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trading technologies for financial-market professionals

Managed Services

Special Report

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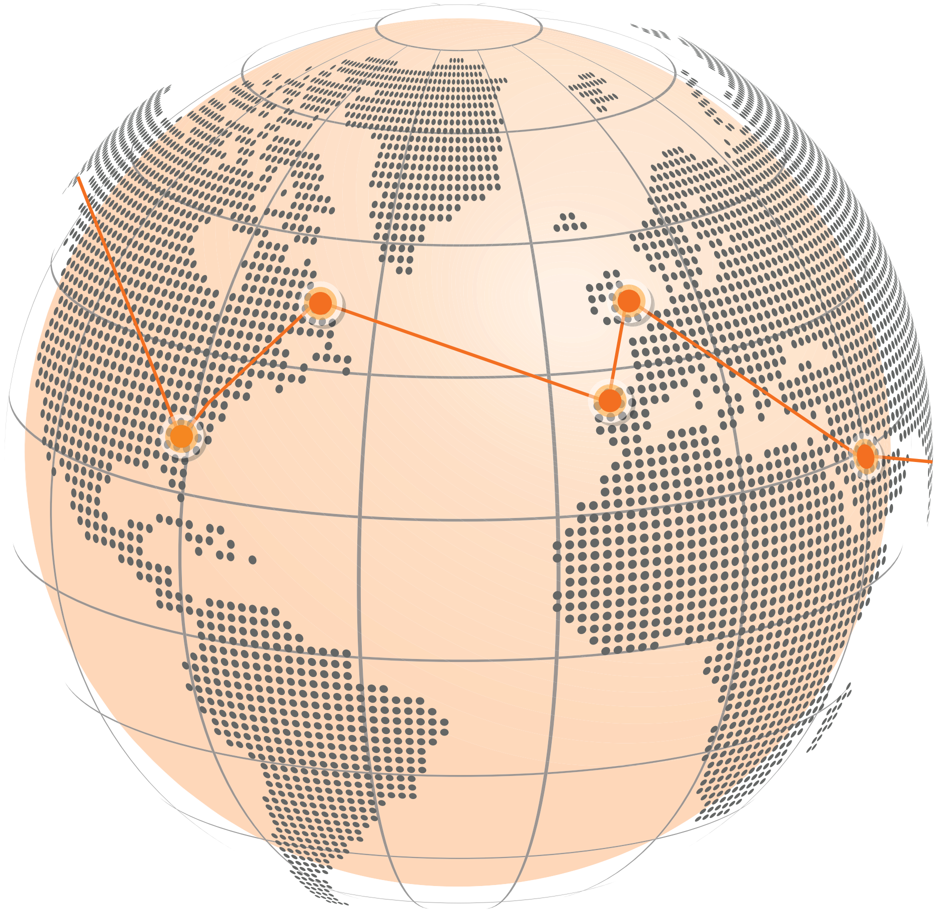

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Resentment Waiting to Happen?

Given the rate of change across the capital markets and the need for both sell-side and buy-side firms to stay abreast of the latest developments, while simultaneously putting themselves in the best possible position from a technology and operational perspective to take advantage of new business opportunities, it is not surprising that firms of all description are looking to service providers for specialist technology and operational support.

Outsourcing certain business processes has long been a part of the capital markets landscape. After all, why would buy-side and sell-side firms go through the pain and often considerable expense of developing technology and operational expertise in-house when they can partner with a provider whose bread and butter it is to manage those same business processes, and which in many instances it already manages on behalf of other clients as well as or better than they would ever be able to do in-house? For large numbers of capital markets firms, it's a no brainer—it simply doesn't make operational or economic sense for them to manage largely commoditized business processes in-house, especially when they do not provide them with a competitive advantage.

But in recent years, the activities wrapped around outsourcing and managed services (not to mention the business rationale for entering such relationships) have changed. Now, outsourcing is synonymous with total "lift-outs" and handing over to a specialist provider those functions that have become laborious and overly complex, while managed services is all about accessing and adding niche functionality, data or applications to an existing technology stack that would simply not otherwise be technically or economically possible. The difference, therefore, is subtle, but significant.

