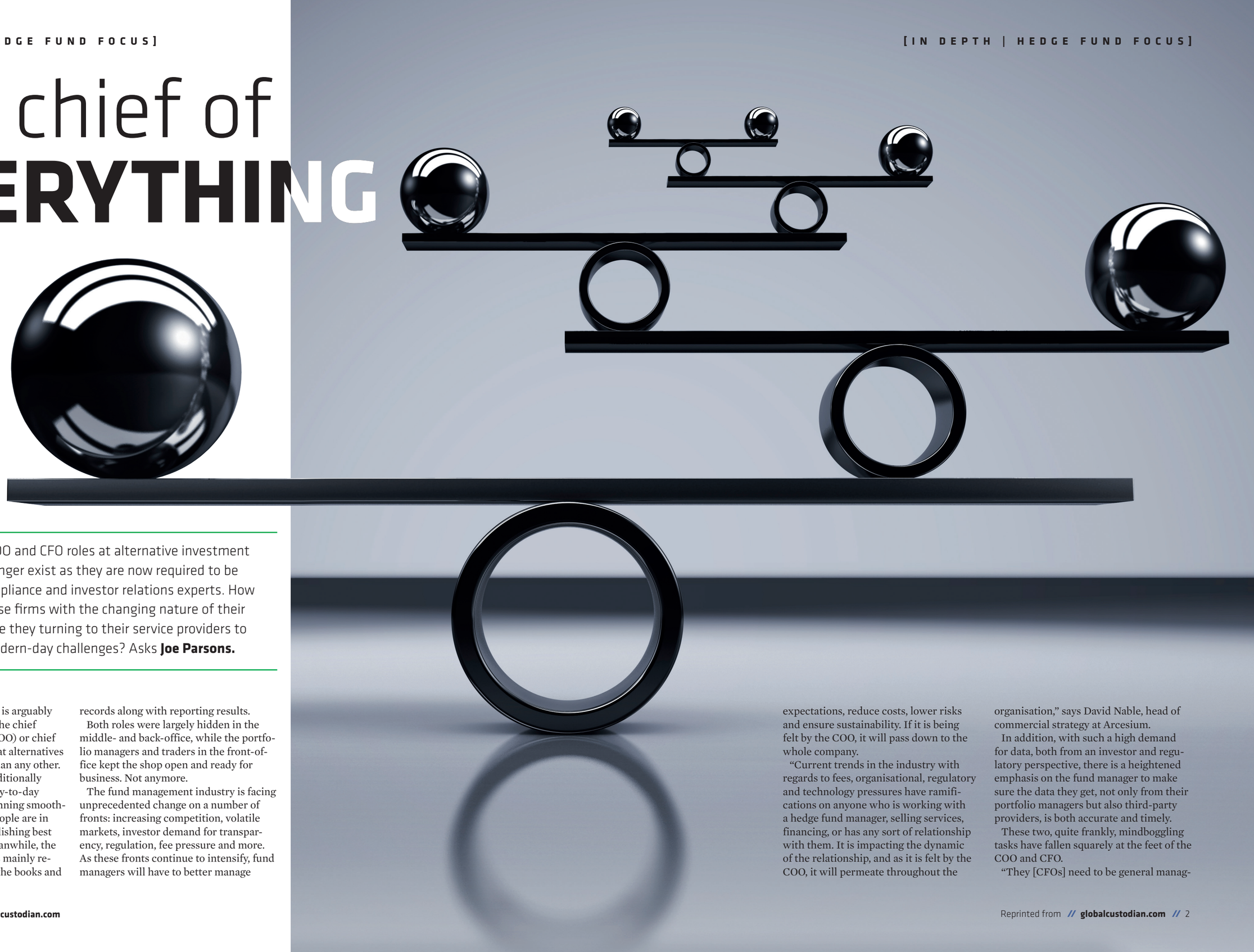
The chief of **EVERYTHING**



The traditional COO and CFO roles at alternative investment managers no longer exist as they are now required to be technological, compliance and investor relations experts. How prepared are these firms with the changing nature of their roles, and how are they turning to their service providers to meet these modern-day challenges? Asks **Joe Parsons.**

Doing more with less, is arguably more applicable to the chief operating officer (COO) or chief financial officer (CFO) role at alternatives investment fund manager than any other. The role of the COO has traditionally involved making sure the day-to-day functions of the shop are running smoothly – ensuring all the right people are in the right place - while establishing best practices and processes. Meanwhile, the traditional role of a CFO has mainly revolved around maintaining the books and records along with reporting results.

