

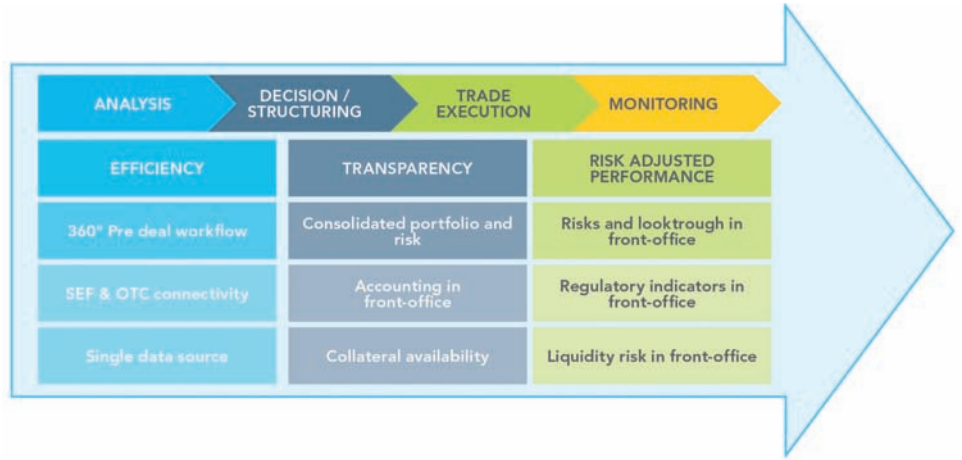
Sylvain Privat, buy-side product manager at Misys, explains why having a robust, scalable and sustainable IT platform is essential for fund managers looking to stand out from the crowd

Enhancing the value chain

HEDGE FUNDS REVIEW: Is today's 'new normal' really any different for investment managers than past environments?
Sylvain Privat: The current environment is a somewhat unique combination of events that has put pressure on the margins of asset managers. It's the combination of long-term underperformance of equity in the decade between 2000 and 2010 – which accelerated the 2008 credit crisis – and muted cash flows into investments. In addition, there is now an unprecedented level of regulation and investors are a lot more cautious. All this has brought significant additional costs to asset managers, forcing them to find new solutions. Many have turned to alternative products. These investments have increased from 5% to 19% in pension funds portfolios over 15 years. Passive investments, such as exchange-traded funds, have experienced double-digit growth for the past 8–10 years.

HEDGE FUNDS REVIEW: When companies move into these new alternative products, is enough thought given to the IT infrastructure that will be needed to support them?
Sylvain Privat: I think it's fair to say that, when investment companies expand into a new asset class, they quite frequently underestimate the cost of not being prepared. Often these new markets will be covered by spreadsheets or a system that is completely segregated from the company's other activities. Therefore, data is created that is inconsistent and not in sync with the rest of the company. Some companies have thousands of spreadsheets, which is a clear breach of transparency, as well as an unmanageable operational risk. This is especially true when companies are growing and launching lots of new products. They can become so dependent on fragile architectures that growth strategies can become risky and destructive. If the technology or infrastructure that underpins the new strategy is not scalable, the asset growth will not be scalable either. In the new normal, it's critical for asset managers to be innovative, but trading complex assets requires sophisticated risk analytics, which need to be consolidated with the rest of the company portfolio. Having the ability to manage margins across complex

Enhancing the front-office value chain



multi-asset portfolios requires a close link between all asset classes.

HEDGE FUNDS REVIEW: What might some of these new exotic classes require in terms of IT?
Sylvain Privat: When a company wants to trade a new asset class, the front, middle and back office all need to be connected. It's critical that portfolio managers understand where the risk is in their portfolios and have the information they need to make decisions across everything from the most complex asset classes to simple bonds. At the same time, they need a framework to provide analytics on each of the asset classes so that front-office users can understand the consequence of potential new trades. There is also an increasing need for middle-office information in the front office. For example, the portfolio manager will want to know whether a trade should be cleared on a derivative platform and what the expected margin is. There's a definite benefit to having an integrated credit system in the front office. Questions such as, 'what is the impact on accounting profit and loss?' are also very important. Crucially, it's increasingly important for asset managers to ensure that no regulatory rules are breached. Hence pre-trade controls are also needed in the front office. If a portfolio manager is trading a new over-the-counter (OTC) contract or a complex derivative, all constraints, limits and risks have to be checked before the trade is executed.

HEDGE FUNDS REVIEW: What sort of overhaul is required to move from a silo-based approach to true front-to-back integration?
Sylvain Privat: All firms are different,

but investment companies first have to think about their long-term strategy – where they want to go and whether they have the IT infrastructure to allow sustainable growth. They need to work out the best way of rolling out integration, whether it is asset by asset or branch by branch, portfolio by portfolio or front office, middle office then back office. Integration can then be rolled out block by block, as and when the company is ready for it, in order to avoid unnecessary disruption to the business.

