

Top shops - big winners!

What's driving improved service and product innovation in FX prime brokerage?

The events of the past 18 months have put credit firmly in the spotlight, giving rise to a new round of product innovation within the FX Prime Brokerage space. Frances Maguire explores how it has also raised the ante on improving customer service levels amongst the leading providers.

The reshaping of the FX prime brokerage market, as both prime brokers and customers reassess their exposure to counterparty credit risk, has led to much greater emphasis on margining and limit monitoring in real time, as the market places greater focus around the management of risk and collateral.

"Prime brokers are managing risk themselves by ensuring that their counterparties are safe. Likewise, as the whole issue of risk has increased in focus, algorithmic traders now have the ability to monitor what they are doing in real time," says Gil Mandelzis, founder and chief executive officer of Traiana.

Andrew Coyne, managing director, head of FX Prime and G10 e-Commerce, at Citi says that there is still a focus on credit and many clients are still looking for increased security around their assets held at banks, which Citi is providing, and there is a greater awareness of credit methodologies employed and the amount of collateral they are required to hold. "Prime brokerage clients are managing their collateral more closely, which make a lot of sense in the current climate," he says.

"Eighteen months ago, the first question a potential prime brokerage customer would ask was about price. Today that is far down the list. Now the first question is 'what is your credit rating?' They want to know how safe their funds are and whether they will be in a segregated account," says Peter Plester, head of prime brokerage at Rabobank International, who says the most marked difference following the crisis has been the focus on credit.

Credit crisis

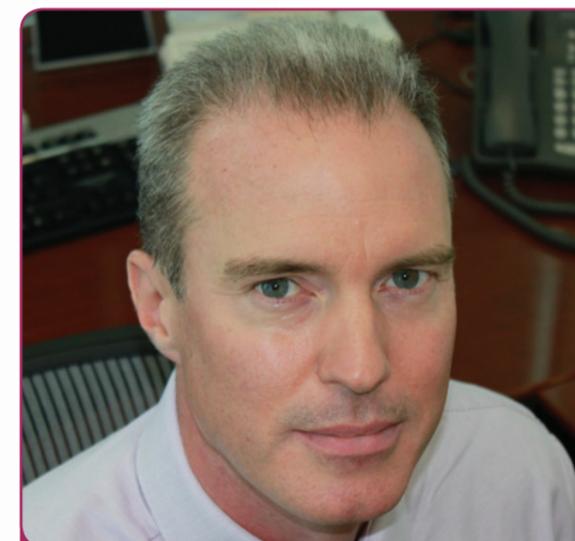
The credit crisis has had a profound impact on the FX prime brokerage market. As a result, organisations

with aspects of their business where they cannot demonstrate real time risk monitoring have had to reduce the amount of risk that they can take with these types of clients and have been unable to on-board additional clients.

According to Mandelzis the re-evaluation of credit has also given rise to the prime-of-prime model, where FXPB providers have turned clients or introducing brokers, has been growing in a very meaningful fashion in the past few months. He says: "These are second tier organisations, that are prime brokered by the first tier banks, and then they are prime brokered by second, or third, tier players because balance sheets are just so valuable now."

While the first tier banks have been focusing on first tier players, the mid-tier banks, who used to be prime brokers themselves, when credit was cheaper, are now becoming the clients of the first tier banks, providing algorithmic services to the third tier players.

But despite this shifting landscape, Mandelzis says there is still much product innovation in the FX prime brokerage market. Three years ago, there was very severe price competition in the market as players, in some cases, were effectively buying market share and this put huge pressure on the sustainability of the FX prime brokerage model. Today, he says, the focus on risk management has opened up a whole raft of new opportunities and this is also leading to the provision of cross-product capabilities.



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"The FX prime brokerage market is extremely vibrant and growing," he says. "There are new participants coming from the asset management community, which had previously shied away from FX prime brokerage. Now asset managers recognise the exposure they have and the difference large balance sheets can make. Because of this they are opening up to the business of FX prime brokerage and the prime-of-prime model. As a result, from a product innovation perspective, there is a lot happening."

