

# Securities Industry News

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## NEWS DESK

Security flaws in Treasury auctions, a Chicago futures and philanthropy dynasty, and more. **PAGE 3**

## PERSPECTIVES

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**GUEST COLUMN:** Automated tools are significantly improving the buy side's trading efficiency, says FIX City's Paul Scott, "with increased decision support ... and a greater ability to demonstrate best execution." **PAGE 7**

## SPECIAL REPORT

Best execution has many definitions, but market participants are transfixed on two—contained in the SEC's Regulation NMS and the European Commission's Markets in Financial Institutions Directive—as deadline dates loom. This week, *Securities Industry News* takes a look at best execution and the associated metrics of transaction cost analysis (TCA) as urgent internal priorities as well as compliance concerns. One complication: The accuracy of the myriad benchmarks and methodologies is "questionable," says JP Morgan's Carl Carrie. Also, front-end technology suppliers respond to best-ex demands; TCA goes in pre-trade and real-time directions; and advances in fixed-income markets. **PAGE 14**



SEC's Regulation NMS and the European Commission's Markets in Financial Institutions Directive—as deadline dates loom.

## DEPARTMENTS

**STANDARDS & PROTOCOLS:** A FIX Protocol Ltd. effort to standardize fixed-income confirmations runs up against an SEC requirement for paper documents. **PAGE 12**

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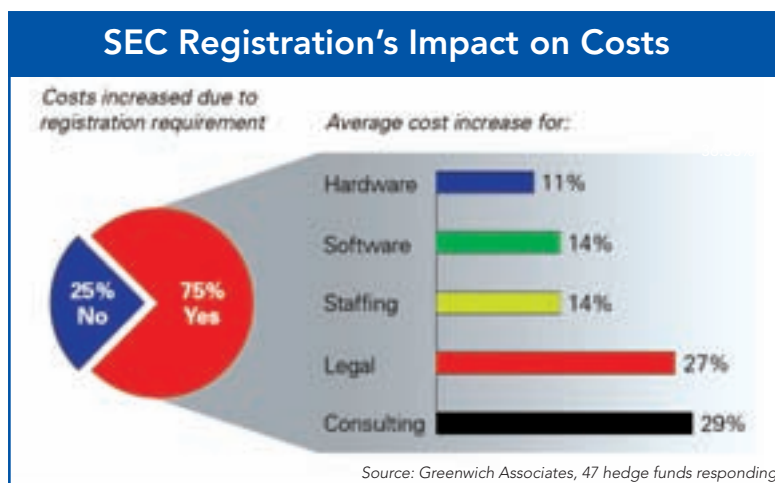
Euroclear's settlement engine, Eagle Investment's new CEO, acquisitions by GL Trade and Markit. See Breaking News at: [www.securitiesindustry.com](http://www.securitiesindustry.com).

## With Hedge Fund Rule Sidelined, Two-Year Lockups Are Rolled Back

BY CAROL E. CURTIS

The Securities and Exchange Commission's hedge fund registration rule, which took effect in February but was struck down in June by a federal appeals court, offered hedge fund advisers a way to sidestep the regulation: They could lock up clients' money for at least two years.

Now, according to a report by Greenwich Associates, advisers are easing their lockup requirements, largely because investors are demanding liquidity. "Two-thirds of the hedge funds [surveyed] that said they extended their lockups to get around registration now say they plan to roll back their lockups to their original periods," typically one year, said Tim Sangston, a consul-



tant at the Greenwich, Conn. research firm.

At the same time, the report concludes that the registration policy will leave a "lasting legacy" in the area of hedge fund compliance and, given the uncertainty about the SEC's posture, an opening for state regulators to fill the breach. The latter did not much concern those responding to the Greenwich

survey conducted between July 18 and Aug. 3. Three-fourths of the 47 respondents are U.S. based; 42 percent of them rated state regulators strict or very strict, but 85 percent did not anticipate supporting industry groups that would seek to influence state hedge fund policies.

