

The middle office: What is it and who should handle it?

Just before summer, **Tell Media Group**, in cooperation with **RBC Investor & Treasury Services**, invited representatives from Nordic fund companies to discuss outsourcing and how to handle the middle office. Tell Media Group founder Niklas Tell moderated the roundtable.

By: **Niklas Tell**

The discussion started with Niklas Tell sharing some of the initial findings from the RBC Asset & Wealth Manager Survey concluding that the main reason for outsourcing the middle office seems to relate to offensive rather than defensive decisions. With scalability being the main reason for outsourcing, according to the survey, Niklas Tell asked Ben Pumfrett whether he agrees with the findings?

BEN PUMFRETT: "Every client is different of course but scalability and supporting asset managers' strategic growth plans is absolutely a theme that we see. The discussion on outsourcing also becomes more real when asset managers are looking to expand their business with new asset classes and new markets. The pandemic has also increased the focus on risk management. The industry has performed well during this period of working from home but it has put a focus on operating models and many are reviewing outsourced options as a part of that."

NIKLAS TELL: GUSTAV - HAS THIS PERIOD MADE YOU REVIEW YOUR OPERATIONAL MODELS?

GUSTAV OHLSSON: "We have outsourced most of our back office and to some extent the middle office so this period of working from home has not affected us very much. People have had the same access to systems and tools as previously. The sales side has of course been affected and we have needed to become better at digital meetings and digital marketing, but from a portfolio management point of view it has worked well."

NIKLAS TELL: WOULD YOU AGREE WITH THE BENEFITS OF OUTSOURCING THAT BEN MENTIONED AND THAT WERE HIGHLIGHTED IN THE SURVEY CONDUCTED BY

RBC? MAINLY, SCALABILITY AND BEING ABLE TO ACCESS NEW MARKETS AND INVESTING IN NEW ASSETS.

GUSTAV OHLSSON: "Yes, I agree with those benefits. You have to weigh all of this together of course and I also think cost is important, which obviously comes with scalability. The price of asset management services is going down and we therefore have to work to lower the costs for managing assets in order to maintain margins."

SAMUEL K. HAILE: "I agree with Gustav. We're a fairly young company and we built the systems internally when we started ten years ago. We haven't had any problems working from home during the pandemic. The question whether you should outsource or not depends on a lot of variables and as you scale the business you obviously ask whether you can continue with the system and set up you have in place, or are you better off with an external partner. One thing that's very important to us is that we have extensive expertise and knowledge in-house."

NIKLAS TELL: KEEPING EXPERTISE IN-HOUSE IS EXACTLY WHAT RBC FOUND IN THEIR SURVEY AS THE MAIN REASON FOR NOT OUTSOURCING THE MIDDLE OFFICE. MATTIAS, WHAT'S YOUR SET-UP AT TUNDRA FONDER?

MATTIAS MARTINSSON: "We've had employees in Pakistan and Vietnam for many years and we are used to working remotely, so the pandemic didn't change very much for us. When it comes to the administration, we have selected to outsource most of the middle office. We are a small firm and we need an external partner to help us. That said, it's important to understand that you're still responsible for what's done by the external party. That means that you need knowledge internally and the burden of CEOs in Sweden

