

TRADING UP

OPTIMISATION, OUTSOURCING, AND THE REINVENTION
OF THE BUY SIDE TRADING DESK

THE AUTHORS



DAVID ROGERS PARTNER

BEng (Mechanical Engineering) (Hons), *University of Reading*
MSc (Automotive Product Engineering), *Cranfield University*

David has over 21 years of experience in the financial services industry, holding senior trading roles with leading global buy and sell-side institutions. He was previously Head of Trading, Asia-Pacific for State Street Global Advisors in Hong Kong, where he led Fixed Income, Equity, Currency, and Derivatives execution. David has also been responsible for Electronic Trading, TCA and platforms at Fidelity Management & Research, and had a 12-year career on the sell side, running APAC Portfolio Trading at UBS and Deutsche Bank. David began his career at Goldman Sachs in London.

He specialises in buy and sell side platform transformation, assisting end asset owners bringing trading in-house, and has had extensive exposure to the outsourced trading industry.



BENJAMIN QUINLAN

CEO & MANAGING PARTNER

BCom (Hons 1) / LLB (Hons), *Macquarie University*

Benjamin Quinlan is the CEO and Managing Partner of Quinlan & Associates. He is also the Chairman of the FinTech Association of Hong Kong an Adjunct Professor at the AIT School of Management, and a Conference Ambassador for the Hong Kong Tourism Board. In addition to these roles, he sits on the Advisory Committee for Hong Kong Science and Technology Park's Technology Validation Initiative, the Asian Financial Forum Steering Committee for the Hong Kong Trade and Development Council the Finance, Tax & Legal Steering Committee of the Australian Chamber of Commerce and the Finance & Treasury Committee at the Hong Kong General Chamber of Commerce (HKGCC). Benjamin. He is also a Senior Advisor / Board Advisor for a number of leading startups, a Mentor for PingAn's Cloud Accelerator, a Guest Contributor for eFinancialCareers and Regulation Asia, and has been widely recognised as one Asia's leading FinTech influencers.

Prior to founding Quinlan & Associates, Benjamin was the Head of Strategy for Deutsche Bank AG's Equities business in Asia Pacific and its Investment Bank in Greater China. He has also worked at Oliver Wyman, UBS AG, and PwC.



EASHAN TREHAN

SENIOR CONSULTANT

BEng (Computer Science and Finance) (Hons), *University of Hong Kong*

Eashan Trehan is a Senior Consultant at Quinlan & Associates. He is also an Academic and Career Advisor at St. John's College, University of Hong Kong (HKU).

Prior to joining Quinlan & Associates, Eashan interned at J.P. Morgan, in the investment solutions division where he researched multi-asset investment opportunities, as well as at Deutsche Bank in credit risk, finance, and business management. Eashan was also the Head of Finance and Technology at student-led Eureka Consulting Group (ECG), where he completed various consulting projects for MNCs and other leading Asian firms.

SPECIAL THANKS

We would like to thank our research analyst, Emily Yang (MBA candidate at UCLA Anderson School of Management) for her extensive work in helping with the preparation of this report.

CONTENTS

EXECUTIVE SUMMARY	6
SECTION 1: BUY SIDE TRADING LANDSCAPE	8
SECTION 2: PRESENT CHALLENGES	17
SECTION 3: ECONOMIC WASTAGE	22
SECTION 4: EXPERT OPINION	34
SECTION 5: THE WAY FORWARD	36
SECTION 6: POTENTIAL UPSIDE	64
SECTION 7: KEY IMPLEMENTATION CONSIDERATIONS	67
SECTION 8: CONCLUSION	70
SECTION 9: HOW CAN QUINLAN & ASSOCIATES HELP?	71

EXECUTIVE SUMMARY

Over the past three decades, the growth of the asset management industry has been accompanied by a broad-based evolution in a critical element of the investment process: trading.

While historically viewed by the asset management industry as a high cost, operational necessity, the implementation leg of the investment value chain – known as the buy side trading desk – plays a critical but often overlooked role in fund performance enhancement and consistency, as well as genuine alpha generation.

Despite benefiting from numerous technological developments over the years, especially the growing use of electronic trading, the buy side trading desk has had to contend with several challenges, including a dearth of competitive pressure, unresolved inefficiencies, and growing cost burdens. In more recent years, asset managers have witnessed a significant reduction in fees on the back of industry consolidation, the entry of new digital-first players, and a secular trend in favour of low-cost, passive investing. In response, many asset managers have resorted to cost cutting and/or a lack of investment to protect their bottom lines.

The size of the industry is still significant, however: for example, in 2020 alone, asset managers spent USD 14.9 billion globally, or 51% of their budget, on equity trading expenses such as commissions, capital commitment, and so on.

While cost cutting may appear to be a logical response to rising industry headwinds in the short term, the fact is, many buy side trading desks suffer from significant internal inefficiencies that result in sizeable economic waste. We estimate that some of the largest fund managers are spending up to USD 14 million p.a. in explicit costs for their execution operations, with roughly one-third of this (i.e. USD 5 million p.a.) being squandered as a result of structural, technological, cultural and operational problems.

More critically, however, are the implicit costs being generated by asset managers from maintaining sub-optimal trading operations, many of which are frequently overlooked. We estimate a lack of technological proficiency, poor choice of execution method, and the widespread absence of internal / external partnerships is, on average, impacting fund performance by 1.2-2.7% p.a., costing the very largest asset managers in excess of USD 18 billion p.a. in opportunity cost (i.e. lost fund performance) to their end asset owner clients.

The noise around the outsourced trading industry has grown very loud in the past year, and the sheer number of participants now is very striking. Despite this, we see a limited, genuinely accretive usage argument for a significant proportion of the asset management industry. While staffing a full-time desk is no doubt a meaningful economic commitment, outsourcing, despite its marketing, follows the basic tenet of Best Execution in somewhat of a haphazard manner. In farming out trading, it is likely that an asset manager could be falling short of both its performance and regulatory obligations.

Our extensive research, along with interviews with industry professionals on both buy and sell side, highlights that a persistence in carrying sub-optimal practices is rife within the trading industry, reinforcing the need for structural changes and a more fundamental reinvention of the buy side trading desk.

We identify three key pathways asset managers can explore to make their trading operations more accretive to their investment process, including outsourcing, internal optimisation, and a hybrid solution.

Through a careful examination of various strategic, operational, and financial considerations, we see sizeable benefits for asset managers who can get their trading construct right; from improved client engagement, execution quality, operating efficiency, and teaming / culture, to reduced internal costs.

Given the sheer size of the economic upside at stake for their end clients, we see this as a critical time for the asset management industry to start trading up.

SECTION 1

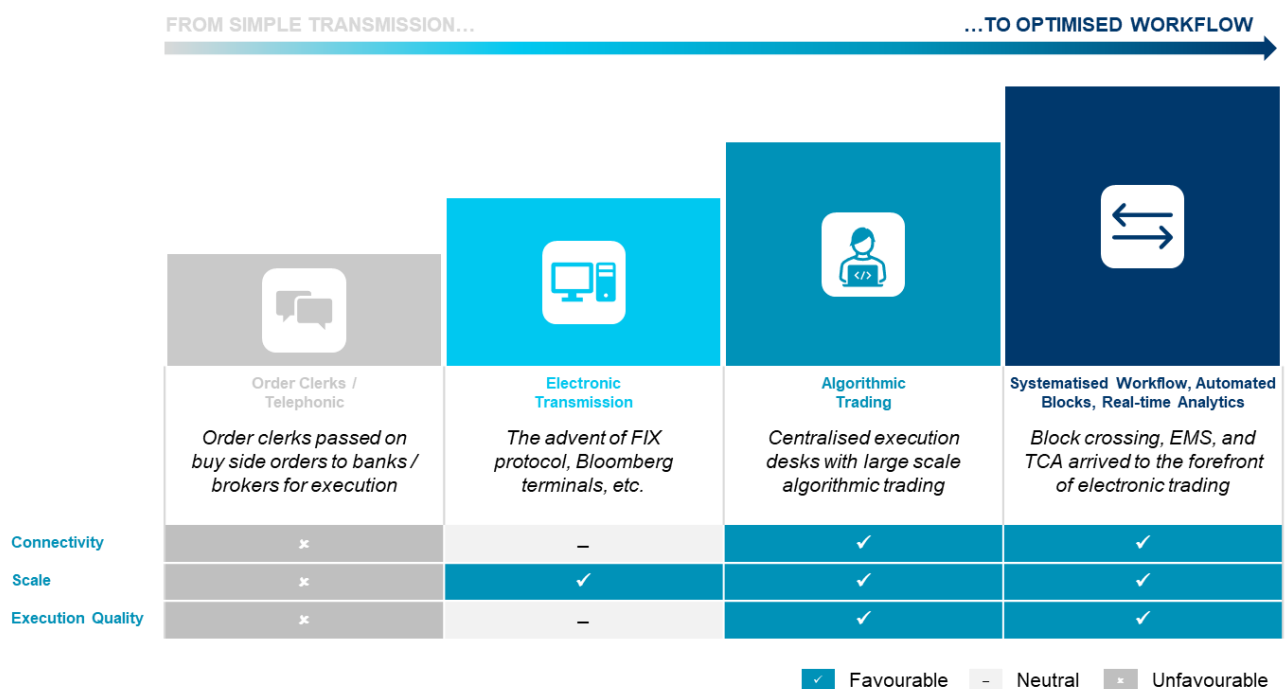
BUY SIDE TRADING LANDSCAPE

MODEL EVOLUTION

For nearly thirty years, asset managers around the world have deployed in-house trading functions as part of their operational framework to deliver a more holistic investment capability.

As instrumentation became more complex and turnover grew, the separation of fund management and the execution of orders became more popular, reflecting a growing evolution of the buy side trading model (see Figure 1).

FIGURE 1: THE EVOLUTION OF BUY SIDE TRADING



Source: Quinlan & Associates analysis

1. ORDER CLERKS / TELEPHONIC

Trading responsibilities were originally devolved from portfolio managers to employees who were essentially “order clerks”, receiving and then passing on orders to a broker or bank for execution, via telephone. Trades would be booked manually for onward settlement. Technology was extremely nascent, with relationships – neither liquidity, nor measurement – reigning supreme.

2. ELECTRONIC TRANSMISSION

The advent of Financial Information eXchange (“FIX”) protocol, which was originally launched in 1992 (but not widely deployed until the early 2000s), along with the proliferation of Bloomberg terminals and a move away from Unix-based Order Management System (“OMS”) environments, accelerated both the connectivity as well as scale through which the buy side could operate. Execution quality could also, tentatively, begin to be assessed, such that broker choice became a more tangible consideration for asset managers.

3. ALGORITHMIC TRADING

When electronic trading via broker-provided algorithms became available on an industrial, institutionalised scale in the mid-2000s, centralised execution desks made a step-change in their approach and attitude towards the transacting of large volumes of global equities and fixed income, currency, and commodity (“FICC”) instruments. Their job descriptions even quietly changed from “dealers” to “traders”, as they were the ones who were starting to transact directly on or with the market itself.

Although different asset classes’ technological development was moving at varying speeds, the relevance of the trading function grew considerably during this time, with the largest asset managers employing up to a dozen full-time employees globally.

4. SYSTEMATISED WORKFLOW, AUTOMATED BLOCKS, REAL-TIME ANALYTICS

Fast forward another 15 years and the centralised execution desk model is today deployed in single as well as multi-asset fund management operations, large and small. Given that the value of implicit (i.e. market and stock movement) and explicit (e.g. commissions, human, and technological, etc.) costs are better understood than ever before, the largest operators now have three times the number of earlier staff, transacting billions of dollars of flow on behalf of their asset contributors daily.

Algorithmic trading has moved into the non-equity and derivatives spaces, block crossing can now be anonymously negotiated via electronic platforms, and Execution Management Systems (“EMS”) have the capability of displaying Transaction Cost Analysis (“TCA”) in real-time, as individual fills are returned from the market.

As a result of this four-stage evolution, with investment returns now being scrutinised more than ever by end asset owners, trading has become an integral and transparent part of the investment process, being triangulated with portfolio management and sales / client servicing, then overlaid with a framework containing compliance, legal, and operational aspects.

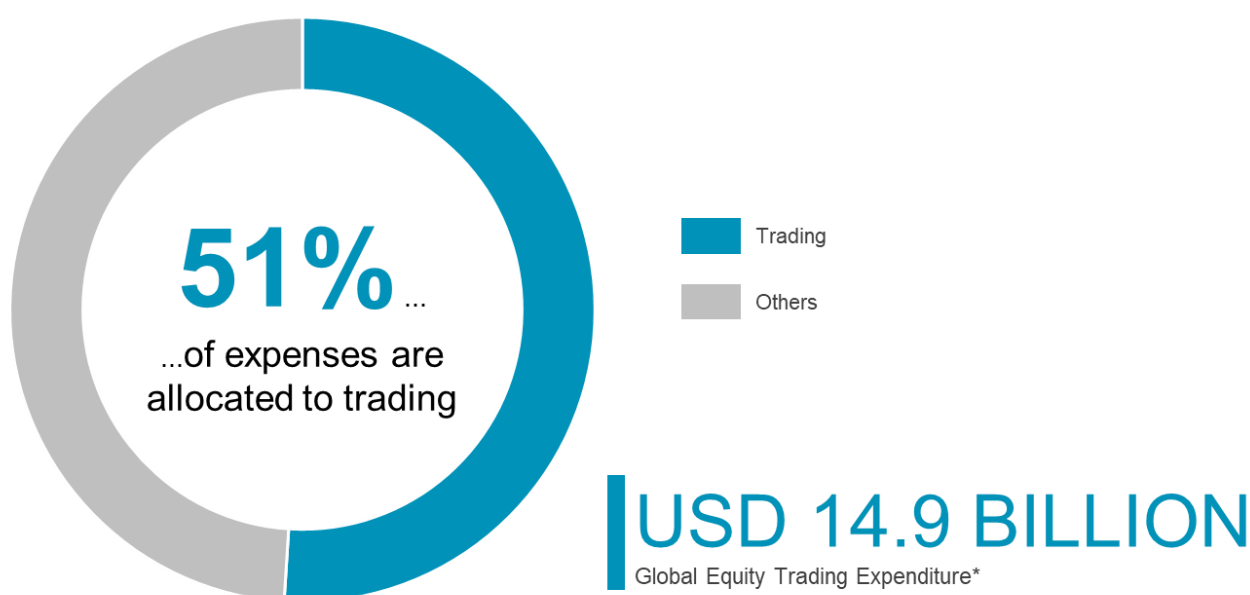
MARKET SIZE

Given the growth experienced by the investment management industry, and the subsequent requirement for internal execution services, the question of what the buy side trading model looks like in terms of scale, and where it goes from here, arises.

Excluding financing-related costs, global spend by the asset management industry on cash

equity research, advisory, corporate access, sales coverage, and trading / execution services reached USD 29.2 billion in 2020. Of this, 51%, or USD 14.9 billion, was spent on trading, including all commission payments (such as Commission Sharing Agreements (“CSAs”) and Research Payment Accounts (“RPAs”)), the use of capital commitment, and any other execution-related service costs.¹

FIGURE 2: GLOBAL BUY SIDE EQUITIES SPEND BREAKDOWN (2020, %)



*including all commission payments (such as Commission Sharing Agreements (“CSAs”) and Research Payment Accounts (“RPAs”)), the use of capital commitment, and any other execution-related service costs

Note: financing related costs have not been included

Source: Greenwich, Quinlan & Associates analysis

Note: the equivalent FICC number is opaque due to the way the majority of services are priced and consumed, e.g., a currency trade would mostly be transacted through utilisation of a bank’s balance sheet as opposed to an agency trade settled against a commission. It is for this reason that this research paper will focus primarily on equities throughout.

¹ Greenwich, ‘Buy-Side Trading Desk Budgets in 2021: Technology Pays Off’, June 2021, available at: <https://www.greenwich.com/market-structure-technology/buy-side-trading-desk-budgets-2021-technology-pays>

For the purposes of this report, we are not considering commission pay-out to the street, capital commitment costs, CSA/RPA payments, etc., which form the basis of the USD 14.9 billion figure above. These expenses are traditionally paid out by the fund(s) being managed, whereas the cost of running the trading desk is borne by the asset manager themselves (this can be one of the factors involved in pricing any given client mandate).

Due to the significant variance in turnover between different types of funds (it can vary between 20-200%+), as well as the absence of

clear relationship between the above factors and these pay-outs, we are focusing solely on *the costs the asset manager themselves bear*, as well as any execution performance they may forgo as a result of inadequate workflow and poor culture. The first factor affects the asset manager's cost base, while the second the end asset owner's performance.

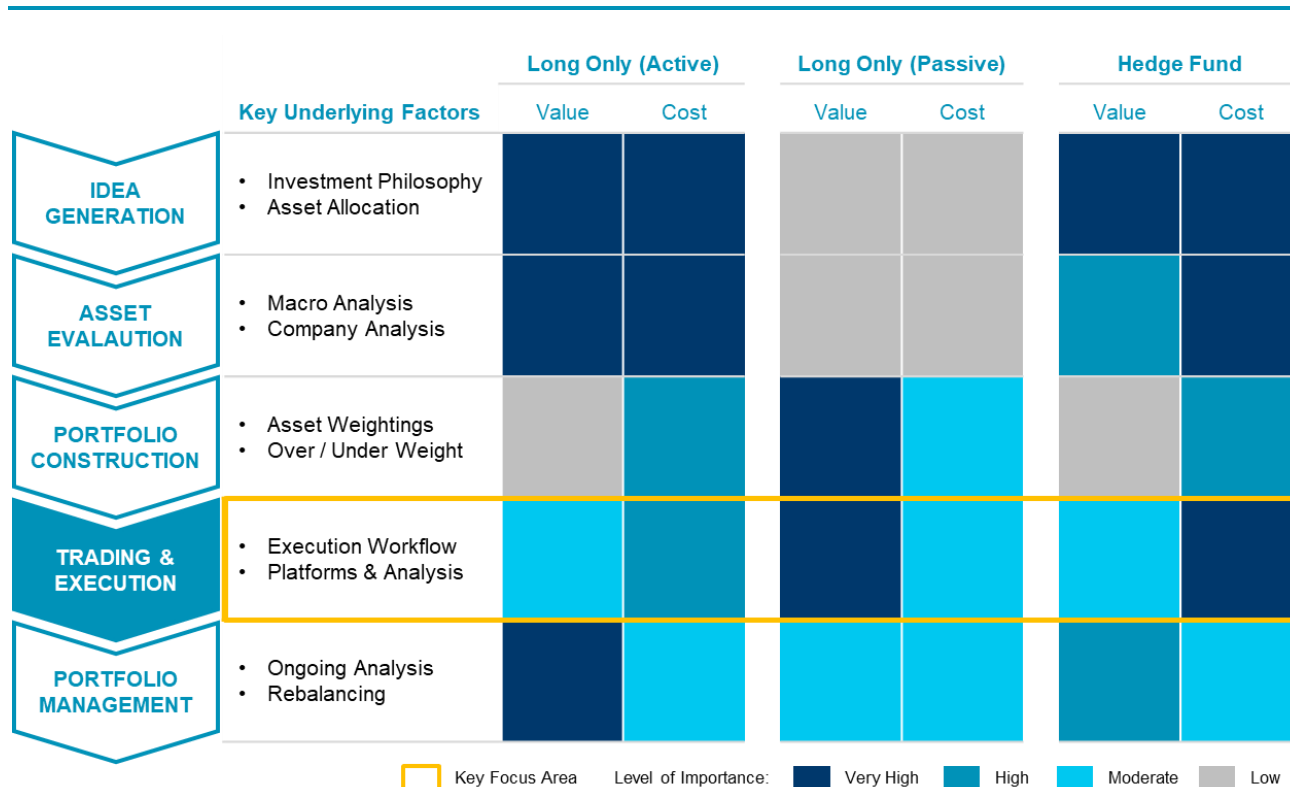
In an outsourcing situation, the operational overhead of maintaining a trading desk completely or partially disappears, depending on how the service is used.

