ERGO
CONSULTANCY

Event 2

Outsourced Trading, Beyond Execution

Outsourcing Influencers Community:
A conversation with Wells Fargo, JonesTrading
and Outset Global – November 25th, 2020

Outsourcing Trading, Beyond Execution – Event 2

The second in our series of webinars was held on November 25th 2020 – with **Randall Mcdonald** from **Wells Fargo**, **Andy Volz** from **JonesTrading** and **Adam Bandeen** from **Outset Global**. This series of webinars looks at solutions Outsourced Trading providers are offering the buy side over and above outsourced equity trading

Opening the conversation Adam Bandeen discussed **trading in Private Markets**, a relatively new but fast-growing area for Outset. He explained that the offering came at the behest of clients who considered Private Markets as "somewhat chaotic". Outset has hired two new members of staff to build the offering which is proving to be "super interesting".

Randall Mcdonald discussed **new client engagements** – "it's about listening to a client and their points of pain. The Outsourcing model does not fit every situation in the same way, but we do most often see clients at a point of change. Either the launch of a new firm where they want the entire infrastructure, or a new fund where they need access to brokers they do not speak to, or managing a product or market they do not have expertise in. Clients also consider Outsourcing as AUM declines and the cost structure needs addressing – the beauty is the ability to tailor to client needs."

Andy Volz **continued the theme** discussing how Jones often work with start-ups to provide infrastructure and fund-raising solutions as well as supporting firm's expansion and contraction needs. He acknowledged that the **execution of trades was only a small proportion of the activities** performed by Jones as the outsourced provider.

Clients, Volz said, relied on their providers for help with a broker vote, research access (in the US), and he also highlighted Jones's Private Markets group. He concluded by saying that he felt Outsourced Trading firms often became almost 'consultancy like' to the hedge funds they served.

The panellists generally agreed that the largest area of focus was not replacing internal trading desks but supporting them in areas where they had challenges in their ability to trade such as

- **Out of time zone trading**, including US and Asian execution for managers based in the UK/EU.
- **Asset classes** they were less strong in, including Private Markets, FX or Fixed Income.

Co-sourcing was discussed, with Outset saying that only 35% of their clients used the full outsourced trading offering whilst 65% relied on them to fill gaps and trade anonymously.

This led to an interesting discussion on the preferred model of outsourcing which can be known by a variety of names. It should be noted that, as Randall pointed out earlier, there is no one perfect model as different clients will have different needs.

To add to this, we (Ergo) have had clients choose different models at varying times after examining the implications of each. Many providers operate multiple models and the advocate of each can make convincing arguments for their preferred models.

As always it pays to understand the differences fully before making a choice here is an example of a couple of different models to help clarify:

1. Agency model

The Agency model facilitates the asset manager by connecting them to their outsourced provider in a single connection so that they operate as a single counterparty for trading and settlement. The outsourcer deals in the market in their own name and maintains the relationships with brokers/liquidity venues.

This has been the way outsourced trading has traditionally been marketed in the UK.

Advantages:

- Single counterparty and single settlement relationship ease the administration burden on the fund.
- The Outsourcer generally has far more counterparty relationships than any single asset manager giving the potential to access greater liquidity.
- Using this model anonymises the originator of the trade.

Disadvantages:

- The underlying fund is not as well-known in the market
- There can be a perception of IPO allocation disadvantage.

2. Reception and Transmission of orders (RTO) model

Under the RTO model the Outsourcer deals in the name of the underlying funds with a list of counterparties that the underlying fund manager verifies and maintains.

This is far more common in Continental Europe, particularly France.

Advantages:

- The fund retains its relationship with 'the street' and therefore its presence in the market.
- The fund can interact with brokers via broker reviews.
- The perception from large asset managers is that they benefit in IPO allocations.

Disadvantages:

- RTO places a higher burden on the fund manager because they need to onboard and manage counterparty relationships and settle directly with each broker. Resulting in more onerous middle and back office processes than the agency model.
- The counterparty list is unlikely to be as large as the Outsourcer maintains leaving the fund manager exposed to a more limited venue selection – i.e., venues they cannot execute in.

The participants then went on to highlight their buy-side desk credentials, rather than being viewed as sell-side service providers, with Adam from Outset explaining they paid commission to the street, received IOI's and were listed on Bloomberg as a buy side. Whereas the larger multi-faceted firms (Jones & Wells Fargo) pointed out that their Outsourcing operations were run from different locations, on different systems to their parent which was how they dealt with 'conflict of interest' questions if they were raised.

When asked if bigger was better Adam commented – better for who? Andy mentioned that JPMorgan had considered entering the fray and commented that he thought that might not be the best idea before saying "but you would expect me to say that wouldn't you!".

The consensus though was that the penetration of Outsourced Trading is currently sitting at around 10% of potential so there is still a lot to play for and there is space in the market for different models to sit alongside each other.

What with that and the range of asset classes, geographies and services which are emerging 'beyond execution' there seems to be a lot of potential growth left in Outsourced Execution and probably even more potential in 'Co-sourcing' where managers engage with providers for services they either don't want, or need to build in house capacity for.

Please join us for the third event in the series which will take place during the last week of January 2021.