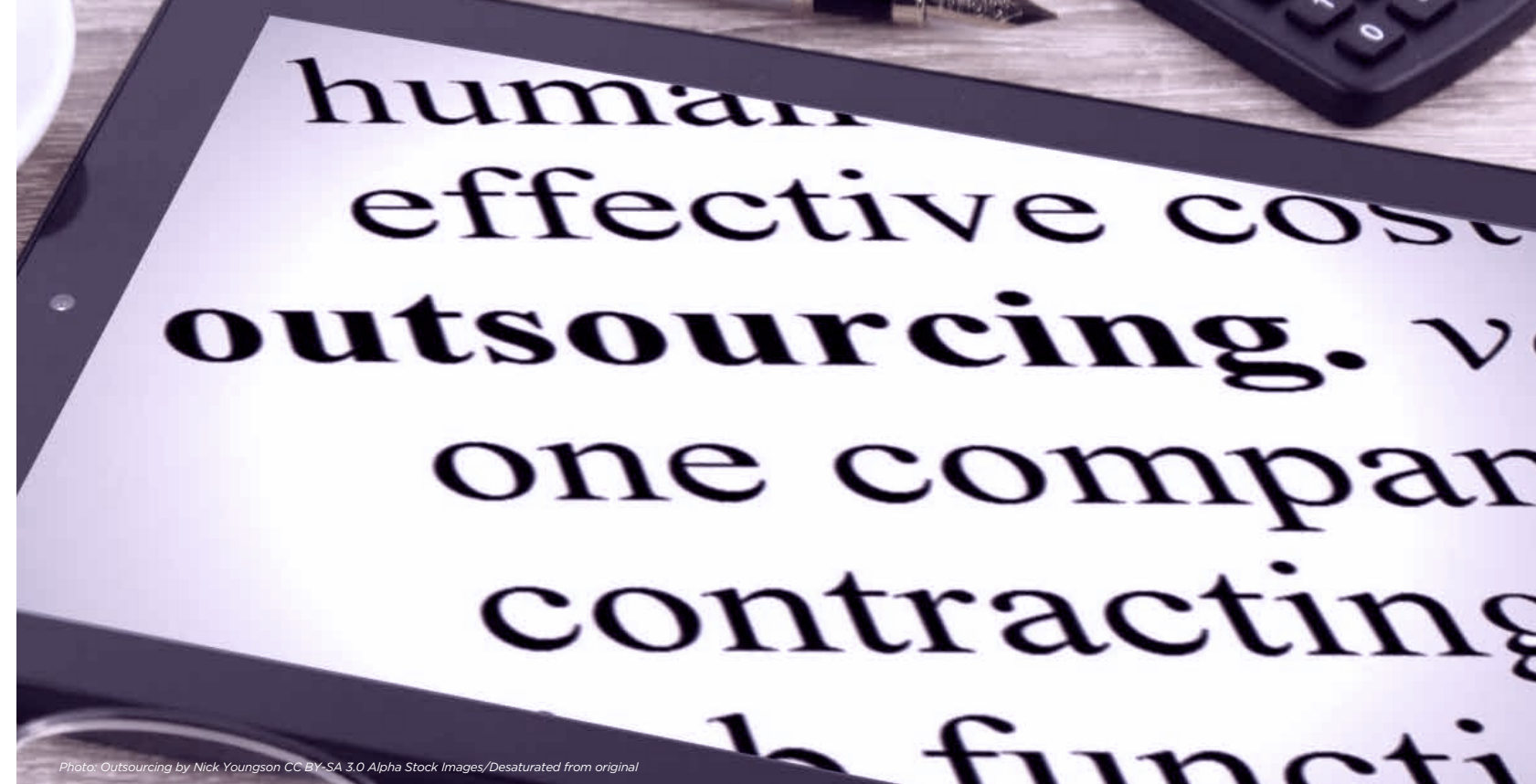


Photo: Outsourcing by Nick Youngson CC BY-SA 3.0 Alpha Stock Images/Desaturated from original

is heavy. The day-to-day work is of course made easier when you have an outsourcing partner, but ultimately you are still responsible for what is done."

NIKLAS TELL: BOTH SAMUEL AND MATTIAS TALK ABOUT THE NEED TO KEEP EXPERTISE AND KNOWLEDGE IN-HOUSE REGARDLESS OF WHETHER YOU OUTSOURCE OR NOT. BEN - IS THAT AN ARGUMENT THAT YOU'VE COME ACROSS AS WELL?

BEN PUMFRETT: "Yes it's definitely something we hear and we tend to see that from two perspectives. The first is that it's a comfort, especially among smaller asset managers, to have the staff internally who know the business intimately. These people are also often involved across different aspects of the operational work. However, we have recently witnessed start-ups launching fully into an outsourced model as many of the middle office services have now reduced that price of entry to support smaller clients. The second reason is that even if you outsource the process, you are not outsourcing the responsibility. You need to monitor and pick up on exceptions where you need to step in. Regulators globally are increasingly focusing on making sure that an oversight framework is in place. This is something that we regularly consult and help our clients with as they want to understand the oversight required. A client should not need to do the work all over again to keep that oversight but rather have near real-time full transparency and exception-based views of their activities."

NIKLAS TELL: IF WE TAKE A STEP BACK IT MIGHT BE GOOD TO DEFINE WHAT WE MEAN BY THE MIDDLE OFFICE AS IT CAN MEAN DIFFERENT THINGS AT DIFFERENT FIRMS. SAMUEL - DO YOU WANT TO START BY EXPLAINING WHAT'S IN YOUR MIDDLE OFFICE?

SAMUEL K. HAILE: "As you say, it can differ between firms. Our middle office operation is very broad and covers everything from KYC, receiving money from clients and placing that into orders, to risk control and reporting. A person that works in our middle office should have a deep and broad understanding of the business."