KEY PARTICIPANTS

While there are many types of buy side participants in the market, we will focus specifically on three key groups: (1) Long Only (Active); (2) Long Only (Passive); and (3) Hedge Funds.

In order to better understand the importance of the buy side trading desk to these asset managers, there is a need to first understand the role it plays in the overall value chain (i.e. from idea generation to portfolio management) of a typical asset manager (see Figure 3).

FIGURE 3: ASSET MANAGEMENT VALUE CHAIN²



Source: Quinlan & Associates analysis

² Note: it is important to note that distinct differences exist in terms of the value (with regards alpha generation) and cost (to the overall value chain) of trading between the three types of asset manager. Each asset manager starts its journey with a specific commercial proposition targeted towards its existing and potential investors, followed by: (1) an internal structure; (2) governance controls; and (3) culture, in order to deliver and then maintain this proposition, enhancing the value and cost points.

1. LONG ONLY (ACTIVE)

Since Long Only (Active) managers are required to place a relatively greater emphasis on specific asset selection rather than broad-based index- or sector-based investing, the trading function is generally awarded with a lower degree of importance. While operational intensity may be lower, there remains a greater requirement to provide ideas, market / stock colour, and block crossing (to minimise implicit costs of trading in large / high volume situations). However, since position returns are much higher, they tend to dwarf any perceived value-add from trading.

On the flip side, cost sensitivity towards trading is high, given the greater emphasis on alpha generation and service provision to portfolio managers, on top of other operational requirements, all in an environment of high compensation as well as working pressure.

2. LONG ONLY (PASSIVE)

Given that Long Only (Passive) funds are focused generally on tracking indices (with some degree of enhanced beta) rather than outright alpha generation, they typically attempt to drive outperformance via accretive workflows

and enhanced / re-optimised broker measurement. However, there is no ongoing requirement for authentic, alpha-related value-addition since their trading desk's focus tends towards operational solidity.

The cost of trading is a significant factor for Long Only (Passive) funds. While traders are being paid only slightly smaller sums than their Long Only (Active) and Hedge Fund counterparts, they are incurring higher operational costs against demonstrably lower returns and a tighter fee environment, since they are not involved in any form of idea or direct alpha generation.

3. HEDGE FUNDS

Akin to Long Only (Active) fund managers, due to the alpha profile of Hedge Fund managers, the trading function receives less importance. As such, Hedge Funds tend to attach a lower value to buy side trading.

The cost of trading, however, is more sensitive, along the lines of Long Only (Active) fund managers. This results in significant importance being attached to buy side trading costs by Hedge Fund managers.

THE BUY SIDE TRADING DESK

Depending on the size of the operation, buy side trading desks tend to be segregated by specific fields of expertise. This can be asset-based (e.g. dedicated FICC or equity traders) and/or country, sector, or grouping based – for example, United Kingdom equity, European technology stocks, or Emerging Markets credit. Smaller fund managers have significant crossovers, which brings the multi-disciplined – or multi-asset – trader into play.

Traders will operationally back each other up, either locally or via other geographies. In the case of Hedge Funds and Long Only (Active) Funds, they tend to have primary “coverage” responsibility for specific portfolio managers (“PMs”), who augment their portfolio construction and management process with content and colour from the desk, mostly collated from news feeds such as Bloomberg, as well as broker inputs. In the passive space, PMs are not usually covered proactively, instead needing traders for ad hoc information (e.g. corporate actions, liquidity events, etc.) and operational requirements.

From a start-up to a trillion-dollar asset manager, the remit of a typical trader has today become truly multi-faceted. In the aftermath of

the Global Financial Crisis (“GFC”), due heightened regulatory rigour around the world, the more senior a trader is, the greater the degree of non-execution responsibilities they now assume. As such, compliance- and operational-related tasks feature prominently.

Moreover, given the rapid rise in electronic trading usage and measurement, as well as a greater focus on trading-based idea generation (especially prevalent in the Hedge Fund space), the modern trader has had to adapt to become more analytical in their day-to-day role.

Additional responsibilities – ranging from assessing brokers through empirical evidence to running pricing models and working with more complex instrumentation – has meant that the waterline has risen noticeably, with modern traders now needing to cover four key sets of responsibilities: (1) operational; (2) platform; (3) external; and (4) regulatory management (see Figure 4).

However, only a small proportion of these could be considered as execution enhancing / alpha generating (i.e. adding performance to the fund, over and above the PM) and/or accretive in a commercial sense (i.e. contributing to the growth / maintenance of assets from a given client).

FIGURE 4: REMIT OF BUY SIDE TRADERS

	Responsibility	Description
OPERATIONAL	Order Execution	• Execution method selection, liquidity provision, and broker selection
	Operational Risk Management	• Managing operational risk (.g. settlement issues, trade amendment / cancellation)
	Market Colour and Content Delivery	• Assimilate and deliver colour / content for portfolio managers, research analysts
	Stock / Macro Ideas Generation	• Generate asset-specific / macro ideas (especially for hedge funds)
	Performance Characteristics Measurements	• Measure characteristics (e.g. intra-day and post-trade analytics, TCA reporting)
PLATFORM	Electronic Trading Development	• Algorithm trading capabilities development, vendor screening
	OMS / EMS Maintenance and Enhancements	• Vendor communication, new functionality deployment
	Counterparty Risk Management	• Counterparty exposure / creditworthiness assessment (for OTC instruments)
	Commission Management and Allocation	• Management and allocation of commission, as per prescribed requirements
	Specific Project Management	• Ad hoc projects like new broker measurement methodology, broker onboarding
EXTERNAL	Global Workflow Oversight and Development	• Take charge of internal responsibilities (e.g. regional order routing, etc.)
	Industry / Market Stewardship	• Activities designed to further contribute to the industry (e.g. thought leadership, etc.)
	Client-Facing Responsibilities	• Direct or indirect client work, such as presentations, collaboration with sales teams
	Broker Efficacy and Relationships Management	• Assess and maintain broker efficacy and relationships (empirically and/or subjectively)
	New Counterparties / Platforms Onboarding	• Onboarding new banks / brokers, in collaboration with legal department
REGULATORY	Compliance Responsibilities	• Ongoing staff training, product control implementation, and maintenance of standards
	Regulatory Oversight	• Liaising with internal and external compliance authorities

Alpha Generating / Execution Enhancing / Commercially Accretive Tasks

Note: figure is designed to be exhaustive; not all traders will perform all of the above tasks
Source: Quinlan & Associates analysis

1. OPERATIONAL

The core, day-to-day responsibilities of a buy side trader typically revolve around execution of orders, which includes: (1) determining the primary method (and/or price) of execution; (2) ensuring the provision of liquidity; and (3) selecting the most appropriate broker or bank for the task. While executing orders, traders also need to be wary of operational risks, such as linkage and settlement issues.

Besides execution, traders also provide colour around the latest market updates and contribute to alpha generation via activities such as generating stock / macro ideas and measuring performance characteristics of intra-day trades and through post-trade analytics.

2. PLATFORM

The platform management responsibilities of a trader may encapsulate project work, such as (1) developing electronic trading capabilities; (2) working with vendors to maintain and add new functionalities to OMS / EMS; (3) reflecting on counterparty creditworthiness, especially with regards to FICC and derivatives instruments; (4) managing allocation of commission; (5) overseeing global workflow and development of the firm; and (6) other special projects that may be assigned on an ad-hoc basis.

3. EXTERNAL

Traders may be given external duties of a commercial nature, aimed at facilitating the inflow of new business, or maintaining existing assets, through activities such as (1) industry thought leadership; (2) direct and indirect client work (e.g. attending meetings, delivering presentations, etc.); (3) assessing broker efficiency in terms of empirical and/or subjective metrics and maintaining relationships; and (4) assisting in onboarding of new clients, in collaboration with the legal, credit, and compliance departments.

4. REGULATORY

As a trader progresses in their career, they typically take on a greater degree of regulatory oversight, which includes overseeing ongoing

training, proper maintenance of standards, and liaising with regulatory authorities. An example of this is in Hong Kong, where the Securities & Futures Commission (“SFC”) have enacted the role of Responsible Officer. In holding this title, a person has direct and individual accountability over the policies and procedures the trading desk discharges daily, needing to be evidenced as and when an audit situation arises.

The concept of “Best Execution” also comes into play here. Long been thought of as an abstract idea, loosely linked with “getting the best price”, it is now enshrined in regulatory doctrine in developed markets worldwide. Most agree that today, it is synthesised through a combination of factors that encapsulate the above which, if asked by a regulator, need to be demonstrated, measured, and logged in policy and procedure on an ongoing basis.

SECTION 2

PRESENT CHALLENGES

Despite significant and ongoing outlay in trading, along with the expanded remit and enhanced technologies, there has not been a wide-spread, industry-adopted evolution in the buy side execution model since the advent of algorithmic trading in the mid-2000s.

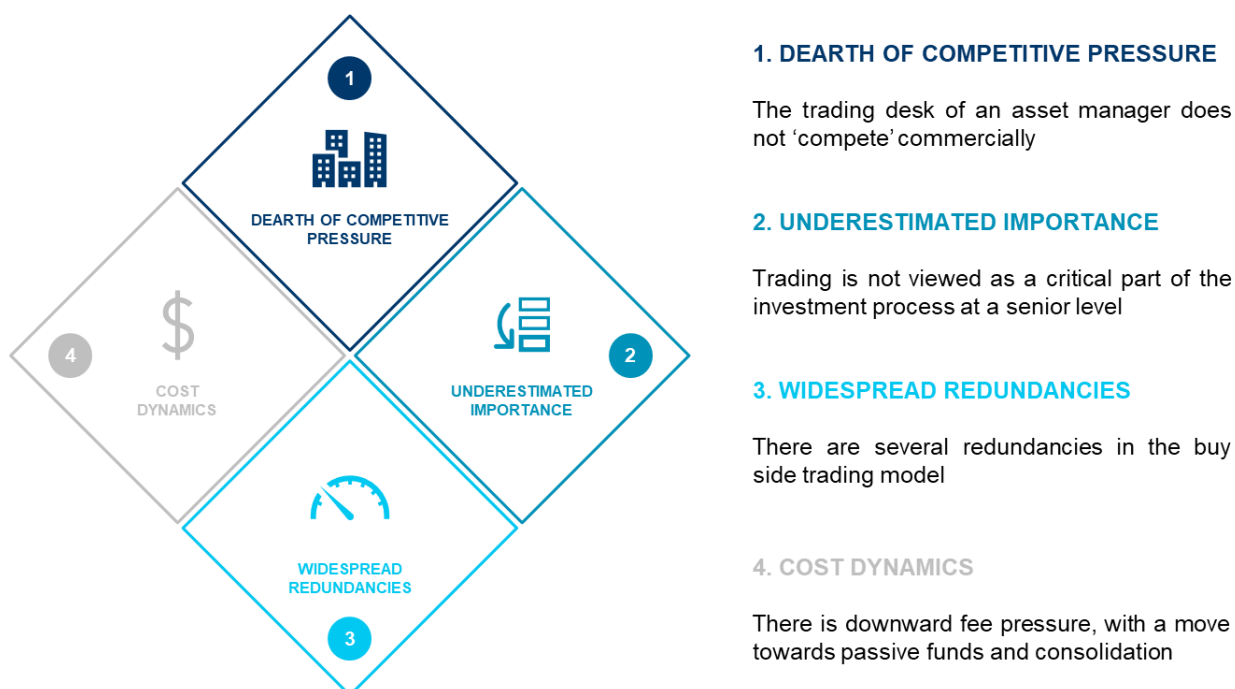
Although we may have seen a broad array of cultural, technological and structural improvements at buy side firms in recent years – most trading desks now have a highly organised, professional attitude and approach, and there are some shining examples of first-class desks – we believe that top-line performance is still not being achieved as well as it could be broad writ, presenting a clear opportunity cost for the end asset owner, while

bottom-line economic wastage plagues the internal cost line for the asset manager themselves.

To address this, we will establish the elements that provide headwinds to the buy side trading model, the redundancies within it, and then attempt to quantify the economic wastage and opportunity costs associated with these factors.³

There are four key challenges that are being faced by asset managers with regards to buy side trading: (1) a dearth of competitive pressure; (2) underestimated importance internally; (3) widespread redundancies; and (4) cost dynamics (see Figure 5).

FIGURE 5: NOTABLE CHALLENGES



Source: Quinlan & Associates analysis

³ Note: no forms of systematic trading (e.g. high frequency trading, or "HFT") have been included in our considerations throughout this report, given the demonstrably different model they operate under.

DEARTH OF COMPETITIVE PRESSURE

The trading model does not encounter actual competitive pressure. In short, while there are various ways in which trading can demonstrably deliver value to clients, it has no external commercial proposition.

The trading desk of an asset manager does not 'compete' with another asset manager's trading desk, but as highlighted in our previous report, *Alternative Alpha*,⁴ its portfolio management – and by extension, their sales – arms certainly do. As such, there is no external force that fundamentally compels cultural and technological advancement.

UNDERESTIMATED IMPORTANCE

While the past decade has seen a demonstrable increase in the buy side's use of platform technology, electronic trading methods, and more robust analytical techniques for its execution businesses, in many cases, particularly at the C-suite level, trading is still not viewed as a truly critical part

of the investment process, which brings into question the deployment of technology spend and human resource allocation.

This largely cultural bias, often derived from a lack of functional knowledge (i.e. most senior leadership on the buy side come from the portfolio management or sales side of the business) means that often, trading is thought of as an important, yet operational adjunct, to core investment activity. Indeed, from a USD 100 million hedge fund to a USD 1 trillion+ long-only fund manager, recent years have witnessed an observable stagnation – or worse still, disinvestment – in centralised, in-house trading functions.

To this end, a survey by Greenwich in June 2021 highlighted that while spend on equity trading had increased by 12% year-over-year in 2020 (note: FICC went down by 1%), nearly half of the funds were dedicated towards new work-from-home practices as a result of the Covid-19 pandemic, with a further third being spent on market data-related costs, which have been steadily rising over the years.⁵

⁴ Quinlan & Associates, 'Alternative Alpha', September 2017, available at: <https://www.quinlanandassociates.com/insights-alternative-alpha/>













⁵ Greenwich, 'Buy-Side Trading Desk Budgets in 2021: Technology Pays Off', June 2021, available at: <https://www.greenwich.com/market-structure-technology/buy-side-trading-desk-budgets-2021-technology-pays>

WIDESPREAD REDUNDANCIES

Despite the complexity and advancement now seen in buy side trading, several sub-optimal

features still exist within the model, primarily of an operational and human resource nature (see Figure 6).

FIGURE 6: BUY SIDE TRADING MODEL REDUNDANCIES

Operational	Description	Human Resources	Description
 Periods of Inactivity	<ul style="list-style-type: none"> Periods of inactivity where not trading / generating alpha (amplifying fixed-versus-variable cost argument) 	 Insufficient Team Size	<ul style="list-style-type: none"> Teams often too small, so execution quality dips on busy days (orders just farmed to 'favourite' broker)
 Operational Tasks Burden	<ul style="list-style-type: none"> Too much operational management (e.g. settlement problems, etc.) as opposed to value-add 	 Irrational Behaviour	<ul style="list-style-type: none"> PMs often become irrationally dependent on specific trader coverage (most smaller funds set up like this)
 Lack of Market Content	<ul style="list-style-type: none"> Feel for market themes becomes lost in broader responsibilities (problem in larger, particularly passive, desks) 	 Outdated Skill Sets	<ul style="list-style-type: none"> Skill set of typical trading desk lacks technological fluency (adoption of ET methods, real/objective TCA use)
 Poor Scalability	<ul style="list-style-type: none"> Insufficient scalability to efficiently handle increase in flow, without loss of execution quality 	 Lack of Personal Growth	<ul style="list-style-type: none"> Being serviced by a large panel of brokers can lead to less-than-desirable, sluggish behaviour
 Regulatory Overhang	<ul style="list-style-type: none"> Trading is being increasingly dragged into a burdensome regulatory regime (i.e. more regulatory tasks assigned) 	 Poor Networking Skills	<ul style="list-style-type: none"> Lack of commercial / interpersonal flare (e.g. broker relationships, fostering partnerships, etc.)
 Poor Division of Labour	<ul style="list-style-type: none"> Problems regarding division of labour, countries / stocks covered, PMs covered, a sense of protectionism, etc. 	 Cultural Shortcomings	<ul style="list-style-type: none"> Poor culture of back up (i.e. when trader A is away, trader B does not maintain trader A's rigour)

Source: Quinlan & Associates analysis

1. OPERATIONAL

There are several operational redundancies in the buy side trading model. For instance, and by far the most common problem, there are often periods of inactivity during which no trading activity takes place, with nothing immediate / reactionary to fill the gap. The additional burden of operational and regulatory compliance tasks can severely dilute workflow quality and a feel for relevant market themes.

