

## **William Keunen, Global Director of Citco Fund Services, discusses what shadow administration really means.**

Considerable interest has been shown of late in the supposedly new concept of shadow administration, particularly in light of the news that the world's largest hedge fund has effectively appointed two administrators. But, in reality, shadow administration has been around since the beginning of hedge funds; the difference is that the industry now focuses much more on the operational process and analyses new trends with greater interest.

So, what are we really saying? Well, to begin, the vast majority of hedge fund managers are tracking their funds' activities themselves, and rightly so – they need to retain control of all investment related data to facilitate real-time discretionary portfolio management decision making and oversight of the risk management process. Funds typically engage an administrator to maintain the official books and records, perform back-office functions, reconciliations, net asset value calculations, reporting and all investor related processing. In addition, many managers also maintain their own general ledger, with the administrator tying back to both the street and the manager's accounting records as often as daily. The 100% shadow approach by managers has traditionally made more sense for the complex fund groups and gives most comfort to investors in the sense that it provides real “belt and braces” checks and balances; moreover, a recent Ernst & Young survey found that 89% of investors favoured shadowing at some level.

So, what are we seeing in terms of revisionist thinking about the operational model? Well, the start-ups (which are now really picking up steam) generally seek to partner with their administrator as much as they can, i.e. take advantage of the scale, technology and infrastructure they bring to the table – at least initially. Once they gain scale themselves, they may re-consider their options and tweak the operational model to suit evolving needs. Existing funds are definitely considering their options. Outsourcing functions such as the production of the annual financial statements and regulatory and tax reporting seem to represent low-hanging fruit, while risk and transparency reporting come up too. Other areas such as middle

---

---

office functions follow, and provided that a robust control and oversight framework are available to the manager, further opportunities for administrators can arise. Finally, managers understand that to fulfil their function they have to own the database that feeds the investment process, wherever the data that feeds it flows from; and this area requires most careful consideration in terms of design and control.

One area where we as administrators value managers who shadow effectively is in relation to investor recordkeeping; given the complexity of investor related activities it is imperative all stakeholders are on the same page to avoid misunderstandings and incidents.

So, back to my initial remark about the recent announcement by a large fund to use two administrators. Some of the comments I have seen infer that only a small bracket of funds with tens of billions in AuM could scale the costs of such an approach to justify charging investors for two administrators, but I have to assume they have done their homework and have kept fund costs within an acceptable range; and no doubt, this is what all funds are being forced to do in some form by their institutional investors. In any event, we are all performing our own analysis of key data points, and like our hedge fund clients, we seek to achieve the right balance between the investments we make and the ability to generate a return over time; hence the decision to pass up on certain opportunities despite their apparent attractiveness.

In conclusion, the best solution for the industry is the one that fits each fund best – hedge funds are not commoditised products, so what works for one may not for another – hence the need for managers to work with their service providers to build an infrastructure that provides the best results in terms of operational integrity within acceptable economic terms of reference. Whatever the solution, the art of shadowing remains integral to the way the industry works.

### **Contact details:**

Email: [wkeunen@citco.com](mailto:wkeunen@citco.com)

Phone: +1 (305) 577 8373