Now that all of the leading banks offer FX prime brokerage services, Mandelzis does not believe there will be many more new entrants into prime brokerage however he does believe that new players will enter into the prime-of-prime brokerage space, and that many new clients will enter into FX prime brokerage. "We are seeing a continuous stream of algorithmic players from the equities and futures world that are starting to participate in trading FX as an asset class and we will continue to see many players from the asset management side come into FX prime brokerage," he says.

He adds that another impact of the credit crisis is that a lot of the retail aggregators are moving from an agency model to a principal model, and when they do so, they stop being the counterparty to every trade and become prime broker clients. He believes this move away from bi-lateral relationships to the

prime brokerage model will continue due to increasing regulation and the rising cost of credit.

Multi-prime revisited

The collapse of Lehman Brothers made prime brokerage clients seriously rethink their counterparty credit risk exposure and as a result the shift towards the multi-prime model in a bid to diversify credit risk has been revisited.

Not surprisingly, the need to diversify counterparty risk by appointing more than one prime broker has made the FX prime brokerage even more competitive. Edward Pla, Global Head - FICC Prime Services at UBS, says: "Many clients have quickly become interested in having more than one FXPB provider in order to diversify counterparty risk. In addition to the traditional criteria used to evaluate an FXPB, this puts a premium on prime brokers with scalable front to back infrastructure and a highly organised and efficient on-boarding process."

Pla believes that the demand for multi product prime brokerage is clearly increasing and as this trend advances banks will offer clients an increasingly integrated service across client on-boarding, client service, reporting and margin management.

The spotlight is very much on the management of risk in prime brokerage but according to Citi's Coyne, the need to consider diversification into multiple prime



Martine Bond

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brokers is nothing new. "It will depend on a client's business. Typically, if a client has multiple prime brokers it is two, occasionally, depending on the size and the scope of the client's business, they may employ three, but that is rare. However, for most firms, the more prime brokers you add, the less efficient the model becomes."

But for Martine Bond, global head of FX prime brokerage at Morgan Stanley, the move towards a multi-prime environment has been one of the biggest trends to emerge over the past two years. She says: "Until two years ago, a significant proportion of the larger hedge funds and broker dealers would consolidate all of their risk with one counterparty. This was particularly evident in the FX prime brokerage community, however we have seen a move away from the single prime broker model with most clients, large and small, adding a second or even a third counterparty."

She adds, however, that moving to multi-prime brings additional considerations from a client's perspective. There may be additional operations and IT requirements to maintain an efficient multi-prime model, and there may be some fragmentation of margin if clients hold a trading portfolio across multiple counterparties. In general, however, the security and back up offered by an active second prime broker is now considered by clients- and their investors- to be an essential component of prudent post-crisis business.

Morgan Stanley has had an FX prime brokerage business for a number of years. However the business was traditionally focused on servicing clients of the firm's equity prime brokerage offering, and for whom FX activity is usually more limited and solely for hedging purposes. In early 2009, Morgan Stanley moved to aggressively expand and augment its FX prime brokerage offering, spending the last year creating a broad and comprehensive FXPB platform, which is now successfully partnering numerous standalone FX clients.

Bond says: "Morgan Stanley is a relatively new to the FX prime brokerage market and so we have been able to shape the business around our experience and in line with clients' needs today. As a result of this new trend towards multi-PB, the most important consideration we have built into our FXPB platform is the flexibility to create the smoothest possible integration process for our clients. We have multiple connectivity solutions, broad capabilities in terms of the types of reporting we can send back to clients,

and full connectivity with a full spectrum of industry standardised tools. This complete flexibility means we can really help clients, which are using the multi-prime brokerage arrangement by not forcing them to have to change their existing workflow to fit us. We are completely adaptable and can comfortably fit in with our clients' workflows."

