Investor Transparency as a Differentiator

MANAGING LP RELATIONSHIPS IN UNCERTAIN TIMES

Transparency's Critical Role

Seasoned investors have weathered volatility in the past, but the economic downturn introduced a new level of unpredictability into the investment landscape. While this is unlikely to dampen the rising popularity of the alternative asset class (in fact, allocations have historically increased during downturns), it is definitely impacting investor confidence.

To reassure uneasy investors, General Partners (GPs) should focus on supporting new levels of transparency, responsiveness, and candor.

Transparency has always posed a challenge for the private markets. The complexity of the asset class, the ease with which it has attracted capital in the past, and the lack of a single reporting standard have all hindered the development of processes that support the consistent, detailed, and timely delivery of information to the Limited Partner (LP).

But as the industry faces one of the greatest disruptions in its history, it's more important than ever for investment firms to re-evaluate the way they communicate with and report to their investors. Investor communications and reporting are critical capabilities during a downturn, but they also hold the key to success as the private markets benefit from the inevitable upturn.

This white paper considers how GPs can win the trust of their LPs during the downturn and position themselves advantageously for the influx of allocations that are predicted to transform private capital in the future.

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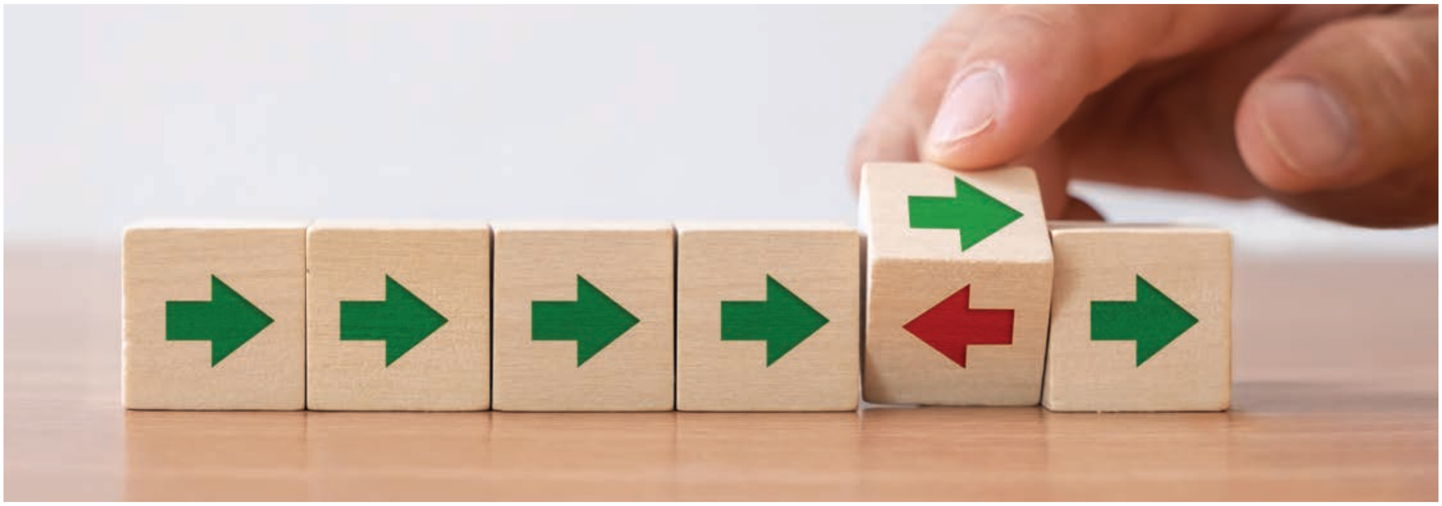


Communication Is Priority One

The trend towards greater transparency for the illiquid asset class was greatly accelerated by the 2008 recession as LPs, jolted out of a decades-long complacency, began to demand more information in order to monitor and understand their investments. During the downturn, GPs can expect LPs to renew the quest for more information as they seek to make sense of the market volatility that will impact valuations, exits, and returns in the coming months.

