

The Registration-Outsourcing Connection

By Chris Grandi

January 9, 2006 - With the Securities and Exchange Commission's hedge fund registration deadline only weeks away, many fund advisers are in the midst of determining how they will use information technology to establish their policies and procedures. Some are scrambling to get their IT plans under way, others may even be in panic mode. For the benefit of all, here are some basic guidelines that will hopefully lead to informed decisions as the deadline nears.

To best position an operation for SEC registration, two key items come to mind: transparency and disaster recovery. To help you monitor your fund activity at all levels and to be prepared for an SEC audit, you need technology that delivers in-depth transparency into your various electronic communication, trading and accounting systems.



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First, this requires having quick and complete access to your firm's applicable e-mail and instant messaging (IM) activity, including messages from third-party information providers such as Bloomberg and Reuters. To ensure access, you must have an automated e-mail and IM archiving system that stores the records in an SEC-compliant format. You must also be able to view and download messages in their original formats, complete with attachments. Finally, the system should have thorough and easy-to-use searching capabilities so you can find records quickly and efficiently.

Secondly, you must have comprehensive access to all levels of your pre-trade compliance, trading, portfolio accounting and performance systems, as well as to any personal account trading activity. If you don't have an order management system or a pre-trade compliance system, it's time to strongly consider moving in this direction. For your existing systems, you need to take full advantage of their drill-down access, compliance monitoring, audit trails and general reporting engines. You may have to fine-tune some real-time compliance checks, reevaluate various reports and their parameters and develop new methods by which to better access key data.

As for business contingency planning, you must demonstrate to the SEC that in case of a disaster your firm can be completely operational at all times. Therefore, you need to have a thorough contingency plan, complete with 24-7-365 hardware monitoring, automated data replication and an off-site archive, and fast and secure remote connectivity to your applications and data.

As part of preparation for an SEC visit, it's now required that managers perform an internal audit of their operations and compliance systems. Additionally, it's strongly recommended that you or a third party perform an internal audit of your various IT policies and procedures, document weaknesses, understand deficiencies, and have a plan underway to correct them. The SEC will perceive a lack of this as a liability, and there's a good chance you'll be further scrutinized.

Regardless of whether IT is in-house or outsourced, you need to take stock of the entire infrastructure to ensure your firm is using your technology correctly and to its full potential. Most important, you must ensure that your core investment management and IT systems enable your business to be fully compliant with SEC regulations.

At an in-house shop, operations and IT staff should evaluate every aspect of internal IT tools and processes: pre-trade, trading, portfolio accounting, performance, analytics, reporting, data network security, backup and disaster recovery and e-mail and IM archiving. One goal of the analysis should be to improve and correct the use of existing tools and their associated processes as well as to enhance data network and security activity. Lastly, you need to close any loopholes that may affect SEC compliance.

If you outsource, the service provider should perform the same level of analysis on the specific systems and services for which you've engaged them. Once again, the end goal is to enhance and correct existing technology use and processes and to ensure that mission-critical systems enable your business to be fully compliant with the SEC.

If you're considering entering into an outsourcing arrangement, it's also critical to perform an internal audit of systems and processes, determine your specific requirements and do a cost-benefit analysis. This will enable you to make informed decisions about what makes the most sense for your business and what services best align with your business goals. Once you move forward with an outsourcing arrangement, make sure you have a solid implementation plan, achievable milestones, in-depth quality assurance, a well planned rollout and an ongoing performance tuning and maintenance schedule.

In-House vs. Outsourcing

Marshaling staff to either implement "insourced" technology or work with and oversee an outsource provider is an enormous challenge. As you evaluate which route to take, you must first decide whether you even have the appropriate resources to take this on in-house.

If you're a smaller firm, you might just decide you don't have the bandwidth to handle the workload. If you're considering having in-house staff perform these duties, you need to match up your candidates' skill sets with the job at hand. Some of the more obvious skills are project management expertise, technology implementation experience and, in general, solid technical acumen. I suspect that in the great majority of cases, firms may not have a person with this level of experience and would feel more confident engaging with a proven outsource provider, especially at this late date. In doing so, you delegate a pressing IT workload to a third party whose main focus is on hedge fund operations and IT, and who may even provide compliance strategy, planning and implementation services. This, in turn, lets internal staff focus on core business competencies while the firm reaps the benefits of decreased capital outlay, transfer of technology risk, better deployment of resources, and business continuity.

But time is of the essence. The IT paradigm has progressively shifted toward outsourcing. With this model, your team concentrates on the business: making smart trading decisions, tightly managing your fund or funds and delivering first-class service to clients. Meanwhile, you transfer IT responsibility to seasoned industry professionals who understand the nuts and bolts of an investment management infrastructure. It's their sole responsibility to keep your operation cost-effective, secure, efficient, operational and in full compliance with SEC regulations.

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