Consolidation will improve standardisation
Convergence drives strategic partnerships
Cultural fit is key to long-term M&A success
Driving the future of fund administration

HEDGE FUNDS
PRIVATE EQUITY FUNDS
FUND OF FUNDS

How did SS&C become one of the world’s fastest growing fund administrators? First we built the industry’s most experienced team of fund accounting experts. Then we gave them the industry’s gold standard in fund accounting and management software, which we own, support, and enhance ourselves.

Outstanding experience, expertise, technology, independence, and transparency. That’s how SS&C drives the future of fund administration.
In this issue...

04 Hedge fund administration: M&A will improve standardisation
By James Williams

07 Strategy will be to focus on ‘growth from the core’
Interview with Jack McDonald, Conifer Financial Services

10 Convergence drives strategic operational partnerships
Interview with Peter Sanchez, Northern Trust Hedge Fund Services

17 Cultural fit is key to long-term success
Interview with Christine Waldron, U.S. Bancorp Fund Services
Hedge fund administration: M&A will improve standardisation

There is plenty of scope for further consolidation in the hedge fund administration space, but only those with a clear strategic vision and a willingness to reinvest in their businesses will likely emerge as tomorrow’s winners. By James Williams

Consolidation in the hedge fund administration space remains a prominent trend and as investment banks re-assess the profitability of non-core business divisions and small administrators sink or merge in response to market complexity, it is one that is unlikely to end anytime soon.

In the last few years Goldman Sachs has sold its fund administration business, BNP Paribas acquired Credit Suisse’s fund administration division, US Bancorp Fund Services acquired Dublin-based Quintillion, Mitsubishi UFJ Financial Group has acquired Butterfield Fulcrum and UBS, SS&C Technologies acquired Citigroup’s Alternative Investor Services division.

In particular, MUFG and SS&C Technologies – the former as part of one of the world’s largest banks with USD2.4 trillion in assets, the latter a leading technology company – have been active this year. This month, MUFG Investor Services, (the global asset servicing group of MUFG), announced it had completed the acquisition of Rydex Fund Services, a 1940-Act mutual fund administration business, from Guggenheim Investments, adding USD52 billion in AuA to bring the total AuA for MUFG Investor Services to USD422 billion.

Back in May, the group also acquired Capital Analytics, the private equity administration business of Neuberger
Berman Group to bring its private equity and real estate AuA to USD145 billion.

Likewise, SS&C Technologies acquired Wells Fargo Global Fund Services in September 2016 adding an estimated USD42 billion in AuA and the capability to support a wide range of complex strategies traded by global portfolio managers including credit, structured credit, private equity, private debt, real estate and hybrid structures.

What these acquisitions would seem to illustrate is that tomorrow’s successful fund administrator will be one that can support fund managers across the entire product and liquidity spectrum, from daily liquidity ‘40 Act funds through to the most illiquid real estate funds.

“I wasn’t surprised by the Wells Fargo decision as it didn’t appear to be a strategic priority of theirs,” says Jack McDonald, President and CEO of Conifer Financial Services. “We rarely saw them in the marketplace.”

In his view, SS&C is seeking to build scale in fund administration by leveraging their software business, particularly after their acquisition of Advent Software. “Mitsubishi appears to want to be one of the largest fund administrators by diversifying their product mix via acquisitions, having invested in fund-of-funds, hedge funds, private equity, ETFs and ‘40 Act funds administrators,” adds McDonald.

**Technology driving change**

Dermot Butler is the former Chairman of Custom House Group. Commenting on SS&C’s approach to making acquisitions, he suggests that by not integrating each acquisition it must make it difficult to reduce costs that arise from synergies, unless of course they end up using the same technology and systems.

“I think what will soon become the by-word is ‘independence’. Managers and Investors are going to become more concerned, not necessarily with the size of the administrator but that they are fully independent. Whatever they say or do, they are doing it without any potential conflict.

“Custom House Group have picked up business and had some nice due diligence results from serious institutional investors and it was largely because of our independence, combined with our first-class processes and people,” says Butler.

