Let's be clear.

A common view on transparency

Intralinks and Opalesque commissioned a survey to ask institutional investors two fundamental questions:

1. What type of information do they really need?
2. Why do they need it?

Our goal is to foster a dialogue between fund managers and investors with the hope of finding a common view on what ‘transparency’ really means to both parties.

Overview

Fund managers and investors are in a tug-of-war over the issue of transparency. Once content with a performance update, basic valuation and general market commentary, Limited Partners (LPs) are now digging deeper, asking more questions and requiring more information from General Partners (GPs) than ever before.

The old saying was that no one asks questions when you're up 20 percent. That might very well be changing – and you can thank the financial crisis of 2007-2009, Bernie Madoff, Lehman and the challenges fund managers found themselves in during this time period.

There is a significant disconnect between the information investors want from their fund managers and what the managers are providing. Too much is never enough for the LPs, but GPs are rightly concerned about giving away the 'secret sauce'.

The intent for this survey is to inspire a dialogue between fund managers and investors to find a common view on what 'transparency' really means to both parties, and to establish baseline objectives for reporting and communication.

Andre Boreas
Director – Alternative Investments
Intralinks, Inc.

89% *Hedge Fund*

71% *Private Equity & Real Estate*

Investors who didn't invest in new funds due to transparency concerns

Executive summary

The survey was conducted by Opalesque and Intralinks in February and March of 2014. Over 100 responses were received from institutional, family office and ultra high new worth (UHNW) investors. Sixteen different countries were represented in the survey, with approximately 70% of the responses from North America.

- While hedge fund investors have seen an increase in transparency over the past three years, there is still room for improvement, with only half of the respondents indicating an appropriate level of transparency from their managers.
- 89% of hedge fund investors and 71% private equity/real estate investors have chosen not to invest in at least one new fund due to concerns over lack of transparency.
- Leverage/exposure is the second-most important criteria (after performance) for hedge fund investors evaluating a fund, with 96% of respondents indicating it to be “Very Important” or “Important.”
- For private equity/real estate investors, portfolio company/property valuations and financials is the second-most important criteria (again, after performance), with 93% of respondents indicating it to be “Very Important” or “Important.”
- Over 85% of investors would like to have their information delivered in an electronic/data format to facilitate their analyses.

Transparency improves, but is it enough?

Alternative investments are now firmly positioned as an important part of an institutional investment portfolio. Private equity and real estate have been an institutional mainstay for years, but hedge funds, long an investment that appealed mostly to UHNW investors, have seen a surge of interest more recently among institutional investors. High correlations in traditional equity strategies, low interest rates and a strong memory of the 2007-2009 financial crisis have all played their role in investors seeking uncorrelated sources of alpha.

However, institutional investors require a very different set of engagement criteria than the average investor, and many hedge fund managers are struggling to catch up. Even the more institutionally established private equity market is facing a new set of transparency, communication and reporting requirements. These new rules are forcing managers to re-think how they structure their entire organizations across marketing, operations and technology.

Both hedge fund and private equity investors report that transparency is improving. Figures 1 and 2 show that 66% of hedge fund and 45% percent of private equity investors indicated an increased level of transparency over the past three years.

