Full steam ahead

With many of the post-crisis regulations now coming into force, Darren Crowther of 4sight Financial software gives his overview of the fast-growing market

JUSTIN LAWSON REPORTS

How are things going at 4sight and how do you find the market at present?

The market for technology solutions is currently very strong. The huge volume of regulatory change that is now unfolding is mostly driving this, along with increasing cost pressures affecting market participants.

4sight is therefore growing quickly. We've added four new clients in the last six months, and we've increased headcount in line with demand. Due to ongoing interest in our products, we're now pre planning for more work. We have a healthy sales pipeline and we see a very positive outlook for 2014-2015.

We're now reaching the implementation stage of many of the new rules created in the aftermath of the crisis. Most firms have defined their target operating models and are in the process of rolling out changes to processes and technology solutions. A few firms have finished their preparations.

However, there is a small subset of firms who have not yet started. We recommend they begin moving forward as soon as possible to avoid bottlenecks and disruption to business.

The trend for centralising collateral management across silos and then optimising the collateral pool has now taken off. People have gone from talking about optimisation to doing it.

4sight has been well placed to meet demand for enterprise collateral management because of our background in inventory management and the more complex nuances of securities lending and repo margining.

In terms of our business model, because of the wholesale changes required by financial firms to thrive in the new market environment, technology vendors have, to a certain extent, become consultancies as well as software providers.

Rather than just offering technology, we seek to add value for clients by educating them on market trends and helping to simplify the complexity of the new rules.

We then offer solutions that reduce the headaches involved in complying with the new regulations. Our core aim is to therefore to provide technology products that help our clients to open up new opportunities, and emerge from this difficult period of change in a stronger competitive position.

Have you seen a slight uptick in RFPs? Are banks looking to invest in technology?

Last year we experienced double the number of RFPs that we would typically receive in previous years, so it's more than a slight uptick. This trend has continued into 2014 and we expect it to keep growing for some time.

Many firms are starting to realise that in-house or legacy solutions aren't fit for purpose, given the large-scale evolution in market structure caused by new rules and a general trend for consolidation of collateralised business units to reduce costs and optimise revenue.

The scale of change means maintaining a software system in-house and keeping it up to date as new rules come in is no longer economically viable for all but the largest banks.

Likewise, older vendor supplied solutions are not able to deal with the demands of the new, more complex operating environment.

This includes more operationally intensive collateral management and margining processes as the market moves to trading via CCPs. It also involves dealing with a regulatory pressure to centralise the use of inventory to cope with balance sheet, RWA and Basel III reporting and analysis.

In parallel to this, there is a general industry trend to outsource IT services to third party IT providers. Externally hosted, software as a service (SaaS) solutions are also becoming much more popular. Many RFPs are therefore asking for a hosted option and this is a model we have rolled out for a number of new clients.

Collateral, for the past six years has been the most talked about area at

conferences. Are you seeing strong growth in this business area?

Collateral has been a huge growth area. In 2009 and 2010 we started seeing a few early adopters centralising their collateral management across silos and then automating and optimising their collateral usage. These weren't necessarily the largest tier one banks, although of course some of these firms were ahead of the curve.

It was often our smaller, more nimble clients, who were able to adapt more quickly to the new consolidated collateral model.

Aside from that, demand for optimisation grew gradually. We were in the education phase where people were trying to understand what optimisation really was and whether there was any benefit in doing it. That stage has now ended.

We are seeing the market move en masse to this new centralised collateral management and optimisation model as the business efficiencies and return on investment become widely accepted.

In addition, a lot of the work around collateral management has focussed on simply complying with the new EMIR and Dodd Frank rules around central clearing. This involves significant changes to business models and technology, such as connecting to various CCPs and Clearing Brokers/FCMs, modelling CCP margining processes and coping with an increase in collateral movements.

Once the dust has settled from the move to trading via CCPs, then many firms will look at how they can further reduce their collateral costs through technology driven process improvement.