A number of related themes are addressed in this special report, including: how firms should go about evaluating the functions they can and cannot afford to offload to, or take from, a service provider; the regulatory and fiduciary implications (and possible restrictions) that need to be considered when contemplating a managed service relationship; the financial, operational and technical benefits that stand to be gained on the back of such services; and the key ingredients that should be present in managed service arrangements. Such partnerships have the potential to yield significant benefits to both parties, but as with all relationships, they are only a few failed promises from souring. ■

Victor Anderson
Editor-in-Chief

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Redline Unveils Managed Consolidated US Exchange Feed

Redline Trading Solutions, the Woburn, Mass.-based low-latency ticker plant and feed handler vendor, has unveiled a fully managed consolidated datafeed of US equities and options market data, dubbed RedlineFeed, using the firm's InRush ticker plant to aggregate and normalize the data from direct exchange feeds.

Redline officials say the service—pricing for which will be based on the number of venues, symbols and servers required—will provide the cost advantages associated with managed services without compromising latency, since the service will be "nearly as fast" as Redline's direct feed solution, with latency of "single-digit microseconds" from exchange tick to trading application. The feed is available at Equinix's datacenter campus in Secaucus, NJ and other co-location facilities, and uses hosting capabilities provided by managed infrastructure vendor Options.

"Redline says the service—pricing for which will be based on the number of venues, symbols and servers required—will provide the cost advantages associated with managed services without compromising latency."

New Analytics Vertical from CenturyLink after Cognilytics Acquisition

CenturyLink has formed a new vertical to provide cloud-based, managed predictive analytics and big data services to capital markets firms, following the acquisition of San Jose, Calif.-based big data technology and analytics provider Cognilytics last year.

At the time of the acquisition, CenturyLink planned to integrate Cognilytics' predictive analytics, data visualization and big data deployment management tools with its own network, cloud and managed services infrastructure.

Go Vertical

Since then, however, the vendor decided to "vertical-ize" Cognilytics' business, and has created a new business vertical offering of predictive analytics and big data technology packages to financial services customers. The first of the new financial services packages will comprise Cognilytics core capabilities, while the second will introduce additional features, says Manav Misra, chief knowledge and science officer at CenturyLink Cognilytics.

CJC Expands Managed Services Offering

Market data consultancy and real-time systems support and management provider CJC has expanded its development offering in response to client demand for managed services around market data.

The vendor has had its own development team since 2005, but the recent uptick in demand for managed services—particularly around the creation of custom feed handlers, combined with support of analytical services and tick-capture systems—has prompted the vendor to expand its development function in order to respond to this growing demand. The expanded development team comprises just over 10 staff members worldwide, led by software developer Tony Maggs, who has worked for CJC since 2005 and reports to Paul Tomblin, chief technology officer at CJC.

The team will focus on providing clients with expertise to support several areas of market data management, such as writing custom feed handlers to capture tick data from exchanges, as well as analytical services to review the data, and the creation of bespoke tools, says CJC chief executive Paul Gow.

Expertise

The team has expertise in developing financial solutions across real-time market data subscription and publishing from traditional market data platforms using APIs, such as Thomson Reuters' Robust Foundation and Ultra Performance APIs, and Microsoft's Speech Application Programming Interface (SAPI). It also has knowledge of low-latency time-series storage and analytical systems, integration with order management systems through customized APIs, visualization using technology from Datawatch-owned Swedish data visualization software vendor Panopticon, and analytics that leverage big data technologies like Hbase, Hadoop and Cassandra.

According to Gow, the majority of financial institutions use various tick capture products, ranging from off-the-shelf vendor solutions to bespoke services, but before this year, clients preferred to hire developers in permanent on-site positions to manage them. However, more recently CJC has seen increased demand for vendor services that can tap into their expertise and experience, he adds.

The development team will serve CJC clients in New York, London and across the Asia-Pacific region, and reflects the vendor's plans to provide scalable support and consultancy services to customers, Gow says.

Exegy Readies Feed Handler for IEX TOPS Feed

St Louis, Mo-based hardware ticker plant vendor Exegy has added a new feed handler for New York-based dark pool IEX's upcoming Top of Book Quote Feed (TOPS) to its managed services ticker plant offering, to meet demand from sell-side agency brokers and buy-side clients for access to the data for best execution and price discovery.

Official testing

In response to demand from sell-side and buy-side clients, Exegy has built a feed handler for the new TOPS feed. Development and internal testing of the handler took less than four weeks; the vendor is now beginning an official testing phase with the dark pool, according to Exegy chief technology officer David Taylor.