Furthermore, a sense of protectionism may also emerge at times, causing friction over allocation of resources to particular countries, stocks, sectors, or portfolio managers. These issues can invoke scalability and cultural problems related to increased workloads and cross-desk collaboration.

2. HUMAN RESOURCES

An inelastic approach to human resource allocation (i.e. overall team size, and/or rigidity of division of labour) can result in several problems related to workflow load balancing. This is especially acute on high volume days, and prevalent in the Long Only (Passive) space where, ironically, outside these busy periods, the inactivity problem takes hold (i.e. flow tends to gravitate towards specific moments in time, like month ends, or index rebalance days).

Furthermore, portfolio managers have also been seen to have an irrational dependence on specific trader coverage, especially in the case of smaller funds. It is also notable that a meaningful proportion of the buy side trading community exhibit limited technological fluency and curiosity, in addition to often narrow personal networks, which serves to limit ongoing development work.

DESPITE THE COMPLEXITY AND ADVANCEMENT NOW SEEN IN BUY SIDE TRADING, SEVERAL SUB-OPTIMAL FEATURES STILL EXIST WITHIN THE MODEL

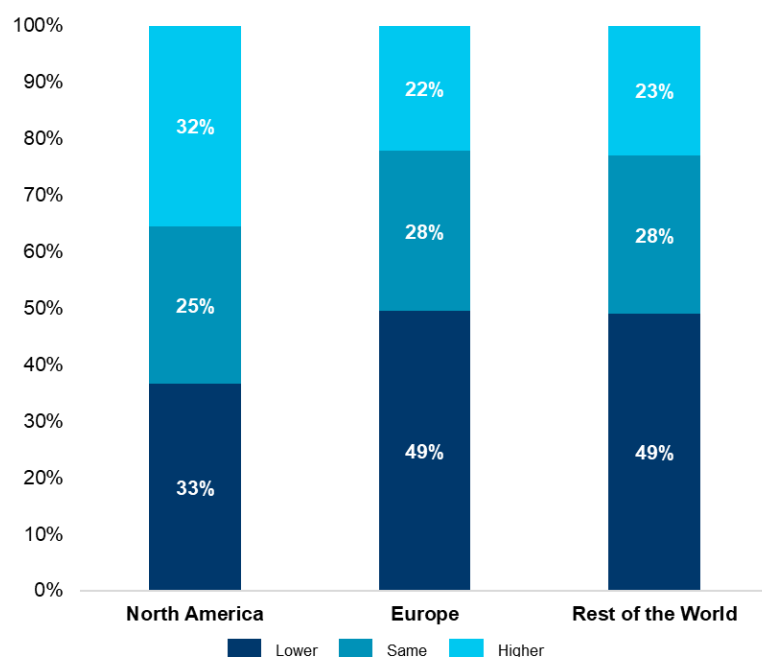
COST DYNAMICS

Irrespective of the size of asset manager, there are now considerable cost dynamics the buy side needs to consider. These come in the form of commercial and operating / internal pressures – the first very often being the driver of the second.

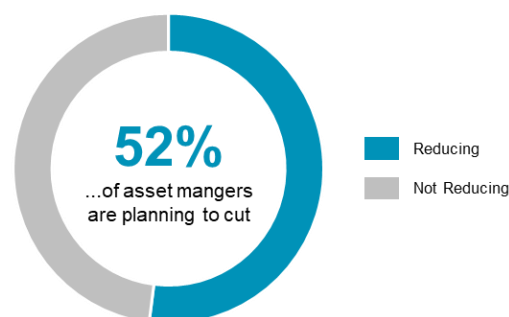
The industry has broadly seen a reduction in fees as a pattern of consolidation, new, technologically enabled entrants, and a shift to low-cost, passive investing, has taken hold. As a result, asset holders are demanding traditionally higher-fee active investing for cheaper rates. Because of this, as the clamour for alpha (benchmark outperformance) has grown, costs have come increasingly in focus (see Figure 7).

FIGURE 7: DOWNWARD FEE PRESSURE

Fee Levels 2016-2019, %



Fees and Expense Ratios 2020, %



New ETFs / Alternatives / SMAs¹ 2020, %



¹Separately Managed Account

Source: Quinlan & Associates estimates, Brown Brothers Harriman, bfinance

The expense of running an in-house trading function is borne by the asset manager, so this can often make a direct contribution to the expense ratio of a given fund (i.e. the total percentage of fund assets utilised towards the operational, administrative, and marketing

costs of running it). Therefore, structurally, it can be one of the considerations when new mandates are priced. As a large cost centre, trading is becoming increasingly targeted as an area where savings can be made.

SECTION 3

ECONOMIC WASTAGE

As established, cost is an essential factor when asset managers evaluate the efficacy of their trading desks. There are several (1) “explicit”, as well as (2) “implicit” cost factors that need to be analysed when quantifying the overall cost of running an in-house trading function. These estimates will be used as the basis for determining our estimates on economic wastage.

EXPLICIT COSTS

In order to determine the overall, fully costed expense of running a buy side trading desk, the various underlying components need to be identified and quantified, including: (1) human resources; (2) hardware needs; (3) software needs; (4) data needs; (5) infrastructure; (6) support staff; and (7) external consulting (see Figure 8).⁶

FIGURE 8: EXPLICIT COST FACTORS



Source: Quinlan & Associates analysis

⁶ Note: as per commentary below Figure 2, we are not considering commission pay-out to the street, capital commitment costs, CSA / RPA payments, etc. We focus solely on the costs the asset manager themselves bear, and the subsequent performance wastage (“opportunity cost”) that exists

HUMAN RESOURCES

The human resources (“HR”) component is inclusive of both compensation – which encompasses base salary, discretionary bonus, and long-term incentives – and other employee benefits such as healthcare, insurance, and pension fund contributions. This element can contribute up to 80% of the total, per-head trader cost.

HARDWARE NEEDS

Trading desks experience a meaningful outlay on hardware, which are inclusive of workstations, monitors, telephones, and dealer boards, among other equipment.

SOFTWARE NEEDS

Execution (and related settlement) is a software-intensive exercise, with most desks running around a dozen core applications. These costs include Order and Execution Management System (“OMS” and “EMS”), Bloomberg terminal(s), basic desktop programs such as Microsoft Excel, as well as other licences and subscriptions for items such as analytics tools, video conferencing, and news subscriptions.

DATA NEEDS

Data requirements are inclusive of a variety of visible cost factors, such as cloud usage costs, fees paid for access to market data, as well as data on indices, derivatives pricing, product information, etc.

INFRASTRUCTURE

Although the Covid-19 pandemic may have witnessed the rise of work from home arrangements, buy side trading still experiences an out-sized office requirement, largely due to the need for screen real estate. This results in the cost of renting office space and any equipment, such as furniture, that may be either purchased or leased.

SUPPORT STAFF

Besides traders, there are various other forms of internal support staff that play a pivotal role in supporting buy side trading desks. These include information technology (“I.T.”), compliance / legal, operations, HR / payroll, and secretarial positions.

EXTERNAL CONSULTING




Apart from internal staff members, a need to rely on external specialists for consulting, particularly in areas including quantitative services and compliance / legal (i.e. on a mandated, contract basis) can arise. This is notably prevalent in the smaller funds space.

TOTAL COST

Taking the above expenses into account, the median, annual, fully costed per-head amount for a trader is calculated and presented across three tiers of seniority (i.e. junior, mid-level /

deputy, and senior / head of trading), based on our three fund types (see Figure 9). It is notable that the cost per trader varies across the tiers based on the type of asset manager, given each type possesses a marked variation in the level of compensation.

FIGURE 9: VISIBLE EXPLICIT COST PER TRADER (2021E, USD)

	SENIORITY	 LONG ONLY (PASSIVE) <i>Long Only (Passive) fund managers typically spend less than their peers on traders</i>	 LONG ONLY (ACTIVE) <i>Long Only (Active) fund managers spend moderately on a per-trader basis</i>	 HEDGE FUND <i>Hedge Funds generally incur a higher per-trader cost than other asset managers</i>
	Senior Trader / Head Of Trading	500,000	645,000	786,000
	Mid-level / Deputy Head Of Trading	320,000	363,000	531,000
	Junior Trader	232,000	258,000	359,000

Level of Costs: ■ High ■ Moderate ■ Low

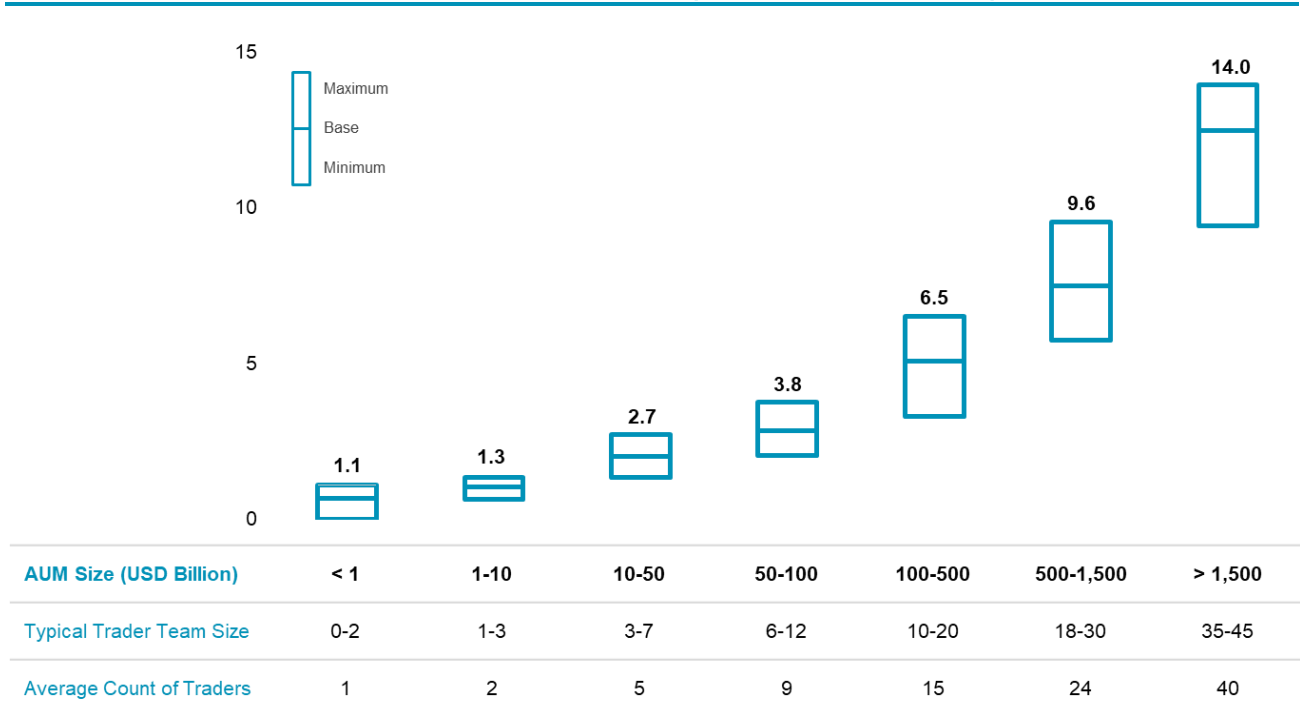
Note: the above figures represent the approximate median annual cost per trader, excluding group / central allocations, rounded to the nearest USD 1,000

Source: Greenwich, CBRE, Robert Walters, SCMP, Quinlan & Associates estimates

Based on these fully costed outlays of staffing internal desks, along with the expected number of traders at buy side firms, we estimate that, depending on their assets under management

("AUM"), managers may spend up to USD 14 million p.a. in direct costs on their execution operations (see Figure 10).

FIGURE 10: OVERALL EXPLICIT ANNUAL COST (2021E, USD MILLION)



Source: Greenwich, CBRE, Robert Walters, SCMP, Quinlan & Associates estimates

Via the identification of these top-line costs present in maintaining a trading presence, and in highlighting several operational and cultural

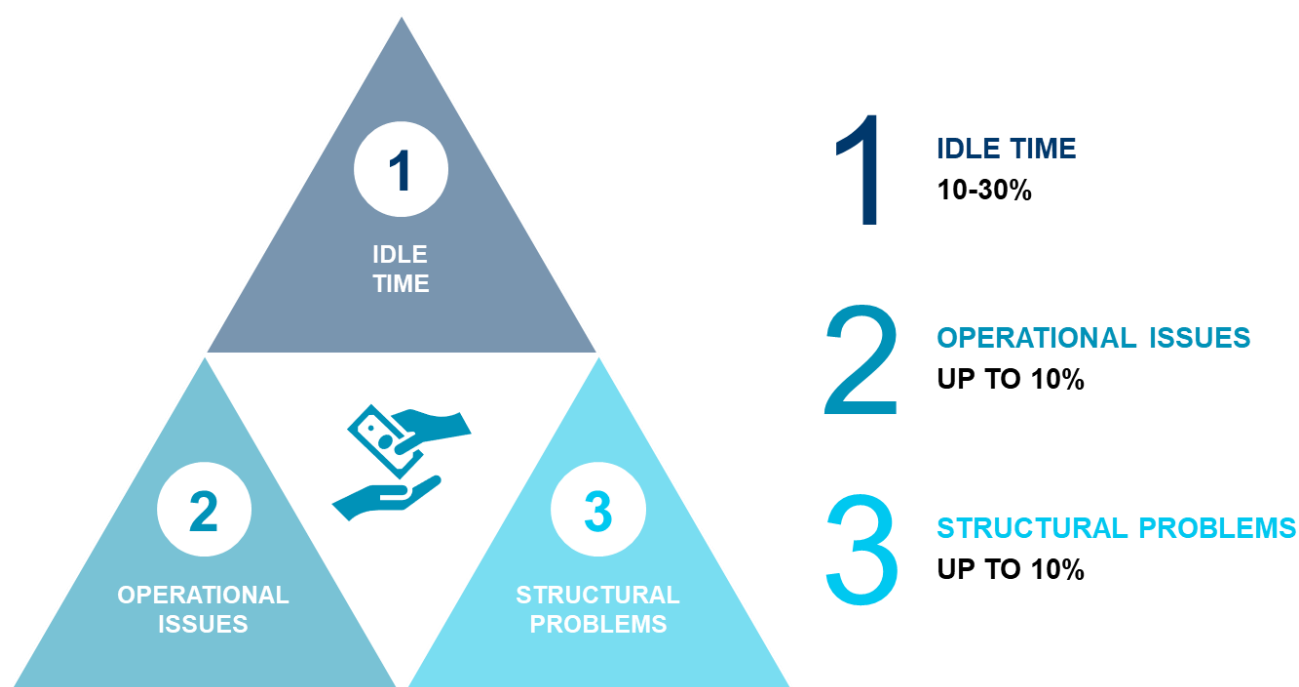
overhangs that act as hidden drags on the business, it is now possible to estimate the wastage associated with these explicit costs.

EXPLICIT COST WASTAGE

Explicit cost wastage refers to something the asset manager pays for themselves but is not

being utilised to the full. It can be further broken down into three categories: (1) idle time; (2) operational issues; and (3) structural problems (see Figure 11).

FIGURE 11: EXPLICIT COSTS (PER DAY)



Source: Greenwich, CBRE, Robert Walters, SCMP, Quinlan & Associates estimates

1. IDLE TIME

Idle time refers to periods in which traders are not engaged in productive activities. These can typically be classified into normal idle time, which is any period where the person is disengaged via a feeling of having nothing to do (and therefore spending excessive time off the desk, or surfing the Internet, for example), and abnormal idle time, which is a result of sub-optimal time management and control (e.g. spending unnecessary periods on non-accretive tasks).

We see this as a significant problem for the buy side trading industry – from juniors to heads of desk. We estimate ~20-30% of a typical day can be lost to idle time in the case of a large Long Only (Active) and Long Only (Passive) funds, and ~10-20% for Hedge Funds.

2. OPERATIONAL ISSUES

Operational situations frequently crop up on a typical trading desk. For example, settlement breaks, errors, regulatory compliance issues, and broker-related problems (e.g. correctional action, connectivity) may all lead to a loss of as high as 10% of a day, further resulting in explicit cost wastage.

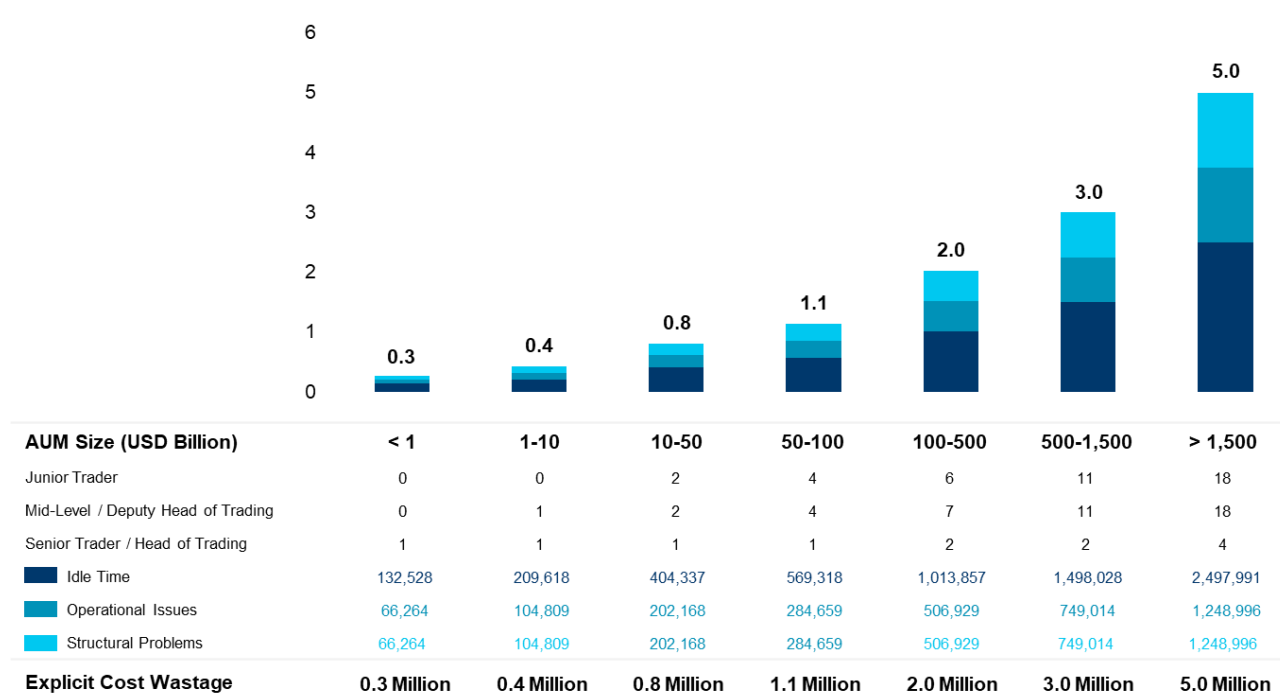
3. STRUCTURAL PROBLEMS

A very common issue for many asset managers, cost wastage may result from sub-optimal structural decision-making, deriving from (1) division of labour (e.g. people being too busy or too quiet operationally); (2) siloing of roles and functions (i.e. a lack of operational fluidity); (3) a lack of flare (i.e. where traders are not willing to try new methods of execution or embrace technological change); and (4) no scalability (i.e. where a desk is not capable of increasing capacity due to people/technology constraints). Such structural problems may lead to 10% of a day being wasted.