Back in March 2015, Custom House announced that it had agreed with TMF Group – a global provider of business services that merged with Equity Trust in 2011 - to go back to being a fully independent administrator: Custom House Fund Services. The deal is, in a way, a reverse M&A, giving Custom House the ability to operate unconstrained as a fully independent administrator with no ties to a parent company.

“The fund administration model has changed. Your system still has to be able to produce all the accounts plus various management and compliance reports and it’s all much more automated. I used to refer to Custom House as a specialist accounting service. Today, it is a specialist data collector, manipulator and producer. Managers need data to file this report to one regulator, that report to another regulator and yet another report to investors, and make sure they’ve got everything on file for the auditors. Managers expect all these commercial and compliance reports to be provided by the administrator,” says Butler.

Which is perhaps why a company with the technology heritage of SS&C Technologies is leveraging the chance to acquire different administrators, using technology as the backbone for building a successful administration group that spans multiple asset classes, product groups and geographies.

This ‘Fintech’ approach, as it were, is something that very few others in the market can compete with.
Confidence in Conifer.

27 Years of Experience. Exclusive Focus on Fund Services.

Conifer Financial Services

Fund Administration
Middle Office
Tax Services

www.conifer.com
Conifer Financial Services is one of the world’s leading independent fund administrators. It has more than 200 clients representing more than USD110 billion of combined assets under administration (AuA) and has a strong footprint in both the US and Asia (Singapore) following its successful merger with Vastardis Capital in 2014.

Speaking with Hedgeweek, Jack McDonald, President and CEO of Conifer Financial Services, says he is not surprised by the recent acquisition activity in the industry. In his view, fund administration is, in many regards, a scale game and consolidation will continue over the near term.

“While bigger isn’t necessarily better, scale does matter. In addition to the challenges faced with increased client/investor demands and ongoing fee pressures, there are rising regulatory and compliance pressures, for example, that we as a service provider need to be prepared for. Investors are asking more from their managers who, in turn, are asking more from us.”

With respect to consolidation in the fund administration arena, McDonald sees three key trends emerging with respect to the acquirers. Firstly, there are mergers between peers, similar to Conifer’s merger with Vastardis Capital in 2014. Examples can be where two firms come together to leverage the strengths of each organisation and add more scale to the overall operation. Secondly, there are the larger consolidators, such as SS&C and Mitsubishi. Thirdly, McDonald expects new types of acquirers will enter the marketplace. For example, while investment banks have largely exited the fund administration business, custodial banks, insurance companies and other types of asset servicers will likely increase their participation. Cross-selling integrated, higher margin and value added services to a broad universe of asset managers has the potential to augment the slower growing traditional custody and clearing operations.

The custodial trend for acquiring fund administrators is being driven by MUFG Investor Services among others, the global asset servicing group of Mitsubishi UFJ Financial Group. Its latest acquisition, announced on 3rd May 2016, was Capital Analytics, the private equity administration business of Neuberger Berman Group.

McDonald thinks that custodial banks will play a larger role in the next wave of consolidation in part because they recognise that they haven’t invested as much in their performance reporting and analytics businesses to satisfy the marketplace demands. Traditional ‘books and records fund administration’ platforms were originally built through the lens of a custodian, says McDonald, “because many of their institutional clients engaged them for integrated custody and accounting whereas independent fund administrators built their reporting platforms through the lens of servicing accounting and delivering insight into performance trends required by investment managers and investors. There is a big difference.”

As asset owners increase their allocations to alternative managers, independent fund administrators are gaining market share. “We are seeing a definite shift in the market with large asset allocators needing more in the way of analytics and performance reporting than banks have historically provided. I expect Conifer and others to be beneficiaries of this trend.”

There is a good argument to suggest that custodial banks are more inclined than investment banks to invest in and provide administration services because asset servicing lies at the heart of their business model. Prime brokerage, by contrast, is capital intensive and leans on the balance...
sheet of investment banks, particularly with respect to Basel III constraints. When investment banks have a need to sell assets and strengthen their balance sheet to raise assets, the fund administration business is often a likely candidate because broadly speaking it is not thought of as a core asset.

