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Technology**

Hosted services roundtable
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Hosted services are not new to the financial services industry. But during these testing times it is a model that has become more relevant to buy-side firms, offering managers the benefits of fixed IT costs, reduced time to market for new applications, and ease of maintenance and regular upgrades. But if the hosted services model is the way forward, why is it not more prevalent on the buy side?

Q *To what extent has the global slow-down altered demand for hosted services from a buy-side perspective?*

Neil Smyth: Over the past twelve months we have seen a dramatic increase in interest for hosted services from our prospective and existing clients. The hosted service we have offered since 2002 was really a service that we provided only if clients were asking for it. But in the past twelve months we have focused on our hosted offering, and we are now seeing the vast majority of our prospects in this area. Over 90% of our prospects this year have been hosted services so we are seeing a real increase in demand, especially with the economic situation. People realise it is a simple benefit.

Mal Cullen: We saw an increase in activity in our hosting business well before the economic downturn; in fact we saw a significant increase in our business two or three years ago, but I would say that in the past twelve months we have seen a few things in the marketplace changing significantly. The pressure on firms to reduce internal costs has made companies



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downturn, and largely driven by the benefits of a lower cost of ownership model. What the downturn has provided specifically in our business – risk management – is a focus on robust risk processes. That has added an incentive for people to implement risk systems and most of our demand today – 90% or more – is driven by a hosted model.

Q *Peter, are these sentiments consistent with what you're seeing?*

Peter Ellis: Yes, I think so, but I think it's perhaps a bit more complex than just finance. I think that what is happening is that there is a bit of a shift in the power base, from IT to business users. Business users are primarily interested in functionality... and they want the functionality tomorrow. They do not want to wait nine months to go through a long implementation programme.

Q *Cliff, from a buy-side perspective, have the drivers for looking at outsourcing technologies or operations changed at all?*

Cliff Warner: I don't think they have changed from maybe five or six years ago. I agree with some of the points that the technology providers have made and what Peter has said, but I think it comes down to three points: revenue, risk, and rationalisation. What is key to all buy-side firms is their ability to sell products and that is affected by their total expense ratio. The total expense ratio is impacted not only by the service providers (custodians and administrators), but also the investment manager and the technologies and support. Revenues driven by new products and the need

to get to market quickly is important, and I think risk – more so over the past eighteen months – has become very important for most buy-side firms. You have to remember the majority of them lived off spreadsheets in the early days, and some of them still do. However, large firms are very different. Small and mid-sized buy-side firms do not have the ability to maintain large technology bases and are therefore looking to outsource. Now, probably more than ever, most firms are over capacitated. They grew their technology to a level that allowed them to manage certain volumes, but assets under management have gone down, transaction volumes have changed, and now they have to move to a variable-cost model. Hosting technology is one of the things that can help.

Q *Where do you find the demand for hosted services coming from? New clients, existing clients?*

Mal Cullen: We are seeing existing clients that traditionally hosted applications in-house looking towards using a service provider. In the past twelve months a significant number of our installed clients have come over to our Eagle Access hosting solution. We have gone back to our clients and re-educated them in terms of what can be provided today, in contrast to a few years ago when we originally had that discussion, when the offering was not so mature.

Andrew Aziz: To some extent it is a function of the segment and the type of functionality that they are using our systems for. Our existing clients have already made a legacy investment in the solution, so the cost to switch is really

look at opportunities to have their technology structures hosted, partly because the firms have grown over time. They have put in place IT structures that no longer make sense with the reduction of assets under management – the cost structures they put in place are not sustainable so they are looking at hosting providers to help them reduce those costs. Therefore we have seen it primarily on a cost-reduction basis.

We have also seen that the decision-makers around certain technologies are now at CFO level and are looking at cost reduction.

Andrew Aziz: I would concur with both those points. We saw growth beginning probably about three years ago, before the economic

'Small and mid-sized buy-side firms cannot maintain large technology bases and are therefore looking to outsource. Assets under management have gone down, transaction volumes have changed, and now they have to move to a variable-cost model'

Cliff Warner

about debating the maintenance costs. There is a tendency to see how the (outsourced) service can augment their implemented solution, whether it is for new business or additional functionality, while there may be a longer-term plan to wean themselves off the installed solution. Work for new clients is predominantly driven by a hosted model. But certain segments

are still looking towards an installed solution, particularly some of our insurance clients

Neil Smyth: We are really seeing a mix of the two. Mal mentioned Eagle had gone back to its client base to sell them the story of the benefits of switching to a hosted model; they may well have had a different viewpoint two

or three years ago, but now there has been advancement in the technology and wrapping the services around hosting. As a vendor, when you are hosting you are taking on the responsibility of the complete delivery of that product as a service.