She says that a lot of clients use Traiana's Harmony and integrating with this network has been very successful but, because Morgan Stanley has built its FX prime brokerage model to offer maximum flexibility, even if clients are not using industry standards, Morgan Stanley can still work with them to integrate any format they need to make the FX prime brokerage offering seamless for them.

Multi-asset offerings

Morgan Stanley's FX prime brokerage has also been built with another trend in mind – the growing interest in cross-asset class trading – and the offering is cross-product with seamless access to trading platforms for listed derivatives, fixed income instruments, FX and equities instruments, alongside OTC clearing services for credit derivatives and interest rate swaps.

Bond says: "If you are a client looking for a prime broker, not only can you receive Morgan Stanley's expertise in each product, but you can also access a wide range of instruments and experience the full breadth



Ed Pla

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of Morgan Stanley's services. Our client tools are really seamless, so there is one margin call, one set of reports, and one website which provides access to everything."

At UBS, the continued investment in front to back FXPB capabilities has meant a recent focus not only on continuous improvement in areas such as client reporting, collateral management and exception management, but also on further integration with other parts of UBS Prime Services, such as Equity Prime Brokerage, Exchange Traded Derivatives and Fixed Income Prime Brokerage.

Pla says: "Clients will increasingly look to partner with providers who can provide comprehensive market access for both multi venue execution and clearing. The latter will grow increasingly important as central clearing initiatives gather momentum and co-exist with traditional OTC clearing services."

The trend towards multi-asset prime brokerage, and the need to access different markets, such as interest rates, fixed income and futures products, alongside FX, has given rise to a demand for cross-margining, according to Coyne. "If the client's business needs access to different markets, the most important requirement they have is cross-margining," he says.

Citi has evolved, and continually improved, its FX prime brokerage offering to meet these demands and uses a Value at Risk model to margin across multiple asset classes. Coyne says: "We have been improving the margining models over the years and although the cross-product margining has been in place for some time we continue to improve that as well."

But Coyne adds that not all clients are looking for multi-product solution and for this reason, Citi focuses on bringing the products together to make it work like a single service.

Aligning with client needs

Chris Hansen, global head of Deutsche Bank's cross asset client clearing business, dbClear, says that the bank is reflecting its offering to align with its clients' needs for things such as deep and liquid direct market execution, access to assets, and a robust clearing and settlement solutions, within an integrated platform. "We are trying to mirror the needs of our clients from a platform and asset gathering perspective," says Hansen. "This positions us differently from other players and away from their siloed approach."

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Last year, Deutsche Bank began a major restructuring initiative across its Autobahn trading platforms, FX and listed clearing business, and post trade services business, merging its sales coverage teams and infrastructure into a single unit aptly named Global Client Solutions. The FX prime brokerage business is a key component of this combined business line.

Jason Vitale, head of FXPB at Deutsche Bank, says that the bank has merged its offering to suit any number of client types and requirements. The Deutsche Bank FXPB platform is intricately linked with DB's listed futures and options business and Deutsche Bank's managed account platform, dbSelect. "This means that clients are not taken off into individual service silos," says Vitale. "Under one umbrella, we can provide them access to assets, multi product execution, FX and listed clearing, and unique cash management solutions."

"We have moved from a very segregated approach where we were offering FXPB in isolation. Now we are fully leveraging other areas of Deutsche Bank's global franchise, providing one cohesive state to the client. From servicing pension funds and hedge funds to high frequency algorithmic traders or retail aggregator accounts, we have various tools and services which clients can mix and match to create an intelligently

packaged solution. Once you have those core businesses all working as one, the incremental services are relatively straightforward to add.”

Deutsche Bank also offers an integrated cash management solution with unique FX delivery capabilities through its FX4Cash platform. “It is a growing need from all of our clients to have a FX delivery component in their cash management solutions included in their clearing relationships,” Vitale says.

