6 reasons U.S. Fund Managers are turning to outsourcing

- **7 in 10 managers outsource some element of their fund operations to a specialist fund administrator**
- **An outsourcing provider specializes in fund administration, accounting, regulatory and compliance services**
- **Six considerations for private capital managers who are evaluating their outsourcing needs**

A recent survey in the U.S. suggests that at least 70% of managers outsource some element of their back office or fund operations to a specialist fund administrator. With tightening regulations, fast-paced tech innovations and growing investor demands among the reasons given by surveyed managers for outsourcing, this percentage is expected to continue to rise. ***Debbie Reeve*** *and* ***Scott Kraemer*** *share six challenges fund managers may be facing in the current market and how outsourcing these to the right partner can help you overcome them.*

Broadly speaking, outsourcing involves a fund manager appointing a third-party service provider to undertake certain activities relating to the day-to-day administration of a fund. The scope of the role is as narrow or as broad as the manager determines and can range from delivering specific services to support an in-house back-office team, to providing most of the back office, middle office and operational support necessary for a fund to function. A survey among U.S.

CFOs found that 7 out of 10 managers were outsourcing some aspect of their administration, while the Carne Atlas 2024 report found that 85% of U.S. managers surveyed expect to increase the level of outsourcing of their European business over the next five years.

Typically, more comprehensive outsourcing relationships will see the outsourcing partner assume responsibility for the administration of the fund, investment and management vehicles, as well as performing key regulatory activities.

The outsourcing role is usually fulfilled by a professional provider which specializes in the provision of fund administration, accounting, regulatory and compliance services. These businesses range from financial institutions that service multiple industries to independent specialists that work exclusively with fund managers.

Here are six challenges private capital managers may be facing, which accelerate the requirement to evaluate their outsourcing needs:

1. Reprioritization in a transforming market

According to McKinsey's Global Private Markets Report 2024, private markets assets under management totalled $13.1 trillion as of June 30, 2023, a number that's grown nearly 20% per annum since 2018. The Carne Atlas 2024 report expects the global value of private markets to exceed $21.08 trillion by 2030.

Despite the fundraising slowdown and the amount of dry powder in the market, alternatives continue to be an attractive sector for a diverse range of investors and for many managers, this has brought about a strategic rethink. Managers are increasingly recognizing that their ability to capitalize on new opportunities in the market will be dependent on their ability to quickly "scale up" their operations to accommodate their ambitions.

Scaling up at pace can be challenging. Recruiting new staff with very different expertise and skill sets, investing in training and new technology, and adapting controls and procedures can not only be costly but also very difficult to achieve in a short space of time.

The outsourcing model allows managers to grow at a pace that suits their goals because the professional administration business will already have the people, technology and operating platform in place. What's more, the onus is on the

outsourcing partner to continually enhance their operational capabilities to support their clients' ongoing and ever-evolving requirements – capital investment that is largely made by the professional administration business rather than the manager.

2. Tighter regulation

While private markets fund managers operating in Europe have had to contend with an onerous and burdensome regulatory environment in the shape of the Alternative Investment Fund Managers Directive ("**AIFMD**") for a number of years, the U.S. has historically been comparatively "light touch". This, however, is changing.

Regardless of the Court of Appeal's ruling in June 2024 to strike down the SEC's proposed PFA Rules, most managers are already performing a gap analysis to see where their LP reporting is lacking, and realigning their operating model accordingly. Part of this process is working out what can be done in-house, what it makes sense to outsource and how existing partners can be leveraged.

During a recent roundtable discussion hosted by Aztec, some of the U.S. managers present, who also operate in Europe, said they are streamlining their approaches to reporting and in some cases, where they are also operating in Europe, using the AIFMD as a reference to standardize reporting requirements. Despite the striking down of the PFA Rules, managers expect the SEC to focus on enforcing the rules that already apply, increasing scrutiny on managers.

In addition, in August 2024, FinCEN introduced new AML and CTF regulations aimed at combating money laundering, terrorist financing, and other illicit financial activities. These regulations are part of a broader effort to enhance oversight within the financial services industry. Managers will need to be compliant by January 1, 2026. There are other compliance factors that will affect managers, including cybersecurity and climate change, which will result in additional reporting and operational requirements in time.