Because hedge funds (and other alternatives managers) have traditionally utilised non-custodian fund administrators, there is an opportunity to convert some of these managers to the custodians, provided they have the requisite service and technology to satisfy their needs; often, acquiring another administration will be the most efficient investment to make.

MUFJ Investor Services have proved to be active acquirers but it remains to be seen if the likes of State Street, BNY Mellon, Northern Trust, etc, will step up their acquisitions in the hedge fund administration space.

McDonald identifies three important ingredients when developing a recipe for a successful fund administrator. First, one needs a broad team of experienced management and staff able to support the business as client demands evolve. “While our primary job is to make sure the accounting is done accurately and consistently, delivering the highest levels of client service is key,” stresses McDonald.

Second, a successful administrator is one that is nimble and strategically adept at building partnerships with clients to meet the dynamic challenges that alternative fund managers, and their investors, face in the industry.

Third, any credible administrator has to have a sophisticated level of technology to support the business,” remarks McDonald. “Today, you have to do more than give standard accounting reports to clients. The world has changed with all signals leading to the administrator as the official books and records; as such, if clients have multiple products with multiple custodians, prime brokers, etc, they will come to the administrator and ask them to aggregate financial information and report in dynamic ways.”

Furthermore, McDonald believes the market values the fact that Conifer Financial Services is an independent administrator providing superior client service and technology in a focused manner. Their strategy going forward, he says, will be to focus on growth from the core, “opportunistically investing in systems and architecture, whether organically or via future acquisitions, all with an eye towards adding value to clients as we build our business.”

“By definition, independent administrators have the opportunity to be more nimble than larger bank-owned platforms. With over USD110 billion in AuA, we have sufficient scale to satisfy institutional clients with our stability and breadth of the organisation while being acutely focused on every one of our clients from a service and partnership perspective. We’ve seen the results of this focus as our business has continued to grow over the last couple of years,” concludes McDonald.

“While bigger isn’t necessarily better, scale does matter... Investors are asking more from their managers who, in turn, are asking more from us.”

Jack McDonald, Conifer Financial Services
“At a high level, what you see is a tremendous need for expertise. As alternative fund managers expand into different asset classes, they’re encountering new structures with sophisticated waterfall calculations and regulations. Each domicile they operate in has requirements both for the fund and the vehicle they use. All of this change raises the question, ‘Can you gather enough expertise to be able to meet the needs of increasingly sophisticated clients?’

“This need for expanded expertise is driving a lot of acquisitions,” comments Bill Stone, CEO of SS&C Technologies.

He says that just as technology companies like Uber and Amazon are changing the way we live our lives, the same is true for those who are can provide technology expertise to fund managers to support them in areas such as financial record keeping, position reporting, performance attribution, etc. “There is masses of financial data administrators have to slice and dice for managers to help them report to different regulators and investors.

“Fund managers are structuring themselves to be in the best possible position to chase alpha anywhere. SS&C’s ability to integrate the Singapore, Hong Kong, Sydney and Melbourne offices of Citi with Wells Fargo gives us an increased level of expertise. This is very important to a variety of fund management groups that are trying to find alpha and outperform in a competitive environment,” remarks Stone.

Peter Sanchez is CEO of Northern Trust Hedge Fund Services, one of the more prominent custodian bank-owned fund administrators. Speaking about technology, Sanchez says that “we have a technology framework that allows us to handle all types of investment strategies and portfolio complexities. Our technology utilises one data set throughout the trade and NAV lifecycles. Trade capture, fund accounting, performance attribution and P&L, investor accounting and investor reporting are all done on the same platform.”

This is helping Northern Trust to respond to convergence in the alternative funds space as hedge fund managers develop more private equity-like structures and PERE managers add hedge fund-like satellite strategies to their core offerings.

“There is masses of financial data administrators have to slice and dice for managers to help them report to different regulators and investors.”

