Solving Investment Industry Challenges:

The Strategic Role of Managed Performance Services

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Executive summary

The investment industry is undergoing significant transformation due to technological advancements, shifting investor preferences, and regulatory reforms.

These changes are evolving in line with wider macroeconomic pressures, including the rising cost of living, growing inflation rates, and the threat of recession.

In addition, financial services firms around the globe say they are experiencing significant difficulty recruiting and retaining skilled compliance and performance team members.

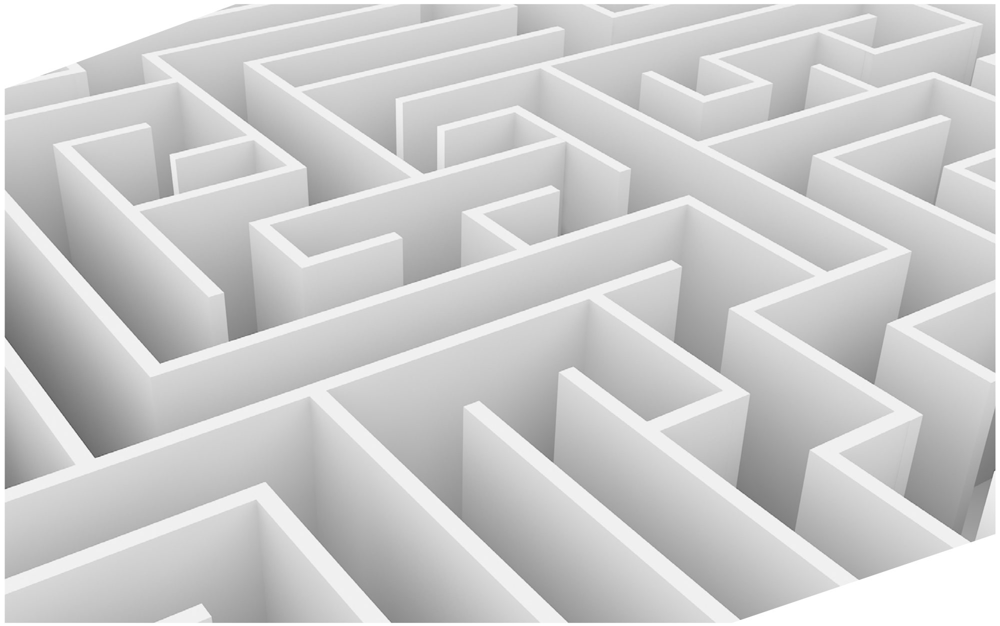
The escalating pace of regulatory change around the globe, and the need for more people to undertake new or expanded forms of compliance processes, has driven a talent shortage and increased turnover. What's more, staffing costs are growing while budgets remain the same.

This environment of heightened regulation and increasing scrutiny and costs, is placing significant pressures on firms, affecting their ability to deliver competitive returns to investors, and maintain high levels of service quality.

Management of these costs requires firms to adopt more efficient and effective investment performance measurement and reporting processes, and leverage technology and specialized expertise to reduce the burden on in-house resources.

In this paper, we explore how some firms are solving these resource challenges by:

- Exploring the case for managed services – a form of outsourcing - to address contemporary industry trends and concerns that are making the investment landscape increasingly complex and competitive.
- Examining best practices investment managers should be aware of when utilizing a managed service provider to help ensure a successful relationship.
- Debunking common concerns, discovering best practices, and uncovering solutions to help firms overcome perceived challenges.
- Looking into some real-scenario case studies to see how firms benefited from managed services.



The case for outsourcing investment performance services

Firms are increasingly challenged to increase the effectiveness of their performance programs, manage with fewer internal resources, ensure high-quality results, reduce turnaround times, and lower costs.

These pressures leave firms in danger of creating risky exposure gaps in their performance program.

