



Why It's Time To Reconsider Traditional Middle Office Outsourcing Models



ENFUSION
Software. Services. Analytics.



Why It's Time To Reconsider Traditional Middle Office Outsourcing Models

For over 15 years, asset managers have outsourced certain operational functions with the goal of improving efficiencies, streamlining processes and reducing costs.

But many firms are now facing a hurdle: traditional outsourcing models are falling short of expectations, especially in the areas of the middle office and back office oversight, and operational continuity is at risk. Some of the obstacles that asset managers have encountered with traditional outsourcing models are:

- + **Loss of control**
- + **Lack of transparency**
- + **Data integrity**
- + **Processing delays**
- + **Confidentiality concerns**

As asset managers continue to offer expanded, more complex product suites, their demand for services such as outsourcing is increasing—and a solution is needed. In this paper, we examine the issues with existing outsourcing systems and shed light on a solution that is revolutionizing the financial services industry.

THE BACKSTORY:

How Did Asset Management End Up Here?

First, let's look at the path that has led asset managers to the outsourcing scenario they now face. After the global financial crisis, and even prior to that point, many Chief Operating Officers (COOs) began outsourcing back office responsibilities because it solved an organizational problem. By handing over functions such as reconciliations, transaction processing, third-party communications and official NAV publications to their fund administrators, COOs could dedicate more time to overseeing the core aspects of the business.

Success in taking on back office functions had fund administrators and securities services providers eager to offer middle office services. Asset managers were ready to hand over more control, especially as they faced pressures to cut costs and increasing regulatory requirements following the global financial crisis. But soon it became

apparent that outsourcing the middle office was not as clear-cut as handing over the reins to the back office, and manager-level issues in the middle office were also present.

These mounting concerns are largely centered around the fact that service providers and asset managers are misaligned when it comes to the interfaces and trading systems in use. Other unintended issues have included middle office processing delays and errors when the fund administrator has taken on shadow NAV reconciliation—or the process of maintaining a separate and independent accounting book of record and financial statement to verify the official NAV produced by the fund administrator.

These issues led asset managers to ask: With so much uncertainty, does it make sense to outsource our middle office and back office oversight functions?

With so much uncertainty,
does it make sense to outsource
our middle office and back office
oversight functions?

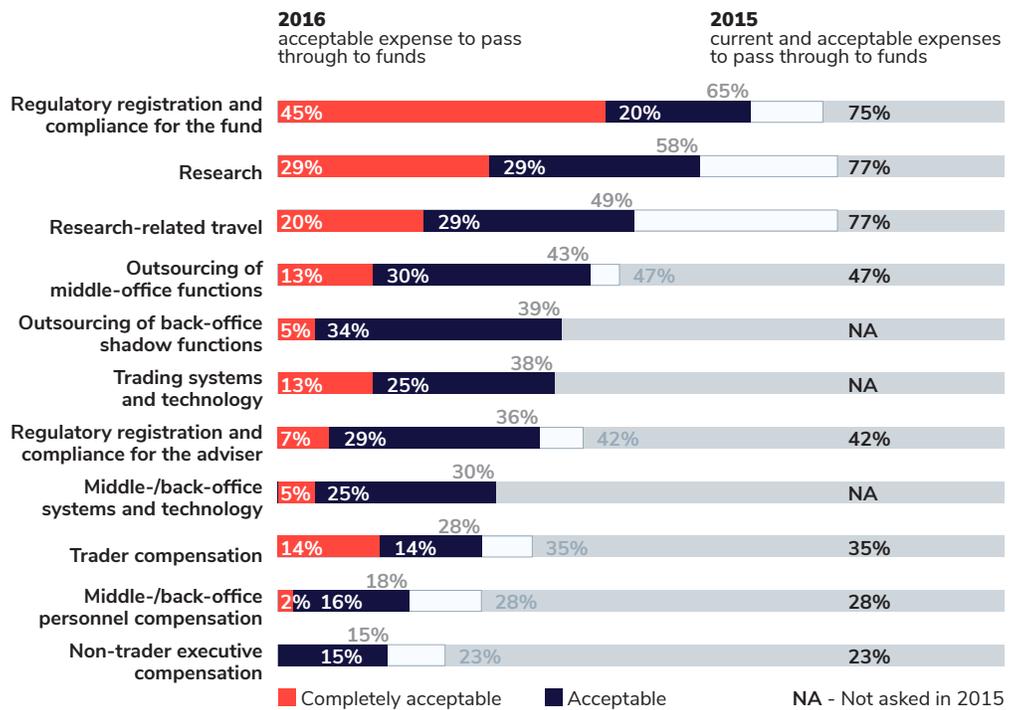
Why Traditional Modes of Outsourcing Are Falling Behind

