

Superior Client Servicing: the key to meeting demand for FX Prime Brokerage



Frances Maguire

Now that dust from the financial crisis is beginning to settle, Frances Maguire explores how prime brokers are upping the ante on providing superior client servicing in order to fuel the next round of growth.

Few would disagree that FX prime brokerage is a technology game but as the market matures it is becoming harder to compete on technology alone so FX prime brokers are setting their sights on broadening their offering to include multi-asset class prime brokerage and differentiate themselves by offering superior client servicing.

The message coming from the regulators on both sides of the Atlantic is that clearing for over the counter (OTC) instruments is likely to be required.

This has prompted an anticipated new round of growth as institutions look to bring listed and OTC products onto one platform, perhaps developing cross-asset capabilities in doing so.

Different trends

According to Gil Mandelzis, CEO of Traiana, there are different trends arising from the various client segments using FX prime brokers. He says: "At the highest level of automation – the high frequency players and the retail brokers - the whole notion of being able to process tickets in real-time and the ability to provide aggregation and netting is of top priority. These clients are looking to optimise real-time capability, and want unlimited capacity and real-time reconciliation at a very low cost."

Another important client segment is the emerging prime-of-prime players, who are, in essence, both clients of the traditional prime brokers but also have prime brokerage clients themselves. "This is a segment that really started emerging a few years ago. It has been growing very significantly recently as credit has become more expensive and players have become less interested in becoming prime brokers with their own balance sheets. Instead, they are relying increasingly on the large banks for that purpose."

Mandelzis adds: "We are definitely seeing a very significant number of asset managers that are emerging now as new clients who are seeking FX prime brokerage relationships and who are not used to being FXPB clients. These are characterised by relatively complicated workflows and the prime broker has to be able to accommodate these very complex workflow and portfolio structures to include portfolio allocation, averaging, and aggregation services."

An important client requirement relating to FX trading, for the high frequency traders as much



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as the CTAs and the asset managers, is the ability to manage across asset classes, at the very least for reporting and position keeping purposes, but quite often beyond that in terms of cross margining, futures and over the counter (OTC) products. "A lot of these clients are trading FX cash and futures all day long but they are trading each on separate systems and dealing with separate desks within the banks, and therefore they receive reports from separate reporting systems. So, in actual fact, the behaviour of the client is not reflected in the way the bank is reporting back to them. This is definitely a very significant need which is accommodated by the leading prime brokers," says Mandelzis.

He adds: "If you look at the world from a FXPB perspective, there is obviously much work that needs to be done on rates and credits and other products, which many players are investing in, but from an actual flow perspective not a lot exists yet. Most of the flow is still in FX and futures, where the offerings are pretty comprehensive, but complete cross-product post-trade processing is where the industry ultimately needs to get to."



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once there is a clearer picture of the future regulatory treatment of OTC and FX options,” he says.

Shift towards FX Prime Brokerage

Mark Mc Donnell, managing director, head of FX Prime Brokerage Sales, EMEA, at Bank of America Merrill Lynch, says: “The financial crisis meant that a number of FX players left the market and this forced a reassessment and a shift towards FX prime brokerage as a mechanism to mitigate some of the risks involved in foreign exchange trading.”

Added to this, McDonnell says that there is also a growth in the population of clients, mainly from the real money environment, which have been trading other asset classes beyond FX, who are now becoming more active in foreign exchange.

This has prompted an increasing demand for enhanced levels of FX prime brokerage in a multi-asset class environment and has afforded a post merger Bank of America Merrill Lynch the opportunity to reposition its FXPB platform to maximise the synergies with other businesses such as Global Futures, Derivatives clearing and the UCITs platform. In addition, the Bank continues to add client service personnel globally and restructure client services to support a prime brokerage offering that will enable clients to trade across asset classes in a more integrated way in terms of margining, reporting and how prime brokerage services are delivered.

McDonnell stresses that market leading, robust, scalable technology is the backbone of a successful prime brokerage business. “It obviously affects how we connect to the client, how we connect to the market, and it also dictates how we manage risk on a real-time basis, both in terms of FX and in terms of other asset classes,” he adds.

Bank of America Merrill Lynch continues to invest heavily in building out the technology platform that supports its FX business. The foreign exchange prime brokerage component is core to the overall FX offering and according to McDonnell FXPB has, and will continue to benefit from the technology and process engineering initiatives that are driving the expansion of the Firm’s FX franchise globally.

The diversity of client types worldwide has meant that the Bank of America Merrill Lynch business plan looks at providing FXPB solutions across the entire FX investment cash flow and looks to deliver a

consistently high-level of service quality globally, but able to be managed to local client requirements and different regional regulatory regimes.

In terms of value added services, McDonnell says that the realignment of the FXPB business with the wider prime brokerage offering has resulted in FXPB clients gaining access to the bank’s capital introduction service, asset gathering capabilities and various distribution engines, as well as the services of a hedge fund consultancy group for new managers.