Bill Stone, SS&C Technologies

“We have been investing into the back end of our system, focusing on sophisticated investor servicing tools as well as leveraging our existing tools to track performance and cash flows at the investment level. For example, private equity firms today ask for the return not only on a Limited Partner, but the return on a specific asset including all the cash flows and expenses and the return on a legal entity that holds that investment or portfolio,” adds Sanchez.

More and more capabilities that leverage powerful data tools, such as tagging attribution tools, are becoming an important part of the solution set as fund administrators evolve their product offering in line with the changing needs of alternative fund managers.

Playing to custodian banks’ strengths

All of which involves capital expenditure; something that the investment bank-owned fund administrators have not necessarily had the luxury of pursuing.

Fund administration is not necessarily a core banking service. As the regulators put more capital requirement pressures on the banks – principally under Basel III – it is forcing them to look hard at whether this is a profitable area in which to continue investing.

“The complexity of the assets and fund structures alternative fund managers are putting together requires a tremendous investment in technology and I’m not sure banks want to make the financial commitment,” suggests Stone.

By contrast, the core business of trust banks is asset servicing. They can compliment asset servicing with asset management services, wealth management and advisory services and as Sanchez is keen to emphasise: “Their whole bottom line
Convergence drives strategic operational partnerships

Interview with Peter Sanchez

In order for the alternative funds industry to evolve one point that needs to be addressed is that the term ‘Hedge Fund Administration’ is too narrow. Firstly, one cannot avoid a trend towards convergence within alternatives that has steadily gained traction in recent years as hedge fund managers develop more private equity-like fund strategies, and vice-versa; this has resulted in the term ‘hybrid fund’ being bandied about.

Secondly, as traditional asset managers and asset allocators move beyond the concept of hedge funds as a distinct asset class and move towards portfolio strategies such as risk factor analysis, engineered beta, and synthetic alternatives, it is giving rise to more sophisticated portfolio construction as they adopt hedging strategies and techniques long practiced by hedge funds. Asset managers are running a gamut of absolute return funds to compliment their long-only products, and across the industry (both traditional and alternative) managers are launching regulated liquid alternatives to cater to a wider audience.

These two trends are essentially part of the same narrative: industry convergence. At a wider level, what this means is that fund administrators need to become solutions-oriented to support their clients, which in turn means going far beyond the confines of what was once considered hedge fund administration; the industry has simply moved on.

“We believe there is going to be significant convergence in the alternatives arena in terms of service providers as well as asset managers all converging to offer overall alternatives strategies rather than specific products: hedge funds, private funds, etc,” says Peter Sanchez, CEO, Northern Trust Hedge Fund Services.

“In the end, with a broader ‘alternative’ fund administration mandate we believe that to stay competitive in this business – given the consolidation of the industry, the price pressures that managers are feeling, the demands from regulators and investors – there is a significantly higher bar to investing in your business. We think only the committed asset servicers and committed trust banks will be able to make continued capital investment into their people and technology.”

Private equity capital structures (closed end funds) are being used more prevalently by hedge fund managers to trade distressed credit and other long-term investments, which changes the way they rely on their appointed fund administrator. Not only do these managers want enhanced transparency and reporting on listed securities, they want expertise in servicing hard-to-value, less liquid assets, as well as the accounting complexity necessary to support closed end [waterfall] structures.

“As hedge fund managers increasingly use PE capital structures to make investments into long-term distressed assets, hedge fund administration becomes too narrow a description for the challenge of operating that convergent and consolidated investment model. In that context, we are looking to leverage our capabilities, not only by looking to solve things from a capabilities perspective but also from a client’s needs perspective in terms of reporting and accounting,” says Sanchez.

Another distinct trend that Sanchez increasingly sees is a mindset among its fund manager clients to outsource functions

FUND ADMINISTRATION Hedgeweek Special Report Oct 2016
in such a way that enables them to partner and run their businesses cheek by jowl with their service providers. This is evidenced by the fact that an increasing number of PE managers are turning to outsourcing.

