Investment Operations Outsourcing
A Mutual Fund Director Perspective

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Today’s Speakers

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Investment Operations Outsourcing Defined
What is “Investment Operations”

Traditionally Retained Advisory Functions

**Investment Management Company – “The Front Office”**

- Distribution
- Research
- Investment Decision
- Trading
- Compliance

Increasing Trend Toward Outsourcing Non-Advisory Functions

**Investment Operations – “The Middle Office”**

- Portfolio Accounting
- Cash Management
- Investment Performance & Analytics
- Reconciliation
- Front Office Reporting

Traditionally Outsourced Non-Advisory Functions

- Fund Accounting and Administration
- Transfer Agency
- Custody
What is “Investment Operations”

**Investment Operations**

The people, systems and processes that support and enable core “front office” investment management activities. It includes maintaining the “investment book-of-record” through the management of all post-trade execution activities that support and enable the investment process:

- Provides the daily (and intra-day) positions and cash values on which investment decisions are made
- Maintains the “investment book-of-record” through daily portfolio accounting to ensure proper position and cash management:
  - Reconciles/interacts daily with fund accountants and custodian(s) to ensure accurate position data
- Provides performance measurement and analytics to define daily “investment performance” vs. “fund performance”

**Key Considerations:**

- **Cost:** Can represent 30%+ of overall operations and technology costs or 1-5 bps of AUM
- **Operational Risk:** A complex operating environment on which the investment process relies
## What is “Investment Operations”

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Investment Operations Outsourcing: What’s Driving It?
Why Are Managers Outsourcing Investment Operations?

Enhanced Operational & Business Performance

- A predictable but variable cost operating model
- Future cost avoidance
- Improved risk management control
- Regulatory compliance assistance
- Access to world-class operations and technology platform
- A culture of control, risk management and compliance
- Heightened focus on core competency of investment management – not operations
- Comprehensive analytics
- Higher quality data for improved and faster investment decision-making
- Detailed operating metrics based on Key Performance Indicators (KPIs)
- Risk-based operational oversight
Why Do Some Managers Continue to Retain Investment Operations?

Key Reasons Managers’ Retain Investment Operations

- “Operational alpha” or the business/investment value created through investment operations
- Desire to maintain control of operations and the operational data
- Lack of a commercial business case for outsourcing
- The political and/or human resources aspects of reducing staff
Middle Office Outsourcing: A Predictable Evolution?

Manager Disadvantages
- Cost Center
- Change: Increasing Pace & Complexity

Provider Advantages
- Strategic Revenue Center
- Committed Real and Human Capital
- Scale and Operating Leverage
- Culture of Accounting and Control(s)
- Risk-based Oversight

Where is the market today?

Time

Capability and Service Levels

Initial Conversion(s)

Pressure

Provider(s)

Manager(s)

Support

Investment Manager(s)
Mutual Fund Director Perspective
Mutual Fund Director Considerations: Potential Benefits

- Avoids long-term erosion of operational capability/performance due to margin pressure and the ongoing need for cost containment
- Lower, long-term “total cost of ownership” of operations and potential for lower cost to unit holders
- Enhanced transparency into operational performance through Service Level Agreements (SLAs) and Key Performance Indicators (KPIs)
- Access to an industrial strength infrastructure including enhanced operational controls and risk management:
  - Extensive client and internally mandated audit and control requirements
  - Robust risk management framework
- Enhanced focus on the investment management process and investment performance – not operations
- Improved business performance including flexibility and speed-to-market
Political / Cultural Implications:

- Outsourcing investment operations can result in a redeployment and/or reduction of staff

Oversight and Risk Management:

- Requires managers to implement a robust oversight function (a new competency)
- Operational risk can be outsourced but not abdicated (reputational risk, etc.)
- Requires providers to have and provide transparency into a strong operational risk management framework

The viability and/or timing of investment operations outsourcing varies by investment manager

Choosing the right provider:

- It is critical to establish a true business partnership, not a traditional client-vendor relationship
- A cultural match is important as the provider serves as a strategic extension of the business
Concluding Thoughts

- The role of Trustee has changed substantially and has intensified – It is more important than ever to understand the operational framework of your investment manager
- Investment operations outsourcing capability maturity and market acceptance are accelerating
- It is a viable method for improving business performance and enhancing focus on the core competency of investment management
- While outsourcing investment operations has proven benefits, it must be analyzed thoroughly by each manager for timing and viability