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GLOBAL OUTSOURCING SERVICES

black book

*Hedge Funds' Guide
to Outsourcing*



Illustration by Chris Buzelli

STREAMLINING

For a growing hedge fund, the decision to do business with more than one prime broker can save money and facilitate growth, but it can also make life more complicated. Without a significant investment in technology, how can a fund handle its order management, real-time P&L, position aggregation and accounting activities in a multi-prime environment? Credit Suisse and Paladyne Systems believe they have the solution

In June, Credit Suisse and Paladyne Systems, a New York-based software vendor, announced a strategic alliance to offer a multi-broker trading system for Credit Suisse's hedge fund clients by the fourth quarter of this year. The system—which contains order management capabilities, as well as accounting functions through a partnership with Advent Software—is being presented to Credit Suisse clients as an integrated front-to-back office, value-added service.

Other brokers, such as Goldman Sachs, Citigroup, Bank of America and Lehman Brothers, offer multi-broker execution, but their systems—REDIPlus, Lava Trading, Instaquote and RealTick, respectively—are limited to front-end execution management and do not provide order management, real-time P&L, position aggregation and accounting, says Sameer Shalaby, CEO of Paladyne Systems.

“If one of Goldman's hedge fund managers wants to use REDI to start executing at Morgan Stanley, how does he create an aggregated portfolio? The answer is: He has to do it himself. Broker front-ends do not provide this function, so hedge funds must set up their own internal infrastructure,” says Shalaby. “Many hedge funds perceive they are locked into a single prime broker relationship due to technology. The Credit Suisse-Paladyne solution frees them to be truly independent of any one prime broker.”

RELATIONSHIPS

prime brokerage

So why would Credit Suisse be offering its clients a system that will enable them to take business elsewhere? "It's about the fight for transaction flow and balances. For Credit Suisse, the Paladyne offering is yet another example of value-added services designed to attract more prime brokerage business," says Brian Shapiro, CEO of CarbonBased Consulting, an IT research and advisory firm that specializes in buy-side technology.

"Having a system that can help hedge funds not only use, but also manage multiple brokers is compelling," says Matt Nelson, senior investment manager

at TowerGroup. "One of the many challenges facing growing hedge funds is the need for data aggregation. Small managers often do get handcuffed by their own technological and resource limitations, preventing them from exploring multi-prime relationships. Finding a low-cost technology solution that allows the manager to aggregate data across multiple prime brokers and view a single, consolidated, real-time P&L, rather than having to log into multiple Web portals, makes the manager's life a whole lot easier."

"Small managers often get handcuffed by their own technological and resource limitations"

either a local install or on an application service provider (ASP) basis—meaning Paladyne hosts it. For Credit Suisse customers, the platform is offered on an ASP basis, which adds up to significantly less overhead for hedge funds that do not want an onsite IT department.

The platform includes Portfolio Master, the OMS and real-time P&L component; Analytics Master, a reporting, data warehouse and analysis engine; Security Master, for reference data; Price Master for collection, storage and analysis of pricing and market data; Client Master, a client relationship management module; and Advent Geneva, for portfolio

accounting. The Paladyne-Credit Suisse suite includes FIX connections to Credit Suisse's direct market access (DMA), Advanced Execution Services and algorithmic trading tools. It can also connect to several other brokers' tools—their smart order routers, as well as to their DMA and algo products. Paladyne can integrate with independent execution management systems such as Portware and TradingScreen, as well as with broker front-ends such as Goldman Sach's REDIPlus and Morgan Stanley's Passport.

cate indications of interest (IOIs), and to Millennium advertised trades, as well as integrated broker natural IOIs, via the NYFIX IOI package.

"When we considered all the capabilities NYFIX could offer our clients, they were a logical choice as a technology and connectivity partner," says Shalaby.

Howard Edelstein, CEO for NYFIX, says that given Paladyne's hosted and integrated ASP solution, it was a perfect candidate for its "Powered by NYFIX" offering. "By leveraging Paladyne's hosted ASP solution, we expect to reach a larger number of hedge funds that want a turn-key electronic trading and order routing solution," he says.

For Advent, the deal marks the first time the company will be offering Geneva on a hosted basis. Robert O'Boyle, Advent's vice president of global accounts, says the Geneva component of Paladyne's platform is the complete product and not a "Geneva light" version. "The evolution of the hedge fund business is such that for hedge funds to effectively chase alpha, they require access to a wide variety of products, which can come from multiple prime brokers. However, they need a holistic view of the fund's holdings across all the primes for reporting, performance and solid analytics. The Paladyne relationship provides hedge funds of all sizes with the opportunity to get that holistic view, plus access to the industry's most comprehensive and evolving hedge fund investment management platform, without the need to install the application locally."