MATTIAS MARTINSSON: "I think, in reality the simple explanation is that the middle office should be the part of the organisation that have an oversight of both the front- and back office. They should be the checks and balances and that requires knowledge of both ends of the business."

NIKLAS TELL: BEN, BEING THE MIDDLE OFFICE EXPERT IN THE CONVERSATION. WHAT WOULD YOUR DEFINITION OF A MIDDLE OFFICE BE?

PARTICIPANTS

- **SAMUEL K. HAILE**
Head of operations, Partner, Arctic Asset Management
- **GUSTAV OHLSSON**
CEO, Atle Investment Management
- **MATTIAS MARTINSSON**
Founding partner, Tundra Fonder
- **BEN PUMFRETT**
Head of product and profitability middle office, RBC Investor & Treasury Services
- **JOHAN LINDBERG**
Managing director, head of Nordics, RBC Investor & Treasury Services



SAMUEL K. HAILE
Head of operations, Partner, Arctic Asset Management



GUSTAV OHLSSON
CEO, Atle Investment Management



MATTIAS MARTINSSON
Founding partner, Tundra Fonder



BEN PUMFRETT
Head of product and profitability middle office, RBC Investor & Treasury Services



JOHAN LINDBERG
Managing director, head of Nordics, RBC Investor & Treasury Services

BEN PUMFRETT: “From a service provider point of view we need to be a bit more contained and precise on what the middle office is. It’s a challenge when everyone defines the middle office slightly different. People tend to agree on 80 per cent of what it is but then there’s this 20 per cent where it differs. We tend to view the middle office as activities post execution. The research, the investment decisions and the execution of trades sits in the front office and then the middle office will be responsible for the consolidation of that data and making sure that it’s correct. The middle office would deal with trade management in terms of matching & settlement monitoring, corporate actions and maintaining the investment book of records. The middle office should really be that hub stitching together the data from multiple sources, such as different custodians, making sure that the fund managers get a single view.”

NIKLAS TELL: GUSTAV, WHAT WOULD YOU SEE AS SOME OF THE MAIN CHALLENGES WHEN IT COMES TO OPERATIONS AND THE MIDDLE OFFICE? IS THERE ANYTHING THAT STOPS YOU FROM DOING WHAT YOU WANT FROM A DISTRIBUTION OR PRODUCT DEVELOPMENT POINT OF VIEW?

GUSTAV OHLSSON: “So far we haven’t run into anything that limits us from doing what we want to do. We have recently opened up distribution to the US and to Australia and that has worked with our current set-up. I think the main difficulty when it comes to operations and product development is data. Being able to connect and access data in an efficient way. That currently takes a lot of time and is an area that could improve.”

BEN PUMFRETT: “I agree regarding data and technology and moving towards more open architecture. As an industry, we see that this is happening and it’s becoming more plug-and-play. Making sure integration is easy for asset managers has certainly been a focus area for us when we have developed our middle office offering. The transition should be easy and the system should easily plug into order management systems or risk platforms internally. It shouldn’t require a lot of internal development to make it happen.”

SAMUEL K. HAILE: “I agree with what has been said regarding challenges. However, one of the biggest hurdles for a company such as ours is to keep the employees for longer periods of time in this position. You use a lot of time to train them but for many it’s more of a temporary position or a stepping-stone to get into the front office. Keeping the people with deep and broad knowledge can be challenging.”

NIKLAS TELL: JOHAN, YOU TALK TO A LOT OF ASSET MANAGERS IN THE NORDIC REGION. WHAT ARE YOU HEARING WHEN IT COMES TO THE MIDDLE OFFICE AND OUTSOURCING?

JOHAN LINDBERG: “What we see in the Nordics is that small- and mid-sized firms typically run their middle offices internally and it’s been convenient to have easy access to people in-house. In the current regulatory environment, it is however becoming increasingly more challenging to run the post-trade activities internally. We are of course talking about our own book as we are selling outsourcing services but it’s a fact that we are taking over more and more middle offices from Nordic asset managers. One also needs to remember that technology is completely different compared to ten years ago. With the current technology it’s much easier to break up the operational processes in order to outsource parts of it and still efficiently integrate with what is kept in-house.”

NIKLAS TELL: JOHAN TALKED ABOUT THE POSSIBILITIES WITH TECHNOLOGY TODAY. GUSTAV, DO YOU SEE THAT THERE ARE NEW POSSIBILITIES, NEW MODELS THAT YOU CAN ADD TO IMPROVE THE SYSTEMS YOU ALREADY HAVE?