“We’ve seen reports stating that 50 percent of the PE industry will be outsourced whereas just a few years back that number was probably in single digits,” says Sanchez. He says that rather than call itself a hedge fund administrator, Northern Trust considers itself as a ‘strategic operations partner’ to support its alternative fund managers with a much broader service model.

What Sanchez is referring to here is the ability to react to the pressures that Northern Trust’s clients face at any point throughout the lifecycle of their business. As the convergence trend continues, and managers and investors alike move away from the concept of hedge funds as a distinct asset class and embrace alternative strategies, tomorrow’s successful fund administrators will be those who can deliver the right solutions as a valued partner.

As Sanchez points out, managers are feeling the pressures related to regulatory reporting – Annex IV under AIFMD, Form-PF, FATCA (and the associated investor due diligence requirements); investor demands in terms of transparency on exposures and evolving strategies; diversification demands in terms of finding new sources of alpha; pressures related to lack of financing balance sheet as prime brokers pull back their level of support; continuous risk reporting pressures, not to mention ongoing cost pressures in relation to management fees and performance fees.

“Managers have got to run a business whose investments generate performance in the most cost-efficient and scalable fashion and the only way to do this is to find a strategic partner that can give the manager ideas as to how to grow the business efficiently and minimise their operational risk. Someone who will take accountability for their responsibility, as any good partner should, and invest in technology and expertise to support managers as they look to move into new areas of the market and develop new strategies,” explains Sanchez.

This illustrates the extent to which fund administration has changed. Any serious fund administrator today is one that does not react to client demand but develops a blueprint such that the administrator proactively creates solutions to support the client in their business evolution. Rather than merely offering a suite of commoditised products, managers want a la carte services in order to benefit from operational efficiency and greater accountability.

This ability to act as a strategic operations partner is part of Northern Trust Hedge Fund Services’ DNA and originated with the 2011 acquisition of Omnium, a hedge fund administrator subsidiary of Ken Griffin’s Citadel; Northern Trust’s first hedge fund client.

“This was a hedge fund administration business built to service middle and back office in any trading strategy; global macro, event-driven, convertible arbitrage, etc. Its core foundation was technology. When we acquired Omnium a significant number of people stayed on from Citadel and we have continued to build out our technology capabilities with significant investment over the last five years,” confirms Sanchez. He says that some of the key aspects of being a strategic operations partner as opposed to an administrator include:

- Drive innovation
- Collaborative problem solving
- Mutual trust
- Solutions versus services.

When asked what the future of hedge fund administration might look like, Sanchez responds: “One thing you have to remember about trust banks is that their core business is asset servicing. Their whole bottom line – be it profitability or return on equity – is based on that business.

“I think the winners are going to be those administrators who solve client needs, meet client requirements, and move towards a partnership-orientated business model rather than a product-based business model. I think to do that, to be really solutions-focused and an extension of a client’s business, you are going to have to invest in the business. In that context, I think going forward the trust banks will be in a much better position to reinvest in the business than the independent fund administrators.”

Northern Trust Hedge Fund Services actively encourages managers’ feedback to help them develop their solution-based model. By knowing what those insights and frustrations are, Northern Trust is able to tailor its functionality. Some of the larger clients it works with act as test pilots for the solutions that Northern Trust develops and are, says Sanchez, “instrumental in terms of influencing the way we build out functionality.”

“For a client who is looking to outsource some of their collateral management functionality, for example, they strategically partner with us to define what their needs are and write the requirements that then form the basis of the technical functionality that we build and the operational teams we put in place.”

In conclusion, Sanchez says that Northern Trust intends to remain at the forefront of the fund administration industry and continue to solve the challenges that its clients face:

“We are trying to develop a multi-service type business with our clients. If we leverage the two trends – the convergence within alternatives and the expectation of clients to have a broad capability set from their fund administrator – the future bodes well for Northern Trust.”
be it profitability or be it return on equity - is based on that business. “When trying to solve problems, investment banks think about how to give investment solutions; how to earn fees and raise capital for their clients. In that context, they tend not to think about how to become a solutions provider to a client on custody, on corporate actions and complicated NAV structures.