We see the demand primarily from new clients and, going back to the point Peter made, that is driven by them wanting the software now. The speed of implementation is on a different scale to local (internal) implementations because a lot of the responsibility of that implementation falls on the vendor.

We recently had a risk implementation in Europe up and running inside five weeks. That is pretty much unheard of when you are implementing locally.



(l-r): Anderson, Warner, Ellis, Aziz, Cullen, Smyth



Investit's Peter Ellis

Q *Cliff, let's turn this question on its head and look at London & Capital as a buy-side organisation. What are the issues that typically come up when considering the possibility of outsourcing certain technologies, applications, or even business processes?*

Cliff Warner: I think it varies according to the size of organisation. Larger organisations have a more bureaucratic structure, plus there is often a power base within an IT organisation that keeps large organisations from moving away because there are so many people employed. In the small organisation it is different. The biggest problem one faces in a small organisation is the fear of not being able to meet the sudden business changes required in a boutique firm and, more importantly, being quick to market. Outsourcing the technology, once it is outsourced, tends to

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Peter Ellis

be purely technical in terms of keeping the servers up and running and occasionally having some helpdesk support. However, the problem with a small firm is that it is not part of your ethos when you move to a structure like that. Most asset managers are entrepreneurs, and entrepreneurs run in different directions. That means you have to meet the demands of the business every day and sometimes – not always – outsourcing does not support that. But the way it can support it is by taking the business operations outside as well, which is something that as a software vendor you may not be able to do.

Peter Ellis: I think that is a very good point and at the risk of being provocative – which I am not normally – Victor made the point in his introduction that this (hosted model) is not new. Go back to the early 1990s and there were bureau services.

A lot of small investment management firms ran their back offices through a bureau service, particularly in North America. There are different infrastructure and architecture models available today that were not around 15 or 20 years ago, which makes it more attractive, but there is a difference between software vendors that have always offered hosted solutions and have only ever been available as a hosted solution – Factset comes to mind – and the

software vendors that first built an installed solution and then converted it to a hosted offering, which is the trend we're seeing.

Andrew Aziz: To be provocative in response, I think they are two different models – and I am not sure if I am speaking for the panel, but I think I might be. There is a difference between just hosting the software in an independent environment for a company and a standardised model that is accessed by multiple clients. I think the two clusters fit nicely into what we would call an ASP, which is essentially providing reports based on standardised models, rather than a managed service model. Essentially, the real difference between that and the installed model is where the hardware is installed. The configuration and parameterisation is still done by the client and is therefore unique to each client.

Q *Typically, what are the issues you cite as being important for the organisations that you try to move onto a hosted environment?*

Mal Cullen: When we deal with buy-side firms in general, their reluctance to give up control of their data is something we have to take into account. When we talk about hosting the applications for our clients we tend to talk about the fact that they still have other

applications internally, whether they are spreadsheet models, internal systems – order management systems for example – or data-rich applications. So the ability to give clients the assurances they need – that they can still have control over the data while they outsource their applications – is definitely a key selling point from our perspective.

I think there are definitely some hybrid models out there now where people can still have access to all their data locally. That is really the biggest fear on the buy-side: not being able to control the other applications that are relying on those systems.

Q *Cliff, in your experience have those data fears ever been realised?*

Cliff Warner: Well, the actual data problems are rare, but the fear of them occurring remains. The value that a buy-side firm has is its client base and its data – that is what it lives off. The biggest problem one has when moving to a hosted model concerns the data being taken out. It worries people.

First of all, there is a confidentiality fear – which is a bit ironic, because that tends to be taken away – and then there's the fear they will lose access to their data and be unable to create other models from it.

That is very important. I think the biggest fear

is the fear of divorce – it's expensive. If I go to a hosted model and it breaks down I have a big problem to bring it back in-house.