3. Building a global portfolio

Private markets are becoming an increasingly global industry with growing numbers of U.S. managers raising private capital, investing in or launching funds in Europe. According to the Carne Atlas 2024 report, 88% of U.S. managers surveyed are raising capital in Europe and of the 12% who aren't, half plan to do

so within between one and three years. This strategy, of course, brings opportunities but it also brings numerous challenges and implications from an operational, regulatory and fund structuring perspective.

By partnering with a professional outsource provider, managers are able to leverage local expertise and resources to meet their international requirements without having to build a presence or operation of scale in a new jurisdiction.

For example, many U.S. managers operating in Europe will establish a sufficient local presence to meet their local substance requirements, while appointing a professional administration business to provide many of the services critical to the effective day-to-day operation of the fund.

4. Democratizing private markets

One of the most exciting trends in the industry right now is how retailization is opening private funds up to a broader range of investors. Digitalization allows investors to onboard more easily while tokenization means investors can buy a portion of an underlying asset, with more investors accessing private assets than ever before; the World Economic Forum has forecast that 10% of global GDP will be tokenized by 2030. With administrative efficiency gains of 60-70% being frequently touted through retailization, it's hard to imagine such adoption stopping there.

Simultaneously, there are more retail investors with access to the required amount of capital to invest in private markets, as wealth is transferred to the next generation and technology enables funds to onboard more investors more efficiently.

5. Enriching the investor experience

As investors' demand for more detailed reports and a seamless digital experience increases, the relationship between a GP's investors and its administrator is more critical than it may have been before.

Investors recognize that their interactions with the fund manager, from onboarding and data collection to reporting and ongoing correspondence, will largely be shaped and delivered by the fund's back office and operations team – which can be provided by an external provider.

Increasingly, investors expect to be treated as an extension of the client relationship that exists between the fund manager and its outsourced provider, therefore managers must select a third party that can truly become a trusted partner.

6. Operational best practice

While many of the points raised above can be the catalyst for a manager deciding to outsource, there is a growing appreciation in the U.S. that fund administration has become a specialist role crucial to a manager's long-term success in a digital and global environment.

Today's operating environment is more complex than ever before, and professional administrators are well placed to help fund managers navigate the regulatory and technological complexity. Also, that role doesn't just extend to navigating challenges such as the growing compliance and reporting burden and increase in cyber-crime, but also helping managers to develop, evolve and, in some cases, even redesign their operating models to include the requisite number of controls and achieve operational efficiencies, make more informed investment decisions, and enhance investor relations through more timely and professional communications.

Managers may even want to go further than the traditional back-and middle-office outsourcing model and leverage the evolving technology of professional administration businesses to assist with front office functions, such as ESG governance.

Choosing an outsourcing partner

The right administrator can add value across all aspects of a fund manager's business, which means it's a decision the manager must get right. Taking the time to do proper due diligence on a potential outsourcing partner and a thorough assessment of their credentials is critical.

Managers typically want to "deep dive" into the following areas as part of that process:

- Level of experience, particularly the outsourcing partner's track record of working in the manager's target asset class and jurisdiction
- History of investment in new technology and systems, and commitment to

embracing innovation

- Whether the service model is relationship-based and delivers a stable, dedicated and consistent team over the life of the fund
- Level of emphasis placed on building long-term partnerships and ability to meet managers' evolving requirements
- Robustness of the operating platform including industry best practice controls and procedures
- Depth and breadth of expertise
- Client advocacy including retention rates, NPS and testimonials that endorse service quality
- Ability to provide services from the leading fund jurisdictions and local expertise available in those locations.

Every manager will, of course, place their own level of importance on each of these areas based on their needs today and their ambitions for tomorrow. No matter what these are, however, all managers will need to be sure of their selected partner's commitment to fulfil their evolving needs throughout a fund's life cycle as well as being aligned to the manager's future roadmap.

To find out more about how the Aztec Group can leverage its private markets expertise to support your fund, please contact Debbie or Scott directly.