



**Middle and back
office outsourcing:
Midway to maturity?**

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Introduction and executive summary

Introduction and executive summary

If the outsourcing of Middle and Back Office functions was becoming common across the Financial Services sector before the 2007-8 financial crisis, the wave of regulation that followed accelerated this trend.

Large bodies of regulation, such as Basle III, have paid particular attention to the integrity of risk management, the capabilities of IT systems and governance and reporting processes. This has meant large-scale investment in IT by Financial Services companies, and many firms have recognised that it is **more efficient to outsource their requirements and concentrate internal resources on their core businesses**.

Regulation continues to develop. With the Dodd-Frank Wall Street Reform and Consumer Protection Act in the United States and the European Market Infrastructures Regulation (EMIR) in Europe, for example, obligatory clearing and reporting for over-the-counter derivatives has followed. Again, the attraction of outsourcing has increased.

If regulation has been a major factor behind outsourcing, it is by no means the only one. Cost pressures, the drive for greater efficiency, the need to demonstrate prudent administration to stakeholders, risk management and advances in technology have all played their part. It is fair to say that **very few companies now use only home developed solutions and processes to run their operations**. Especially so where they are standardised across particular markets, such as equities and bond clearing.

BNP Paribas Securities Services, working with YouGov, surveyed fifty senior individuals from across a range of Banks, Brokers, Broker-Dealers and other sell-side organisations, to look at outsourcing in greater detail. These individuals all have a prominent say in the post-trade operations of their firms, and results from the survey shed light on current outsourcing patterns and motivations, as well as hinting at future developments in this area. The following stand out as the main findings:

- **Outsourcing** of Middle and Back Office functions has become **very much the norm** – most firms represented in the survey do it, though on a selective and partial basis
- Outsourcing of **Clearing** is particularly common
- Outsourcing is seen as a **long-term strategy**, driven by a desire to focus on core capabilities – as opposed to an exercise in cost-reduction
- Protecting against **market and regulatory change** is also an important motivation
- In selecting providers of outsourced services, firms look for **product quality** and **client service** above all else. Very much related to service, the responsiveness of providers is the main worry companies have over outsourcing
- Having a specialist provider is the preferred set-up of many, and **current set-ups seem to meet needs moderately well**
- At the same time, **satisfaction levels are not strong**, which indicates the potential for future innovation to better meet needs
- While strategic motivations are more important than cost in the decision to outsource, it is also true that price remains a factor. Firms expect to have access to excellent products and service levels but also to save money. The **continued development of technology** may be the means by which these goals can be achieved together

Section 1

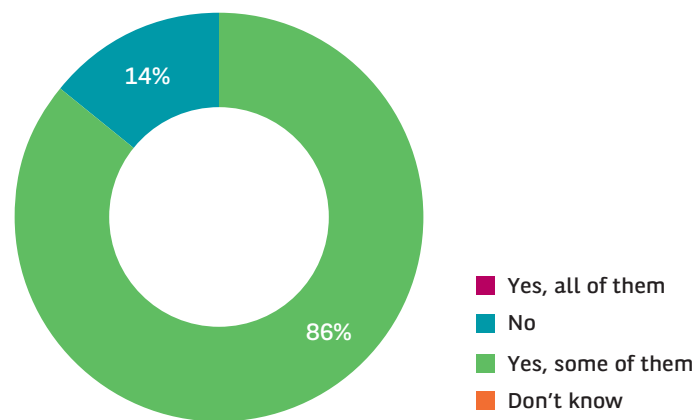
Outsourcing: the picture now and in the future

Partial outsourcing the norm

Outsourcing of Middle and Back Office functions is an extremely common practice, with the vast majority of respondents (86%) indicating that they outsource these in part. None outsource the entirety of these functions, while a small proportion (14%) keep them entirely in-house.

The seven respondents who indicated that their organisation does not currently outsource were asked a follow up question as to whether this was something they would consider in future: none ruled it out.

Figure 1 – Overall current outsourcing (all respondents (n=50))



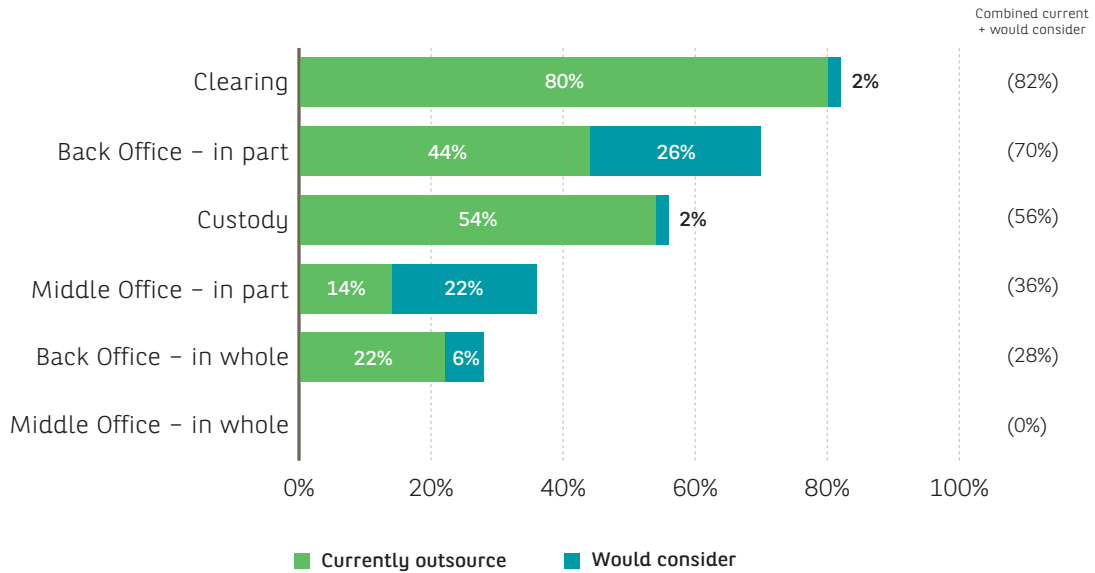
Q. Are any elements of your organisation's Middle and Back Office currently outsourced?

