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Monetizing Regulation and Data Requirements

MARKET STORIES FROM 2008 ARE GRIM, but the experience of Northern Trust executive Daniel P. Houlihan is an exception. He joined the firm as global head of product strategy for the firm's middle office outsourcing business in 2008, and found it to be the right moment for the business.

Q&A

By Andrew Shilling

"It was actually a good thing, in a sense that outsourcing is in effect a recession business," says Houlihan, now the firm's executive vice president of global fund services in North America. Since then, Houlihan has transitioned from a pure focus on middle office outsourcing to overseeing the entire P&L of the firm's products, custody, private accounts and target audience.

Houlihan says he has become more involved than ever in both developing and executing strategy.

"My job is to ensure the profitable growth in the business, but I also have operations that report to me as well as the client relationship," he explained in an interview with *Money Management Executive*. "I'm responsible for all of it."

What have been some regulatory challenges the firm has faced since you joined in 2008?

It's big. It's a burden. It's complicated.

We're a bank so we have to look at regulation for ourselves as an institution as well as on behalf of our clients over the last five years, and we continue to do this.

We have invested very heavily, not only in retooling systems, but also investing heavily in people to build a corporate regulatory framework as well as a business level regulatory framework that is connected and allows us to read the regulations, understand them, translate them into layman's terms for our clients and operationalize them.

The operationalization is often times investing capital in our systems to be able to produce the data in a new way; whether it's Form PF or Money Market Reform, or striking a variable NAV as opposed to a constant NAV.

So the system changes are a challenge; but it's just as much about the people and having enough people and capacity to keep up ourselves on behalf of our clients, but also to advise and educate our clients.

Our regulatory team spends a lot of time not only translating the regulations, but discussing them with our clients. It's a huge part of our life now, and what's interesting is thinking about how we monetize that.

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> *Daniel P. Houlihan, executive vice president of Northern Trust's global fund services in North America*

We have got to figure out a way to turn regulation into net income where it's fair for us and fair for clients.

In some cases it's straight forward. Like in Form PF, which is a regulatory filing that we had to retool our system for and there was no cost associated, but something like that you can put an explicit price on it.

Monetizing regulatory translation, then, is still developing?

Yes, absolutely, because in some cases you can do much more straight forward activity based costing and commercialize it, and in other cases it's much more opaque. And sometimes it's indirect. The regulation may actually create other business and other revenue opportunities and in some cases it doesn't.

How has the looming interest rate increase affected the way the firm does business?

Working for a bank, certainly in this low interest rate environment, has had a commercial impact for us because we take care of people's cash and get paid on that. But as a bank, that's old news because it has been that way for a long time. We've been able to deal with that, frankly for me, because my business is growing we're getting allocated more capital now, even in a low interest rate environment, than we were five or six years ago, but it hasn't had a direct impact on our ability to invest in the business, which is a positive.

It has been a challenge for the banks because if you think about some of our money market products, they are effectively at a zero yield so we're all waving fees, so it has been a challenge. But the other side of that is it forces you to be more innovative and look for other ways to generate revenue.

Are you introducing any new products at Northern Trust?

We just launched a product called CompleteFX, which is an outsourced passive foreign exchange service. It's for firms, like global equity firms or where the firm doesn't look at

FX as a way to generate alpha, to look at it as a cash-management function.

What CompleteFX allows our clients to do is outsource that entire function. So, we would do the trading and all the operational aspects of determining what trades need to be executed and facilitating that in the market. We have got a handful of clients at the moment and a very decent pipeline, so that's an important business going forward.

What is your expected future investment in technology?

We're planning to spend $2.2 billion over the next five years in and around our technology infrastructure and our capabilities, so there is a lot in the works in terms of continuing to build out an increased capability.

We're still seeing considerable money flowing out of the markets and into alternatives; whether it's public hedge funds or private equity, infrastructure or real estate, so we continue to invest there, not only in infrastructure, but also human capital to be able to meet the needs of our clients as they shift assets in a lot of cases from traditional into these more esoteric types of products.

One of the other bug things technologically that we're looking at is we did an acquisition I think three years ago of Omnium, which was the hedge fund administration arm of Citadel, the large hedge fund.

And through that acquisition we got a large number of very talented people, but also a perpetual license to Citadel Technology's underlying application which was built by Citadel, and we are now using that as our hedge fund administration platform, but continue to utilize that more broadly across the enterprise, even for our traditional clients.

The reason for that is, in our view, it's a next-generation technology particularly around accessing data and accounting in the sense that a lot of the systems that are out there today, particularly portfolio accounting systems were built when securities were cash, stock or bond and that's simply not the case anymore and this particular system was architected in a way that it's asset class and type agnosti-c and can handle anything.

And the architecture of it is much more real time and that data structure, data access, is really superior, so what we continue to do is look for ways to not only use that for our hedge fund clients but to use that more broadly for other client types as well.

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What types of products do you want to see more of, and what existing products can use improvement?

Data is the challenge. That's so cliché but it is true. One of the challenges that we have is that no two asset managers are created equal.

So the way they look at data; there are securities classifications, industry classifications and they all vary. There is no standard out there. So, to try and connect to an interface back and forth with 200 different asset managers in the U.S. is difficult because on some level you have to have the data customized for those particular clients. I wish there was a standard API to be able to plug into a client's front end. The implementation is hard and takes time. But it's just a nature of the business.

What do I wish it was? I wish we could provide in essence, and this is a the evolution of the investment manager in a box, where we can push out complete solution, including front office tools for our clients to be able to do everything on our platforms and through our service model. That to me is the golden egg.

How could you monetize that?

For example; say you have a start-up firm — one group spins out of a big firm; they have a good story and clients but no infrastructure. They have to buy an order management system; they have to get office space and all that.

I would love to have the turnkey solution that says, here you go. All you have to do is turn this thing on; you get some training and off you go.

Today, typically what will happen — particularly in the middle office — is we'll interface with a client or a management system so they'll have an owner management compliance and training system on their side, we interface with that and send trade information back and forth.

But the challenge is there is a lot of different owner management systems out there with different levels of capability of functionality and again not every manager is different; some need heavy-duty OTC capability others need just straight equity.

So, it is difficult to say that you can have an owner management system today that does everything for every assert manager. I'm not sure that that's realistic at the moment. There are lots of good systems out there, but to be able to handle everything that any asset manager could do is, I think is a big ask.

Let's hope it would be that, being able to have a manager in a box without having to do the heavy duty work that comes along with it.

We have witnessed the generational shift from mutual funds to ETFs in just a few years. What is next?

What is next is already happening, which is asset class convergence.

There will always be pure play hedge funds, but more and more traditional managers and traditional investors are getting into and wanting more esoteric product — whether it's a pure hedge strategy, infrastructure strategy, real estate, private equity — and so being able to have a single platform that can handle all that asset class convergence. What a firm is going to need with investing in all of these different asset types is consolidated reporting and consolidated performance across all that.

Right now, in the industry level, there is not one system out there that can handle all this stuff.

Our mission, and our goal, is to be able to support asset class convergence on a single platform. So, that's a big part of our transformation and strategy as we move things forward.

It's a challenge at the industry level because it is such fragmented marketplace. There are lots of special systems out there that handle private equity and real estate and being able to build all that out in a next generation single platform; that's the silver bullet. MME

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