“As a core competency of an asset servicing business, a trust bank is going to continually invest in that business because it is their core business. I think the investment banks looked at the administration business as a back-office business that they could make annuity fees on, but once they began facing balance sheet restrictions, they decided to look at what their actual core competency was, and it became quickly apparent that asset servicing was not part of it.”

Hence why so many investment banks have followed suit once Goldman Sachs took the decision to vacate the space a number of years ago.

Although a more natural fit for the custodians, Stone actually regards MUFG as a bit of an outlier in terms of M&A activity. “You don’t see J.P. Morgan, or HSBC for example, anywhere near as active in acquiring fund administrators as they might have been five or 10 years ago. I think there is a pause with the major banks, with MUFG the exception to the rule. This might partly be down to the convergence point made above, as more illiquid assets and products come to market.

“While custodians have control of the assets, primarily the custody is on tradable assets; stocks and bonds. Level 3 assets tend not be held custody by banks. They might have information on Level 3 assets but they are essentially a private contract between the fund and whomever they purchased the asset from.

“The requirements are extremely intricate. The accounting and reporting on performance, tax and valuations becomes a big drain on IT resources because one has to build algorithms and information delivery devices to satisfy clients’ needs across those non-tradable asset classes,” explains Stone.

“We are only looking at private equity and hedge fund business. The administration platform, currently, is 45 per cent PE and 55 per cent hedge so we are pretty well diversified.”

Alex Mascioli, North Street Global Fund Services

Deal optics
When considering M&A opportunities, McDonald sees two lenses through which Conifer would look at an acquisition. “Firstly, if it is strategically important from a product extension standpoint,” says McDonald. “And secondly, if it is strategically important from a geographic expansion standpoint.”

Alex Mascioli is CEO of North Street Global Fund Services. Mascioli brings a deep well of M&A expertise to the table having initially set up as an investment bank, North Street Global Markets, before establishing the fund administration business within the group two years later, in 2013.

This was achieved by acquiring a small New York-based hedge fund administrator, called Hedge Fund Solutions, to diversify into the fund services space.

“Then, in 2014, we acquired Hedge Solutions based out of LA to give us a West Coast presence. We are currently working on our latest acquisition, which we hope to close by the end of the year,” confirms Mascioli. He says the plan is to continue the focus of building out their administration arm in hedge funds and private equity funds.

“Each month, our Global Head of Sales, Dean Betzios, holds a competitor analysis meeting with the sales team to gauge where the firm stand among industry peers and identify any gaps they can fill in regarding services offering.

“We have data files on many of the other administrators, revenue-wise, size-wise, key people, etc. We identify potential targets and connect with the relevant people. Those introductions are either via a mutual attorney or through a small- and middle-market investment bank, or it could even be...
BORN 2006
10 YEAR ANNIVERSARY
14 INDUSTRY AWARDS
15,000 INVESTORS
10 OFFICES 75 EMPLOYEES
INNOVATION
18 OPERATIONAL TIME ZONES
100,000 INVESTOR STATEMENT RECIPIENTS MONTHLY
4,000,000 STATEMENTS SENT TO DATE
700 FUNDS 400 CLIENTS
TEN YEARS
STRONGER
FASTER
SMARTER

To learn more, contact a member of our sales team
sales@opusfundservices.com
Christine Waldron is global head of the Alternative Investment Solutions team at U.S. Bancorp Fund Services. Discussing the acquisition process, she says that the key is to focus on the firm’s core expertise and to only make strategic acquisitions when the right opportunities arise.

“If you look at our history, it has been a combination of the two. We have identified strategic targets where we’ve integrated them into the wider USBFS offering that provide us with access to new markets and increase our scale. Also, from a strategic perspective, it’s important for us to maintain the culture of our acquisition targets; this is a people and a relationships business. It is critical that there is not a significant overlap with our existing offering, creating unnecessary complexity. I also think it is important to have product evolution and product development. As a fund administrator, you are going to have to also evolve your product offering, your processes and systems, and your people, to support changes that are happening in the marketplace,” explains Waldron.