By outsourced, we mean any function which is supplied by a company that is not related to your company or to your wider group.

Clearing most commonly outsourced function

By far the most-commonly outsourced element of the Middle and Back Office is Clearing, with 4 out of every 5 indicating that this function has been outsourced to an external provider. This is followed by Custody, which is outsourced by around half. As might be expected, the Back Office is far more likely to be outsourced than the Middle Office: Two-thirds (66%) say their Back Office is outsourced to at least some extent, compared to 14% who say the same of their Middle Office. Looking more specifically at the Back Office, part-outsourcing is the most common approach (44%), but a notable 1 in 5 (22%) say they outsource this entirely.

Figure 2 – Current and future outsourcing (all respondents (n=50))



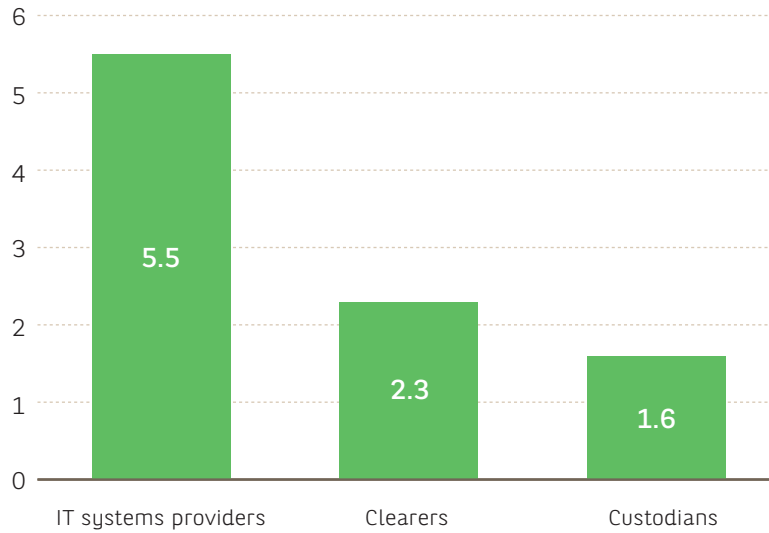
Q. Which of the following functions does your organisation **currently outsource**?

Q. Which of the following functions might your organisation **consider outsourcing**?

There are also signs that outsourcing will grow yet further. Regardless of current operational set-up, respondents were asked to indicate which functions their organisation might consider outsourcing in future, that are not currently outsourced. In addition to the 44% who currently outsource their Back Office in part, a further quarter of all respondents (26%) say their organisation would consider doing so in future. Despite the fact that part-outsourcing of the Middle Office is comparatively rare, the potential for growth here is similar – with 22% saying they would consider this in future.

Survey results also highlight the extent to which organisations rely on multiple IT systems providers. Even including those who said they employ no external IT providers (18%), the average number of providers across the survey is 5.5. For Clearance and Custody, the tendency is more to rely on one or two providers, with 2.3 and 1.6 the average numbers respectively.

Figure 3 – Average number of outsourcing providers (all respondents (n=50))



Q. Thinking about your organisation's current post-trade operations, how many of each of the following types of providers does your organisation currently use?

Section 2

Why outsource?

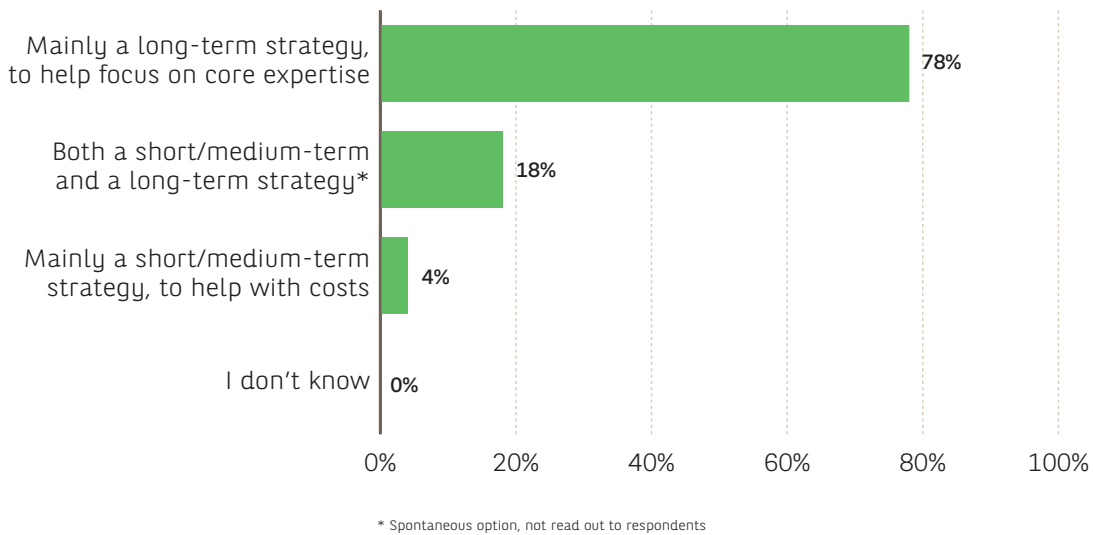
In many industries, outsourcing is often characterised as an effort to reduce costs rather than a long-term strategic decision that allows the outsourcing company to focus their resources on their core expertise. The best examples from a cost-reduction perspective have probably been in software development and in call centre operations, and cost can also be a consideration in Financial Services. However, regulation, risk management and being able to demonstrate that steps have been taken to hire experts and use high-integrity external systems carry significant weight in outsourcing strategy, beyond merely saving on administration costs.

