

Hedge tremors

Hedge funds should aim for a single repository of all active financing transactions to make sound financing decisions and illustrate complete control, says Jean-Paul Musicco of Trading Apps

MARK DUGDALE REPORTS

New regulations are affecting securities finance in its entirety, but the buy side is thought affected more than most—how are hedge fund and prime brokers dealing with new regulations in terms of technology?

On a relative basis, I guess I would have to agree with you, if you consider how much regulation sell-side firms currently have to manage globally on a daily basis. On an absolute basis though, the buy side will most likely experience a limited amount of regulatory requirements when the first wave of regulation finally gets finalised and implemented. That's the direct impact on the buy side.

The indirect impact on the buy side over time will be much more impactful as prime brokers in the near future will become much more selective on which type of assets, the amount of leverage being provided and the amount of assets they take onto their balance sheet. For the past 20 years, prime brokers have been focused on bringing as many clients and assets onto their balance sheet as the overall impact on finite resources (unsecured cash, balance sheet and risk weighted assets) was minimal, and the profitability for selling all services as a bundled solution was maximised by this approach. By the time the new regulations are fully implemented, prime brokers will most likely be much more selective about the clients they choose to provide balance sheet and services to globally.

What that means to hedge funds is that they will now have to implement finance technology within their own environment that can handle all securities finance transactions (cash and derivatives), and depending on whether the fund is a single strategy fund or a multi-strategy fund, numerous types of assets and possibly many more financing providers of all types will drive the level of system complexity.

Treasury or trade administration roles for the larger funds should expand over time to play a more significant role, especially for the funds that leverage and trade both cash and derivative products. For the equity-based funds that in the past just defaulted delivery instructions to various prime brokers, they may have to start negotiating their long and short financing transactions more frequently.

Finally, with respect to the buy side, due to the impact of the financial crisis in 2008, a full treasury structure requiring the ability to handle cash management, margin management, custody management, multiple prime brokers and

derivative counterparties should be at some phase of development to handle the new world requirements for financing assets.

For prime brokers, I believe some of the necessary changes for technology required will be around much more robust 'pre-trade' analysis and real time messaging of executed transactions to a centralised risk or treasury repository. End of day files or intra-day spreadsheets at some point in the near future will no longer meet the standard for regulatory calculations that would be required from various product groups to ensure that all relevant regulatory calculations are within the policies and procedures established by an investment bank.

Historically, securities finance systems have not been tasked with many pre-trade analysis checks to ensure that the potential transaction would be eligible to be booked, other than a price check, a credit check or to provide a locate affirmation. Most of these systems were looking to ensure simple compliance functions, before a trader could proceed with the booking.

In the future for prime brokers, I believe that in order for the business to be competitive as central management aggressively looks to achieve acceptable returns from each business, new transactions will require better front-end tools that will offer numerous pricing options for various inputs to fully understand if a trade will meet the business's overall target goals.

How are hedge funds handling multiple prime brokers and the associated technological challenges?

I see this as a bifurcated market for hedge funds. A small group (fewer than 100) of the top-tier hedge funds have dedicated information technology development groups that either build specific securities finance solutions or buy and modify vendor solutions that communicate with their core systems, as well as the prime brokers to support the dedicated finance staff.

For the remaining majority of approximately 10,000 hedge funds in the world, the operations or trade support team are using Microsoft Excel and other equally simple and certainly not scalable solutions to run mission critical components of the business. These funds will only consider making the investment if they are challenged by investors and/or regulators in the future to provide timely reporting about their activities. Securities finance systems that we offer will provide a full treasury solution.

What about transparency in terms of pricing is this a need, and is it being met?

I believe there are adequate solutions out there in the market if your firm has the staff or better yet, the systems to bring in this type of data. So yes it is being met if you are focused on seeking out a solution from one of the current vendors. We currently offer solutions that allow clients to import files from the various vendors as well as a centralised solution for their current prime brokers that illustrates all of the fields of data that the vendors offer.

What should hedge funds look to achieve with their securities finance technology?

Without question, having a single repository of all of your active financing transactions is the best way to make sound financing decisions for all of your funds and more importantly, to illustrate to your counterparties and investors that you have complete control of your financing positions.

Our Position Manager App is one of our cornerstone apps for any hedge fund in that it provides a single point of entry for any multi-entity, global hedge fund. This app allows the user to aggregate the entire positions for all of the portfolio companies on a net basis so the user can truly optimise data for the entire firm. Or if you are looking to drill down into the individual items that are held by each PM at each prime broker, we provide that level of granularity as well. Our easy to use quick filters and search functions provide the opportunity for each finance staff member to customise the view in which they feel most comfortable, and they can save each version as a favourite on their app dashboard. **SLT**



Jean-Paul Musicco
Managing director
Trading Apps