Both roles were largely hidden in the middle- and back-office, while the portfolio managers and traders in the front-office kept the shop open and ready for business. Not anymore.

The fund management industry is facing unprecedented change on a number of fronts: increasing competition, volatile markets, investor demand for transparency, regulation, fee pressure and more. As these fronts continue to intensify, fund managers will have to better manage expectations, reduce costs, lower risks and ensure sustainability. If it is being felt by the COO, it will pass down to the whole company.

"Current trends in the industry with regards to fees, organisational, regulatory and technology pressures have ramifications on anyone who is working with a hedge fund manager, selling services, financing, or has any sort of relationship with them. It is impacting the dynamic of the relationship, and as it is felt by the COO, it will permeate throughout the organisation," says David Nable, head of commercial strategy at Arcesium.

In addition, with such a high demand for data, both from an investor and regulatory perspective, there is a heightened emphasis on the fund manager to make sure the data they get, not only from their portfolio managers but also third-party providers, is both accurate and timely.

These two, quite frankly, mindboggling tasks have fallen squarely at the feet of the COO and CFO.

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DAVID NABLE, HEAD OF COMMERCIAL STRATEGY, ARCESIUM

ers rather than accountants," says Robert Caporale, CEO of Exchangelodge and the former CEO of JP Morgan's alternative investment services business.

A recent article from BNY Mellon coined a new phrase to describe this trend, with COOs and CFOs of today being repositioned as the 'chief of everything but investment' (or COEBI – pronounced Kobe).

This is because they are now involved in nearly every area of running a firm, aside from the actual trading function. They now need to oversee the data coming in for compliance, on top of the latest technological advancements, be involved in matters of HR and investor relations. The result is that the role of the average COO/CFO is stretched so thinly they could be on the point of breaking.

A new breed of C-suite executives

So how prepared are these new breed of COOs and CFOs to take on this challenge, and what is being done in the industry to help them?

Kevin Skorzewski, director of business development for BNY Mellon's alternative investment services (AIS) business and co-author of the article, believes that the official job title of the operations chief no longer captures the scope of what the COO of a hedge fund business actually does.

In fact, the COO is touching on nearly every part of the fund manager, having profound impacts on the operation of the firm.

"We are seeing the COO role blurred with those of the CFO, CCO and the CIO. COOs are getting involved in finding new ways to operationally fund different strategies, which then entail more complex transactions from a custody, margin and administration perspective," he says.

"The COEBI role is about finding ways to achieve operational alpha, and this usually touches everything that the organisation does."

In order to accomplish this, fund managers need to come to terms with the reality, when hiring a new CFO/COO, their responsibilities will go well beyond their traditional functions of the past.

Let us first look at the changing nature of the CFO. Michael Huczko, CEO of Pinewood Capital Management and the former COO of Duquesne Capital Management - during this time, the hedge fund managed money for George Soros, explains when fund managers first hired a CFO, they had the attitude that they were just looking for a chief accounting officer.

"Yes there are a lot of accounting responsibilities involved, but in a small firm, they [CFO] have to take hold of the risks not just in the portfolio but the whole business," says Huczko.

He recalls a time at Pinewood - which provides strategy development and capital raising services for new hedge funds - carrying out due diligence on a $15 billion hedge fund and interviewing their CFO.

"The CFO was a qualified accountant but every question we asked about their portfolio, he had to turn to someone else. He did not understand what they were trading, so how could he of understood the risks and where to pay attention to," Huczko adds. "I am concerned, in that respect, that when funds go off the rails when focusing on accounting, they lose sight that they need to understand, from a reporting standpoint, where the risks are."

For the COO, their role is more collaborative, not just with vendors but also with other departments within the alternatives investment manager. This could include collaborating with internal risk assessment teams to streamline client and regulator communications, making the call to recruit specific talent or invest in a particular technology. It also involves responding to data and cyber security breaches, or working with custodians and fund administrators to streamline processes.