Mascioli likes the M&A market right now because as more of the small independent administrators get bought or merge with each other, it is creating a vacuum in the middle market: “Our average hedge funds are between USD125 million and USD140 million. We have some smaller funds, we...
have a few larger funds, but we like the middle market because we are making a name for ourselves through the expanded opportunities that the consolidation process has provided.

"I think it’s going to become very difficult for small administrators going forward. The rising cost of compliance and adherence to certain standards is going to outpace their bank accounts (and balance sheets) in my opinion."

Impact on smaller managers

One of the inevitable consequences of continued consolidation is that smaller fund managers face the risks of having to find a new administrator. People will initially be concerned as to whether the client service team will change, whether the rates will go up and whether the client service experience will change?

"In a scenario where the client experience is stable and/or improves, I think it will lead to a high degree of retention. If the opposite is true, and the people the manager previously dealt with are no longer in the client service team, etc, clients can get anxious. Most people in that situation tend to adopt a ‘wait and see’ approach," comments McDonald.

When making an acquisition, people want to retain clients and the easiest way to do that is not to mess with the model if it’s working.

"Clients want consistency. At the end of the day, changing your fund administrator is not easy to do. If you can sustain or augment the level of service, of product, of pricing, or improve via an acquisition – i.e. better reporting or improved overnight reporting - then clients should remain happy," he adds. "At Conifer, we strive for continuous improvement of the client experience."

Lack of standardisation

Hedge fund administration remains a highly fragmented industry. The number of independent administrators is unnecessarily high – there are an estimated 78 fund administrators in Luxembourg alone - creating an unstructured miasma that lacks standards or uniformity. To take a very simple analogy, in the automotive industry, global car manufacturers use robust messaging and logistics standards. The number of airbag suppliers is in the tens, rather than the hundreds, as is still the case in hedge fund administration.

"The last number I heard is that there are approximately 300 fund administrators and I think that number needs to be cut down to 50 or 70 over the next couple of years, and even farther over the next five years."

"There are too many administrators. As a result there is no uniformity as there is in the prime brokerage business and there needs to be," proffers Mascioli.

Stop the race to zero

One of the biggest issues in the HFA space is not just the lack of standardisation and sheer diversity of players, it is the fact that over recent years administrators have engaged in a race to zero, constantly lowering their prices in a bid to win mandates. This has diluted the service offering and partly explains why, at the lower end of the scale, smaller administrators have either gone under or been forced to merge.

This act of self-cannibalisation is economically unsustainable.

"It is not beneficial at all to continue to drive down prices just to try to win new business," states Waldron. "What I have found is that our clients want assurance that we are profitable and that the partnership is profitable to us as a business because they understand the risk of that not being the case."

"Our clients expect us to have a mindset of continuous improvement; improving on our offering, on our efficiencies and that
Forward thinking is the first step

We’re committed to providing smart, clear and honest guidance to help you meet your goals. From hedge funds and fund of funds to private equity, we are experienced with virtually every type of product in the market. Trust that our global alternative investment experts can provide innovative solutions to help support your plans for success.

Global hedge fund administration made simple

- Administration and accounting
- Custody services
- Investor services
- Legal administration and compliance
- Middle office services
- Registered office services
- Tax services
- Technology
- Treasury services

For more information about our comprehensive suite of services for alternative funds, exchange-traded funds and mutual funds, call 800.300.3863 or visit usbfs.com.
Cultural fit is key to long-term success

Interview with Christine Waldron

The pace of consolidation within the hedge fund administration space shows no let-up, with MUFJ Investor Services, the asset servicing arm of Mitsubishi UFJ Financial Group, having just announced its latest acquisition; Rydex Fund Services, a 1940-Act fund administration business formerly owned by Guggenheim Investments.

One of the reasons fuelling this trend is that hedge fund managers and their end investors are looking for a flight to quality, as well as security (from a size and scale perspective).

“They want administrators with a diverse book that can support a wide range of funds and support them as they continue to grow and evolve with a wide array of product offerings,” comments Christine Waldron, global head of the Alternative Investment Solutions team at U.S. Bancorp Fund Services.