Levels of transparency over the past three years

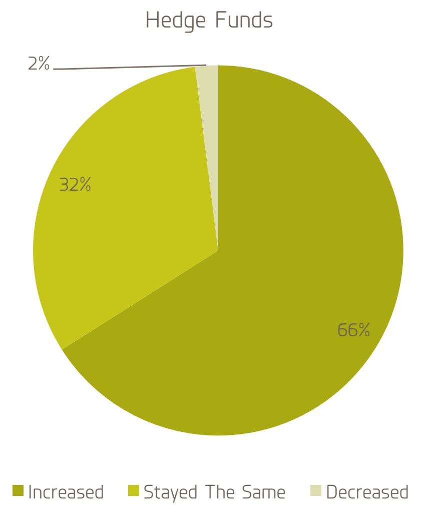


Figure 1

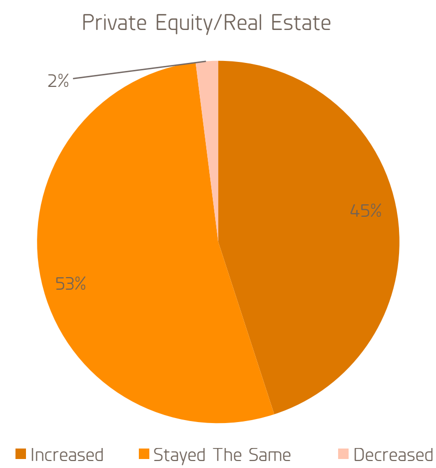


Figure 2

Is the amount of transparency sufficient?

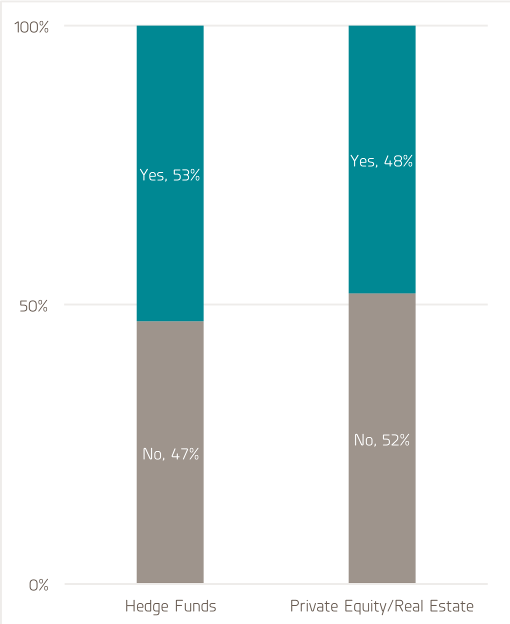


Figure 3

Despite this improvement, half of the respondents still feel that it is not currently sufficient (see Figure 3).

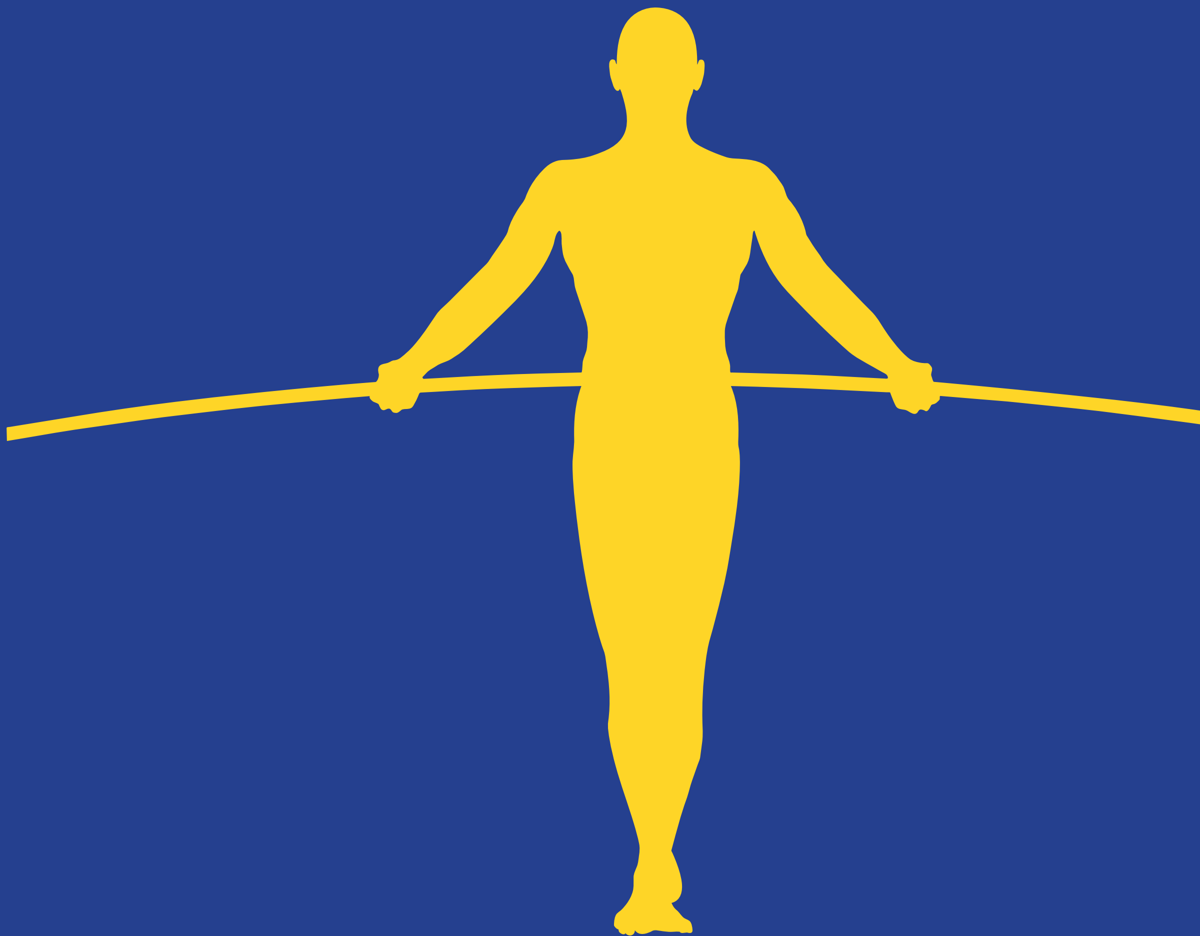
As the CIO at a large east coast family office commented:

