HOW TO PICK THE RIGHT FUND ADMINISTRATION SYSTEM: 5 KEY TESTS

HOW TO PICK THE RIGHT FUND ADMINISTRATION SYSTEM: 5 KEY TESTS

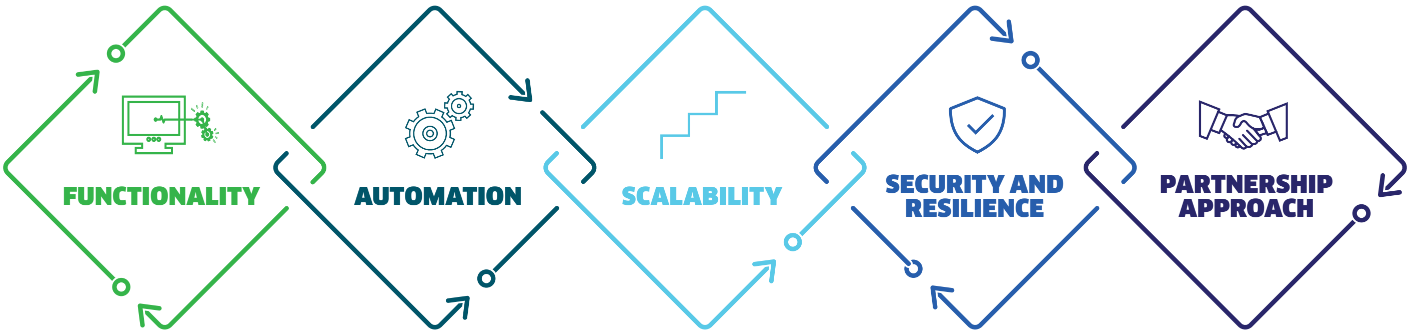
Technology has become a defining battleground in the fund administration space.

Fund administrators are ever more central to the smooth running and profitability of their investment management clients. But as fund managers hive off more functions, their third-party provider and attendant regulatory risks grow. Stringent due diligence examinations are now the norm as managers search for outsourcing partners that can deliver the requisite speed, quality and reliability of service.

Testing administrators' IT infrastructures has become a key focus of that due diligence process. If the services and functionality are not up to scratch, fund managers will simply look elsewhere – which makes picking a rich, reliable and flexible technology platform of critical importance to fund administrators' competitiveness.

What to look for in a fund administration system: 5 make or break factors

Having the right investor servicing software can make all the difference in winning tenders and holding on to clients. But what does the "right software" look like?



SYSTEM CHOICE: 5 MAKE OR BREAK FACTORS

1. FUNCTIONALITY

Some form of functionality shortfall is often the driving motivation behind a system replacement. New fund structures come to market, investment managers diversify into different asset classes or end-investor servicing demands evolve, producing support gaps that need to be filled.

Multi-asset class capabilities

The shift away from traditional 60/40 portfolios in favor of greater asset class diversification – evidenced most notably by the progressive rise in alternative asset class allocations – remains a powerful ongoing trend.

Amid "an inflationary and higher-for-longer interest rate environment," Goldman Sachs Asset Management (GSAM) expects to see a "renewed focus on the role of hedge funds and their ability to provide a differentiated source of portfolio return."[1] Its 2024 Outlook also predicts a growing role for private markets in portfolios, helping provide return enhancement and diversification at a time of geopolitical and macroeconomic uncertainty. This includes private credit strategies, where strong interest will continue, "aided by structurally higher interest rates compared with the past 15 years."

Adams Street Partners' fourth annual Global Investor Survey echoed the GSAM findings, with two-thirds of respondents planning to increase their private market deployments in 2024.[2] Almost 90% of the investors surveyed believe private markets will outperform their public market equivalents over the long term.

WHAT YOU NEED

Alternative assets bring important operational idiosyncrasies. Investors need to be properly registered at onboarding. Commitments must be set up and monitored at each stage of the fund life cycle, with tracking of all drawdowns, distributions, transfers and switches. Valuations and investor reporting depend on allocating income and expenses appropriately, with support for even and uneven allocations needed for different fund structures.

The array of performance, management and transaction fees, trail commissions, taxation calculations, clawbacks, hurdles and waterfalls can be complex and customized across investors. For private equity funds, waterfall and fee calculations must be produced on both a whole fund and deal-by-deal basis, with close rebalancing and equalization. Systematic control is essential to ensure valuations are fast, accurate and consistent.

Powerful data analytics are needed to generate desired performance metrics such as internal rate of return, time-weighted rate of return and total value to paid-in capital – and the performance, fee and valuation figures reported to investors.

