

FOCUS ON

MOVING INTO THE MIDDLE OFFICE

The term 'back-office' is fast becoming an anachronism to describe the role of a hedge fund administrator. *HFMWeek* spoke to Mark Schoen of Northern Trust about the surge in demand for middle- and front-office support services



Mark Schoen

is the head of product and strategy for Northern Trust's hedge fund services in EMEA. Prior to this, Mark served as Northern Trust's head of product and strategy for EMEA, which included fund administration, investment operations outsourcing, derivatives, FX, cash and global custody. He has nearly 15 years of experience in product management and development.

Changes in the global hedge fund industry are transforming the traditional outsourced fund administration model. Far from being confined to a 'back-office' end-of-month reporting role, today's new breed of fund administrator is at the hub of a fund manager's daily operations. Mark Schoen, head of product and strategy for Northern Trust's hedge fund services in EMEA, explores the momentum behind administrators' move into the middle-office.

Q **HFMWEEK (HFM): WHAT ARE THE BIG PICTURE TRENDS DRIVING THE GREATER FOCUS ON 'OUT-SOURCING' MIDDLE-OFFICE SERVICES?**

A **MARK SCHOEN (MS):** Fresh regulation and shifting investor expectations are the key drivers. However, to a certain extent, it depends on who we talk to. For start ups or new launches, managers increasingly want to be able to focus on trading and delegate infrastructure responsibilities, and it helps, at a time of greater regulatory scrutiny, if they can align themselves with a partner that can deal with all that administration.

When it comes to larger, established players, they're normally either looking to deal with an expertise gap or a capability gap that prevents them from meeting strategic growth targets. They might be moving into a new strategy, where some of the technology that we can supply aids portfolio oversight, allowing them to achieve real-time transparency into operations, including being able to access and manage live data such as trade processing and P&L. The key factor is that a robust middle-office allows managers to make more informed decisions faster and reduce time spent on operational matters, so they can maintain focus on executing their investment strategy.

Q **HFM: WHAT TYPES OF FUNCTIONS ARE FUND ADMINISTRATORS BEING ASKED TO SUPPORT AND WHAT TYPES OF HEDGE FUND MANAGERS ARE LOOKING TO OUTSOURCE THEM?**

A **MS:** We are experiencing demand from hedge fund managers to provide a spectrum of middle- and front-office services. They need support around trade

flow processing, P&L reporting, strategy tagging and compliance monitoring and risk analytics. Increasingly, we're seeing interest in integrated front-office functionality as well – order and execution management, pre-trade compliance, treasury functions. And moving these functions to a specialist asset servicer rather than an external technology vendor means managers can leverage both technology solutions and a substantial reservoir of operational domain expertise.

In terms of clientele, our sweet spot straddles both the traditional and alternative worlds – blue chip managers moving into the hedge world as well as hedge fund managers with complex strategies and more esoteric asset classes. That's our target area, a blend of traditional managers, new strategies, sovereign wealth funds and other large institutional investors that have an alternative bias. All of whom can benefit from a fund administrator employing a more holistic approach to portfolio oversight.

Q **HFM: WHAT ROLE IS THE INVESTOR PLAYING IN THIS DEVELOPMENT?**

A **MS:** A number of investor expectations are driving this shift: transparency, independence of function and regulatory oversight. In addition to transparency, the investor is also seeking demonstrable independence of the record about how the middle-office is being run. The engagement of a highly established provider can supply more investor confidence in the rigour of valuations and reporting, especially when it comes to more esoteric instruments.

Managers also have much greater regulatory oversight right now. Some of the reporting requirements of the EU's Alternative Investment Fund Managers Directive (AIFMD) are perfect examples of the types of duties that an investor would be pleased to see outsourced to an administrator. With this in mind, a focused office of, for example, ten to 15 managers, can benefit from the global infrastructure of a support team of many hundreds of people focused on delivering a set of comprehensive middle-office services.