"IEX is entering the official testing period, where it broadcasts data on public multicast to different groups, so we are participating in that testing, along with clients, to make sure they are ready," Taylor adds.

As a fair-access market, IEX has a number of market data initiatives in place to ensure that raw speed does not provide certain participants with an unfair advantage. For example, the dark pool does not offer co-location, and delays distribution of market prices slightly to ensure fair distribution to all customers.

Exegy users will benefit from being able to include or exclude the feed on the fly to support price discovery and order-routing decisions, according to Taylor. "One of the major features of our product is the ability to build multiple, user-defined composite views of the market, and add or drop markets based on market conditions. Users have the ability to include IEX prices, but also the ability to retain a user-defined composite view of protected markets so that they can see the National BBO that is subject to Reg NMS to make sure they are compliant," he says.

The greatest demand for the feed has come from investment banks and their agency brokerage businesses that need to be able to reach all liquidity pools to achieve best execution for their clients, Taylor says.

"As soon as IEX announced this feed, we had interest from many of our agency clients to take data to include in-routing decisions, as they place trades on behalf of their customers," he adds.

As part of its managed services offering, Exegy customers can add the IEX feed to their existing appliances free of charge, without having to deploy any additional hardware. ■

Liquidnet Outsources Asia Back-Office Services to BNP Paribas

BNP Paribas Securities Services has struck a deal with Liquidnet to provide the trading network with a suite of back-office services for its Asia-Pacific business.

The custodian bank will allow Liquidnet to support its growing equities business in the region by reducing manual processes and risk within its broker confirmation and custody areas, offering third-party clearing and settlement, as well as assistance with record keeping.

"Through its offering, we are able to further improve operational efficiency and provide a smooth flow of post-trade processes and reporting to our clients in Asia under US regulations," says Andrew Walton, COO of Liquidnet Asia-Pacific. "Liquidnet, with the help of BNP Paribas Securities Services, will be able to focus on our core business, which is connecting global investment managers to source block size liquidity opportunities across markets and continents."

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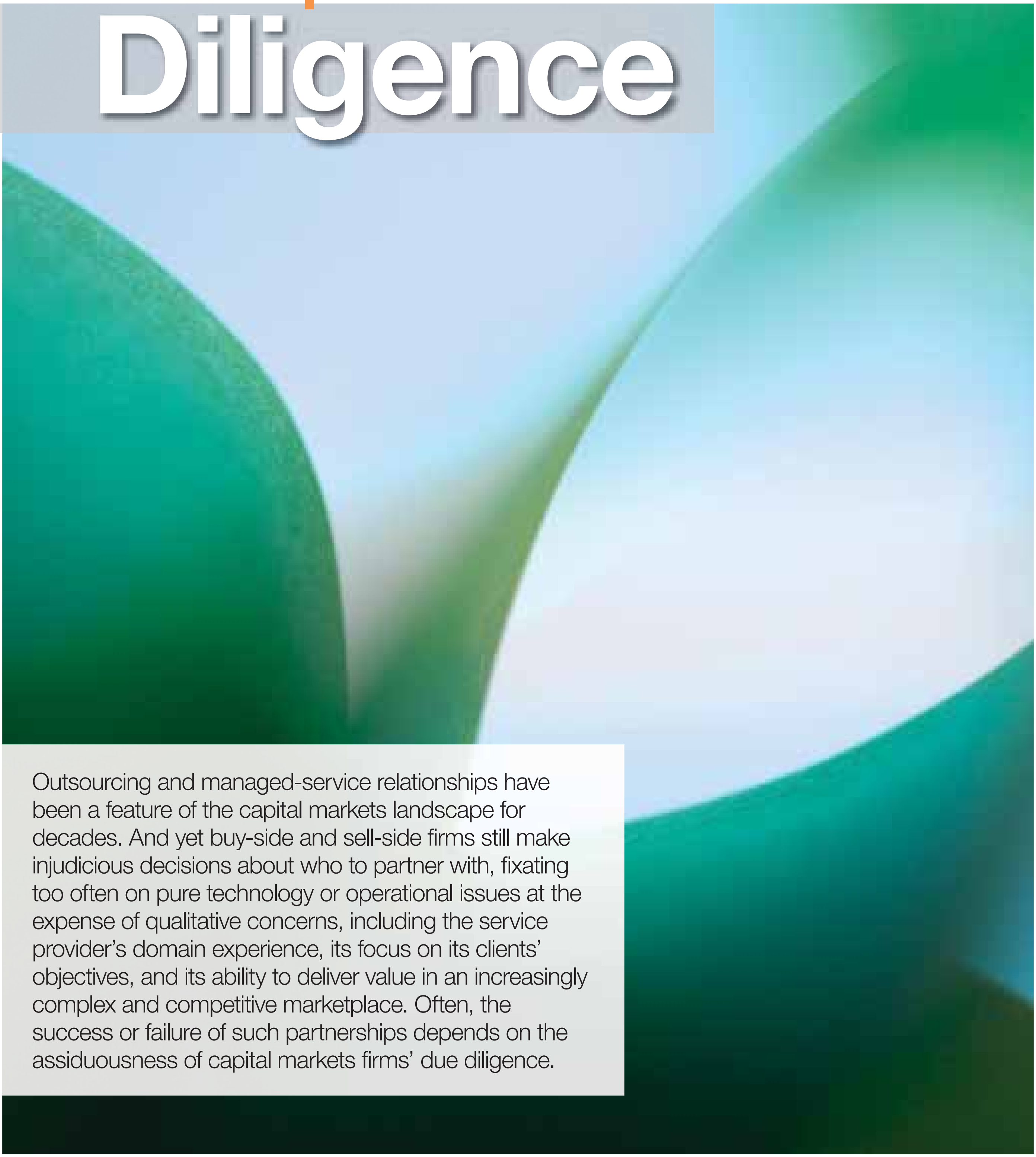
In order to adapt to international regulations, Liquidnet will also mandate BNP Paribas' prime brokerage subsidiary to complement its Asia-Pacific service, and comply with the US Securities and Exchange Commission's rules on derivatives clearing, trade reporting and new capital requirements. ■