The way you communicate with your LPs during uncertain times will shape their perception of the relationship for years to come and have a direct impact on your next fundraise. A large part of that communication takes place through reporting, which this white paper covers in detail. But it also takes place through ad hoc emails, phone conversations, and meetings. Investors will be anxious for information and reassurance, and GPs need to demonstrate transparency through prompt and proactive communication.

BE MORE RESPONSIVE.

Don't wait until you have all the answers before reaching out. It's more important to demonstrate your willingness to communicate swiftly and proactively. Share the answers you have today, and reassure your LPs that you are working on getting the rest of them soon.

COMMUNICATE MORE FREQUENTLY.

This is the time to increase the cadence of your communications. Give your LPs frequent updates, let them know what you're working on, especially with regard to investments on the "watch list," and share what you think the future holds, especially with regard to capital activity.

EXPLORE NEW COMMUNICATION CHANNELS.

Opportunities for in-person conversations may not be possible for some time. Firms that have relied on face-to-face communication in the past need to explore new ways of engaging their investors. Consider hosting virtual meetings and interactive digital events such as Q&A or AMA ("Ask Me Anything") sessions.

This is the time to increase the cadence of your communications.

Be Ready with the Answers

Amid market volatility, LPs can be expected to spend more time and energy on monitoring their portfolios. Even those who stayed relatively hands-off during times of economic growth can be expected to become more active and involved as their exposure to risk increases.

BE READY TO ANSWER THE QUESTIONS THAT LPs ARE MOST LIKELY TO ASK DURING THIS TIME:

- How are you allocating resources to support your portfolio companies? What are the strategies and assumptions underlying these choices?
- Are you allocating time and resources to explore new investments during the downturn? Where do you see the opportunities?
- What impact do you expect the current uncertainty to have on future valuations?
- How would you characterize the credit quality among your LP base? Have you spoken to your LPs about their liquidity? Have you conducted a credit analysis?
- How will you be making portfolio-company data available in a timely way for review and analysis?

Over the next few pages, we examine some of the ways in which GPs can prepare themselves for honest conversations with their LPs, including sharing capital activity projections, delivering realistic valuations and metrics, and adopting industry reporting standards.

Share Capital Activity Projections

During an economic downturn, it's particularly important to monitor the liquidity of the investor base and perform rolling projections to determine capital needs. Sharing these projections with LPs requires little additional effort and can go a long way toward addressing their concerns about the liquidity of the fund. By sharing capital activity calculations, you will reassure your investors that you understand the heightened threats to liquidity and are conducting ongoing analysis to ensure stable and healthy access to capital for the portfolio.

Communicating with LPs more proactively around capital activity and upcoming commitments also helps GPs identify potential liquidity issues sooner. Becoming aware of a liquidity problem for the first time within the 10-day window of a capital call creates a very difficult situation, and your investors may need more time and flexibility to meet their commitments at a time when "cash is king" and capital may be less readily accessible. Proactively sharing capital projections will provide much-needed reassurance to investors, give them more time to plan, and generally help to keep the lines of communication open.

DATA POINTS TO SHARE INCLUDE:

- Proactive drawing of sub lines
- Clearing of sub lines
- Liquidity for portfolio
- Investor illiquidity

IN A FLASH POLL, GPs REPORTED THAT DURING THE FIRST 30 DAYS OF THE COVID-19 PANDEMIC:

16%	5%	49%	30%
experienced a higher frequency of calls	experienced more investors calling	experienced both a higher frequency of calls and more investors calling	saw no change in call volume or number of investors calling[1]

1 PEF Services, Investor Transparency as a Differentiator: Managing LP Relationships in Uncertain Times (webinar), March 2020.

Adopt Industry Reporting Standards

The lack of standardized reporting requirements has always held illiquid assets back when it comes to supporting the same level of transparency as other asset classes. With no universal guidelines to bring consistency to investor reporting, LPs have struggled to compare performance across asset classes, understand and verify the data, and identify the metrics required to communicate effectively with stakeholders.

Frustrations about the complexities and inconsistencies that characterize reporting from GPs are acute during times of economic volatility as the pressure mounts for LPs to understand the bigger picture, protect their investments, and satisfy their boards and clients.