These explicit cost wastage dynamics are pervasive throughout the industry. We estimate that some of the largest asset managers are

losing up to USD 5 million p.a. (i.e. ~35% of their total explicit costs) on explicit cost wastage (see Figure 12).

FIGURE 12: EXPLICIT COST WASTAGE (2021E, USD MILLION)



Note: The estimates are exclusive of group / central allocations

Source: Greenwich, CBRE, Robert Walters, SCMP, Quinlan & Associates estimates

We now consider the implicit costs embedded within the buy side trading model, ones that

have a direct effect on the performance of the assets being managed.

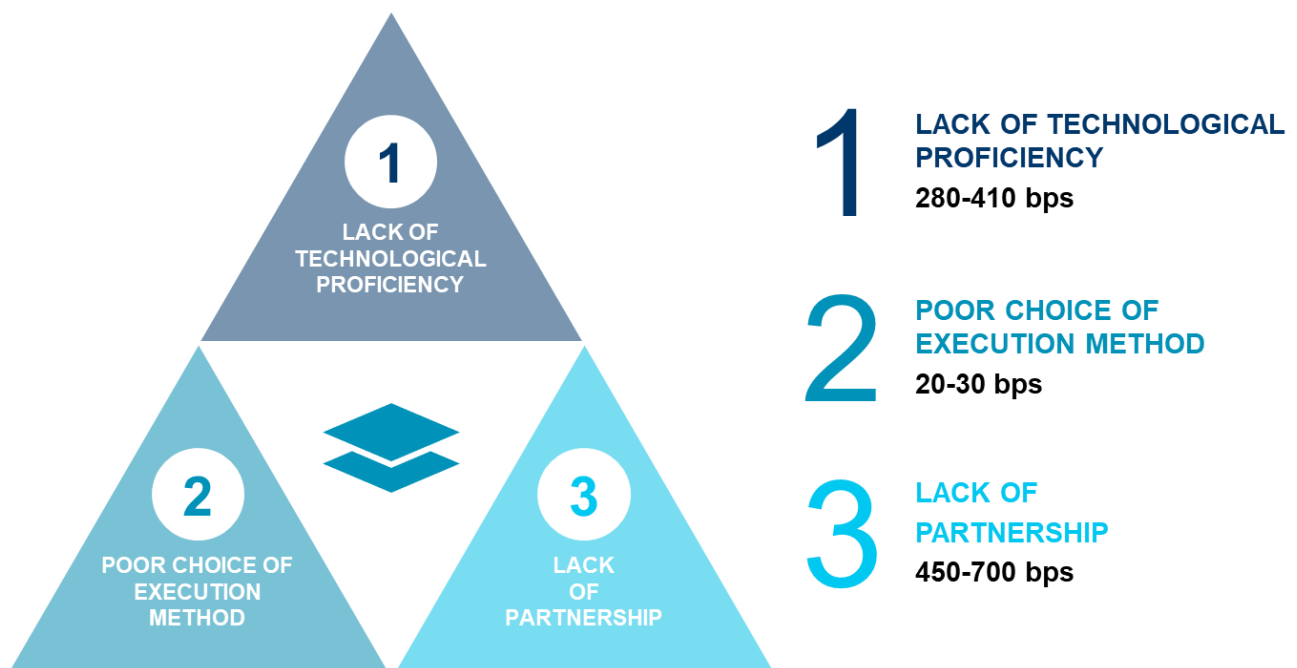
IMPLICIT COSTS

A fundamental, but often worryingly overlooked, part of any investment process with regards to trading is the ability to move in or out of a given position (or set of positions) with maximum efficiency, both in terms of operational and execution performance. Against a backdrop of 91% of actively managed, international equity funds underperforming their benchmark in the

past 20 years,⁷ the importance of minimising this cost cannot be overstated.

Implicit (“opportunity”) cost refers to the performance foregone as a result of sub-optimal structures and workflows, via the factors laid out above. It can be further broken down into three key categories, being: (1) lack of technological proficiency; (2) poor choice of execution method; and (3) lack of internal / external partnership (see Figure 13).

FIGURE 13: IMPLICIT COSTS (PER ANNUM)



Source: Quinlan & Associates estimates

⁷ S&P Indices versus Active (“SPIVA”), ‘SPIVA: 2020 Full-Year Active vs. Passive Scorecard’, March 2021, available at: https://www.ifa.com/articles/despote_brief_reprieve_2018_spiva_report_reveals_active_funds_fail_dent_indexing_lead_-_works/

LACK OF TECHNOLOGICAL PROFICIENCY

There is a widespread lack of technological proficiency (and curiosity) that has been witnessed on the part of buy side trading desks. For instance, traders are often found using an inappropriate algo; in a less-liquid equity or currency trade, deploying a strategy that relies more on consistent participation (as opposed to one that reacts intelligently to the ebb and flow of available liquidity) can cause unnecessary impact. This alone can cost 30-50 bps p.a. in aggregate, unobtained fund performance in a typical year.

An additional 50-60 bps p.a. may be lost in the case of a robust, systemised workflow not being deployed for liquid / semi-illiquid execution. Furthermore, not using an Electronic Communication Network ("ECN"), Request-for-Quote ("RFQ") or blocks desks for illiquid / block crossing may result in 200-300 bps p.a. worth of implicit opportunity cost.

POOR CHOICE OF EXECUTION METHOD

Trading desks may at times leverage more expensive, sub-optimal trade execution methods, that can result in a further 20-30 bps p.a. of implicit costs. For example, using traditional Sales or Portfolio Trading when an electronic solution could be deployed (the algo used on the broker side almost certainly won't be tailored to the asset manager's specific requirements).

LACK OF INTERNAL / EXTERNAL PARTNERSHIP

There is often a lack of true partnership witnessed on the part of buy side trading desks with respect to external stakeholders. We observe this is a particularly large contributor to loss of execution (and hence fund) performance.

Operational focus means a desk can become somewhat insular; as such, lack of collaboration and transparency (on items such as liquidity provision and algo development) with core brokers may cost an estimated 200-300 bps p.a. in missed performance; much higher than simply choosing the wrong strategy.

On top of this, not engaging with clients (direct or indirect, via the Sales team) may cost a further 200-300 bps p.a.. This is also high because it goes to the heart of execution quality – and hence fund performance – with a prime example being the ability to have deep-dive discussions on benchmark and liquidity requirements, truly understanding what the end client needs.

For internal stakeholders, such as portfolio managers and sales / client service staff, performance can also be lost due to a lack of discussion and partnership, resulting in another 50-100 bps p.a. of implicit opportunity cost. Examples of this come in the form of education in what trading provides, which could then be transmitted to the clients themselves.

Finally, and perhaps most significantly, a lack of collaboration and communication within the trading desk itself can cause headwinds for execution quality. In our surveying we observe a consistent lack of communication between traders, even in smaller operations, leading to fragmented and inconsistent workflows. Often, when enhancements are established, they are deployed on a trader's individual book as opposed to across the whole desk.

All-in-all, poor partnership can result in as much as 700 bps p.a. being lost.

It should be noted that when moving up the AUM scale, the opportunity cost effects become improved upon: despite ongoing poor habits regarding selection of execution method, sub-optimal cultural aspects, and the deployment of

more systematised workflows, higher AUM asset managers have generally been solid adopters of execution-improving solutions such as algorithmic usage, automated block crossing, etc.

It is for this reason we introduce the concept of a “Sophistication Level” to the above metrics; this dampens the full effect of these sub-optimal

practices to better reflect the true performance foregone by fund managers. While variances exist (e.g. some smaller asset managers will be strong users of ET), we believe this is a fair reflection, in aggregate, across our seven AUM buckets. We can then quantify these opportunity costs in basis points per annum, both in terms of their top line as well as constituent parts (see Figure 14).

FIGURE 14: IMPLICIT COSTS QUANTIFICATION (BPS, PER ANNUM)

	RAW*	TR ¹	AUM SIZE (USD BILLION)						
			< 1	1-10	10-50	50-100	100-500	500-1,500	> 1,500
SOPHISTICATION LEVEL**	0%	32%	10%	10%	20%	20%	40%	60%	60%
LACK OF TECH. PROFICIENCY	345.0	110.4	99.4	99.4	88.3	88.3	66.2	44.2	44.2
Not Using Algos	40.0	12.8	11.5	11.5	10.2	10.2	7.7	5.1	5.1
No Systemised Workflow	55.0	17.6	15.8	15.8	14.1	14.1	10.6	7.0	7.0
Not Using ECN / Blocks Desks	250.0	80.0	72.0	72.0	64.0	64.0	48.0	32.0	32.0
POOR CHOICE OF EX. METHOD	25.0	8.0	7.2	7.2	6.4	6.4	4.8	3.2	3.2
More Expensive / Sub-optimal	25.0	8.0	7.2	7.2	6.4	6.4	4.8	3.2	3.2
LACK OF PARTNERSHIP	575.0	184.0	165.6	165.6	147.2	147.2	110.4	73.6	73.6
Core Brokers	250.0	80.0	72.0	72.0	64.0	64.0	48.0	32.0	32.0
Client Engagement	250.0	80.0	72.0	72.0	64.0	64.0	48.0	32.0	32.0
Internal Collaboration	75.0	24.0	21.6	21.6	19.2	19.2	14.4	9.6	9.6
OVERALL	945.0	302.4	272.2	272.2	241.9	241.9	181.4	121.0	121.0

¹Turnover Rate

**“RAW” refers to mid-range of estimated implicit cost slippage, for example Lack of Technological Proficiency 345 bps p.a. (derived from a range of 280-410 bps p.a.)

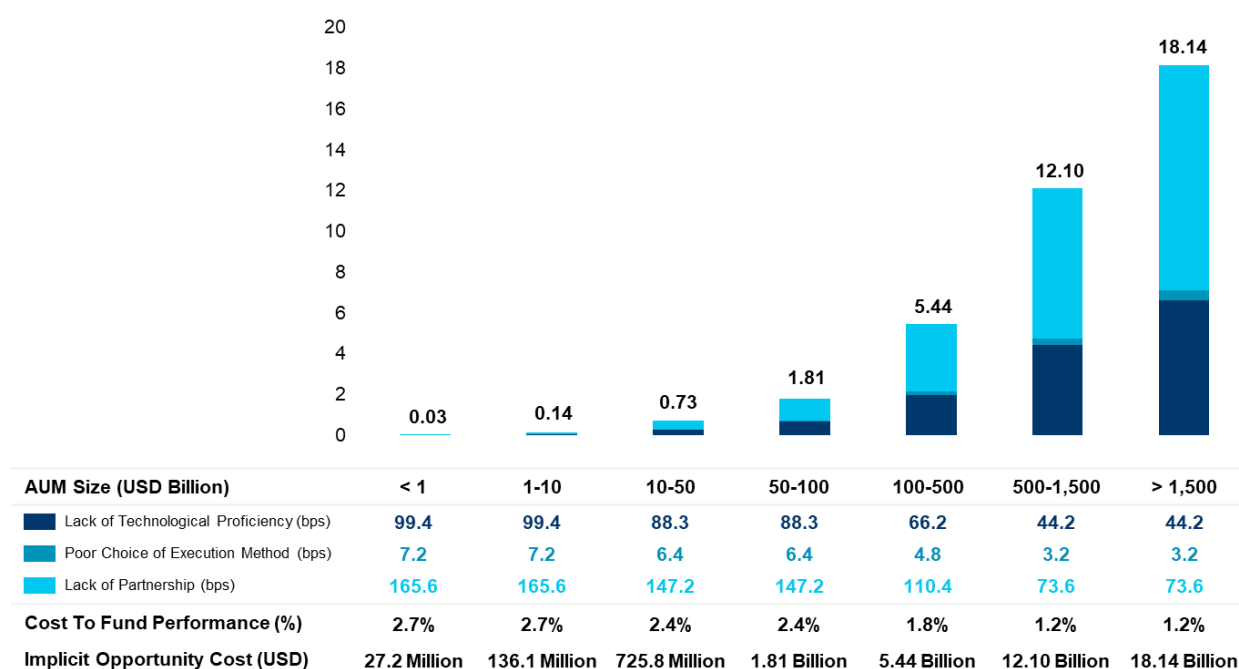
**Actual individual opportunity costs, per AUM category, defined as RAW implicit costs x TR x (1 – Sophistication Level)

Source: Investment Company Institute, Quinlan & Associates estimates

Using these figures, we can now project the performance lost to end asset owners across the AUM spectrum in dollars and percentage terms. Note that our model uses an average fund turnover rate of 32% against the median assets, for the slippage elements to be applied

to. Further, to acknowledge of the possibility of overlap in the factors in Figure 13 (i.e. asset managers will look to solve more than one issue concurrently), we present these figures in the worst-case scenario (see Figure 15).

FIGURE 15: IMPLICIT OPPORTUNITY COST (2021E, USD BILLION)



Note: estimated average turnover rate of 32% p.a. has been applied to mean AUM figure (for example in USD 100-500 billion bracket, USD 300 billion is used), before applying slippage rates from Figure 13

Source: Investment Company Institute, Quinlan & Associates estimates

In summary, we estimate that many asset managers are taking a 1.2-2.7% p.a. hit to their fund performance, irrespective of absolute performance, resulting in an implicit opportunity cost of as high as USD 18.14 billion for the very largest managers. This is in addition to an explicit cost wastage figure as high as USD 5 million.

We believe these figures shine a light on the inefficiencies ingrained within the current buy side trading desk model. Portfolio construction methods aside, in an environment where gross fund performance is broadly underwhelming, especially when elevated fees often take the net figure negative, these headwinds are having a

significant impact on an asset manager's ability to outperform their peers (as well as the broader market).

This mix of structural, regulatory, and operational issues has often impeded true innovation. A static investment picture, against a backdrop of rising costs, has been one of the primary determinants of the rise of the outsourced trading desk.

It is for these reasons the buy side trading model finds itself at a key juncture in its development: should it be outsourced, optimised, or a combination of the two?

WE ESTIMATE THAT MANY ASSET MANAGERS ARE TAKING A 1.2-2.7% P.A. HIT TO THEIR FUND PERFORMANCE, IRRESPECTIVE OF ABSOLUTE PERFORMANCE, RESULTING IN AN IMPLICIT OPPORTUNITY COST OF AS HIGH AS USD 18.14 BILLION FOR THE VERY LARGEST MANAGERS

SECTION 4

EXPERT OPINION

In speaking anonymously to several senior financial services professionals, on both the buy as well as sell side, it is clear that the trading model at many fund managers has room to improve. This snapshot of anecdotal evidence – some given as direct opinion, some as admissions of sub-optimal practices – serves to validate the empirical findings that workflows

and cultures can and should be bettered to enhance fund performance (see Figure 16).

To provide more appropriate context with regards to the expert interviews and to also expand on the points discussed earlier, we have outlined our take immediately after.

FIGURE 16: ANECDOTAL EVIDENCE FROM BUY AND SELL SIDE



Source: Quinlan & Associates interviews

Expert interview A sheds light on how the use of well-established technology for currency trading at a bank would improve efficiency and execution price, while in the case of interview B, it provides colour from the perspective a broker, emphasising on the need for clients (i.e. buy side trading desks) to partner brokers better by: (1) listening to their feedback; (2) being more receptive to change; and (3) building an algo suite that better suits the flow being traded.

Interview C, from a European asset manager, demonstrates how they are structurally curtailing their ability to appropriately localise flow in the Asian region and empower their traders on the ground to build a better, more targeted process. Business through non-Electronic Trading ("ET") channels [Portfolio Trading ("PT") / Sales Trading ("ST")] is hardly ever allocated in a truly systematic way, particularly for overnight markets. Therefore, it becomes extremely hard to truly measure.

These shortcomings are further evidenced anecdotally by interview D, which dissects a broker's observation of clients' deployment of enhanced workflow (in this case, equities) but then failing to use it correctly. This conveys that the optimisation method is almost certainly leaving execution performance on the table, given that brokers have far more subject matter expertise and empirical evidence.

Interview E lends further weight, as by not adopting more socialistic, desk-wide methods of allocation of ET flow, aggregate broker performance becomes almost impossible to accurately measure and feed back to the sell side, for which coverage then becomes a problem. It also has the effects of perpetuating poor habits by individual traders in their country- or desk-based siloes. For a large asset manager such as this, this creates an enormous, aggregate problem of opportunity cost.

Interview F highlights another problem that hurts trading desks, speaking to a lack of internal cooperation with other related functions, i.e., they have a quant / TCA team but don't partner with the desk to better guide or optimise the functional behaviour of algos, nor assess more traditional (but still heavily used) methods of execution.

A final, oft-cited piece of feedback by brokers is that the buy side simplistically states that they "always prefer Algo / Salestrader / PT Trader A over Algo / Salestrader / PT Trader B", without being able to truly explain why. Relationship-based trading is still pervasive, and the feedback that, "things have always worked out for me that way", remains a very common theme.

In summary, there are a variety of problems that have plagued the buy side trading fraternity ever since the advent of widespread algo usage. Instead of basing strategy or coverage person choice on actual, measurable performance, asset managers frequently adopt sub-optimal habits, largely derived from subjective user experience rather than assessing in an empirical fashion.

