FUND CFO FOCUS 2022

The future private capital CFO

Unleashing potential in the ESG era

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Transforming operations to unleash potential

I am pleased to introduce the key findings of our new survey on the attitudes of private capital CFOs on future challenges. The research helps us at Intertrust Group ensure that our own development continues to track the anticipated needs of our clients, while at the same time providing a snapshot of industry expectations against which clients themselves can measure their own positions.

This is the second consecutive year in which we have run such a survey and I was struck by two aspects of the results. One was confirmation of last year's finding that the majority of private capital CFOs plan to alter their current balance between in-house and outsourcing, particularly with regards to technology. Second was the growing importance of ESG at all stages of the investment process, from assessing opportunities to monitoring continued compliance.

The data presented will no doubt raise a number of questions in themselves that readers will want to discuss. We welcome your queries and look forward to further fruitful dialogue.

Chitra Baskar
Chief Operating Officer and Global Head of Funds and Product
Intertrust Group

What changes do private capital fund CFOs anticipate in their roles in the decade ahead?

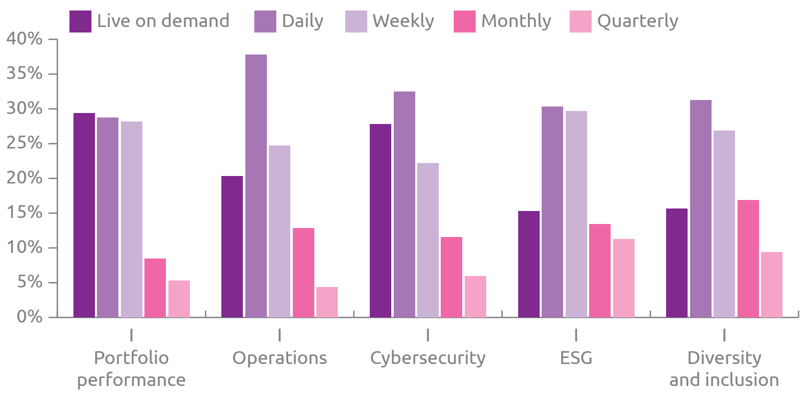
This is the second year in which Intertrust Group, in partnership with Global Custodian, has polled chief financial officers (CFOs) of private capital funds on the data demands they anticipate from their investors in the years ahead and how they plan to meet them. A development this year was the inclusion of a more detailed segment on attitudes to ESG, which identified both levels of engagement and challenges to implementation of ESG policies and strategies.

Completed in January 2022, the survey resulted in 320 validated responses from CFOs or their direct reports from across the private capital investment spectrum. Responses were received from US, UK, China and Western Europe. In a parallel survey, 110 investors in private capital funds – mainly in US, UK and China – provided their own perspective on the same concerns.

Several of the high-level conclusions were broadly in line with last year's findings. The demand from LPs for regular data is strong and growing, particularly in the areas of portfolio performance, operational service-level agreements (SLAs) and cybersecurity. Technology is seen as the key to meeting those needs, whether in-house or outsourced, and there is an expectation that meeting the information demands of clients will result in a change in the status quo when it comes to the balance between what is outsourced and what is managed in-house.

There is also a degree of continuity in the ranking of those issues that draw the attention of investors and their intermediaries, with portfolio performance not surprisingly retaining its position at the top of the list.

Fig. 1: In the decade ahead, I am anticipating the following trends in LP demands for regular information



Cybersecurity will always be crucial to CFOs as the frequency of attacks across all jurisdictions shows no sign of slowing. For that reason, it is an area where timeliness of reporting is more important than frequency.

David Sarfas,
Intertrust Group

Within those confirmations of previous results, there are nuances, however. In 2022, expectations from CFOs about required frequency of data updates (see fig. 1) appears to have decreased slightly in a number of areas. In 2021, for example, 31% of respondents expected their investors to be looking for live updates – or at least access on demand to such updates – on portfolio performance and 27% for live updates on cybersecurity. While results for the latter remains similar, the majority of clients are expected to be satisfied in other areas with daily or weekly information updates. Portfolio performance, operational SLAs and cybersecurity nevertheless remain the top three issues of interest.

Besides regulation, there is an increasing demand by LPs for managers to monitor and report on the ESG performance of their portfolio. The pressure is building up for all managers, including those of traditional funds without any stated ESG ambition. And technology will play a key role in that.