Q *Andy, it is no secret that hedge funds are very protective over their data, strategies and clients. Is that an issue that you come up against?*

Andrew Aziz: Less than we expected, but in certain jurisdictions that becomes more of an issue. The counter balance is that we often find that many of our hedge fund clients perceive it as a marketing tool – something they can wave in front of their investors to show they have robust risk processes in place. We also have clients that are pension funds, who are demanding more transparency around risk, so we are seeing two opposing forces there.

Neil Smyth: Going back to Cliff's point – the concern about data leaving the organisation – that is where the asset manager needs to do its homework on the vendor they are about to choose. What we have done at StatPro is, rather than it being a tactical decision, it is a strategic shift in the way we are delivering software. And we are seeing that Software-as-a-Service is a proven model

of software delivery. However, you obviously take on a lot more responsibility, which is why we offer things like ISO 27001 certification – independent auditing of the entire hosted service around the information security of that data, because that is critical to the client. They want to be sure that if they are handing their data to a software vendor to host, the vendor knows exactly what it's doing with that data. Being able to demonstrate that you have an externally audited procedure – SAS 70 (Statement on Auditing Standard 70) in North America and ISO 27001 in the UK and Europe – is important. That is one of the key things to reassure your clients, that you know what you are doing with hosting.

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Andrew Aziz, Algorithmics





Peter Ellis: I agree with everything everybody has said, but now I am going to disagree in that I think the data thing is blown up. I mean, who are the people that put up the objections to hosted services? It's not the business users, it's the IT people. Asking IT people to support a hosted service is like getting a bunch of turkeys in the room and saying 'Do you think Christmas is a good idea?' What are they going to say? 'Oh no, look at all these problems here. You have got to be scared of this and you have got to be scared of that and you have got to make sure you are doing this!' I will go back to what I said a few minutes ago: this is not a new concept. The idea of having a bureau service which has got all your data in it, that is an old concept so I think the data issue is a bit exaggerated.



Q *Are we likely to see this demand being sustained over a lengthy period? In other words do you think the ASP model (for want of a better term) is going to be responsible for the lion's share of future business from a buy-side perspective?*

Peter Ellis: Yes, I do actually. I think that one of the reasons for the move towards hosting is that the best-of-breed approach has served the industry quite well for a few years, but it comes with huge systems integration overheads and the cost of upgrading one of those components could be almost as much as the cost of implementing a new one. If you have got a range of different systems in your platform, keeping them all in step is a significant overhead and I think people are waking up to that and saying: 'Actually, that served us well but we need to move into a new world.' And I think that new world is ASP.

Mal Cullen: I absolutely agree with that. Eagle has been in the business of hosting for over twenty years now and it is definitely our preferred delivery platform for our software. I think that now the model has matured and the client base is there, there is no turning back in terms of vendors moving in that space. I also think there are compelling reasons for both the vendor and the buy-side client: the cost of supporting a client on a hosted basis is cheaper for us; and we can access the technology stack and resolve problems more quickly for the client. Going back to the upgrades issue, I think as a vendor we reinvest about 30% of

our revenues back into our product, and the research and development to add functionality for our clients is a huge initiative. The internal cost of doing an upgrade and buying a new technology, installing versions – that whole process is very time consuming. But we provide that as part of our service. There are benefits on both sides and for that reason it is a win-win for the vendor as well as the client.

Q *What types of buy-side organisations are not suited, to this particular model? Perhaps Cliff, you would like to comment on that?*

Cliff Warner: It is an interesting question because I think there is not a buy-side organisation that is not suited to this model. I think it is an ethos and I think it comes down to the unit cost of delivering it. The issue you may find – and I hate to say this – is that buy-side firms are looking for a solution and one technology is often not a solution. Therefore you have to bring two or three technologies together. Moreover, technology sometimes is not seen as a solution. Again, I hate to say it, but it is the service providers – the custodians and administrators – who provide the solutions. Technology just supports it.

I have the view that you need a bit of competition. Some of the vendors need to get together and work together rather than compete with one another. I think one or two need to get into bed with some of these large providers because they are the ones who are going to be hitting the buy-side firms from a trading perspective, from a books and records perspective, providing pricing and even providing frontline portfolio management

systems. It is about how you sell the model to the people. At the lower end they need a total solution, as Peter said, but at the higher end you have to pick and choose.

