Transforming Real Assets Fund Operations

STATE STREET

Based on our experience working with multiple clients and transforming fund operations for large asset managers, we have developed a four-step execution plan to transform real assets fund operations.

Managers considering outsourcing to achieve operational efficiencies should follow this four-step action plan to optimize outcomes.

Real assets investment managers have experienced explosive growth over the past several years. However, the headwinds of extensive regulatory and market change, increased investor demands and fee compression could dampen future prospects. As the world continues to respond to the global health emergency associated with COVID-19, operational resilience has been put to the test.

To be able to compete effectively, managers recognize the need to focus on their core business of sourcing, managing and transforming assets, while fulfilling stakeholder requirements of greater transparency, better reporting and tighter accounting controls.

One solution to optimizing the operating model is to offload non-core tasks to a trusted partner as part of an operational transformation. This involves changing the operating model, adopting a risk-based approach to managing operations and deploying third-party solutions for non-core tasks.

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Step 1: Discover

Evaluate your existing structure

Assess existing capabilities

Identify gaps and opportunities

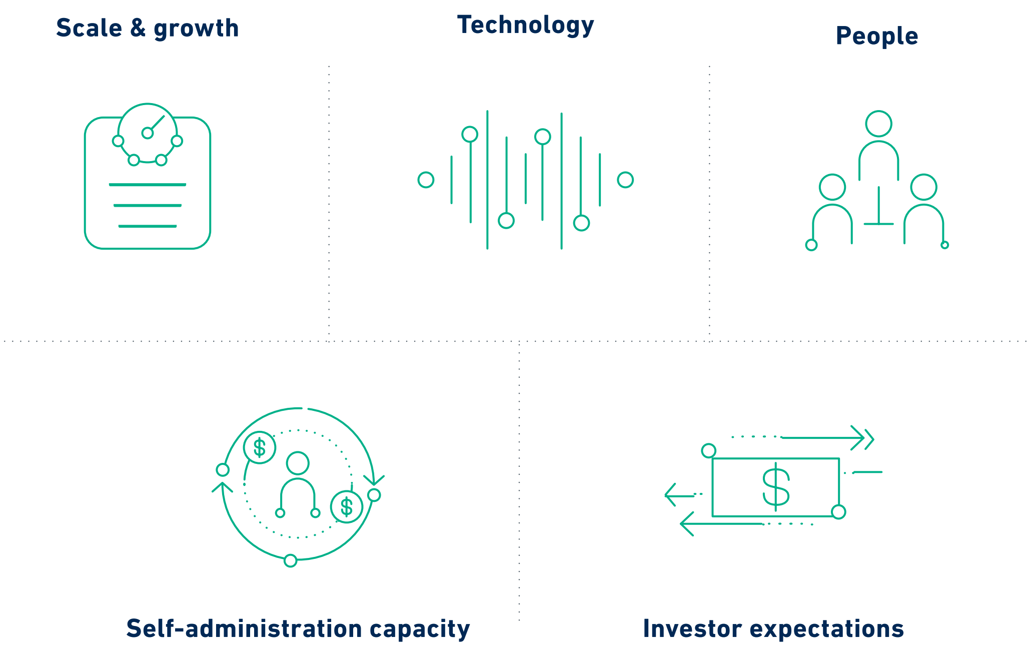
Define your transformation goal

Outline the components of fund administration for transformation

In thinking about undertaking an operational transformation, you should first assess existing capabilities and identify gaps and opportunities in getting to your goal. This starts with defining the components of your fund's administration, which are typically the back-office and some middle-office functions necessary to successfully support operations. This includes accounting, recordkeeping, financial reporting, audit and tax return support, capital call and distribution processing, investor AML/KYC reviews, and execution of all investor deliverables.

Step 2: Define

Define the key drivers for an operational transformation



As you think about the aspects of your business that are driving your transformation, you will want to reflect on your organization's key challenges and aspirations, including core strengths and areas that require a more focused effort.

It will also be critical to evaluate your needs when it comes to scale, self-administration capacity and technology, as well as how investor expectations and your staff factor into your transformation goals.

Exhibit 1: Examples of operational transformation

Client	Initial Drivers for Change					Outsourced Outcome
	Scale & Growth	Self Administration	Technology	LP's	People	
Large, complex asset manager with $80bn+ in private equity commitments and large private equity fund of fund business	●		●	●	●	• Expanded outsourcing and vendor consolidation solution allowed firm to focus more on growth (40,000+ investors). • More efficient model is introducing opportunities to decommission systems (Shadow book). • Streamlined operating model allowed firm to focus on core business and investors and scale there fund of funds business to $80bn with numerous product launches annually.
Asset manager with $21bn+ in private equity commitments and large private debt book. Complex closed-ended and evergreen structures	●		●	●		• Focus on technology and integration with administrator allowed the manager to efficiently scale and grow, while streaming the review process and timeline. • LP reporting enhancement driven by market forces (ILPA) and facilitated by operating model and scalability.
A large, global alternative investment manager with a diverse and complex product offering	●	●	●	●	●	• A cohesive, bundled back-office outsourcing solution enabled client to reduce headcount and IT expenses, saving over $4m annually. • Automated client's reporting, reducing risk of error by 90% and enabled them to focus on enhancing investor returns, along with strategic product and asset growth and scale.
Top 10 real estate manager looking to avoid major technology investment, reduce costs and simply their business model	●	●	●	●	●	• Lift-out of personnel and proprietary technology to State Street, establishing a real estate Center of Excellence in Atlanta. • Improved service delivery through a 25% reduction in reporting times. • Transition of personnel from "back office" to "client service" created greater career development opportunities.