...BY NOT ADOPTING MORE SOCIALISTIC, DESK-WIDE METHODS...THIS CREATES AN ENORMOUS, AGGREGATE PROBLEM OF OPPORTUNITY COST




SECTION 5


THE WAY FORWARD


By identifying that the buy side trading model needs to become more operationally and culturally efficient, in order to provide genuinely accretive value to the investment process, we will investigate three key paths through which this can potentially be achieved: (1) outsourcing (i.e. outsourcing of the fund manager's


business, in part or in whole); (2) internal optimisation (i.e. optimisation and rationalisation of practices with existing human and technological capital); and (3) a hybrid solution (i.e. targeted outsourcing and optimisation based on personalised needs) (see Figure 17).


FIGURE 17: POTENTIAL SOLUTIONS

	1 	2 	3 	
	Outsourcing Third-party Solution Provider	Optimising Internal Proprietary Solution	Hybrid Mix And Match	
DESCRIPTION	Outsourcing to a third-party vendor may cut short-term costs, but at the expense of long-term benefits	Although time and money-wise costly, internal optimisation can deliver greater long-term incremental returns	Assessing each process to decide whether to outsource or optimise can help allocate resources optimally	
CRITERIA				
STRATEGIC	PERSONALISATION	✗	✓	-
	QUALITY CONTROL	✗	✓	-
	TECH / INNOVATION	✗	✓	-
OPERATIONAL	TIME REQUIRED	✓	✗	-
	LABOUR REQUIRED	✓	✗	-
	SCALABILITY	✗	✓	-
FINANCIAL	REVENUE BOOST	✗	✓	-
	SET-UP COST	✓	✗	-
	ONGOING COST	✗	✓	-

 A hybrid solution empowers a tailor-made approach for each process element

 Favourable

 Dependent / Neutral

 Unfavourable

Source: Quinlan & Associates analysis

OUTSOURCING

Starting with outsourced trading, given the rapid growth of service provision in the space, this report will offer a full analysis of the industry's participants, value proposition, and efficacy.

The concept of outsourced trading (i.e. when an investment manager hands over some or all operational responsibility for anything execution- and markets-related to an external party) has been available in various forms for over 15 years. In the mid-2000s few had implemented it to a full-service level, but recent years have witnessed rapid growth in both the number of providers as well as the breadth of services offered.

Growth in the outsourced trading market has coincided with a broader trend in the asset

management industry, where non-core investment functions have been farmed out to businesses which offer "pay-as-you-play" or retainer-style payment models. Compliance Asia, for instance, with four offices in the Asia-Pacific region, has aggressively captured a significant proportion of the outsourced compliance market by catering for the new and small funds space, providing licensing and ongoing regulatory oversight services.

The first and most important point is that outsourced trading firms do not adhere to a single template. While their unified offering is execution services to the asset management industry, between each other they: (1) offer different trading services; (2) have different corporate structures; (3) utilise different settlement and pricing methods; and (4) have vastly different degrees of sophistication.





GROWTH IN THE OUTSOURCED TRADING MARKET HAS COINCIDED WITH A BROADER TREND IN THE ASSET MANAGEMENT INDUSTRY, WHERE NON-CORE INVESTMENT FUNCTIONS HAVE BEEN FARMED OUT TO BUSINESSES WHICH OFFER "PAY-AS-YOU-PLAY" OR RETAINER-STYLE PAYMENT MODELS

PROVIDERS

Most firms advertise themselves as being “global”, although it is important to note that many of the companies discussed in this section, especially the independent ones, do not have physical presences in all three major regions, particularly Asia-Pacific. This has not, however, proved to be an operational headwind in terms of service provisions, with technological advancements, coupled with a willingness to work night shifts (especially prevalent in the US), meaning firms can offer genuine, round-the-clock service.

There are approximately 40 outsourced trading companies presently in operation worldwide. Of these, we bucket the 29 primary participants into four distinct groups: (1) asset managers; (2) banks / custodians; (3) brokerages / prime brokers; and (4) independents. Some of them overlap due to their breadth as a financial services firm (see Figure 18). We segment where the outsourcing operation resides within the corporate structure (e.g. State Street’s outsourced trading business resides in their bank / markets division, SSGM, as opposed to their asset manager, SSGA).

FIGURE 18: OUTSOURCED TRADING PROVIDERS

ASSET MANAGERS	BANKS / CUSTODIANS	BROKERAGES / PRIME BROKERS	INDEPENDENTS
			
<p>Commercial extensions of original in-house trading functions, often viewed as the firms who have the same make-up as the buy side clients they serve, but on a more mature, industrialised scale than the independent sector</p>	<p>Global heavyweights in the banking, asset servicing, and custody spaces. Their key selling point is often wrapping up the whole execution and settlement ecosystem, generally viewed as the most operationally reliable and creditworthy counterparties</p>	<p>Also global in reach, this group consists primarily of the firms that historically provided prime brokerage, inter-dealer broker, and electronic trading services. These players are typically seen as those which provide the best “trading DNA”</p>	<p>The disruptors / start-ups who were all born out of a desire to provide better execution services and truly embrace the ethos of what an outsourced trading firm should do (i.e. act as an unconflicted extension of the asset manager’s desk)</p>

Note: given many participants are part of broader financial services organisations, the above have been categorised based on the business arm which houses the outsourced trading business
Source: Quinlan & Associates analysis

Outside these firms, we identify a further dozen firms globally that operate either on a small-scale, niche, or country-specific basis. For example, Melbourne-based BestEx, which

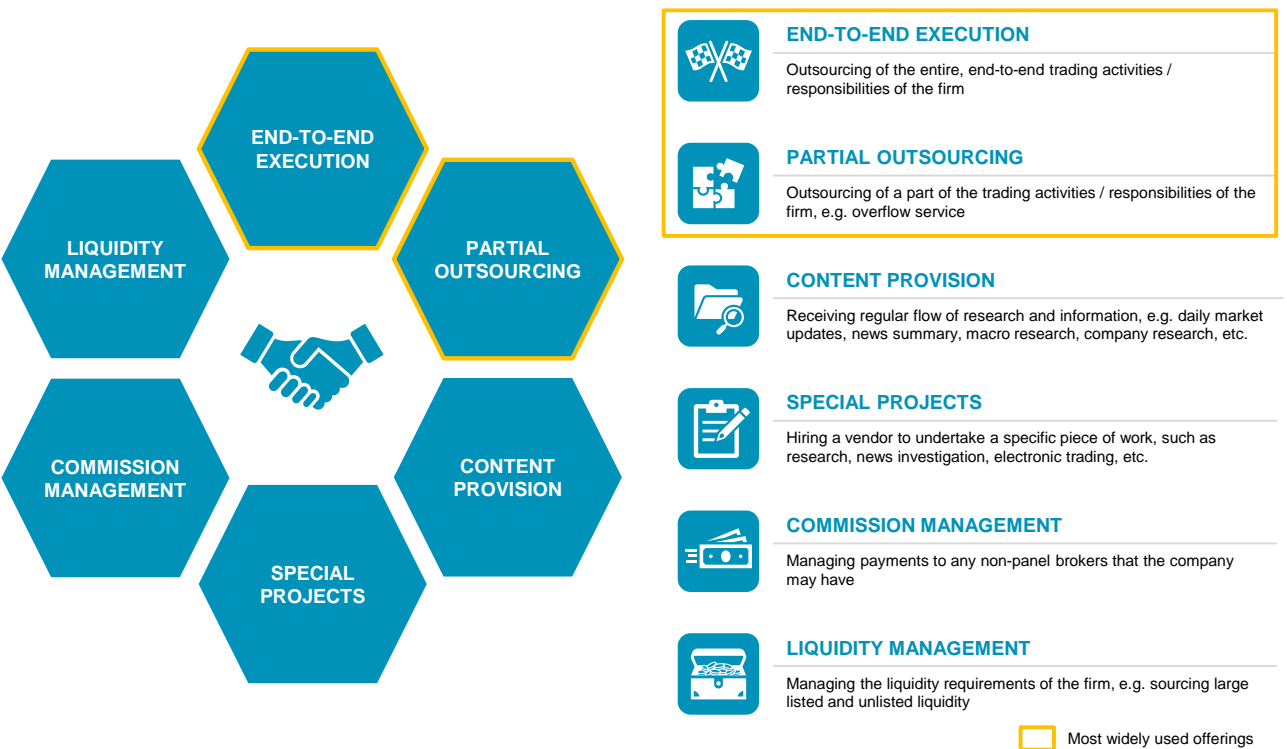
primarily run an equity block crossing network but offer outsourced trading as an ancillary service.

CORE OFFERINGS

We have identified six core services that are being provided by outsourced trading firms, with

the first two items (i.e. full and partial outsourcing of execution services) being the most widely used (see Figure 19).

FIGURE 19: CORE OFFERINGS



Source: Quinlan & Associates analysis

1. END-TO-END OUTSOURCING

This is where an asset manager's entire book of business, across the asset spectrum, gets farmed out to the outsourced trading firm. Prevalent in the smaller funds space; these are low turnover firms who are often established from one to two portfolio managers and do not have specific trading expertise, connectivity, or operational capacity.

2. PARTIAL OUTSOURCING

A popular option for firms that: (1) require a specific part of their trading book looked after (e.g. Fixed Income in an Equity-focused shop); (2) occasionally need additional bandwidth (e.g. firms that run a lean trading operation of one to two traders); and/or (3) only operate in certain geographies (e.g. in the North American or European time zones, where a local asset manager has Asian exposure and requires someone "on the ground" to trade overnight for them).

3. CONTENT PROVISION

Again popular among smaller funds, if the in-house traders are focused on execution and have a busy book of business, outsourced firms are often used as an aggregated source of daily news flow, macro, and company details, rather than the end client using their panel of brokers.

4. SPECIAL PROJECTS

As noted previously, the remit of a buy side trader may include carrying out project work, either for external clients, or in relation to internal teams, workflows, or optimisation requirements. Outsourced firms can and do assist in this, especially when there is an existing commission payment line.

5. COMMISSION MANAGEMENT

Often, an asset manager may not be a counterparty to a certain broker (i.e. they are not on the "panel"), but that broker may have provided research which needs to be paid for via some form of commission arrangement. As discussed later in the report, most outsourced trading firms have hundreds of broker relationships, so they can act as an intermediary to facilitate this.

6. LIQUIDITY MANAGEMENT

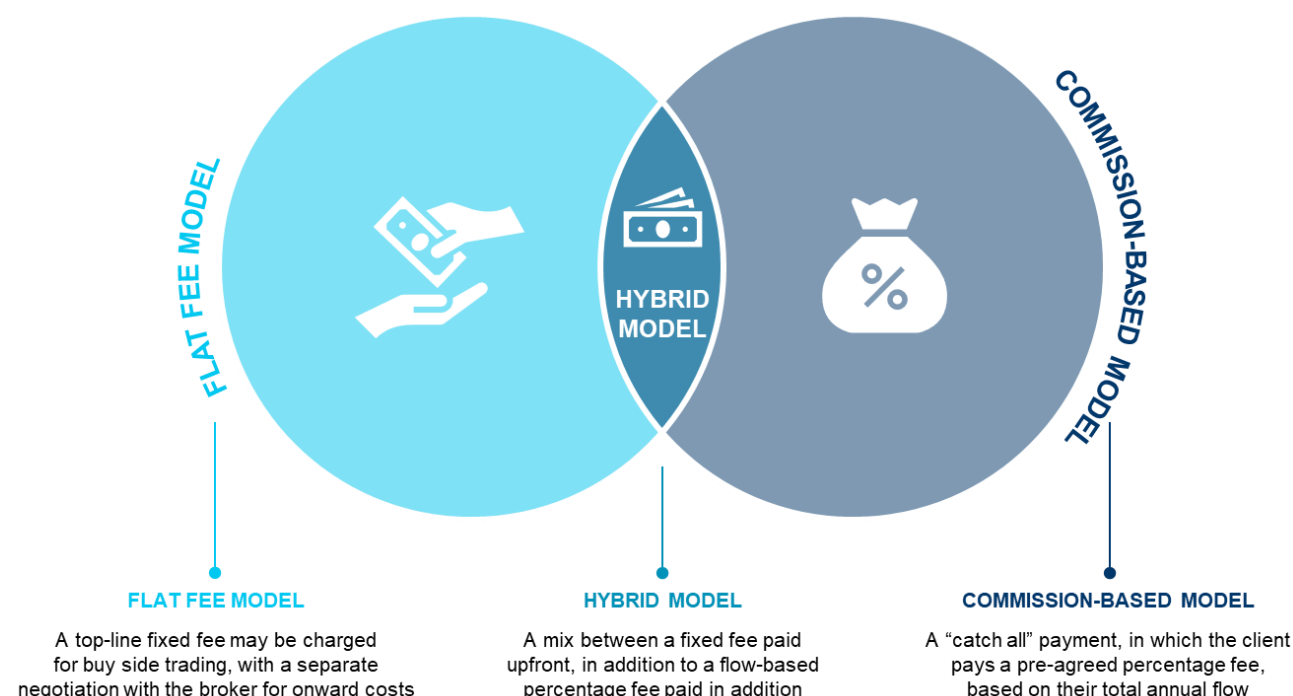
A significant and growing segment of the outsourcing market. Previously, an asset manager would utilise their broker network in order to source the other side for a particularly large, illiquid, or unlisted security. Due to sell side information leakage concerns, outsourcing firms are now being increasingly deployed to carry out the investigative, broking-style work. Margins can be significant in this space, often running into a percentage of gross notional as opposed to basis points.

PRICING

In terms of how outsourced trading firms get paid, there are three core pricing models that are prevalent: (1) flat fee model; (2)

commission-based model; and (3) hybrid model (see Figure 20). There are marginal variations on these themes, depending on end-client requirements, but most businesses will be compensated in this way.

FIGURE 20: OUTSOURCED TRADING PRICING MODELS



Source: Quinlan & Associates analysis

1. FLAT FEE MODEL

Outsourced firms can simply charge their asset manager clients a top-line fixed fee, leaving them to negotiate with their broker providers their own onward cost. In this scenario, unless it is a swap trade, the outsourced firm tends to be the counterparty to the trade, and they make their margin “internally” and opaquely to their client.

2. COMMISSION-BASED MODEL

Secondly, a spin-off of the flat fee option, a “catch-all” payment, can be employed. Under this payment model, the asset manager commits to giving the outsourced firm a percentage of their total flow for the year, at a

pre-agreed, explicit rate. Under this agreement, the outsourced firm manages all remaining flow to the client’s preferred broker(s), usually at no additional charge.

3. HYBRID MODEL

Finally, a service fee-style of payment exists, where the outsourced firm adds a fee on top of the commission rate their asset manager client has agreed with a given broker. In most cases, the asset manager settles directly with the broker as counterparty to the trade, often referred to as “RTO” (i.e. Reception and Transmission of Orders), leaving the outsourced firm to take their fee for acting as conduit.

THERE ARE THREE CORE PRICING MODELS THAT ARE PREVALENT: (1) FLAT FEE MODEL; (2) COMMISSION-BASED MODEL; AND (3) HYBRID MODEL

BENEFITS AND DRAWBACKS

Having covered the outsourced trading landscape, their core offerings and pricing models, we now arrive at the key question of why asset managers use outsourced trading firms, and what the downsides are.

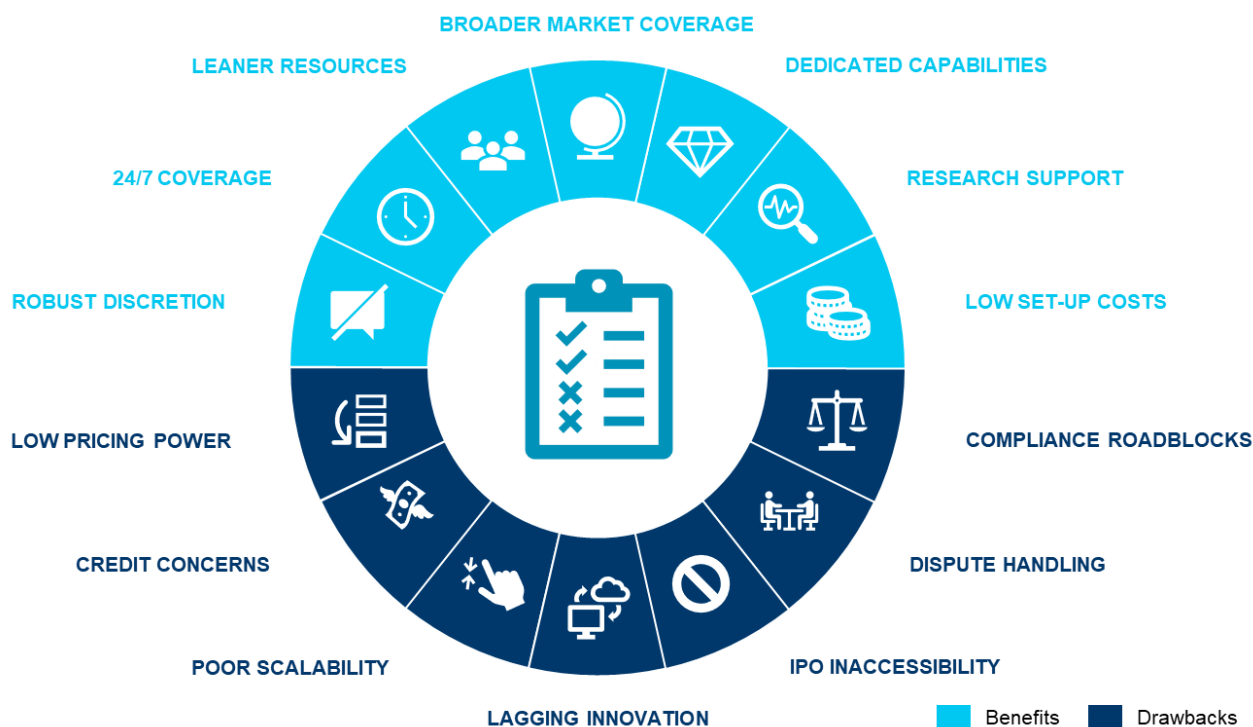
Currently the preserve of asset managers in the lower AUM segment (such as family offices, hedge funds, and smaller long-only managers), as introduced outsourced trading is used primarily for the management of operational costs related to trading, technology, execution and coverage service, international / offshore trading, commission management, access to

research, and expansion into non-core asset classes.

In terms of primary benefit, outsourcing allows asset managers to get a better handle on their fixed costs related to execution: they will only pay for trading when they use it, so it becomes a variable cost. This is one of the fundamental and most appealing arguments for using the service and is the most cited selling point by the outsourced industry itself.

Outside the core issue of explicit cost savings (per those outlined in Figure 7), there are numerous benefits and drawbacks to using an outsourced trading provider (see Figure 21).