Q *A good example of the co-operation and alliances that you referred to – getting into bed with somebody else – is the news that Algorithmics and Eagle are talking to one another about the possibility of doing something on an ongoing basis. Perhaps Mal and Andy you'd like to comment on that – or is it too early to talk about specifics?*

Mal Cullen: I am happy to comment on that. I think Eagle has been primarily focused on three core competencies: our data management solution; investment accounting; and performance measurement.

We are always open to forming strategic alliances with complementary offerings, whether it be on the risk side, the management side, or in other areas. Typically, our clients demand some integration with other providers' applications.

Given the turn of events in the past twelve months, market risk has become probably the highest-profile project in most organisations, and risk systems are very data-rich applications – so any firms that have implemented a data management initiative are a natural fit for us.

Andrew Aziz: Likewise, with StatPro and so on, I think there are lots of opportunities. I think it is a very valid point that you mentioned best-of-breed, but at the same time, you do not want to lose that if you move. I think there is an opportunity for various providers to create complementary solutions.

'Given the turn of events in the past twelve months, market risk has become probably the highest-profile project in most organisations'

Mal Cullen, Eagle Investment Systems

Peter Ellis: I agree. I think that if best-of-breed is going to survive then we need to move more to the ASP-type model. I think the notion of having a best-of-breed platform, where you have a number of different installed solutions maintained in house, is a spent idea.

Neil Smyth: I think there is a risk from an integration perspective when you implement best-of-breed products on an installed basis. Similarly, if you replicate that scenario in a hosted environment you are going to have problems because how do you integrate all those hosted solutions with each other?

You may want an equity attribution system, a fixed-income attribution system, a GIPS system, a risk based system... and you may want to feed those applications with data and get complex asset pricing. So StatPro has put together a platform to deliver a single hosted solution to our clients offering all of those disciplines. Clients then can integrate third-party data into that.

Nobody wants to buy an empty box anymore – you do not want to buy an empty piece of software, whether it is installed or hosted, because you are still going to end up having the same problem: how are you going to feed that piece of software [with data]? So taking the installed model and moving it to a hosted environment can still leave you with quite a few problems unless you have integration.

Q *From a compliance and a regulatory perspective, and maybe even business continuity as well, are there benefits to taking the hosted route from a buy-side perspective?*

Neil Smyth: Business continuity is expensive. Each application is graded according to how business critical it is – risk might be very business critical but composites reporting might be less so – and we see our clients facing issues with business continuity because it is not cheap. So, if they can outsource that middle-office analytics platform and data to a vendor and say 'You are now responsible for business continuity, prove to me that you do it properly, we want to get involved in your tests (we want to do a six monthly test or an annual test); that removes a huge headache from the asset manager in terms of business continuity. The business people just want to know they can gain access to the application if there is a big problem somewhere. They do not care about the underlying IT infrastructure – they just want to use that application within say one hour of a failover, which is something that we offer. Multi-site failover – if London is unavailable you can failover to North America et cetera – if you can wrap that into your service it's very compelling for clients, because they know the reality of doing that themselves is very difficult.

'The SEC wants to see you have total knowledge and control of everything, from a calculation to a basic process that takes place within your shop, whether it is outsourced or not'

Cliff Warner, London & Capital

Cliff Warner: I'm a bit torn in my answer to Neil's comments, because I'm not sure that buy-side firms have mission-critical systems demands like that. However, the FSA requires the asset manager to take total responsibility and they have to have monitoring control.

If I outsource anything I still have to have monitoring control. One of the downsides of outsourcing is that sometimes I lose that control, so one has to create a governance structure where you have that control. That is key from a regulatory point of view. Can it help your regulatory and compliance? Yes, it can. Obviously the things that you sometimes have to do today manually or as part of an ad hoc process, outsourcing it and having technologies that support it, will provide you with those additional services. Rather than actually looking at it from a regulatory point of view, I think clients now are demanding it and that's more important.

If I can respond to an RFP by saying 'This is outsourced, it is outsourced to this company, and this is how they are accredited etc,' that's a good thing. But if I tell them I am doing it myself, they start to ask questions, although it's not necessarily about the technology – they might ask about the processes and procedures and the technology drives a lot of that.

