The Evolution of Fund Administration

In the past, fund administrators typically lagged well behind prime brokers, lawyers, and auditors in terms of perceived importance. However, this perspective has changed a great deal over the course of the last few years.

Philip Niles
Butterfield Fulcrum

It was not too long ago that fund administration was considered a dusty, underwhelming industry ranking relatively low on the list of priorities to stakeholders in the alternative investment world. Much of the focus was allocated to the front office, especially by investors during the due diligence phase, and little deliberation was reserved for the middle and back office work performed either in-house by an investment manager or by their fund administrator (assuming that the fund even had a fund administrator). In addition, on a list of service providers, fund administrators typically lagged well behind prime brokers, lawyers, and auditors in terms of perceived importance.

However, this perspective has changed a great deal, especially so over the course of the last few years. As investor demands intensify and the regulatory environment becomes increasingly complex, fund administrators have been called upon to extend their offerings to clients. While some of this change has been of a reactive nature to a developing landscape, much of what is now handled by fund administrators has been of their own design using a proactive approach, constantly adopting new processes and technology to serve the needs of their clients.

Though the changes in the fund administration world built over time, the credit crisis of 2008 certainly accelerated this evolution. It was during and following this period that investor demands for increased reporting, more frequent deliverables, and heightened transparency became the new norm. In response to these requests, alternative investment managers were able to leverage their fund administrators to provide new or enhanced reporting. Moreover, a number of previously self-administered funds quickly discovered they were only able to maintain their investor base by utilizing a fund administrator, leading to a further expansion of the industry.

This extension of the fund administration world continued as investment managers sought to outsource a number of their middle and back office tasks. As costs continued to rise, investors became more fee sensitive, and the requirements of all interested parties became more intricate, fund administrators became the natural choice to absorb a great deal of the operational tasks that were previously performed in-house by an investment manager. While this started with the traditional back office functions, it has recently extended into the middle office as more fund administrators handle trade date reporting and reconciliation on a daily basis. Taking this a step further, some progressive fund administration firms are offering front office solutions in the form of order and portfolio management software to their clients; the ability to offer a true, seamless front-middle-back solution has become a defining characteristic in the fund administration world, separating the best from the rest.

> **"As investor demands intensify and the regulatory environment becomes increasingly complex, fund administrators have been called upon to extend their offerings to clients."**

Technology has been another area in which fund administrators have rapidly transformed themselves in recent memory. Spreadsheet-based solutions are now horribly insufficient in the face of increasingly complex fee calculations, fund structures, and allocation requirements. Second-rate technology introduces a host of new risks and issues, such as manual errors, an inefficient operational workflow, and longer turnaround times for reporting and information distribution. Fund administrators who wish to remain competitive have invested a great deal of time, energy, and money in best-in-class technology solutions, whether they are proprietary or sourced through industry-leading third parties.

Perhaps more than anything, there has been an ideological shift in the approach of fund administrators in recent years. A fund administration business model based on a one-size-fits-all solution for every client is not only dormant, it has likely gone the way of the typewriter. An ability to craft customized, bespoke solutions for clients is now mandatory, as every alternative investment manager has unique needs and wants, both for themselves and for the investors they serve. Fund administrators who cannot adapt to this paradigm shift will find themselves falling far behind their peers, especially when it comes to larger, more demanding engagements.

The current environment bears witness to further evolution, specifically in how fund administrators are assisting their clients in navigating the ever-changing regulatory and compliance landscape. Numerous fund administrators have introduced solutions for items such as the Foreign Account Tax Compliance Act (FATCA) and Form PF, the SEC's major step into data gathering at alternative investment firms. To be sure, regulation and compliance will continue to be a hot-button issue in the industry and forward-looking fund administrators are putting the necessary infrastructure in place to handle these new demands.

Evolution, of course, is an ongoing process and there are certainly additional areas over the coming months and years where fund administration firms will step up to meet new challenges or stay on top of changes in the industry. Some fund administrators are introducing online portals for client and investor reporting, further bridging the transparency gap and streamlining workflow. In addition, another area getting increased traction is with respect to subscriptions and redemptions as fund administrators look to enhance this process, including the use of online subscriptions, redemptions, and transfers.

Needless to say, fund administration has altered significantly over the last few years. As the alternative investment space changes, sometimes with breathtaking speed, fund administrators have become acutely aware of the need to change along with it. It is no longer sufficient for a fund administrator to use sub-standard technology or static operational processes; to do so will quickly render a firm uncompetitive and unable to satisfy the wishes of new or existing clients. The relatively swift changes in the alternative investment field have created an opportunity for differentiation within the fund administration industry; there are now firms that have evolved along with the world of finance in general and those who are simply struggling to keep up. To be sure, Darwinian principles hold for fund administration as it does for any other industry: it is truly survival of the fittest and the ability to adapt makes the difference between survival and extinction. *