Antonello Argenziano,
Intertrust Group

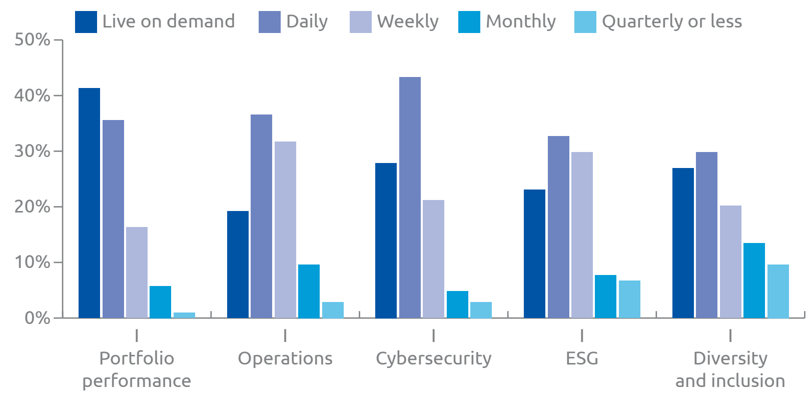
Having access to data in real time is positive, but this is not the hedge world where you want to know instantly where your cash is and how you can deploy your capital, where the investment opportunities are. What investors want is access to data to deal with their own investor requests in a timely manner. Getting access to portfolio information, getting an understanding of the business, is important at any point in time. If nothing changed from yesterday to today, that's fine. Having immediate access to the data doesn't necessarily mean the same as having real-time data.

Jonathan White, Intertrust Group

The investor view

While the order of priority remains more or less the same, it appears that CFOs may be underestimating investor expectations in certain areas. The survey of investors themselves suggests that more than 40% will be wanting live information updates on portfolio performance, while some 55% will be looking for live or daily updates on ESG – 10 percentage points higher than anticipated by CFOs.

Fig. 2: In the decade ahead, we expect regular information on the following



What may account for these discrepancies? On the face of it, CFO expectations seem reasonable given the nature of private capital investments, where investment decisions in individual funds are not short-term plays.

CFO expectations may also reflect the fact that, while many private capital investors have brought with them expectations from the more liquid markets in which they cut their teeth, these may lessen over time as comfort and familiarity with the specificities of private capital markets become more familiar, coupled with a decrease in levels of investor uncertainty that characterised the earlier stages of the Covid-19 pandemic.

Another interpretation, however, is that from an investor perspective, the frequency of updates expected is a marker of a desire to have access to the data as and when required for monitoring and reporting purposes rather than as triggers for action.

> Increased data frequency is clearly going to be a big challenge, because it's not going to be easy to have that data flow from the underlying portfolio companies in which they invest into a reporting mechanism on a live basis.
>
> **Antonello Argenziano, Intertrust Group**

Investor expansion

Investor expectations will also be affected by expansion into new areas of private capital investment opportunity. Private equity remains the area on the private capital investment spectrum in which the 320 CFO respondents are most active, followed closely by venture capital (see fig. 3). While this is likely to remain so, expansion is anticipated over the next 24 months in all strategies (see fig. 4).

Fig. 3: Which of the following are you already active in? (Select all that apply)

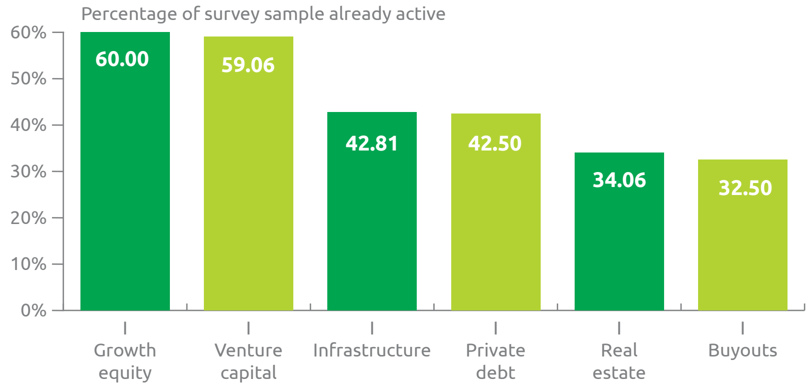
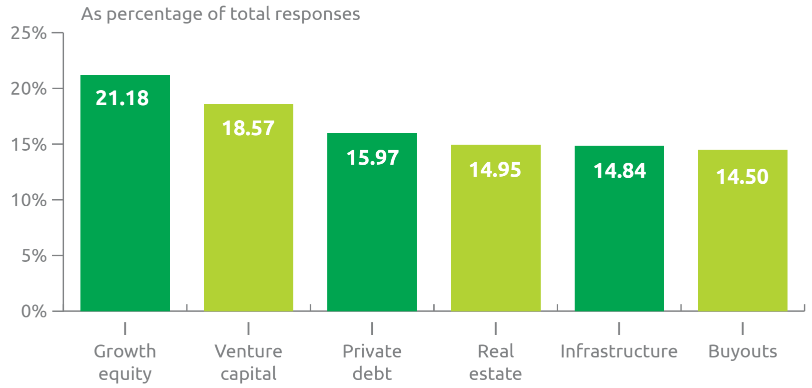


