Privcap/Presents

A Conversation With
Jonathan Korngold
General Atlantic

With insights from:

Debevoise & Plimpton LLP
Grant Thornton LLP
And featured charity:
Central Park Conservancy

About Privcap Media

Privcap is a digital media company that produces events and digital thought-leadership content for the global private capital market. Privcap Media offers communications services to market participants.

Privcap is known for its authoritative online video programs and digital reports. Since its launch in September 2011, Privcap has produced dozens of focused reports, and about 800 video programs—mostly in-depth interviews and panel discussions with private investment experts. Privcap's audience has grown to about 8,000 unique visitors each month—a mix of institutional limited partners, general partners, high-net-worth investors and service providers. Each week, Privcap and its sister site PrivcapRE release and promote new content.

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If you are a GP or LP and would like to request an invitation to a future Privcap Presents gathering, please email events@privcap.com

If you are a service provider interested in being a sponsor of a future event and report, please contact Gill Torren at gtorren@privcap.com

About Privcap Presents

Privcap Presents is a series of invitation-only networking events designed to bring together GPs, LPs and other guests. The events are organized by Privcap Media and hosted in partnership with leading professional service providers.

Each Privcap Presents event begins with an intimate, on-stage interview with a notable leader from the private equity industry. A transcript of that interview is used as the basis for a digital report (like the one you're reading now) that is made available to Privcap's global audience. Also included in Privcap Presents reports are perspectives from the event partners, including a non-profit selected by the featured interviewee.

No Longer Your Parents' Financial Services

At the January 28 Privcap Presents event, Privcap CEO David Snow interviewed General Atlantic managing director *Jonathan Korngold* about how technology is propelling financial services into the future

Jonathan Korngold, General Atlantic

Privcap: Can you talk about how your firm invests in financial services?

Jonathan Korngold, GA: Financial services represents anywhere from 25 percent to one third of our overall portfolio. We've had the luxury of having invested in financial services for decades now, and there are probably not many subsectors in which we don't have some deep experience.

How much longer will we all be carrying around wallets?

I don't think wallets are going away anytime soon. You will always have a wallet, but it might not be leather. Today, 40 percent of transactions are still in cash. That being said, we are seeing profound changes in payments that are being driven by a number of factors, including a change in consumer behavior, the growth of omni channel purchasing, and the means by which businesses are interacting with their clients. The single most dramatic shift we're seeing in payments is innovation in the customer experience. For example, with Apple Pay, the user experience is phenomenal in terms of being able to just use your thumbprint, which provides an added layer of security for merchants and consumers.

What are some of the significant changes you see in asset management?

In many strategies, there's been a general shift from actively managed funds, such as stockpicking and traditional mutual funds, to more passively oriented strategies, such as ETFs, that are aiming to replicate benchmarks.

In 2014, nearly three-quarters of all U.S. active managers weren't able to outperform their benchmarks. It's a very tough position to be in, particularly if your value proposition is to beat your benchmark net of fees. While actively managed funds will always serve a valuable role, in many asset classes, such as large cap U.S. equities, I would just as soon put my money in a Vanguard S&P 500 index fund and have a good chance of outperforming the stock pickers. That's a trend that is here to stay.

Another important change is in the emerging markets, where we're seeing tremendous growth and demand for asset management products. As GDP per capita and wages increase, people now have more money to invest. Rather than just keep everything in their savings accounts, bank clients can now get additional yield through simple investing in funds, such as money market products.

Technology is also really enabling more of a self-service approach. It's making it cost-effective to provide wealth management services to people other than high net worth individuals, in both developed and emerging markets.

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General Atlantic's Korngold and Privcap CEO David Snow

From left to right: John Vasily of Debevoise & Plimpton LLP opens the event; invited guests network and mingle

According to reports, 50 percent of the wealth in the world is controlled by 1 percent of the people. Do you see barriers to change in the high net worth world because there's such an expectation of hands-on, white glove service?

First, fees are under pressure across the board, forcing advisors to increasingly play the role of asset allocators and leaving less room for "bespoke" offerings. Traditional wealth management services are quite involved and require adequate fees to support the level of service that high net worth clients demand. However, in order to extend the scope of these services to the millions of people whose net worth falls below the "high net worth" threshold, advisers will need to use technology extensively to make the economics work for all.

Do you see alternative investments becoming more popular with a different crowd of investors in the high net worth world? And how will products be packaged and promoted to people other than the traditional limited partners?

As I noted earlier, three-quarters of traditional mutual funds' active managers in the U.S. didn't outperform their benchmarks last year. That's not the case for a lot of alternatives and, in particular for private equity, where performance has been more resilient.