Vitale adds that providing a one-dimensional offering and competing around price alone is no longer enough to succeed in FX Prime Brokerage. “If you just want FXPB, of course, we will be that one-stop shop. But the reality is that our clients demand more from their banks and expect us to be there across the entire product range.”

Says Vitale: “Now that we have put together an infrastructure that can look across all of the services we are able to find new ways to help clients monetize their relationship with us more effectively. By this I mean delivering value added solutions beyond FXPB clearing. Services such as portfolio financing, margin optimization, post cleared execution services and cash management can all be packaged to meet a clients needs.”

Product innovation

There is continuous innovation in the market, whether it is through more clients accessing more anonymous liquidity sources, such as EBS and Reuters, or whether it is coming from clients building out multi-prime brokerage platforms and needing to improve operational efficiency across multiple counterparties. Other industry initiatives, such as the new CLS Aggregation Service, will enable prime brokers to continue to improve their efficiency.

At Morgan Stanley, Bond says the FX prime broker has a 99.95 per cent STP rate for spot FX trading but she says there is room for improvement in STP rates for options, where not all banks and dealer are sending via Harmony, which is the industry-wide platform. “As volumes continue to increase, prime brokers have to manage their capacity and increase capacity hugely, and this is an area we are focusing on, to make sure we stay ahead of that capacity curve,” she says.

For Bond, FX prime brokerage alone, on a standalone basis, can be an extremely profitable business so long as the correct investment in technology and operational infrastructure is made to get the required



Jason Vitale

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levels of STP. But more importantly, Bond adds, FX prime brokerage is an excellent access point for clients into the rest of the firm.

She says: “Usually this means that FX prime brokerage clients are going to increase the amount of e-commerce or voice trading execution that they do with you in FX. Also, where you have a multi-asset prime brokerage platform it is a great way to introduce clients to other asset classes, whether it is interest rate clearing or equity prime brokerage.”

For clients, Bond believes product innovation is at the top of their list of priorities and Morgan Stanley is constantly looking out for new services to deliver and new client facing technology and reporting tools. Client service is also hugely important to the firm and an area where Morgan Stanley has traditionally excelled. She says: “Morgan Stanley takes a holistic view of the client and their overall relationship with the firm.