Disciplined Due Diligence



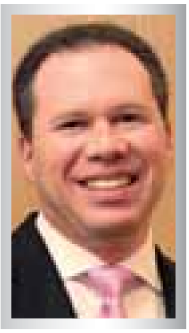
Outsourcing and managed-service relationships have been a feature of the capital markets landscape for decades. And yet buy-side and sell-side firms still make injudicious decisions about who to partner with, fixating too often on pure technology or operational issues at the expense of qualitative concerns, including the service provider's domain experience, its focus on its clients' objectives, and its ability to deliver value in an increasingly complex and competitive marketplace. Often, the success or failure of such partnerships depends on the assiduousness of capital markets firms' due diligence.

Q **Typically what business processes/functions are capital markets firms looking to take from a managed service provider, and why?**

John Lehner, CEO of technology solutions, BNY Mellon: Historically, the business processes that people have looked to outsource have been functionally aligned—they've looked at back-office and middle-office accounting, for example. What's changing rapidly is the migration toward the front office, as well as demand for core technology, infrastructure and data services. There is also the need to have access to people and talent who support those services. What we're seeing evolve rapidly is demand for more technology infrastructure or enterprise-type technologies, as well as data-related requirements. The reason we're seeing that is because of the competition for talent and resources, especially in the financial services industry. It is becoming much more complicated, more competitive, and it's also becoming more expensive to do it yourself.

Paras Sidapara, global head, managed services, Thomson Reuters: I certainly think anything that is possible to do in a standardized way is a candidate for a managed service, because it allows the total cost of ownership (TCO) to benefit from economies of scale from the provider. Historically, that has lent itself well to workflow solutions and back-office processes, but less so for the front office. However, cost pressures have meant that TCO and capital expenditure are under the spotlight in business areas previously considered no-go. The demand for regulation and compliance has meant that significant amounts of human capital are also having to be deployed in different ways. Both these forms of resource pressure have led to a forced review of how to seek savings, and I personally have been party to such decision-making when working for sell-side firms.

Thomson Reuters brings expertise in market data content and combined with our market-leading Enterprise Platform (TREP) for handling the dissemination of that market data, our expertise level in this space is second to none. It is therefore unsurprising that our customer base has grown to nearly 500 customers in a relatively new line of business of five years—we are experts at running the platform that delivers content to our customers. TCO is driven down, not only through the economies of scale enjoyed by service providers, but also by the ability to access deep technical expertise in TREP should a problem arise.