"I'm more concerned with my hedge fund managers than my PE or real estate managers given my liquidity dynamics. The actual reporting hasn't changed that much but if I ask for a particular piece of information, I usually get it. It does make me wonder if the same level of information is being afforded to all investors in a fund."

If information is only made available when it is asked for, are GPs reaching the level of transparency that investors need?

Reporting standards – still lacking

The lack of standards for investor reporting has been a much-discussed issue. There have been a number of efforts over the past few years to develop a common set of data elements to facilitate the exchange of information across all industry participants. Organizations such as the Institutional Limited Partners Association (ILPA) have created a set of templates and best practices to encourage private equity GPs to standardize reporting to increase transparency and improve efficiency for both fund managers and investors. However, results have been mixed, with full industry adoption still lacking. Both the Open Protocol Enabling Risk Aggregation (OPERA) and the Hedge Fund Standards Board (HFSB) have been established to foster the same type of communication in the hedge fund industry with, again, widespread adoption still pending.



Investors' changing expectations

The investor/fund manager courtship once limited to the three Ps (people, process and performance) has evolved significantly. While the three Ps remain important, investors (particularly institutions) are taking a much closer look at a fund's operations, infrastructure, reporting, risk management, service providers and counter parties. Investors today want to understand the operational risks as much as the performance risks.

In making a new investment, information inquiries can be broken down into two components during the due diligence phase:

1. Information and context on the portfolio's past performance and its current composition.
2. Expectations on what information will be made available in the future (investor reporting), both formally and informally.

"It's about finding a balance. The key is to keep an open dialogue with your limited partners and understand what they are trying to accomplish with the information. Certainly we do not want to put our portfolio companies at any kind of disadvantage but we understand the need for thorough due diligence by investors."

From a leading California-based venture capital firm regarding information of a portfolio's past performance and current composition.

Both investors and fund managers need to be up front with expectations of reporting and communication going forward, post-investment. Both sides should articulate as clearly as possible what information can be expected, when will it be delivered and in what format. With new relationships, fund managers might very well decide that they will "tier" their transparency, providing more information to prospects and investors after a level of comfort has been established around the sharing of sensitive data.

Investors' changing expectations

According to the survey, expectations around reporting and communication have indeed changed over time, with a growing need for a higher frequency from their managers. Historically, hedge funds have reported on a monthly basis to their investors, with private equity and real estate managers reporting quarterly.