Outsourced managed services are becoming an increasingly popular choice for firms aiming to relieve themselves of operational challenges. According to the latest **Cost of Compliance Report from Thomson Reuters**, 38% of firms outsource all or part of their compliance functionality, driven by the need for additional assurance on compliance processes (52%), the lack of in-house compliance skills (42%), and cost (43%).

80%

of firms have considered or will consider downsizing their employee base in the next six months

KPMG 2022 CEO Outlook

The move to managed services has been influenced by several factors:

Economic downturn

With many countries facing or in recession, economic uncertainty presents firms with staffing challenges. According to the **KPMG 2022 CEO Outlook**, when preparing for an anticipated recession, 75% of firms have implemented or plan to implement a hiring freeze in the next six months and 80% have considered or will consider downsizing their employee base in the next six months.

Managed services can play a key role during these times as a reliable solution that helps stabilize operational risk and costs, requires no benefit overheads or lengthy onboarding process, and allows for scaling as needed.

Talent shortage

An exodus of talent can also mean that expertise and specialism leave with the person. Individuals with the right specialisms and expertise prove a costly and time-consuming process.

Unsurprisingly, these trends mean compliance staff costs more, as a scarcity of people with key skills raises salaries. In the 2023 Thomson Reuters survey previously mentioned, a majority (61%) of respondents said they expected the cost of senior compliance officers to increase (51% slightly more than today, 10% significantly more).

Scalability

As investment firms grow, their performance measurement and reporting requirements can become more complex, necessitating additional resources and expertise. By outsourcing these functions to a third-party, firms can access the necessary resources and support to scale their investment performance programs efficiently and effectively.

Managed services offer scalable solutions, accommodating the needs of growing firms and facilitating seamless expansion into new markets.

This scalability also allows firms to focus on their core competencies while still meeting the demands of their expanding client base.

61% ***of respondents said they expected the cost of senior compliance officers to increase.***

2023 Thompson Reuters Cost of Compliance Report

Cost savings

According to the **Deloitte 2023 Global Shared Services and Outsourcing Survey**, the number one reason for outsourcing is cost reduction (followed by standardization and efficiency of processes).

The outsourcing of an investment performance program management to a third-party firm can reduce time and costs related to hiring, on-boarding, and retaining in-house staff, technology investments, and other overhead expenses.

For example:

- On average, it takes 28 weeks to reach optimum productivity at a cost of £25,200 per employee (according to research by **Oxford Economic**).
- The loss of an employee costs approximately 33% of their base salary. Employee turnover exceeded $700 billion in costs to employers in 2021, more than doubling since 2009 (according to research by **Work Institute** in the U.S).

By leveraging economies of scale, a third-party firm can offer cost-effective solutions that minimize the burden on in-house resources.

Additionally, by streamlining processes and leveraging the third-party firm's specialized expertise, investment firms can improve the efficiency and accuracy of their performance measurement and reporting processes, potentially leading to further cost savings.

Unmatched expertise and up-to-date knowledge

Navigating complex regulatory requirements and delivering accurate, compliant performance measurement solutions is not a simple task.

By outsourcing to a third-party, firms can tap into a team of experts with unparalleled industry knowledge and experience. This increases your workforce of specialists that are solely focused on performance measurement and reporting functions.

These experts possess a deep understanding of industry standards, best practices, and the nuances of investment performance calculation methodologies. By leveraging their expertise, investment firms can ensure their performance programs are robust, reliable, and in line with the latest regulatory guidelines.

Reallocating this specialized function to an outside organization that has high levels of subject matter expertise helps free up internal resources, and in turn deliver value and improved outcomes.

This expertise is crucial in an industry that is rapidly evolving and subject to changing regulations.