Fig. 4: Which of the following are you planning on diversifying into in the next 24 months? (Select all that apply)



There's likely to be more deal volume, because in the US at least, the banks are basically there to act as intermediaries to facilitate transactions rather than as investors in their own right. The emergence of debt funds has become extremely prolific, I would say, in the US, and also in Europe, though less so for the moment. When we think of assets under management for private debt, we're basically talking about USD1 trillion, globally. If you talk about private equity investments, which include venture capital, we're talking about USD7 trillion.

David Sarfas,
Intertrust Group

The perception of outsourcing as throwing it over the fence and giving it to somebody else to do is outdated. More often than not, it involves strategically working with a third party to bring the tools they need to enhance their business

Jonathan White, Intertrust Group

Technology

To meet the need for frequent and reliable data in the years ahead, both CFOs and investors confirm last year's finding that further investment in technology is seen as the way to meet these needs. The question remains around how it is integrated into the existing workflow and whether this is best achieved in-house or by calling on third-party expertise.

Participants were asked how they planned to expand the skill sets of their in-house finance team over the next three years (see fig. 5). Technology was the first priority with over 70% of CFO respondents expecting to hire expertise in that area.

Fig. 5: In the next three years, I expect to expand the skill sets of my in-house finance team by hiring in expertise in... (Select all that apply)

	% of total responses*	% of sample**
Technology	26.78	71.88
Accounting	21.19	56.88
Operations	19.44	52.19
Tax	14.55	39.06
Investor relations	17.81	47.81
Other	0.23	0.63

**Column two shows the relative importance of each skill set as a percentage of all responses selected*
***Column three shows the percentage of the 320 CFO respondents who selected this option*

At the same time, however, they do not appear to be making a binary choice between in-house expertise and access to external resources (see fig. 6). A majority of respondents plan to complement their in-house expertise with access to outsourcing, whether in the systems themselves or the expertise to run them. Interestingly, a majority of CFOs expect to have to revisit their current balance between in-house and outsourcing (see fig. 7).

Fig. 6: In the next three years, I expect to complement the skill sets of my in-house finance team by seeking outsourced expertise in... (Select all that apply)

	% of total responses*	% of sample**
Technology	24.44	60.94
Accounting	20.80	51.88
Operations	19.92	49.69
Tax	18.42	45.94
Investor relations	16.29	40.63
Other (please specify)	0.13	0.31

**Column two shows the relative importance of each skill set as a percentage of all responses selected*
***Column three shows the percentage of the 320 CFO respondents who selected this option*

Fig. 7: As the fund grows, we plan to... (Select all that apply)

	% of total responses*	% of respondents**
Invest in expanding our technology framework	24.75	62.50
Increase the size of the in-house finance team	24.26	61.25
Invest in distributed ledger functionality	17.20	43.44
Retain our existing balance between in-house & outsourcing	17.20	43.44
Outsource more functions	15.72	39.69
Not applicable: we don't anticipate the fund will grow	0.87	2.19

**Column two shows the relative importance of each option as a percentage of all responses selected*
***Column three shows the percentage of the 320 CFO respondents who selected this option*

The fact that PE fund investors appear to show a preference for in-house options (see fig. 8) may be a factor in the declared choices of fund CFOs, but even among fund investors, there is a recognition that in-house investment and outsourcing can go hand in hand.

