

Fund managers gear up down south

The South African investment management industry is small, although not insignificant, compared with the traditional strongholds of the US East Coast and Western Europe. But as **Victor Anderson** reports, a small industry does not necessarily imply an unsophisticated one, as investment managers look to technology in order to tighten up their services for increasingly demanding investors

South Africa is an unusual place. It's a country full of contradictions and incongruities that become immediately apparent during the short journey from Cape Town International Airport to the mother city some 30 minutes away. Flanking the N2 motorway on both sides as one drives towards the slopes of Table Mountain are informal (squatter) settlements, the houses of which consist of corrugated iron and plastic sheeting... and yet most have telephone lines

radiating outwards to them from centralised telegraph poles. It seems that living in relative poverty (poverty, it seems, is always a relative term, and this is especially the case in Africa) is more endurable as long as you can call your friends and talk about it.

The South African investment management industry is small, but it is growing at a significant rate. At the start of 2002, for example, there were only a handful of hedge funds in the Republic, but that figure swelled

to upwards of 140 funds (with approximately \$2.75 billion under management) by the start of 2009. Traditional asset management operations have not grown at the same rate but that market is fairly well saturated and like those of the US and Western European segments, M&A activities have kept the total numbers down, although assets under management continue to grow.

Technology is considered an important facet of the local buy-side landscape as firms look

to automate previously manual processes, shore up compliance procedures which typically could not be managed without the use of technology, and extend their portfolios to include new and exotic instruments not previously supported by legacy trading infrastructures. One technology vendor active in the local market is Charles River Development, which made the move down south after responding to an RFP from an investment manager for its Charles River IMS (Investment Management System) front-office platform.

"We won that RFP, and as part of any process as we get into a new country, we started looking at the size of the market, what the opportunities were, and what changes we'd have to make [to our technology] that are specific to that market," says Jon Steward, managing director for Europe, the Middle East and Africa at Charles River Development. "I would say that South Africa is the same size as the French and German markets for us," Steward continues. "But the other benefit of establishing a presence in South Africa is that it gives us a gateway into the whole Africa region. There are a number of other countries – Kenya for example – that have shown interest in Charles River."

The South African buy-side market is no different to the UK or US markets when it comes to knowledge sharing and knowing what your competitors are up to, a phenomenon that in the African and Australian context is often referred to as the 'bush telegraph'. This informal knowledge flow, according to Steward, has benefited Charles River: "A lot of our promotional work is done by happy customers," he says. "It's a fairly small market – from our perspective we're looking at about 20 good-sized prospects – but it's a market where everyone talks and I think a lot

of the promotional work goes on between our customers talking to our prospects."

Recent success

Since that initial contract in 2006, Charles River has signed a handful of local investment managers. Metropolitan Asset Managers, the tenth largest fund manager in the region with approximately \$6 billion under management and a headcount of 80 is one such signing.

Anton Berkovitz is managing director of Ilanyezi* Investment Holdings and ex-head of business strategy at the Cape Town-based multi-strategy investment manager.

According to Berkovitz, most South African buy-side houses have back-office systems with some front-office (dealing) functionality and are therefore significantly different compared with the average buy-side firm in the more mature asset management markets.

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Jon Steward, CRD

That is understandable given the relative nascence of the South African marketplace, although this is starting to change as buy-side firms grow in terms of assets under management and sophistication.

Prior to awarding Charles River the Metropolitan contract, Berkovitz informed Metropolitan's executive committee that he would be prepared to consider any system or vendor already in South Africa or that wanted

to be in South Africa. Five vendors fit the bill, he reports. "The system we had been using was AIMS, primarily a back-office and accounting platform from Microgen," Berkovitz says. "They produced a front-office system that, over time, became too lightweight for us and so we decided we needed a more comprehensive front-office system, and as the need built up, we had to satisfy a growing list of requirements from the portfolio managers and dealers."

According to Berkovitz, there was a requirement that the system be FIX-enabled, which Metropolitan could have implemented separately or as part of a wider single front-office system. "Eventually we had enough of a business case to get a decent front-office system with the ability to cover all of these needs, and which would be cheaper and easier to maintain in the long run," he says.

Complex

Berkovitz explains that one of the other drivers spurring Metropolitan into looking for a new front-office platform was the firm's complicated implementation process from a portfolio construction and dealing perspective. The way the portfolios were constructed was a combination of asset allocation modelling handled in one area and stock selection modelling in another. "We were going to have to develop a system – a small application focused just on portfolio construction – that could be integrated into that process to do this for us," he says. "In the end we decided to look for this functionality as part of the new integrated front-office solution. Most of the vendors I spoke to said they could support our portfolio construction process, but during the demos they realised they couldn't. Charles River on the other hand, was the only vendor that said it could not



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support our portfolio construction needs the way we wanted them to, but that they had another client for which they had to build similar functionality. They were the only people who properly understood what we were doing."

At the end of 2005, instead of undertaking a detailed examination of the top two or three candidates from the preliminary investigation, Metropolitan decided to do a three-month proof of concept with the number one candidate (Charles River) on its short-list. If it worked, according to Berkovitz, the firm would go straight into the implementation, but if it didn't, Metropolitan was prepared to go to number two. "We started the implementation in the middle of January 2006 and we wanted to go live in mid-July, but in the end we went live about a month later with all three modules, and across all asset classes. The project included a simultaneous integration into two back-office systems, and a new scrip-lending system, as well as the implementation of FIX.