To test respondents’ views on this, a simple question was asked as to which of the two motivations – cost reduction or long-term strategy – mainly lie behind the outsourcing of Middle and Back Office functions.

The vast majority (78%) indicate they see outsourcing as a long-term strategy designed to help the outsourcer focus on their area of expertise, with hardly any (4%) saying it is mainly a short-to-medium term exercise driven by cost-reduction.

This is not to say cost is unimportant, however: nearly 1 in 5 (18%) say that they consider outsourcing to be both a long-term and short/medium term strategy, without this being presented as an answer option.

Figure 4 – Basis of outsourcing strategy (all respondents (n=50))

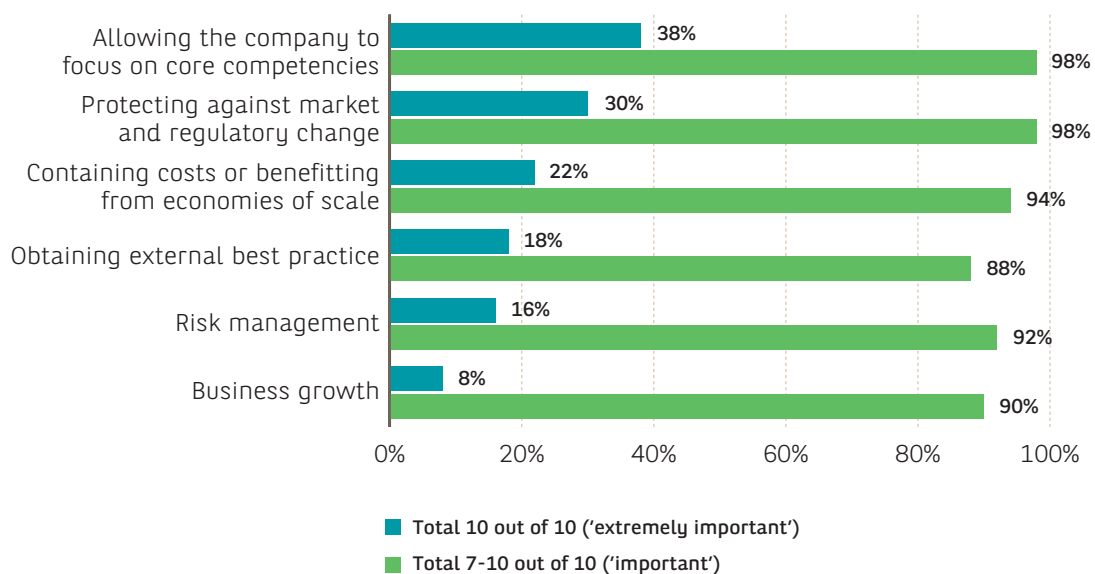


Q. Some people see Middle and Back Office outsourcing as a mainly short or medium term strategy to help manage costs, whereas others see it as mainly a long-term strategy that helps them focus on their core expertise. Which is closer to your view on Middle and Back Office outsourcing?

Protecting against market and regulatory change also an important motivation

The strategic motivation for outsourcing was examined in greater detail through a question that asked respondents to rate the importance of a range of factors as potential 'drivers' for outsourcing decisions.

Figure 5 – Outsourcing and drivers and potential drivers (all respondents (n=50))



Q. Regardless of whether your organisation currently outsources or not – how important do you think each of the following factors are as drivers for deciding to outsource?

Multiple factors are important to at least some degree here: on the 0-10 scale used, where 10 represents a factor being 'extremely important', all drivers are rated at 7 or above by at least 88% of respondents. **This indicates that an outsourcing decision is usually underpinned by several strategic imperatives.**

Looking at the percentage who believe a driver to be 'extremely important' (i.e. rating it 10 out of 10) we see that some drivers are more important than others. **The potential offered to focus on core competency** again comes through, with nearly 4 in 10 (38%) rating this as extremely important.

It should also be noted here that 'containing costs' ranks third in the list, despite the fact that very few give this as the main basis for outsourcing compared to longer-term motivations: **cutting costs may not be the main reason to outsource, but it is still an important element.**

In the context of the recent increase in regulatory requirements faced by many firms, it is also telling that the second highest-rated driver on this measure is protecting against market and regulatory change.

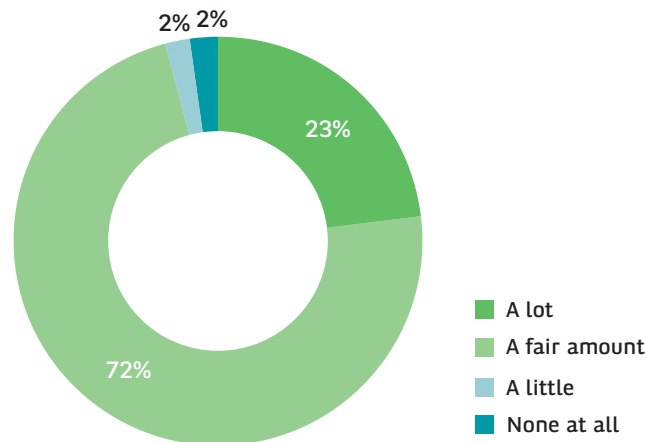
For many, engaging external providers is a useful approach in keeping up with the pace of these demands: in effect **it is not only a ‘service’ that is being outsourced, but also the task of staying abreast of requirements.**

One example of this is the use of Custodian Banks in managing and reporting on assets held and administered on behalf of asset managers.

