



Just another day at the (middle) office?

Alessia Lorenti, Head of Business Development, Institutional & Fund Services at Edmond de Rothschild Asset Management (Luxembourg), and Annick Elias, Partner at Deloitte, discuss the rise of outsourced middle office offerings over the last five years and explore the specific needs of the investment management industry.

What is Deloitte's perception on middle office as a fully-fledged outsourced service?

Annick Elias: Over the last five years, we have observed that outsourced middle office services have consistently been gaining traction. It has now become commonplace for asset management companies to include specific questions regarding middle office capabilities in requests for proposals when selecting a provider for delegated activities.

Consequently, a majority of larger asset servicers have included a middle office package in their product mix, in addition to their core depositary, fund administration and transfer agency activities. Smaller and medium central administrators, who have not all deployed these services yet, are also researching the topic, meaning that these services stir-up interest beyond the selected few global players who have already set them up.

More importantly, global asset managers have started to drive a paradigm shift by increasingly presenting themselves

as technology companies, and offering integrated middle office solutions on a SaaS ("Software as a Service") basis.

What activities are typically included in these offerings?

Annick Elias: In the context of outsourced services for investment funds, the term "middle office" is often used as a hypernym. It can cover a broad range of services, from trade capture and matching, to performance attribution and risk reporting, from position keeping and IBOR, through to reconciliations, valuation, cash management, collateral management, FX management, and/or fund dealing.

Offerings will generally vary based on the scale of the provider. Global asset servicers may propose a full scope of services, all included in one middle office package. Smaller and mid-size organizations will often offer trade capture, matching and position keeping as part of their core MO offering, and other services such as various reconciliations, fund dealing or securities lending as part of their fund administration and depositary offerings. ➤

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Clients' expectations may differ, depending on their segment. For example, a global asset manager will have an interest in a post-trade global solution covering their whole range of funds. This may involve trade capture and matching, asset valuation, and/or corporate actions, but also some specific services to better support their front office departments such as risk reporting, data analytics etc.

For the asset owner segment, insurance accounting is an additional service usually operated with middle office systems.

Finally, small and medium-sized asset managers might be interested in PMS tool hosting as they do not have such capabilities in-house.

Figure 1
Scope of middle office services by segment

	Global asset manager	Lux' fund flagship	Small asset manager
PMS tool hosting			
Trade capture and matching			
Position keeping/IBOR			
NIB assets and IB assets reconciliations			
Valuation			
Cash management and treasury			
FX management			
Collateral management			
Securities lending			
Fund dealing			
Performance attribution, Risk reporting, etc.			
Self-service reporting platform, data analytics for front office activities			

Included in the MO offering

Not included in the MO offering

Source: sample of services taken from Middle Office service providers' websites

What is the outsourced middle office's value proposition to asset managers?

Annick Elias: For global asset managers, an inclusive and global solution will help streamline processes, as they will benefit from a harmonized solution for the whole fund range. That being said, the main benefit of these offerings is to reduce the burden of non-core activities for the front office, so that asset managers can concentrate on portfolio management and on distribution, ergo generating performance and returns, and growing their asset base.

Due to increased regulatory scrutiny, it is essential for asset managers to have access to highly detailed information on transactions, fees or positions with minimum turnaround times. The middle office will act as a data aggregator, providing an umbrella solution for the front office to access data from providers and data vendors in a consistent format and in a timely manner. This is particularly relevant for asset managers with an international exposure, working with multiple providers locally.

Alessia Lorenti: I agree with Annick's earlier comment that middle office is a hypernym. However, the service offerings described by Annick are clearly back-to-front solutions. These are designed by back office service providers for the middle and front office departments, essentially focusing on post-trade activities, as their primary purpose is to support the back office tasks linked to fund administration and custody. As a result, such service providers often offer a very limited set of ex-ante functionalities. Essential tools including pre-trade investment restrictions controls, portfolio modelling, cash management and forecasts, as well as functionalities linked to hedging, are not always part of the package.

Some solutions also rely on pricing models that are inadequate for asset managers. For instance, providers will apply a fixed fee for the MO service, while the bottom-line

for an asset manager willing to outsource is doing so precisely to transform fixed costs into variable costs. Other offerings are service extensions to service agreements with funds rather than the asset manager.

We have been focusing on front-to-back solutions with ex-ante service offerings, such as portfolio management systems, data management services, with a risk management framework, pre-trade compliance, performance analysis tools, and reporting capabilities. These solutions have been built for the in-house portfolio management front and middle office and are today offered to third party managers as a mutualized solution.

