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Outsourced Trading, Beyond Execution

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In the beginning

The precise start point of a new genre of service is always difficult to pinpoint but Barry Savitz claims to have created the first Outsourced Trading Desk in 1993 at Furman Selz in N.Y. Interest grew fast and sometime in 1997 Furman Selz was sold to ING, and separately in the same year Williams Trading was formed.

By the turn of the new millennium when the term Outsourcing was used in the context of a Hedge Fund front office it generally referred to the Outsourcing of the dealing function for the underlying funds and was predominantly referring to the equity asset class only.

Fast forward to today and there is a multitude of different providers offering a vast range of services across multiple asset classes.

The Outsourced Trading business in its early years was small and many of the early players had worked together and whilst the early players like Williams and CF Global worked hard to promote the business model globally the adoption was slower than many might have hoped. This did not stop notable entrants like Tourmaline and Outset Global forming in 2011 and 2012 respectively, and whilst competitive they all had somewhat of a similar approach and scale to each other.

When the larger players, like State Street, started to enter the market a wider variation of services came to the fore, including transition management, and more diverse asset class mixes coupled with offices in ever more locations. When State Street stepped back from Outsourced Trading in 2017, Northern Trust stepped up to the plate and took that business and its customers onto their platform. Other larger entrants to the market, like Cowen, were formed off the back of corporate takeovers and joined a group of firms with additional strength and more diverse geographies.

And then

Whilst many assume that Outsourced Trading firms seek to replace the whole of an Asset Managers execution infrastructure the reality can be quite different. Many managers look to keep some specialist execution expertise in house and employ the outsourcer to support the asset classes or geographies that they are less proficient in.

There are various industry terms used to describe this 'co-sourcing' arrangement but what it allows asset managers to do is have 'boots on the ground' in asset classes or geographies where they do not have the desire or need to have a presence. It also allows the same managers to select providers based upon particular service offerings or requirements.

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We have seen these include:

- Trading and execution in non-core asset classes
- Cover for the trading desk
- Use of Outsourcers to reach execution venues not on the managers approved list
- External Middle and Back office support
- Enhanced TCA understanding and evaluation
- Access to software like OMS/EMS etc
- Transaction Reporting (T+1 reporting)

Asset Managers often do not think about the 'edge cases' in their asset mix. Whilst a fund such as a long / short equity hedge fund, may consider themselves equity-only, it is clear that many more asset classes are needed to run a global portfolio properly; there is almost certainly an FX requirement, as well as a need for Fixed Income to manage cash balances, then either exchange traded or OTC derivatives to manage hedging. Each of these assets, transactions, and business models may require expertise that may not be readily available in-house.

Executing orders across a range of asset classes requires specialists who can settle these transactions. This is another area where managers are increasingly relying on outside providers.

Some managers use their Outsourced Trading provider to assist with settlement whilst others contract with specialist middle and back office firms to carry out their entire post-trade activity from pre matching and settlement of the trades to custodian management, position management and reconciliation all the way through to Net Asset Value calculations.

Outsourcing Influencers Community

We have recently created the Outsourcing Influencers Community to help asset managers select the outsourced service provider that best suits their trading, execution as well as middle and back office needs.

Clearly each outsourced provider will present their solution as optimal, the truth is virtually none are an exact match for every client / fund type which is why, despite having run more selection processes than almost any other firm in this space, no two selection processes have ever look identical to us. Different managers with different internal requirements and different internal skill sets will require different solutions.

The aim of this initiative is to support the industry solution requirements and de-mystify the maze of offerings. Helping both managers and providers to understand the requirements of each other and to promote best practice in the industry.

Areas addressed include

- How to identify providers in areas where the manager is not an expert
- How to evaluate the best fit provider from a broad range of choices
- Understand the different operating models between the UK, EU and USA
- Discuss the advantages and disadvantages of anonymity when dealing
- Understanding where the responsibilities lie re Best Execution
- Identify the conflicts of interest in various business models
- Understanding the advantages / disadvantages in various business models
- Get comfortable with the time zones and locations services are provided from

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Case study – beyond execution

We recently worked with an asset manager who decided to use external provider(s) for a significant proportion of their trading support activities. At the end of the process an effective and efficient partnership was created to deliver a best of breed solution with the outsourcer delivering a far wider remit than we have seen previously.

This responsibility split is illustrated below

The Asset Manager

- Attracted net new money and managed accounts
- Responsible for asset allocation and portfolio construction
- Chose and managed their own PMS
- Created orders and staged them in an OMS

The Outsourcer

- Executed orders
- Pre matched and settled trades
- Responsible for corporate actions, cash balances and FX trades, including covering overdrafts and pre-funding accounts
- Calculated the trades required for cash management and FX and sent them to the PM's for approval

The Asset Manger

- Checked and approved the trades

The Outsourcer

- Managed daily update to asset managers books and records followed by overnight process
- Responsible for transaction reporting and reconciliation
- Responsible for managing and reconciling positions with custodians.
- Responsible for the cash and stock reconciliations, NAV calculation and balance checks
- Produced the quarter end reports
- Produced and published the RTS 28, and RTS 27 reports

The Asset Manger

- Wrote the historical and forward-looking commentaries included in the quarter end report(s)

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What next?

The conversations, which started with Outsourcing being about trade execution, predominantly in equities, have moved on a long way in the 25+ years. The next stage in Outsourcing for asset managers is now more clearly that which happens before, during and 'beyond execution'.

We will be running a webinar entitled '**Outsourcing – beyond execution**' on **September 30th** when we will be discussing the latest industry trends and opportunities with a panel of Outsourced Trading experts. We will be looking in more detail at the type of services that are now available beyond trade execution. Please do join us. Click the link to register

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