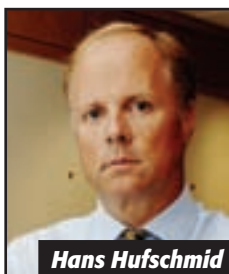
"There is a demand from investors to end lockups," noted

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## GlobeOp, Administration Master, Looks Beyond Fund Basics

BY KATHERINE HEIRES

GlobeOp Financial Services, an independent technology provider and hedge fund administrator with \$99 billion of assets under its purview, is no stranger to market meltdowns, volatility—even an epic hedge fund crisis. According to CEO Hans Hufschmid, that's not a bad set of credentials.



Hans Hufschmid

Founded in 2000 by five people—Hufschmid and three others are

alumni of Long Term Capital Management (LTCM), the hedge fund felled by the 1998 meltdown of the Russian bond market—GlobeOp came into existence because of a then-overlooked fact: LTCM's operational and technical infrastructure was highly efficient and battle-tested, so much so that auditors

looking at LTCM when it was winding down suggested that many hedge funds could benefit from the same

set of systems and tools.

"Often, when there's a meltdown, there's a huge administrative mess, but that wasn't the case at Long Term," says Hufschmid. Ron Tannenbaum, GlobeOp's London-based head of marketing, points out that LTCM never failed to make a payment, restated earnings or missed a deadline for audited financial statements, even during the bleakest times. Thus emerged the seed idea for GlobeOp: a company that would focus not on global trading but on

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## As the World Discovers Risk, RiskMetrics Races Ahead

BY JANICE FIORAVANTE

The "Seinfeld" television series was a cultural landmark for many, and one 1996 episode had particular significance for Ethan Berman. "George walked into Jerry's apartment with a big book under his arm and announced, 'I'm going to be a risk manager,'" Berman recalled recently. "A whole profession has risen up where one didn't exist 10 to 15 years earlier."

Berman is CEO of RiskMetrics Group, a New York company that JP Morgan & Co. spun out in 1998 and

that has had much to do with the rise of that profession and of the systems and data businesses that grew up to support it. "Seinfeld" may have been a bit ahead of the mainstreaming trend, but Berman foresees a logical progression to where, in 10 to 20 years, "people will look at risk the way they check their stock tables, saying, 'Hmm, the risk is 42 here and 87 here—it's twice as risky.'" Already, he noted, Goldman



Ethan Berman

Sachs Group in its annual report is showing its value at risk. "It's not just a quantity thing anymore," Berman said. His company is putting its risk analysis tools in the hands of wealth managers, financial advisers and their clients. "Today, we're being used by hedge funds and asset managers, as well as insurance companies and other corporations," he added.

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## Panel Proposes NYSE Proxy Rule Changes

Discretionary voting could be eliminated by January 2008

BY CHRIS KENTOURIS

A New York Stock Exchange-sponsored committee has recommended a sweeping overhaul of the Big Board's decades-old proxy rules, calling for prohibition of so-called discretionary voting for corporate directors and further analysis of fees for mailing proxy materials to beneficial shareholders.

The working group also said that the NYSE should support efforts for issuers to improve communications with beneficial shareholders, although it did not specify how. Among the possibilities often cited by corporate issuers and transfer agents is mailing proxy materials to "street name" shareholders directly rather than through financial intermediaries.

The proxy working group was headed by Larry Sonsini, chairman of Silicon Valley law firm Wilson Sonsini Goodrich & Rosati, with major buy- and sell-side firms and some of the largest corporations represented, including Merrill Lynch & Co., Morgan Stanley, Vanguard

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## ASSET SERVICING

## GlobeOp — Continued from page 1

providing state-of-the-art technology for global hedge fund administration and operations. Specifically, it would offer software and capabilities designed to automate the middle- and back-office operations of hedge funds—not a common business approach back then.

“Essentially, what we do is take the operational complexities of hedge fund management away from our clients and let them focus on trading strategies and risk management,” Hufschmid explains.