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Herman Weintraub, principal, GFT: Capital markets firms seeking operational efficiencies and cost-cutting are motivated to outsource all functions that do not directly enhance their core competencies or provide them with a competitive advantage in the marketplace. In theory, this should include everything in the trade life cycle, from the point of trade decision onward. However, this is an unachievable goal. Managers cannot outsource their responsibilities to regulatory and governmental authorities. Nor can they outsource their fiduciary responsibility. They must maintain oversight of their processes and systems from end to end. This poses an inherent conflict within the paradigm—a managed service paradox.

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> **Herman Weintraub, GFT**

Joseph Lodato, chief compliance officer, Guggenheim Securities: Utilities, such as security masters or Office of Foreign Asset Control (OFAC) data are utilities capital markets firms look to use with their systems. These utilities provide data that take an enormous effort to maintain and do not provide any competitive advantage. Legal entity identifiers are another example.

Communication utilities that provide managed network connectivity are examples of infrastructure that is hard to duplicate by any one business. These are extensively used by capital markets firms, especially since the fragmentation of the markets.

More recently, direct market access (DMA) services and algorithmic trading software services are becoming more popular, as these are hard to establish and maintain for smaller firms.

> "Capital markets firms need to consider the expertise in the whole managed services package and be able to depend on the provider with the same level of expectation as they would if that service was being provided internally. Business owners should not have to concern themselves with the how and why of the solution—dependability on the service in terms of operational performance and stability are key factors to consider." **Paras Sidapara, Thomson Reuters**

Q What are the ingredients that need to be present in the ideal managed service offering, and what should capital markets firms look for in a prospective provider?

Lehner: The obvious ones are clear requirements and expectations. Clients and providers need to sit down and ensure that expectations are clear, which includes all the detail around those expectations. I think you also need to have a service provider who, while focusing on the benefits of their service offerings, also looks at it from a client-centric perspective. By that I mean, when you're evaluating a provider, it isn't enough just to tap into their global scale or security and risk capabilities—it's important that they see this relationship through a client lens and not just from what they bring to the table.

Also, how and what business problems is this relationship going to solve for the client? I don't think it's something that people always look at. I think they get the requirements and expectations part right, but I don't know if clients really understand the importance of selecting a provider who understands their underlying goals, challenges and opportunities, and the drivers for why they're engaging in this in the first place.

Sidapara: The clue is in the name—in offering a managed service, we manage the implementation, upgrades, and operational stability and scaling on behalf of the customer. Of course, the key to success is the service and this is where there is much confusion between outsourcing and a managed service. The service is defined in terms of the characteristics of the provision—does it provide what the customer requires, in terms of what they need in order to run their business? Capital markets firms need to consider the expertise in the whole managed services package and be able to depend on the provider with the same level of expectation as they would if that service was being provided internally. Business owners should not have to concern themselves with the how and why of the solution—dependability on the service in terms of operational performance and stability are the key factors to consider. All this means that our customers can get on with their core business and be more agile in doing so. Agility in terms of future growth is important too—a local business today could quickly turn into a global one tomorrow—so there is much benefit to be had from consistency in delivery of a service across the globe, and in the case of Elektron Managed Services (EMS), having a portfolio of service locations across the globe is fundamental to our position in the market.

Weintraub: Savvy buy-side firms are evolving their managed service relationships to address the responsibility paradox. Rather than contract a firm to handle one or more functions via that provider's black box service, they are contracting firms to manage their own, fit-for-purpose processes. This new business model—co-sourcing—addresses the managed service paradox by achieving the cost-savings that come with utilizing service providers, while enabling management to retain oversight and responsibility.

Joseph Lodato
Guggenheim Securities

Lodato: Managed service offerings need to have "service" as part of the offering and not just in name. Some service providers see themselves as providing infrastructure-as-a-service only and so the service stops at the infrastructure. Firms need providers to provide "service" that helps manage change, risks, and growth for the company.

Q Are there any functions that capital markets firms cannot afford to hand over to a managed service provider, given their importance to the business?

Lehner: That's a great question. I think it's different for different firms. People's tolerance and their willingness to figure out how much they need to control versus how much they are willing to turn over to a service provider is very different. I think there is a line of comfort or a continuum in terms of how far people are willing to go. That is largely driven by a firm's appetite for change, as well as where they identify themselves in terms of engaging with the service provider from more of an early adopter-type model, and how much they feel they have to retain control over certain functions. That varies widely from organization to organization across different geographies, and depends on various regulatory, technology and other drivers.