Fig. 8: We would like to see our fund CFOs... (Select all that apply)

	% of total responses*	% of participants**
Increase the size of the in-house finance team	27.84	69.09
Invest in expanding their technology framework	26.74	66.36
Invest in distributed ledger functionality	19.41	48.18
Outsource more functions	13.19	32.73
Retain their existing balance between in-house & outsourcing	12.82	31.82

**Column two shows the relative importance of each option as a percentage of all responses selected*
***Column three shows the percentage of the 110 investor respondents who selected this option*

Data may be captured once, but then they have to be reported according to multiple standards and frameworks. Complexity may come initially in how you gather the data, but once gathered, the question is how you deploy that data according to multiple outputs. This is where I think technology is key because it will help translate that data input into multiple outputs.

David Sarfas,
Intertrust Group

ESG

This year's survey introduced an optional section on ESG, which a majority of CFO respondents (84%) chose to complete. This in itself indicated that ESG is definitely on the CFO agenda, even if its relative importance varies from fund to fund. In general terms ESG considerations are recognised as an area with which they need to engage, even if the practical nature of that engagement is yet to be established. Of the total CFO survey sample, including those who chose not to complete the optional ESG segment of the survey, 58% nevertheless recognised that ESG was very important to their LPs (see fig. 9). Some regional variation was evident (see fig. 10), with US and UK based LPs perceived to place the highest priority on ESG factors, but in all cases, a tiny minority dismissed ESG concerns.

Fig. 9: How would you describe your LPs' expectations when it comes to ESG?

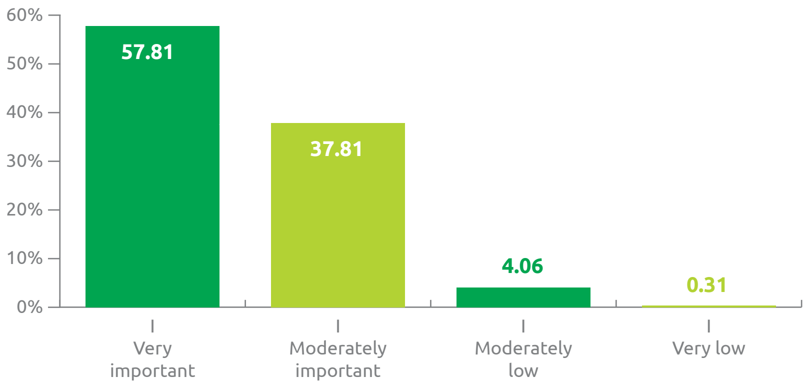
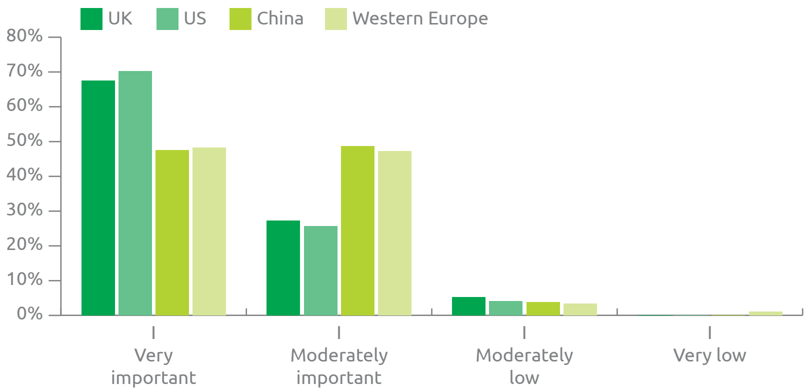


Fig. 10: Regional differences in perceived LPs' expectations of ESG



Knowledge and expertise on ESG integration and timely ESG data are crucial to comply with investor demand and sustainability legislation. A framework to collect, monitor and report ESG data is key in this and, in turn, technology, scalable processes and expertise will be necessary in addressing those requirements.

