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*Summary of panel discussion:
Perspectives on transparency – defining transparency
in private equity and its hurdles, past and present*

LEODORAN
FINANCIAL
— Targeted Timely Expertise —

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TRANSPARENCY IN PRIVATE EQUITY

DEFINING TRANSPARENCY

The elements required for transparency in private equity by its investors or limited partners (LPs) are consistency, granularity, and optical depth with an eye to automation in data aggregation.

- Consistency means achieving broadly accepted standards for the line items in general partner (GP) to LP reporting, including LP-centric investment costs, and their definitions or calculations so that an investor can make 'apples-to-apples' comparisons
- Granularity can be defined as a measure of the level of detail in reporting which could be applied to an everyday concept such as knowing your net paycheck amount compared with the more granular detail of having your gross pay and a breakdown of all withholdings
- Optical depth (an appropriated physics term) used to describe the depth of transparency such as fund-level or portfolio company level

SUFFICIENT REPORTING

GPs typically agree up front to the types and level of detailed reporting that will be provided in LPAs and side letters, the legal agreements signed with investors.

Further, many GPs will explain that their reporting is "sufficient" meaning that they meet all requirements as agreed. Or, that in addition to meeting LPA requirements, their reporting already provides all the details that an investor is requesting such as the granular details of the ILPA Template¹.

If this is true, one is left to wonder where then is the lack of transparency for investors?

It is in the lack of standardization of reporting and the resulting inability to automate the collection of accurate, consistent, and sufficiently granular incoming data across many investments within the LP's portfolio.

¹ See www.ILPA.org

Example A

% of capital
Partner %

Total capital commitment
Capital contributed to date (includes transfers)
Remaining commitment

Opening capital balance
Contributions during the period
Contributions receivable
Distributions during the period
Transfer of interest
Syndication costs

Investment results
Interest income
Management fees
Management fee offset
Other expenses
Realised gain/(loss)
Deemed gain/(loss)
Change in unrealised gain/loss; Net investment results
Unrealised loss on cash escrow
Equity interest in net operating income and realised gain from investees
Equity interest in change in unrealised depreciation from investees
Incentive allocation

Closing capital balance

Example B

**Statement of changes in capital account
from October 1, 20xx to December 31, 20xx**

Capital commitment

Capital account balance at October 1, 20xx, at cost

Net operating income (loss)

Partnership distributions

Capital account balance at December 31, 20xx, at cost

Net unrealised appreciation of investments at October 1, 20xx

Change in net unrealised appreciation/ depreciation of investments

HURDLES TO TRANSPARENCY

IN THE BEGINNING

We have seen a concerted push by LPs for more transparency in the last decade and investor knowledge of fee² practices continue to increase. The progress made has been mostly coordinated by organizations such as the ILPA or Institutional Limited Partner Association³ and their educational efforts.

Early resistance from the GP side to increasing transparency cannot be summed up as the private equity manager's desire to "hide" fees or avoid scrutiny; there were some reasonable GP concerns such as fee information being taken out of context and need to first understand what LPs sought in reporting.

Frequent questions from both sides were:

- As LPs can we press our GPs for additional details or certain templates on current investments without LPA provisions and will it interfere with our ability to invest in future funds with this GP?
- GPs wanted to know for what would LPs use this information and with whom would it be shared?

CURRENT HURDLES

Today, we have hundreds of GPs completing the ILPA Template and other accepted standard templates and efforts such as the ADS Initiative seeking to automate and streamline reporting. Taking the current format from PDFs and Excel files to digital, transportable data files that can be mapped into any LP technology for capturing portfolio data.

However, there are some lingering barriers to adoption and/or automation:

- PDFs versus Excel hindering automation
- Customization of Standards preventing scale
- Plus-one requests for templates are not in place of other custom requests
- Market conditions giving GPs the upper hand in negotiations
- Need for adaptation to all areas of broader private equity space

² The word "fee" is often used in LP conversations to include not only the GP management fee but also to refer collectively to carried interest which is a share of profits, fund-level expenses, and certain charges that occur at the operating company level.

³ See www.ilpa.org

- Proprietary data concerns with certain details at greater optical depth
- Public records or FOIA that interfere with GP compliance or LP requests
 - In the US, it is important to provide for both an appropriate and useful level of transparency to the public while allowing the public pension fiduciaries to access detailed, pertinent investment information required for analysis and decision-making without risk of violating contracts or exposing competitive or proprietary information

SUMMARY

The goals or elements required to achieve transparency in private equity remain the same today and while substantial progress has been made, a coalescence of LPs and all supporting or oversight bodies is needed to continue to push, together, toward the future, desired state.

Sunlight in private equity has the potential to chase away real and perceived threats but over-exposure could be damaging to all involved.

It is prudent for an LP to seek to measure and monitor investment costs in context. This effort has been approached by LPs as a compliance exercise for LPA adherence and for analysis in the overall fund performance for consideration on future investments or renegotiations. Further, it is only over a period of years – much in line with the private equity lifecycle – that more granular information becomes most useful providing for comparative trends and an opportunity to perform higher analytics.

It will be important in the coming months and years for pension fiduciaries to continue to pursue a very objective and rational view of private equity and its investment costs, which must always be viewed in context of returns, while considering private equity's role in the portfolio allocation and its benefit to the plan beneficiaries.

ABOUT



LORELEI GRAYE

Lorelei Graye is founder and independent consultant for Leodoran Financial which currently advises PFA Solutions, Colmore, Ipreo and contributes to industry efforts in private capital that seek to benefit the industry as a whole.

Ms. Graye is speaker, author, and often-cited subject matter expert in private fund reporting focusing on key issues surrounding public pension policy while serving institutional investors (LPs), GPs, and their service providers globally by providing operational and procurement expertise, communications, marketing, and strategic management consulting.

Prior to founding Leodoran, Ms. Graye served the public retirement system in South Carolina where she spearheaded the State's development and implementation of an annual fee collection, validation, and reporting process which was featured in a prominent CEM Benchmarking study⁴. Ms. Graye has traveled extensively since that time to promote best practices and build consensus among commercial firms, institutional investors, trustees, regulators, and policymakers around the globe that are focused on private equity.

A key supporter of the ILPA Fee Transparency Initiative⁵, an Ambassador of the Transparency Task Force⁶, and organizer of the 2018 ADS Initiative⁷, Ms. Graye has over 20 years of business experience with degrees in finance and accounting, summa cum laude.

⁴ Dang, Andrea CFA; Dupont, David CFA; Mike Heale. "The Time Has Come for Standardized Total Cost Disclosure for Private Equity"

⁵ See www.ILPA.org

⁶ See www.TransparencyTaskForce.org

⁷ See www.ADSInitiative.org