In terms of tangible business benefits on the back of the IMS implementation, Berkovitz is clear: "The biggest advantage for the business – and this was significant – was in the dealing and portfolio construction area. We also had a business benefit from pre-trade compliance."

According to Berkovitz, the IMS also offers sophisticated FIX connectivity – Metropolitan is currently running version 4.2 – which he says has benefited the dealers themselves. "We lost two dealers shortly after we implemented the system and the head dealer at the time said that if it hadn't been for Charles River he wouldn't have been able to cope. It has benefited the front office in general but specifically the dealing and portfolio construction areas."

Bulge bracket signing

Shawn Smith is chief information officer at STANLIB in Cape Town, an investment manager with a strong fixed-income track record (although he stresses that STANLIB has also got significant equities expertise) with approximately \$30 billion under management, making it the third largest South Africa manager in terms of assets under management. According to Smith, STANLIB was one of the first investment managers in South Africa to implement an order management system (OMS) which it did back in 2000. "In June 2007 we started looking at replacing the incumbent OMS – there were certain shortcomings with the old system, FIX being one of the major ones," he says. "We also had a few issues around

fixed income," Smith adds. "South Africa's market is unique when it comes to fixed income in terms of the valuations of the instruments and the OMS we had been using struggled with the nuances of the South African market."

Alun Cutler, senior business consultant at Charles River Development, echoes Smith's assessment: "Generally in the fixed-incomes market space you have different practices in terms of fixed-income calculations," he says. "Inflation bonds for example are treated according to a different look-back period and the money market trades in a subtly different way."

Smith explains that the Charles River project was initiated shortly before his return to STANLIB. "My predecessor was involved with the initial system selection and I arrived midway through that process," he says. "But I was happy to see that STANLIB had taken a leap forward and were looking at a new front-office system because I was aware of the previous system's shortcomings.

Like Metropolitan, STANLIB whittled down the list of potential winners for the front-office platform to two, before the strength on Charles River's South Africa-based consultants and the IMS's fixed-income capabilities came to the fore. "It was the quality of Charles River's consultants who came out and did the demo, and it definitely revolved around fixed-income specifics and certainly the FIX order routing,"



Smith says. "Both systems had similar functionality around the basics – equities and FIX – but Charles River outshone the competitor in the fixed-income space and that's with specific reference to the South African market."

Prime time

Johannesburg-based prime broker Sanlam Prime Services, a wholly owned subsidiary of Sanlam Capital Markets, implemented the Charles River IMS at the end of Q3 2008, becoming the first prime broker globally to offer its hedge fund clients access to the front-office platform. "We host Charles River here at Sanlam Prime Services," says Terence Naidu, co-head of Sanlam Prime Services. "Our clients log in via Citrix, get their hardware authenticated as well as input their user names and passwords. When they login to Charles River they are able to view their portfolios, trade off them, and have their compliance monitored at the same time," he says.

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Naidu, who describes the functions of prime broking services in the South African context as primarily scrip lending and funding, says Sanlam Prime Services has two funds currently on the system, while a management firm overseeing three funds is expected to sign up at the end of this month (February).

One of the funds currently using Sanlam as a prime broker is the GenX Statistical Arbitrage Hedge Fund, managed by Nafees Hossain. "His strategy is based on a model that he's developed and is most active in volatile markets. As you can imagine, he's been trading up a storm over the past few months," Naidu explains. "He turned over his portfolio twice in January alone."

Prior to joining Sanlam Prime Services, Naidu worked at Peregrine Capital, one of South Africa's longest running and best performing hedge funds, and like a number of hedge

fund managers, most of Peregrine's front-office functions were run on Excel. "When you entered a trade or updated your portfolio, you ended up doing it five or six times on different spreadsheets and it was very frustrating," he says. "Considering the frustrations I learned from that experience, I wanted something that was easy to use – something similar to Excel – that would allow me to manage my portfolio in real time, do your 'what if' scenarios, and route trade orders via FIX. But perhaps one of the biggest considerations was that there was built-in compliance – we enter the fund manager's mandate restrictions into Charles River and this helps him monitor his compliance more closely."

Does Naidu see Sanlam's technology front-end as a competitive advantage? Without a doubt, he says. "A lot of the current technology offerings in the prime broking space limit funds when it comes to the number of instruments they can trade. With Charles River being able to handle equities, fixed income, options, swaps and other complex derivatives, it allows funds to trade a lot more of these products – and it provides you with a single view of your portfolio."

** Ilanyezi is, according to Berkovitz, a concatenation of the three Zulu words for 'sun', 'moon' and 'stars'. ><*



Terence Naidu,
Sanlam Prime
Services

Salient points

- Technology is seen by South African investment managers as a way of improving efficiencies across the front office while also broadening the scope of instruments they can trade
- FIX is one of the most often cited reasons for upgrading front-office technology as the local market embraces electronic trading practices
- Technology vendors keen on gaining a foothold in emerging markets would do well to focus on those markets' idiosyncrasies from a functionality perspective