

Ireland's Evolving Fund Administration Industry

The fund administration industry in Ireland has undergone significant change in recent years. Both industry participants and the services offered continued to evolve. Changes within the industry have presented administrators with many challenges but also with opportunities to expand their product offering and thus, to generate additional revenue. KB Associates undertakes periodic surveys for the purpose of maintaining a database detailing the functionality provided by each of the administrators in Ireland. As many of the administrators are part of large organisations which offer a range of services over and above traditional fund administration services this database covers all services offered to fund managers/promoters by these organisations such as trustee, custody, stock lending and financing services. By combining this product information with Lipper data which details the scale of activity for each of the administrators we get a unique insight into the evolution of the industry. The most recent KB Associates survey was completed in June 2009. The most recent data available from Lipper in relation to assets under administration is from June 2009.

Current Market Environment

Before turning to these developments it is appropriate to consider the environment that administrators now face. Many funds have experienced reductions in assets during the past 18 months as a result of both redemptions and negative performance. An inevitable consequence of this has been significant reductions in administration fees, which are generally charged at a basis point rate of the fund assets. Given the relatively fixed cost base of many administrators this fall in revenue has had a major impact on profit margins in the industry from the levels previously experienced.

This comes at a time when calls for enhanced regulation and greater transparency are at their

height, especially for the hedge fund industry. The likelihood of increased regulation for hedge funds, along with the desire of many managers to market their funds as highly transparent products, is likely to lead to greater demands of administrators. Such demands may increase the burden on administrators but may also present additional service opportunities and thus, revenue opportunities. In such an environment the need to clearly define and market their service functionality is of utmost importance for administrators.

Market Developments

Some of the interesting trends which can be seen from a review of the KB Associates survey and the Lipper statistics are as follows:

- Consolidation of large administrators
- New entrants to the administration industry
- Tactical alliances among service providers
- Increased market coverage of global custodians
- Increased offering of middle office services
- Improvements in reporting
- Increased focus on internal control/compliance
- Reduced availability of financing
- Reduced availability of trustee services
- Reduced availability of director and money laundering reporting officer services

Consolidation of large administrators

One of the most visible changes in the industry has been the growth in market share of the major administrators. As at 30 June 2009 the top six administrators in Ireland, including their subsidiaries, accounted for over 70% of market share, based on the annual assets under administration statistics provided by Lipper¹. This

compares with a market share of just over 57% for the top six administrators as at 30 June 2005. A major contributing factor to this increase in market share has been the acquisition activity of the major players as they seek ever increasing scale globally. Some of the larger acquisitions took place in 2007 when many of the firms being acquired were large participants in the market in their own right. State Street International acquired Investors Bank and Trust, Bank of New York acquired Mellon Fund Administration and Citi acquired BISYS. In the case of State Street and Bank of New York this represented a further strengthening of their already strong position in the market. In Citi's case this acquisition propelled it into the top tier of administrators, having previously held a position of 19th in the Irish market in 2007.

The top five administrators in Ireland as at 30 June 2009 are all major US banks. Bank of Ireland Securities Services is in sixth place. The top four positions have been occupied by BNY Fund Services, State Street International, JP Morgan and Northern Trust for the past four years. Citi has moved into fifth spot following its acquisition of BISYS.

The larger administrators tend to focus on fund managers with substantial assets under management, often in excess of several hundred million dollars. This means that opportunities continue to exist for a number of administrators outside of the top tier to provide services to clients whose size may not represent desirable business for the larger administrators.

New entrants to the administration industry

There have been many new entrants to the industry in the last two to three years who are competing for such opportunities. Many of these new entrants are specialist firms set up by individuals with vast experience in the industry and are offering only fund administration services. Examples of such firms are Admiral Administration, Apex Fund Services, Equinox Alternative Investment Services and Quintillion.

Instead of the larger players in the market squeezing out the smaller administrators there now appears to

be a developing tiered system of administrators with different tiers focussing on managers with different levels of assets under management and tailoring the service offering according to the various clients' demands.

Tactical alliances

Many of the leading administrators in Ireland are part of large international custody and administration providers which can offer a comprehensive service to potential clients including trustee, custody, stock lending and financing services. In cases where administrators do not have the functionality to offer these services directly there has been a developing trend to establish tactical alliances with a preferred service provider in order to offer potential clients a full servicing solution, albeit through the use of different service providers.

Global custodian market coverage

Those firms offering a custody service are now covering more markets than ever before. The average coverage of global custodians is now 95 markets, in comparison to an average coverage of 80 markets in 2006. A major contributing factor to this increase is the representation of emerging markets.

Middle office services

More administrators are now providing middle office services such as portfolio rebalancing and trade matching. While many of the larger administrators have provided middle office services for several years it is an area that many of the smaller administrators have recently entered to meet the increased demands of clients. There are now over 15 administrators in Ireland offering these services.

Reporting

The level of transparency and reporting required by clients has increased in recent years. Real time

reporting is increasingly being provided by administrators and the ability of clients to customise reports to suit their own needs is an area that continues to be developed. The nature of investor reporting is also developing with more demand for electronic and web reporting services compared to the basic fax service which may have been provided to investors in the past. Reporting by administrators to both clients and investors is an area that is likely to see further developments as the need for transparency continues to be of paramount importance especially in relation to hedge funds.

Internal control/compliance

The requirement for enhanced compliance and internal controls by administrators has become an even greater priority for clients and investors in recent times. Administrators have responded to this requirement and there has been a noticeable increase in the number who now possess SAS 70 Type II reports compared to the results in 2006, indicating a higher level of independent verification of procedures and controls. Of the respondents to the KB Associates survey there are now 17 administrators operating with a Type II SAS70 as opposed to just 10 in 2006.

Availability of finance

Custodians have traditionally provided financing arrangements for their clients. The survey results this year indicate a far more restrictive supply of financing. In the 2006 survey the respondents who provide finance all provided financing to custody clients for liquidity purposes, while over half of them provided finance for the purpose of leveraging. While the custodians were less willing to provide finance to non-custody clients there were a number of custodians willing to do so for both liquidity and leverage reasons. In what is symptomatic of a much more restrictive credit market the responses this year illustrate a very different environment. While the vast majority of custodians still provide finance to their custody clients for liquidity purposes many will not provide finance for leveraging purposes. The supply of

finance for either reason to non-custody clients has become virtually non-existent. In addition, the tight restrictions placed on credit means that those who are still providing finance are only doing so to clients who fulfil very strict criteria.

Trustee services

The more cautious approach of the service providers can also be seen in the provision of trustee services. In the 2009 survey the number of service providers noting that there are certain funds to which they are willing to provide administration services but are not willing to provide trustee services has increased from the 2006 survey. Such fund types include property funds and funds containing physical assets as opposed to securities.

Director and money laundering reporting services

Administrators are also moving away from provision of directors and money laundering reporting officers. This is particularly true in the case of the larger service providers. These services are still provided by some administrators particularly some of the smaller entities.

Such changes to the product offering of the administrators and their parent organisation continues to reflect a developing industry where firms respond to the ever increasing demands of regulatory bodies and clients while maintaining tight control of their risk exposure. The challenge is to offer a clearly defined product range which meets the desired risk/reward profile of the administrator's ultimate parent. The surveys demonstrate clearly to us that many administrator/custodian groups have refined their services to achieve this goal. The question for the future is who will step in to offer the services and assume the risk that many firms no longer deem desirable.

¹ includes all funds administered in Ireland