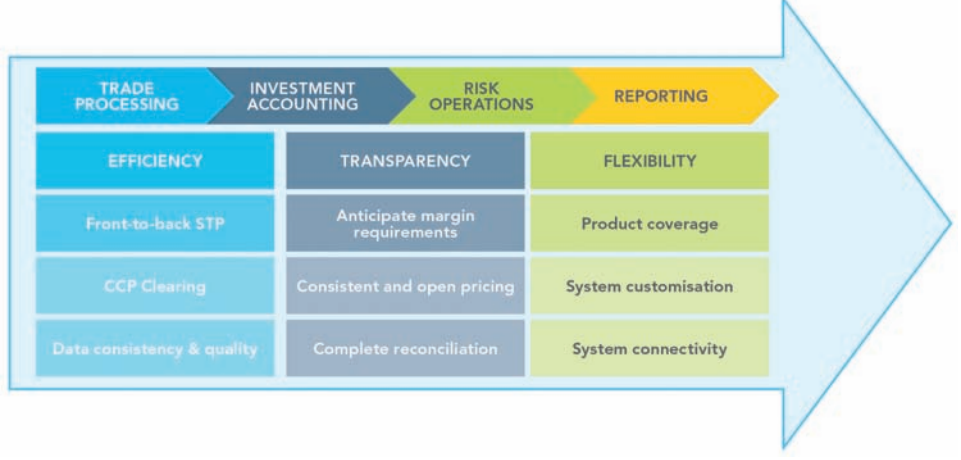
HEDGE FUNDS REVIEW: Can a fully integrated cross-asset IT system really allow expansion into new asset classes?
Sylvain Privat: The key differentiator of integrated systems versus best-of-breed approaches is that integrated systems come with the broadest financial experience across equity, credit and fixed income, as well as instruments from cash products and sophisticated derivatives. Secondly, the architecture is very open and can handle a lot of variations and specificities so it can be reconfigured by users easily when a new situation or requirement arises. Furthermore, the system covers a wide range of operational procedures and can utilise many types of market data via a single database, so it has the ability to cope with new and unexpected requirements, which may be highly specific or exceptional. It can also be a powerful tool to handle change management. Misys Sophis solutions, for example, are used both by investment banks and buy-side institutions, so there's a huge transfer of value and expertise from the sell-side to the buy-side.

HEDGE FUNDS REVIEW: What are the major drawbacks of best-of-breed specialist solutions?
Sylvain Privat: The two major drawbacks are cost and operational issues. Having different best-of-breed solutions often turns out to be very expensive and unmanageable when a firm experiences growth. Operational issues, such as problems around change management, can occur when new strategies are needed. Data management can also become problematic when you have silo systems all using their own databases and, essentially, their own version of the truth. Front-, middle- and back-office personnel will therefore all have different data and different views for the different asset classes that are traded. Having intraday real-time knowledge therefore becomes impossible because there are discrepancies between portfolio indicators, performance and the status of trades.

HEDGE FUNDS REVIEW: Isn't there a danger with integrated models that an element of specialisation is lost?
Sylvain Privat: This is something we acknowledge. Some specialisation is compromised. But having a system with the capability to grow with the investment firm is an important tool for investment management companies. CEOs want systems that do the job at a low cost and with rationalised and compliant workflows. This is very difficult to achieve by having layers of silo-based systems that are added to an existing framework. With this infrastructure, there is no consolidated view available for the CEO or other senior officers. This could lead to trouble with transparency around trading functions and the cost of this could be huge. A breach of regulatory rules or internal risk management guidelines could quickly lead to reputational risk, something no manager can afford. You don't want to have unmanaged risk at any level in the portfolio.

HEDGE FUNDS REVIEW: What is the best way of managing data in order to be transparent and compliant with different sets of regulation?
Sylvain Privat: Regulation has brought uncertainty to asset managers, especially around data management. To cope with that in an effective way, risk managers need both standardisation of data and flexibility around data management due to regulatory uncertainty. We put forward a solution for each piece of regulation but, at a system level, our aim is to be future-proof when it comes to regulation. For clients that want

Enhancing the operations value chain



to trade a cleared derivative we can compose a comprehensive regulation-specific module, for example a European Market Infrastructure Regulation (EMIR) or Dodd-Frank module. Systems can also enable the client to benefit from some of the regulation. For example, Solvency II is a game changer for investment companies, as insurance companies now need to put aside some capital when a firm takes market risk. So there are some interesting opportunities due to all the transparency requirements that will be implied from this new constraint. We look for opportunities. We monitor the regulatory environment constantly and are in frequent discussions with regulators in order to understand the details.

