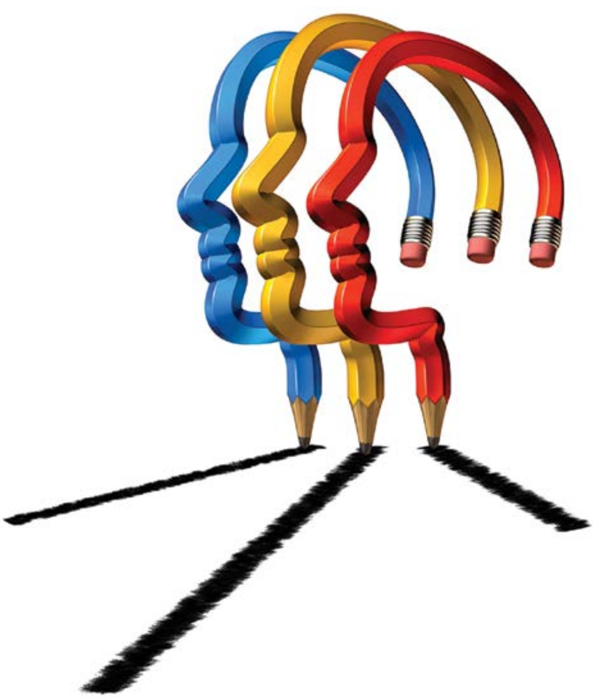
Interoperability: the ability to make systems and organisations work together

Years of history and painstaking development – component by component, some proprietary and some purchased – have shaped the operational frameworks that distinguish midsize to large hedge fund managers from each other. These substantial investments in back- and middle-office technologies – including general ledger, data warehousing, and shadow books and records – result in a level of business intelligence unique to each manager.

Keep legacy systems

It is only natural that managers remain committed to the systems and processes to which they have invested such great time and effort. Yet as they reach their growth targets their need for scalability drives them to seek new ways to augment, consolidate, and remove obstructive redundancies from those systems and processes. Many turn to outsourcing to liberate their operations from cumbersome components. Outsourcing affords managers the freedom to reallocate resources to treasury, collateral, risk management, and business intelligence with little disruption. Keep in mind that because not all outsourced providers are created equal, appointing the one best matched to a manager's unique framework is essential to expanding the capacity utilisation of operations systems.



A more seamless integration makes managers more efficient while the resulting transfer of focus to other products and business lines enhances a manager's ability to differentiate themselves from the competition.

That said, staying with legacy systems removes the need to retrain on new systems and avoids the attendant increase in help desk inquiries during day-to-day operations. This is a strong argument against supplanting existing technology, as a provider's adaptability must also extend to providing an excellent customer experience. Some managers prefer direct access to the provider's team, preferring not to deal with help desks.

Outsource providers with strong interoperability skills are those who know how to integrate a variety of technologies to have them work well together. Such providers understand the value inherent in a manager's business solutions. They

"The decision to outsource ultimately depends on the size of the manager, and sometimes outsourcing can be more expensive than doing things internally. While I am a proponent of outsourcing, in some circumstances, having internal staff or systems dedicated to supporting the business does have advantages. This is because sometimes problems or issues can be fixed sooner internally rather than having to send an email to an outsourced provider or go through to a help desk."

– COO of a London-based hedge fund

offer a seamless ability to service and adapt all back-office and middle-office software systems so that funds can retain their legacy systems by improving upon them.

Boost rather than replace

Pragmatic operating officers seek adaptable providers that adjust their services to complement a fund's legacy systems and those who can pattern themselves after internal frameworks. "COOs and their operations teams have a huge amount on their plate, be it dealing with multifarious global regulations or operational demands from institutional investors. In addition, many firms are adopting broader strategies and require outsourced technology on independent platforms to assist their existing infrastructure," says Chitra Baskar of Viteos Fund Services. The London-based COO agrees, adding: "Often, vendors push their own systems and are reluctant to build or adapt technology or services alongside those of their clients."

Although some managers may opt for a new framework most are reluctant to convert wholesale to a new platform and supplant their legacy investment entirely. Some providers that lack interoperability capabilities insist that managers migrate to the providers' platforms. But even technology solutions from managed services may not provide a complete solution and may require significant amounts of data conversion, retraining, and parallel reconciliation. Alone or in tandem, these are significant deterrents to moving away from legacy systems and onto an outsourced technology platform, as they distract from day-to-day operations. Offering the option to retain legacy systems indicates that a provider understands the manager's businesses, asset classes, and strategies and is sensitive to the immense task of migration.

"When choosing an outsourced provider," says the COO, "it is essential to find service providers that have interoperability and can complement the existing systems of hedge fund clients."

Outsourcers offering complementary systems that enhance either legacy systems or upgraded components without the need to migrate are optimal. The best-matched provider must exhibit interoperability on legacy systems or those chosen as a replacement. Their state of art systems exist and work in partnership, thereby adding value to the manager's process. Though not be obligated to do so, managers who do not have a choice of systems can choose to migrate to the systems of the outsourcing provider.

Full data history conversion

As investors demand transparency into historical performance and attribution, managers face the colossal task of converting their complete history to any new platform, a significant undertaking for managers running full, in-house books and records. Maintaining a record of this data is essential if managers are to solicit institutional capital. A challenge therein for managers is sourcing historical data, which may cover performance attribution or various risk calculations, particularly if their technology infrastructure has undergone enormous changes.