Sidapara: It's about drawing the line between what is commodity and what is proprietary in nature. Over the years the benefits of running your own market data infrastructure have dwindled. A recent TABB Group report suggests that expert staffing is the highest cost contributor; the key is entrusting those commodity elements to experts in the field, who can fulfill those functions in a better and cheaper way. For example, an algorithmic trading engine is what gives firms the edge over their competitors, but the acquisition of inputs such as market data, provision and maintenance of space, power and hardware in a co-location data center, do not.

Weintraub: As previously mentioned, firms cannot outsource any aspect of the business that creates a competitive advantage in the space, or anything that would be viewed as the firms' core competency. Moreover, in order to retain appropriate levels of regulatory responsibility, managers cannot outsource anything that reduces their oversight into their own processes. For this reason, an ideal solution is one in which the service provider works as a virtual extension of one's own firm for application development along with non-advantage-generating processes. This creates a highly transparent, collaborative relationship between the co-sourcing partner and the capital markets firm, allowing the firm to benefit from outsourcing efficiencies without losing control over key processes.

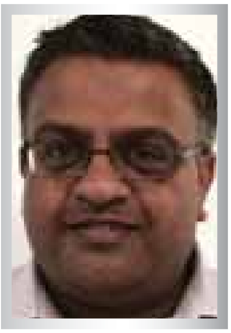
Lodato: Placing security issues aside, I would say if flexibility and innovation is needed in the service then that is better home grown if you can acquire the skills and talent to handle that in-house. Functions like compliance surveillance and reporting require access to most, if not all, the firm's information, so it is hard to hand that over to a managed service provider, given the connections and integration issues.

Q How have recent regulatory reforms around managed service offerings/outsourcing relationships and the quality and resiliency of providers' offerings affected this aspect of the industry?

John Lehner
BNY Mellon

Lehner: It's created a lot of additional scrutiny, a lot of additional due diligence, and has added additional dimensions. There are well-documented statements from several regulators in different jurisdictions—whether it's here in the US or in Europe or Asia—about what people should consider when looking at managed services. In addition, we now have a growing and heightened sensitivity around privacy and security. There is also a growing list of cyber-security and data-privacy issues coming into the framework.

Sidapara: Regulatory reform has had a significant impact on the industry. We have seen recent events highlight the necessity for resilience to threats. The Monetary Authority of Singapore's guidelines on *Threat and Vulnerability Risk Assessment* led Thomson Reuters to move the Elektron Managed Services to a new location, and while our customers are obligated to be compliant, we recognize that we underpin their operations. We also offer multiple locations in several geographies that serve as back-ups to one another



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for those customers requiring business continuity and disaster recovery solutions, alongside extending our proposition in managing deployed environments. Given also that Basel III requires capital reserves for operational risk, the desire for moving to operational expense means capital reserves can be maintained with less difficulty using a managed service such as EMS, but the onus is of course also on firms like Thomson Reuters to provide a class of service that reduces the operational risk for our customers.

Weintraub: The pace of regulatory change is increasing at unprecedented levels; keeping up with a changing regulatory landscape is the new normal for capital markets firms. In this environment, firms are increasingly relying on service providers to help ease their regulatory burden and streamline internal processes; concurrently, recent reforms around outsourcing relationships have forced capital markets firms to be more diligent in their vendor evaluations and governance programs.

These changes have combined to create an environment in which capital markets firms are increasingly depending on vendors to handle a wide variety of processes, while simultaneously tightening controls over vendor selection and management. The co-source paradigm tightly aligns with regulatory reforms by maintaining the firm's oversight and control of processes.

Q How can providers deliver a balanced approach to both the professional consultation service and technical skill?

Lehner: The way to do that is to have a deep and direct understanding of the client's business, and people who have worked in the business that you're providing the service for. You need to have people who have the background, the skills and the direct experience in terms of front-, middle- and back-office technology. Some providers might consider themselves a one-size-fits-all. But you need to approach each client on an individual basis with a consultative approach to really understand their drivers and what is unique about them. While economies of scale and benefits of a variable cost model come into play, it's important to remember that every company brings something to the table that is unique to them. That complexity needs to be understood if you're going to make one of these managed service relationships work.

