FROM SUPPORT TO EMPOWERMENT

Drawing lessons from Global Custodian's annual industry surveys, David Nable, managing director and head of client and partner development at Arcesium, suggests the lines between technology and business are blurring for the better.

GC: Technology is, not for the first time, in the bottom quartile of results in the GC Prime Brokerage survey. Why do you think that is?
David Nable: Client-facing technology at the prime brokers has tended not to get much love over the past decade, and it has really been for good reason. It's not a meaningful driver of business for them. Before the financial crisis, many of the hedge fund managers had one prime broker. As such, in addition to all the typical things that they would expect from their prime broker – access to quality balance sheets, capital introductions, consulting services, and the like – clients also relied on the prime broker to provide them with technology to help run their business.

Post-crisis, that dynamic changed. Fund managers left the single prime model and had to look for different ways to get their consolidated reporting. That shift resulted in significant growth for independent technology companies that sold their consolidation accounting and reporting software directly to the fund managers; alternatively, the administrators stepped in to fill the void for consolidated reporting. In that market dynamic, the primes themselves began competing with a different value proposition, de-emphasising front-end hedge fund technology and re-emphasise, things like quality of their balance sheet, access to that balance sheet, high end consulting and capital services, and a more holistic banking relationship.

With the changing expectations for what services a prime broker needs to provide and emphasise, as well as a larger and more divisible fee pool, there have been a notable number of entrants into the space. Who are those new entrants? In particular, firms with expansive balance sheets who are looking to deploy their capital to the hedge fund community. The common thread among the existing primes and the new entrants is that they are emphasising their technology spend on areas that are most impactful to the clients, which is not really the front end. They're not putting an order management system on their client desktops; that sort of value proposition has largely shifted either to the independent technology companies or to the administrators.

Instead, they are building new swap platforms to deploy their balance sheet to new client segments. They are taking quantitative approaches to improve the internalisation rates that drive down the cost of funding, which, of course, ultimately benefits the clients. They're digitising the capital introduction process, and they're building infrastructure to offer more innovative cross-asset financing platforms.

These initiatives all require massive technology investments, and all of the prime brokers' clients are seeing meaningful benefits from this associated spend. I would argue that some of the higher-ranking categories in your survey actually reflect the prime brokers' investment in technology to support those initiatives.

GC: That is perhaps reflected in the relatively high score for Operations.
DN: I agree. In the survey respondents' minds, they do not necessarily associate those things with technology directly because it is not how the clients experience that technology. For example, a new cross-asset margin financing platform is not experienced as a website, but as a very sophisticated funding solution.

I don't blame the prime brokers for not spending a lot of money on new reporting, or a fancier website, because that's not what the clients ask of them. The clients are pressuring the administrators or the independent technology providers for that. Instead, they want balance sheet and capital services from their prime brokers. I think the primes have been phenomenally responsive to that client need.

GC: Is there anything where you think primes are still lagging in terms of meeting client expectations?
DN: I would say that there is a gap in expectations concerning transparency in margin and funding allocations. The way the clients experience the margin and financing process is still largely as a black box. There is, of course, diversity in the prime brokerage market, but by and large, clients do not feel that they have real transparency into how the prime brokers assess capital requirements, margin requirements, and the like. Certainly, it may exist in a legal document, and they may provide some methodologies to the client. However, in terms of technology, almost none of the prime brokers offer their clients a portal where they could perform a 'what if' analysis. What if I

David Nable, managing director and head of client and partner development, Arcesium

trade this new asset class? What if I bring on this new distressed portfolio? How much will it cost to fund and how much collateral will I have to post? In terms of technology, I believe that is an area that is lagging.

GC: If we move to the Hedge Fund Administration (HFA) survey, one thing that's quite obvious is that scoring is more generous than it is for the PBs. Where do you think technology has played the greatest role in convincing these respondents to be generous in that way?

DN: Again, I would say that technology is at the heart of all of these categories. We can talk about things like cloud and AI all day, but the reality is that many administrators are still processing a significant amount of activity via fax. For some of these firms, when you talk about digital transformation, to them, it means converting the fax to a PDF. I would argue that it's the manual processes at some administrators that are driving prices up, because it requires more humans to do the work, and actually results in a poor overall client experience. Too many administrators are thinking about technology as an expense to be managed, as opposed to an investment that will make them more competitive and more nimble in reacting to their clients' needs.

In fairness, given the administrators' experience with technology, this view is not unreasonable. For years, the HFA industry has approached change through a series of small measures, to the point where anytime a client wants to trade a new asset class or introduce a new type of instrument that they haven't processed before, the administrator needs to upgrade dozens of systems. That's hardly a recipe for agility.

I believe, for administrators to be truly responsive to their clients' needs, they need to fundamentally rethink their architecture, which, for most firms, was put in place decades ago. For hedge fund administrators to really improve the client experience across all of these components, they need to go beyond individual solutions for individual problems. That's a recipe for having 78 different systems that you then need to integrate, maintain, and upgrade.

Have the humans do what the humans are there to do and thoughtfully design architecture to automate the rest. There's no magic bullet. It's really about a culture of empowering their people with technology so that they don't have to do what the technology should do. Then, when the technology is behind the scenes, they can focus on adding higher value service and support to those clients.

GC: Are HFAs equipped to make this holistic assessment of technology needs versus human resources? Or are the decisions about IT siloed, to an inconvenient degree within organisations?

DN: It differs from firm to firm. I think the most agile firms, and the firms who will win over the next decade, are viewing technology as a strategic part of their business. Another major point is that there is a blurring of the lines between technology and the business. We see now, at very forward-thinking firms, that operations and accounting staff are expected to know how to program. For example, some of Arcesium's new positions in accounting and operations now have programming requirements in the job description. We want people who are digital natives; we want people who know how to take a data-driven approach to do their job. We are not an administrator ourselves, but we often compete with them for talent and this is a common thread. That doesn't mean the global heads of fund accounting and shareholder services are suddenly learning to program in R and Python, but it does mean they need to be thoughtful about the architecture that supports their client business. If you are a senior leader at a major administrator, you definitely need to think about how architecture, data governance and information flows impact your ability to deliver your product to existing and new clients.

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