

# Facing private equity operational and governance challenges?



## How a Defined Benefit Plan team reduced risk and improved decision-making.

The investment team for a multi-billion dollar defined benefit plan (the Plan) has Limited Partner (LP) commitments to more than 200 private equity funds. When the Plan began investing in private equity, the team didn't fully appreciate the significant operational lift that a large number of investments would require. Eventually, the operations team was overwhelmed by the sheer number of Cash Flow Notices, Partnership Capital Account Statements, and Quarterly Financial Statements it had to process. Further, the team struggled to utilize all of the rich data General Partners (GPs) shared with LPs in these documents.

As a governance body, the board's investment committee was concerned with the risk associated with this significant private equity operational burden. The committee wanted to improve its governance framework through stronger internal controls, timely and accurate reporting, and transparent stakeholder communication.

As a result, the Plan sought out a comprehensive solution to alleviate the heavy operational burden, ensure accurate Net Asset Values (NAVs) for each private equity fund investment, improve data management, and enhance analytics for the private equity portfolio.

### Step 1: Identifying the pain points

The operations team experienced several acute pain points. Each of these represented not only hours of inefficient time spent, but significant risk for the Plan and the organization. The team identified several key problem areas.

#### Document overload

The team had to process an estimated 2,400 Partnership Capital Account Statements annually, along with 800 Quarterly Financials and 1,200 Cash Flow Notices. This amounted to approximately 4,400 documents each year, creating a significant administrative burden. For the IRS Schedule K-1s funds produce each year, the Plan did not have a repository. In fact, the Plan did not have a good process for gathering and centrally storing any of the documents it received.

#### Data management

Managing data from over 200 LP commitments was a daunting task. The team needed to track and manage documents and data for each commitment, including capital calls, distributions, and performance metrics. For each commitment, GPs share details on underlying portfolio companies. This involved handling vast amounts of data, often running into hundreds of thousands of data points. The Plan maintained the data in an unwieldy Excel spreadsheet and outright failed to track valuable data points for every investment.

#### Manual processing

The reliance on manual processing led to inefficiencies and increased the risk of errors. The team spent countless hours on data entry, reconciliation, and validation, which diverted their focus from more strategic tasks.

#### NAV calculation

Ensuring accurate NAV calculations for each private equity fund investment was complex and time-consuming. Without a fastidious shadow accounting, the Plan risked reporting an erroneous NAV for the holistic private equity sleeve of the portfolio. The team lacked the capacity and struggled to maintain consistency and accuracy, leading to potential discrepancies in financial reporting.

## Portfolio company data

Collecting and aggregating data on all private portfolio companies was another significant challenge. The team needed to gather information on sector, geography, and performance for each company, which was labor-intensive and prone to errors. With so many GPs using their own taxonomies, harmonizing data to draw conclusions for the aggregate portfolio proved cumbersome.

## The goal: Improving communications and decision-making

Not only did it take many weeks to prepare standard board reporting each quarter, but the front office sought more detailed analytics to better understand its private investments.

The team wanted to improve decision-making and their ability to explain those decisions to the board. The keys were identified as comprehensive data management and greater analytical horsepower.

**Better analytics:** The team lacked the data architecture and flexible software to cut the private portfolio in interesting ways to better understand exposures by sector or geography or performance by strategy type or investment category. Assessing liquidity requirements and gauging liquidity risk were a “best guess” rather than a scientific aggregation of the underlying data with deliberate portfolio stress testing.

**Efficient reporting:** The operations and investment teams scrambled to produce the same reports quarter after quarter for board reporting rather than efficiently producing a consistent set of reports and spending time critically analyzing the information to share unique insights with the board. Standard reports like performance analysis and attribution, exposures, liquidity analysis, and tracking unfunded commitments required manual effort rather than simply clicking a button.