From a securities finance point of view, centralising collateral allocation with the derivatives desk makes a great deal of sense. The securities lending and repo desks will play a fundamental role in sourcing the collateral required for derivatives margining and liquidity coverage ratios. Holders of surplus CCP eligible assets should also be able to generate new revenues by lending to those who are short these types of assets. Smart firms are now aligning their collateral management desk in this way.

Have you noticed any changing collateral demands in any of the markets you work in?

Not currently, there is still a lot of cash collateral due to the low interest rate environment and the operational ease of dealing with cash. We expect that to change though as central banks begin tapering their QE programs.

We believe 2015 will be a key year for collateral demand. Many of the factors that will increase the need for high quality collateral will come into play.

Basel III liquidity coverage ratios will create added demand that will increase incrementally until 2019. In addition, the clearing mandate for derivatives in Europe will create a need for more high quality collateral. New bilateral margin rules will also start to take effect.

By 2016, we should therefore have a better idea of the extent of collateral scarcity.

In response, we are seeing some clients starting to organise their securities finance desks around collateral, for example, bringing in the high quality liquid assets required for derivatives margining and Basel III Liquidity Coverage Ratios (LCR).

The LCR rules kick in on 1 January 2015 so those firms that are proactive in getting technology support in place will minimise the impact of the LCR on their business.

For example, it makes sense to utilise existing internal inventory to satisfy the LCR before going to the street to source LCR eligible assets. Likewise, you don't want to pledge out LCR assets as collateral if you can avoid it.

There should be higher demand for securities that meet the LCR requirements so establishing a natural flow of assets coming into the firm at the lowest funding cost makes sense.

These are some of the key reasons why a significant and increasing proportion of our pipeline have been driven by fixed income and treasury departments with a focus on repo financing and fixed income inventory optimisation—whilst also needing full support for equity collateral and SBL. We believe 4sight is unique in its provision of all these components in a single system solution.

You have recently launched an equity derivatives software solution for synthetic prime brokerage. What was the thinking behind this?

We've always had a strategy of diversifying into new product areas and equity derivatives naturally complement our existing Securities Finance and Collateral Management suite.

Basel III capital requirements and balance sheet pressures increase costs for prime brokers, which they will then either have to absorb or pass on to customers. Because of the way Basel III treats synthetic trades, there are capital and balance sheet efficiencies in offering these structures compared with traditional securities finance trades.

This is resulting in a growing trend amongst prime brokers to offer synthetic financing for hedge fund clients, so we wanted to offer a technology solution to support this.

When combined with our 4sight securities finance and collateral products, it will also allow us to provide prime brokers with a one-stop shop for prime financing, including synthetic and physical trading, real-time inventory, collateral optimisation, margining and financing.

What else is on the horizon for 4sight in terms of new product lines, updates or markets?

We aim to offer the most functionally rich securities finance solution available on the market and have continued to invest heavily in our 4sight securities finance system. Our roadmap includes, amongst other things, adding new functionality to our repo module, including enhancing tri-party repo, increasing financing trade support for GMRA/GMSLA, expanding our connectivity to more ECNs and developing an interface to Eurex's CCP for securities lending.

In terms of regulatory trends, we've recently developed risk weighted asset and balance sheet usage calculators so users can analyse capital costs and balance sheet consumption at the point of trade.

We're also working with customers to support Basel III liquidity coverage ratio requirements and other aspects of Basel III that will affect securities finance such as the net stable funding ratio and leverage ratio.

In terms of technology, we now offer new deployment options including hosted SaaS solutions as demand for SaaS becomes more widespread.

On the enterprise collateral management front, we now fully support margining of cleared derivatives with automated workflow, handling for all IM, VM, PAI, coupon, fees and interest flows. We've combined this with an easily replicable solution for connectivity and rules handling with the wide range of FCMs and CCPs.

Finally, we continue to develop more advanced optimisation algorithms. This includes holistic optimisation that factors in capital efficiency, LCR ratios, collateral opportunity costs, trade type optimisation and optimal counterparty selection. As pre-trade analytics solutions become widely used this is also an area where we will look to innovate and provide tools to help our clients maintain profitability in the new, more challenging business environment. **SLT**

Darren Crowther
Application development director
4Sight Financial software