Hufschmid, joined by other LTCM alumni—Tom Deegan (who left GlobeOp in 2004 for a start-up), Alison Gregory (head of enterprise risk management), Didier Martineau (head of risk services), Ira Rosenblum (director and head of client relationship management in New York) and James Webb (now a consultant at hedge fund FrontPoint Partners)—have found the association with a famous, if notorious, hedge fund to be an advantage. “People always wanted to meet us just because of the Long Term Capital connection and to learn firsthand how to avoid potholes and how we managed various aspects of the fund,” the CEO says.

GlobeOp has grown from an original core of five employees to approximately 1,500 and is providing administration and technical services to upward of 160 clients and 1,006 hedge funds, funds-of-funds and other institutional entities. The services include automation of collateral management; trade, cash and position reconciliation; and fund compliance, performance analytics and client reporting. Back-office activities include derivatives processing and valuation. GlobeOp also provides select access to front-office execution capabilities including currencies, equities, bonds and derivatives. Of particular note is the reputation GlobeOp has built for expertise in pricing over-the-counter fixed-income instruments and derivatives such as credit default swaps (CDS).

Mike Adams, head of operations at Sanno Point Capital Management, a new multi-strategy fund in New York, notes that the derivatives competencies in particular brought his firm to GlobeOp’s door. “We needed an administrator who could handle derivatives pricing and have benefited from the fact that GlobeOp has a trade capture and accounting system that is truly derivatives savvy,” says Adams.

He adds that one of the GlobeOp team members assigned to his firm had previously worked with the International Swaps & Derivatives Association, which has been in-

fluential in setting standards for improving and streamlining CDS processing. “They were expert on the subject of derivatives and collateral optimization as well as securities operations, showed us what to look out for pre-launch and assisted us in our operation on a daily basis,” says Adams. He also appreciates the fact that GlobeOp through its alliances introduced Sanno Point to some of the leading data and service providers in the CDS market: Markit Group and T-Zero.

According to a survey by *Hedge Fund Manager* magazine and Advent Software released in April, GlobeOp has upward of \$80 billion of hedge fund assets and \$19 billion of fund-of-fund assets under administration. The \$99 billion total makes it the ninth-largest global hedge fund administrator, a

business led by Citco Fund Services (\$330 billion), HSBC Alternative Fund Services (\$222 billion) and State Street Corp.’s International Fund Services (\$175 billion). Also ahead of GlobeOp in the survey were Bisys Alternative Investment Services, Goldman Sachs & Co., Investors Bank & Trust Co., Fortis Prime Fund Solutions

and Caceis, though GlobeOp leads administrators such as Bank of New York, SS&C Fund Services, UBS Fund Services and Butterfield Fund Services.

GlobeOp clients include Amaranth Advisors of Greenwich, Conn., with a reported \$3.2 billion under management, the publicly held hedge fund giant Man Group of London, BlueCrest Capital Management of London, Pioneer Global Investments of Dublin and Rubicon Fund Management of London.

### Growth in Europe

GlobeOp became the administrator of choice for some of the largest new hedge funds launched in Europe in 2005, according to a report issued by the EuroHedge database. Still, the firm says 70 percent of its customers are U.S.-based. Hufschmid says GlobeOp has added to its customer base recently by “decoupling” some of its full-service, middle-office technology offerings and licensing them on a one-off basis to hedge funds as well as insurance companies, banks and corporations—any entity doing derivatives trading.

GlobeOp considers New York and London its dual headquarters, but it is incorporated in Luxembourg and has offices in Harrison, N.Y., Mumbai, India, the Cayman Islands, a recently opened one in Hartford, Conn., and two disaster recovery sites in New York state, 70 miles apart.

The expansion in Hartford—a capital of the insurance industry, in contrast to the hedge fund haven of Fairfield County near New York—was favorably received late last month by Gov. M. Jodi Rell. “That GlobeOp Financial Services is coming to Connecticut and creating 150 new, high-paying jobs is great news for Hartford and the local economy,” she said. “The hedge fund industry is growing in Connecticut. [GlobeOp’s announcement] may signal the beginning of an expansion of this key industry into the Hartford region.”

