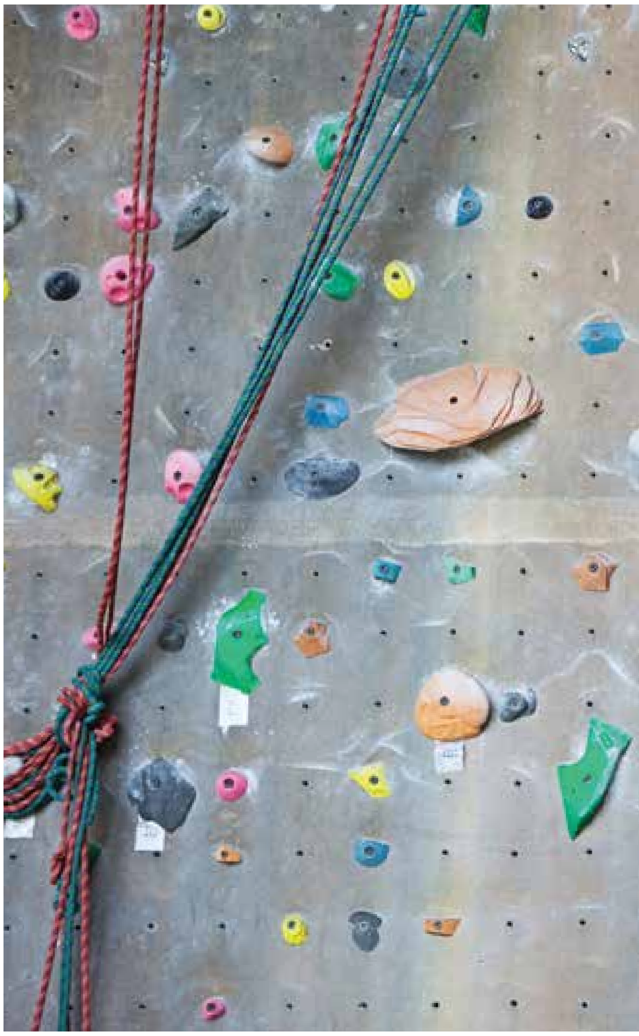

EU Fund administration
Embarking on a journey to overcome challenges and target operational excellence

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Since the global economic turmoil of 2007, the investment management industry has been hit by a series of headwinds, causing a sharp decline in Assets under Management (AuM). It is only recently that the pre-crisis level of AuM has been exceeded, but in the meantime, the industry landscape has drastically changed.

Mutual fund industries are dealing with shorter market cycles, and external events, such as the introduction of new regulations, which are reshaping the industry. During the economic crisis, asset managers tried to contain costs and create pressure to renegotiate fund administration fees. Although the situation has improved on the AuM side, the fund administration industry is facing a lasting low fees scenario. The sector has managed these circumstances in the short term by postponing investments and cutting costs, through the automation of operational tasks and offshoring/ outsourcing operations. However, the capacity of these measures to reduce costs will soon be exhausted.

The industry is currently facing a wave of new regulations that are required to be implemented within a short timeframe, while AuM is expected to grow. As a result, the focus is now moving from costs to investments, and five main business drivers have been identified:

1. Competition
2. Cost containment
3. New product launches
4. Service offerings
5. Regulations

These factors are remodelling the industry, and in each case, specific challenges can be identified that may be tackled via the introduction of business and technology measures.

1. Competition

The past couple of years have seen many asset servicers opting out of the fund administration industry to refocus on their core business. Small players can no longer sustain a 'scissor effect', between increasing costs and pressure on fees. Hence, the low added value fund administration industry requires either a critical mass or a focus on a specific market to get positive returns.

A concentration of AuM among the top service providers has taken place and global competitors are emerging. Despite this, there were very few mergers and acquisitions during the economic crisis; instead, growth is essentially coming from a more favourable economic environment as well as organic growth, as companies slash prices to on-board new clients, further emphasizing the significance of scale economies and organisational efficiencies.

This status quo looks to be changing in light of the new regulations and the need to strengthen the service offering. Organisations are shifting from a cost-based approach to making the investments necessary to sustain growth and address the new regulatory requirements. Accordingly, the significant investment expected is highly likely to lead firms to seek to outsource this very low income activity and to create 'one-stop shop' businesses.

2. Cost containment

Cost containment is still one of the top priorities of fund administrators due to reduced margins and higher cost of new products and new regulatory requirements implementation, in addition to fund managers who are pushing to reduce fees. Clearly, one of the main drivers is to completely outsource non-core activities, such as IT infrastructure or development, which represents a low risk profile versus high expected savings.

The other trigger to consider is offshoring activities to low-cost Asian or Eastern European countries, even though this option has already been used by the majority of global players. The main challenge here is achieving the same operational standards and quality in these countries.