The market for outsourcing is expected to continue to grow in the coming years as asset managers look for solutions to cost and regulatory pressures, technology innovations and resource skills/talent management. Many Fortune 500 companies spend more than \$1 billion annually to outsource their services.¹ And according to Ernst & Young, investors are comfortable with outsourcing support functions, including middle office services—an area that asset managers have identified to reduce expenses (*Display 1*), but only one in five has done so.

DISPLAY 1:

Investors Show Little Resistance to Outsourcing Certain Firm Functions

How acceptable is it for your managers to pass through the following expenses to the funds in which you invest?



Source: EY 2019 Global Alt Funds Survey

While outsourcing back office responsibilities has been successful on many levels for asset managers, they've not had the same experience when depending on fund administrators and service providers to take over certain middle office functions.



Here are the major, middle office related issues that have complicated the outsourcing relationship between asset managers and fund administrators:

+ Shadow NAV Reconciliation.

Investors and the U.S. Securities and Exchange Commission require asset managers to publish accurate fund NAVs at the end of each business day and mistakes could result in a significant fine. The fund administrator's back office officially calculates the NAVs, which are cross-checked via the shadow function to verify that the NAVs are correct. Third parties are often retained to fill the shadow role, but ultimately, it is the asset manager that is accountable for providing error-free calculations. Therefore, the question must be asked: does outsourcing this function make sense? If mistakes are made, it is the manager's responsibility. No matter how advanced the technology, fund administrators have made mistakes at times when they issue NAVs.

+ Lack of Transparency/ Loss of Control.

Chief Operating Officers are required to maintain operational control over an asset manager's business, which means trusted and dedicated support staff are essential. For instance, when a function such as trading is outsourced, and the operation is not centralized, and it's nearly impossible for the COO to audit or see trades and transactions that are booked in real time.

+ Processing Delays/ System Alignment.

When an asset manager and an outsourcer are working on disparate systems, they're disconnected from each other, and the asset manager is not able to easily view what the outsourced team can see. This scenario can cause delays due to latency and file exchange issues, and increased susceptibility to mistakes due to data mapping and data transformation errors.

+ Confidentiality Concerns.

Some asset managers have raised privacy concerns regarding the use of outsource providers and how their firm's proprietary or protected information is being stored and used.

+ Staffing Risk.

Firms that heavily depend on one individual or team with a significant amount of knowledge about the business or a particular role can face serious turnover risk when a key person leaves the organization. Asset managers deal with hiring and training risks, along with business continuity challenges in a fixed cost model as their number of funds and AUM grow. issue NAVs.

THE BACKSTORY:

Where Do We Go from Here?

We believe a solution exists through managed services which is the innovative, next evolution of outsourcing middle and back office oversight functions. It's a cloud-based model that goes above and beyond traditional outsourcing by providing true front-to-back capabilities and process centralization, allowing the transparency and accuracy that COOs have been requesting, and that investors and regulators require.

As investments become more complex, a skilled, independent managed service provider can handle critical middle office operations, allowing COOs (and CEOs, CIOs and their staff) to see exactly what the provider sees—in real time. Instead of using disparate systems, the combined team operate in single source, integrated software solution

that delivers real time information as tightly controlled and efficient processes are completed, allowing the asset manager to analyze data instead of manufacture data.

This use of one singular system alleviates worries about the transferring of data across different platforms or the extra time spent aligning systems. With a front-to-back cloud-based operating model, all parties are in sync, down to the version of technology in place, with provider software upgrades immediately available to the asset manager.