Because Custodians are tasked with complying with reporting requirements set by regulators and must themselves stay abreast of them, it can often make sense for organisations to harness the Custodians’ knowledge, experience and economies of scale – rather than maintaining an internal compliance and regulatory team.

The ability of outsourcers here can be seen from the fact that 95% of respondents who currently outsource indicated they have either a lot or a fair amount of confidence in their supplier(s) to adapt to the pace of market change.

Figure 6 – Ability of providers to keep up with pace of market change



Q. Thinking about your organisation’s current Middle and Back Office supplier(s), how much confidence do you have that they are able to adapt to the pace of market change

The technological capacity of outsourcers can also be important in enabling clients to ensure compliance – as one respondent to the survey put it: “I think technological advancement can also be added as a driver, due to the fact that a huge investment is required these days to build the technology to meet licensing system requirements”.

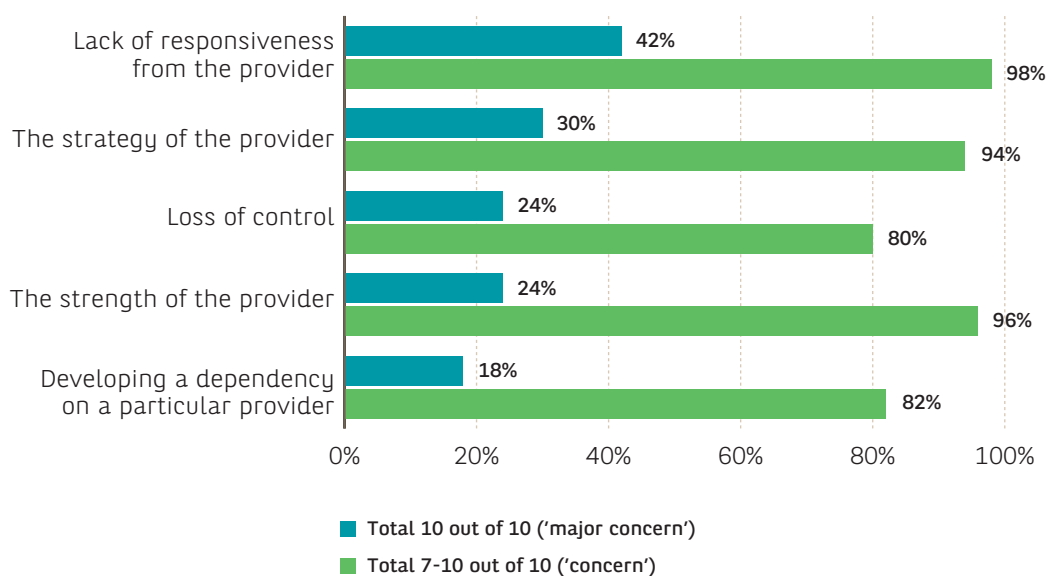
In this regard technology investment can often mean developing the capacity to work seamlessly with other organisations in terms of transaction straight-through-processing. **It makes better sense to buy systems or services from a provider for whom these are its core business,** and that are already tried and tested, rather than developing proprietary systems from scratch.

Responsiveness of outsourcing providers a major concern

While there are several compelling reasons for companies to consider outsourcing Middle and Back Office functions, such a decision does not come without concerns. The provider's strength and strategy, responsiveness, loss of control and developing dependency are worries to at least some extent for the vast majority.

Of these, the biggest worry is a lack of responsiveness from the provider with around 4 in 10 saying they consider it to be a 'major concern'. The strategy of the provider(s) is also a major concern for over 3 in 10, while dependency is less of a worry with this being a major concern for around 2 in 10.

Figure 7 – Concerns over outsourcing (all respondents (n=50))



Q. When outsourcing post-trade operations, or if your organisation were to do so, to what extent would each of the following be concerns for you?

Compatibility between provider and client is also a theme that comes out in comments made by respondents – both at a general business model level, and also at the more detailed level of individual processes. It is thus **important that both parties develop a close, symbiotic, working relationship in order to align and integrate models, systems and processes.** Examples here could include interfacing enterprise resource systems, straight-through-processing, clearing and settlement of securities trades.

Section 3

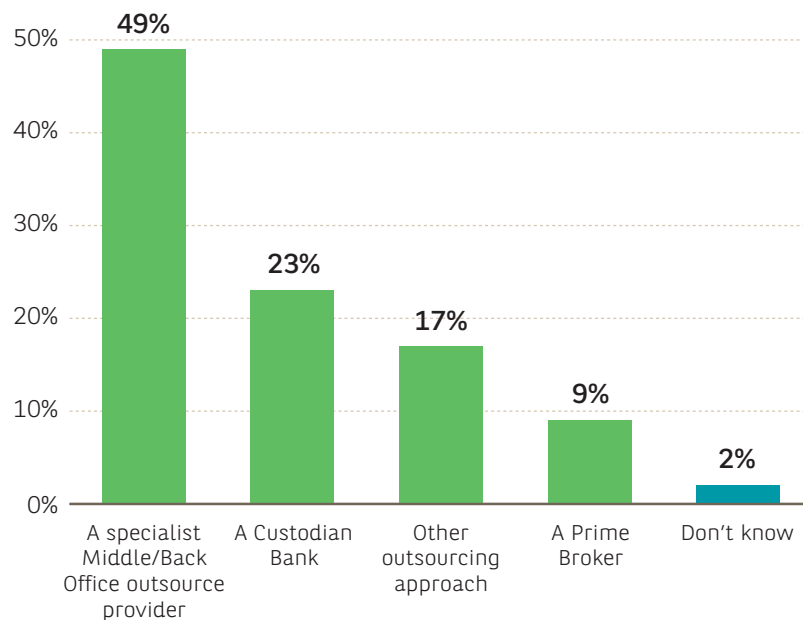
**Outsourcing providers:
what do decision-makers
look for?**

While price is not unimportant, multiple long-term strategic factors are the main drivers behind a decision to outsource. Once this decision has been made, and potential providers are being evaluated, what do firms then look for in potential providers?