HEDGE FUNDS REVIEW: What level of transparency are investors now demanding and how can that be delivered?
Sylvain Privat: Transparency, which hasn't always been a priority, is now at the top of the agenda, but it can mean different things to different investors. Some investors only want to know what their exposures are so they can understand their market risk. Others want to know exactly where in

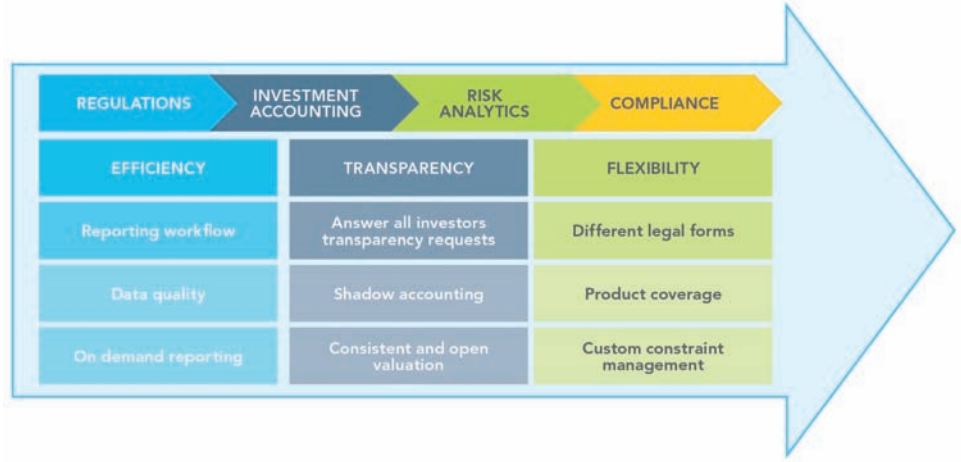
a portfolio the performance is coming from. Investors are very aware of non-linear risk now so they require stress tests and value-at-risk (VaR) indicators that provide them with additional understanding of what is actually at risk in that portfolio. Increasingly, what is now required is an understanding of liquidity. Investors want to know what proportion of the portfolio is liquid, what is not and what kind of security is being traded. This sort of information is often being offered to investors now. Institutional investors tend not to want investment companies to outsource too much in the way of operations and IT. They at least want the firm to have the ability to replicate the portfolio and have a high level of visibility of positions so they can challenge the custodian if necessary. At Misys, our product strategy is increasingly influenced by the demands of investors. We see their needs as highly important as, in essence, they are our customers' clients.

HEDGE FUNDS REVIEW: What IT requirements will there be due to the movement of OTC derivatives to electronic platforms? What about strategies based on both cleared and non-cleared derivatives?

Sylvain Privat: Cleared OTC derivatives contracts are going to move closer and closer towards securities in terms of portfolio management, operations and pricing. From an IT perspective, the derivative reform will put increased demand on the front office, pricing and on back office and straight-through-processing. The impact is not only on the ability to price instruments internally and run portfolio management, the system will also need to handle the different central counterparties (CCPs). This is a far more complex situation than bilateral trading. In the past, OTC pricing has never needed to be standardised. The situation will be even more complex for managers with strategies that use both cleared and non-cleared derivatives, and most of the investment industry will be in that situation. A more complex valuation process will be required, using overnight indexed swap discounting or a credit value adjustment methodology, to handle the bilateral trades appropriately. This will be a major change for investment companies. They will need a system that can handle all constraints consistently across a range of portfolios and manage transparency requirements across all the different instruments that are traded. If they don't have that, the whole valuation and hedging process will be flawed.

HEDGE FUNDS REVIEW: How will collateral management be affected by derivative reform? What are the benefits of an integrated platform on collateral and margin management?
Sylvain Privat: Derivative reform will result in a rising need for collateral and therefore investment firms will have to pay much closer attention to the way they manage collateral and inventory, and look at optimising their collateral management. Integrated platforms are seen as a solution to combine collateral management with advanced risk management capabilities such as VaR. This enables a portfolio manager to replicate, reconcile and anticipate the consequences of trading a new OTC product on a portfolio. An integrated platform will have a portfolio management tool, a VaR engine and a collateral management tool. This information can be made available in real time or near real time to portfolio managers, which enables better decision-making when assessing the impact of a new trade on the portfolio. In this instance, best-of-breed systems will have trouble getting the necessary information to the relevant person in time to enable optimal collateral management.

Enhancing the investor services value chain



Sylvain Privat is a senior buy-side product manager for Misys. His role is dedicated to the flagship solution for investment management, Misys Sophis VALUE. He is responsible for all strategic and client-driven developments across the front-office, risk management and operations management areas of the system. Sylvain holds an MSc in general engineering from L'Ecole Centrale Paris, with a specialisation in applied mathematics and finance.