Q **HFM: HOW IS THE CHANGING REGULATORY LANDSCAPE AFFECTING THE FUND ADMINISTRATION MODEL?**

A **MS:** The rapid expansion of regulatory requirements, combined with the globalisation of the investment management industry, presents myriad challenges for hedge fund managers: from the latest developments to the EU's AIFMD and the Ucits directive, to the US's Form PF and Foreign Account Tax Compliance Act (Fatca).

The pace and complexity of regulatory change has put an acute focus on fund administrators being able to help managers navigate these changes. Because managers are expanding across markets, this demands a co-ordinated global approach which encompasses direct product solutions, as well as guidance and commentary through workshops and briefings.

The upshot of this is that an administrator cannot just build a team or a service and call it 'regulatory support'. Rather, fund servicers need to build a base of expertise across a complex and expanding array of topics, as well as discreet solutions that correspond to the demands of different regulations. Where other areas of administration

can be applied broadly across strategies and asset classes, regulatory support is decidedly more granular in nature and requires more specific expertise.

Q HFM: HOW IS MIDDLE-OFFICE SERVICING IMPROVING DECISION MAKING?

A MS: Timeliness is the real driver of the value of middle-office services. A real-time system gives managers instantaneous transparency into exposures for any asset class or position. Another key driver of value is the flexibility of data management. Our ability to tag, sort and view data through tagging capabilities enables far greater granularity for decision making, meaning a portfolio can be assessed in a number of different ways. Northern Trust Hedge Fund Services' Position Block concept is applied to each transaction, which effectively creates a series of views that clients can use to reflect their book structure – views can be sorted, aggregated, etc., by strategy, desk, trader, fund, portfolio, or any other characteristic. These multiple views are a powerful tool and further enhance a manager's decision-making process. It's all about empowering fund managers with the information they need to make better investment decisions faster, and achieve improved investment performance.

Q HFM: HOW CAN ADMINISTRATORS SUPPORT TODAY'S CONVERGENCE OF TRADITIONAL AND ALTERNATIVE INVESTMENT STRATEGIES?

A MS: We see this convergence from both directions. Traditional managers are looking to lift ideas from the hedge fund world and are expanding into new and more complex asset classes. At the same time, hedge fund managers are wrapping their strategies into more traditional fund structures such as Ucits or other onshore vehicles. We're seeing traditional managers who are effectively creating multi-strategy portfolios such as diversified growth funds: commodities, fixed income, equity and FX exposure, with a macro overlay. This presents potential servicing issues as their operational infrastructure was, in all likelihood, designed with a particular asset class in mind. The ability of an administrator to support multi-strategy funds with multiple asset classes, and to do so with consistent capability across asset classes, is a major advantage in today's marketplace. As this convergence continues, we expect that such capabilities will become increasingly important.

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MARK SCHOEN

Q HFM: IS THIS JUST A STORY ABOUT TECHNOLOGY?

A MS: No. Technology is only half the story. Certainly, we have unique technology that we



believe is ahead of the market: it's real time, it has tagging capabilities, it's one system that covers all asset classes and all users. But ultimately, the shift of the administrator's role is about a greater degree of interaction and engagement with clients. You need the right talent that can work with the client in the first place – the nature of the system improves and increases the dialogue.

The complexity of these investment strategies means administrators must have the internal expertise around asset classes to be able to support and manage processes effectively. So while technology is very important, this greater level of interaction requires client-facing staff to have a high level of expertise and executive oversight around internal risk management and accounting policy.

Q HFM: IN SUMMARY, WHAT ARE THE BENEFITS OF A 'FRONT-TO-BACK' OFFICE ADMINISTRATION SOLUTION?

A MS: First, consistency of data and integration of systems across front-, middle-, and back-office functions promotes better, more accurate, more available data and fewer reconciliation breaks. We believe the administrator function works best when it is integrated with a middle- and back-office solution which feeds directly into fund accounting and investor servicing activity. Second, one of the unique facets of our platform is that our middle-office tools are available to support front-office decision making in real time. This model is truly different from the static back- and-forth model that defines the traditional relationship between a fund and their administrator. Both clients and staff can look at the same data, in the same views, at the same time. This enables Northern Trust to become a 'virtual' extension of the manager's office – independent but dynamic. ■