Qualifying criteria

To be an effective prime broker today, McDonnell believes there are certain minimum qualifying criteria. They are: the overall credit and liquidity profile of the prime broker; a market leading and open architecture technology platform; an efficient client on-boarding and integration process; superior client servicing globally; and the value-added components, such as capital introductions and other consultancy services,

which are becoming increasingly more important in the decision to award prime brokerage mandates.

“The credit quality of the prime broker and the ability of the prime broker to offer various client money protection solutions to mitigate the client’s exposure to the prime broker have become critical,” McDonnell says. “Most importantly, consistent delivery of excellent client service will be the key feature in keeping that client and encouraging that client to divert more volume your way.”

Jason Vitale at Deutsche Bank says that today’s FXPB clients are in a position where they are looking for a provider to navigate their business in a changing marketplace, whether this change is coming from pressure from increased regulation, or continuing compression of bid/offer spreads, or even credit trading strategies in their particular asset class, they feel need to have a platform provider to help them alleviate the stress of change.

For this reason, over the past 18 months, Vitale says that Deutsche Bank has focused on putting together a platform that can ‘plug and play’ different asset classes and different services in a toolkit where the client does not have to worry about a lot of these stresses.

He says: “The client service element of this platform is not a service but core to the actual platform we are providing. We made a decision some time ago to put out FX client services along other asset classes, both OTC and listed products, so that by cross-aligning the FXPB client services, our team is able to share processes and client tools.”

Vitale says that it is easy to take various products and teams and “smash them together” at banks but the danger is that the actual value-add provided in the particular product silo can be saturated and lost. “Our view is to keep the product silos working in isolation but find interesting ways to make them work together, whether it is at the front end delivery to the client, or a combined escalation point, in terms of client services, or a combined margin or settlement approach. The most important point is that you do not saturate, or that you lose your FX expertise. We are very fortunate to have an extremely experienced stable FXPB client services team.”

Deutsche Bank has aligned all of the OTC and listed products under its dbClear banner, covering FX, interest rates, credit derivatives, listed futures and options and equity derivatives, to bring together sales, client services and the platform in a combined way for the client.



Mark McDonnell

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Integration

Integration with the clients’ order management and reporting systems will also become a focus of attention as prime brokers provide new asset management clients with full STP in dealing with allocations, aggregations, averaging, reconciliations and confirmations. The recent partnership between Traiana and State Street has further strengthened the Harmony network as a communication platform for the industry by both adding clients to the network as well as providing significant enhanced capabilities for receiving messages in a specified format from a variety of sources. “One way or another, prime brokers will need to be able to take those files and messages from the asset managers and the CTAs and enable complete STP of the workflow,” says Mandelzis.

A noticeable impact of the credit crisis on the FXPB landscape has been a rethink on the number of prime brokers used. Sophisticated players realised they were overly concentrated and as a result added to the number of FX brokers they used, quite often as a back-up. At the same time, according to Mandelzis, there is a new trend. “This systemic shift is behind us and those who are going to diversify have done so. However, we are now seeing almost the reverse, where an asset manager, who used to trade with 10 or 20 players, is now realising they don’t like exposure to so many counterparties and as such they are actually reducing the number of counterparties they are exposed to by moving to an FXPB model, away from bilateral.”

For Mandelzis, spiralling volumes and capacity issues are still an issue in the industry. A year or two ago, the industry started addressing this, both as an industry and as individual firms, and progress has been made. But work still needs to be done as the process is still ongoing.

“Foreign exchange as an asset class will keep growing at a very significant pace, and within FX, prime brokerage will continue to be a dominant offering. As a result of this growth, there will be additional segments that will become prime brokered. Beyond this, cross-asset trading will become a significant play,

Regulatory pressures

Vitale says that the demand for a cross-asset clearing offering is coming from the expectation that regulation originating from the US will require clients to be smarter about how they manage their portfolio, primarily ensuring they are efficient about how they navigate their margin portfolio and settlement portfolio. "This puts the onus on their clearer to find more creative ways of pulling everything together," he says.

Additionally, irrespective of incoming regulation, Vitale says that clients are already asking about how they can pull both the listed portfolio alongside the FX OTC portfolio, and he believes that finding ways to bring listed and OTC instruments together in FX will enable providers to prepare for the OTC initiatives on the regulation side.

However, building all the services in one location is not without its problems, for example the ability to handle increases in volume and services offered. "The way forward is the modular approach, both in terms of the underlying products and services, such as reporting, margining and settlement, so one platform is not being overloaded nor being the central location of development."

In the past, clearers would highlight the number of trades they could do in a day or a year, but now, with the kind of volatility and volumes being seen, the importance is in how many trades can go through a throughput process within seconds. "These two dynamics, throughput versus capacity, are much different from the perspective of trying to plan architecture. What Deutsche Bank is focusing on is ensuring that throughput is maximized at every stage in the trading lifecycle of the platform. Vitale says the need to strive for the best technology will never go away, nor will the need for flexible integration, but alongside the importance of investment in IT infrastructure, is the expertise, and the stability, of the prime brokerage team.