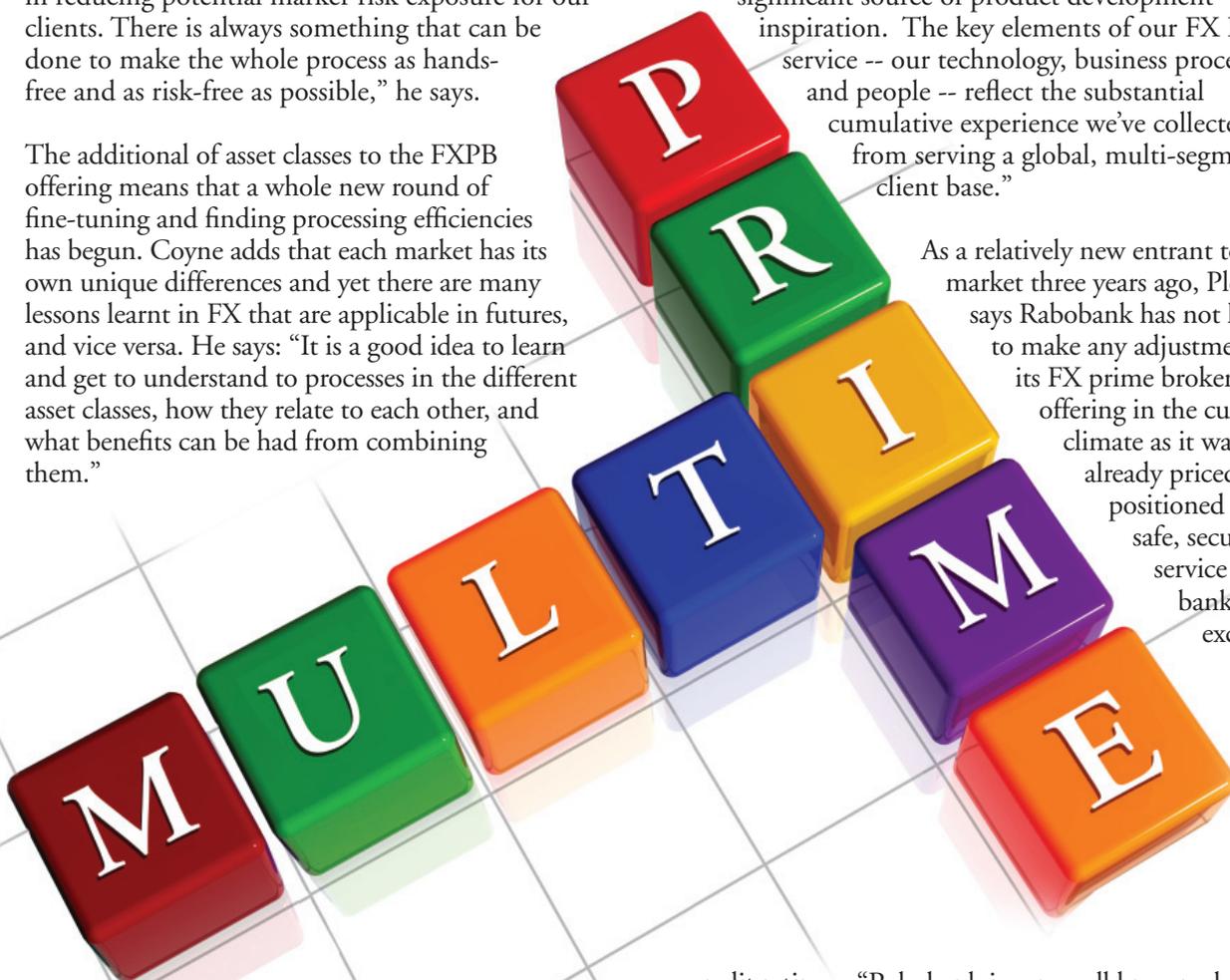
“One illustration of this is in the way we have sought to optimise margin efficiency for our clients. For example, we have a lot of clients trading currency futures on the Chicago Mercantile Exchange and who also trade spot FX. Much of this client base will be engaged in arbitrage activity between the futures and cash markets, and so we offer some very creative margin regimes that enable us to margin the client, on a portfolio basis, across those two asset classes, and in real-time as well as providing all the reporting and collateral in one suite.”

Citi's Coyne too is in little doubt that FX prime brokerage is still a technology play and there is still a drive towards processing gains. "There will always be another way of looking at workflow and speeding up the real time processing aspects of what we do, in reducing potential market risk exposure for our clients. There is always something that can be done to make the whole process as hands-free and as risk-free as possible," he says.

The additional of asset classes to the FXPB offering means that a whole new round of fine-tuning and finding processing efficiencies has begun. Coyne adds that each market has its own unique differences and yet there are many lessons learnt in FX that are applicable in futures, and vice versa. He says: "It is a good idea to learn and get to understand to processes in the different asset classes, how they relate to each other, and what benefits can be had from combining them."

Pla says the drive for product innovation in FX prime brokerage is coming from the evolving needs and service expectation of clients. He says: "The requirements that result from the ongoing development of our clients' businesses remain a significant source of product development inspiration. The key elements of our FX PB service -- our technology, business processes and people -- reflect the substantial cumulative experience we've collected from serving a global, multi-segment client base."

As a relatively new entrant to the market three years ago, Plester says Rabobank has not had to make any adjustments to its FX prime brokerage offering in the current climate as it was already priced and positioned as a safe, secure service from a bank with excellent



Technology a differentiator

Coyne believes that a successful prime brokerage model relies upon technology, which is still a differentiator, overlaid with staff expertise and good servicing. He says clients will judge the quality of a prime broker on a few fronts but technology, and commitment to technology, is still top of the list.