The company has weathered significant marketplace changes over its six-year life. “Trends in Hedge Fund Administration,” a report that Boston-based research firm Celent issued in August, notes that this once-clubby business with a handful of providers has become a crowded field of at least 70 administrators. “Firms like GlobeOp are not lonely anymore and are seeing a lot more competition,” says analyst Denise Valentine, author of the Celent report. At the same time, the U.S.-based hedge fund industry has swelled to \$1.3 trillion in assets, generating more business for both large and specialized service providers.

The past two years have seen a fair amount of merger and acquisition activity, as in the acquisition of Hedge Fund Services by Fortis Prime Fund Solutions and AIB Fund Administrators by Moutant in 2006, and Mellon Financial Corp.’s acquisition of DPM and Northern Trust Co.’s of Baring Fund Administration Services last year.

Also changing the sector has been the entry of management consultants and out-sourcers. Accenture announced a deal earlier this year with hedge fund Citadel Investment Group for market data management, while Viteos, a U.S.- and India-based firm, established a full-service business process outsourcing practice for hedge funds.

How has GlobeOp held up amid the ferment? Hufschmid says that its status as an independent administrator has helped to maintain its growth. “We don’t execute trades, and we don’t compete with our clients on any level,” he says. “That allows us to do truly independent pricing and not have someone on our staff who might take advantage of that for their own trading purposes. For us, this is a big selling point.” GlobeOp is one of the few administration leaders—Citco is another—still independent of financial institution ownership or prime brokerage affiliations.

In 2003, Boston-based private equity firm TA Associates invested \$82 million in GlobeOp for what Hufschmid describes as a significant minority stake. TA is the largest shareholder, with Brian Conway, a TA managing director, and Jonathan Meeks, a TA principal, on the GlobeOp board. TA assisted in the recruitment of GlobeOp’s pres-

ident and COO, Vernon Barback, and keeps its eyes open for acquisition opportunities for the firm. “GlobeOp is profitable and self-financing and is best known in the market for its ability to price complex strategies,” Conway says.

Hufschmid adds that GlobeOp further capitalizes on its ability to cope with the increasing urgency of daily net-asset-value calculations and the attendant technology needs that have accompanied these demands.

Barback, based in the New York office, says that the firm has kept up with growing technology demands, in part, by building Java-based proprietary applications and systems around three primary applications supplied by outside vendors: Reuters’ Kondor+ trade access system, the Advent Geneva accounting system and the Koger NTAS shareholder ledger. Around these processes, the firm has more recently launched a real-time internal messaging system that utilizes IBM MQ series technology, so that communications can flow more freely between the different operations. GlobeOp maintains approximately 600 servers, Barback says, primarily Sun Solaris and Hewlett-Packard workstations with some Linux applications in the mix.

The company credits its growing presence in India as helping it stay up-to-speed and meet growing volumes. “We currently have 850 full-time employees in Mumbai primarily involved in the daily servicing of our clients,” Hufschmid says. That gives the company a 24-hour, 7-day operation rolling across the time zones, though the CEO is quick to point out that it doesn’t outsource. “Our business is so complex and customizable—it’s not like Microsoft’s business, where you can outsource one process and serve many clients,” Hufschmid says. “With us, every client is a custom installation and so we have stayed focused on building expertise in-house.”

### Street Experience

Hufschmid says that a large proportion of GlobeOp’s staff has Wall Street experience, conferring another competitive advantage. “When a hedge fund comes to us, they understand that we have done the same things that they are going to be doing and share a common knowledge base,” he says.

In addition to serving as co-head of the London office of LTCM for five years, Hufschmid spent ten years with Salomon Brothers in London and New York, in part as head of foreign exchange sales and trading. Barback is a former global head of operations and technology at Citigroup Asset Management.

Rosenblum was director of security operations and treasury management at LTCM from 1993 to 1999, and before that managed operational infrastructure at Salomon



Vernon Barback

## TECHNOLOGY

## RiskMetrics — Continued from page 1

A typical hedge fund may have started with just one trader with a winning strategy, but eventually it gets to the point of wanting a more comprehensive, centralized risk function. That's essentially where Dennis Weatherstone found himself in 1989, when as the newly installed chairman of JP Morgan he asked that a report on the company-wide risk picture be on his desk at 4:15 p.m. daily. By 1994, RiskMetrics was established as a business unit fulfilling that need for JP Morgan and other buyers of its tools.

