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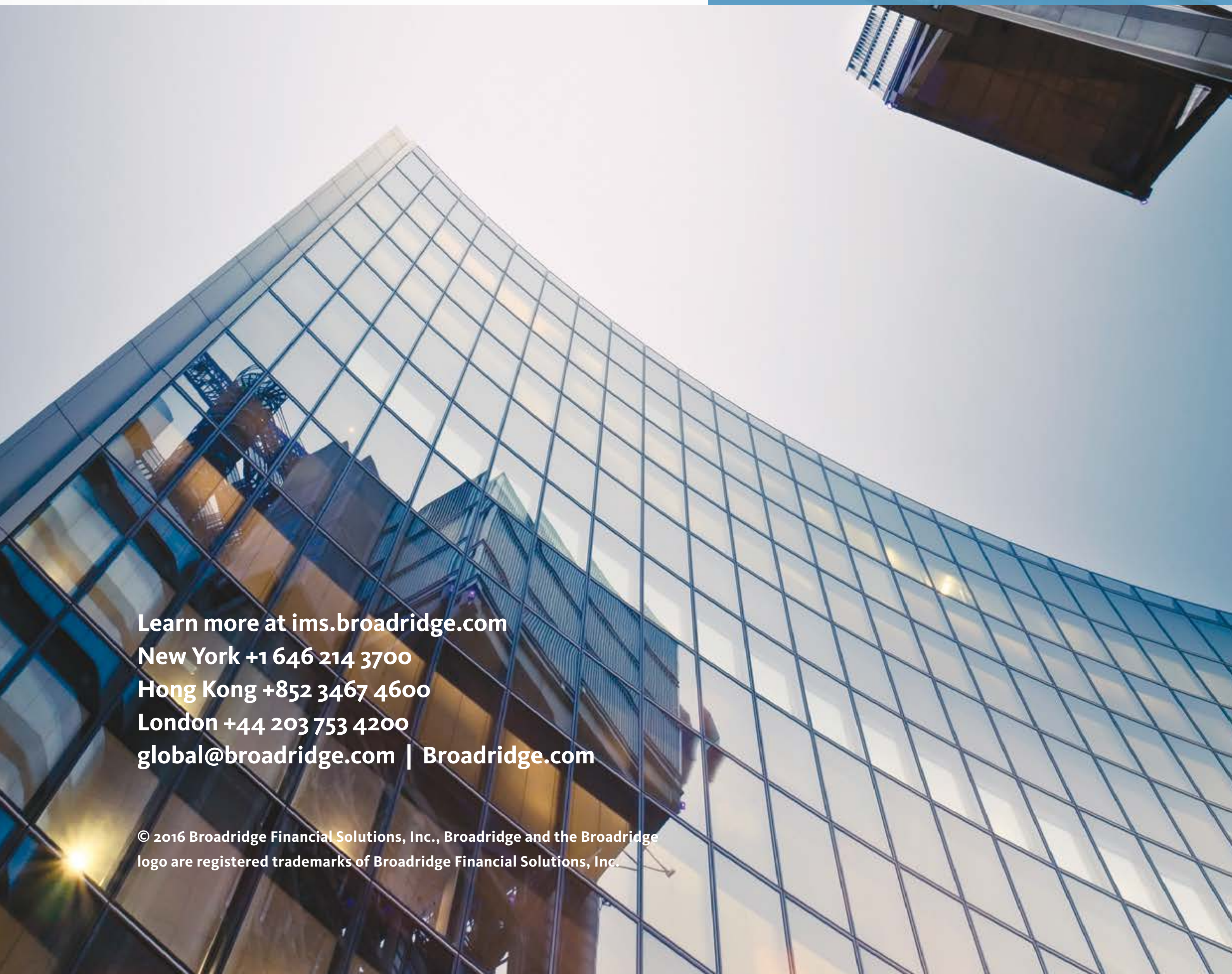

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The virtues of outsourcing technology and operations

Interview with Bennett Egeth

How hedge funds view their technology and operational models is fast evolving. Consider a simple example: the need to reconcile with half a dozen prime brokers and an administrator.

In the past a large fund would think nothing of developing a proprietary solution, but now there are other choices:

- Buy an off the shelf software that automates the reconciliation process
- Hire a managed reconciliation service
- Push the recon function to a fund's HFA or middle office proposal as a value-added service.

Previously, managers would build complex internal technology frameworks to reconcile with their prime brokers, but the option to outsource this function has grown.

As Bennett Egeth, President of Broadridge Investment Management Solutions, observes, "Managers see the benefits of auto-reconciliation because not only does it decrease the cost of their technical infrastructure (reliance on fewer systems), it also reduces the operational effort needed to support these systems. For example, one of our clients is a USD3.5bn credit derivative fund that uses an integrated system that auto-reconciles with their fund administrator and seven prime brokers. That's providing the manager technology and labour savings."

Cleansing reference data, automating end-of-day pricing data and processing corporate actions all are key areas where technology solutions can reduce operational overheads. Egeth estimates that there is at least a 30 to 40% cost saving – if not greater – to using an outsourced technology managed services provider. When discussing managed services, it's important to make a distinction between technology managed services (hosting) versus operational managed services; the former would apply to the above example of the credit fund.

Bennett Egeth, President of Broadridge Investment Management Solutions

In operational managed services, the manager goes a step further and uses an outsourced provider to take over the running of certain operational tasks and become, in effect, an extension of the manager's operations team, which may reduce the operational headcount to a handful of key staff.

"When a firm trades a new asset class, not only do they need the operational expertise in that asset class, they also need back-up for that expertise if the key person is out of office. A lot of large funds have built significant operational infrastructure and I think everyone acknowledges that operations can become a more 'mutualised' and shared solution," says Egeth.

"There's an ability to pool the knowledge and expertise of operations staff that support multiple funds, rather than having to retain that expertise in-house for every different fund. This can lead to a 30 to 40% cost savings – if not greater – when using an outsourced managed services provider."

At 50,000 feet, there are, says Egeth, four questions that can have a significant impact on the cost structure of a large hedge fund:

- Can I consolidate multiple providers to a limited number of providers or even a single trusted provider for my solutions? Every additional vendor brings expense, vendor management, integration and support work.
- Do I need to host the infrastructure myself?
- Do I need to do all the operations functions myself? What tasks, knowledge and redundancy do I need to do?
- What level of controls (shadowing?) do investors expect me to perform independent of the work done by my administrator?

In a nutshell, what is differentiating? If you took every function and subjected it to the test: "does it help generate alpha or raise capital." ■