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SEC and Private Equity

Daniel Giardina & Colleen Malloy | Private Capital Markets

Private Equity has become a hot topic in 2016. Global uncertainty and criticism around solvency and fees have caused institutional investors, LPs, university endowments and public pensions to allocate more capital to the private space. As a result, the Securities and Exchange Commission (SEC) has started to give private equity the same level of attention that they have given other, more traditional asset classes. Recent high-profile cases have resulted in a number of fines and related judgments against private equity general partners and as was made clear by a recent speech by Andrew Ceresney, Director, Division of Enforcement at the SEC, it is likely that this pressure will only increase going forward. What happened to attract this attention and how can investors best prepare themselves to deal with it successfully?

Take CalPERS for example; in the last few years, the firm has faced intense public scrutiny in regards to its performance, investment decisions and the fees paid to its various investment managers. A recent article in Pensions & Investments reported that CalPERS' private equity portfolio had declined by nearly $10 billion dollars during that time - to $24.6 billion from $34.2 billion. This was despite the fact that private equity was found to be CalPERS's best-performing asset class over the previous 10-year period. A number of factors play into this decline, but two major sticking points are of particular concern. One, as a public entity CalPERs faced transparency requirements that limited the number of (acceptable) managers to which it could commit funds. Two, the difficulties in managing numerous manager relationships resulted in efforts to curtail the establishment of new ones.

"Institutional LPs we have observed [have found] that operational due diligence, once thought to be unnecessary in private equity, is now taking a greater role at many organizations."

Marc Wyatt, Director of the SEC's office of Compliance Inspections and Examinations

Another challenge facing private equity is the increasing demand for accurate and timely valuations. As John Ferro, Partner and Practice Leader of Grant Thornton's Valuation Services noted in a recent white paper, as private equity firms start to register with the SEC, they have to contend with the fact that "Valuations are one of the agency's (SEC) main areas of focus" and that "it is crucial to perform the analysis [firms need] using multiple valuation approaches." ILPA has also joined the chorus exhorting the private equity community to adopt stronger valuation practices by publishing a set of valuation principles and best practices for private equity firms. With regulators ramping up their focus on transparency in valuation, firms are being forced to increase their attention in this area.

So what is a General Partner to do? Simply put, General Partners must take control of their data. According to a recent survey by EY, the number of funds subject to regulatory examination increased to 47% in 2015 from 28% in 2013. At the same time, 45% of investors say that reporting requirements are the most concerning issues facing them.

As it stands, a significant number of firms still rely on Excel to complete the necessary reports needed to meet regulatory compliance requirements and investor requests. This can involve sorting through numerous emails, spreadsheets, PDFs and other sources of data. As a result, many of these reports are prone to errors that can result in misstatements in the billions of dollars. When firms adopt technology solutions to these reporting and regulatory requirements, they cut down on the time and expense of meeting these requirements while ensuring a greater degree of data integrity and transparency. This, in turn, enables them to rise to the challenges, deliver a higher level of service, and stand out from the competition.

For more information ipreo.com/private-markets or PCMinfo@ihsmarkit.com

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