ESG

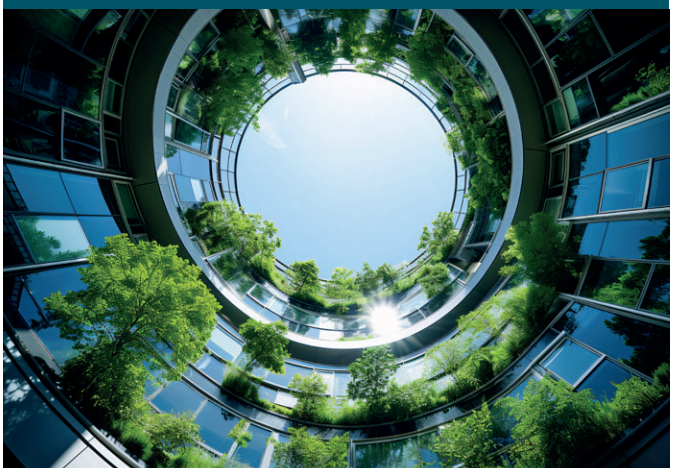
Despite the negative headlines around environmental, social and governance (ESG) investing, interest remains strong. The Adams Street survey respondents reported that impact and/or ESG is seen as the greatest investment opportunity in 2024. Over 60% of investors said ESG considerations are a determining issue in their investment strategies, and 93% agree or strongly agree that an investment's return value can be enhanced by incorporating ESG factors. Hedge fund managers are among those increasingly incorporating environmental and social metrics into investment strategies to generate insights.[3]

At the same time, regulator and investor reporting demands are growing as stakeholders seek more transparency around performance, risk and the ESG credentials of fund products.

WHAT YOU NEED

Data to measure and analyze the impact and performance of investments, and reporting tools to deliver the information on key ESG metrics to end-users, are central to these investment analysis and transparency trends. A joined-up data model and integrated systems that can provide look-through from the shareholder record to the underlying portfolio will be key to tracking the portfolio components and delivering transparent, timely reports on the investor's ESG attributes.

Fund administrators that can seamlessly capture the swaths of incoming ESG-related data into their platform, standardize it into usable formats, check the quality, extract relevant components, and create and distribute comprehensive investor, regulatory and management reports will add real value to clients.



[1] *Asset Management Outlook 2024: Embracing New Realities*, Goldman Sachs Asset Management.

[2] *Navigating Private Markets in 2024: Opportunity Knocks as Change Accelerates*, March 4, 2024, Adams Street Partners

[3] *Hedge Funds Are Stepping Up Exposure to ESG Strategies, UBS Says*, Jan. 10, 2024, Bloomberg

Regulatory compliance

Progressive regulatory change is upping the compliance burden on asset managers. Many are turning to their administrators for help.

Anti-money laundering (AML) and Know Your Customer (KYC) requirements are ratcheting higher in markets around the world. Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS) rules continue to tighten. The EU's Sustainable Finance Disclosure Regulation (SFDR) and Markets in Crypto-Assets Regulation (MiCA) are now in force. The Corporate Sustainability Reporting Directive (CSRD), and amendments to the Alternative Investment Fund Managers Directive (AIFMD) and Undertakings for the Collective Investment in Transferable Securities (UCITS) Directive, collectively referred to as AIFMD II, are coming down the line. Transparency demands, as seen with the U.S. Securities and Exchange Commission's new private fund adviser rules, are on the rise.

WHAT YOU NEED

Meeting the regulatory demands takes multi-level, multi-jurisdictional solutions. AML compliance rests on delivering real-time visibility and control at every stage of the customer life cycle, from client onboarding to ongoing due diligence and real-time suspicious activity monitoring. The disparate regulatory reporting requirements depend on automated workflow management, data accuracy, control and flexible report engines that can provide appropriate granularity into positions, performance, risk and fees.

Client servicing expectations

Customization, transparency, ease and responsiveness have become key service watchwords in fund administration.

Limited partners (LPs) want customized reports offering granular breakdowns of activity, positions and valuations, with rigorous performance and risk analytics (preferably in real time) so they can see how their money is managed, stated Preqin's 2023 Service Providers in Alternatives report. "Given the increasing LP focus on transparency, GPs will be looking for service providers who can help them improve reporting capabilities as a source of competitive advantage."

WHAT YOU NEED

Investors now expect seamless digitalized interactions at every stage of the fund manager relationship. That starts with onboarding and attendant KYC and AML checks. Subsequent subscriptions, redemptions and drawdowns should be automated and hassle-free. An automated reporting capability is essential to meeting investors' demands for detailed, tailored reports, while ensuring full control over the release of data. Providing LPs with online portal access to interactive dashboards, offering 360^0 views of their accounts and easy two-way communications, is a must-have.