Comprehensive services

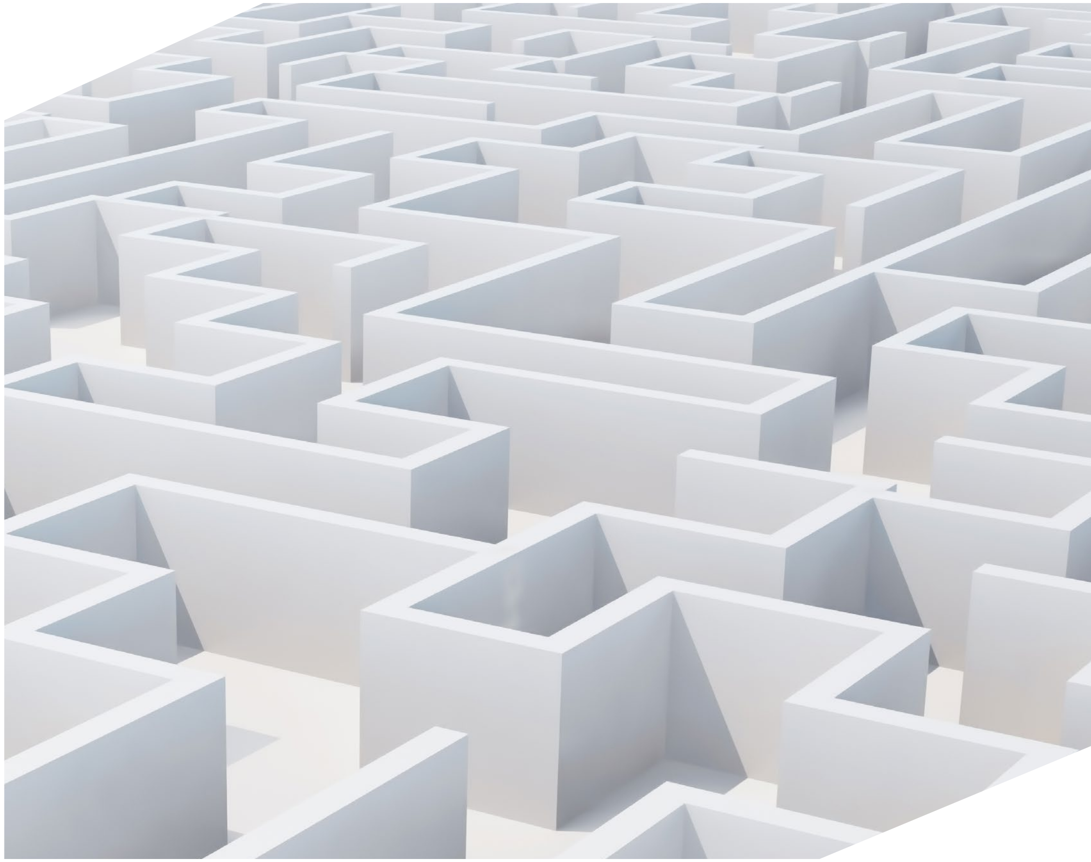
Depending on the vendor selected, a third-party firm can provide a wide range of services, including portfolio and fund-level performance calculations, composite maintenance, compliance and verification oversight, and other performance-related statistical calculations.

These comprehensive services can enable investment firms to access end-to-end solutions for their investment performance program needs, ensuring a seamless and integrated approach to performance measurement and reporting.

This allows investment firms to focus on their core competencies and strategic objectives while still meeting the demands of their clients.

Risk mitigation

Engaging a reputable governance, risk, and compliance (GRC) firm is critical when considering risk mitigation. By leveraging the third-party firm's expertise and resources, investment firms can reduce the likelihood of errors, omissions, and non-compliance with regulatory requirements. This can have significant consequences in terms of penalties, reputational damage, and loss of investor confidence. Furthermore, engaging a third-party firm with strong GRC expertise can help firms identify and address potential risks proactively, ensuring a more robust and resilient investment performance program.



Best practices for engaging a third-party firm

Engaging a third-party firm with a knowledgeable team of performance experts can provide significant advantages for investment managers. However, to ensure a smooth and effective working relationship, it's crucial to follow principles and practices that align objectives and expectations.