Specialist providers the most-preferred set-up

Banks and Broker-Dealers have a range of outsourcing options available to them, and amongst these a specialist provider is the option of choice for many. Around half (49%) of all respondents say this is how they prefer to outsource – or would prefer to do so if they were going to outsource. Just under a quarter would employ a Custodian Bank (23%), with only a small proportion (9%) opting for a Prime Broker. Several (17%) indicate a different outsourcing approach here – generally ‘Component Based Outsourcing’, with the approach varying according to the function in question.

Figure 8 – Preferred outsourcing approach (all respondents (n=50))



Q [OUTSOURCERS]. Which one of the following is your most-preferred outsourcing approach?

Q [NON-OUTSOURCERS]. Which one of the following would be your most-preferred outsourcing approach?

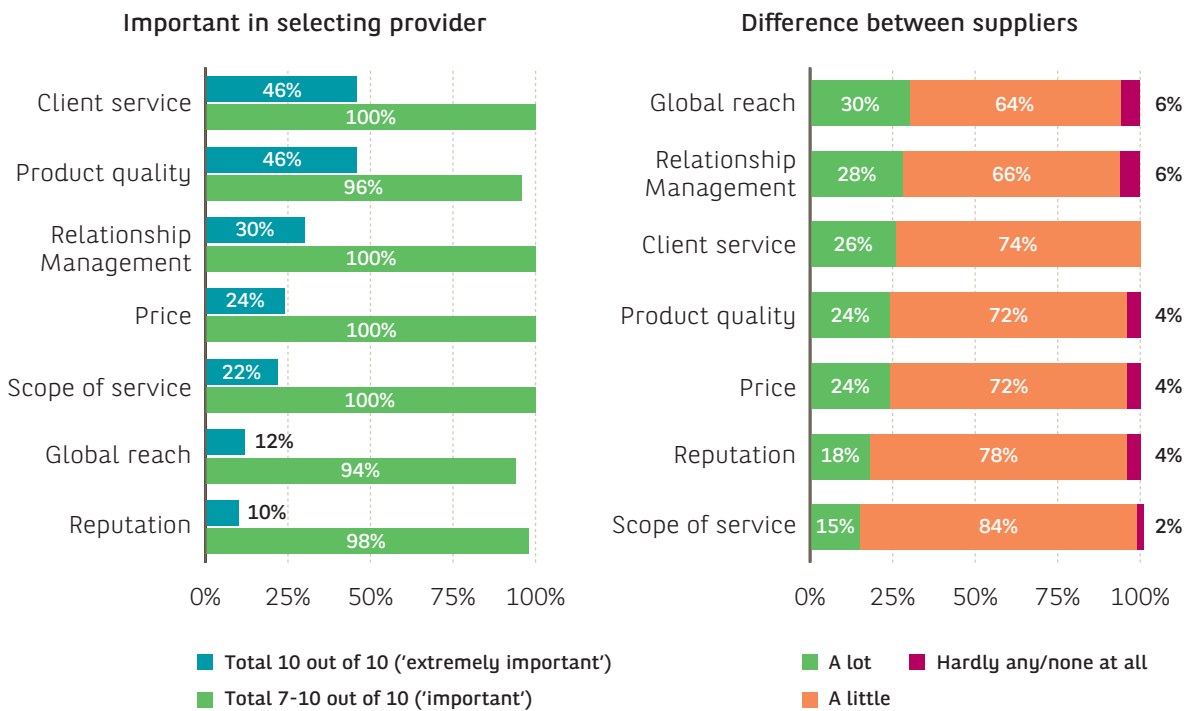
Client service, product quality the most important for providers to offer

As with the initial decision to outsource, a wide range of dimensions are important in the selection of an individual provider. Client service, product quality, relationship management, price, scope of service, global reach and reputation are all considered important to at least some extent by virtually (and in some cases literally) all respondents.

However, the client service and product quality offered by providers emerge as being paramount, with nearly half (46%) rating both as being ‘extremely important’ (10 out of 10).

In the current market environment, with margins under pressure, providers that can meet the challenge of delivering high-quality services will stand out. Relationship Management is third on this measure, with price fourth – again confirming that while not the most important factor, it is still a significant part of the consideration process.

Figure 9 – Factors in selecting outsourcing providers (all respondents (n=50))



Q. Regardless of whether your organisation currently outsources or not, how important do you think each of the following factors are as drivers for deciding to outsource?

Q. Thinking about each of these areas again, how much difference do you believe there is between various Middle and Back Office suppliers?

On these factors, the vast majority of respondents consider there is some degree of difference between suppliers, although this tends to be more moderate than large in extent. For both the two most important factors involved in selecting a provider (Client Service and Product Quality), around a quarter believe there is a lot of difference between suppliers. The area of greatest difference is global reach, but this is also a factor that few decision-makers consider to be extremely important.

A number of other factors were also mentioned by respondents as being important in selecting a provider, including knowledge of the market, financial soundness, and day-to-day processing capacity.

