manager and a new administrator.

A smooth process built on the back of a detailed plan can allow a fund to upgrade its administration services with no interruption in the reporting requirements and minimal disruption to investors.
MANAGING YOUR OUTSOURCING RISK

As regulations have become more stringent, PE managers are under the spotlight to deliver a huge array of complex information accurately and on time and are turning to fund administrators to fulfil these ever-increasing obligations. To mitigate risk, prudent managers must conduct appropriate operational due diligence when selecting a new fund administrator for their fund.

As part of this due diligence process the manager must consider their fiduciary obligations to all stakeholders, especially investor of the Fund.

Below are considerations that are be taken into account the ensure administrators are minimising operational risk for their clients.

Cyber Security Risks

Not only are cyber attacks more prevalent, but they are becoming ever more sophisticated and destructive. As a result, regulators are increasingly penalising firms over data leaks or for inadequate and ineffective controls for data security. Fund administrators must strive for no less than a 100% safe and secure environment for their stakeholders.

Risks from Regulation

Faced with the constant threat of sanctions for non-compliance, fund managers often look to their administrators to guide and assist them to deliver on their regulatory obligations. Clients need administrators to provide robust and accurate regulatory reporting, backed by effective compliance monitoring programs to provide assurances that all regulatory requirements are being met.

The Risk of Outsourcing Services

Outsourcing services to a third party is commonplace across the fund administration industry. Outsourcing brings its own risks and challenges and, as a result, outsourced relationships are gaining greater regulatory
scrutiny with an increasing emphasis on service provider management, internal controls, liability, risk management, compliance oversight and data security. Administrators such as Centaur choose not to outsource any of their fund administration services to external third parties. They remain fully in control and accountable for all the services they provide to our clients.

Organizational Changes

Even the smallest organizational changes, if not properly managed, can have a significant adverse impact on the day-to-day functioning of the firm and the services it provides.

Fund administrators need to be flexible, be open to change and have a robust change management process in place to identify and mitigate the associated risks when changes need to occur.

Risk from Technology Failures

Although technology and automation are powerful tools for reducing operational risks associated with manual error, they can also present their own unique risks if not properly controlled.

Risk management forms an integral part of all technology related initiatives to avoid disruption to the provision of services. It is vital that the administrator ensures adequate and effective business continuity planning and disaster recovery processes are in place and regularly tested.

TRANSITIONING SERVICE PROVIDER IS NO LONGER A DAUNTING PROSPECT:

Investors are supportive of funds moving service providers to obtain a better level of service and better contractual terms. The proof is in the numbers: To date, 50% of Centaur’s clients have migrated from other service providers.

It’s all about making the transition smooth and performing in real time. Having a detailed plan with a dedicated team ensures that the transition to a new administrator is made effectively and seamlessly.
STEPS TO ENSURE A SEAMLESS TRANSITION

Appointing a third party administrator is a significant decision. Funds can’t afford service disruption, even for a moment. The right fund administrator can help make the transition as seamless as possible with no decrease in service level and minimal disruptions to investors.

Moving fund administration is a process, but it doesn’t need to be a difficult one. Whether you are outsourcing administration for the first time or considering moving to an administrator with more experience and focus on the private equity sector, Centaur shares its best practices for a smooth transition:

STEP 1: SERVICE LEVEL GOALS

The first step in an effective transition process is to define service level objectives and goals for each phase of the contract. Clear and timely communication is key at this stage of the process to address any issues that may arise. At Centaur, dedicated teams are put in place for the on-boarding of each private equity fund client.

STEP 2: KNOWLEDGE TRANSFER

It is vital for the administrator to obtain a full understanding of the fund’s existing operations and structure, including all SPVs and co-investment vehicles. Centaur assigns a client service team at this stage, well in advance of the service start-up date. All LP records are checked as part of the on-boarding process. Additional checks are made to identify areas where efficiencies can be made, ultimately leading to better reporting once the administrator appointment goes live.

STEP 3: DATA COLLECTION AND INTEGRATION

Fund data may present challenges. Funds store data in different formats, from spreadsheets to complex databases, which the new administrator must collate and integrate into its technology platform. Bringing both financial and non-financial data from disparate sources into a new system can be a mammoth task so it is important for the fund administrator to have robust systems and processes in place.
STEP 4: PARALLEL ADMINISTRATION

Operational stability is core to a successful transition service. In the period between contract signing and service start-up, experienced administrators execute a parallel administration service. Appropriate bank accounts are set up, legal documents are reviewed, and relationships are developed and maintained with the fund’s external service providers, such as auditors, lawyers and bankers. These steps ensure greater efficiency and no unnecessary costs down the road.

STEP 5: ADMINISTRATION SERVICES GO LIVE

During this final phase of the on-boarding process, systems and processes are tested, accounting records are prepared, and all stakeholders are informed. Once the fund is up and running, Centaur’s on-boarding team continuously anticipates clients’ future requirements and presents ideas in a proactive manner.
Technology is a critical component of a successful administrator. As fund administration complexity and regulatory burdens grow, technology is playing an increasingly critical role in the administration process. Clients can reap the benefits of third-party systems without the cost and time associated with implementing and maintaining them in-house. In the current environment, many administrators have been proactive in keeping funds connected with their investors and advisors. This can be done in many ways, such as hosting virtual board rooms and delivering accurate and timely reporting.

Fund managers need to be able to rely on real-time access to reporting through portals where they can drill down into data at any time and across multiple jurisdictions with complete transparency.