Weintraub: Co-source providers, like ourselves, have focused over the years on particular niches within the financial services industry and are recognized as thought leaders in the space. This, married with stable, near-shore technical development talent, is what creates a compelling value service for buy-side and sell-side firms.

In order to truly act as a "virtual extension of one's firm," as mentioned earlier, co-sourcing partners must be able to not only offer specialty technological expertise, but also add value to this knowledge through an understanding of the industry and business trends. Too often, firms see service providers as a means to an accelerated solution—a manager might say, we need to accomplish X by doing Z—without realizing that greater efficiencies can be achieved by reworking the process.

By bringing in a service provider that has industry expertise and consultancy capabilities in addition to technical skills, firms can not only find better technical solutions, but also restructure and innovate processes that are no longer achieving optimal efficiency.

Lodato: I find too many providers are trying to sell services through a consultative sales approach. That is not differentiating to me. They need to know my business and its risks better than I do and should come to me saying, "here is the area to focus on because XYZ is about to happen that will affect your business."

Q What role does customer collaboration play in improving a firm's operational agility and ensuring a premier service experience?

Lehner: What's important is not just the initial engagement and doing the assessment, the search, and the transition—it's the constant and ongoing engagement between the client and the service provider in an organized and managed way right across the firm. So it's not just the operations or the technology people from the client, but also the business engagement and the front-office engagement to get right, because this isn't a one-time thing—it evolves.

The reason why firms make these decisions—whether it's pure infrastructure, technology or operations—is that they want a partner. They need a partner who is going to help them solve this challenge on a long-term basis. To be that collaborative partner, you need to have players from across the client firm at the table on an ongoing basis to ensure that you're validating the roadmap, what you're providing today as a service, and what's coming next. You need to do that on an ongoing, committed way, and not just up front.

Sidapara: I think the level of collaboration is directly correlated to the success of a managed service adoption. The reason is very simple: the more that the provider understands about the customer, the better the service can be aligned to what the customer wants. Sometimes this even means sharing (under an appropriate NDA of course) intimate details about an operation. For example, we undertook a TCO study with a tier-one investment bank and came to the conclusion that an almost 20 percent saving could be achieved by adopting Thomson Reuters' Elektron Managed Services. Additionally, having a deep understanding of where the customer wants to take their business means that the service and capabilities of the provider can develop ahead of that curve, which directly improves their agility.

Finally, this works both ways. I strongly believe that we have to be honest with our customers about what we can and what we cannot do. That is key to a premier service experience—that the expectations set with the customer are what the vendor is able to and strives to deliver. As is of course inevitable with any technical operation, things can fail even in a fully resilient service such as EMS. The key here is that the customer is proactively kept fully aware of the potential impact to their business—our Inxite tool provides a market-leading experience on desktops and mobile devices so that our customers are guaranteed awareness of any event that could impact their business.

Weintraub: Collaboration is at the heart of the co-sourcing paradigm. Unlike traditional off-shoring, which is fraught with challenges arising from communication issues, a co-sourcing service provider relies on near-shore and on-site resources. This means that the co-sourcing provider operates in the same time zone and language as the firm, allowing for a closer working relationship between capital markets managers and service providers. Moreover, because a co-sourcing partner has extensive knowledge of the firm's fit-for-purpose processes and technologies, this business model allows for agile development in collaboration with the firm, and for the continuous evolution of the firm's operations and infrastructure.

Q How does co-sourcing address the challenges that capital markets firms face with traditional offshore service providers?

Weintraub: There are a number of common problems with traditional outsourcing—management fatigue (due to middle-of-the-night meetings), language barriers, high resource turnover, and poor productivity resulting from miscommunication of delivery expectations. Moreover, the separation that inherently exists between offshore providers and capital markets firms means that managers may lose control over critical operations, which poses regulatory risk.

In contrast, co-sourcing allows for easier communication between the service provider and the managing firm, it has consistently lower turnover levels, and offers higher-quality resources. In addition, the higher transparency and collaboration between the provider and the firm means better regulatory oversight, and a more robust and iterative development process.

In these ways, co-sourcing allows capital markets firms to take advantage of the benefits of outsourcing—namely, cost savings, increased efficiency, and better agility—without sacrificing control or process quality. ■

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