Running multi-site operational centres may be problematic and the expected benefits can sometimes be eroded (tax and regulatory hurdles, learning curve of the offshore location, etc.); there may also be advantages, however, such as the ability to provide Asian time-zone support to clients. As for onshore activities, staff reduction/containment, is creating pressure, as more and more tasks are requested by regulators or fund managers. To tackle this situation, investment in staff development and a reduction in manual processing is needed to drive down costs and manage operational risks.

3. New product launches

A diversification of the products used by investment companies is under way, as a result of the financial crisis and new regulations.

As the investment management industry launches new products, administrators are forced to keep up with the pace of innovation by offering services that will enable them to rapidly capture market share. But investment is needed and considerable organisational implementation efforts will be required. The exponential growth of ETF product launches is the perfect example of complexity, in both business and technology terms, with pressure on prices due to low margins. ETF products require management of cross-border activity and multiple intraday NAV computation with flawless data, as these are used by market makers.

Regulatory requirements were initially perceived as a burden but organisations have begun to move from aiming to be compliant to targeting their efforts towards driving efficiencies, and sometimes aiming to achieve a competitive advantage. For example, new fund structures have been developed and rationalised in light of the master/feeder structure allowed by UCITS IV.
New challenges are arising from the development of alternative products with the introduction of AIFMD, which is expected to boost this sector. Automating processes to manage alternative assets in the same manner as UCITS funds will require integration of new platform systems that can handle a variety of products, ranging from art to real estate. One of the key challenges will be data consolidation and the set-up of new connectivity flows with third parties for reporting and transparency to all parties.

Given the growing demand for diversified products, fund administration segmentation is likely to happen through either 'one-stop shop' fund administrators operating like a supermarket to deliver services to clients, or niche boutiques targeting specific markets.

4. Services

Middle office services are not part of the core business of asset managers. This is where fund administrators can step in to build extra services that will ease pressure on the core fund administration business by generating new revenues. Diagnosis is one thing, but the implementation of such services will require moving up the value chain and working more closely with the front office to provide services like trade processing and matching, collateral management or risk management. A side effect of maintaining both strategic positions at the pre-trade level and the end of the chain with the fund administration would add an extra level of data quality checks and reconciliation.

5. Regulation

As a rule, regulators are aiming to re-establish and maintain trust in the financial sector. A series of directives are now shaping a new landscape and impacting all aspects of the mutual fund industry. At the fund administration level, regulators are increasingly focusing on the transparency of the services delivered and the schedules of fees charged to funds. They are also indirectly on the spot when regulations are implemented and require extra reporting or monitoring that must be implemented to cover fund compliance. Consequently, operational architecture needs to be efficient in order to keep costs at a sustainable level.

On the other hand, these effects can lead to a new organisation based on competence centres that can respond to client needs in an efficient way. Besides, some regulations are clearly expected to have a positive impact, either by attracting new assets under management into existing funds, or setting up new products requiring fund administration services.

Business and technology measures

1. Business

During the global economic crisis, the fund administration industry was squeezed between plummeting fees and pressure to provide further services. As a result, operations and investments were set aside, since the industry took the approach of focusing solely on cost cutting or containment. One way actively used to handle the matter swiftly and efficiently was the offshoring of low value-added services in low-cost countries. Unfortunately, an attempt to ship more activities abroad could carry risks, if the only target is streamlining costs. Companies considering offshoring activities must shift from a short-term cost-cutting view to a long-term strategic plan. In fact, these offshore emerging markets are quickly developing, with firms seeking to reduce soaring human resources expenses, as well as growing internal demand, thanks to an emerging middle class.

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Consequently, offshoring activities must fall within a global strategic plan to redefine the worldwide operating model of fund administration activities.

In this context, offshoring activities could be a way of testing the water of emerging markets, and seize pole position to capture market share. For instance, the initiatives of the Chinese authorities to build a UCITS-like framework could trigger the development of a local mutual fund investment industry. Alongside offshoring activities, other initiatives can be set up with competence centres around the world aimed at achieving operational excellence. To overcome overlap and inefficiency, every centre should be dedicated to a particular activity or product.

But focusing only on the cost side is to forget that the fund administration industry is associated with back office activities and low value-added services.
To challenge this view, the sector needs to innovate and promote new services that will generate extra revenue. This can be achieved by moving up the value chain and getting closer to the asset managers (e.g. development of middle office services).

2. Technology solutions

Accessing these new growth drivers will create considerable pressure to align business and organisational requirements with technology. Expensive investments in IT are needed to implement cutting-edge systems that are able to sustain the development of an agile organisation. The aim is to position the organisation in the starting blocks to be ready for future growth with up-to-date IT systems.