Rather than asking investors to define their preferred reporting standards, GPs need to take the lead on this issue. The level of reporting you offer to your investors needs to be based on pragmatism and best practice rather than individual investor preferences. While it may be realistic to provide specialized reporting to LPACs or anchor LPs, delivering personalized reporting across the board is likely to place a heavy operational burden on your firm and hinder your ability to scale.

To deliver the level of detail that LPs are looking for, while ensuring that your reporting practices are sustainable and scalable over the long term, align your reporting practices with the standards recommended by industry organizations such as the Chartered Financial Analyst (CFA) Institute, the Institutional Limited Partners Association (ILPA), and the National Council of Real Estate Investment Fiduciaries (NCREIF)/ Pension Real Estate Association (PREA). Adopting these industry standards not only lends credibility to your firm, but it also enables you to standardize and digitize time-consuming reporting processes.

Improving reporting transparency and fee disclosures is the number-one means by which GPs are improving relationships with LPs.[2]

The percentage of GPs who ranked enhanced investor reporting among their top three priorities more than doubled from 2018 to 2019 (up from 11% to 24%).[3]

2 BDO, 10th Annual Private Equity Perspective Survey, 2019.

3 EY, 2019 Global Alternative Fund Survey.

GIPS®

The CFA Institute developed the Global Investment Performance Standards® (GIPS®) to replace regional performance standards with a single, international version capable of covering all asset classes worldwide. The main goals of 2020 GIPS Standards are to improve adoption (especially among alternative asset firms), simplify the standards, and reduce compliance costs. Its value to the alternative asset community is evident in the restructured standards that better represent the illiquid closed-end group of assets, such as the use of pooled funds vs. composites. With this revision and broader use of the standards, advisors are now able to assess all types of investments—including real estate and private equity—against an appropriate benchmark.

Learn more at gipsstandards.org

ILPA

The Institutional Limited Partner Association (ILPA) has been a key player in driving greater transparency and accountability in private equity markets. Of particular value during the current downturn is ILPA's Portco Template (tinyurl.com/y7ye9zuh), which provides guidance for reporting on portfolio companies, including cash available as of the reporting dates availability under credit lines, burn rate, leverage ratios, interest rate coverage ratios, any fund guarantees or commitments to the portfolio company, and any credit concerns regarding co-investors. For overall portfolio performance, the template includes industry and regional NAV exposure, TVPI, RVPI, DPI, and IRR.

Learn more at ilpa.org

NCREIF AND PREA

The National Council of Real Estate Investment Fiduciaries (NCREIF) and the Pension Real Estate Association (PREA) have established reporting standards and global definitions for the real estate industry, including closed-end funds. These standards allow investors to have confidence in their performance indices and reports. Most recently, the first Global IRR Index (tinyurl.com/yc9d58sl) was released for closed-end, non-listed real estate funds as part of a suite of global indices.

Learn more at reportingstandards.info

GIPS® AND ILPA ARE GAINING RAPID ACCEPTANCE

60%

of alternative asset managers expect to see the industry start voluntarily complying with the GIPS standards.

75%

of consultants/investors exclude managers from searches some or all of the time if they do not claim compliance with the GIPS standard.[4]

More than

1 in 3 firms

now use ILPA templates.

The number of firms using ILPA templates increased from

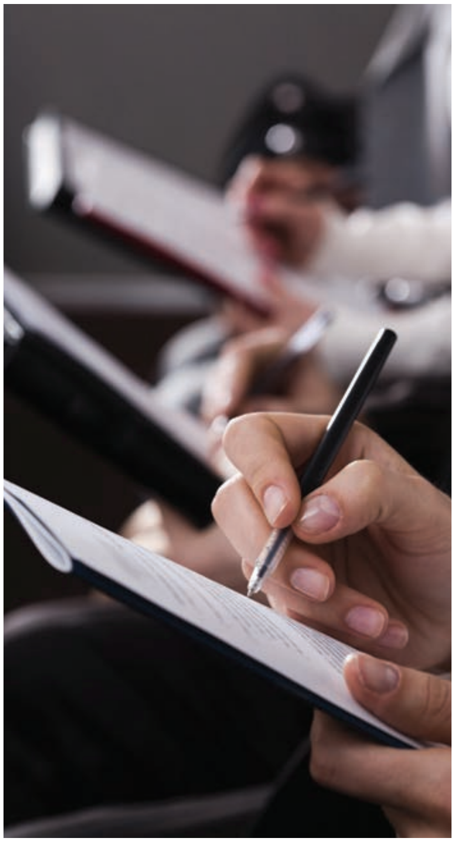
31% to 35%

between 2016 and 2018.[5]

