The Tracker

Third-party ManCos: A Buyer's Guide 2023

Seventh annual report on third-party ManCo hosting platforms for asset managers

IFI Global

Contents

Introduction

2022 turned out to be a calmer year for most third-party ManCos. The majority still grew, but not at the searing pace of preceding years. More challenging times in equity and fixed income markets meant that growth was at a slower pace than in any of the six previous annual reports published in this series. Arguably a period of consolidation was needed after such a rapid expansion, especially from 2018 to 2021.

Inflows into funds are down everywhere, including in Ireland and Luxembourg, the EU's two major cross-border fund jurisdictions. At the end of 2021 Ireland had €4.1 trillion in fund assets. At the end of the first half of 2022 that figure was down to €3.9 trillion, a drop of 4%. Luxembourg had fund assets of €5.85 at the end of 2021. In July 2022 that was down to €5.37 trillion, a decline of 8%.

> Third-party ManCos have continued to grow in popularity with fund managers

By comparison assets at third-party ManCos were up for 88% of those reporting to the Tracker for the last 12 months. The average AUM growth of the ManCos listed on page 15 is up by 21%. (Newly merged ManCos, in 2022, are not included in this analysis.)

This shows that third-party ManCos have continued to grow in popularity with fund managers. It looks like managers of many stand-alone ManCos are coming around to the conclusion that the costs of running their own operations in Ireland and Luxembourg no longer makes economic sense, especially in tougher times for markets with inflows well down. Therefore, a large part of the reason why the AUM of most third-party ManCos have done

relatively well over the last 12 months is because they have been the recipients of a migratory trend from stand-alone to third-party operators in this business.

There are over 600 ManCos and AIFMs in Luxembourg and as there are approximately 450 ManCos and AIFMs in Ireland. This means that there over 1,000 of these entities in the EU's two major cross-border fund jurisdictions. The vast majority of these are stand-alone operations, established as subsidiaries of managers whose global headquarters are elsewhere.

As has been said in previous issues of this Guide, it will eventually become uneconomic for all but the very largest fund groups to survive and prosper as stand-alone ManCos, at least in heavily regulated EU jurisdictions like Ireland and Luxembourg. Joining a third-party ManCo for regulatory assistance, risk management and so forth is becoming standard practice for most managers.

The Tracker estimates that a mid-sized stand-alone ManCo, post Brexit, will need at least eight full-time staff to meet the regulatory bar. In its CP86 review the CBI, the Irish regulator, said that even the smallest management company had to have at least three full-time employees with the requisite experience to do the job. Employees include highly remunerated individuals who are qualified to perform the critical tasks such as the risk oversight function.

This is the Tracker's seventh annual ManCo Guide. It remains the only entirely independent source of information on third-party management companies. We believe that the information on the following pages covers the key issues managers need to address when out shopping for a ManCo platform provider.

ManCos have become an important part of IFI Global's Selection Intelligence Service (SIS). SIS was launched to help managers, especially those in the US, make more informed selection decisions on independent directors for their fund boards, jurisdictions (EU and offshore), service providers as well as ManCos.

Market development

Last year's Guide covered what we called the emergence of 'mega' ManCos in some detail. They have changed the structure of the third party ManCo business to quite a significant extent. .

The new breed of mega ManCo shows how far this business has come. It is a very different from the days when this was just a relatively straightforward outsourced compliance function. That is how ManCos on the alternative side of the fund business got started. They were small, specialist entities that set up shop to do ManCo hosting for alternative managers when AIFMD was coming into effect, ten years ago now.

Sharply rising interest rates and declining stock markets have made it more difficult for PE managers to find and execute new transactions

Today technology has become a great deal more important than it was back then. This has required substantial investment. It is one of the reasons why private equity managers became as associated as they have become with ManCos: to help build large, scalable businesses which are tech driven in their operations.

