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FUND OUTSOURCING

'ASSESSING THE CRITICAL ISSUES AND CONSIDERATIONS WHEN OUTSOURCING OPERATIONAL FUNCTIONS AS A FUND MANAGER'



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SPECIAL WHITEPAPER:

Focus, Flexibility and Expertise: The Value of Outsourcing



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For new businesses speed-to-market can be all-important, and outsourcing offers best-of breed functionality that can help investment managers launch in as little as three months.

The financial crisis has acted as a catalyst for new start-up companies globally, with a number of managers leaving their roles in investment banks and choosing to strike out on their own. Regulation and risk management is now also vigorously driving this trend. In addition, the Volcker Rule in the US – which prohibits banks from risking their own capital in speculative trades – is forcing investment banks to reduce proprietary trading exposure to meet capital adequacy requirements. Many investment banks are therefore spinning-off their trading desks, lowering barriers to entry and offering entrepreneurial managers the opportunity to start their own businesses.

“Starting from scratch meant that it was critical to establish sufficient investment management infrastructure”

Against this backdrop, investment operations outsourcing is playing an increasingly large role in the plans of start-up investment managers – providing a cost-effective platform to manage their investments and clients while enabling them to fully focus on their strategy and core competencies at critical growth phases. Crucially, the platforms available have developed to such a degree that these transitions can be done extremely quickly, with start-ups being fully operational inside of three months, from planning to execution. Importantly, the quality and functionality available is comparable to anything the investment management industry can offer. An example is the launch and subsequent growth of boutique investors, Independent Franchise Partners (IFP).

INDEPENDENT FRANCHISE PARTNERS

London-headquartered IFP is an employee-owned investment management firm, focused on a single, long-

established investment discipline. With US\$250 million under management at the time of launch in June 2009, it now manages assets of more than US\$6 billion as of June 2011. Managing global and US equity strategies, its investment approach focuses on high-quality franchises with strong value orientation.

IFP's founding partners, with more than 75 years of combined investment experience, had left their previous employers after ten very successful years to establish a new investment management firm. Starting from scratch meant that it was critical to establish sufficient investment management infrastructure to attract new clients within a three-month launch period. As part of their launch planning, IFP's management made a conscious decision that they wanted their business to remain as lean as possible and focus particularly on activities they considered 'core' – stock research, portfolio construction, trading and client service capabilities. All other operations would be outsourced. Resources and start-up expenditure would be focused on launching the company and marketing their business to investors, rather than on the time-consuming process of building their own back office. Following a selection process, management elected to outsource their back-office to Northern Trust.

MORE THAN JUST A SERVICE

Speed to market is a critical factor in achieving a successful launch and IFP's founders faced a range of tasks that had to be completed extremely quickly. Aside from establishing a working infrastructure, they had to complete an aggressive schedule of tasks, ranging from finding premises to gaining FSA approval. In such circumstances, the best investment operations outsourcing offer far more than just processing capabilities such as trade validation and settlement. They are "knowledge companies" that harness their experience to deliver alternative thinking on how objectives can be achieved. IFP's launch demanded this approach, and required creative solutions for one of the shortest launch periods ever planned in the industry.



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MEETING THE 38-DAY TIMETABLE

Drawing on a history of handling migrations, Northern Trust provided an implementation timetable of 38 days for contract completion, as well as a tactical interim solution to help get the company up and running. The solution devised involved IFP being migrated onto Northern Trust's back office platform and controls, utilising temporary manual interfaces until a permanent front-office infrastructure was later developed.

In such situations, flexibility is crucial and both parties worked together in a highly collaborative process that enabled fast decision-making to be carried out. For example, Northern Trust began committing resources to the project on the basis of the company's Letter of Intent and worked on the launch in parallel with ongoing contract negotiations, to ensure that any contract delays did not prevent the launch schedule being met.

MANAGING THE RELATIONSHIP

Outsourcing offers investment managers the ability to offer clients a first-class service in fields such as their client reporting and in other back and middle-office functions where the start-up manager often has less resource to allocate. Using a provider's existing infrastructure therefore offers a proven, cost-effective answer that can be implemented relatively swiftly at lower and more predictable cost than an in-house solution.

However, the use of an external infrastructure inevitably involves the investment manager becoming reliant on the outsourcing provider for their business to function smoothly. Our experience is that establishing open lines of communication, and ensuring strong integration takes place between both organisations, are key steps in achieving a successful outsourcing relationship. Attaining clarity over individual roles and protocols is equally important, particularly as the outsourcing provider will be undertaking duties that have regulatory and legal impacts for which their client will continue to be ultimately responsible. A robust framework should be established at the outset that governs and clarifies the roles and responsibilities of all parties in the outsourcing relationship.

ENABLING GROWTH

In the case of IFP, Northern Trust's single global operating platform was a strong match with the client's reporting requirements. In particular, our platform's information

delivery is driven through a single unified source rather than via multiple portals and supports IFP's managers as they track their portfolios and strategies, which span a variety of fund vehicles and pooled products managed from Chicago, Dublin and London.

Our portal provides an integrated view of their assets and portfolios – functionality that allows IFP to efficiently oversee the outsourcers' management of day-to-day operational issues such as undertaking reconciliations, looking into failed trades and handling service issues accurately, quickly and efficiently. In addition, the outsourcing partner should have sufficient capability, scalability and flexibility to accommodate managers' future growth plans. This ability to support future growth is fast becoming a driver behind the adoption of outsourcing.

In the case of IFP, Northern Trust supported rapid growth in assets under management from US\$250 million to US\$6.2 billion in two years. We have assisted throughout via our capability to introduce new clients swiftly and smoothly onto their investment platform, as well as formulating comprehensive servicing solutions for new products that have been launched across multiple fund platforms. We have also been able to support diverse manager strategies and add value through offerings such as white-labelled reporting and integrated performance and risk reporting.

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THE VALUE OF OUTSOURCING

In sectors ranging from telecommunications to insurance, companies choose to outsource parts of their business functions to reduce their costs, grow more swiftly and help reduce risk. For investment managers, investment operations outsourcing offers all those advantages and more. It has evolved from a purely cost-driven processing capability to a strategic tool providing a best-in-class service experience for managers and their clients – plus access to knowledge, experience and technical expertise at every stage of growth.





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This article is extracted from the 'Fund Outsourcing' report by Clear Path Analysis, published September 2011