4 eVestment, The Value of GIPS Compliance: 2018 Manager and Consultant Survey.

5 pfm, Fees & Expenses 2018: A pfm Benchmarking Survey.

Identify the Right Valuations and Metrics



Conducting valuations and communicating the data to investors pose a challenge to GPs even in the best of times. During uncertain times, the challenge becomes that much greater, as uncertainty complicates the calculations while increasing the level of scrutiny that LPs apply to them. This makes it more important than ever for valuations to be realistic and consistent to ensure credibility today and into the future.

LOOK TO YOUR PEER GROUP.

Arriving at fair value doesn't mean applying a fire-sale price; it means conducting the valuation as an orderly transaction that takes current market conditions and comparative market value into account. If your peer group is down 20%, your valuation should be in line with that. There may be nuances that positively or negatively affect the value of a specific portfolio company, but any deviation from the peer group will need to be substantiated with evidence.

STICK WITH THE PROCESS.

Whatever your valuation process, that process should be consistently applied during good times and bad. It may be expedient to use comparables during a market upturn and discounted cash flow during a downturn, but any time you shift your weighting between approaches, you need to have a strong and defensible rationale.

AVOID DOUBLE-DIPPING.

To the extent that you're using comparables, remember that within those comparables, future performance has already been adjusted. If you apply that comparable multiple to an adjusted future performance portfolio number, that will double-dip you to the negative. The International Private Equity and Venture Capital (IPEV) Board published special valuation guidelines (tinyurl.com/yc27s5es) to provide GPs with a framework for avoiding this situation and delivering LPs the fair value information they need during times of extreme market volatility.

Whatever your valuation process, that process should be consistently applied during good times and bad.

Re-examine Portal Technology

Technology has become a critical ingredient in helping GPs keep pace with the increased cadence of communication and deliver the levels of transparency today's LPs expect with scale. Its role in supporting transparency will continue to grow.

Even before the downturn of March 2020, an EY report found that the majority of GPs (77%) were sharing static files such as PDFs and Excel documents via an investor portal, compared to just 22% who still used email to share this type of information with investors.[6] As market uncertainty intensifies the need for detailed and timely information, investor portals will become an even more critical resource, providing "always-on" access to a wide range of investment data without putting a strain on back-office resources.

The adoption of more sophisticated portal technologies may also accelerate due to the long-term impacts of the pandemic. Prior to the downturn, EY found that while just 1% of GPs were currently providing investor reporting via a business intelligence tool, nearly one in four (23%) expected to offer that service over the next three years.[7] As firms fast-track digital transformation initiatives, digital portals that offer the ability to visualize fund and portfolio trends and access and manipulate the underlying data are likely to become the industry norm.

For firms that lack the internal resources to set up and maintain complex portal technology, a technology-enabled fund administrator can set up and maintain advanced, customizable investor portals as part of their service.

INVESTOR PORTALS SHOULD:

- Scale back-office operations sustainably
- Deliver a best-in-class investor experience
- Enhance security for sensitive data

6 EY: 2019 Global Private Equity Survey: How Do You See the Opportunity in Your Obstacles?
7 EY: 2019 Global Private Equity Survey: How Do You See the Opportunity in Your Obstacles?

