

Global Investment Technology®

Volume 16, Number 24

September 17, 2007

Strategic Business and IT Intelligence for the Securities & Investment Industry

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Northern Trust Optimizes Its Technology Resources In a Global Model, Addressing Middle-Office Needs

Northern Trust Company, with \$4 trillion in assets under custody, provides fund administration services for an asset base of about \$23 billion in alternative investments worldwide, including 170 hedge funds represented by 50 managers. With many of the firm's buy-side clients transforming their business models, Northern Trust is looking at how to adjust its own services accordingly. This effort includes a focus on global scalability to handle large volumes of business. Northern Trust also is continuing to perfect an effort to leverage a seven-day week using its various locations globally to pass operations activities along from time zone to time zone in order to prevent gaps in processing. To enable 21st century processing models such as these, Northern Trust works with clients to make their input integral to its efforts. *Global Investment Technology* spoke with Jana Schreuder, President, Worldwide Operations & Technology, Northern Trust Company.

GIT: How must investment operations infrastructures keep pace with globalization, multi-asset strategies and the ascent of alternative investments?

JS: To deal with alternative asset classes and the globalization of the industry, investment managers face the challenge of adhering to changing standards. Second, they have to invest in the technology or outsource the activity to a company that has done so. Northern Trust has made a sizable investment in technology and has a good recent track record in handling outsourcing decisions for asset managers. Third, asset managers have to pay attention to regulatory compliance, which is increasingly important. Northern Trust has invested in technology not just to facilitate straight-through processing, but to facilitate independent valuations and analysis of the integrity of the data from those investments. All of this is true globally, but firms must comply with different regulations in different jurisdictions. The same type of trading could happen in Europe, Asia or North America, yet the regulatory approach or the markets can be different, and that has to be understood. So asset managers either have to invest in the expertise to understand the different markets, and the technology and processes to operate in those different markets, or outsource it to someone specializing in each market.

SPOTLIGHT

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GIT: Could you share an overview of current technology and operational initiatives at Northern Trust and your IT priorities for 2008?

JS: We have two priorities in technology and operations. One is to support the growth of our personal and institutional business. The second is to optimize our resources, meaning constantly improving and perfecting the balance between the very high and increasingly demanding quality service we need to deliver with an acceptable level of risk, at an acceptable cost both for our organization and our clients.

We continually build and strengthen our global operating model, including our tools, talent, integration, development and processes for distributing the work among the North American, European and Asian regions. We spend about \$300 million annually on technology to support our business growth. That growth is 10 to 15 percent each year. Compared to our competitors, we really hold down cost even when spending more, because we leverage our common platform and use open source software and advanced server technologies. We are pursuing larger multi-year IT projects with deliverables each year, first focusing on client servicing for our entire organization. This is a response to the need to choose between building something once or buying it and integrating it for use by everyone, whether for individual or institutional clients. This year, we have been working on our enterprise relationship management system, which provides a single repository to capture all our clients' information and all our processes that support delivering to a client, so our clients are assured of a consistent experience regardless of location or where they transact business. In 2008, we will fine tune tools that extract the information for our partners throughout our global enterprise, whether for failed trades, or for analyzing emerging needs. Another focus in our multi-year strategy is to make sure our investment solutions are supported by state-of-the-art desktop tools. We work with our portfolio managers, in line with the proliferation of private equity, hedge funds and other alternatives, and the greater use of derivatives in our own investment activities on behalf of clients. We are designing tools that enable our portfolio managers to make educated decisions in real time and receive real-time notifications, whether of market events or compliance events.

GIT: What sort of features and capabilities are portfolio managers seeking in state-of-the-art tools for supporting alternative investment strategies?

JS: They require not just traditional asset management tools to buy and sell securities, but also open architecture for any level of investor. They want research, analytics and 'what-if' modeling all at their fingertips, and easy access to allocation models and pools of external third-party investment managers specializing in particular asset classes. They want to pull in information, compare it to the risk profile and investment objective set with the client, then lay out options for portfolio allocation. Then they want to assess how the decisions are panning out based on what the markets are doing in real time, and then creating client-ready information to communicate those activities. That's the type of decision-making and information flow we're facilitating through the tools that we're developing in investment solutions.