[4]*Service Providers in Alternatives 2023, Sept. 20, 2023, Preqin.*

2. AUTOMATION

Functionality must be matched with performance and smooth client service if fund managers are to attract and retain clients. Sustained margin compression throughout the value chain adds to the focus on process and cost efficiency. All of which takes automation.

The reality is that legacy platforms, spreadsheets and manual workarounds remain all-too-common in the administration space, bringing workflow inefficiencies, risk and duplicated cost – issues that are magnified when replicated across asset classes and business lines.

WHAT YOU NEED

No single platform will cover an administrator's full enterprise technology needs. But properly configured, monitored and controlled systems with functionality-rich, multi-asset class and multi-jurisdictional capabilities – underpinned by intelligent workflow management tools to maximize process automation at every stage of the transaction and investor life cycle – will enhance data integrity, eliminate errors, increase speed and stability, and maximize client satisfaction.

3. SCALABILITY

Scale in fund administration is increasingly vital as fund managers seek to outsource ever more middle- and back-office activities. Simply ramping up headcount to support asset and client growth is no longer an option given the demands for service speed and pressure on admin cost bases from tightening margins.

WHAT YOU NEED

Automation – by introducing faster, more hands-free processes that reduce firms' dependence on manual intervention – allows for more unconstrained growth. But beware the illusion of automation. A fund administration platform may be able to host the data and run the reports you want. Functionality counts for little, though, if it isn't married with reliability and robustness regardless of activity throughput.

4. SECURITY AND RESILIENCE

Given the money and sensitive data they control, financial institutions are prime targets for cybercriminals. Firms will be attacked. The only question is when and how they deal with the situation.

WHAT YOU NEED

Minimize the risks. Look for software built on a modern architecture with the latest security protections, such as dual key, maker/checker transaction controls, row-level security and tailored user permissions. And ensure the vendor vets any open source or third-party software libraries it uses to ensure it only employs reputable sources.

Platform resilience and data redundancy are also coming under the spotlight as part of fund administrators' disaster recovery and business continuity planning protocols. Is data backed up and easily recoverable? Does the administrator use cloud-delivered solutions that allow it to piggyback on the cybersecurity investments made by its system vendor?

5. VENDOR DEDICATION AND PARTNERING

Fund administration systems are long-term purchase decisions. The solution provider's stability, strength and commitment to the sector, and development road map for its technology, should be central considerations in the selection process.

Proven track record

A healthy company with a proven track record and dedication to the industry gives administrators, and their investment manager clients and prospects, assurance that the system will be supported for the long haul and won't suffer from key person risk.

Deep fund industry domain expertise

Does the software provider combine deep technology expertise with industry domain knowledge? And is it leveraging that to provide clients with actionable industry insights and best practice guidance?

Responsive support

What happens when a problem emerges? An update is needed? A new regulation is introduced or an industry event takes place?

Automated support systems are part of the equation. What matters most to clients, though, is access to people: having expert client service teams, account managers and strategic relationship directors available to resolve problems and queries.

Technology that grows with you

Software is not a one-time, set-and-forget purchase. A system may serve your purposes now, but will it in two years, or five or 10?

All technology companies should have an active technology road map and be investing heavily in it. Equally, that upgrade path needs to be aligned with your development trajectory. If the provider doesn't have the capacity or desire to collaborate on those developments, capability shortfalls will become pronounced and the relationship strained.

A trusted partner

Pure transactional-style relationships with service providers leave administrators ill-equipped to thrive in a changing world. Will the vendor evolve with you, and continue to provide the level of customer service you seek?

A partnership approach works best when the vendor's employees have real fund administration experience and can put themselves in clients' shoes. Collaboration based on frequent communication will help you leverage the full functionality of the vendor's systems, and inform ongoing product development plans to achieve continuous, maximum return from the solutions and services.

Conclusion

Replacing a fund administration system entails a major investment of time and resources, bringing expense and disruption. Look at the system capabilities you have and where as a business you want to go, then determine which platform can best support your ambitions. Ultimately, the benefits the right solution can deliver will far outweigh the cost.

About FIS

FIS is a leading provider of technology solutions for financial institutions and businesses of all sizes and across any industry globally. We enable the movement of commerce by unlocking the financial technology that powers the world's economy. Our employees are dedicated to advancing the way the world pays, banks and invests through our trusted innovation, absolute performance and flexible architecture. We help our clients use technology in innovative ways to solve business-critical challenges and deliver superior experiences for their customers. Headquartered in Jacksonville, Florida, FIS ranks #241 on the 2021 Fortune 500 and is a member of Standard & Poor's 500® Index.

www.fisglobal.com/contact-us

twitter.com/fisglobal

linkedin.com/company/fis

ADVANCING THE WAY THE WORLD PAYS, BANKS AND INVESTS™