The CEO may be the face of the business who sets the strategic goals, but the COO is the one that executes them. However, the majority of COOs and their back-office teams are still plagued by the same challenges faced for years - how to overcome Microsoft Excel.

Excel spreadsheets are still, surprisingly, commonly used both by COOs and CFOs carry out their functions, but this is hampering their ability to provide insightful and analytical data to both investors and their portfolio managers.

Daniel Nikci, founder and principal of Applied Fund Solutions - an outsourced CFO and middle- and back-office solutions provider to alternative investment managers - believes COOs must be proactive in understanding the technology on offer in order to take on these responsibilities and move on from Excel.

"The options are out there, and the responsible COO has to take the initiative. They have got to move internally from Excel and lower contributing areas, and into more advanced platforms where they are more analytical," says Nikci.

Similarly, Paul Busby, global head of ENSO, adds that the evolution of technological solutions on the market would help this transition away from Excel for COOs.

"From an operational standpoint, with the exception of the biggest hedge funds in the world, a lot of workflow is still done on spreadsheet. However, technology is helping to shift this dramatically. With the emergence of third-party software-as-a-service (SaaS) platform offering, gone are the days of clunky and install applications - they are now very adaptable, allowing COOs to adapt themselves," says Busby.

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KEVIN SKORZEWSKI, DIRECTOR OF BUSINESS DEVELOPMENT, BNY MELLON ALTERNATIVE INVESTMENT SERVICES

While the CFO and COO may not be physically involved in the execution of trades, they are now becoming a very important component in the front-office.

Front-office savvy COO/CFO

Huczko believes it is therefore necessary for the C-suite finance and operations executives to understand fully every trade that is taking place, why it is taking place, and who would be involved.

"A good COO/CFO needs to be aware of every single transaction, how it was executed, where it was held in custody, what it means for the portfolio, and how to unwind it," he adds.

With portfolio managers venturing into new asset classes, it is up to the COO and CFOs to ensure they have the right vendor relationships in place to facilitate this.

This could include finding a completely different financing construct to support the launch of a credit book, or adapting your fund administration relationship to facilitate the launch of smaller, separate accounts.

The launch of separately managed accounts could become even more troublesome for the hedge fund COO when the asset manager dictates what prime broker or fund administrator to use, according to Arcesium's Nable.

"Particularly if you are heavily reliant on a primary administrator to handle data aggregation and reporting across multiple entities, you have this orphan separated

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account that doesn't go to that fund admin. You would therefore have to pay that fund admin to administer the account, or have your own in-house system to manage it," he explains.

"With all of these fund admins, it breaks down your business model and you need a better way to manage and organise your information."

COOs and CFOs are assessing where they can get these vital tools to support their front-office. This includes trade capture information, flexible charting of accounts, streamlined swap templates, custom equity basket support, and enhanced reconciliation. The COO also needs different forms of reporting and new dashboards.

They will have to decide whether to constantly update internal systems and build the tools themselves, or establish new partnerships with their fund administrator.

Firms including BNP Paribas Securities Services, SS&C, and State Street, are doing just this by providing new tools that allow greater integration of the COO/CFO with the front-office.

"Some COOs are dealing with 15 year-old technologies and are constantly spending money to keep it up-to-date. They are required to be technologists when that is not their background, and then connect to a variety of new counterparties and clearing agents. There is so much effort to maintain that, so a front-to-back solution and deploying an order management system (OMS) means they can do all of that," says Diarmuid Ryan, head of hedge fund services, BNP Paribas Securities Services.

"The pressure on the COO is often cost and infrastructure-driven, and they want to transform costs by going to one-stop shop for front-to-back solutions. This has been resonating very well and a growing topic for both our firms and we see a lot of potential for it."

BNP Paribas Securities Services recently partnered with technology vendor Broadridge to use its Portfolio Master platform, which combines order management, portfolio management and risk management, to give it a range of front-office capabilities alongside its fund administration services.

Meanwhile, State Street is utilising its 'financing and trade' relationships with hedge funds and bringing them onto the front-to-back platform it has developed following the Charles River acquisition.

