

Easing the Stress of Special Purpose Vehicles and Funds of One

Finding the Right Admin Partner to Survive in the New Financial Landscape

Increasingly, institutional investors and family offices are making more and more direct investments. This has led to the formation of special purpose vehicles (SPVs). In addition, many families and ultra-high net worth individuals are organizing their own private funds, called funds of one. What's more, major institutions often have literally hundreds of these vehicles. In addition, Dodd-Frank and last summer's SEC directive have raised the bar on key compliance, administrative, accounting and tax issues. The new landscape has added complexity to administration, accounting and reporting, tax and regulatory compliance without the resources or expertise to deal with the associated administrative demands.

What makes these entities especially challenging is that they often fly under the radar, remaining dormant and unnoticed — until there's a problem. Professionals say a special purpose vehicle is "quiet until it's not." In a given year, there might not be any transactions that take place because the events that give rise to payments have not been met. Other times, there may be a single transaction in a year or maybe a transaction quarterly. The specific activity, cash flows and filing requirements are typically dependent on the purpose of the investment and the investors, the jurisdictions and regulatory regimes involved, and the surrounding contracts.

Given the low transaction volume and perceived lower level of maintenance necessary, management often puts these SPVs "off to the side" to focus on core business functions like trading, investing and financing. But the lower profile of these entities does not lessen the importance of sound administration and compliance. The accounting, tax and regulatory requirements (including valuation) are the same as any other vehicle — especially if a filing or reporting deadline is missed. Not paying attention to SPVs or ignoring them altogether could result in penalties, fines and reputational risk.

Some firms are dealing with the administrative burden internally at great cost and business distraction. Others simply aren't dealing with it at all, leaving themselves vulnerable to risk, compliance actions and significant fines.

What's becoming increasingly clear is that firms need to find a better way to achieve regulatory compliance and operational efficiencies for SPVs while maintaining their business focus and managing costs.

Given that the operational requirements of these entities demand a high degree of specialization, more and more firms are looking to outside experts to help manage the process and effectively mitigate risk, rather than staffing up with dedicated internal resources. Unfortunately, some firms don't know where to turn to find the right resource or what to look for when choosing the right partner. Below is a set of key questions to help firms find an operational partner that's the right fit for their special purpose vehicles.

- **Do you have both business and ops expertise?**

The operational elements of a special purpose vehicle are complex, but so are the business goals and needs of the firms that create them. The right partner understands and can add value on both sides of the equation. It's not simply about understanding which forms to file or requirements to follow; it's about how they fit in the context of a firm's business. It's perfectly acceptable to ask a potential partner if they have former fund company executives and compliance experts on staff. In fact, it's advisable. A partner must function at the intersection of operational expertise and business acumen to deliver the greatest amount of value.

- **How do you integrate tax and accounting?**

Integration has become an all too common buzz word, but in this instance it's a necessity. Accounting may be different than tax and regulatory assets under management (RAUM) and may differ from dollar assets under management (AUM), but the right partner has to be able to integrate each of those disparate data points and convey them in a way that's meaningful to business stakeholders and regulatory bodies. Be sure to ask potential partners if they have a proven process for integrating key components and effective strategies to leverage them for the benefit of the business.

• How do you ensure accuracy?

Accuracy seems like it should be the baseline in any business, but in the highly complex and rules-driven world of special purpose vehicles it's not a given. Top tier admin partners should be able to demonstrate a repeatable process for ensuring the accuracy of data, filings, and forms and a system of checks and balances for making sure nothing falls through the cracks. Strategy and service are critical characteristics in a good partner but they must be grounded in accuracy to achieve risk mitigation and ultimately create business value.

• How do you back up your data?

This seems like more of a technology question, and it is to some extent; but it is also a critical business question. An admin partner is the keeper of vital business data that needs to be accessed in a secure manner regularly and protected so it can be referenced in perpetuity. A firm should have an in-depth understanding of the tools and systems the administrator uses to back up data. Do they own the systems? If not, who is their technology partner and are they stable enough to trust for the long haul? In the new financial landscape data rules and how you protect and preserve it is paramount to long-term regulatory and business success.

• Are you in the business for the long haul?

SPVs and funds of one in particular have become much more prevalent in light of recent regulatory reforms and some admins have jumped into the fray as a way of broadening their businesses. But firms have to question if they're committed to maintaining the resources it takes to provide value going forward. Do they have a deep enough team to serve a complex client base as their book of business grows? Will they have the staff continuity to provide seamless service as the relationship evolves? Do they have the bench strength to provide specialized expertise in niche areas as needs arise? Firms have to feel confident their admin is in the business for the long haul so they can focus on their own long-term growth.

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- *eVestment*, 2014
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Conclusion

For large firms with countless SPVs and funds of one, the new regulatory and administrative landscape is forcing their hands. They must find a better way to meet their operational and compliance requirements without compromising business focus or opening the door to unnecessary risks. Working with outside experts has been the answer for some, while others are apprehensive to make the leap because they fear giving up control.

The right partner should provide the transparency and reporting to make control concerns a non-issue, deliver the flexibility that works within a firm's existing business framework and have a platform that is scalable. The challenge is that it's not always easy to tell which admin partners will actually do those things when the relationship begins. The questions above are a good starting point to help firms vet potential partners, and identify the most effective way to handle their SPVs and funds of one in a way that helps them survive and thrive in the new financial landscape.