

# Service Providers Under Hedge Fund Pressure

Stockholm (HedgeNordic) – With both hedge funds and service providers maturing and in a process of transformation, managers are continually and perhaps increasingly re-evaluating whether they are getting the services they need, according to a new special report from Preqin.

“Service providers are a vital part of the hedge fund landscape, assisting in the smooth running of operations,” says Amy Bensted, head of hedge fund products with Preqin. “They perform a range of vital services in the industry, such as custody and valuation of assets, facilitating securities lending, providing advice on regulation and fund terms, and assisting with the fundraising and investor subscription processes.”

In recent years, however, sources of divergence have begun to emerge. Funds have been outsourcing portions of their administrative operations amid increasing regulatory pressure and the intensifying complexity of investment strategies in order to focus on generating returns. Meanwhile, fund service providers are being forced to adapt to a multitude of challenges amid regulatory overhaul, new technologies, cost containment and new political uncertainties (such as Brexit) in order to maintain service quality and fees. The challenges and needs of each means they may increasingly sometimes find themselves at cross purposes, as suggested by some of the findings in the Preqin survey.

Costs and quality of service are the leading concerns for hedge funds. Other factors stemmed from developments beyond the control of service providers themselves, such as the growth in a hedge fund’s AUM, dealing with regulations or the perception of investors influencing manager views. Meanwhile, most service providers work with between one and three hedge funds at a time, though 14% of the largest ones, such as Morgan Stanley Prime Brokerage, work with as many as 10 hedge funds at a time.

25% of all hedge fund managers surveyed by Preqin at the end of 2016 had changed service provider at least once in the past year, and a minority of these doing so even more often. Of these, 39% changed their prime broker – the largest proportion – by contrast to the 19% who switched their fund custodian, the smallest proportion.

55% of hedge funds cited costs as being the central reason for changing service provider. Administrators, custodians, auditors and law firms were most likely to fall into this category. By contrast, 21% were unhappy with the level of service, the category prime brokers and marketers mainly fell into. Of those that changed service providers, 20% changed their law firm, with 42% citing cost as the central reason for the shift, and a third cited dissatisfaction with the quality of service, according to the survey.

“In order to retain hedge fund clients and win new business, service providers need to address concerns over cost and quality of service, particularly as investor scrutiny over fees and performance continues to grow,” added Ms Bensted. “These firms will need to maintain a careful balance by improving their service offering while still reducing costs.”

While the turnover of service providers in 2016 has actually dropped to 25% from the 30% in 2015 reported in the previous Preqin report, the balancing act facing service providers is set to remain a concern for the foreseeable future.

