

FOCUS ON

BEST PRACTICE

Peter Sanchez of Northern Trust Hedge Fund Services explores the key themes and benefits of a 'best practice blueprint' for fund managers and their administrators



Peter Sanchez

is CEO of Northern Trust Hedge Fund Services. Prior to this, Peter served as global head of business development and client service for Omnium. He has more than 20 years of experience in business development, client service and operations.

Optimising the relationship between managers and administrators can sometimes be difficult. Peter Sanchez, chief executive at Northern Trust Hedge Fund Services, explains how both hedge fund managers and administrators can make the most out of their relationship by moving into a best practice operational environment.

Q **HFMWEEK (HFM): WHAT CHARACTERISTICS DEFINE YOUR MOST POSITIVE/PRODUCTIVE RELATIONSHIPS WITH CLIENTS?**

A **PETER SANCHEZ (PS):** I would say there are three common themes that characterise our most productive relationships with clients.

The first theme is engagement. We operate in a daily environment so that data management is an ongoing process rather than a month-end one. Clients that engage with us on a daily basis have more accurate data, get more value out of our services, and have a smoother month-end close.

The second theme is operational perspective. We don't expect clients to be operational experts – that is why they hire us – but the results are better where the client shares the goal of operational best practice, which in turn supports the manager's ultimate goals of saving time and money.

The third of these would be effort and commitment in terms of implementation and ongoing controls. We have an intensive implementation process for new clients, and a daily control environment to maintain accurate data. Clients who collaborate with us on both counts have a better experience on a day-to-day basis.

Q **HFM: WHAT DO YOU FEEL ARE BEST PRACTICES THAT ADMINISTRATORS CAN EMPLOY TO BETTER SERVE THEIR CLIENTS?**

A **PS:** One area where we see misalignment between administrators and their clients is that many administrators are focused on breaks – cash breaks, position breaks, P&L breaks – at month end. This leaves the manager, fund staff, and the administrator spending time and energy cleaning up these breaks at month end to support the NAV.

We feel that this is treating the symptom rather than the disease – a lot of that work would go away if there were more focus on trade capture. The best practice is to take in complete details of trades each day and focus on maintaining a 'pristine' trade book. If you get trade capture right, you get the right cash flows. Life cycle events are likely to be auto-generated, booked accurately and incorporate the correct accounting entries. Lastly, your valuations are more accurate because you have all the attributes in your system. A little time spent each day getting trade capture right results in a less onerous month-end process, and both administrators and the managers they serve tend to spend less time on inputs and more time on analysis.

Secondly, administrators must be able to handle multiple strategies and products, and we see a lack of consistency and breadth in terms of product coverage. Often, administrators employ manual processes or have ancillary systems 'bolted on' to their platform. In a best practice model, all data for all functions should be stored in one system, and it should support all functions across a significant portion of product types. Daily trade data should be used to produce P&L, which then drives NAV and financial reporting, which should feed into investors' statements. The goal is one data set with no time wasted on internal reconciliations. If you can achieve that, the administrator is more focused on analysis and delivering value to their client rather than on maintaining their internal workflows or manually handling certain product types.

Third, transparency is absolutely critical. At Northern Trust, we have a client desktop that delivers real-time transparency into trade processing, P&L, valuations and lifecycle events. It creates an interactive, collaborative experience between us and our clients rather than a bilateral experience using reports. When you do this, you allow the client to manage their trade capture, P&L, and NAV lifecycles online.

Another big advantage is that our employees use the same systems, so that when a client calls us, we are looking at the same data in the same view as our clients, which is incredibly efficient. No time is wasted trying to run a report or recreate an issue – it's all right there on the screen.

Q **HFM: WHAT ARE THE BIGGEST IMPEDIMENTS TO ACHIEVING BEST PRACTICE? FROM THE ADMINISTRATOR'S PERSPECTIVE? FROM THE MANAGER'S PERSPECTIVE?**

A **PS:** As an administrator, the single biggest issue is the use of stub trades to represent complex product types. We need to receive full trade attributes if we are to maintain and accurately process assets each day. With stub trades, even straightforward tasks – processing a swap reset, for example – become more difficult. Instead of an administrator reconciling a cash event or swap reset independently to a third-party, the administrator using stub trades must rely on the third-party for the event or reset information. Additionally, administrators who use stub trades are challenged to properly value assets, and they are forced to dedicate energy collecting and reconciling valuation inputs.

Another impediment is the lack of domain expertise. Expertise around different asset types, especially the more complex fixed income and OTC instruments, is the

difference between an operational model that works on paper and one that delivers value in practice. If the administrator has people in place who know the assets and can engage with clients, the client and the administrator get a much more positive experience and a better overall workflow.

From the manager's perspective, best practice can only be realised to the extent that the manager participates in best practice and engages with their administrator. For example, the benefits of capturing full trade attributes are

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only possible if the manager delivers that data. If we provide real-time transparency, daily P&L and robust daily controls, but the manager doesn't engage with us until month end, the value of those processes is diminished. In our most successful relationships, clients engage with us and they derive substantial benefits – they spend a little bit of time each day engaged in reviewing their data, rather than a lot of time at month end trying to clean up the book, and they have a vastly better experience as a result.

Q HFM: IF BOTH THE ADMINISTRATOR AND THE CLIENT ACHIEVE BEST PRACTICE, WHAT IS THE END RESULT?

A PS: The end result comes down to a lot of the themes we have covered here. First, the managers have more time to focus on their strategies, their trading, their investments and their investors because they spend less time on infrastructure administration.

Second, month end becomes 'just another day' in terms of control environment, in terms of cash flow analysis, in terms of minimising reconciliations and in terms of the amount of time spent to support the monthly NAV.

Third, managers have access to an accurate and complete data set that they can use to manage their business. They have confidence in the accuracy of the data and use it to drive informed decision making around investment strategy. The manager is less concerned about reconciliations to the front office trading system because all of the data is right there to see and use.

Fourth, everyone has a clear picture of their role and what the rules of engagement are: the manager engages with the administrator where doing so supports the process, but they are not tied up in investigating all of the idiosyncrasies of the administrator's systems or controls. Instead, they are focusing on data analysis, trading strategy and overseeing the control environment.

At the end of the day, if everyone gets to best practice, interaction between manager and administrator is efficient and valuable, data is accurate and the control environment is such that managers don't need to dread the month-end close the way they used to. In summary, the fund administrator becomes a natural extension of its clients' business. ■