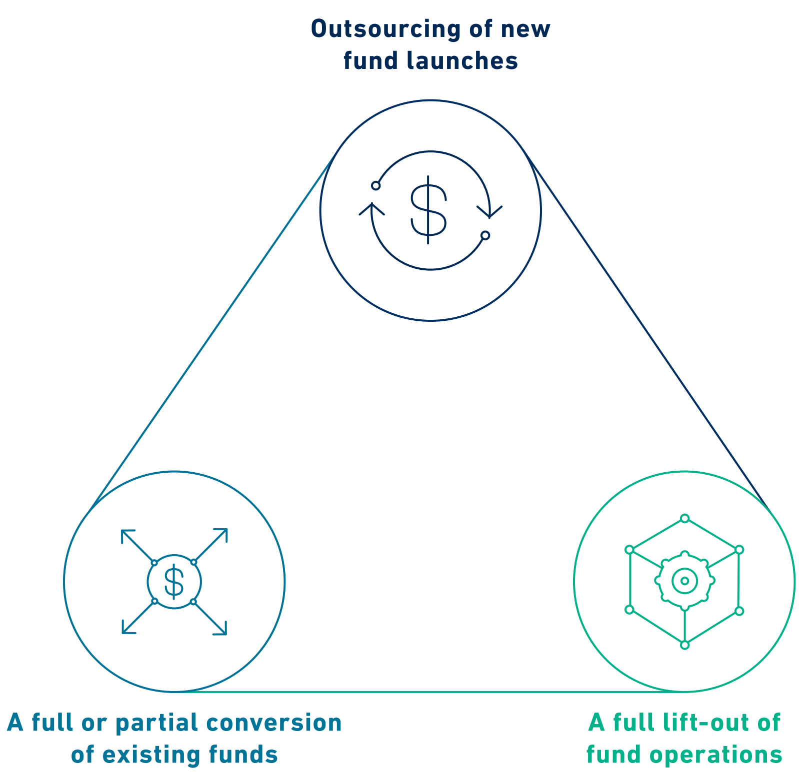
● Scale & Growth ● Self Administration ● Technology ● LP's ● People

Step 3: Decide

Choose the transformation model that best suits your business

The next step is to decide which transformation structure is right for your business depending on what operational efficiencies you want to achieve. There are three common models that can address your unique business needs:

- **Outsourcing of new fund launches**
  When launching a new fund, you would maintain the current operational infrastructure, technology and staffing, while outsourcing additional headcount. This will not add headcount as the fund scales. Single-strategy managers that want to enter a new strategy but lack operational expertise often opt for this model.
- **A full or partial conversion of existing funds**
  In a full conversion, you would convert all historical data to the fund administration firm. Managers of older vintage funds, perhaps in the fifth year of a 10-year fund term who may not want to convert all of the historical data, may choose a partial conversion. In this case, you may opt to have the administrator start with opening balances at the fund's new fiscal year. This approach works well for managers who have a separate mechanism for tracking returns and investor historical data.



- **Under a full or partial conversion,** you would continue to manage operations and IT infrastructure until the conversion is complete; there will also be a transitional period of overlap between the existing and outsourced operations. As part of the outsourcing process, you will need to review the quality of data and the age of funds. Keep in mind the need for targeted hiring or transfer of employees to the third-party fund administrator. Once the conversion is complete, the fund manager's in-house employees focus on fund oversight and front- and middle-office engagement. The third-party partner will manage the fund's administration and other back-office requirements.

- **A full lift-out of fund operations** A full lift-out includes technology and people. It involves the transfer of ownership of databases and systems, as well as fund administration. The fund administrator would retain your manager's staff and over time integrate your team into their infrastructure. The administrative work is immediately transferred to the fund administrator so that the team that remains with the manager — the "oversight team" — can quickly focus on fund oversight and asset and portfolio management. We typically see this with firms that are growing at a faster pace than their fund operational infrastructure can support.

Managers on this growth trajectory tend to require more dollars invested to upgrade their current accounting systems and technology; require more headcount, often as result of turnover combined with growth; and require a solution that can manage the increased volume of investors and their need for transparency.

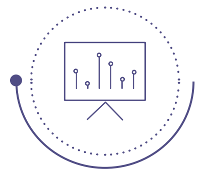
Step 4: Deploy

Execute on the four strategic pillars of transformation

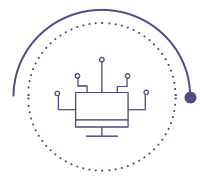
Once you decide on the transformation structure, you should conduct an in depth evaluation in four areas: operations, technology, human capital and cost analysis.