We believe that such services will offer higher added value, especially for such clients as independent asset managers and family offices. Such clients may not have access to the large packages—mainly due to a size criteria established by some software providers as part of their strategy, and/or because they wish to avoid developing and maintaining their own IT platforms.

Data management services have become a key consideration for our clients. In addition to the maintenance of static data, middle office solutions need to offer connectivity to major data vendors for valuation and corporate actions' management purposes and to include a data redistribution component. Moreover, regulatory reporting requirements such as AIFM and Solvency II have significantly increased the need for middle office data.

There is also a demand for open architecture solutions. Asset managers may want to extend access of middle office data to multiple stakeholders such as their portfolio control teams, so that they can carry on their tasks regardless of a NAV calculation cycle. This responds to a specific need in certain European markets in which the management company remains responsible for the NAV review and validation, even when the calculation is delegated to a fund administrator. Likewise, this enables management companies to fulfil their general oversight duties in markets, such as Luxembourg and Ireland, in which the NAV calculation and validation is fully delegated to the fund administrator. ➔



Commercially, are there any benefits for providers who are offering this service?

Annick Elias: It allows the providers to enhance the scope of their offering and to bring new value added services to the market, including data management, IBOR maintenance, pre-trade compliance and new reporting capabilities. This can generate new revenue streams, whether middle office is offered as a stand-alone service to new clients, or as an extension to an existing service agreement.

We have observed a clear tendency to package middle office services as a separate contract, as opposed to a list

of sub-activities in the custody or fund administration agreements—although many providers may indeed chose to apply size criteria when selling the service as a stand-alone.

This also gives an ability to gain market shares and win clients who have selected another custodian and/or fund administrator should such service providers be willing to offer middle office on a stand-alone basis.

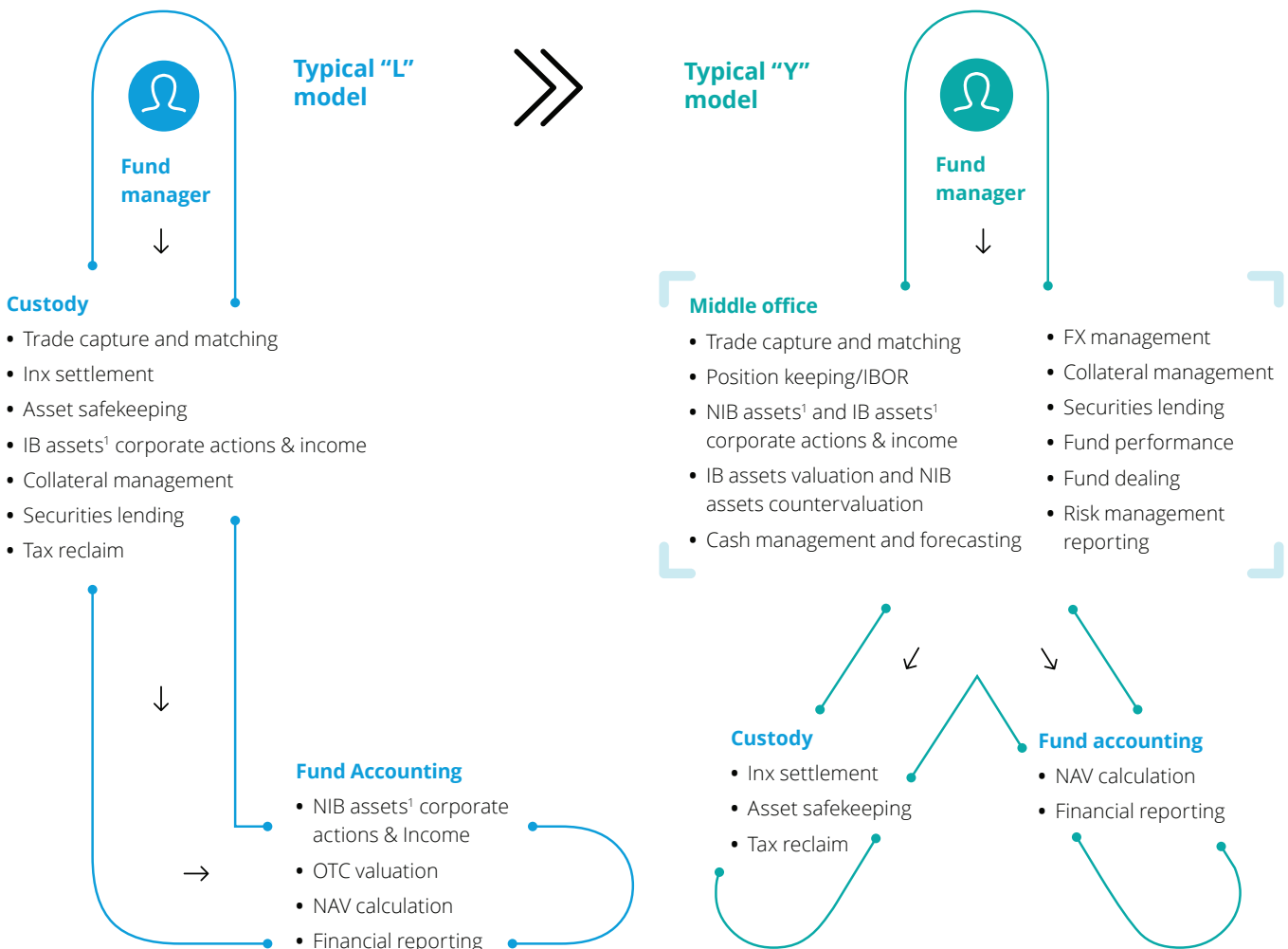
The front office to obtain key transactional, market and positions' data is an efficient way for the providers to “lock-in” their clients, thereby increasing their chances to