At the start, 85 percent to 90 percent of the business was geared to banks. That portion is now down to 30 percent, with the buy side including hedge funds accounting for as much as 50 percent. "It's not that the [bank] business has shrunk," Berman said. "The pie has gotten larger," and pushed RiskMetrics' annual revenues well over \$100 million. The firm has also grown from about 25 employees to 300. In the past year, RiskMetrics has added offices in Chicago and Frankfurt to sales offices already in place in London, Singapore and Tokyo. It will open a San Francisco office later this year.

Among those in the diversifying client base are pension funds and individual investors—and not just those of high net worth. Through a pact announced in May with E-Trade Financial, for example, RiskMetrics' Risk Analyzer tool is available to E-Trade's online brokerage customers. It's an example of RiskMetrics' morphing from being a provider of software to a provider of services.

"More than three-quarters of the growth that RiskMetrics is experiencing is service-related," Berman said, referring to the processing and enrichment of data and generating of reports, many going to advisers and wealth managers. But he added, "Actually, we don't account for service versus product, because if we host our software on an ASP—application service provider—basis, what does that make it, a service or software? It becomes hard to separate one from the other."

Smoothing risk management's—and RiskMetrics'—path to wider acceptance and

new audiences was standardization. "Risk needed to be defined in consistent terms," said Berman, 44, who opened an office in India for JP Morgan before returning to New York in 1995 to run RiskMetrics. Berman likened it to the credit rating agencies: "When you see an AAA rating, you know what that means," he said. "Similarly, an institutional investor knows what a risk grade of 40 means compared to 240. If our model came up with a 40 and another model with a BB, it just wouldn't be useful. It would be frustrating to clients."

RiskMetrics bases its business on a methodology published by JP Morgan and available on the Internet. It is the most downloaded document on the firm's Web site. "By publishing our model, we continue to get feedback," Berman explained. Because RiskMetrics' 700 clients comprise a large community, "it makes it reasonable to provide standards," and "we promote the power of community. It's good for financial markets. Our clients know a lot. In dialogues between our research people and the real-world users, we're hearing, 'I'm doing this or that,' and it's so helpful to our company."

Berman added: "You wouldn't expect us to say to a large institution like a pension plan, 'Trust us, our model is proprietary.' Instead, we say, 'here's how we calculate'—it's transparent to our users. And it's through adopting the best practices of our customers that our model has gotten more and more useful."

In theory, all customers' experiences are aggregated to benefit the community as a whole. "A large hedge fund may come up with a new trading vehicle that we've never heard of and need new reports," said Berman. "This is why we're constantly innovating. We share that information with all our clients." Research and development encompasses more than half of the staff, he said. "We'll continue to evolve," said Berman. "We're an idea company. Our ideas have legs. The rest of the Street buys into those ideas. We develop them interactively with clients."

Brothers. Tannenbaum previously served as managing director and global head of hedge fund coverage at Rabobank International in London from 1998 to 1999; he was at Union Bank of Switzerland in London from 1991 to 1998 and managed bonds, capital markets and structured derivatives teams at Salomon Brothers in New York, London and Tokyo from 1981 to 1991.

While GlobeOp has independently carved out a niche with specific expertise in hedge fund administration and related services, Celent's Valentine says it remains to be seen whether the firm will continue to prosper in light of the ongoing consol-

idation, the relentless demand from clients for technology upgrades and lower prices, the exposure to fiduciary risk and the increasing globalization of the hedge fund market. On the positive side, she gives high grades to GlobeOp and other administrators that can tout specialized skills in securities valuation.

Brian Shapiro, CEO of CarbonBased Consulting, a New York-based technology adviser to hedge funds, views GlobeOp's expertise in the pricing and support of "esoteric credit strategies" as a key advantage and differentiator, but also an ongoing challenge. "Their abilities in these areas are a

But Berman doesn't consider RiskMetrics a bleeding-edge technology developer. He prefers to call it a "fast follower. If a new instrument is created, we have to model it," he said. "And when we solve it, we share it, even with those customers who won't need the solution for ten years."