To a greater extent than many realise, the creation of these mega ManCos has been fuelled by a substantial wave of private equity money that has come into this industry over the last few years. However private equity investment subsided in 2022. The more difficult macro-economic and market environment has brought the private equity boom to an end, at least temporarily. After a couple of years of record-breaking performance 2022 wasn't so great for the PE industry. Sharply rising interest rates and declining stock markets have made it more difficult for PE managers to find and execute new transactions.

This has implications for ManCos (and fund industry service providers). There are likely to have been a number of ManCo deals in the pipeline but nothing substantial came through in 2022, other than the Waystone-KB Associates merger. That is a big change on what had become the standard pattern of behaviour in the third-party ManCo industry over the last few years.

Prior to the Waystone-KB Associates merger there was a substantial wave of M&A deals in this industry. It started in 2018. In that year Lawson Conner, a small niche provider in the UK was acquired by the SGG Group. That, in turn, was taken over by IQ-EQ. This came shortly after the acquisition of LIS, another niche provider, by Sanne and the Alter Domus takeover of Fund Partners in Luxembourg, as well as the acquisition that FundRock made of a UK ACD, also called Fund Partners. The big merger in 2020 was the link-up between DMS, MDO and Montlake. Another notable recent takeover was MJ Hudson’s acquisition of Bridge. In 2021 the Carne Group announced that it had secured a €100 million investment from Vitruvian Partners. Also in 2021 Apex completed its acquisition of FundRock. And it announced its takeover of Sanne.

Another noticeable trend has been the internationalisation of the business.

When third-party ManCos got going this was almost entirely a local cottage industry, with a very different set of entities offering this service in Dublin and Luxembourg. Now many of the large players in Luxembourg have branch offices in Ireland – and vice versa.

ManCos & US managers

In 2021 IFI Global launched a monthly publication for US alternative managers looking to come to Europe or go offshore, called FSI. FSI conducted a research study last autumn which showed that third-party ManCos are becoming increasingly popular with US alt managers wishing to go overseas. IFI Global surveyed US alternative managers, and their advisors, with a combined AUM of $62 bn on their international fund structuring choices.

> Third-party ManCos are becoming increasingly popular with US alt managers wishing to go overseas

IFI Global researchers discovered that the big and well-known US law firms, responsible for advising alternative managers across the US, are the chief reason why ManCos are now being used as frequently as they are by their clients. It appears that US managers are more likely to take the advice of their lawyers on what to do overseas than their equivalents in the UK or elsewhere.

Europe can seem like another planet to a manager based in, say, San Francisco – particularly if their business up that point has been built up entirely in the US. IFI Global researchers were often told by managers that they use a third-party ManCo because their lawyer told them to do it; it was the best available option (and, of course, much less expensive than setting up a management company on a stand-alone basis). No one surveyed said that they had looked seriously at going it alone.

One the most interesting findings of this research study is that 47% of the manager sub sample surveyed were aware of what a ManCo, in Europe, actually is. This is considerably higher than the last time IFI Global had asked this question in research in the US. Three years ago very few of the US managers, with no office in Europe, that IFI Global surveyed had heard of a ManCo.

Many US managers have been put off developing their business in Europe not only by the regulatory burden and its complexity but also by the lack of contacts and connections to assist them with distribution. ManCos obviously help them with regulation; it would be a logical extension for them to do more in distribution too. Some are now doing this.

The findings of FSI's research suggest that third-party ManCos are a potential bridge into Europe for US managers. ManCos take care of the kind of things US managers will have no expertise in at all – especially the EU's heavy and increasingly complex regulations.

Fees

The vast majority of ManCos base fees in part on a percentage of the fund's AUM. However, a small number do it just for a flat rate. The size of the fund is obviously critical to this. The most common arrangement is a combination of a fixed flat fee and a percentage of the fund's AUM – but how much the remuneration is based on one or the other is very much up for negotiation. ManCos that specialise in hosting illiquid alternative funds appear to be the likeliest to base their fees on a flat fee.

Many providers of third party ManCo services take into account a fund's complexity when determining their fees, although this is not universal.

Probably the largest single reason that there is such wide variety in fee structures is that provision of ManCo hosting services is a very long way from being on a level playing field.