Paladyne Systems was formed last year when a group of hedge fund software industry executives acquired both the technology and the development team from a multi-billion dollar, multi-strategy hedge fund. The product, which has undergone significant development since, is positioned as a multi-asset class, front-to-back office integrated solution for small and mid-sized hedge funds. In addition, specific modules of the platform are being targeted at larger funds as

After evaluating other vendors, Credit Suisse chose Paladyne in part because of its potential to be attractive to clients of all sizes—from start-up hedge funds to multi-billion dollar funds, says Sal Ventura, head of development for prime services. "The platform is modular. For start-ups, we can offer the whole front-to-back suite. Large funds with existing systems may be interested in specific modules such as Price Master, Security

Merrill, Portware Team Up for Broker-Neutral Offering

Master or Analytics Master. For mid-size funds, we can offer modules, or, if a fund likes the Paladyne-Credit Suisse suite, it may be prompted to reevaluate its existing vendor relationships."

Credit Suisse's plans to offer Paladyne technology to its clients for "free"—or as part of the overall brokerage relationship—is likely to ruffle the feathers of existing OMS vendors.

Dave Quinlan, president of Eze Castle Software, says hedge funds with existing order management systems are not going to rip them out and replace them with Credit Suisse's, because one way or another, the hedge fund will have to pay for whatever technology it uses. "Giving away software doesn't just happen. There will always be a quid pro quo. Someone is getting paid somewhere. The broker can provide a new tool, but it will, for example, structure the relationship so that a certain percentage of commission dollars must be driven through the account; or the fund will be expected to carry a certain amount of balances with the brokerage. That way, the broker can pay Paladyne for the software and still make money. When a hedge fund starts using a broker-provided software platform, it gives up the flexibility to execute with whom it wants," says Quinlan.

Paladyne's distribution extends beyond Credit Suisse to small and medium-sized fund administrators. One administrator, Viteos, was looking for a system that could handle multiple asset classes and currencies for its alternative investment clients. Viteos wanted a system it could host that would enable managers to enter information that would be fed directly into a back-office platform. "Our marketplace is the \$100 million to \$1 billion funds that have outgrown their lock-in to a single prime and are looking at a wider range of investment products, destinations and emerging markets," says Shankar Iyer, CEO of Viteos. "With Paladyne, we allow customers to pick which modules they need and integrate

Credit Suisse is not the only company seeking to offer its clients a broker-neutral trading platform as a value-added service. In September, Merrill Lynch announced a strategic partnership with Portware, an independent provider of execution and order management technology.

Merrill will offer clients its own version of the Portware system, under license from Portware, which will include access to Merrill's proprietary data and analytics, algorithms and other services. Merrill clients will also have access to Portware's complete suite of trading solutions.

For Merrill, the partnership gives it a trading system from which to grow a customized platform for its clients. The Portware offering will initially focus on institutional clients. However, Mike Stewart, head of global cash equity trading at Merrill, says he expects the system to appeal beyond institutions, to hedge funds and professional trading firms.

Merrill Lynch's agreement with Portware differs in several significant ways from the Credit Suisse/Paladyne deal. First, the products are different. Portware is an execution management system, specializing in trade execution, DMA, algorithmic trading and other automated trading strategies. Paladyne is an order management system with FIX-based order routing, portfolio management, and accounting capability. In addition, Credit Suisse is targeting prime brokerage clients, while Merrill is seeking to reach a wider client base.

The systems will also be hosted differently. While Merrill will host the Portware solution for its clients, Credit Suisse will leave hosting to Paladyne. For clients who worry about information leakage, this difference could be significant, says Matt Nelson, senior investment management analyst at TowerGroup.

Stewart says Merrill's client technology strategy, of which the Portware platform is a part, will evolve over time, and the company expects to offer more functionality—including real-time P&L, position aggregation, portfolio accounting and risk management—as client demand warrants.

Portware's CEO, Eric Goldberg, says that clients are realizing the distinction between multi-broker and broker-neutral. "Clients today are demanding more choice. They want technology that offers true neutrality, single systems that allow them to access all their trade destinations and their offerings. The broker community is stepping up to this demand, and our deal with Merrill is a direct reflection of that." —PB

them with their own execution management systems."

Citigroup, which offers Lava Trading for the front office, recently introduced a middle- and back-office solution that is also broker-neutral. In August, Citigroup Global Transaction Services launched a platform called OpenPrime, based on LineData's Beauchamp portfolio management technology. Citigroup is hosting the product, and it will be targeted at hedge funds and funds of funds, regardless of with whom they prime.

Developed jointly by Citigroup GTS and the prime brokerage businesses, OpenPrime is designed to equip funds to utilize a "one-stop" platform to manage complex portfolios and help satisfy investor and regulatory requirements. "Our goal is to enable funds to launch and grow their business as well as facilitate the transition to multiple prime brokers in a timely, cost-effective manner," says Ali Hackett, managing director and co-head of global equity finance at Citigroup. —Patricia Buchanan