“We expect to continue to see that consolidation trend. That said, we are also observing new entrants to the fund administration space who are focusing on niche areas of the market. These launches tend to be with some scale already in place. Gone are the days of seeing new start-up fund administrators that do not have substantial backing.”

Another factor driving M&A activity, as observed by MUFJ’s acquisition of Rydex and Australia-based MainstreamBPO’s acquisition of New York-based Fundadministration, is the desire to extend the reach of administrators’ product capabilities. Both acquisitions broaden the AuA in registered fund assets and, in MainstreamBPO’s case, extends its footprint into North America.

Back in 2013, U.S. Bancorp Fund Services acquired Dublin-based Quintillion, Ltd to extend its own footprint into Europe. Indeed, over the years it has done a number of acquisitions in both the registered and unregistered space, with a strong cultural fit underlying each acquisition.

Waldron says that this cultural fit is an important consideration when managers select their fund administrator.

“Managers should make sure that their service providers are closely aligned with their culture and mindset. You really need to act as a cohesive unit when servicing alternative funds.

“Being a successful fund administrator also requires having a strong understanding of where a manager’s offering might be going. It’s important that a manager understands where their product offering is likely going to get the most traction with investors and then making sure they pick service providers that can support all the products that they might choose to develop.”

U.S. Bancorp Fund Services has seen encouraging growth in niche areas of the market such as private equity, distressed credit and real estate. This has been possible thanks to the flexibility of its investments in technology and its ability to develop proprietary solutions whilst leveraging core technology.

“We see an increasing blend between pure hedge fund strategies and pure private equity strategies. The same is happening in the liquid alternatives space, where we’ve seen a blend between alternative and traditional fund managers launching ‘40 Act alternative mutual funds,” says Waldron.

She believes that the bank’s long history of servicing the regulated ‘40 Act funds space, which dates back to 1969, gives it a clear differential edge.

“It is an area of the market that fund administrators need to support as fund managers increasingly run unregistered as well as registered fund structures. The barrier to entry on the liquid alternatives side is much higher. You have to have a much wider degree of technology and infrastructure to be able to effectively support those types of products,” concludes Waldron.
achieve those objectives. We have an execution and reward system which leads to a great esprit de corps.”

Butler agrees that the model is unsustainable.

“I’ve no idea how some administrators are able to stay in business, with their price models. I don’t know if they will survive, although the old ‘suck-in’ trick still seems to work, whereby a “loss leader” price is agreed in year one, only to be doubled, or more, in years’ two or three,” he says.

**Set a clear strategy**

To remain successful, Northern Trust’s Sanchez believes it is necessary to solve clients’ issues with a strategic operations partnership mentality. By default, this means continuously investing in the business to build functionality and capabilities that meet the needs of the largest fund managers.

“To be able to enhance your product in terms of administration, plus offer cash management, depositary, trade execution and wealth management advisory to name just a few, I believe that the largest fund manager clients will likely end up with trust banks that are able to invest in their business and, importantly, generate a high ROE on their business.

“Whilst there will likely be fewer independent administrators in future, they will still exist and play an important role (especially in terms of pricing) to smaller fund managers. I could see a situation where the biggest managers become so big that they start to move into multi-administrator relationships. Some of the largest traditional asset managers have multiple administrators and I could see that happening in the alternatives industry, perhaps based on strategy, or investors requirements,” suggests Sanchez.

As a concluding observation, SS&C Technologies’ Stone highlights the importance of setting a clear strategy and then leading the organisation to execute that strategy.

“I think that’s something we do pretty well and something that I am very focused on. This allows the entire organisation to understand what our objectives are and share in the fruits of our labours if we achieve those objectives. We have an execution and reward system which leads to a great esprit de corps.”

There will be plenty more consolidation over the coming years. The industry needs it. Whilst some large custodian banks and independent administrators will support the upper echelons of the industry with multi-product, multi-geographic service models as the alternatives industry converges, further mergers among smaller administrators will help to create a more standardised model.