Operations

- Operations covers processes, controls and risk environment. Keep these best practices in mind before you transfer responsibilities:
- Conduct a detailed review of the operational infrastructure to identify gaps in your model, map the risks and create a governance framework. Identify areas typically outsourced such as tax preparation and filing, property and fund accounting, and treasury and cash management to determine if these are strengths or weaknesses for the organization.
- Investor reporting and portals should be designed to track activity, provide insight and analytics, and deliver required documents. The ideal platform would have the ability to connect the fund- level data with the investor-level data.
- Create documentation that clearly delineates critical business processes, handoffs, dependencies and workarounds.
- Plan projects to clarify scope and establish a strong reporting structure to maintain control and establish strong KPIs.



Operations



Technology

Human capital

Cost

Technology

Conducting due diligence on your current technology stack, including applications, general ledger and cloud-based tools, will help you better understand process flows for critical operations, potential failure points and system dependencies. Investors require that managers have technology in place to provide detailed reporting on their investments and a mechanism for transparency. Identifying and mastering the best technology applications that can support the reporting needs of investors is not necessarily a core competency of most managers, but is certainly expected of the fund administration industry. Best practices include:

- Establish realistic targets for decommissioning or continuation of existing technology platforms.
- Move toward new technology, including analytical and investor tools.
- Assess the post-transition impact on other teams, such as asset management, investor relations and transactions teams that rely on data from specific technology systems.
- Data migration and whether to maintain historical data versus starting with opening balances.
- When evaluating the administrator's technology capabilities, pay attention to its investor portals, accounting platforms and analytical tools. Fund administration platforms typically allow data to be tracked at each level of a fund structure, from investor commitments and fund-level data through to the underlying real assets investment. These systems often involve a costly and time-consuming process of implementing and maintaining the technology in-house, which can be avoided almost entirely with a fund administrator.

Human capital

Assessing staffing needs may be the most challenging component of the outsourcing process. Ask a few important questions: Can your existing team evolve to meet the needs of your future-state operating model? How do you transition the team from day-to-day fund accounting tasks to a risk-based approach using analytics? In the case of a lift-out, which individuals should move to the fund administrator and who should remain in an oversight capacity? Best practices include:

- Conduct a thorough evaluation of intellectual capital ensuring appropriate resourcing of the oversight function and create a strong governance framework. While internal teams are often deliberately lean, a manager builds out staff with bench strength in areas like investor relations, compliance, valuations and security. For the administrator, hiring a large team of technical experts who support multiple funds makes financial sense. Building a similar team in-house can be expensive.
- Oversight staff should be trained on the fund administrator's platform to develop future economies of scale and serve as a foundation for organizational success.

- In a lift-out scenario, prepare the team for new roles and responsibilities under the future-state model. The team will no longer be responsible for detailed preparation of workpapers, but will now focus their attention on KPIs, risk metrics and strengthening internal operational controls.

Proper evaluation can help your workforce grow and enhance their roles, while the organization benefits from a stronger operating model to achieve its strategic goals. The decision to move specific staff to an administrator can be challenging. However, there are clear benefits for all parties involved. The team being lifted to the fund administrator may have opportunities to work with new clients, to move from a cost center at the fund manager to a revenue center with the new fund administrator, and career progression that is not contingent on the fund manager's growth. The team that is retained — the "oversight team" — expands their analytical capability, moves to provide enhanced support to the asset and portfolio managers, and maintains a higher focus on critical risk areas of the business.

Cost

With the operational house in order, it's time to think about finances. Fixed overhead costs like back-office salaries and benefits in a growth scenario can be turned into a variable expense when outsourced. For example, most limited partner agreements (LPAs) allow for fund administration costs to be paid by the fund; many LPAs specifically allow for the cost of a fund administrator like audit, tax and legal professional fees. Best practices include:

- When a fund is being wound down, the manager is saddled with fixed costs while not earning management fees to support the overhead and infrastructure. An outsourced back office reduces costs.
- Consider the true cost of full-time hires, which not only includes salary and benefits, but also recruiting, training, developing and housing a team, which equate to fixed costs. When using a third-party administrator, these fixed-costs convert to variable costs that increase as you launch new funds and decrease as funds wind down upon reaching the end of their term.
- Consider the current projection of financial costs by category (personnel cost, occupancy, IT, outsourcing costs, others) for the next three to five years. This allows you to compare the costs of using a third-party fund administrator to your projected operating model cost as you make the cost benefit analysis on your operational transformation decision.

Working with a Trusted Partner

To keep the focus on managing and buying real assets, a fund manager can outsource its fund administration to a competent and trusted partner. Managers considering outsourcing should take an in-depth assessment of strengths and weaknesses and how a transition would impact investors, operational infrastructure and other teams within the organization. A deep and thorough evaluation of operations, technology, human capital and cost can help put your organization in a stronger position to transform operations.

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