FIGURE 21: BENEFITS AND DRAWBACKS (IN ADDITION TO COST SAVINGS)



Source: Quinlan & Associates analysis

1. BENEFITS

Outsourced trading firms aim to be an extension of a buy side desk's business, and not simply be an execution utility like a sell side broker would be. They share their culture and want to grow with them through long-term partnerships; in particular, the independent firms foster a real sense of being bought in to how the asset manager operates, names that are relevant to it, workflow, and so on. They want to grow with them. Some of the key upsides are outlined below.

1.1. ROBUST DISCRETION

For private / unlisted / large transactions, outsourced trading desks are extremely useful because they can generally be trusted to a greater degree (than a broker), as they aligned with their client's aims, and hunt for liquidity in a more disciplined and discreet manner.

1.2. 24/7 COVERAGE

Out-of-hours, international markets coverage and execution for an asset manager is highly valued. This is particularly prevalent for US-based fund managers.

1.3. LEANER RESOURCES

In the way they would not possess sufficient operational expertise in the fields of compliance, legal, and operations, smaller firms often do not have the resources, time, or capability to build a trading presence, making outsourcing a natural and valuable option.

1.4. BROADER MARKET COVERAGE

In the case of smaller hedge funds, they experience much broader and multi-faceted coverage than if they were sending orders directly to a broker. In focusing primarily on the required outcomes of the asset manager, the outsourced trading firm becomes their "eyes" on the market.

1.5. DEDICATED CAPABILITIES

Larger firms, particularly in the Bank/Custodian segment, wrap in an outsourced middle office / settlements / custodial solution with the execution piece, often including currency services.

1.6. RESEARCH SUPPORT

The volume and fragmentation of written and digital content means that for small- to medium-sized firms, content aggregation and delivery can be a problem. The outsourcing of this element is very useful, which can be paid for with the outsourced firm's extended broker network.

1.7. LOWER SET-UP COSTS

If electing to establish an in-house business, the initial setup costs will be significant with regards the factors outlined in Section 2. Managers who use outsourcing firms only pay for the services they use, and there are no hidden / sunken costs.

2. DRAWBACKS

There are, however, several downsides to using outsourced trading firms when compared to utilising one's own in-house execution function. We outline some key downsides below, before going on to outline further issues as part of an analysis of the industry's value proposition.

2.1. LOW PRICING POWER

Outsourcing firms still need brokers to transact. The current situation (i.e. fairly low volumes to trade against a large panel of brokers) means that almost all firms have very little real "pricing power" with their sell side partners. Most brokers report that servicing outsourced trading firms is not a priority for them. Reinforcing this, many outsourced firms have highlighted the poor service they receive from the sell side,

including a lack of capital commitment, if needed.

For brokers, the outsourced industry's pay-out / relevance is small compared to majority of their other asset management clients with whom they trade directly. As such, the services they provide are largely reactionary in nature, meaning the outsourced firms themselves become hindered with their end clients.

2.2. CREDIT CONCERNS

Credit concerns on larger tickets / high-volume trading days, where the requirement to stake capital with exchanges and/or clearing houses, can be a significant issue. This is especially problematic for smaller, independent firms who may not have sufficient balance sheet, or partner with brokers who cannot accommodate their requirements.

FOR BROKERS, THE OUTSOURCED INDUSTRY'S PAY-OUT / RELEVANCE IS SMALL COMPARED TO MAJORITY OF THEIR OTHER ASSET MANAGEMENT CLIENTS WITH WHOM THEY TRADE DIRECTLY

2.3. POOR SCALABILITY

At present, the outsourced industry has not demonstrated its capacity to truly scale up to cope with significant volume days, such as index rebalance events or major market moves, often comprised of multiple tickets of the same stock on the same side.

For example, during the height of the Covid-19 pandemic in March / April 2020, it was widely noted that most outsourced firms were unable to cope with the marked increase in volumes, resulting in execution control issues, platform delays, and settlement problems.

2.4. LAGGING INNOVATION

A question mark hangs over the industry regarding its technological development: the outsourced trading firms are largely facing off against smaller funds with vanilla execution requirements. Questions remain about whether they could, for example, develop a multi-market, multi-category, systematised electronic trading solution, if asked by a client.

2.5. IPO INACCESSIBILITY

As per previous comments regarding pricing power, a lack of sway with the sell side can hurt an outsourcing firm's ability to achieve IPO allocations for their clients.

2.6. DISPUTE HANDLING

In the RTO model, problems can arise with handling of disputes and/or errors. As the outsourced firm are not counterparty to any given trade, should the broker bear the cost, or the asset manager? There have been reported incidents of brokers cutting off outsourced trading firm because the latter was unable to take a loss on an end client error.

2.7. COMPLIANCE ROADBLOCKS

Due to counterparties not being set up, in a bid to get a trade completed often a pass-through (or "give up") trade needs to be enacted with a clearing broker; this can be an operational / compliance headache leading to settlement problems.

AT PRESENT, THE OUTSOURCED INDUSTRY HAS NOT DEMONSTRATED ITS CAPACITY TO TRULY SCALE UP TO COPE WITH SIGNIFICANT VOLUME DAYS

INDUSTRY VALUE PROPOSITION

In addition to these positives and negatives, other key structural points regarding cost and Best Execution come into play.

The following were consistent surveyed themes; concerns of using outsourced trading firms versus deploying and developing in-house talent, and/or structural deficiencies of the model. Furthermore, there are question marks over whether outsourced trading firms fully deliver on their advertised advantages. This leads to three key questions:

1. Who bears the cost of the outsourcing?
2. Is the outsourcing firm truly honouring Best Execution every time they trade? and
3. Do outsourced trading firms actually do what they say they do?

1. COST ALLOCATION

When an asset manager builds out and staffs an internal trading function, they themselves pay for it as part of the cost base of the firm. But when brokerage commissions are paid out to the street, the fund itself (i.e. the end asset owner) foots the bill.

It is accepted that outsourced trading is defined as a “service”, so it follows that end asset owners can justifiably be asking if they are paying for something that benefits the asset manager in a broader sense as opposed to their fund in isolation – so the scope of the service provision comes into question.

KEY TAKEAWAY: *asset managers must be clear in how they provision for the use of an outsourced desk, in any Request for Proposal (“RFP”) for a new mandate, Investment Management Agreement (“IMA”), as well as their own internal policies and procedures.*

2. BEST EXECUTION

In addition to concerns related to trading expertise raised in the below analysis, outsourced trading firms will often trade electronically to maximise their margin (see pricing model in Section 3.1). Why is this?

If a hedge fund client, for example, is paying 10bps for execution, why would the outsourced firm send it to a broker’s high-touch Salestrader for 8bps when it could just trade electronically themselves for 1-2bps?

This is a direct conflict with the idea of optimising execution outcomes – because in many cases, using an algo is not the right method of transacting (e.g. high ADV lines, special situations, rights issues), something exacerbated by a lack of experience in the use of algos, as previously noted.

KEY TAKEAWAY: *in a regulatory sense, the onus remains on the asset manager to understand, measure, log, and report all factors (not just execution quality) their outsourced firm is responsible for. Their local regulatory body can – and will – ask for proof of this discharge of duties in an audit / inspection situation.*

3. PITCH VERSUS REALITY

To assess the efficacy of the service offering provided by outsourced trading firms, we have analysed the main value proposition put forth by the industry. Based on extensive interviews with executives from buy and sell side, as well as multiple outsourced trading firms, we break each point down against the real-world experience of the people who consume and offer the service (see Figure 22).

FIGURE 22: TESTING THE VALUE PROPOSITION

TAGLINE	PITCH	CORROBORATING	CONTRADICTING	VERDICT
COST SAVINGS	<i>Turning a fixed cost into variable cost, reducing resource slack, reducing employee turnover and downtime, and reducing implicit cost of execution</i>	<ul style="list-style-type: none"> ✓ Especially true for low AUM ✓ Staffing a desk is expensive, and it does turn a fixed cost into a variable one for AMs 	<ul style="list-style-type: none"> ✗ Notable hurdles related to cost exist (see Section 5.1) 	✓
EXPERIENCE / ACUMEN	<i>Being covered by a highly experienced team of market professionals, thereby gamering the benefit of alpha generation</i>	<ul style="list-style-type: none"> ✓ Hires are typically people of established industry tenure, trustworthy and reliable 	<ul style="list-style-type: none"> ✗ Tend to have narrow, non-diverse skill sets (mostly single stock background) ✗ Little exposure to modern methods of trading, e.g. Algos ✗ Difficult for PMs to vet traders 	-
INFORMATION COVERAGE	<i>Increased bandwidth without dropping off service levels to PM</i>	<ul style="list-style-type: none"> ✓ Act as an extra pair of eyes ✓ Often become the trusted eyes and ears of desk/PM 	<ul style="list-style-type: none"> ✗ None 	✓
PARTNERSHIP / ALIGNMENT	<i>Outsourced firms fully integrate into the PM's investment process, clearly understanding their positions and risk. Ability to make a judgement call if needed, communicating relevant information</i>	<ul style="list-style-type: none"> ✓ Have the capacity to genuinely understand and be able to cope with an AM's requirements 	<ul style="list-style-type: none"> ✗ Difficult to outsource a firm's investment culture ✗ Market as an extension of the buy side but act in a similar capacity to a broker firm 	-
TECHNOLOGY CAPABILITIES	<i>The asset manager does not have to invest in expensive trading systems themselves, because the outsourced firm has it</i>	<ul style="list-style-type: none"> ✓ Technology is perfectly adequate for smaller-fund, lower turnover, single security-centric clients 	<ul style="list-style-type: none"> ✗ Most don't use "state-of-the-art" technology (unless at large FS firm) ✗ No ongoing utilisation of real-time analytics, venue aggregation, list trading or algo wheel functionality 	✗
NO CONFLICT OF INTEREST	<i>Desks are fully independent and unconflicted, segregated from other business units and acting as an extension of the asset manager's operational requirements</i>	<ul style="list-style-type: none"> ✓ Independent firms are generally unconflicted, with no internal overlap with client aims 	<ul style="list-style-type: none"> ✗ Some firms in the broker segment have outsourcing operations physically on same desk as normal brokerage ✗ Many act like brokers w.r.t. crossing of stock ✗ Employee compensation is often derived from commission income ✗ Some internalise flows over picking best price ✗ Some route via financially incentivised venues/brokers 	-
OVERFLOW / SCALABILITY	<i>"Pay as you go" model to increase bandwidth</i>	<ul style="list-style-type: none"> ✓ Extremely useful for smaller / multi-asset desks; bandwidth instantly available so can help during stretched times 	<ul style="list-style-type: none"> ✗ None 	✓
DEEP LIQUIDITY	<i>The advantage of having multiple brokers available, even if the asset manager is not connected to them</i>	<ul style="list-style-type: none"> ✓ Does help aggregate liquidity options ✓ Provide with greater access, globally ✓ Reassess broker lists under MiFID II, but outsourcing allows large panel 	<ul style="list-style-type: none"> ✗ Most outsourced firms advertise X-hundred brokers, but concentrate >80% of flow in a handful of counterparties ✗ "Deep liquidity" can often be a misnomer (large array of brokers vs. actual volume) 	-
BESPOKE / CUSTOMISED	<i>Have a firm that does tailored / ad hoc project work for an in-house trading desk, such as market / stock research, pricing screens</i>	<ul style="list-style-type: none"> ✓ Commission management is a useful area for paying and managing brokers 	<ul style="list-style-type: none"> ✗ Very few real-world / meaningful examples of customised work 	✗
USE OF TCA	<i>Ability to use a third party to measure execution quality; rigour in assessing trading results</i>	<ul style="list-style-type: none"> ✓ None 	<ul style="list-style-type: none"> ✗ Most firms: patchy, ad hoc use, little culture or expertise ✗ Clients may not have sufficient enough flow 	✗
STREET RELEVANCE	<i>Ability to support direct-to-broker workflow, for commission payout and research management</i>	<ul style="list-style-type: none"> ✓ Some outsourced solutions connect client directly to the end broker in terms of payment (RTO model) 	<ul style="list-style-type: none"> ✗ None 	✓
REGULATORY SUPPORT	<i>Keeping on top of, and look after, all regulatory matters on behalf of the client</i>	<ul style="list-style-type: none"> ✓ Help keep up with regulatory news flow and changes, this is a very useful service 	<ul style="list-style-type: none"> ✗ Although licenced, cannot report to a local regulator on behalf of the AM, nor advise 	✗
COVID-19 ADAPTABILITY	<i>Outsourcing of business continuity protocols (BCP) and ability to work from home on behalf of the asset manager</i>	<ul style="list-style-type: none"> ✓ None 	<ul style="list-style-type: none"> ✗ Most AMs have set up robust WFH protocols anyway, so this is not an accretive benefit 	✗

✓ Agree - Dependent / Neutral ✗ Disagree

Source: Quinlan & Associates survey and analysis

One of the stand-out themes, in the most important field of execution itself, was that while most outsourced traders are trusted, highly experienced, and offer great coverage capabilities (in terms of provision of stock and market content), they have limited understanding of how to expertly use algos.

This is largely a function of their background and skill set, with very few from electronic trading-centric positions on the buy or sell side. Through poor, or non-targeted strategy selection, this has the potential to severely dilute Best Execution capabilities, and hence the overall service.

As such, while some explicit, visible costs may be saved, execution quality is seen to diminish when transacting through an outsourced trading firm.

KEY TAKEAWAY: *ultimately, asset managers need to be able to demonstrate to their end asset owners that in exercising their fiduciary duty, outsourcing is the right path to take in with respect to execution quality, risk management, cost, operational and regulation liability, and service level between portfolio manager and trader.*

ULTIMATELY, ASSET MANAGERS NEED TO BE ABLE TO DEMONSTRATE TO THEIR END ASSET OWNERS THAT IN EXERCISING THEIR FIDUCIARY DUTY, OUTSOURCING IS THE RIGHT PATH TO TAKE IN WITH RESPECT TO EXECUTION QUALITY, RISK MANAGEMENT, COST, OPERATIONAL AND REGULATION LIABILITY, AND SERVICE LEVEL BETWEEN PORTFOLIO MANAGER AND TRADER

CUSTOMER UPTAKE

According to a recent research report, global annual spend on outsourced trading stood at USD 354 million in 2020, or 2.4% of the USD 14.9 billion equity trading figure outlined in Section 1.⁸ While this will undoubtedly grow as participants offer differentiated services and funds focus on costs, we have reservations regarding the rate of growth.

The same report outlines a bullish, +50% CAGR scenario based on the widespread adoption of outsourced trading by large asset managers, leading to an annual spend of USD 2.1 billion (or 14% of the total) by 2023. We see this forecast as highly unlikely.

Corroborating this current spend figure, the surveyed usage of outsourced trading is still very low. In the US and Canada, for international trading only, usage is ~10%⁹ – meaning for domestic execution it is likely to be much lower, at ~5%. In Europe, we estimate this figure to be ~3% and, in Asia, where the concept is nascent and availability of firms on the ground extremely low, less than 1%.

Fortunately, for the outsourced trading firms, business is sticky. Once an asset manager commences a trading relationship, they tend to use them on a sole basis (or, at worst, a single additional firm). However, this hinders innovation as, unlike the sell side brokerage firms, outsourced trading firms do not feel the effect of competitive pressures.

⁸ BNY Mellon, 'Why Outsourcing is Turning Trading Inside Out', 2020, available at: <https://www.bnymellon.com/content/dam/bnymellon/documents/pdf/aerial-view/why-outsourcing-is-turning-trading-inside-out.pdf.coredownload.pdf>

⁹ Greenwich, 'The Outsourced Trading Evolution Continues', 2020

FUTURE PROSPECTS

While there are undoubtedly benefits, principal among which is the potential for bottom-line cost savings, we do not believe outsourced trading is, or ever will be, a panacea for the broader investment industry. Due to the current limiting factors in terms of service provision, on top of the various optimisation methods in-house desks can deploy in order to improve trading performance (see below), we see a more muted growth story for the industry in the region of 5-15% CAGR over the next 5 years.

Other recently published estimates have stated that by as early as next year, ~20% of asset managers with an AUM > USD 50 billion are expected to outsource some part of their execution business. Unless there is a fundamental repositioning of the sell side's client trading offerings to repurpose some or all their execution services platforms into outsourced trading operations – starting with UBS; see comments below – we disagree with this assessment.

As noted in the introduction, total buy side spend on trading services has not been changing meaningfully year to year. Therefore, the only way in which the industry can grow to this extent is to take asset manager pay-out from the brokers themselves, who would see their own business cannibalised in order to satisfy this growth. Over time it is unlikely that the biggest securities houses will allow this dynamic to take shape, potentially accelerating their entry into the market in order to control pricing pressures.

We see UBS's recent entry into this space as a major event, one which will almost certainly cause competitive pressure on the independent and broker/prime broker segments. As a large house with a major prime brokerage footprint, they will immediately be able to offer their hedge

fund clients a dedicated "buy side" style trading service.

There are, however, immediate conflict-of-interest concerns. Calling it their "Execution Hub", it is noticeable that UBS has elected to set up this new business in their brokerage / prime brokerage unit, as opposed to their segregated asset management arm. The concern is by capturing the flow from their captive, smaller funds audience, they may not be able to honour Best Execution standards, given the likelihood they will route an outsized proportion of the outsourced order flow to their own brokerage arm, as opposed to using an authentic broker-neutral approach – like an independent outsourcing firm would.

If UBS can move past these issues, demonstrating they are truly acting in the best interests of their clients, it represents an opportunity to be first to market, bringing UBS's pricing and technological power to bear on this burgeoning part of financial services. So much so, we predict that outsourced trading could be offered at close-to-zero (or perhaps even zero) commission rates in future, especially if they already have an income stream from any funding leg of the client's activity.

