BACK OFFICE

What lies beneath the surface of a debt fund?

The key to effective fund administration is a detailed understanding of a fund's inner working. **Stephen Osmont**, director at fund administrator The Aztec Group, takes a deep dive

When you talk about a fund, what is the topic of conversation? Is it the regulatory environment affecting the fund? The valuation methodology? Maybe it's about information security and the importance of having robust controls in place? Of course not. What people want to know about is the front office, the investment strategy, the acquisitions, the capital raised and the exits.

Yet, none of this just happens. It's the middle and back office activity that ensures the front office can generate the headlines. Every fund needs a suitable structure, investors need to be on-boarded and managed, financial and tax reporting needs to happen, cash needs to be made available and compliance obligations must be met.

In many ways a fund is like an iceberg. The fundraising and the deals may be visible, but so much of running and operating a fund goes under the radar.

And just like fund managers which need to be nimble to grasp opportunities, the middle and back office team, whether in-house or outsourced, has to be ready to adapt to industry developments that can impact the day-to-day running of a fund.

HIDDEN FACTORS

As a fund administrator, we have a rather unglamorous view of a fund. It is a complex web of legal structures, serving many purposes and spread across several jurisdictions. Every fund needs a vehicle, such as a limited partnership, that glues the investment, investor and operational components together, carry vehicles to compensate, holding companies to structure the investments – the list goes on.

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What most managers don't have at their disposal is an off-the-shelf solution. Every fund will have its own unique DNA in terms of its investments and investors, and that DNA will determine where the fund and its holding companies should be located so it can deliver operational and fiscal efficiencies. Factors such as the volume and sophistication of the investors will also help to determine domicile and whether lighter touch regulatory regimes, such as the Jersey Private Funds regime or the Luxembourg RAIF, are an option.

Establishing a fund is a highly complex process with a lot of variables in play. Of course, the structuring itself is the domain of the legal and tax advisors, but when everything is in place, the middle and back office needs to step forward to run the often complex structure. And that is equally challenging. Each jurisdiction has it own legislation governing the operation of a fund, with their own reporting and administrative requirements.

It's up to the team managing the operations and administration to ensure they not only have a strong understanding of the different regulatory environments, but can operate the various entities and ensure that those operations are managed uniformly across all jurisdictions. That's one of the core advantages of outsourcing – the manager will have a middle and

back office team that already has a presence across the leading jurisdictions, with the accompanying expertise and experience, and processes and procedures to ensure there's consistency in approach.

THE RIGHT NAVIGATION SYSTEM

Today, everything from financial reporting, payments, record keeping and investor communications uses technology in some way. Not only has it helped us work more efficiently, but it has improved accuracy and reduced human error. It's also brought about more control and structure to our activities.

But while technology has revolutionised how we administer funds, it's also presented some challenges from a resource and cost perspective. Technology isn't static. Fund managers that want to take advantage of the latest technological developments will need to invest in more than the system itself, but also the configuration of that system and any relevant training requirements.

That's why outsourcing is the preferred route for many managers because the cost of technology will effectively be shared across a wide client base. The outsourcing partner is also likely to have its own in-house systems team which will tailor the system to the manager's requirements, drawing on its experience with other clients with similar operating models.

Cost aside, perhaps the most notable downside to technology is the information security threat. We've all read the recent press coverage and understand the damage that can be done, both from a reputational and financial standpoint, when sensitive information falls into the wrong hands. The threat is made worse by the fact that hackers have evolved from individual fraudsters to sophisticated extra-national organisations.

A robust risk management framework, with clear controls, policies and procedures is an absolute must to counter the threat. Accreditations and certifications such as ISAE 3402 and ISO 27001, which represent the gold standard in quality control and information security respectively, should be sought.

Stephen Osmont

Specialist outsourcing providers typically have dedicated information security professionals in situ, who will not only put in place the right measures, such as encryptions, penetration testing and access controls, but help create a culture of vigilance and awareness regarding the risks through training and education.

ENTERING CHOPPY WATERS

One of the biggest shake-ups to the operation of funds in recent times has been the growing regulatory reporting burden. FATCA and the Common Reporting Standard (CRS) are good recent examples of major regulation to have impacted our industry, with MIFID II having come into force and GDPR just around the corner. That's even before you consider the stringent compliance and reporting requirements now in play at a jurisdictional level.

This presents several challenges for fund managers, among which is the increased cost burden and professional training attached to such regulatory complexity.

CRS is undoubtedly one of the most high profile regulatory developments over the last couple of years. Driven by the OECD to introduce greater cross-border tax transparency, signatories to CRS are required to obtain information from their financial institutions and annually exchange that information with other participating jurisdictions.

In force since 2016, it's been far from plain sailing. The problem lies in the lack of a common framework, which is ironic given its name. For example, you have Luxembourg which requires full details of the person submitting the information, whereas Guernsey and Jersey require only registration numbers. Cayman and Bermuda stand alone in asking for institutions to submit multiple CRS returns using jurisdictional basis. Then you have the different deadlines, with some jurisdictions flexible on dates and others being far more rigid.

The easy answer to how such regulatory developments should be dealt with is to be as proactive as possible. That means monitoring developments and asking questions at the earliest opportunity, enabling any necessary system or process enhancements to be introduced and the right external advisors engaged in a timely manner.

In reality, regulatory reporting and compliance have become such specialist areas that many managers see handling this in-house as a risk. Indeed, in our experience, fund managers want their outsourcing partner to manage this component as an integral part of their offering.

STEERING THE SHIP

To flip my analogy around, what the front office captain needs is the right helmsman to steer the ship – one who knows their way around the regulatory, legislative and technological icebergs and can ensure it remains on the right course. A specialist outsourcing partner might just be the right answer. ■