Schreuder: Advancing multi-national operations.

their expertise.

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GIT: What trends are you seeing in operations outsourcing? Do you see greater growth in modular or partial outsourcing?

JS: We see the most interest right now in the middle office — for us to provide investment operations, reconciliations and corporate actions processing. Those are the pain points where firms realize there is a significant investment required in tools, expertise and talent for the middle office, which they would rather not make. They would rather pay us to help support their trading decisions.

Regionally, we see a lot of opportunity in the US, where investment managers now see operations as not only complicated, but full of high-risk processes that are outside their core expertise. Having worked with us as a custodian, they know and trust our expertise. They also know the platform they're used to in delivering custody information is the same platform we're leveraging to process and deliver their investment middle- or back-office information. That's where we're seeing growth. So far our model has proven rather strong and pretty flexible. This isn't a cookie-cutter business. While the platform and the functions are very similar, how an investment manager works in their front office, the kind of information they're used to and need, and the type of flow differ greatly from manager to manager. Each time we take on an outsourcing client, it's an exercise in developing the right relationship. It's a very highly developed technical servicing relationship that has to happen between the middle- or back-office functions that we're providing and the front-office decision makers.

GIT: Northern Trust requires that clients use its outsourcing model, vis-a-vis platform, process, people and technology. How do you get managers to fundamentally reconsider their operating models?

JS: Asset managers differ in how they make decisions to invest their capital and also in where are their pain points. Investment managers are saying either they haven't invested in IT and have a lot of pain in their back- or middle office, or they have invested but don't want to continue to invest because they see that as a drain from their core competency. They're usually happy to go through the transfer of their back-office or middle-office system onto ours. That is collaboratively planned, tested and then executed with the investment manager and Northern Trust. In some cases, the difficulty is what to do with their back and middle office talent. In smaller shops or shops that are feeling the pain, it's usually not as significant an issue as in the bigger shops that have a lot of people that they want employed. In those cases, we will insist that we use our processes, platform and tools, but we will take on their experienced back-office or middle-office people, and have done that. That solves that potential pain point and makes that decision a little easier.

GIT: What are some of the pain points that persist in global portfolios, particularly in valuations, performance measurement, and risk monitoring?

JS: We need to continue to work on the transparency that clients need. Transparency, understanding exposure to risk and how underlying holdings in some of these funds or funds-of-funds can affect performance, is the key. The regulatory environment has to encourage it. As asset servicers, we need to con-

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We need to hone in on collaboration in the next three to five years and invent the next solution, like multi-national pooling, for emerging markets needs.

tinue to expand and leverage our capabilities. For example, globally, Northern Trust has pioneered multi-national pooling. Looking at global organizations, particularly pension managers with employees and pension plans domiciled in multiple countries, we seek ways to be more efficient and leverage investment decisions. We hired a number of tax, investment, operational, technology and product experts to figure out a method for multi-national clients to pool investment decisions for the benefit of differently domiciled pension components of their funds without losing the specific country tax advantages. Multi-national pooling is an opportunity in globalization and a way to collaborate with clients to understand their needs and aspirations, and to evolve our services.

GIT: What do you think the business will look like in three to five years? What will be the new challenges people will be confronting?

JS: From an operations and technology perspective, five years from now, a lot of the challenges we're talking about with the alternative assets marketplace and globalization will be more mainstream and status quo. We will certainly continue to have the challenges of working in multiple time zones, supporting systems that are 24/7. A continued proliferation of investment vehicles will always be a part of that, but it will be more mainstream and less top-of-mind as the focus. The challenges from an operational and technology standpoint will be enabling our clients to do much more, much faster with the huge amount of data that we have at their disposal. We need to hone in on collaboration in the next three to five years and invent the next solution, like multi-national pooling, for emerging markets needs that are not yet apparent. □