Choose the Right Investor Portal

Whether you plan to set up and manage an investor portal in house or rely on a fund administrator to provide this digital capability, ensure that the portal is capable of collecting, calculating, and sharing the metrics valued by investors and required by ILPA and GIPS® standards:

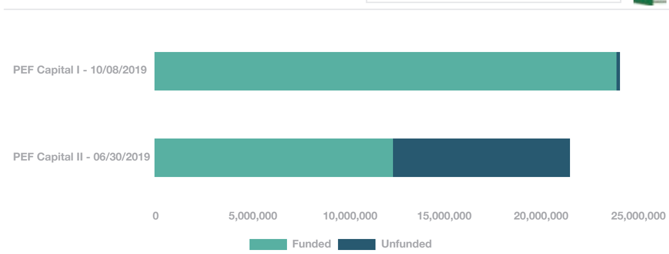
- DPI (distributions to paid-in capital), RVPI (residual value to paid-in capital), TVPI (total value to paid-in capital, which is also the combination of DPI and RVPI), and IRR at both gross and net levels
- Details for capital calls, including the name of the investment, type of expense, and impact to unfunded commitment
- Details for distributions, including the breakout of interest on subsequent closings, income, realized gain, return of capital, and carried interest (if the distribution, or a portion thereof, is recallable, ensure that its impact to unfunded commitment can be recorded)
- Gross management fees, management fee offsets, waived management fees, and management fee rebates
- Expense details, including (at minimum) advisory fees, broken deal expenses, director fees, monitoring fees, and placement fees
- Carried interest (accrued and paid) and claw back (potential obligation and amounts returned)
- Fee and expense reimbursements
- For fund of funds: management fees, including the details above, plus fees and expenses and carried interest (accrued and paid) for the underlying funds

Portfolio Value by Industry – As of 12/31/2019

Industry	Fair Value
Management of Companies and Enterprises	20,000,000
Mining (except Oil and Gas)	10,000,000
Motion Picture and Sound Recording Industries	45,705,331
National Security and International Affairs	18,200,000
Oil and Gas Extraction	11,450,000
Professional, Scientific, and Technical Services	15,160,000

Portfolio Company Name	NAICS	NAICS Subsector	Legend Description	Business Description	Fair Value
Adamantium Holdings Inc.	212	Mining (except Oil and Gas)	Mining (except Oil and Gas)	Mining (except Oil and Gas)	10,000,000.00
Advanced Idea Mechanics	541	Professional, Scientific, and Technical Services	Professional, Scientific, and Technical Services	Professional, Scientific, and Technical Services	-
Cerebro Digital Partners	512	Motion Picture and Sound Recording Industries	Motion Picture and Sound Recording Industries	Motion Picture and Sound Recording Industries	46,705,330.95
Cross Technological Enterprises	541	Professional, Scientific, and Technical Services	Professional, Scientific, and Technical Services	Professional, Scientific, and Technical Services	15,160,000.00
HYDRA Partners Inc.	551	Management of Companies and	Management of Companies and	Management of Companies and	20,000,000.00
Parker Industries	928	National Security and	National Security and	National Security and	18,200,000.00
Roxxon Energy Corporation	211	Oil and Gas Extraction	Oil and Gas Extraction	Oil and Gas Extraction	11,450,000.00
Total					**121,515,330.95**

Funded/Unfunded Commitment



PEF Capital Partners Fund I, LP

Date	Commitment	Contributions	Recallable Distributions	Unfunded Commitment
01/05/2013	24,000,000.00	-	-	
01/10/2013	-	3,840,000.00	-	
04/21/2013	-	1,200,000.00	-	
03/10/2014	-	3,120,000.00	-	
09/30/2014	-	4,800,000.00	-	
05/01/2015	-	2,400,000.00	-	
04/30/2016	-	2,208,000.00	-	
10/08/2018	-	2,400,000.00	-	
01/03/2019	-	3,840,000.00	-	
Balance as of 06/30/2019	**24,000,000.00**	**23,808,000.00**	-	**192,000.00**

PEF Capital Partners Fund II, LP

Date	Commitment	Contributions	Recallable Distributions	Unfunded Commitment
08/25/2017	21,500,000.00	-	-	
09/10/2017	-	2,766,863.54	-	
12/29/2017	-	3,943,114.70	-	
05/21/2018	-	2,673,298.11	-	
01/10/2019	-	2,766,863.54	-	
Balance as of 06/30/2019	**21,500,000.00**	**12,150,139.89**	-	**9,349,860.11**

ViewPoint
Powered By PEF Services

Prioritize Next Steps

These are unprecedented times, and the challenges can feel overwhelming for GPs whose operational capacity was already stretched to the limit. But the shift towards greater transparency becomes more manageable when you break the project into stages, identify the priorities, and focus on one thing at a time. The most important thing is to show investors that you're moving in the right direction.

