

Private Equity and Real Estate Services

– challenges and opportunities for pension funds

Recent falls in pension scheme funding levels have highlighted the risks from mismatched assets and liabilities – ie. that there is insufficient capital in the pension fund to meet forecast obligations to current and future beneficiaries – and, unsurprisingly, the majority of pension funds are keen to reduce or remove such investment risks and better manage volatility in the future. Such sentiment was evident at the J.P. Morgan 2010 European Pension Funds Summit. This annual event creates a forum to share industry expertise at a time when all aspects of pension provision, affordability and regulation are in the political and economic spotlight. One of the clearest messages of the day was that risk control and monitoring remain a priority.

Accordingly, in response to the need to reduce investment risk and improve coverage ratios, pension funds are diversifying their portfolios, adopting alternative investments and other more complex strategies. In the Netherlands, pension funds typically now have at least a 10% investment allocation to real estate, while UK pension funds are pursuing a renewed property market, due to a predicted rebound in the market, believing these asset classes will bolster flagging portfolios over the long-term. Private equity, too, is considered by some to be an excellent diversifying asset class, which is currently attractive in terms of investment opportunity.

Such trends require that pension funds are equipped to meet the new challenges they face with these alternative assets, both in terms of resource and expertise, as follows:

Enhanced investor needs. Greater demand for independence and internal controls, as well as increased reporting, transparency and timeliness, brings the challenge of comparing in-house administration and independent administrators equitably against criteria of quality and service levels.

Intensified cost pressures. Heightened focus on finance and operations to reduce costs means that in-house pensions personnel are required to balance risk and reward, and improve efficiency with fewer resources, while addressing the ever-present need to invest in operations.

Additional regulation. Greater scrutiny of alternatives by regulators has resulted in increased regulation, such as the AIFM Directive, and new legal and accounting regulations require research and knowledge to implement.

Increased globalisation. A highly competitive and developed market has fuelled expansion into international and global markets, requiring research into local risks, regulations and enriched multicurrency technology.

A different breed: characteristics of alternative assets

Alternative assets are different in many ways from traditional asset classes. Some key differences are set out below:

Investment characteristics

- Less transparent: information available only to those with specific knowledge/resources
- Typically active, investments are made opportunistically over a number of years
- Wide dispersion among managers
- Chief driver of manager's compensation is profitable realisation of portfolio companies
- Investment is illiquid (for example, for 10 years in some asset classes) via closed-end funds

Custody

- Safe-keep client partnership agreements
- Custodian agnostic

Accounting

- Valuation information received quarterly, in-arrears from the fund manager
- Manual reconciliations with Fund Manager require specific private equity training and expertise
- Complex structures and accounting rules require significant expertise

Reporting

- Standard reporting methodology is to use an Internal Rate of Return, since private fund managers exercise control over the amount and timing of cash flows into or out of their funds
- Portfolio Analysis calculated at the strategy, family, vintage year level, including commitment monitoring
- Underlying portfolio company reporting by region/industry
- Lack of an industry accepted private



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equity benchmark/index

- Limited Partner (LP) subsequent closes, requiring rebalances

How J.P. Morgan can support alternative asset portfolio management

Effective administration of these assets requires a different approach with different expertise. In order to provide a top quality service, the right people are critically important – people with experience in private equity. In EMEA, the Head of the J.P. Morgan business is a former private equity CFO. The head of the reporting analytics team formerly worked at a leading private equity research organisation, and was responsible for the production of quarterly and annual European private equity statistics for one of the most respected industry associations.

Systems are also of vital importance. J.P. Morgan uses Investran to perform its alternative asset administration. Investran is a market-leading private equity product and we have invested heavily to customise it for our alternative investment clients. It is no longer acceptable to administer an alternatives portfolio on a conventional custody platform. Such a platform will not be able to calculate performance accurately. Also, capital commitment information will need to be kept offline. By contrast, a specialist customised system such as Investran provides a fully integrated solution addressing all these needs.

Investran also provides a central repository for information related to a

fund's private equity and property investments. Our administration services thus help pension funds track valuations provided by underlying investments, and our enhanced reporting and analytics tools provide fund managers the information they need to review these on a timely basis. Coupled with J.P. Morgan's proven processes and procedures, this ensures that investments are administered appropriately and that information is easily available for use by auditors, investment managers and other stakeholders.

Partnering with an industry leader

The combination of people, technology and processes in J.P. Morgan's service thus provides the same level of professionalism for private equity as our clients would expect for more conventional assets.

J.P. Morgan Private Equity and Real Estate Services

- Top Rated Overall in Private Equity Administration – Global Custodian, Private Equity Administration Survey, 2007, 2008 and 2009
- #1 Private Equity Assets Under Administration – ICFA Magazine, Alternative Fund Administration Survey, 2009
- Staff of over 275 experienced private equity professionals worldwide
- Group services a total of 110 clients, with more than \$230 billion in assets among private equity and property funds and investors
- Service 56 institutional limited partners (primarily pension funds), with \$142 billion in private equity and property investments

We would welcome the opportunity to talk with you in detail about your alternative asset allocation, and how you are currently managing these challenges.

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