GUSTAV OHLSSON: “There’s a lot left to do. There are always new things to do in this business, not least thanks to regulators, and we are for example looking at how to integrate ESG data and systems. Our core business is portfolio management and sales and marketing. When you have a good system in place for the front office it’s easy to outsource the middle- and back office. I would however say there’s a lot left to be done when it comes to sales and marketing and in getting timely information to clients. What we would like is to have the performance charts in a sales persons Power Point linked to the back-office systems.”

NIKLAS TELL: SAMUEL I KNOW THAT YOU ARE KEEPING THINGS INTERNALLY, BUT WITH REGARDS TO TECHNOLOGY - ARE THERE AREAS WHERE YOU ARE CONSIDERING OUTSOURCING IN ORDER TO IMPROVE YOUR INTERNAL SYSTEM.

SAMUEL K. HAILE: “It’s more about the underlying data and especially data related to ESG. With all the new regulation coming in that area it is requiring us to expand our reporting significantly. For the first time since we established the firm in 2010, we have now hired two people to the operations team with a background in technology. They are working on building the type of reports that Gustav was talking about. Today four out of seven funds have reports that can be updated by a click of a button.”

JOHAN LINDBERG: “When we come in and cover local funds, mandates and offshore funds for a client, two things happen: The first is that they can concentrate on their portfolios as our service is custodian agnostic. The second thing that happens is we become data providers. We gather all transactional data for all portfolios, regardless of what structure it has, in one place. Then we provide that information back to clients. It essentially becomes a way to streamline the need for data.”

BEN PUMFRETT: “We see a couple of things in the market. The first relates to questions that are purely technical. It’s about how clients can integrate with data better and there are now solutions, such as APIs, that make this very efficient. The second point is how clients can control data and the vast number of data points. Part of our job is to make sure that we have checked the data for errors and flagged outliers, but it’s also about how the data is presented. It should be visual to the point that you instantly understand what you are looking at.”

NIKLAS TELL: I ASSUME THERE ARE TWO OPPOSING POWERS AT WORK HERE. ON THE ONE HAND IT MIGHT MAKE SENSE TO OUTSOURCE BECAUSE INVESTMENTS IN TECHNOLOGY AND BEING AT THE FOREFRONT COSTS MONEY. HOWEVER, ON THE OTHER HAND YOU MIGHT WANT TO KEEP THINGS INTERNAL BECAUSE YOU CAN CUSTOMISE AND TAILOR SOLUTIONS SPECIFICALLY TO YOUR OWN NEEDS. SAMUEL - WHAT ARE YOUR THOUGHTS ON THAT?

SAMUEL K. HAILE: “We are a small firm and we don’t have that many different products. We also have good insight into the markets where we are active and we therefore still think it’s better to keep things internally. At this point in time, we’re able to develop things internally in order to be able to present the information that we want to our investors. However, that could change of course. If we grow and add a lot of different strategies and enter into markets that we are less familiar with it might make sense to look at outsourcing.”

MATTIAS MARTINSSON: “I would agree when it comes to data. Finding ways to source data into presentation material is necessary. We have built our own internal proprietary systems, which was initially done as a control function. As we are focusing on markets such as Pakistan and Bangladesh we wanted to stay on top of prices and corporate actions. That means that we are now able to bring real time data on our holdings into presentations, which was discussed earlier. In terms of ESG, we started to work on that intensely some six years ago and the most recent development is that we’ll shortly be able to show how much carbon emissions are moving out from companies in the portfolio every second. As mentioned, this was initially done as a control function but it has grown into something that is also very useful as a client engagement tool.”

JOHAN LINDBERG: “This is certainly what we see in general in the Nordic region. Outsourcing of the middle office typically comes into play when you take a broader look at your business, which might be when you start to launch funds in other domiciles. Then, looking at how to handle your middle office becomes a natural question. Going forward I think the key will be to combine the two, which is to keep internal competencies and at the same time use external expertise.”

SAMUEL K. HAILE: “I certainly think things would be different if we were to start from scratch today. Then outsourcing would probably be a more natural part of the business model. We certainly see that with firms starting today. They focus fully on the core business, which is portfolio management and the front office.”

BEN PUMFRETT: “I agree with the fact that today is different and I think there are two main reasons for outsourcing. If you look back 10 years, the price points to enter some of these outsourcing services were much higher than they are today and that pushed fund companies to do more things internally. That has changed. The second reason is speed to market. Using external providers enables a new fund company to focus on their core business as they don’t simultaneously have to build the whole operational structure as well.” ●