Technology and Client Service

There is no doubt that technology has become critical to client service. Fund administrators need to offer immediacy, personalization and transparency, all on an accessible and secure platform. However, person-based client service should never be compromised and should work with technology to provide advice and assistance based on experience.
THE RISE OF THE HYBRID FUND ADMINISTRATOR

As managers develop more private equity-like fund strategies and hedge funds become more attractive to private equity investors, there is a real demand for administrators to deliver a hybrid solution that incorporates elements of both private equity and hedge funds. Centaur presents four reasons why legacy service providers have been losing private equity clients to more robust fund administrators who offer hybrid administration services.

DEMAND FOR GREATER EFFICIENCY AND ACCOUNTABILITY

Successful managers have responded to investor demands by offering greater transparency and access to all asset classes via one vehicle rather than having to invest in many. This hybrid flexibility gives managers a competitive edge, by driving down costs and improving operational efficiency. It also brings significant complexity for administrators, requiring new reporting models and multiple additional services.

As a solutions-focused firm that supports clients, Centaur goes far beyond the confines of Fund Administration. Rather than supplying a suite of individual products, Centaur acts as a single source that delivers overall administration strategies to our clients, covering both hedge funds and private equity funds.

COMPLEX STRUCTURES AND REGULATIONS REQUIRE EXPERTISE

The implementation of regulation, such as AIFMD and FATCA, has added a level of complexity to multi-layered fund structures. This has seen costs rise for all regulated firms as more capital is invested to meet regulators demands.

It makes economic sense for managers to outsource regulatory compliance functions to expert providers where possible. Administrators have the necessary skills and data to ensure that all funds comply with regulatory requirements. The same applies for complex structures, where the hybrid model reduces operational errors, delays and inaccuracies associated with the increased complexity of multiple fund structures.

MORE INVESTMENT OPPORTUNITIES

Traditional private equity administrators have limited experience, which in turn stems the business development of their clients. At Centaur, clients have the bandwidth to develop new products and report their performance using the most innovative systems in the market.

TRANSPARENT REPORTING IS THE NEW STANDARD

Managers want high quality, accessible and customised reporting from a single source and in a form that meets the managers, the investors and in many cases, the regulator’s requirements. Successful administrators create robust and accurate reporting in a single report drawn from multiple sources.

Centaur looks to solve our client’s hybrid requirements by offering a full range of reporting capabilities. These can pull up assets from hedge funds, private equity funds and Hybrids to be made in a single report.
SUPPORTING CASE STUDY:
SENTIENT EQUITY PARTNERS

Sentient opts to outsource its fund administration services to Centaur and reaps the benefits

After 18 years of self-administering their funds, Sentient Equity Partners (SEP) made the decision to outsource their fund administration. Their objective was to reduce their key man risk, leverage Centaur’s technology rather than support their own and provide their LP’s with an independent solution. They selected Centaur because of its independence and in-depth knowledge of the Private Equity market.

CHALLENGE

Following a successful growth trajectory, Sentient Equity Partners recognised the need to outsource their administration as they were outgrowing their internal infrastructure. Sentient also wanted to offer their Limited Partners an independent fund administration solution with specialist knowledge that could fulfil all reporting and regulatory requirements.

SOLUTION

Following an extensive search, Sentient chose Centaur for its expertise and independence. After converting Sentient’s historical data onto Centaur’s PR system, Centaur PR then mirrored Sentient’s IRR calculations to ensure the on-boarding process was effective and seamless. Now, Centaur manages all fund administration for Sentient, including corporate services, fund accounting and reporting. The result is reduced costs and increased efficiencies for Sentient’s funds.

“We see Centaur as an extension of our team. They are always on hand to guide us through regulatory developments and their technology is scalable to grow with our firm. We are delighted with our choice in Centaur and look forward to growing our relationship into the future.”

RESULTS

- Centaur PE converted 18 years of administration history onto Centaur’s PE software solution and mirrored Sentient’s IRR calculations.
- Centaur now responsible for Sentient PE fund administration, accounting for their GP entities and trusts, CRS, FATCA, AML Services and all capital call and distribution processing for their LP’s.
- Centaur PE reduced costs and risks for Sentient while providing a more independent administration solution to Sentient’s Limited Partners.
- Sentient is enjoying improved technology with the most innovative systems in the market that will grow with the firm.
- Centaur PE’s experienced team ensures Sentient is kept up to date with regulatory requirements.

ABOUT SENTIENT EQUITY PARTNERS

Sentient Equity Partners (SEP) originates from The Sentient Group which was the preeminent private equity fund in the natural resources sector. SEP was established by the Key Persons of the Sentient Global Resources Funds to continue with the management of US$2.7bn in the development of quality metal, mineral and energy assets. For more information, see sentientep.com.
NEXT STEPS

Appointing a third party administrator is a big decision, but it doesn’t have to be a difficult one. Centaur has a huge amount of experience in onboarding and their transition services team are at hand every step of the way for our clients during the process.

Our product team and service team assigned to clients manage the projects efficiently and effectively to ensure continuity of service offering.

ABOUT CENTAUR FUND SERVICES

Centaur is a leading independent fund administrator with offices in the United States, Bermuda, Canada, Cayman and Europe. Centaur delivers independent fund administration and regulatory services globally to the alternative investment fund industry, focusing on hedge funds, private equity and real estate funds, family offices and ILS funds.

WINNER OF TOP PRIVATE EQUITY AWARD: U.S. AND EUROPE

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