Pla, at UBS, believes that transaction processing and clearing lends itself to continuous improvement so he does believe that FX prime brokers will find still more efficiencies in the process, and the improvement in straight through processing rates for exotic options is, for him, one example of where the FXPB industry has made significant progress.

credit ratings. "Rabobank is very well known globally as a leading F&A bank. It is also prominent as one of the strongest and largest financial institutions out there.

"We provide many large companies and financial institutions with the tools they need to help them control risks. Our FX prime brokerage service is one of those tools helping our clients achieve best execution by giving them access to the tightest pricing and deepest liquidity. Asset managers and pension funds for example can now get direct access to the market instead of outsourcing as they have done in the past."

The bank has started white labelling its prime brokerage services for other platforms and has recently added some new platforms including the multi-bank trading platform, FrontierFX, bringing the total number of connections to ten different trading venues offered.



Peter Plester

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Customer service

The increasingly competitive landscape of the FX prime brokerage market has placed customer service firmly at the top of a prime broker's priorities and this is something that Rabobank, as a mutual bank, prides itself on. "Our focus is firmly aligned to our clients and how we can help them achieve their goals".

Plester says: "As a bank we have access to fantastic pricing and liquidity, and to be able to keep these standards high, a lot of work is done to ensure we offer the best products and service that we possibly can. Giving the customers what they need to make their business a success is our core function as a prime broker. We ensure they definitely notice a huge improvement in customer service with Rabobank."

A relatively new trend in the market has been the growth of the multi-prime brokerage model and Plester believes that Rabobank is the fully integrated and sole prime broker for the vast majority of its clients. There has been some interest in the past few months from customers looking to Rabobank as a second prime broker as they seek to diversify concentration and operational risks following recent events in the prime brokerage market. He adds that while some customers do run the multi-brokerage model, others eventually choose one after a period of time and go with one broker.

This is partly down to the fact that costs and the gains from operating efficiencies are still an issue. The number of tickets put through is still a cost and Plester

says that the bank's offering of netting of tickets for customers is the biggest increase in operational efficiency the bank has seen. "Our system allows our clients to net tickets across multiple venues, net the tickets at the time that they choose, and as frequently as they need to, and gives them control over their processing volumes and associated costs," he says.

Straight through processing is offered for all trades going through Rabobank's prime brokerage service and if it does not go straight through then users can net the tickets to decrease the workload. They also have the ability to monitor ticket flows, positions and P&L in real-time with everything displayed on one screen.

Plester says that new FX prime brokerage customers are coming on board as their business grows as once firms get to a certain level of volume there are big benefits in using a prime broker. Additionally, if firms want to access different venues a FX prime broker becomes a necessity rather than maintaining connections to multiple venues in-house.

He says: "It depends very much on the customer type. For fund managers it is about broadening their access to prices with a larger number of counterparties. For banks, it's all about access to prices and rather than setting up numerous credit lines they can plug into Rabobank and concentrate their exposure to one counterparty, which is triple A rated. There is a huge amount of costs involved in reviewing hundreds of different limits, for different banks, every year. Using a prime broker cuts down on the cost, back office workload and maintaining so many credit limits."

New entrants

Just as the prime-of-prime model is gaining traction, Plester also believes there will be still more new entrants to the FX prime brokerage market, as a big area of growth is coming from ex-traders from banks, who, by becoming prime brokerage customers, can get the same access to prices and credit.

For UBS's Pla, the increase in FX market participation is encouraging further investment among service providers, in order to capitalise on new perceived opportunities. "FXPB is among these areas of investment," he says. "It is fundamentally a credit intermediation and clearing service that naturally complements the relatively fragmented FX execution landscape in which we operate. Stability and scalability of all trade processing and client service elements, combined with the benefits of an integrated cross-product prime brokerage platform, will distinguish the leaders in FX PB going forward."