Today, retail investors often use ETFs and other passive strategies to diversify their portfolios and to gain exposure to general market growth. I think they will eventually need to complement this with exposure to alternatives as well, which is why we've begun to see great demand for liquid alternative products.

Which areas of lending and debt do you find interesting?

There are a lot of regulatory mandates, and they have created a tremendous investment opportunity. We've been living through a very benign credit cycle over the last several years. Many of the new nonbank financial companies are relying largely upon algorithms that automate some of their underwriting processes. Because these newer entrants have not lived through multiple cycles, we don't know exactly how their credit portfolios are going to perform over time. It's easy to grow originations right now. The real question is how are you going to grow big while remaining disciplined?

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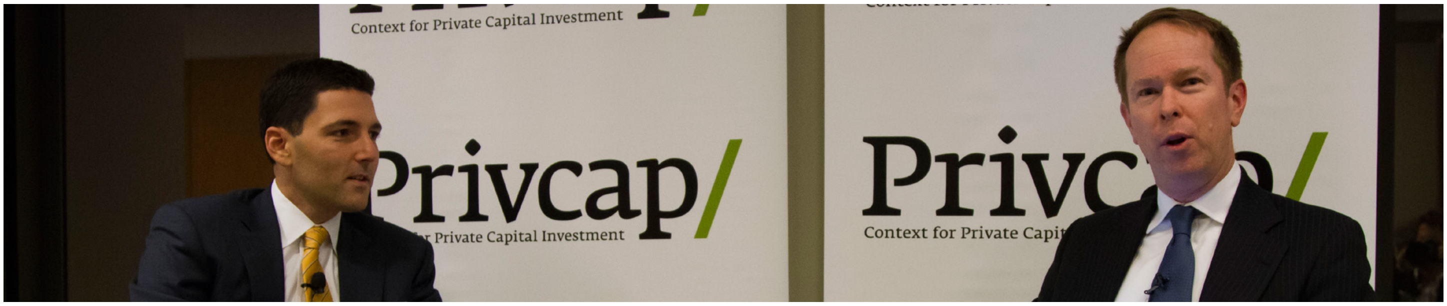

Privcap's David Snow interviews General Atlantic's Jonathan Korngold

> **"It's staggering how fast these companies can grow in the emerging markets."**
>
> —Jonathan Korngold, General Atlantic

We've been frustrated a bit by the way the market is no longer making the appropriate distinction between traditional balance sheet lenders and financial technology companies. Valuations are becoming blurred as the traditional paradigms that are historically applied to wholesale based financing have gone out the window, with people valuing businesses purely on top line growth and originations. We don't think it's sustainable, so, as a result, we've stood on the sidelines for a while.

If you could rank where you see the biggest opportunity to disrupt—to go in and take market share away from legacy players with new technology and new business practices—what would stand out on top?

Like we just discussed, lending and nonbank financial companies are creating great opportunities for disruption and innovation. Another opportunity is in the compliance space. Banks are saddled with billions of dollars in penalties against them, and are searching for cost-effective solutions to manage their compliance needs instead of trying to do everything in house. Small and midsized asset management firms also are potentially in jeopardy due to the burden of managing compliance needs. The scale required to be successful in this new highly regulated world leads us to an opportunity for consolidation.

What is different about the opportunity to build, from scratch, financial services companies in some of these developing markets versus the opportunity here in the U.S. and in other developed markets?

First, in the developing markets, you're not stepping into a situation where you're saddled with legacy incumbents who, if you had a blank sheet of paper, you would never have designed a system around. On a relative basis, you generally have more growth in the developing markets. Countries like China, Brazil, and India are incredibly interesting when it comes to long term secular tailwinds and GDP growth per capita. These provide a wonderful general uplift to base growth and they unlock the power of the emerging middle class, which wants to engage in the financial system in a way that a cash-based economy didn't allow them to in the past.

And it's important to note that your firm has an investment in Alibaba.

It's been a good one for us. It was only three years ago Alibaba started a partnership with a Chinese asset manager through which Alibaba customers and merchants could convert cash in their accounts into units of a money market product. People on the outside said, "That's crazy. It's an e-commerce company. What are they doing in mutual funds?" But, it actually made a lot of sense to enable their customers to earn higher returns on this cash rather than doing nothing. Fast-forward three years and Alibaba is now offering what is now the largest mutual fund in the world.

I did not know that Alibaba was offering investment funds. How did they envision this unfolding, given that investment services wasn't part of their core competency?

They had a massive customer base already, and it was a trusted base. For example, a lot of Amazon users go right to Amazon to make purchases because they trust they will be the low cost provider. And this extends to them using additional services like Amazon Prime or Amazon Prime Now because of the strong relationship they have with the company. Alibaba enjoys that same customer loyalty and trust even more so in China than we might otherwise understand. They have an amazing platform to expand their product and service offering so this was a natural extension. It is staggering to see how fast these companies can grow in the emerging markets.■

Expert Q&A

With David A. O'Neil
Partner
Debevoise & Plimpton LLP

What kind of issues related to cybersecurity and data privacy are you hearing about from private equity clients?