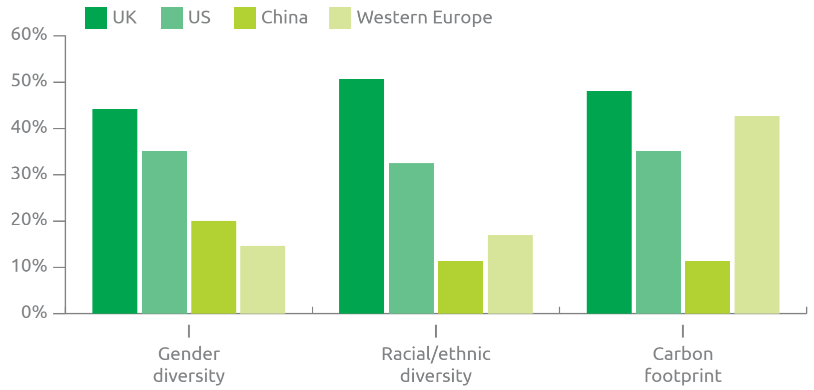
Antonello Argenziano,
Intertrust Group

The survey results indicate that CFOs are more than mindful of the importance of different aspects of ESG on their own investment decisions. As fig. 11 shows, between 67% and 79% of participating CFOs see gender diversity, racial/ethnic diversity, and carbon footprint considerations as either crucial or important in their own assessment of potential investment opportunities. Here again, there are regional differences with gender diversity and carbon footprint of most concern to UK CFOs (see fig. 12). In all regions, however, these factors are considered at least 'somewhat important'. In almost all cases, the percentage of CFOs suggesting any one of them is no more than a consideration is in single figures.

Fig, 11: What role do the following play in assessing an investment opportunity?

	Crucial	Important	Somewhat important	A consideration, but no more
Gender diversity	27.81%	50.94%	14.69%	6.56%
Racial/ethnic diversity	27.19%	40.00%	25.31%	7.50%
Carbon footprint	34.38%	44.38%	17.19%	4.06%

Fig, 12: Crucial factors in an investment opportunity by region



Results also suggest, however, that ESG remains an area where firm policies are still in development. Asked if they had an ESG, CSR or sustainability policy in place, almost 85% of respondents said they did. However, when asked about the implementation of ESG into their investment process, more respondents said they were in the process of implementing ESG policies into their investment process than had already done so (see fig. 13).

Fig. 13: When considering the integration of ESG into the investment process across your funds, which statement most accurately represents your current position?

	%
We are in the process of doing so	51.12
We have already done so	28.73
We plan to do so in the next year	11.57
We plan to do so in the next two years	4.85
We plan to do so, but not within the next two years	2.24
We have no plans to do so	1.49

Respondents clearly recognise the need for a solid framework to manage their ESG data. When identifying impediments to ESG integration into their processes, however, cost and resource constraints were cited as the main obstacles followed by the complexity and variety of ESG data and data sources (see fig. 14). Those two factors clearly interrelate since, if the data sources are less complex, fewer resources need to be applied to their management.

The variety of ESG reporting frameworks is likely to remain a challenge with no apparent consensus across the industry yet as to which are the most applicable, though regulation may narrow the current levels of fragmentation in this area.

Fig.14: What are the biggest obstacles you face in that process? (Please select all that apply)

	% of total responses*	% of respondents**
Cost and resource constraints	24.24	56.72
Complexity of managing multiple sources of ESG data	22.01	51.49
Quantifying and monitoring the ESG implementation process	20.41	47.76
Shortage of knowledge and expertise at GP level	16.59	38.81
Shortage of knowledge and expertise at portfolio company level	9.89	23.13
Additional restrictions ESG places on the investment process	6.86%	16.04

**Column two shows the relative importance of each option as a percentage of all responses selected*
***Column three shows the percentage of the 320 CFO respondents who selected this option*

For most of the managers we're talking to, it's not ESG policy in their own organisation that is the issue, even though that is important; it's their ESG policy and governance models, as they relate to their investment book.

They need to understand those companies and they need to determine what data they're going to need to do that, how they're going to normalise the data they collect, collate and interpret the data to show that the portfolio company meets their ESG governance model whilst also producing returns.

Jonathan White,
Intertrust Group

Conclusion

Our latest survey results reinforce the conclusion that CFOs recognise the need for further resources to meet the expectations of their investors for continual reassurance not only about the performance of the funds themselves, but of their compliance with standards in other areas that are in varying stages of consolidation. While standards and best practices are, for example, fast developing in areas such as cybersecurity, there is work to be done in developing the same degree of industry consensus on how to define, quantify and report on ESG progress.

The extent to which CFOs feel it prudent to increase their fixed costs in addressing these challenges is a matter for further consideration, though there are growing indications that the perceived dichotomy between in-house management and outsourcing is eroding as the industry matures.

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