"Many hedge funds that have fund administration with State Street also do financing with us, they trade FX with us, they use our global exchange platform for analytics. More recently, they have come to us through Charles River," says Paul Fleming, global head of alternative investment solutions (AIS) group, State Street.

"Some of the most interesting conversations we are having are with clients that do fund admin with us and also use Charles River, and want to know how we can provide a more efficient model. As we develop the admin platform and connect it to our front-end, we can provide better analytics all the way down the end client level."

Vendor relationship pressures

Mounting pressures on C-suite executives mean that the relationship hedge funds have with their administrators, prime brokers and custodians are more intense than ever.

The BNY Mellon blog also highlights that as the demands on the COO/CFO increase, there is a higher risk of them becoming a point of weakness for the fund. This has led to calls for greater outsourcing of their administrative and operational burdens.

There is now emphasis on the service provider to be more transparent than ever ensuring the services and data they provide meet the incredibly high standards of the fund manager. This means having an open dialogue on their accounting data, reporting, tax, technology, and regulation updates, as well as communicating to their investors.

"The fund manager has to constantly reach out to their service provider with their own checks and balances and due diligences, as opposed to trusting everything is fine," adds Nikci.

The need to have accurate and timely data for investor and regulatory reasons, means that there is increased pressure on the fund administrator to get it right. There is a constant process of checking, rechecking, validating and reconciling the data going through the fund, either within its own back-office or with the fund administrator.

"They [alternative investment managers] are pushing their providers more, on the data side and to be more data-driven, while also pushing on the technology side to become more automated and take away some of the burden," highlights Caporale.

He adds that these new pressures from the client are forcing service providers to explore radical new ways to gain this data and provide new services. This is seen with State Street and SS&C Technologies' recent acquisitive plays, as well as BNY Mellon's alliance with BlackRock.

"COOs and CFOs are pushing their fund admins and custodians outside of their norm and as a result, those firms are now setting up alliances."

For the smaller and mid-sized alternative investment managers, what is becoming more commonplace is the COO and CFO roles merging into one. In some cases, the chief technology officer (CTO), the chief risk officer (CRO) or the chief compliance officer (CCO) also gets bundled into this.

As a result of this merging of roles, fund managers are often demanding a one-stop-shop-style solution from their third-party provider in order to meet all of their requirements.

"As there is so much interconnectivity between the roles, technology and compliance, they need partners that understand the broader infrastructure and can bring a solution set to support their operations," adds BNY Mellon's Skorzewski.

In these cases, the existing client-vendor relationship of providing back-office services is not enough.

Instead of relying solely on fund administrators and custodians, COOs and CFOs are becoming a lot more creative in who they partner with. Platforms that offer software-as-a-service (SaaS) solutions are increasingly becoming adopted by hedge funds as a way to plug-and-play an individual technology solution rather than implement a top-to-bottom revamp.

This added competition in the alternative investment services space has created a new schism between the vendor-fund manager relationship.

"Historically, there was never a level playing field between the hedge fund and their custodian, prime broker and fund administrator as it was always a one-sided conversation on the data and investment on technology," says ENSO's Busby. "Now it is much more levelled, and hedge funds are using vendors such as ourselves to calculate their wallet and what they pay to the bank broken down by products."

The trends within the alternative fund management industry show that the COOs and the CFOs need to have a complete 360-view of the business. It is no longer sufficient to be a specialist in technology or accounting, but instead there is a need to bring strategic thinking and understanding to everything that is happening around them in order to add value to the firm.

COOs and CFOs need to recognise the changing nature of their role, and look to the service provider industry for support. Services to COOs and CFOs will also no longer be siloed, as the lines between technology and compliance become increasingly blurred. "Not everything can be solely a technology or a compliance issue, they are interrelated and the COO/CFO needs to oversee solutions that are required to tick multiple boxes," adds Arcesiums's Nable.

However, they cannot be lax on their vendor relationships, and could be faced with an even harder task of overseeing their own providers, as at the end of the day, they will be on the hook if their operations or data goes array to both investors and regulators.

"They [CFOs] need to be general managers rather than accountants."

ROBERT CAPORALE, CEO, EXCHANGELODGE