Section 4

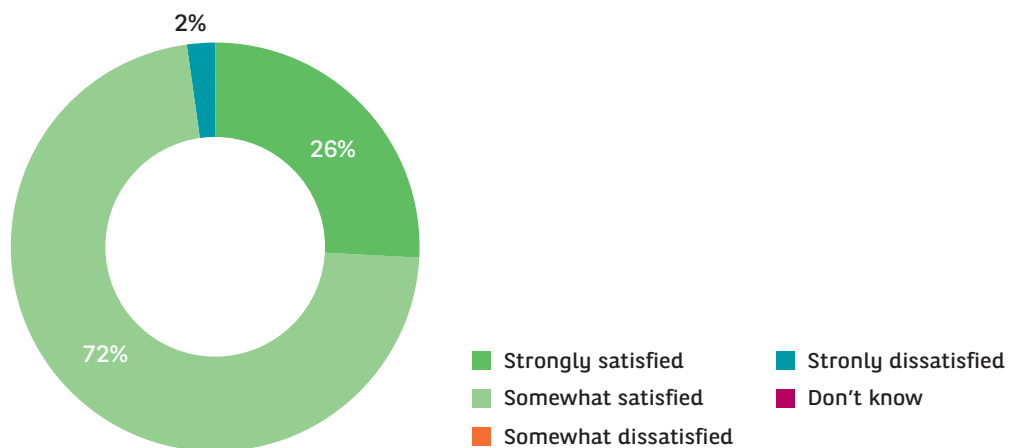
Is outsourcing
meeting needs?

The requirements and demands Banks and Broker-Dealers have of their outsourcing providers are complex: Product offering is vital, alongside excellence in client service. A provider is also expected to help the client keep up with the pace of increasing market and regulatory change. All this, while enabling the client not only to focus on their area of greatest expertise but also – ideally – to save money. To what extent are providers currently meeting these needs?

Most are satisfied with their current set-up: but not strongly so

At the broadest level, **decision-makers at companies that outsource are moderately satisfied with their providers**. Over 7 in 10 (72%) indicated they are somewhat satisfied, with around a quarter (26%) saying they are strongly satisfied. This pattern of results shows that, regardless of the outsourcing model adopted, providers are doing a fairly good job for their clients. At the same time, this **moderate satisfaction indicates potential for greater optimisation** – a theme to which we will return later.

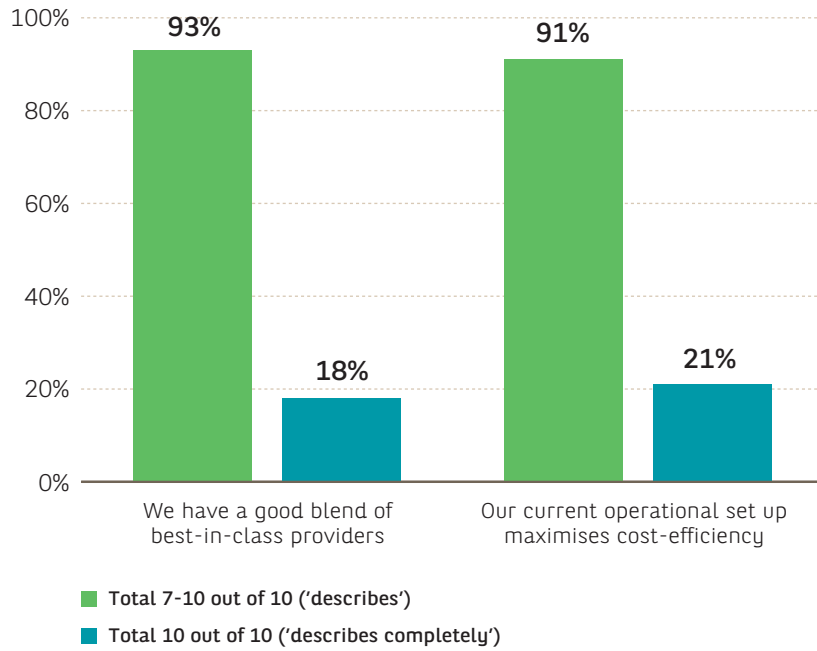
Figure 10 – Satisfaction with provider(s) (all outsourcers (n=43))



Q. How satisfied are you overall with your organisation's current Middle and Back Office providers/provider?

Further evidence of this ‘moderate satisfaction’ comes in the shape of the feeling among outsourcing decision-makers that their organisation ‘has a good blend of best-in-class providers’, and a ‘cost-efficient efficient set-up’ *to some extent but not completely so*. Over 90% agree these statements describe their organisation to some extent, but only around 20% ‘completely’.

Figure 11 – Views on current operational set-up (all respondents (n=50))

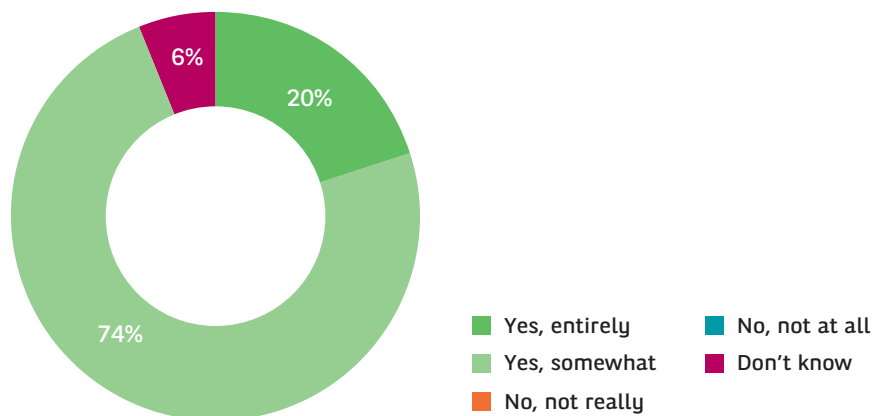


Q. Please tell me to what extent you believe the statement describes your organisation's current Middle- and Back-Office operations.