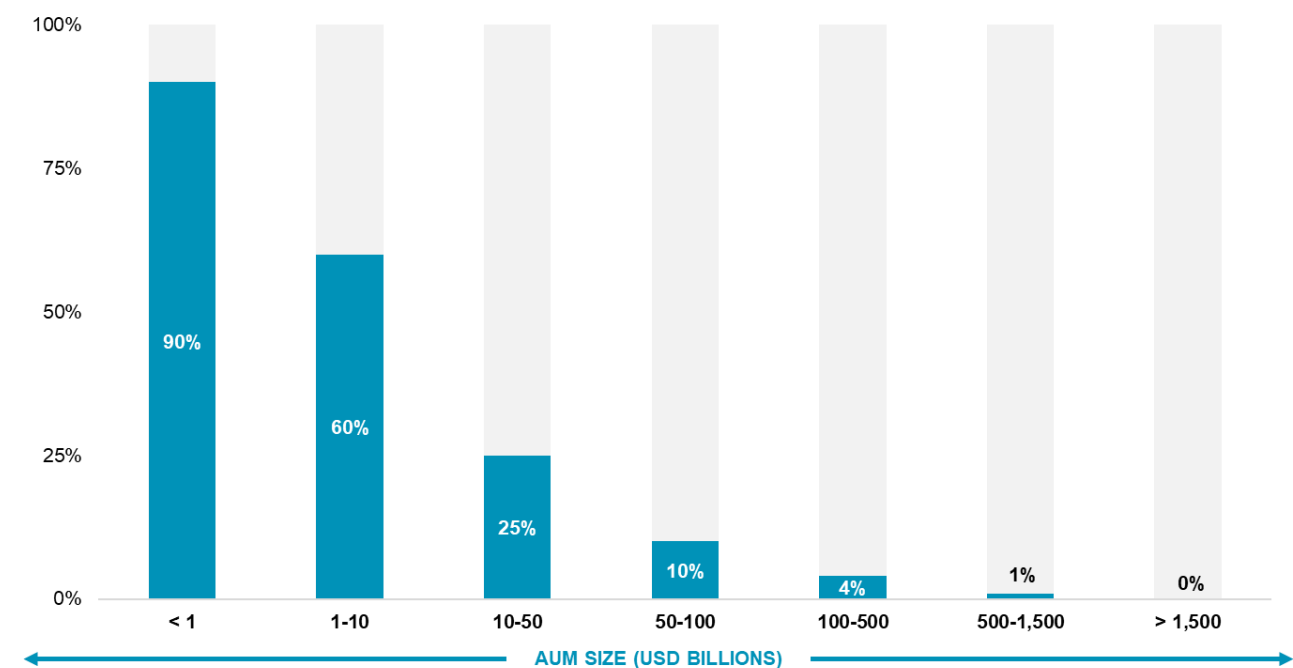
We believe the move by UBS has the potential to severely dilute the existing hunting ground of smaller firms in their outsourcing peer group, especially in the independent space. If this new model proves to be successful, expect other prime brokerage heavyweights, including Goldman Sachs, Morgan Stanley, and JPMorgan, to follow suit.

We believe such moves have the potential to re-shape the sell side service proposition – in short, firms may look, in certain segments of the market, to convert their traditional brokerage offerings into captive, buy side extensions, where they themselves become the execution desk for the asset manager.

A further encumbrance the outsourced trading industry faces is the maximum client wallet they are exposed to; that is, the amount of commission outsourced trading firms can reasonably expect to penetrate, in aggregate. The reality is, there is an increasing level of in-

house trading expertise and staffing as asset managers move up the AUM scale, so the likelihood of using outsourced trading services markedly diminishes with firm size (see Figure 23).

FIGURE 23: OUTSOURCED TRADING MARKET PENETRATION (2021E, %)



Source: Quinlan & Associates estimates

Given the majority of the larger commission payers sit within the larger asset space, we estimate that the outsourced trading proportion of total pay-out (currently at 2.2%) will remain in single figures for at least the next five years.

In an already crowded marketplace, we remain sceptical about the growth ambitions of smaller, independent firms over the long term, especially

those ones without private or listed financial backing. This will have a direct effect on their service offering, given their pricing power and influence in the eyes of the brokers they rely on will continue to be limited, particularly if the sell side “repurposing effect” mentioned above takes hold. As such, for asset managers looking to outsource their trading activities, partner selection is key.

WE SEE UBS’S RECENT ENTRY INTO THIS SPACE AS A MAJOR EVENT, ONE WHICH WILL ALMOST CERTAINLY CAUSE COMPETITIVE HEADWINDS FOR THE INDEPENDENT AND BROKER/PRIME BROKER SEGMENTS... [AS WELL AS HAVE] THE POTENTIAL TO RE-SHAPE THE SELL SIDE SERVICE PROPOSITION

INTERNAL OPTIMISATION

While execution exists as a key pillar in the investment process, the trading desk has long been a resource-intensive element that, in most cases, does not genuinely add measurable value; hence why a pay-as-you-play option (i.e. outsourced trading) becomes appealing.

As highlighted in the cost model exercise in Section 2, it is expensive to maintain an in-house execution function. As such, asset managers tend to allocate resources in the pursuit of improved investment returns via the portfolio construction process – for example, in the fields of enhanced tools for active management, indexation, stock analysis, corporate access, and research provision.

Despite this, there are several steps a buy side trading desk can take to not only validate their place in the investment ecosystem but be genuinely accretive. These lean into, and go more granular with, the redundancies / slack factors highlighted in Section 2, and all involve enhancing existing, in-house functions without the need to farm out any part of the business to an external party. It should be noted that outsourcing a part of a desk's operational burden can be part of these solutions.

By connecting these redundancies to practical actions, it is possible to identify the key elements of optimisation. It is here where we focus on the importance of electronification and culture and introduce the concept of the equity “Algo Wheel” as a case study of performance enhancement potential.

AS THE COST MODEL EXERCISE IN SECTION 2 SHOWED, IT IS EXPENSIVE TO MAINTAIN AN EXECUTION FUNCTION, AS SUCH ASSET MANAGERS TEND TO ALLOCATE RESOURCE IN THE PURSUIT OF IMPROVED INVESTMENT RETURNS VIA THE PORTFOLIO CONSTRUCTION PROCESS

INFLUENCING FACTORS

There are several overarching considerations an asset manager should make in order to optimise its trading operation (see Figure 24). They include external and internal factors, which can be broken into four key determinants:

- Structural (e.g. business set up, team composition, collaboration, and cultural drivers);
- Talent (e.g. interpersonal skills, progressiveness, and curiosity of mindset);
- Technology (e.g. budget, existing usage, inter-operability, and proficiency / fluency); and
- External (e.g. client relationships, value proposition, and the level of trader involvement).

THERE ARE SEVERAL OVERARCHING CONSIDERATIONS AN ASSET MANAGER SHOULD MAKE IN ORDER TO OPTIMISE ITS TRADING OPERATION... THEY INCLUDE EXTERNAL AND INTERNAL FACTORS, ADDRESSING ISSUES RELATED TO STRUCTURE, TALENT AND TECHNOLOGY

FIGURE 24: INFLUENCING FACTORS

	KEY DETERMINANTS			
	STRUCTURAL	TALENT	TECHNOLOGY	EXTERNAL
Poor / Insufficient Measurement	✓	✓	✓	✗
Insufficient Platform Fluency / Curiosity	✓	✓	✓	✗
Lack of Technical Proficiency	✓	✓	✓	✗
Internal Relationships	✓	✓	✗	✗
Loss of Market Touch	✓	✓	✗	✗
Back-Up	✓	✓	✗	✗
Lack of Research / Analysis	✓	✗	✗	✓
Client Involvement	✓	✗	✗	✓
Industry Involvement	✓	✗	✗	✓
Broker Interaction	✓	✗	✗	✓
Inactivity / Idle Time	✓	✗	✗	✗
Operational Overhang	✓	✗	✗	✗
Regulatory Burden	✓	✗	✗	✗
Scalability	✓	✗	✗	✗
PM Dependence	✓	✗	✗	✗
Hierarchical Division of Labour	✓	✗	✗	✗
Cross-Pollination of Ideas	✓	✗	✗	✗
Laziness / Lack of Self-Improvement	✗	✓	✗	✗
Lack of Commercial / Interpersonal Flare	✗	✓	✗	✗
Out-Moded / Inefficient Core Platforms	✗	✗	✓	✗
Legacy Connectivity / Interoperability Issues	✗	✗	✓	✗

✓ Applicable ✗ Inapplicable

Source: Quinlan & Associates analysis

1. POOR / INSUFFICIENT MEASUREMENT

Many buy side trading desks still do not have a proper system of measurement in place. By deploying pre-, intra- (via the EMS environment), and post-trade analysis, this puts the desk on a firm path of getting a better handle on execution quality. This can be done via validation through in-house or external parties, including peer-to-peer gauges.

Work can also be done in the market and/or stock microstructure space; along with the above, it can be translated and delivered into the client-facing team for end asset owner use.

2. INSUFFICIENT PLATFORM FLUENCY / CURIOSITY

Upskilling through better partnership with internal and external stakeholders should lead to better – and broader – platform awareness (including existing OMS / EMS infrastructure), along with algo development work (e.g. individual trader ownership for customisations), which can then be shared locally and/or globally.

3. LACK OF TECHNICAL PROFICIENCY

This includes the introduction and growth of electronic trading methods and/or the introduction of systematised workflow, where possible. Taking on challenges outside comfort zones to learn and improve proficiency can help aggregate trader skillsets.

4. INTERNAL RELATIONSHIPS

Very often, trading desks find themselves operating in a bubble, not aware of how a lack of collaboration with internal stakeholders could improve client performance and experience. Concerted and regular dialogue / work with PM and client-facing teams, regarding how trading

delivers investment performance, can bring immediate possibilities.

5. LOSS OF MARKET TOUCH

Carving out time to market- and stock-specific themes, to provide variation from operational tasks will keep traders sharp and in touch. An outsourcing option can be utilised, where required.

6. BACK-UP

The enacting of a formalised system of back up, tied in with periodic rotations of roles (i.e. changing trading responsibilities for asset classes and/or countries), enables upskilling and seamless operational coverage when individual traders are away.

7. LACK OF RESEARCH AND ANALYSIS

Augmenting point 1, the aim is to convert into a culture based on the empirical measurement of trading outcomes; in doing so, traders are not becoming data scientists, but they are creating connectivity with a quantitative process (internal or external) to enhance their existing trading capabilities. In this scenario, an outsourcing option can also be utilised, where required.

8. CLIENT INVOLVEMENT

Another key initiative that should be considered, where feasible. Usually delivered by the head of desk or senior / experienced traders, direct involvement in client pitches and portfolio / performance reviews can significantly enhance the knowledge and perception requirement of the client. The credibility it brings is enormous and yet vastly underused.

Periodic meetings and/or teach-ins for TCA and special situations can underpin more formal meetings, but key is the ongoing engagement for illustration of trading value-add.

9. INDUSTRY INVOLVEMENT

Public profile for both personal and company franchise is recognised as being important. To this end, representation / speaking at industry events, whether the trader is junior or senior, helps boost confidence and technical proficiency. Media work, where appropriate, can also be undertaken.

10. BROKER INTERACTION

The nature of how buy side trading desks work with, and consume service from, their sell side peers (brokers) has rapidly evolved. The best desks foster deeper, more meaningful relationships, with robust / honest, regular, measurement-based review processes. This brings about the whole issue of partnership, and how, by putting more work in, the buy side trading desk can get better results out.

11. INACTIVITY / IDLE TIME

To ensure fallow periods on the desk are kept to a minimum, traders can be tasked with ongoing, non-operational, slower-burn project work. This can be in the form of client work, or platform-related tasks (broker or technology).

Furthermore, additional orders can be traded on-desk through ET channels rather than farmed out to a broker or outsourced desk; this has the effect of creating greater operational urgency and accountability (also see part 18. below).

12. OPERATIONAL OVERHANG

If operational, non-trading tasks are becoming burdensome, appropriate prioritisation (on a risk-weighted basis) needs to be made, along with the sharing of burden with on- or off-desk personnel. Utilising workflow optimisation methods to ensure functional focus also helps,

along with outsourcing, where feasible (e.g. if tasks are non-core and repetitive).

13. REGULATORY BURDEN

In order to maintain a healthy balance between operational requirements and regulatory tasks, closer collaboration with internal / external compliance stakeholders is critical.

14. SCALABILITY

Another crucial point, particularly as the asset manager grows. Introduction of systematised workflows to allow for larger volume days, and/or when desk is light in terms of people, gives confidence in operational solidity. Parts of the book can be outsourced, where needed.

Finally, a greater degree of flow, where appropriate, can be segmented into ET to become “low touch” and have a specific operational wrapper built around it. Best practice can then be propagated across the desk to ensure consistency.

15. PM DEPENDENCE

Moving into a model when the entire desk covers PMs as a functional and operational outlet creates a healthier, fluid structure that allows more consistent coverage. This is tied in with cross-pollination themes (see part 17 below).

16. HIERARCHICAL DIVISION OF LABOUR

Breaking down traditional siloes, particularly those between ET- and single stock-focused roles, helps the desk to remain on point operationally, ensuring ideas and best practices are shared, and that fiefdoms or protectionist tendencies are not formed.

This is also a problem with countries or instruments that enjoy a higher degree of turnover, often ring-fenced by more senior traders, so periodic, functional rotation of roles (where ownership of book changes from trader to trader) keeps things fresh.

17. CROSS-POLLINATION OF IDEAS

In the spirit of enhancing the value proposition of trading, the inheriting of ideas and workflows from other trading books / asset classes is enormously valuable, as it gives a rounded and more experienced hue to any client delivery or technological project.

Further, a socialistic, “desk of one” approach, particularly with ET, creates a unified and consistent message of functional capabilities and, more importantly, trading results.

18. LAZINESS / LACK OF SELF-IMPROVEMENT

Individual growth (or lack thereof) is a notable problem in most buy side trading desks, particularly at the larger asset managers. Tied in with previous points, crossover of roles on desk, for example, especially if a multi-asset operation, can help in maintaining vibrancy.

Upgrading of cultures / incentives, collaboration with other parts of the Investment organisation, ongoing project work to instill a sense of ownership, along with intra-desk exchanges of ideas, can all contribute to a sense of fulfilment and hence growth.

19. LACK OF COMMERCIAL / INTERPERSONAL FLARE

This consideration is often solved through instilling good cultures on the trading desk, along with employee training (e.g. personal / corporate development programs). Consistent

with other factors, there are also opportunities to empower through on-desk task / project responsibility.

20. OUT-MODED / INEFFICIENT CORE PLATFORMS

This remains a key area for consideration. Workflow optimisation must start with a feasibility / landscape study on platform options to either replace or augment existing infrastructure. This may include utilisation from other asset class / industry group workflows (e.g. using cash equity Algo Wheel technology for futures trading).

This is also where the potential use of the outsourcing trading option lives, in terms of upgrading a desk’s platform. Particularly prevalent in the smaller funds space, an assessment can be made regarding whether a manager should purchase new platform technology or simply utilise an existing stack from an external provider.

21. LEGACY CONNECTIVITY / INTEROPERABILITY ISSUES

We have observed a culture within asset managers – particularly when moving up the AUM scale, and/or when introducing desks over different time zones – of a lack of willingness to tackle more fundamental platform deficiencies. Too often it is the case where individual traders “do their own thing” and focus on their own book of business, not being accountable to a broader, unified aim of the improvement in execution quality, better collaboration in house, and hence aggregate investment performance.

All the above potential solutions can be expanded upon and built out to be core parts of the trading desk’s approach, with the common aim of enhancing fund performance for the end asset owner.





CASE STUDY – EQUITY ALGO WHEEL




It is widely understood that one of the primary methods of improvements in execution performance, as well as workflow efficiency, is through the deployment of electronic trading (“ET”) methods.

Traditionally the preserve of smaller order flow (irrespective of asset class), algorithmic trading

and electronically enabled negotiated block-crossing is now a mainstay of the majority of buy side trading desks. Although Equity was the original pioneer, electronic trading is now available, in some form, across the asset spectrum, including the more liquid Fixed Income instruments such as Rates (see Figure 25).

FIGURE 25: ELECTRONIC TRADING LANDSCAPE

Electronic Trading Service Type		Applicability to Instrument Group			
		Cash equity	Listed futures	Currency	Liquid FICC
1	 Basic / Manual Algos <ul style="list-style-type: none"> • Broker provided or built in-house • Benchmark- or volume-driven strategies • Ability to customise 	✓	✓	✓	✗
2	 Request for Quote (RFQ) <ul style="list-style-type: none"> • Streaming prices, clean user interface • Best price providers appear in panel • TCA output for future counterparties 	✗	✗	✓	✓
3	 Electronic Crossing Network <ul style="list-style-type: none"> • Automated or negotiated matching • Fully anonymised • Can be integrated into algorithms 	✓	✓	✓	✓
4	 Algo Wheel <ul style="list-style-type: none"> • Systematised method of broker allocation • Full customisable / concurrent strategies • TCA-based re-optimisation loop 	✓	✓	✗	✗

 Most modern ET workflow method
  Applicable
  Inapplicable

Source: Quinlan & Associates analysis

Despite its widespread availability, ET is still remarkably underutilised. For example, recent research suggests that in Asian Equities, approximately fifteen years after its inception, only 31% of all trading is executed algorithmically, and a further 4% via ECNs, or Electronic Crossing Networks (such as Liquidnet). This figure is higher in the US and Europe, where methods are better developed and market structure more amenable, but it points to a picture of ongoing and heavy reliance on the Salestrading and Portfolio Trading desks of brokers. Electronic usage in Currency trading is still very nascent, and even more so in Fixed Income.¹⁰

A piece of technology that has gained popularity in recent years has been the “Algo Wheel”. Mostly used in equity trading, either developed in house or in partnership with a technology provider, it is a systematised method of allocating business to a specific set of strategies to a specific set of brokers. It has made great strides in the Long Only (Passive) space due to its ability to distribute a large number of orders in only a few mouse clicks, its key benefit being that it can be programmed to skew the distribution of orders to the strategies and/or brokers that have historically performed the best (see Figure 26).

FIGURE 26: ALGO WHEEL REPRESENTATION



Source: Quinlan & Associates analysis

¹⁰ Greenwich, 'The Outsourced Trading Evolution Continues', 2020

For asset managers that use an Algo Wheel to its full capability (i.e. not just as a tool for workflow efficiency), consolidated execution performance has been shown to improve demonstrably over time. This provides an immediate and measurable commercial advantage to the asset managers, who can highlight the results as part of the fund performance review process to their external clients. For high-turnover end asset owners, this has proved to add millions of dollars of investment performance to their funds.

However, in aggregate, this is a severely underutilised technology. Using the same, surveyed 31% electronic trading rate in Asian equities, of this, 36% utilise “some” Algo Wheel technology. Of these users, 45% of available business is executed this way. This means that just 5% of all Asian Equity business is transacted through one of the most value-added electronic methods currently available.¹¹

In the US and Europe, where market structure and broader liquidity is more amenable to the use of the technology, this number is just 2.6% and 4.5% respectively. Even though ET is more widely used in these regions, the utilisation of the technology is noticeably lower (for example, in the US, just 18% of ET users deploy “some” Algo Wheel usage in their workflow, half the Asian number, despite a far more liquid market).