So that is one benefit of outsourcing, but from a regulatory point of view (which comes

back to the liability issue I raised) I am still responsible.

Neil Smyth: You need that comfort factor – you have to feel comfortable with your partners.

Andrew Aziz: Much of what we have seen is the issue of time to market. People often need to put something in place quickly and the hosted solution, in addition to the other points, offers a quicker way to address regulations.

Peter Ellis: And I think that is one of the original drivers for people going to a hosted solution for a performance system: 'We need something, we have got to get it in quickly, let's just go hosted.'

Q *Mal, Cliff mentioned the FSA and regulatory drivers and how they may impact hosted servicing model. Does SEC, for example, have similar requirements in the US?*

Mal Cullen: The clients are all subject to their own regulatory responsibilities. I think from our perspective, as we started seeing more large global firms taking on our hosting business, we were responsible for increasing our service levels to make sure we could provide documentation for access to information, controls and procedures around when we touch the data, when we are upgrading the application, and

making sure those processes are in place. We have had to go through things like a SOX [Sarbanes-Oxley] certification to make sure the information is available to our clients and we put tremendous investment into some of our infrastructure to provide additional reports and auditability around things. We have processes that will go in throughout the day and emulate the client experience – run a report, check the response time back from the database and log all the statistics, for example. That way we can be confident we are providing our clients with applications that meet their needs.

Cliff Warner: May I respond to that? Having gone through an SEC experience over the past year, one of the things the SEC wants to see is that you have total knowledge and control of everything, from a calculation to a basic process that takes place within your shop, whether it is outsourced or not. One of the things outsource providers need to do – probably a bit more quickly than some of them do – is provide all that information, because the SEC sends you a form and a list of questions before they turn up and you have to go and find the answers.

I ran an algorithmic trading system in the US and I had to go into how that trading system worked, which meant I had to go to the outsource provider to get the information and so on. The problem is some of that is proprietary, but you have to provide it to these guys. You have to have a set of standard answers for the SEC.

Neil Smyth: I think vendors have to realise that they have to be much more open and make this information available to clients to satisfy those areas. So making reports available to clients about how the service is running, what is going

on in the background, the uptime statistics, and the performance levels – basically being open about that and making those available to your hosted clients – is something we are definitely seeing as well.

Q *Are any of your hosted offerings 'lite' versions of the installed offering? I know that going back four or five years the ASP was always a slightly watered down version of the 'real' one – the one that was run in house. Is that a thing of the past?*

Andrew Aziz: There are two aspects to that. There is the software and then there is the service component itself, which includes the software as well as the data management and so on. From the software side we were fortunate because we always had a client-host architecture. It just so happened that both the client and host resided at our customers' site so all we did on the software side was move the host to our facility. So functionally, it is not a lite version – it offers the same software components and the same user interface as our installed version. On the other hand because we are hosting it we have to manage the data, both the inflows from the clients and the processing of the data to produce the analytics. As a result, we have chosen to roll out certain capabilities at a determined rate – we started off with market risk, moved on to counterparty exposures, then to liquidity risk, and now we're rolling out portfolio replication.

Mal Cullen: From Eagle's perspective we have the exact same software deployed for the hosted service as we do for the in-house installations. Feature-for-feature it is the



l-r: Eagle's Mal Cullen and StatPro's Neil Smyth

exactly the same. But we have also found that there is a client base out there for which we want to package up an offering that can be implemented much quicker. We are not going in there and building new interfaces – we are coming up with the pre-defined adaptors to sources that the industry is looking for.

Therefore it allows us to provide a defined-cost structure for the implementation and a much faster time to market to get the application up and running. As we get critical mass from a number of clients using the same structures and platforms, it becomes a cheaper support model for us because they all look the same and we can upgrade them in the same way, with the same support staff monitoring

the same client base. So it does allow us to lower the total cost of ownership that we are deploying.

Neil Smyth: Absolutely. Yes, very similar to Mal's point, it is identical. The hosted experience is identical to the installed experience; whether you are taking our index service, any of our data services, our complex asset pricing service or our analytics platform, what you are getting is exactly the same. Similar to a point Mal made, we are investigating making an offering for a slightly different market that would be a lighter version but our hosted service at the moment is identical to our installed platform. There is no difference at all. >