

Getting connected to the right system by Paul Bray  
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# GETTING CONNECTED TO THE RIGHT SYSTEM



No financial institution can function properly without a well-run back office, as Paul Bray has been finding out

**B**ack room staff are the unsung heroes of the financial services industry, and their efforts are becoming ever more critical to the success of the firms they serve. A generation ago, back office processing was mostly a matter of matching bits of paper. Now it has evolved into an intricate and powerful machine, as a series of new products, from PEPs, ISAs and unit trusts to OEICS and Children's Trust Funds, have required greater and greater sophistication. Some of the challenges they face are external, notably the increasing weight of regulation such as MiFID (Markets in Financial Instruments Directive), COLL and anti-money laundering rules.

"The big one is MiFID," says Charles van der Merwe, chief executive of outsourcing solutions provider Pershing. "Changes to best execution and client classification will involve a substantial amount of work, and each client will need to be treated differently."

The growing popularity of platforms and wrappers as a distribution mechanism poses several challenges for the back office, says Simon Hudson-Lund, chief operating officer of transfer agency outsourcing supplier IFDS. Instead of single, linear transactions on single products, processing systems will be faced with a web of transactions and reporting on several products within a single client account, with the data often held not on their own systems, but on those of the big distributors.

“The complexity around this introduces a huge cost, but the people who really benefit – the consumers and intermediaries – aren’t really paying for it,” says Hudson-Lund. “You’ll need to have some serious capital behind you to compete with the big boys.”

Automation is another hot topic, says Hudson-Lund. “We’re all focused on how we can increase efficiency. Automation at least halves the cost of processing a transaction and can reduce it by 60-70 per cent, as well as bringing benefits in speed and accuracy.”

Adoption of a technical messaging standard, ISO 20022, which specifies the format in which computer systems exchange data, will help to facilitate automation of settlements across Europe. “It will be good for the UK to be part of that bigger network,” says Hudson-Lund. “A big challenge now is how we connect to myriad small IFAs.”

Over the next three to five years the industry can expect to see a standardisation in settlement and trading via EMX, Crest, SWIFT and others, says Ray Pepper, managing director of the transfer agency business at outsourcing supplier, Mellon. “Standardisation will be in everybody’s interests because it will cut costs but won’t affect competition.”

In response to rising costs, margin pressures and shortages of skilled labour, back office administration and systems development are increasingly being conducted offshore, in India, Thailand, Singapore and other developing economies. “You can expect labour cost savings of 60 per cent by moving to somewhere like India,” says Hudson-Lund.

*“Outsourcing is still a growing business in Europe and we expect that growth to continue”*

Operating in other time zones also expands the time window for processing transactions, adds Pepper.

For many firms, especially smaller ones, the cost of developing and maintaining their own systems is simply prohibitive. Building your own back office systems to support platform products could cost a cool £30 million, says Tony Solway, head of securities services at outsourcing supplier BNP Paribas. “Very few firms can afford that. We see people with in-house operations who just don’t have deep enough pockets to deliver best-in-class services.”

For increasing numbers of firms, the alternative is to outsource. “Outsourcing is already the norm in the USA,” says van der Merwe. “It’s still a growing business in Europe and we expect that growth to continue.”

The benefits of outsourcing can generally be divided into the routine – cutting costs, improving service quality, focusing on one’s core business and ‘added value’ benefits such as getting fresh ideas and enabling new business development.

Which of these predominates tends to be driven by the market, says Solway: “In bear markets people outsource to reduce costs, but in better times they’re looking to grow and improve their business.”

So today’s outsourcing clients are looking for added value and competitive advantage from their back office service providers. “You regularly get the

opportunity to help people reposition their business or enter a market for the first time," says

## *Clarity of purpose and give-and-take are the keys to success in an outsourcing relationship*

Solway. "That's where the big opportunities are for clients."

"We have dedicated resources looking at client relationship management and product development," says Pepper. "With 30 years' experience of administering products we have a good idea of what works and what doesn't."

Two decades ago, back office outsourcing was pretty vanilla. Now the watchword is 'value-add', with service providers offering anything from portfolio management systems and executing broker services to front-end services such as trading websites and online access for agents.

To extract the maximum value from an outsourcing relationship, say the service providers, clients should be as open as possible. "The key is very regular communication, both formal and informal," says Pepper. "Our aspiration is to have a balanced partnership. Third party administration services shouldn't be viewed as a commodity you can buy off the shelf."

Such aspirations are not always

met, however. "Few clients operate with us as if we were part of their organisation and not a supplier," says Hudson-Lund. "But it's only when you get into the [partnership] mindset that you get the full benefits from using a specialist firm. There's still a lot of skill and expertise in third-party organisations that their clients don't make use of."

Clarity of purpose and give-and-take are the keys to success in an outsourcing relationship, says Solway. "Be very clear about what you want. A lot of people go into outsourcing to

save money, and then find there's not enough flexibility in the contract to let them expand the service as their needs change. Others are too vague and find they haven't fixed their costs adequately if the market turns bear. You also need scope for both parties to change their relationship without forcing a divorce."

However, says Pepper, at the end of the day it is still your business, and the regulators will hold you responsible for what your service provider does in your name. "You can delegate responsibility," he says. "But you can't abdicate it."

### ABERDEEN CASE STUDY

Aberdeen Asset Management has outsourced back office processing to IFDS since launching its first PEP in 1992. A key driver was to defray the high cost of developing its own systems, but today, says Aberdeen's chief operating officer, Andrew Laing, "the key benefit for us is flexibility".

Aberdeen's average deal volumes are 200-300 per day, but this can rise to 6,000 at peak times, and if the firm completes a merger or launches a new product, transaction volumes can double overnight. IFDS has the staff to cope with these fluctuations, and because it has processing centres around the world it can also offer Aberdeen's international customers processing in their own time zones.

Laing values his outsourcing supplier's "strength and depth in IT. It can justify a level of spend that we couldn't afford, and we get access to a pool of expertise that we couldn't create in-house".

However, he cautions: "You need to keep some expertise in-house, or you lose all ability to challenge or monitor what the outsourcing provider is doing."

Tracking service levels and key performance indicators is important, but this does not always provide a meaningful measure of quality. "So you need managers internally who understand the entire process and can maintain a total dialogue," says Laing. "I encourage our people to meet their IFDS opposite numbers regularly to assess the position on the ground."

Laing is less concerned about the competitive aspects of back office outsourcing. "Admin isn't an area where anyone's seeking an enormous competitive advantage, although it does need to be done properly. You also need to differentiate admin from customer service. We outsource the technical administration but keep customer service in-house."