Below are some recommended best practices for engaging a third-party firm for investment performance program management.

Define clear objectives and expectations: This includes specific required services, performance measurement methodologies, reporting frequency, and any other relevant details. It enables both parties to align their efforts to achieve the desired outcomes and ensure a successful collaboration.

Conduct comprehensive due diligence: Assess the firm's capabilities, expertise, data security, reputation, and track record. Review client references, case studies, and industry recognition to ensure the third-party provider is best suited to address your unique needs and challenges.

Establish clear communication channels: Effective interaction is critical for a successful partnership. Designate points of contact within both organizations to facilitate efficient information exchange and collaboration. Regular meetings and updates will help ensure that both parties remain aligned and informed on the progress of the investment performance program.

Develop a detailed service level agreement (SLA): A well-defined SLA outlines the responsibilities and expectations of both parties and serves as a roadmap for the partnership. The SLA should detail the scope of services, performance metrics, reporting requirements, and any other relevant terms and conditions. By developing a comprehensive SLA, investment firms can ensure a transparent and accountable relationship with their third-party partner.

Foster a collaborative relationship: Encourage open dialogue and feedback to address any issues or concerns that may arise, and work together to identify opportunities for improvement and growth. A successful partnership with a third-party firm requires ongoing collaboration and mutual support.

Regularly review and evaluate performance: To ensure the continued success of the partnership, assess the third-party's performance against agreed-upon metrics and the SLA, and discuss any areas where improvements may be needed. By maintaining a proactive approach to performance evaluation, investment firms can ensure the ongoing success of their investment performance programs.

By following these best practices, investment managers can optimize their engagement with a third-party firm and maximize the benefits of their partnership. A successful collaboration can lead to improved investment performance program management, enhanced compliance, and greater overall success in the complex and competitive investment landscape.

Debunking common concerns regarding outsourced performance programs

While moving investment performance programs to a managed services solution with a third-party service provider has many benefits, some firms may be hesitant to take this step for a variety of reasons. We look at these concerns and outline why these apprehensions can be alleviated by working with the right provider.

#1 Loss of control:

The worry: Outsourcing the performance program will result in a loss of control over the process and quality of results.

Third-party response: A reputable third-party service provider will work closely with clients to develop a customized solution that meets their specific needs and requirements, ensuring the investment firm retains control over key decisions and processes. Additionally, regular communication and reporting will keep clients informed and involved throughout the engagement.

#2 Cost concerns:

The worry: Outsourcing a performance program could be more expensive than maintaining in-house.

Third-party response: While outsourcing may involve an upfront cost, partnering with a third-party service provider can lead to long-term cost savings by reducing the need for additional staff, ongoing training, and technology investments. Additionally, a third-party service provider can provide scalable solutions that accommodate the firm's growth and changing needs, ensuring they only pay for the services they require.

#3 Quality and reliability:

The worry: An outsourced performance program will not deliver the same level of quality and reliability as an in-house solution.

Third-party response: A well-established third-party service provider will have a team of performance experts with extensive industry experience and knowledge, ensuring the outsourced performance program is of the highest quality. Regular monitoring, quality assurance checks, and adherence to industry best practices helps provide investment firms the comfort they need regarding the reliability and accuracy of the performance program.

#4 Regulatory compliance:

The worry: Outsourcing the performance program could expose a firm to increased regulatory risks and potential penalties.

Third-party response: A reputable third-party service provider will have a deep understanding of the regulatory landscape and stay up to date with the latest changes and requirements. This expertise allows the third-party service provider to ensure the outsourced performance program remains compliant with all relevant regulations, reducing the likelihood of regulatory issues or penalties.

Case studies

Global Investment Performance Standards (GIPS®) Compliance

- **Company:** A large global investment manager with more than $160 billion in assets under management (AUM)
- **Location:** Global
- **Financial Services Sector:** Alternatives

Background: This firm faced challenges managing its investment performance program and maintaining compliance with the GIPS standards. The company's global credit business includes corporate credit, leverage loans, emerging markets, structured credit, private credit, and real estate strategies.