**Deeper transparency:** The team ran into fire drills each year trying to determine exposure to specific things like Russia or Silicon Valley Bank because it didn’t consistently track important data from Quarterly Financial Updates. Rather than using software to quickly narrow down which funds were most likely exposed to the “crisis of the day,” the team had to reach out to manager after manager to confirm specific exposures.

## One solution to solve all the pain points

To address these challenges, the Plan identified a robust solution that addressed all the pain points while reducing risk and providing a high level of insight and decision-making support.

SEI proved to be a single provider capable of solving all the challenges through shadow accounting, streamlined investment processing, document management, data ETL (Extraction, Transformation, and Loading), and advanced reporting and analytics.

### Shadow accounting and operational support

The SEI operational solution was comprehensive and focused on the following critical areas:

<b>Official books and records</b>	Building and maintaining the official books and records for the private equity book, ensuring accuracy and reliability.
<b>Document management and data collection</b>	Establishing a process for gathering all documents and storing in SEI’s Document Library on the SEI-managed portal. This centralized system for collecting and managing all investment data now powers detailed reporting and analytics. Not only does SEI track balance and transaction data for each investment, it also integrates third-party vendor data for portfolio company/asset detail.
<b>Single NAV calculation</b>	Managing the process to strike a single NAV for the entire private equity portion of the portfolio, simplifying overall portfolio management. All investment processing feeds data to SEI’s central database which is integrated with Advent Geneva and FIS InvesTran, so that the SEI team could strike the portfolio NAV.
<b>Transaction and expense tracking</b>	Tracking all transactions and expenses related to private equity investments to better understand fees and ensure comprehensive financial oversight.

<b>Operational efficiency</b>	Processing of Partnership Capital Account Statements, Cash Flow Notices, and Quarterly Financials, reducing the manual workload on the operations team. As a fund administrator, SEI provides portfolio accounting services including reconciling any discrepancies and maintaining the official book of record for the private equity sleeve of the portfolio.
<b>General Partner oversight</b>	Strengthening oversight over each GP, ensuring alignment with the Plan's investment objectives and governance standards.
<b>Shadow accounting</b>	Implementing shadow accounting practices, including reconciling quarter-to-quarter Partnership Capital Account Statements and Cash Flow Notices to ensure accuracy. This also involved comparing LP statements with custodial records and resolving any discrepancies through a structured resolution process.
<b>Internal controls</b>	Enhancing internal controls to ensure compliance and accuracy in financial reporting.
<b>Transparency</b>	Improving transparency through detailed reporting, providing the board with greater insights into the private equity investments.
<b>Portfolio company data aggregation</b>	Creating a system to collect data on all private portfolio companies, allowing for aggregation by sector and geography at the portfolio level.

## Enhanced reporting and analytics

SEI introduced straight-through processing (STP) between portfolio accounting systems to allocation systems and other analytics engines to automate monthly and quarterly reporting. Through SEI's proprietary analytics system SEI worked with the Plan to customize and generate more advanced analytics. The advanced reporting and analytics solution included many capabilities, such as:

<b>Top positions</b>	Top-20 positions including Current Value (\$s), Total Cost (\$s), Current Multiple (TVPI).
<b>Exposures by Country, Sector, Industry</b>	Detailed reports on investment exposures categorized by country, sector, and industry, including changes in exposures across those categories over time.
<b>Tranche overview</b>	Exposures and performance by Vintage Year tranches including fields like Commitment (\$s), Funded Amount (\$s), Returned Capital (\$s), Fair Value (\$s), Current Multiples (TVPI, RVPI, DPI) <sup>1</sup> , and Returns (IRR %). <ul style="list-style-type: none"> <li>• Table &amp; chart of IRR by vintage year</li> <li>• Top positions for each vintage year</li> <li>• Best performers (IRR) by vintage year</li> </ul>
<b>Cash flows by vintage year</b>	Cash flow time series by vintage year including by position for each tranche. <ul style="list-style-type: none"> <li>• Commitments</li> <li>• Funded amounts</li> <li>• Returned capital</li> <li>• Current fair value</li> </ul>
<b>Annual cumulative Profit and Loss (PNL) for entire portfolio</b>	Time series PNL for the entire Privates Portfolio including drill down to time series PNL for every position.
<b>Time series performance ratios</b>	Time series ratios like TVPI, RVPI and DPI for the entire Privates Portfolio including drill down to the position level.