Our private equity clients are keenly focused on these issues from two different perspectives. First, they are considering how best to play defense: how to protect their own data against attack, including both their corporate data and the personal information of their investors, and to be sure their portfolio companies are following best practices and the latest legal and regulatory guidance. Second, they are on the lookout for deal opportunities. This can take the form of investments in companies with cutting-edge cybersecurity products or services. It also means looking at target companies that hold a valuable portfolio of data—be it intellectual property or big tranches of consumer information—and figuring out how that data can be monetized while being consistent with security and privacy laws.

What are you telling them with regard to mitigating risk?

We emphasize the need not only to take the technical measures necessary to reduce the attack surface and to thwart intrusions, but also to put in place the same kind of controls and protocols that they would in other areas of legal and compliance risk. Cybersecurity is no longer something you can just leave to the IT department. Increasingly, a failure to follow best practices—data mapping and minimization, segmentation, encryption, and robust controls over vendors and passwords—can be seen as a legal violation. That makes it incumbent on PE firms to bring together their IT, operational, risk and legal resources to mount a coordinated defense. They also need to know the rules of the road for monetizing a target company's information, like the latest court decisions on data privacy and the strict rules followed in many non-U.S. jurisdictions for exploiting personal data or moving it from one jurisdiction to another.

Are you seeing PE firms be proactive to stay ahead of the increased cybersecurity and data security risks?

Everybody is at least beginning to be alert to the threats and opportunities. Some firms are more prepared than others. Those in the best position have recognized that, for themselves and their portfolio companies, cyber risk needs to be approached with the same rigor and on the same level as other more traditional sources of compliance and legal risk. ■

Debevoise & Plimpton

Expert Q&A

With Andrew Kahn
Director, Private Equity
Grant Thornton

What is Grant Thornton doing to help its private equity clients avoid cybersecurity threats and other risks to data?

Private equity clients are unique in that they represent investment businesses on the one hand and businesses of every imaginable type on the other hand. We serve our PE clients with a blend of financial, strategic, and technical resources and understand the different elements of risk for each type of business, which are coordinated through a national or global account team and, ultimately, one or two people who see the whole picture. We provide all kinds of specialists around data management.

How are tighter regulations directed at the private equity sector affecting your approach?

At the moment, there is pressure from the SEC for greater scrutiny around independence, which is to say the services Grant Thornton or other firms can offer in combination. That requires more serious discussion on a more frequent basis with clients to make sure we are in the best position to serve them—and, in some cases, opting out of services by mutual decision.

An unexpected shift in strategy towards an IPO, for example, can raise numerous issues, as we have experienced recently with two middle-market investors based in New York, but can often be worked out if a single variable like timing is flexible.

What are other challenges that your clients are facing at the moment?

In some economic cycles, private equity is looking for money. Currently the issue is not money but, rather, interesting deals. There is a lot of capital competing for a relatively limited number of conventional PE deals, so we are seeing more creativity in asset classes or investment theories. One client recently purchased some toll roads, for example, along with a water treatment plant. ■

Contact: Andrew Kahn, andrew.kahn@us.gt.com | www.grantthornton.com

Grant Thornton

CENTRAL PARK CONSERVANCY

central to the park

Can you tell us why you became a supporter of the Central Park Conservancy?

Jonathan Korngold, General Atlantic: I've had the privilege of being involved with some really great nonprofits, and the one I'd like to mention is the *Central Park Conservancy*. Central Park is probably the most successful example of a public-private partnership and it is so valuable to all New Yorkers.

For those of you who lived in the city in the '70s and very early '80s, the park was not a great place to be. The park was in a state of decay and had become a haven for graffiti, vandalism and other illegal activities. The *Central Park Conservancy* was founded in 1980 as it became clear that the financial needs to sustain and preserve the park required private funding. Today, the Conservancy is responsible for approximately 75 percent of the park's annual operating budget. I was, and continue to be, an active user of the park. New York City itself is one of the safest cities in the world and Central Park is one of the safest police districts in the city. That's tremendous, and it's directly due to the efforts and dedication of the *Central Park Conservancy.*

The mission of Central Park Conservancy is to restore, manage, and enhance Central Park in partnership with the public. The conservancy aspires to build a great organization that sets the standard for, and spreads the principles of, world-class park management, with an emphasis on environmental excellence to improve the quality of open space for the enjoyment of all. For more information, visit www.centralparknyc.org. ■