For example, there are a number of providers that offer AIFMD hosting as a means of obtaining administration, fiduciary or other forms of fund servicing work. And it is noticeable that a number of M&A deals that have been done in the last few years was of independent platforms being acquired by fund administrators in the same alternative fund sector. ManCo fees could be discounted in order to obtain the administration work in some of these situations.

Although there are a wide variety of fee structures it appears that fees have been going up. This is for two reasons: supply and demand as well as the greater focus on risk capabilities by regulators.

The Tracker has heard of senior risk officers at ManCo platforms being paid €200,000 pa in Luxembourg. This might be an outlier but it shows the direction of travel of remuneration for senior executives at ManCo platforms. Their skills are in strong demand and there are few people available to do this job locally, so they have to be imported.

Although there are a wide variety of fee structures it appears that fees have been going up

The minimum fixed fee used to be as low as €10,000 at some of the smaller platforms. But that now appears to be a thing of the past. The more common minimum is €15,000 or even €20,000 but many platform providers will have a fee minimum of at least €25,000 these days. The percentage charged on the assets varies a lot too. 10 basis points is a common minimum, but it can be double that. If the fixed element is low the variable is generally a lot higher than this.

A lot is up to negotiation when it comes to fees. Larger managers, particularly those with well-established brands and fund strategies, are in a much more powerful negotiating position than smaller managers and start-ups.

ManCo due diligence advice

IFI Global's research department has conducted studies with investors and managers on third party ManCos. It is the only independent research and media firm to have done this

It is clear that what matters most to those selecting a ManCo provider are the expertise of the senior staff and the functional capabilities of their platforms. The majority of managers that IFI Global has interviewed say that other factors in selection process are relatively insignificant in comparison with these two items.

A ManCo's risk capability is growing in importance in the selection process and is the size of the ManCo's AUM. They are ahead of other factors such as which other managers are on the platform or whether the provider is from an administration, fiduciary, wealth management or other background.

In the last few years more institutional investors are doing their own due diligence on the platforms that host the funds that they are allocating to. Some of the largest institutions now investigate – sometimes in considerable detail – ManCo platform processes and infrastructure. Many of these due diligence teams have veto power.

Managers should bear in mind, when selecting a platform provider, that the goal of the due diligence carried out

> What matters most to those selecting a ManCo provider are the expertise of the senior staff and the functional capabilities of their platforms

by investors is to determine the level of substance at the platform. Investor due diligence often requires a certain level of substance to approve the investment. Institutional investors also want as much transparency, control and process verification as possible. External risk supervision should be seen within this context: the more comprehensive, transparent and intelligent the supervision of risk the better.

The Tracker's ManCo DDQ

ManCo Due Diligence Questionnaire

Regulatory Status

- Which regulatory/supervisory authority is the Company registered with?
- Please list your Directors and Designated Persons (or equivalent, depending on your jurisdiction) and mark these on an organisation chart. Please show the managerial functions for each Designated Person/ Director and country of residence of the individuals:
- Has the Company been the subject of any supervisory or themed visits from the local regulatory authority in the last three years? If yes, please give details:
- Is the Company by virtue of its regulatory status subject to any special conditions laid down by the home state regulator?
- Are any other Associated Companies regulated?
- Has the Company or any associated Company or any member of staff been the subject of disciplinary action by any regulatory authority in the last five years?
- Has the Company ever been the subject of an investigation into allegations of misconduct or malpractice in connection with its Management Company business or any other financial services or is currently undergoing an investigation by any regulatory body?
- Has the Company or any of its shareholders or any member of the same group ever had its authorisation revoked or suspended by a regulatory authority?
- Is the Company currently pending any litigation?
- Is any investigation by a regulatory authority or disciplinary action in progress or pending?

Corporate Structure/Strategy

- Please provide organisation and corporate structure charts.
- Please provide a brief summary of the strategic direction the business is taking, and, if applicable, its role in the wider group's strategy.
- Please provide a list of committees with a significant role to play in the company's regulated activities, and the terms of reference of those committees.
- Who is the Company's external auditor?
- Have the Company's or any associated Company's audited accounts been subject to any qualifications by its auditors? If yes, please give details.
- Please advise the identity of any individual or corporate entity who owns 25% or more of the company.

