KEYNOTE INTERVIEW

Automating private assets: A work in progress

Private assets automation is still in its earliest stages. But change is on the way, says the product executive responsible for the alternative fund services business at Brown Brothers Harriman, Chris McChesney

Q Where is the private assets market currently on this digitization and automation journey?

If the path of automating private fund assets were a 200-meter dash, the runners have arrived at the track and are just starting to stretch and warm up. In other words, it's still very early days. There has been some progress around digitization, for example in the way in which investors share information relating to deals in data rooms, or how investor statements, capital calls or distribution notes are presented to limited partners through web-based portals. But early victories around automation are even more limited. Some notable progress has been made around the automation of investor allocation calculations and fee calculations, but many operating functions are still dominated by manual processes.

Q Why do you think these asset classes have been relatively slow to modernize–while often embracing digitization from the perspective of their portfolio companies?

Fundamentally, private market investments are done through negotiated bespoke deals. Private market investments are far from homogenous—a deal to invest equity in a commercial building is very different from a private loan made to a middle market company, for example. Due to the sheer variety of investments being made, as well as the lower overall volumes in these asset classes, it becomes harder to use standards for recording, tracking and valuing private deals. Without standards, digitization and automation become an even bigger challenge.

Q Which areas of private assets operations do you consider to be most ripe for automation?

Behind the push toward automation is the limited partners community demanding increased transparency on investment performance, fees, and on the risks contained in their portfolios. One of the areas that is most ripe for automation, therefore, is the production of reporting from both general partners and asset servicers, and then—at the same time—the consumption of that reporting by limited partners. That is where we are focusing some of our automation efforts in developing interactive client interfaces that provide dynamic visualization of information and workflow.

We are also are starting to see progress—albeit imperfect—in the automation of the waterfall calculations. That is a good example of where the limits of automation are now being tested.

Q What advantages would increased automation bring to private asset markets?

Limited partners realize that increased automation would help them achieve better control, transparency and efficiency. But there are benefits for all market participants, including LPs, GPs and asset servicers. Ultimately, automation will accelerate the process of fundraising, as well as deployment and realization of investments. Greater automation will also upend cost dynamics in private market investing and will lead to wider participation by more retail-like investors.

Q What do asset servicers and general partners need to be doing in order to drive automation further?

First of all, asset servicers need to keep investing in, and improving on, their core processing systems in order to have wider coverage across asset classes and flexibility to accommodate complicated deals and multi-layered fund structures. In their role as the primary book of record, asset servicers also need to provide GPs and LPs with better access to their data. Servicers need to think of themselves as information service providers rather than black box processors. In parallel, GPs need to make investments in systems that capture private investments, akin to the way trading systems record trades for public markets. These systems need to record deals and be capable of connecting to the downstream systems used for ongoing administration.

"Servicers need to think of themselves as information service providers rather than black box processors"

Q What are the biggest challenges for the private assets market when it comes to realizing more automation?

One of the most significant challenges is that transparency doesn't necessarily benefit all participants evenly. Some GPs might reasonably believe that the returns they generate from investing in private assets come, at least in part, from the opacity of those markets. Some GPs will find it compelling to compete, not only on the basis of their investment returns, but also on the sophistication of their operating models.

Q What about limited partners? What role do they have to play in driving digitization and automation forward?

LPs need to play a role in advocating for digitization and automation. As an example, digital subscription agreements would allow for potential scale and processing synergies, allowing GPs, LPs and service providers to reduce operational risk and costs—something everyone could benefit from. But adoption remains problematic—it is a business, rather than a technical, challenge that needs to be overcome (i.e. legal counsel accepting electronic signatures).

Q There is currently less outsourcing by private equity general partners in the U.S. than in Europe. Do you think the need to invest in technology will encourage more GPs to outsource?

First of all, the main driver behind the higher demand for outsourcing of private equity fund services in Europe is regulation. European alternative funds are more highly regulated and are often compelled to use third-party providers for some fund functions. It is unlikely that the U.S. will follow the European regulatory model anytime soon, so it will be other factors that will make outsourcing more common.

Realizing automation opportunities will require technology investments of a reasonably high scale. Not all GPs will have the ability to make those investments and will, therefore, look to partner with those that can. In the U.S., it will be more of a technology-related opportunity than a regulatory responsibility that leads to a growth in outsourcing.

Q Do you think private markets will ever adopt automation to the extent that the public markets have? What does the future hold?

Yes. I believe that private markets will, at some point, have very high levels of automation. I don't think it's a question of if, but rather when and how and who leads the way. ■

Automation in action

Many diversified asset managers have portfolios that include both direct private investments and LP positions in private funds that are structured as partnerships.

It is not uncommon for large asset managers to have hundreds of positions in underlying funds. Even though statements and other communications from GPs have been digitized over the past decade and are readily available on electronic portals via download, the tracking and monitoring of these indirect investments is a source of frustration and inefficiency for the investment industry.

Brown Brothers Harriman (BBH) has been engaged by asset managers to streamline the intake and aggregation of this private fund information. In the first phase of implementation, BBH applies standard workflows and common data structures to facilitate a single point of access for information users. We then organize files by date and type for ingestion into downstream systems. In the second phase of process redesign, we apply robotic process automation to the information collection and organization processes to further improve both efficiency and scalability.

Through improvements to workflow, use of common data structures and implementation of a supervised robotics process, BBH is helping investors realize the benefits of substantially faster access to investment information and lower the overall cost of private market investments.