Challenge: The company faced numerous challenges, such as performing manual portfolio and composite calculations utilizing different calculation methodologies (Time-Weighted Return - TWR and Money-Weighted Return - MWR) and had limited in-house expertise to handle the complexities of GIPS compliance and performance measurement. This was due to employee turnover and limited resources to devote to GIPS compliance maintenance and verification.

Solution: The company decided to outsource its performance management and GIPS compliance program to ACA Group. ACA offered a comprehensive suite of services tailored to the company's specific needs, with services including portfolio and composite calculations, composite management, GIPS reports, and expert GIPS standards consulting.

Results: By partnering with ACA, the company achieved several key benefits, including an enhanced GIPS compliance program, improved operational efficiency, and access to industry expertise. The partnership freed valuable time for the company's staff to focus on core business activities and reduced training time due to attrition.

Conclusion: The partnership between the company and ACA demonstrates the value of outsourcing investment performance management and GIPS compliance to a reputable GRC firm. Leveraging the GRC firm's expertise and resources enabled the company to overcome its complex challenges and improve its investment performance program while maintaining a high level of compliance with the GIPS standards. This ultimately led to increased trust from investors and continued growth for the firm.

Case studies

Calculating Perfomance

- **Company:** Large asset manager with more than $800 billion in AUM
- **Location:** Global
- **Financial Services Sector:** Wealth Management

Background: The firm wanted to be able to market several internally managed strategies across various divisions within its network of financial advisers. The firm did not have resources to oversee the composites that are managed by the specific strategist and needed a process in place to ensure the composites created are meaningful and representative of the strategy advertised.

Challenge: The firm faced multiple challenges, including:

1. Calculating gross-of-fee performance across hundreds of thousands of portfolios.
2. Limited technology resources to effectively screen for outliers and calculate the corresponding composite returns.
3. Limited resources to devote time to assess the overall accuracy of the composite and make sure the appropriate members were included.

Solution: To address these challenges, the firm decided to outsource its calculation and assessment process to ACA Group. ACA was able to offer a comprehensive suite of services tailored to the investment management firm's specific needs, including:

1. Gross-of-fee calculations: The provider's team of performance measurement specialists developed a customized calculation process to receive fees paid by the underlying portfolios and derive the appropriate gross-of-fee performance.
2. Composite calculations: Using the calculated performance, the provider developed a process to construct the composite returns, screen for and remove outliers, and calculate the corresponding performance.
3. Composite assessment: Working together with the investment management firm, ACA developed an automated scoring process to assess the accuracy of the composite construction. The scoring process allowed the investment management firm to effectively identify which composites they were comfortable with, and which needed to go back to the strategist to correct.

Results: By partnering with ACA, the investment management firm achieved several key benefits:

1. Improved operational efficiency: With the third-party providing the back-office support necessary to ensure accurate and timely calculation of performance, the firm was able to free up valuable time for their staff to focus on core business activities. It also reduced training time due to attrition and concerns with loss of intellectual capital.
2. Access to industry expertise: ACA's team of performance measurement experts provided ongoing support and guidance, ensuring the firm stayed up to date with the latest industry trends and regulatory developments.
3. Mitigate regulatory risk: ACA provided a value added experience and expertise on Securities and Exchange Commission (SEC) and Financial Industry Regulatory Authority (FINRA) marketing and advertising regulations. The provider consulted with the firm to better inform their understanding of new requirements around the calculation and presentation of extracted and related performance under the SEC's Marketing Rule.