**Commitments and performance by other groupings**

Grouping the portfolio to understand commitments, funded amounts, and unfunded commitments by vintage year; IRR by Direct Investments, Co-Investments, Primary Funds, and Secondary Funds; and IRR by Domestic versus International Funds.

<sup>1</sup> TVPI = Total Value to Paid-In, RVPI = Residual Value to Paid-In, DPI = Distributions to Paid-In.

## An improved governance framework

Ultimately, SEI provided a comprehensive solution designed to be foundational for the Plan's improved governance framework.

### Internal controls

Strong internal controls are key to both compliance and accuracy. For the Plan, this starts with maintaining the official *book of record* for the private equity sleeve of the portfolio. SEI streamlined investment processing to help the Plan's small team properly handle all of the necessary steps to reconcile Cash Flows and NAV statements for each private investment and ultimately produce an accurate NAV for the entire private equity portfolio. As a result, not only was effective investment monitoring and better GP oversight introduced, but resource allocation for the operations team was optimized. Through strong internal controls and better operational efficiency, the team is able to focus on identifying and mitigating risks.

### Timely and accurate reporting

Data management is paramount to timely and accurate reporting. In addition to investment processing, we aggregate data into a centralized database that includes both "balance and transaction" data for each investment as well as "detail" for each portfolio company. Our standardized processes include data reconciliation to ensure data integrity. SEI provides the Plan timely and accurate performance measurement as part of its holistic financial reporting.

### Transparent stakeholder communication

With streamlined and reliable procedures for investment processing, data management, and accurate reporting, SEI ensures the Plan can provide timely and transparent stakeholder communication. Through consistent processes and reporting, the board has access to sufficient data to oversee the Plan and make appropriate decisions. The SEI Novus platform software opens up more robust analytics to drive deeper insights around liquidity requirements, contribution to return, and manager performance. This would not be possible without clean data driving the analysis. With a powerful analytics engine built on dependable data, the Plan now has the necessary data and systems to pursue a culture of continuous improvement in both the front office and the back office.

The implementation of this comprehensive solution not only helped to alleviate the operational burden on the Plan's operations team but also enhanced the investment committee's governance framework. By addressing critical governance topics, SEI provided greater efficiency, transparency, and accuracy for managing the Plan's private equity investments, with the ultimate goal of supporting their long-term investment objectives.

Important Information provided by SEI through its affiliates and subsidiaries. It reflects the opinion and views of the author and is not intended to describe any specific strategy or product. The information in this case study is for information purposes only, does not constitute investment advice or an offer to buy or sell securities, and should not be deemed to be a recommendation to make any investment. SEI Novus is a software company that services asset owners and asset management firms by providing portfolio intelligence software and related data solutions. SEI Novus is not an investment adviser, broker-dealer, or financial institution and does not offer or provide advice regarding analysis of securities or effecting transactions in securities. This case study, insofar as it discusses investment strategies, portfolio construction, and/or other investment-related themes, is general in nature and does not address any individual circumstances or risk tolerances which may vary significantly. The reader is reminded that an investment in any security is subject to a number of risks including the risk of a total loss of capital, and that discussion herein does not contain a list or description of relevant risk factors.

The reader should make an independent investigation of the information described herein, including consulting the reader's own tax, legal, accounting, and other advisors about the matters discussed herein. Much of the material contained in this document is subject to change and SEI has no obligation to amend or update the information.

For Institutional Investor Use Only. Not for Public Distribution

© 2024 SEI®