If a buy side trading desk is willing to put in the time and effort (note: a full build-out of such a workflow will usually take 5-6 months), as well as enact cultural change to embrace a new, desk-wide approach, this example shows how optimisation can be deployed to genuinely enhance client outcomes, all of which are executable using existing in-house resources.

IT HAS BEEN SHOWN THAT FOR ASSET MANAGERS THAT USE AN ALGO WHEEL TO ITS FULL CAPABILITY – THAT IS, NOT JUST AS A TOOL FOR WORKFLOW EFFICIENCY – CONSOLIDATED EXECUTION PERFORMANCE IMPROVES DEMONSTRABLY OVER TIME

¹¹ Greenwich, 'The Outsourced Trading Evolution Continues', 2020

HYBRID SOLUTION

Another option available to an asset manager is to formulate a combination of the two approaches laid down, keeping core trading desk activities in-house and farming out the parts of their business they feel is not accretive but incurs a meaningful operational cost and/or

cannot be optimised (for example in very liquid, very operational money market transactions).

The majority of outsourced trading firms are happy to negotiate a partial / selected piece of the trading desk's flow, operational or project work, and price it accordingly. This then leaves the asset manager to invest solely on the piece they can develop internally, for most value.

ANOTHER OPTION AVAILABLE TO AN ASSET MANAGER IS TO FORMULATE A COMBINATION OF THE TWO APPROACHES LAID DOWN, TO FARM OUT A PART OF THE BUSINESS THEY FEEL IS NOT ACCRETIVE BUT INCURS A MEANINGFUL OPERATIONAL COST, AND/OR CANNOT BE OPTIMISED

SECTION 6

POTENTIAL UPSIDE

OVERVIEW

It is clear that outsourcing and/or optimising of trading operations can deliver significant benefits to an asset manager, both in terms of reducing cost wastage and enhancing fund performance.





These upside opportunities can be distilled into five key considerations: (1) client engagement; (2) execution quality; (3) internal costs; (4) operating efficiency; and (5) teaming / culture. As the aim for asset managers is to improve

fund performance and maintain and/or grow AUM, we rank these in terms of their criticality to the trading desk's enhancement process.

QUALITATIVE

Beginning with a qualitative assessment of these considerations, we outline the recommendations, and subsequent benefits, that improvements from outsourcing and/or optimisation can bring to an asset manager (see Figure 27).

FIGURE 27: QUALITATIVE UPSIDE

CRITICALITY		RECOMMENDATIONS	BENEFITS
<p>Highest</p>  <p>Lowest</p>	 <p>CLIENT ENGAGEMENT</p>	<ul style="list-style-type: none"> Real content to deliver to clients as part of overall investment experience Partnership with PMs and Sales 	<ul style="list-style-type: none"> Better engagement, enhanced commercial proposition Tangible part of investment performance Pitching culture of trading innovation Improved revenues
	 <p>EXECUTION QUALITY</p>	<ul style="list-style-type: none"> Focus on ongoing improvements, empirical-based Investment in electronic trading methods across the asset spectrum 	<ul style="list-style-type: none"> Aggregate uplift in execution outcomes, feeding into fund performance Formation of external proposition for trading desk versus others More measurable and consistent
	 <p>INTERNAL COSTS</p>	<ul style="list-style-type: none"> Reducing human and structural costs (explicit) Improving opportunity costs (implicit) 	<ul style="list-style-type: none"> A meaningful reduction in fixed cost base, thereby enabling more competitive pricing of mandates An improvement in / lessening of the frictional costs of trading
	 <p>OPERATING EFFICIENCY</p>	<ul style="list-style-type: none"> Fewer manual processes, better inter-connected systems Greater scalability on higher-volume days 	<ul style="list-style-type: none"> Better commercial proposition Enhance ability for traders to focus on additional, non-execution tasks (regulatory and operational commitments)
	 <p>TEAMING / CULTURE</p>	<ul style="list-style-type: none"> Improved and more flexible / fluid team dynamics 	<ul style="list-style-type: none"> Upskilling all traders to be more technologically aware, diluting solely operational approach Culture of improvement and technological curiosity Eliminating idle / down time






Source: Quinlan & Associates analysis






We can deduce the relative impact our two scenarios can have on these five factors (see Figure 28). While the cost argument is generally compelling, the impact of the outsourcing option has less impact as one increases criticality. After all, the value of an asset manager's commercial proposition is defined primarily by investment returns, innovation, reputation, and partnership with and for their end asset owner: when considering the value a trading desk brings to these central ideas, as we have

demonstrated, outsourcing can hinder an investment organisation in this sense.

If, for example, an asset manager places careful, considered stock choice and execution at the heart of their investment philosophy, what image – let alone empirical outcome and regulatory obligations – is inferred if by the manager farming out its orders out to someone else for execution in a technologically sub-optimal environment?

FIGURE 28: POTENTIAL IMPACT

OUTSOURCING			OPTIMISATION	
 CLIENT ENGAGEMENT	x	Reduces ability to directly engage with clients as value proposition of execution is diluted	✓	Strong ability to have direct and ongoing conversations with clients regarding performance
 EXECUTION QUALITY	x	Skill set, technology and broker coverage deficiencies lead to inferior execution quality	✓✓	Implementation of optimised workflows and products leads to greatly improved trading results
 INTERNAL COSTS	✓✓	Turns fixed costs (up to USD 785k/trader/year) into variable ones; major savings possible	x	Correctly-executed optimisation is resource intensive for both up-front and ongoing costs
 OPERATING EFFICIENCY	✓	Accretive to the investment process as outsourcing is an extension of existing efficiencies	✓✓	Hugely improves operational efficiency, in terms of scale and manual task dependency
 TEAMING / CULTURE	-	If used for specific flow, helps reduce burden; if outsourced completely, can hinder culture	✓	Upskills existing in-house traders and allows them to be bought in to technological progression

 Key differences
  Highly Favourable
  Favourable
  - Dependent / Neutral
  Unfavourable

Source: Quinlan & Associates analysis

Given the findings in Section 4 (i.e. the relative merits of the industry), it is observed that in outsourcing, the biggest impact subjectively is felt in the areas of internal costs and efficiency,







while when considering optimisation, it comes mostly in client engagement and execution quality, the two most critical elements.

QUANTITATIVE

Taking the five key elements above, we quantify the benefits of putting these measures in place, set against our original explicit and implicit cost factors. Depending on the extent of the implementation, they will have a direct effect on both client fund performance and explicit costs borne by an asset manager.

As demonstrated in Section 2, fund performance can be adversely affected (or “lost”) in the range 1.2 – 2.7% p.a., or as much as USD 18 billion p.a. for the largest asset managers. A further USD 5 million can also be wasted in terms of their explicit costs. This breaks down as per Figure 29, showing where these concentrations lie, along with their relative impacts.

FIGURE 29: IMPACT ANALYSIS

COST SOURCE		CLIENT ENGAGEMENT	EXECUTION QUALITY	INTERNAL COSTS	OPERATING EFFICIENCY	TEAMING / CULTURE	ALLOCATION OF UPSIDE (%)
EXPLICIT	 Idle Time						50%
	 Operational Issues						25%
	 Structural Problems						25%
IMPLICIT	 Lack of Tech. Proficiency						37%
	 Poor Choice of Execution Method						3%
	 Lack of Partnership						60%

Level of Impact: ■ High ■ Moderate ■ Low

Source: Quinlan & Associates estimates

We believe the economic wastage being incurred, as well as opportunity cost foregone, is significant and damaging to many asset managers, which necessitates a concerted effort to overhaul their businesses to allow them

to remain commercially competitive. The upsides to doing this for the firms that move quickest will, in our view, bring a bifurcation in broader service offering, particularly among the larger asset managers.







SECTION 7

KEY IMPLEMENTATION CONSIDERATIONS

In order to make the correct decision regarding an implementation roadmap, there are three core considerations that an asset manager

should examine: (1) strategic; (2) operational; and (3) financial (see Figure 30).

FIGURE 30: KEY CONSIDERATIONS

STRATEGIC	 PRODUCT EXPERTISE	<ul style="list-style-type: none"> Product knowledge, past experience, and overall proficiency required
	 GEOGRAPHIC APPLICABILITY	<ul style="list-style-type: none"> Global / local rollout feasibility and need for local support structures
	 COMMUNICATION ALIGNMENT	<ul style="list-style-type: none"> Efficiency of inter-party coordination and collaboration
OPERATIONAL	 SCALABILITY	<ul style="list-style-type: none"> Alignment with asset / investment aims, including future proofing
	 RESOURCE ALLOCATION	<ul style="list-style-type: none"> Resource allocation needs, with respect to handling of flows
	 TECHNOLOGICAL SOPHISTICATION	<ul style="list-style-type: none"> Willingness to invest in and relative importance placed on, as part of overall IT set-up
	 TALENT MANAGEMENT	<ul style="list-style-type: none"> Team layouts, roles, responsibilities, technical proficiency, and upskilling needs
	 CONNECTIVITY	<ul style="list-style-type: none"> Satisfaction of connectivity requirements
	 INFRASTRUCTURE INTEGRATION	<ul style="list-style-type: none"> Interoperability, ability to integrated with current systems, etc.
FINANCIAL	 REGULATORY COMPLIANCE	<ul style="list-style-type: none"> Mapping of compliance requirements that need to be satisfied
	 POTENTIAL REVENUE BOOST	<ul style="list-style-type: none"> Possible impact on revenue generation (if any)
	 COST SAVINGS	<ul style="list-style-type: none"> Potential for delivering cost savings (if any)

Source: Quinlan & Associates analysis

STRATEGIC

The consideration of product and geographical footprint is important in terms of where the asset manager's trading desk operates, for example, a US-based firm with exposure to Asia; should it set up a local desk, or outsource to someone in the region? A manager's product offering is also important in determining an optimum trading setup.

A move, for example, that involves the transacting of more derivatives instruments or Fixed Income products for a traditionally cash equity-only desk, will require different skill sets and cultures than originally developed. It will also examine existing scalability, as per the

above point, and likely need an expanded technological footprint.

Where relevant, the globality of any new optimisation solution becomes a significant exercise in cross-border planning and execution. Often, other jurisdictions have fundamentally different workflows, approaches, and product requirements, even if a trading business is attempting to solve for the same problem.

Budgetary biases are also introduced if the funds for an upgrade are coming from a centralised technology fund pool – as such, due to the typical spread of revenue, the Americas receives the largest and earliest slice of funding, followed by Europe, then Asia.

THE CONSIDERATION OF PRODUCT AND GEOGRAPHICAL FOOTPRINT IS IMPORTANT IN TERMS OF WHERE THE ASSET MANAGER'S TRADING DESK OPERATES

OPERATIONAL

In order to enact upgrades or changes to the operational model, the following core operational considerations need to be made. Prior to committing to a structural (or even tactical) overhaul, it will be important for the asset manager to understand these factors.

Structural and technological considerations will be critical to this journey, in terms of an assessment of internal capabilities, triangulated against industry-wide standards and cost / operational headwinds.

The basic size, construct, and culture of the existing trading team(s) needs to be assessed. This includes range of seniority, enthusiasm, and curiosity (note: succession planning and team dynamics come into play here), along with technological proficiency and various support functions and external vendor requirements.

In the case of global asset managers, the degree to which optimisation projects align with broader strategic and budgetary aims also needs to be considered.

If the asset manager is in a growth cycle or launching new products which would need to be supported by increased trading volumes, the issue of scalability comes into play. For example, platform capacity, fail safes, product capabilities, and redundancies need to be considered. This invariably involves development through internal and external channels, so following on from the above

structural points, the culture / people aspect should be thought out and planned for.

Following on from the above, an assessment of existing systems capabilities, in terms of their inter-operability with planned new platforms and/or new outsourced providers, is critical. This goes from front-end systems (OMS / EMS) to network and broker connections to back-end settlement interfaces. The degree to which external vendors are relied upon in any optimisation scenario will influence the timeliness and efficacy of rollout.

The triangulation of trading technology, portfolio construction systems, and client facing-related platforms needs to be understood and considered holistically. The budget and appetite for project needs to be set firmly against the accretive performance and/or revenue targets they are designed to bring.

FINANCIAL

This is one of the most critical areas to be considered. It has been demonstrated that as asset managers move up the AUM scale, billions of Dollars can be made in aggregate fund performance through enhancing internal workflows and technologies. An asset manager needs to determine what this number needs to look like for them.

In addition, while smaller on a relative basis, the cost savings argument is also a compelling one in that outsourcing, for example, has the capacity to deliver meaningful results.

SECTION 8

CONCLUSION

Significant underlying cost, operational, and performance pressures exist in the asset management industry. Participants are becoming increasingly mindful of this in a highly competitive landscape where consolidation, structural change, regulation, and focus on measurement is now firmly entrenched. Trading plays a major role in this.

The execution leg of the investment process, originally treated as an ancillary, purely operational function, has evolved into a critical one. And yet, a significant proportion of fund performance is being left on the table, potentially running into the billions of dollars.

If an investment firm recognises the need to optimise, a primary task is to re-wire the culture towards a more collaborative, socialistic, technology-focused effort. Despite sitting on the same platform, siloed behaviours are still ubiquitous, with individual traders focusing solely on their own books, often for years, without any functional fluidity or growth. As such, a decision needs to be made over the

immediate, explicit cost benefits outsourcing brings – with due consideration of its offering – versus the long-term performance benefits of an ongoing investment in an in-house trading capability.

Leading buy-side desks, from all segments, have embraced electronic trading, but usage across the asset spectrum globally is still remarkably low. Consistently encountered was a lack of unified effort in getting broader, systematised usage off the ground, pointing teams in a singular direction. Because of this, the C-suite argument to outsource has become louder.

If the buy side trading model is to prove its worth to the overall investment process, both functionally and empirically, it will need to enact cultural change, as well as take long-term decisions around the deployment of better platform and analytical technology. For the firms that take these steps, the performance upside, and hence stronger value proposition, is there for the taking by trading up.

A DECISION NEEDS TO BE MADE OVER THE IMMEDIATE, EXPLICIT COST BENEFITS OUTSOURCING BRINGS...VERSUS THE LONG-TERM PERFORMANCE BENEFITS OF AN ONGOING INVESTMENT IN AN IN-HOUSE TRADING CAPABILITY

SECTION 9

HOW CAN WE HELP?

There are several ways in which Quinlan & Associates can help you improve your trading desk's value proposition, both internally and externally, as well as its execution performance.

1. LONG ONLY / HEDGE FUND

If you are in the traditional Asset Management space (Long Only or Hedge Fund):

- Capabilities assessment: a thorough pulse check on your trading platform, tied into the broader Sales and Investment ecosystem, assessing wastage and performance opportunity cost, execution methods, and team skill set
- An external landscape assessment, relevant to your core business (who is best in class, what are the premium platforms that produce the best results, etc.)
- Specific workflow and teaming structure recommendations with regards optimisation considerations in Section 4. Can be in the form of a new platform rollout, or overhaul of existing stack – OMS/EMS ecosystem, electronic trading, broker selection, assessment methods – along with team structure and cultural changes
- Formulating local/global electronic trading and Best Execution policies
- Modernising FICC trading methods
- How to build an Equity Algo Wheel: from flow categorisation to algo deployment to broker selection to post-trade measurement and re-optimisation
- Building compelling, client-centric Trading pitches, as part of broader Investment capabilities, along with appropriate collaboration methods with PMs and Sales

2. OUTSOURCED TRADING

If you are considering using outsourced trading:

- A cost-benefit analysis of using outsourcing versus developing an in-house function
- A complete capability analysis of the participants listed in Section 4, establishing best fit for your business including regional- and asset-based variances
- Due diligence/vetting on an agreed shortlist, with recommendations on who to use, how to set them up, and to what degree they should be utilised

3. END-ASSET OWNER / IN-HOUSE TRADING CAPABILITY

If you are an end-asset owner, either considering / in the process of building in in-house trading capability, or investigating outsourcing an existing function:

- A complete, fully costed feasibility assessment of keeping trading outsourced (either with the mandated asset manager, or an outsourced trading firm), or bringing it back in house, along with (or exclusive to) management of the assets themselves
- Pulse check of existing structure, improvements to be made, or feasibility of outsourcing (see above)
- How to expand an existing trading presence, or one from scratch, to include all people, systems, policy, procedural and regulatory considerations

QUINLAN & ASSOCIATES

STRATEGY WITH A DIFFERENCE

Copyright © 2021 Quinlan & Associates

All rights reserved. This report may not be distributed, in whole or in part, without the express written consent of Quinlan & Associates. Quinlan & Associates accepts no liability whatsoever for the actions of third parties in this respect.

The information and opinions in this report were prepared by Quinlan & Associates. This report is not financial or investment advice and should not be relied upon for such advice or as a substitute for professional accounting, tax, legal or financial advice. Quinlan & Associates has made every effort to use reliable, up-to-date and comprehensive information and analysis in this report, but all information is provided without warranty of any kind, express or implied. Quinlan & Associates disclaims any responsibility to update the information or conclusions in this report. Quinlan & Associates accepts no liability for any loss arising from any action taken or refrained from as a result of information contained in this report or any reports or sources of information referred to herein, or for any consequential, special or similar damages even if advised of the possibility of such damages. This report is not an offer to buy or sell securities or a solicitation of an offer to buy or sell securities.

Quinlan & Associates currently or may in the future engage with, seek to do business with, or hold positions in, some of the companies mentioned in its reports, which may give rise to potential conflicts of interest. Quinlan & Associates will actively manage any conflicts of interest that may arise (including by implementing appropriate information barriers and other conflicts management procedures and safeguards), in order to preserve confidentiality and to ensure that Quinlan & Associates remains objective and independent with regards to the contents of its reports.

ABOUT US

Quinlan & Associates is a leading independent strategy consulting firm specialising in the financial services industry.

We are the first firm to offer end-to-end strategy consulting services. From strategy formulation to execution, to ongoing reporting, communications, and employee training, we translate cutting-edge advice into commercially executable solutions.

With our team of top-tier financial services and strategy consulting professionals and our global network of alliance partners, we give you the most up-to-date industry insights from around the world, putting you an essential step ahead of your competitors.

Quinlan & Associates. Strategy with a Difference.