Innovative outsourcing models required to better meet needs

Whether we are talking about the relationship an organisation has with specific providers, or more generally about the ability of available outsourcing models to meet needs in general, we see the same pattern of moderate satisfaction. From this wider perspective, answering about current models for outsourcing in general, three-quarters say they believe current models can or (if they do not currently outsource) could meet their organisation's needs 'somewhat', and a much smaller proportion 'entirely' (20%).

Figure 12 – Do, or could, current outsourcing models meet needs?



Q. [TO THOSE WHO CURRENTLY OUTSOURCE] Do you believe that current models for outsourcing meet your organisation's needs today?

Q. [TO THOSE WHO DO NOT OUTSOURCE] Although your organisation doesn't currently outsource, do you believe that the current models for outsourcing could meet your organisation's needs?

Taken together, survey results suggest that today's most successful outsource providers combine excellent service and relationship management with effective product solutions, to help clients through the regulatory maze and allow them to focus on their core businesses.

Looking ahead, the potential exists not only for improvement in the products and services offered by providers – but also for the emergence of new and innovative outsourcing set-ups.

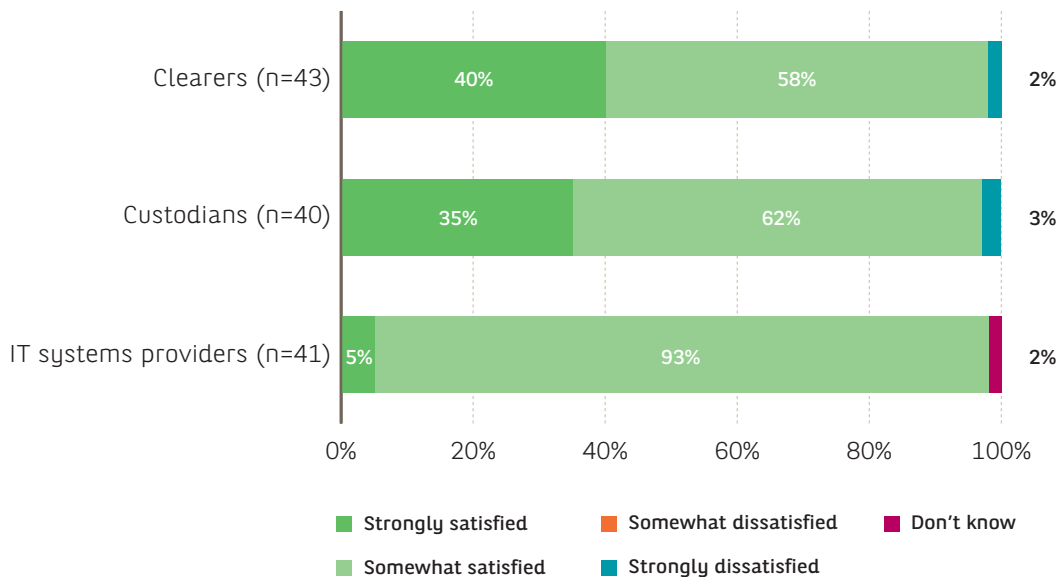
Section 5

How can outsourcing better meet needs?

Results show that both in terms of Middle and Back Office set-up in general, and the services currently supplied by providers, outsourcing is an approach that decision-makers feel well-meets their current needs. At the same time, they also indicate the potential for further improvement and innovation, not least in the context of today's fast-developing operating environment. Where should these improvements lie?

Starting with the more specific aspects of this issue, we see that **the greatest potential for improvement lies with IT systems providers**. While virtually all respondents who engage at least one IT systems company are happy with their supplier, only a small proportion (5%) say they are strongly satisfied with their provider(s). This stands in contrast to Clearers and Custodians, where 40% and 35% respectively of those using providers to fulfil these functions say they are strongly satisfied.

Figure 13 – Satisfaction with provider by type (all with particular type of provider)



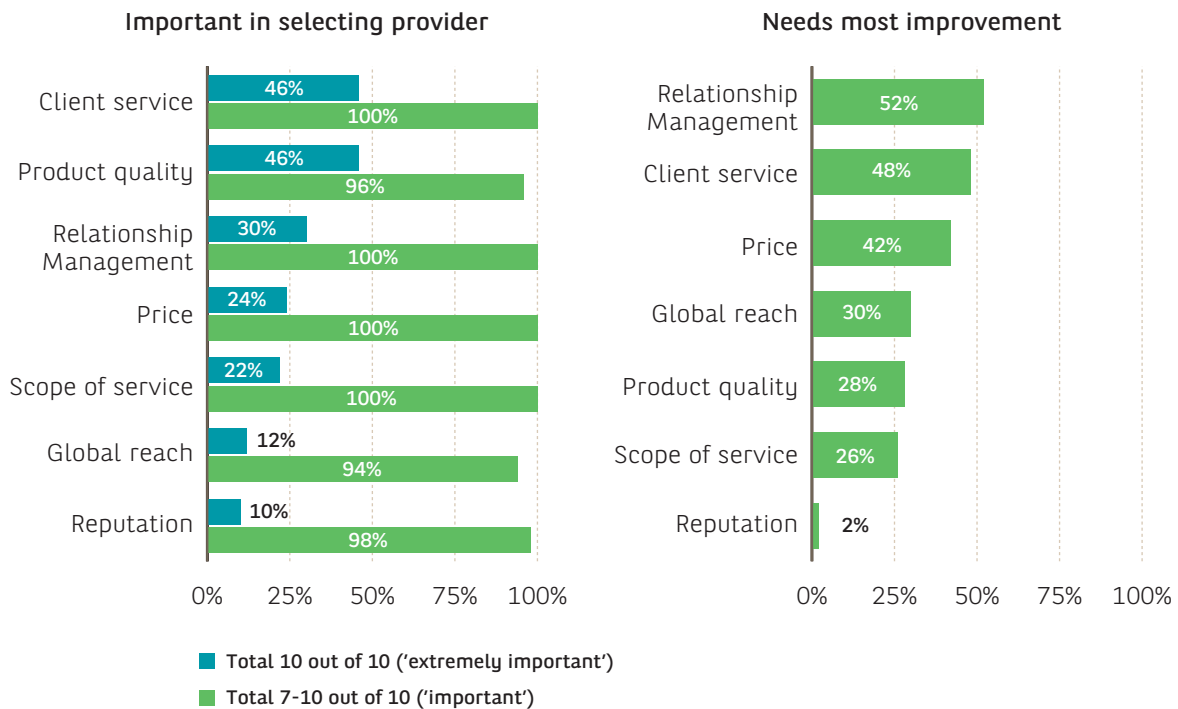
Q. How satisfied are you with your organisation's current suppliers in each of the following areas?