A full 25% of hedge fund investors now require their managers to report on a daily or weekly basis and almost half of private market managers expect to receive portfolio updates at least monthly (Figure 4). At a recent institutional real estate conference, one manager was heard to say that he had a large U.S. pension plan ask for weekly valuations on their investments. One potential reason for this change might be the increased use of the private equity secondary markets to drive liquidity. Indeed, the PE secondary market reached a high of $27.5 billion in 2013 from $25 billion in 2012 (source: Cogent Partners).

Commenting on the increase need for more frequent reporting by private equity managers, a $5 billion PE Fund-of-Fund manager stated:

"Quarterly reporting was the norm forever. Now investment committees want more regular updates. Some of this is being fueled by the opportunity to sell in the secondary markets but some of it is simply because they can get it. If we're being asked for it, we need to ask our managers for it."

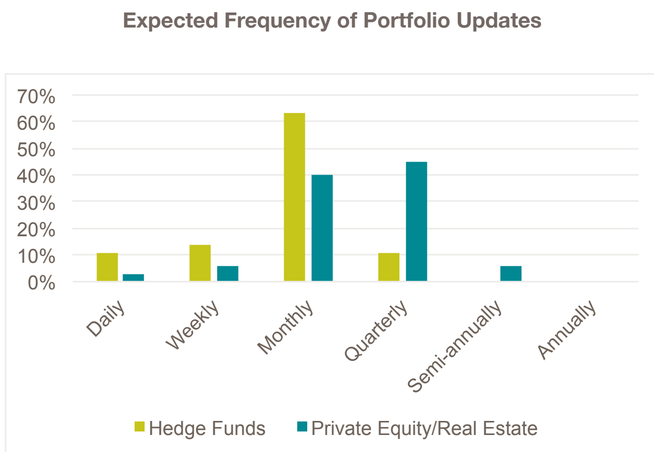


Figure 4

Monitoring, data and technology

One subject brought up by a number of LPs, in particular hedge funds, is the confusion over the types and formats of information investors want on an ongoing basis. Given the lack of data standardization in alternative investments (amongst other reasons), the tried and true method of sending out updates via hard copy or PDFs remains most popular. While this might be fine for investor letters or portfolio commentary, it certainly makes life more challenging for the recipients, particularly when it comes to multi-manager environments and the need to collect, organize, aggregate and eventually analyze underlying manager information.

When respondents were asked to rate what types of information was most important, there weren't too many surprises (Figures 6 and 7). Performance data in both hedge and private capital camps was the most important, as to be expected. However, hedge fund investors did indicate that exposure and leverage information were almost as important as performance information. Given some of the challenges hedge funds faced during the financial crisis (concentrated bets, the exodus of liquidity in the credit markets), it should be no surprise investors have taken to their own form of risk management.