Internal Audit

- Do you have an internal audit and/or risk management function? If so, is this function in-house or outsourced?
- How does this function provide assurance about the activities of the company?
- When was the last Internal Audit carried out?
- Were any significant control findings identified?
- When is the next Internal Audit scheduled for?

Control Assessment

- Does the Company have a controls report in place? If so, please provide a copy.
- Please outline scope of report.
- Does the control report include cyber security controls?
- Please outline which company signs off on the control report.

Training and Competence

- Please describe your Training & Competence arrangements, including:
  - Recruitment
  - Assignment of Regulatory Functions
- What has staff turnover been in the last two years?
- Please provide copies of curriculum vitae or biography for all Directors and Designated Persons of the Company.

Finance

- Please provide a copy of your latest annual or half yearly report and accounts.
- Have the Company's accounts been qualified within the past 5 years?

Insurance

- Please give details of any professional indemnity and/or directors and officers insurance held by the company.

Capital

- What is the company's current surplus over its regulatory financial resources requirement?
- Please advise on what Capital Adequacy requirements are applicable to the Manager Company.
- Please outline how the Company monitors its capital and the results of any recent stress tests.
- Please advise how the Company will obtain additional capital if required.

Technology

- Please provide details of IT solutions for the following areas:
  - Investment Restriction and Borrowing Monitoring
  - Investment Performance Monitoring
  - Best Execution Monitoring
  - Investment Risk Monitoring
- How do you ensure client information remains confidential?
- What physical and electronic security controls are in place regarding business information to prevent inappropriate access to data?
- Describe any material system upgrades or changes in the next 12 months.

Disaster Recovery Arrangements

- Do you have a Disaster Recovery / Business Continuity plan?
- Please describe your IT back-up arrangements.
- Do you have alternative off-site facilities?
- How often is your disaster recovery / BCP tested?
- When was the last full test and how successful was it?
- Please provide a copy of your Business Continuity Plan.

Cyber Security

- Please outline processes and controls in place regarding cyber security.
- Are you aware of any successful cyber security attacks in the last 2 years? Please provide details.
- Are you aware of any attempted cyber security attacks in the last 2 years? Please provide details.

Enterprise Compliance

- Who is responsible for compliance in the firm?
- Is there a separate compliance monitoring function?
- Is this function in-house or outsourced?
- What are the reporting lines of the compliance function?
- Please provide a copy of the latest compliance monitoring plan.
- Please describe briefly the resources available in the compliance monitoring function (staffing, experience).
- What controls are in place to ensure findings from monitoring reviews are actioned?

Policies

- Please provide a copy of the company's compliance policies. If not included within these policies, please also provide copies of the following policies:
  - Combating financial crime: money laundering, fraud and market abuse
  - Financial returns and notifications to local regulatory authority
  - Managing conflicts of interest
  - Recruitment procedures (if not covered by Training and Competence below)
  - Data protection
  - Whistleblowing
  - Key man arrangements
- Who is responsible for maintaining these policies?
- How are they kept up to date?

- Please outline your remuneration policy and confirm that it promotes sound and effective risk management.
- Please advise what policies you have in place to advise regulatory authorities when share ownership thresholds are reached.

Conflicts of Interest

- Please describe the process you follow to manage conflicts of interest (if not covered by the conflicts policy requested above).
- Please describe any current or potential conflict of interest that exist for the company.

Combating Financial Crime

- Please describe the process for monitoring adherence to anti-money laundering rules and regulations?
- Please describe your arrangements to ensure staff are aware of their obligations under money laundering regulations? How often are staff trained in this area?
- How many suspicious transaction reports have been made by the company in the last 12 months?