More broadly speaking, outsourcing **models need to be developed in order to improve client service and relationships, while at the same time offering value-for-money**. We saw earlier that service, product quality and relationship management are particular important factors in selecting a provider, with price also a secondary consideration. This question was followed up asking more generally in which areas Middle and Back Office suppliers need to most improve their offer. Here around **half (52%) of all respondents feel relationship management most needs improvement, with a similarly high proportion (48%) also saying client service needs to improved**.

While outsourcers and potential outsourcers clearly demand a close ongoing relationship and excellent service levels, there are also strong expectations that this should be provided at a price that saves the business money: **4 in 10 (42%) also point to price as being one of the areas that most needs improvement**.

This represents a complex challenge, as the expectation is that providers offer a premium service working in close partnership with their client.

Figure 14 – What do outsourcing providers need to improve most? (All respondents (n=50))



Q. I am going to read out a list of factors that some organisations might use in deciding which service provider to select. Please tell me how important you believe each factor is in selecting an external service provider. Q17. And in which of these same areas do you believe Middle and Back Office suppliers need to most improve their offer?

They must also, however, find ways of operating that allow them to provide these at competitive costs. While these may at first seem divergent goals, innovation could provide the answer to addressing both needs: Providers finding **new and more efficient processes and technologies would enable reduced costs** (and thereby price-to-client) – and allow for more resources to be focused on Relationship Management and ongoing service.

Technology will play a very important role here: this is the most common theme in comments from respondents on what needs to change in order to ensure needs are entirely met. There is a strong expectation that providers need to work with the most up to date technology so as to improve both accuracy and efficiency.

Conclusion – BNP Paribas Securities Services

The 50 senior respondents to the BNP Paribas Securities Services survey carried out by YouGov have asked a number of serious questions of our industry.

There is no doubt that outsourcing is here to stay – even the small number who do not currently outsource are considering its role in their business – and yet an alarming proportion of respondents are only ‘moderately satisfied’ with their outsourcing experience. Surely providers can do better?

In part this may reflect the sheer numbers of providers that respondents employ, and the difficulty in managing the oversight and inter-relationships of a complex model. Increasingly, we foresee that clients will rationalise their outsourced providers into fewer partners – perhaps even a single specialised organisation – that can meet clients’ increasing needs, and allow them to focus on their regulatory obligations and, above all, focus on developing their business.

However, for progress in this direction outsource providers have much to do. A clear message from survey respondents is that cost is not the main driver in the decision to outsource, although it remains important. Instead, clients want added value from their suppliers: excellent client service and quality relationship management score highest in the list of deciding factors, and yet these are also the areas identified as needing the greatest improvement.

Our view is that successful outsource providers will be those that invest. That investment will come in the form of the best and most flexible technology that can be integrated with client systems and processes to create an interdependent and efficient model. A successful investment will yield perhaps greater benefits – the time that outsource suppliers can then spend with clients demonstrating added value: service, relationship management and regulatory expertise.

This survey is the latest in a series of BNP Paribas publications looking at trends in outsourcing across geographies and industries. You will find these, and other related content at our Quintessence thought leadership portal: [securities.bnpparibas.com](https://www.bnpparibas.com/securities)

Project methodology

50 survey interviews were carried out among respondents drawn from a across a range of Brokers & Broker-Dealers (21), Banks (11), Institutional Brokerages (11), Proprietary Trading Firms (5) and Securities Services Firms (2). The results therefore incorporate the perspectives of a wider range of outsourcing organisations and potential outsourcers. At the same time, it must be borne in mind that the perspectives of some organizational types (especially Broker-Dealers) are represented more than others in the overall totals presented.

All interviews were conducted with UK-based respondents, with the focus on larger companies: over three-quarters of those surveyed work at companies with 50+ employees in the UK.

To qualify for the survey, respondents needed to have input into decisions made about the way post-trade operations are run at their organization. Typical job titles of project participants therefore include: Chief Operating Officer, Head of Execution, CFO, Head of Back Office, Compliance Officer, Head of IT, Director, etc.

The interviews were conducted independently by YouGov over the telephone, between December 2013 and February 2014. Respondents were drawn both from within BNP Paribas' own contacts, and from a wider sample drawn up by YouGov.

About BNP Paribas Securities Services

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Covering over 100 markets, with our own offices in 34 countries, the BNP Paribas network is one of the most extensive in the industry. We bring together local insight and a global network to enable clients to maximize their market and investment opportunities worldwide.

Key figures as of 31 December 2013: USD 8,055 billion assets under custody, USD 1,442 billion assets under administration, 7,067 administered funds and 8,225 employees.

For further information please visit www.securities.bnpparibas.com



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