This is where the traditional debate between the advocates of in-house development and third-party software comes in. Steering a course between these two views is not straightforward. However, in-house solutions are viable for large multinational companies willing to invest in a software factory hub able to deliver state-of-the art technology solutions that are in tune with business requirements. The systems are fully integrated into the business and deployed on every site covering the full range of business services. To be fully efficient, no development is done onsite and only support teams work locally as an interface with the hub. Local development can still be an option to build a system from scratch to start an innovative business launch by a competence centre.

On the other side, the decision to call in a third-party software provider can be beneficial to all types of organisation. The fund accountants can get rid of the development activities, thereby reducing costs and allocating more resources to business support. Buying a well-known software package can be a win-win situation, as customers will require development to follow their business, with systems keeping pace with market trends regulations. Nonetheless, every solution comes with its price for the client and some key points must be monitored. A loss of flexibility can occur, and taking on a core system to cover the whole business chain can be challenging. As a result, interfacing multiple systems can be somewhat problematic, not to mention specialised systems that are not evolving in the same direction as customer needs.

Other technological concepts are emerging that are worth considering, such as Software as a Service (SaaS), which involves fully outsourcing the software infrastructure and architecture to a company hosting and maintaining it.

The only aspect left for the client to manage is the configuration of the application, without the hassle of upgrades, migration and so on, which is assigned to a team of experts. The main drawback is that this platform-sharing is done across multiple clients, with the loss of potential differentiation in terms of services offered. It is no surprise that this solution is for now used more for ancillary services, although it can be seen as a good alternative for a new product or service until it passes the incubation phase. The former concept, known as Business Process Outsourcing (BPO) goes one step further, in that it offers the option of outsourcing management of the entire business and infrastructure. It has the great advantage of turning fixed costs into variable costs, but it also has all disadvantages of SaaS, in addition to raising contracting, coordination and reorganisation issues. It goes without saying that this solution needs to be solely dedicated to non-core business activities, with standard and well-established procedures allowing little customisation.

Systems and software considerations are real issues for the fund administration industry, but they are only one part of the equation. The key underlying issue for both the business and technology aspects is data. At the end of the day, the only valuable information for the client is data that is delivered in a timely, accurate and reliable way. The increasingly stringent regulations on transparency and reporting, as well as the development of alternative products, are reasons to re-think an organisation from a data management perspective. Organisations should focus all their attention on data integration and build a consistent data repository interface, aggregating all the information needed by the asset manager. Here, the main issue becomes the interconnectivity of multiple core platforms through various business services and products. Internal and external data coming from different counterparties has to be aggregated too.

Conclusion

Recent years have seen a steady growth in AuM, and more growth can still be expected. It is now time for the fund administration industry to shift from cutting costs to reviewing and rationalising operational processes to secure future growth. The industry is embarking on a journey to implement new regulations, and needs to cope with requests from asset managers to implement new services in order to be compliant. A unique opportunity thus presents itself to gain from this situation by simplifying operating models and consolidating systems into core platforms.

The fund administration industry has a new opportunity to seize through the development of new products and middle office services. To do this, companies need to define a medium-/long-term target operating model and set the milestone of becoming an agile organisation. To move in this direction, business processes must be standardised so that tailor-made solutions are the exceptions. Naturally, this will require significant investment in IT systems, so that the technology can support this development. There is no one system architecture model, but multiple solutions depending on the business model. However, the one common denominator to all these issues is data integration, as what is valued the most by asset managers is data. Finally, by taking these actions to review the business side and upgrade the technologies used, it will prepare organisations to grow smoothly and become more resilient to crises.

To the **point**:

There have been drastic changes in the EU investment fund administration industry since the global economic crisis, and the impact of the factors shaping the sector is stronger than ever:

- **Competition:** small players can no longer sustain a scissor effect between increasing costs and pressure on fees. This is why the industry requires either a critical mass or a focus on a specific market to get positive returns
- **Cost containment**: it is still a top priority to either slash costs or contain them through a wide range of solutions from outsourcing/offshoring to limiting headcounts. These solutions can have different effects and must be implemented in accordance with a targeted strategy
- **Products:** new products are being launched that are forcing the industry to keep up with the pace of innovation. Market share is captured by offering alternative products, although significant investment is required for the provision of appropriate services
- **Services:** middle office services should be offered by moving up the value chain to generate new revenues and ease pressure on the core business
- **Regulation:** regulatory requirements can be perceived either as a burden, or organisations can seize the opportunity to drive efficiencies and create a competitive advantage

AuM growth can still be expected and it is now time for the industry to shift from cutting costs to reviewing and rationalising operational processes. The target operating model must be defined in the medium-long term to set a clear path leading to the alignment of the business with technology. An agile organisation together with data integration will put organisations in the starting blocks to grow smoothly and become more resilient to upcoming and changing market circumstances.