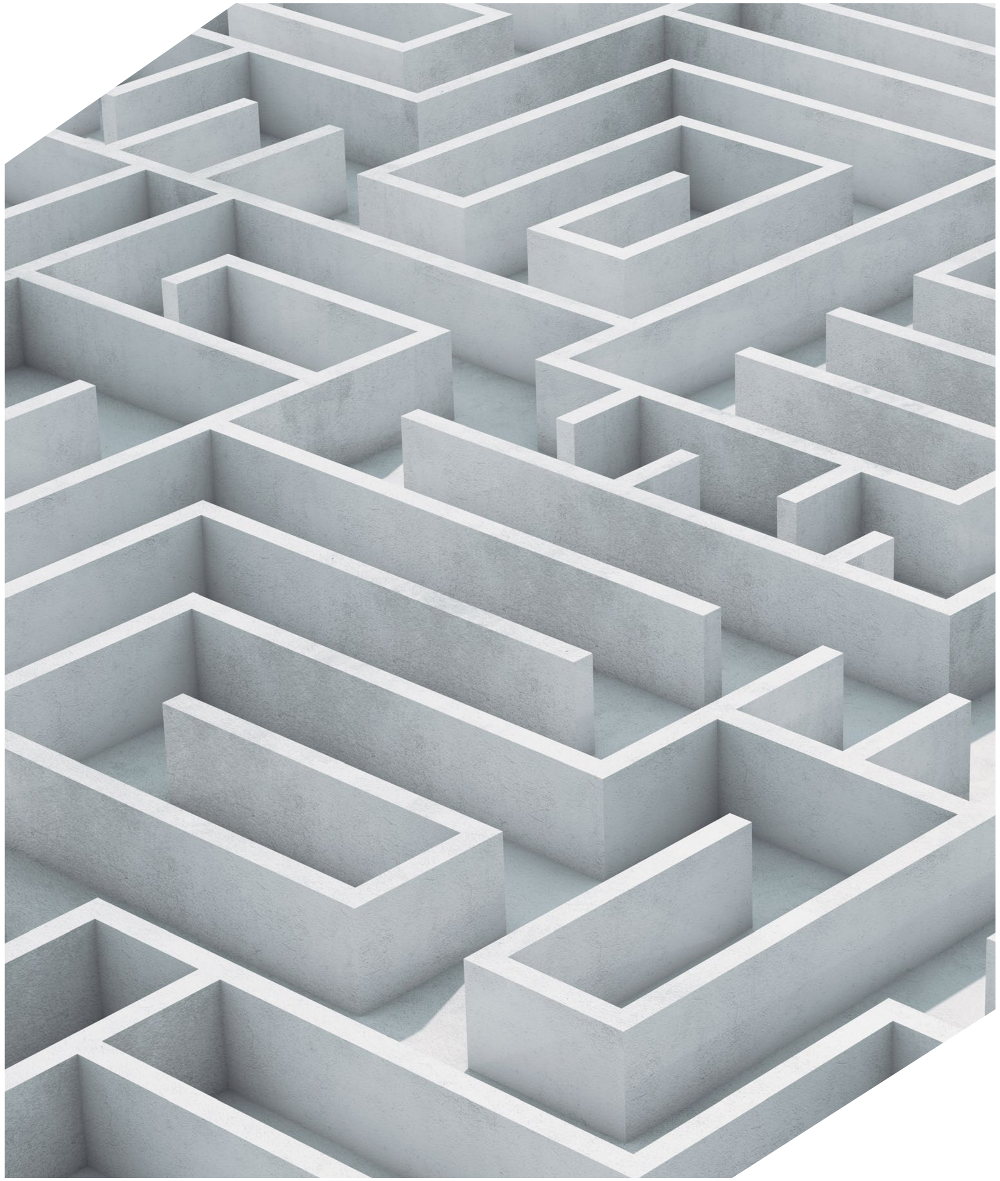
Conclusion: The partnership between the investment management firm and ACA demonstrates the value of outsourcing investment performance management to a reputable third-party service provider. By leveraging the provider's expertise and resources, the firm was able to overcome its challenges and improve its investment performance program while balancing the operational burden of the performance calculation process with the requirements of recent regulatory guidance. This ultimately led to increased trust from investors and continued growth for the firm.