Important types of information for LPs

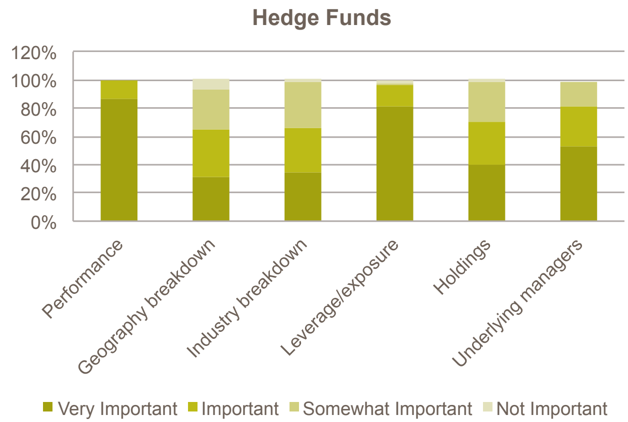


Figure 6

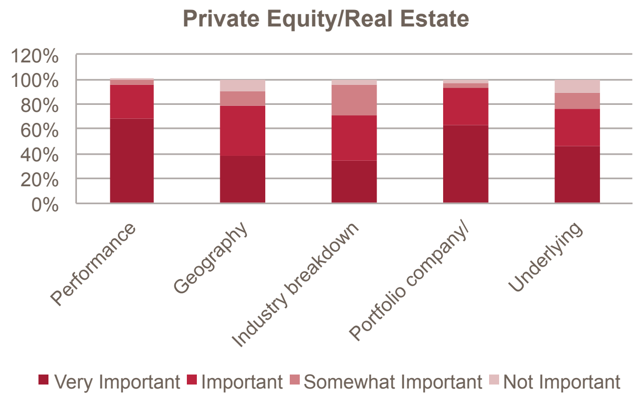


Figure 7

While mutual funds and more traditional long-only investment managers have provided investors with online access to structured data around their investments and holdings for many years, "alternative" fund managers have started moving away from paper-based quantitative reporting.

Over half of the investors in this survey indicated they were receiving some information from their managers in a data download format (Figure 8). Those GPs who aren't providing downloadable data are missing an opportunity, because over 85% of those investors who weren't getting information in a downloadable format felt that it would facilitate the due diligence and monitoring process. Given the advances in technology and SaaS-based offerings, managers have little excuse not to provide investors with the information they need in a format and timeliness with which they need it.

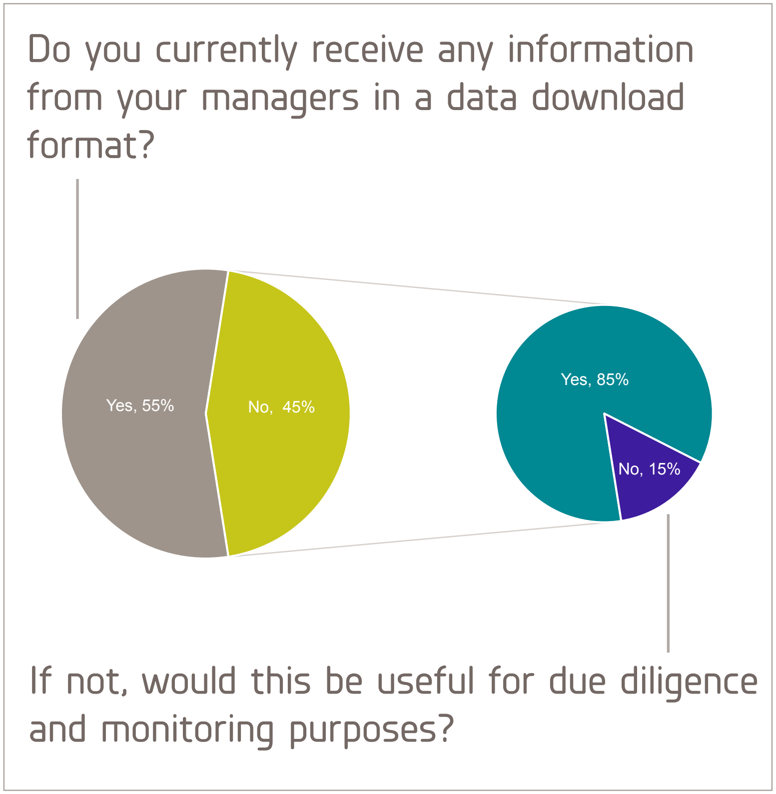


Figure 8

Observations and opportunities

The goal of this survey was to establish some baseline data points around the investor community's need for transparency, reporting and communication. The end result confirmed that progress is being made in meeting investors' reporting expectations. At the same time, there is room for improvement in how investors define, consume and aggregate manager communication. Some observations and opportunities:

- The trend is toward better communication and transparency, but is still not there yet.
- Incorporating data standards as proposed by independent entities could go a long way to facilitate an efficient exchange of data between GP and LP.
- Expectations around transparency and reporting need to be established at the beginning of the manager/investor relationship.
- Technology can play a key role in meeting investor expectations around the electronic reporting of quantitative information – an element that investors are clearly asking for.