The right provider is able to offer a knowledgeable, highly capable, expert team with years of experience, eliminating the need to hire middle office staff. A dedicated, follow the sun global team becomes an

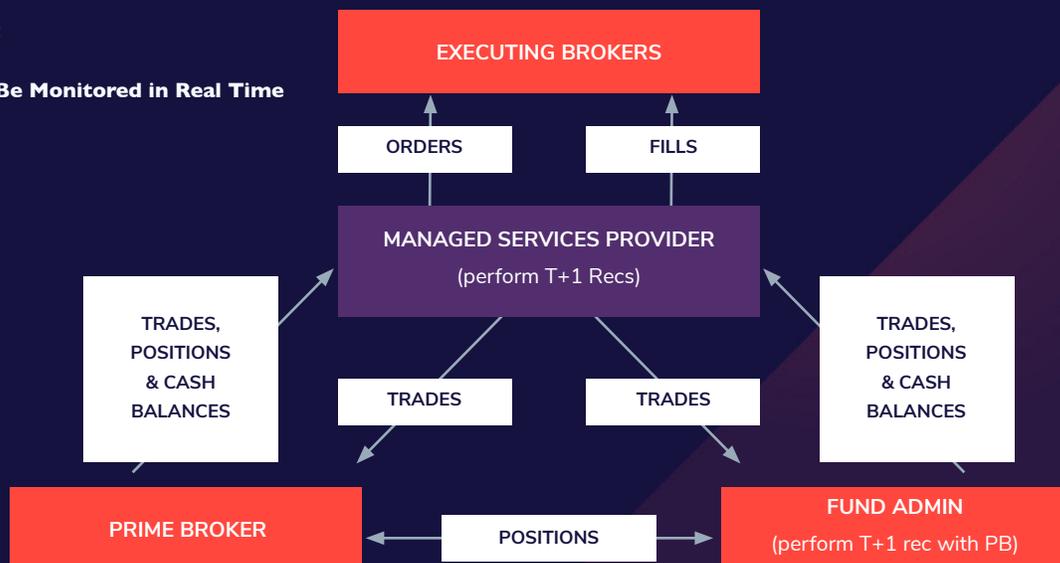
extension of the asset management team by offering consistent, reliable 24/6 support.

Managed Service providers can offer comprehensive middle office and back office oversight solutions, such as all post-trade processes, T+0 trade confirmations, T+1 position and cash reconciliations, general ledger/ shadow accounting, and month-end NAVs reconciliation versus the administrator.

These solutions also provide continuous improvement with the ability to automate manual processes and simplify the operating model and to stay on top of global compliance rules, changes and stipulations that asset managers in different countries must follow, ensuring compliance with regulatory bodies.

DISPLAY 2:

Trading Can Be Monitored in Real Time



MANAGED SERVICES:

A Solution that Bridges Outsourcing and Home Office Transparency

The traditional outsourcing model that asset managers have used for years has fallen short, leaving many COOs and other leaders mired in uncertainty. It's now impossible to ignore the challenges that have arisen when certain middle office roles and shadow NAV functions are outsourced to a fund administrator or fall on in-house staff. Partnering with a managed services provider allows asset managers to have confidence in

their middle office and back office oversight functions, retain transparency, shift from a fixed to flexible resource model, handle confidentiality concerns and be on the same system in real time as the provider. In the end, managed services provide a cost-efficient scalable business model that allows asset managers to strategically focus on business growth, alpha generation and creating greater impact with clients.

A LOOK INSIDE:

A COO explains why his firm chose to go with a managed services provider

“

The efficiency of having an integrated general ledger was one of the key components of choosing a managed service provider. The seamless integration of data from the front and middle office components of the system to the general ledger doesn't exist in other systems. The pre- and post-trade compliance functionality has been extremely helpful in that investors aren't just looking at our investments, but our technology. One of the reasons we chose [this type of provider] was because of the weekly software updates. This has ensured that our system is always current, and we've never had to go through a painful version upgrade. The provider's willingness to develop tools and other enhancements have helped us meet our evolving client needs. We've been able to increase our operational efficiency by outsourcing to the provider's middle and back office services group. Adding this service has helped allow our resources to focus on higher level operational projects and development.

Chief Operating Officer

- Global Asset Management Firm

Enfusion provides the software to fuel today,
the people to navigate tomorrow, and the data
and analytics that define the future.



SOFTWARE



SERVICES



ANALYTICS



ENFUSION
Software. Services. Analytics.

125 South Clark Street, Suite 750,
Chicago, IL 60603
enfusionsystems.com