develop the accounts. Indeed, performing a migration-out is far more difficult than it is the case for other activities such as fund administration and custody.

Can providers who offer middle office services achieve efficiency gains?

Annick Elias: For asset servicers who still rely on L-models, whereby the custody function collects data before re-routing it to other units such as fund accounting for further processing, it could be an opportunity to revisit and modernize their operating models. By removing the dependency on custody, other functions could achieve time gains.

Figure 2
From “L”, to middle office “Y” Model



1. IB stands for In-Bank assets, i.e. assets that EFA holds with his network of custodians / cash correspondents



For organizations who have built their processes around Y-flows (i.e. whereby several units, like custody and FA, receive data simultaneously), the implementation of a middle office function could be useful to prompt discussion on the assumptions underpinning the operating model. The creation of a central middle office hub could create cross-functional synergies in the organization. Where different models are in use across different locations, it may be a good opportunity to align all cross-border activities on a single model.

Alessia Lorenti: According to us, offering MO services to clients is a good opportunity to streamline and optimise all processes from Front to Back across funds and managed accounts, as the PMS tool is interfaced with Back-Office systems, as well as with third party back office providers. For instance, implementing the MO service allows to maximise the number of STP transactions, as well as the number of reports automatically created and disseminated. In doing so, it is instrumental to leverage a robust and flexible IT platform to operate those activities.

What further developments can we expect from outsourced middle Office services in the future?

Alessia Lorenti: Private equity and real estate investment management has grown consistently over the last five years, but is currently under-served in terms of systems and processes. There are many smaller firms, who all still rely on a combination of legacy systems, databases and spreadsheets for control, follow-up and reporting purposes. There are multiple opportunities in this area for a provider who can deliver a solid, cost-effective solution to aggregate portfolio data from multiple sources (for instance, property managers, local asset holding vehicle providers...), assemble management valuation reports for investor reporting, and provide monitoring solutions for industry specific transaction types, such as bridge financing.

Annick Elias: I agree with Alessia. I also believe that information technology considerations will be paramount in these discussions. The increasing demand for real-time information, the development of direct connectivity to order management systems, APIs, data analytics, open-

architecture and self-service reporting platforms, all have the potential to reshape asset servicing in the years to come.

In terms of competition landscape, I expect disruption with new offerings from providers who are not incumbents in the asset servicing industry, bringing innovation and potential for future efficiency gains. We have recently seen an increased interest from large data vendors and major fund managers for activities further down the asset management chain, offering increasingly integrated solutions by leveraging on the strengths of their core front office activities. Similarly, asset servicers are now acquiring front office IT solutions to extend the scope of their offerings to the full asset management value chain.

Finally, we are beginning to see a trend towards the extension of middle office solutions to the private asset segment (external asset managers, IFA and HNWI). It will be interesting to see if global banks offering asset-servicing activities mainly to institutional clients will leverage on their middle office capabilities to support the private bank client segment as well. ●