It's a two-way street. Customers help RiskMetrics stay current and grow, and the company gives back by making its work transparent. Of course, the regulatory climate and the primacy of portfolio risk management and risk-based capital requirements for financial institutions encourage analysis and sharing of information. Berman noted that RiskMetrics does a lot of work with regulators, providing risk management and analytical tools to central banks as well. "We highlight the carrot and the stick as reasons to use risk analytics," said Berman. "We see compliance and sales as being compatible."

### Universal Concern

He added, "The huge global trend is that individuals everywhere are responsible for their own financial well-being"—a message that resonates on all investor levels. Individual investors can do a free portfolio diagnosis that measures and assesses risk through RiskMetrics' RiskGrades system. It has numerous features for portfolio analysis and even provides an overview of the state of the markets. It assigns risk ratings to portfolios. Individual investors can plug in all their investments, trying different combinations until arriving at a portfolio with a lower risk rating.

In the high-net-worth sector, "we give financial advisers analytics, access to information and tools for analysis," Berman said. Wealth management units at Bear Stearns & Co. and Northern Trust Co. are offering RiskMetrics' WealthBench technology platform to independent advisers and family offices. The platform raises the level of sophistication in adviser-to-client communications to include quantifiable portfolio risk, asset allocation and wealth projections.

RiskMetrics customers are now not only using its market data and calculation services,

but are also sending their positions. "People trust us" with their raw data, Berman said, an indication of the company's blue-chip reputation. They "expect that the appropriate security will protect that data."

### Packaging the Parts

RiskMetrics' business has three components—clients' holdings or positions, market data and analytics. "We bundled the analytics and market data from the start," said Berman. "Now we are bundling in the first part as well."

He pointed out that "when hedge funds send reports to their investors, it's usually through their prime brokers. RiskMetrics already has this link for risk calculations." It bridges the gap created by the fact that many hedge funds use multiple prime brokers, making it difficult for any one brokerage to pull together a complete profile of the hedge fund client. Hedge funds raised the possibility of sending their positions to RiskMetrics and, said Berman: "They figured, 'I'm already giving this information to my prime broker, so security is really not an issue.'"

He added: "Hedge funds are focused on trading, not tracking back-office reporting. Even large banks and other financial institutions with large IT departments are doing the same—they like having RiskMetrics give them an end-to-end solution, from positions to coming out with the report. And this is even though they have a large investment in infrastructure."

RiskMetrics is doing this outsourcing for nine of the world's top ten banks. With the bulk of its business in the developed world, RiskMetrics is still awaiting significant take-up in emerging markets. "Places like India—where I opened an office for Morgan before joining with RiskMetrics—are just not there yet," Berman said. "Infrastructure needs to happen." At the same time, RiskMetrics' existing clients are doing more and more business in emerging markets.

"Our marketing has always been and continues to be about education," said Berman, characteristically taking the long view. "After all, we are very early in the risk cycle." ■

big plus, but can they continue to fulfill this role?" Shapiro asks, noting that over time, the staffing and technology requirements of these operations can be punishing for an administrator.

Hufschmid says that GlobeOp remains in the forefront of the pricing business, has scaled up when necessary and will consider takeover opportunities that are "synergistic." He also expects to expand in coming months by continuing to unbundle pricing and technology offerings to appeal to a wider range of institutions and their needs.

"If you took a snapshot of the mutual fund industry 15 years ago and applied it to

the hedge fund industry today, you wouldn't be far off," Hufschmid says. That might not bode well for niche players, but he remains optimistic and doesn't expect substantial compression in his fee structure.

"Certain functions may see fee compression, but the fact remains that hedge funds cannot afford to make bad operational decisions," he says. "A mis-priced portfolio is terminal for a hedge fund," so Hufschmid believes that as long as hedge fund operations require ever-more complexity, scale and real-time capabilities, there will continue to be a healthy and growing demand for what GlobeOp can deliver. ■