Outsourcing explained

A few quick tips for curious investment managers.

Hana Prochaska, our Luxembourg-based Associate Director, recently spoke to Unquote about why investment managers decide to outsource.

What is outsourcing?

With respect to the funds industry, outsourcing refers to an arrangement wherein an investment manager appoints a third party to handle certain activities relating to the day-to-day operations of a fund.

The general scope of outsourced responsibilities is determined by the manager, but the most comprehensive outsourcing relationship will involve the fund administrator taking care of the manager's middle and back-office requirements. This will often encompass the administration of the fund, investment and carry vehicles, as well as acting as the depositary.

Why do managers choose to outsource?

There are various factors that can influence a manager's decision to outsource, but the most common are cost and the need for expertise. Managers are subject to an ever-growing list of AML, compliance, accounting and regulatory reporting requirements. Managing these requirements in-house comes at considerable cost, with managers often having to recruit professionals or pay steep consultancy fees to meet them.

These same factors apply to technology. Managers want the most robust systems in place, but capitalising on technological advancements requires investment. Beyond the upfront costs of new technology, support is required for set-up and configuration as well as ongoing maintenance or upgrades – all of which incur significant long-term costs.

The modern administrator is built and resourced to manage these and a range of other challenges. By outsourcing, the manager gets direct access to the expertise they require, and benefits from the administrator distributing the costs they incur across an entire client base.

Expertise and cost aside, many managers outsource because they want to focus purely on managing their investments, rather than being spread thinly across operational and administrative demands. Outsourcing enables them to do just that.

How do you ensure an outsourcing relationship gets off to a good start?

Selecting an outsourcing partner is not a decision any manager should take lightly, and it is vital that the manager is at ease with the process.

The first step is to undertake a review of the manager's requirements and ensure that the right systems, processes and controls are in place.

With both parties agreed on how the relationship should take shape, a detailed migration plan follows. This should set out responsibilities, action points, deadlines and what measures will be taken to minimise any potential disruption. The manager wants business-as-usual throughout this process, and it is up to the fund administrator to deliver that.

What should a manager look for in a fund administrator? And what makes a good working relationship?

To build a strong relationship with a fund administrator, everyone needs to be on the same page. Demonstrable ability to provide and deliver services consistently both from and across multiple jurisdictions is also an essential pre-requisite.

With regard to service model, administrators tend to lean towards an approach that favours either functionality, or client relations.

A functional approach means client requirements are effectively serviced by different departments, and often different people within those departments, but this leaves something to be desired in the way of continuity.

A relationship-based approach involves building a stable and consistent team around the client, ensuring the manager deals with the same people every time, and effectively operating as an extension of the manager's own team.

Overall, if the relationship feels like a partnership, the manager can be sure they have got it right.

What precautionary measures can I take before choosing a particular administrator?

Managers should pay close attention to an administrator's client base and their background in serving clients of a similar size, investment strategy, asset class focus and geography to their own. Having teams in place with relevant expertise and experience is an absolute must, along with relevant language skills or, at the very least, cultural affinity.

It also pays to observe the scale of investment an administrator has made in their systems. Having the right technology offers an array of benefits, from greater efficiency to enhanced control and security.

Managers should not be afraid to look at retention rates either. It may sound overzealous, but speaking directly to an administrator's previous clients before choosing to start a relationship with them is invaluable. This feedback will either validate the administrator's service proposition, or tell the manager to keep looking.