Conclusion

Performance measurement and reporting are critical components of a successful investment program. Performance marketing continues to evolve globally and is undergoing a renewed sense of scrutiny from regulators and investors alike.

With the investment landscape becoming increasingly challenging, necessitating greater efficiency, compliance, and robustness from investment managers' performance programs is ever important. It's vital for asset and investment owners to ensure their investment performance programs are solid, efficient, and compliant.

In this complicated and competitive investment environment, partnering with a reputable third-party performance expert with both technical and regulatory expertise can help investment managers navigate this ever-evolving landscape and provide unparalleled industry knowledge and best practices in risk management and compliance.



How we help

ACA Managed Performance Services

ACA Group (ACA) can help overcome these complexities by allowing investment firms to leverage unparalleled expertise, scalable solutions, and significant cost savings. In addition, this collaboration can enhance service offerings, strengthen risk mitigation, simplify the intricate investment process, and seize opportunities for growth and innovation.

Our Managed Performance Services blend our extensive experience in the performance market with our internal technology to bring support to any investment firm.

Firms can outsource all or certain aspects of their performance measurement and reporting functions with the assurance they are working with a team that not only understands the technical aspects of calculating complex performance, but also knows industry best practices and regulatory expectations.

Our seasoned team is proficient in supporting firms of diverse sizes and complexities, ensuring the adequacy of staffing and expertise to meet evolving market demands. Our suite of services, customizable to the specific needs of each firm, includes:

- Portfolio and fund performance calculations
- Composite management and performance calculations
- GIPS compliance oversight and verification management
- Risk and other performance-related statistics calculations
- Gross and Net Money Weighted Return calculations (fund and deal level IRRs)
- Private fund management fee and performance-based fee review and reconciliation

As illustrated by the case studies included in this paper, firms that have engaged ACA's services have experienced measurable improvements in their performance programs.

Choosing ACA for Managed Performance Services offers a compelling advantage over both larger and smaller firms. With ACA, clients gain access to a unique combination of superior resources and capabilities, rivaling those of larger firms, while maintaining the personalized attention and responsiveness typically associated with boutique firms.

ACA's global presence and deep expertise ensure comprehensive and best practice solutions tailored to clients' diverse needs, regardless of their size or location. Moreover, the promise of continuity and stability with ACA helps ensure a trusted and reliable long-term partnership, making it the ideal choice for firms seeking exceptional performance consulting services beyond traditional firm size distinctions.

Benefits of ACA's Managed Performance Services

By moving to ACA's Managed Performance Services, you will gain:

- Performance experts with low upfront costs can help you cut the costs for recruiting, onboarding, training, and retaining employees.
- The ability to outsource recurring projects that take time and resources away from typical day-to-day responsibilities, allowing you to focus on firm initiatives.
- A large peer network: we bring together the industry's largest group of performance professionals with extensive industry knowledge, regulatory expertise, and technical skills.

Engaging ACA for investment performance program management is a strategic decision that offers significant advantages. It helps investment firms thrive in a constantly evolving industry landscape.

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Our team

ACA brings together the largest team of investment-performance professionals in the world to deliver a comprehensive range of solutions and help firms navigate complex challenges.

The team includes over 90 performance consultants representing in-depth expertise who work with firms of varying sizes and complexities, including traditional investments, private equity, private debt, real estate, Collateralized Loan Obligations (CLOs), and across all vehicle types.

ACA's performance team is part of ACA Group, the leading governance, risk, and compliance (GRC) advisor in financial services. For over 20 years, we've empowered our clients to reimagine GRC to protect and grow their business. Our global team includes former regulators and practitioners with a deep understanding of the regulatory landscape. Our innovative approach integrates advisory, managed services, distribution solutions, and analytics with our ComplianceAlpha® technology platform.

About ACA Group

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For more information

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