"Offering a highly customised service to clients is essential. It is important for outsourcers to adopt a consultative approach with their clients. This can be achieved by sending their staff in to talk with hedge fund clients about their strategy and business, so they understand it in great detail. In this way, outsourced providers can complement the existing technology architecture rather than encouraging complete replacement."

– Chitra Baskar, Chief Operations Officer, Viteos Fund Services

"This is one of the most important issues COOs have to confront when appointing a vendor. Historic data is difficult to move. Admittedly, moving Excel or Word files is simple, and [these files are] easily replicated. But transferring data or replicating a directory from a PMS or OMS system can be challenging," says the CFO of a New York based multi-billion dollar fund. Costs can be significant for an "inception to date" historical conversion, ranging from $300,000 to $600,000 to bring in 5 to 10 years of history. Additionally, to migrate, reconcile, and load the data could take 6 to 12 months of elapsed time.

For these reasons, an outsourced provider should avoid remodelling or onboarding a hedge fund's entire internal infrastructure and technology. Instead, the provider needs to work alongside the fund manager to achieve better results than either would realise alone.

Interoperability unlocks value

Interoperability is the ability to make systems and organisations work together. The value proposition of the outsourced provider to improve upon a manager's framework necessitates both a cadre of skilled fund accountants and expertise on any platform a manager may operate, without any prescribed technology requirements.

The interoperability skills of outsourcing providers must accommodate the fund's unique business processes, its present operational needs, and its data warehousing. True outsourcing is far more than simply handing over responsibility for the technology. Genuine outsourcing is a strategic business solution for removing the cumbersome components of day-to-day operations. One CFO at a $9 billion US based hedge fund notes that it is essential for outsourced providers to work with managers to secure timely and seamless services and to help educate fund managers' teams on how to get the most out of their legacy systems. This partnership ultimately allows managers to leverage the expertise of outsourced providers to augment their own high internal standards as opposed to simply delegating the role to a third party. One of the benefits of appointing an external vendor is that the vendor often has the resources and breadth of talent to help managers. Such vendors are constantly up to date with the latest training, resources, technology, and best practices.

Freedom of choice

Outsourced multiplatform providers – those who know how to integrate a variety of technologies to work well together – understand the value inherent in a manager's business solutions and offer the ability to service and adapt all back-office and middle-office software systems seamlessly so that funds have the choice to remain with their legacy systems by improving upon them.

Enhancing operations without disruption is a distinguishing characteristic of the skilled outsourcer. The beauty of employing a technology-independent provider is the freedom to choose whichever components or solutions the manager wants to incorporate. Since every fund is different, no single platform works for every fund. By enabling choice, funds can continue to improve their operations and position their frameworks as differentiators. No single solution, regardless of how comprehensive it is, can ever meet the needs of every fund, especially those that invest in a wide range of securities and work in multiple time zones. It ultimately comes down to finding the ideal blend of experience, technology, and processes for each manager.

Autonomous ownership

Outsourced providers that are independent of fund ownership are able to service all their customers equally. They gain no benefit from imposing specific business processes on their clients, since the service and supporting technology they provide are platform-independent. Employing a provider with strong interoperability capabilities ensures that the firm's processes and procedures remain consistent, with no upheaval during transition. This approach is about creating a synergy between the client and the outsourced provider, whereby the provider assists clients by injecting new ideas into their business processes to rationalise their operations, identify efficiencies, and ultimately help improve their business intelligence. By the same token, clients should not need to worry about their strategy or business secrets inadvertently leaking. "Data security is absolutely essential, and it is something to which managers and their investors are increasingly alert." Baskar notes. The London-based COO agrees: "Security, permissioning, and control over data is one of the most important issues at the moment for fund managers."

Since every fund is different, it stands to reason that the more clients a middle-office provider supports, the more interoperability expertise its team will have when it comes to best practices for the implementation and maintenance of multiple platforms and multiple investment types across those platforms. It is therefore essential to work with providers that have extensive experience and capabilities in reconciliations and net asset value calculations for a diverse range of asset and security types.

Flexibility to customise

To truly meet the needs of the modern hedge fund, the middle-office/in-house service must have flexible tools that complement any legacy system. Juggling the competing needs of meeting growing demand, being efficient, and being consistent, interoperablity providers have developed best practices out of necessity. From their panoramic vantage point of servicing multiple managers, they have the advantage of seeing where customisations save time and effort for clients. New clients benefit immediately from a provider's experience with similar frameworks and with all the usual requirements and enhanced automated processes that have been developed to deal with the activities of the post-trade life cycle. This is due in part to the provider's capacity for improved and detailed reporting, made possible by the automation of manual procedures as well as the implementation of processes that address consistent issues across clients.

Along with interoperability skills that accommodate the client's business processes, an experienced team can accurately shadow data feeds to ensure a pristine set of books. Because the outsourced provider ultimately supports the licensed and proprietary technology used by the hedge fund, interoperability also improves business continuity. This independence can help hedge funds mitigate the fallout should a service provider undergo an ownership change or experience some other disruptive event, because the manager will still possess a substantial amount of the technology infrastructure in-house. This is a practice hedge funds and their institutional clientele are scrutinising in depth during operational due diligence proceedings.

Conclusion

The quest for alpha resides to some extent with the ability of managers to make their operations efficient. As firms seek growth from one level to the next, designing systems in an efficient and cost-sensitive manner is not a luxury but a necessity. For many managers, the task of migrating away from legacy systems entirely is daunting. In these instances, outsourced providers with an understanding of interoperability and expertise in accounting and technology are a viable alternative. ■