Enterprise Risk

- Who is responsible for Enterprise Risk in the firm?
- Please describe any Risk Committees in place including Scope, Composition, Frequency:
- Please describe the firms Enterprise Risk Framework.
- Please describe the firms approach to Enterprise risk including use of Risk Registers, Risk dashboards, Key Risk Indicators etc.

Investment Risk Management

- Who is the person responsible for Investment Risk of the funds under management?
- Please describe the firm's Investment Risk Management Process, indicating what and how risks are identified, measured, monitored and managed. What systems are utilised in the Investment Risk management process?
- Please provide copies of your internal policies and procedures on:

  - Liquidity management / risk
  - Performance
  - Market Risk
  - Counterparty Risk
  - FDI Risk
  - Global exposure calculation
  - Please provide a copy of the Company's Risk Management Process (RMP)

Independent Valuation

- Please describe the process to ensure independent valuation of assets that may require more complex evaluation such as structured products:

Investment Monitoring

What is your investment monitoring process and what systems do you use?

Delegate Oversight

- Please list the third-party administrators the Company oversees.
- How many Investment Managers does the Company oversee?
- How many Distributors does the Company oversee?
- Who is responsible for maintaining the Complaints and Breaches registers for the underlying funds under management?
- What management information is produced e.g. on trends for complaints or breaches, and who is this provided to?

Monitoring Fund Compliance

- How do you control and monitor adherence to the underlying fund investment restrictions and requirements?
- Who is responsible for ensuring compliance with the investment objectives and policies and provide details of monitoring capabilities?

Monitoring Financial Control

- How do you control and monitor the preparation of the underlying funds' year end and interim financial statements?
- How do you control and monitor the audit of the underlying funds' year-end financial statements?
- How do you control monitor the underlying funds costs?
- How do you control monitor the underlying funds distributions?

Monitoring Investment Process

- How do you review underlying funds' performance?
- How do you ensure an underlying fund's investment policy is being complied with?

Monitoring Distribution

- How do you oversee the underlying funds' distribution?
- How often do you perform on-site due diligence on Distributers?
- Please describe any Due Diligence Process?
- Please describe your process to ensure that the Funds KIIDs meet UCITS, ESMA etc. requirements?
- How do you ensure the underlying funds are only distributed in registered markets?
- How do you ensure the local registration requirements are met in the appropriate jurisdictions?
- How do you ensure the underlying funds' marketing documentation is appropriate?

Administrator Oversight

- How often do you perform on-site due diligence on Administrators?
- Please describe the Due Diligence Process.
- Please describe how you oversee the Administrators.

Investment Manager Oversight

- How often do you perform on-site due diligence on Investment Managers?
- Please describe the Due Diligence Process.
- Please describe how you oversee the Investment Managers.

Onboarding

- Please confirm what due diligence the management company does prior to taking on a new client.
- Please describe your procedure for the approval of new business for the management company.
- Please confirm what due diligence the management company does prior to appointing a new delegate.
- Please describe your Onboarding process.

Third party ManCo Rankings

Rankings of ManCos in Ireland & Luxembourg

Name	AUM
Carne	$300 bn
Waystone	$300 bn
Universal	€122 bn
FundRock	€116 bn
MJ Hudson	€78 bn
Alter Domus	€61 bn
LRI	€34 bn
Link	€21 bn
Crestbridge	€20 bn
ONE	€20 bn
Vistra	€20 bn
Ocorian	$13 bn
Fuchs	€8 bn
Prescient	€5 bn

Name	No. of Managers
Waystone	332
Carne	230
Alter Domus	133
Universal	124
ONE	120
FundRock	117
LRI	108
Crestbridge	76
Fuchs	76
Vistra	72
MJ Hudson	46
Link	44
Prescient	27
Ocorian	16

Based on reported figures by ManCos to December 1, 2022

© IFI Global 2022

IFI Global Ltd is a fund management research and media business, focusing primarily on the alternative side of the asset management industry. IFI Global conducts proprietary and syndicated research studies and publishes online media.

For more information please go to:
http://www.ifiglobal.com

IFI Global Ltd, 6th Floor, The Minster Building,
21 Mincing Lane, London, EC3R 7AG