IF CAPITAL ACTIVITY IS THE PRIORITY, start working closely with your deal teams to produce forecasts for each portfolio company and develop a way to forecast capital activity that is scalable, as the goal should be the ability to have the information available daily.

IF INVESTOR REPORTING IS THE PRIORITY, see how much additional information you can add to your reports in the immediate future, and get consensus on what can be added over the longer term. Whether or not you think you're ready for new technology, make a commitment to exploring your options, including both self-managed and outsourced solutions.

IF VALUATIONS ARE THE PRIORITY, review your current process with a view to bringing your valuations in line with comparative market value, and clearly communicate any changes in the way valuations are calculated to the team and to your investors. Follow the best practices supported by IPEV, and be prepared to explain how and why you are deviating from comparative market value in the coming months.

In a flash poll, the largest number of GPs (36%) planned to prioritize valuations, followed closely by capital activity forecasts (29%) and enhancing first-quarter reporting packages (24%).[8]

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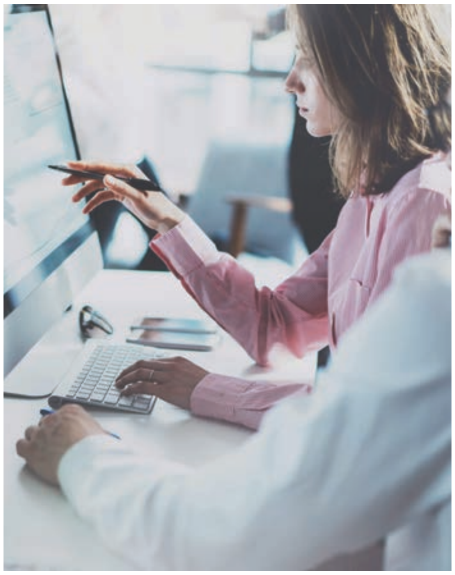
8 PEF Services, Investor Transparency as a Differentiator: Managing LP Relationships in Uncertain Times (webinar), March 2020.

Communication Is Key—Today and for the Future

During times of economic volatility, no investor is naive enough to believe that "no news is good news." While many GPs are understandably hesitant to share disappointing or unexpected news, staying silent is not an option. It's more important than ever to demonstrate the highest levels of transparency by communicating early, often, and with greater consistency and detail. You can't change the reality, but you can change the level of control and confidence that your LPs feel as they navigate that reality with you.



SUPPORT YOUR INVESTORS BY:

Increasing the cadence of your investor communications and seeking out new digital channels to replace face-to-face meetings.

Being ready to answer tough questions about investor liquidity, portfolio company valuations, and investment performance.

Accelerating the adoption of industry reporting standards such as ILPA and GIPS® to demonstrate your commitment to transparency and standardization.

Evaluating portal technologies that can help your firm meet the escalating demand for data and documentation sustainably and scalably.

Adversity is a great teacher. Past crises have galvanized the private capital markets to strengthen their processes and mature their operations. The downturn will have the same impact, as GPs fast-track the development of capabilities and adoption of technologies that enable them to provide the transparency that LPs demand during times of uncertainty.

The alternative asset class emerged from the crisis of 2008 stronger and more attractive to investors than ever. While today's economic landscape is unlike anything the markets have endured before, there is no reason to expect that illiquid assets won't see a similar recovery pattern in the years to come. Asset managers who focus on deepening the commitment to transparency will not only build investor trust and loyalty today, but they will also position themselves to take full advantage of the opportunities ahead.

ABOUT PEF

Since 2002, PEF Services has helped some of the most complex fund types meet stringent regulatory and investor requirements. We are nationally recognized as one of the top boutique fund administrators and back-office specialists for General Partners, Limited Partners, and management companies in the alternative asset space.

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