"We are coming to an inflection point in the terms of our industry and it will quickly separate the 'haves' and the 'have-nots'. Those who are ready for changes in how trades will be both executed and cleared within foreign exchange will be differentiated from those that are not ready to adapt. It is very clear from what is coming from the regulators, that our current modus operandi within foreign exchange prime brokers, or FX clearing, is about to dramatically change," he says.



Jason Vitale

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He believes changes in regulation will mean a whole new area of underlying clients, such as the asset and fund managers, will require FX clearing. Historically these services have been designed for hedge funds but now this will dramatically broaden out and Vitale believes that FXPB clients are looking to partner with the provider which is best positioned to adapt its current offering to the final outcome of the regulation that is passed in the next 18 months.

Superior client servicing

But Peter Plester, head of Prime Brokerage at Rabobank International believes that there is still everything to play for in terms of offering superior client servicing levels because the FX market is still very attractive to new entrants and still growing rapidly.

For Plester, high on the agenda in client servicing is the requirement for connectivity and integration to what is increasingly becoming a more fragmented and complex marketplace as it copes with the rapid growth and spiralling volumes. "Even for banks coming into the market, getting limits set up on the myriad of FX

platforms is a laborious process and plugging into a prime broker means one connection and one limit, making it much easier," he says. "There is a very wide range of venues, from the single bank platforms to platforms with API access for high turnover trading models."

He says that new customers will either want a specific platform or just a need for access to the market so Rabobank will prepare the legal agreements and onboarding documentation the client's behalf to make getting up and running as easy and speedy as possible. We even fill out all the forms for them, so if they are happy the details are correct all they have to do is sign. Plester adds: "They can use Rabobank's single bank platform, that can be live in a matter of days, or if they want to use any of the 15 multi-bank trading platforms we offer connections to, we can provide them with the contacts to the different platforms while integration work gets underway."

While he says the multi-prime customer has become more prevalent since the financial crisis, the multi-prime customer is treated as a new customer, regardless of whether Rabobank is being employed as a back-up or an equal prime broker, rather than a specific new customer type.

Technology

FX prime brokerage continues to be a technology play and remains high up on the list of priorities when firms are choosing a prime broker. According to Plester, being a relatively recent entrant to the FXPB

market gives Rabobank an advantage over the more established players because its FXPB platforms has been designed around providing a full STP solution.

He says: "Being 100 per cent STP, maximises system volumes, clients get real-time reporting via our Client Position Monitor (CPM) application, with no bottlenecks or capacity issues. This frees up our time to deal with client requests and servicing the clients rather than inputting tickets. We also spend a lot of time monitoring our volumes and checking our systems are as future-proofed as they can be."

He adds that during the spike in volumes earlier this year, in May, meant that a lot of prime brokers and banks had to look at their systems to check how it dealt with it. "It was a good stress test scenario for us and everything worked smoothly. The netting solution embedded in Rabobank's FX prime brokerage offering meant that clients could net their tickets reducing throughput. As volumes increase and as clients access multiple platforms, needing tickets to be processed from several different venues, technology and the management of operational risk are becoming increasingly more important parts of the service level provided."

According to Plester, along with the credit rating of a prime broker, real-time reporting systems, netting ability, Rabobank's aim is always to provide clients with the tools they need to optimise their business. "If they request additional services, we do our best to try and provide them."

He believes that the choice of prime broker





Peter Plester

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comes down to credit rating, customer service, quality of systems, ease of on-boarding and price. He says: "Service definitely comes further up the scale than price. They need to know if they send an email it is going to get answered quickly. We are available 24 hours a day out of three regional hubs (London, New York and Hong Kong). Being a cooperative bank, the client is central to practically everything we do and this really helps us to build long-term relationships with them."

Fragmented liquidity

Ed Pla, managing director, global head of FX prime services at UBS says that continued technology investment and innovation has allowed an increasing number of market participants to function as market makers, and as a result, liquidity continues to fragment. "This is driving demand for OTC clearing services to provide access to more diverse sources of price discovery. Client service is now recognised as a differentiator. A well-organized team equipped with

the proper tools, training and controls can drive both business origination and client satisfaction," he says.

Pla believes there are no short cuts to building and growing a substantial infrastructure business. He says that FX prime brokerage is truly a front to back business that requires time and attention directed to all the components that contribute to the client experience. "Trade capture, trade processing and settlement, risk management and database configurations are all examples of areas that must be analysed for capacity and optimised for performance in order to support a top FX prime brokerage franchise."

Furthermore, he adds, automated processes, controls, reports and other utilities are the essential tools in the toolkit for managing the operational risks inherent in FX prime brokerage. He believes that technology innovation and responsiveness are essential, and help define an FX prime broker's offering and their commitment to the business.



Ed Pla

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Pla says that he sees the factors that may ultimately influence how clients choose their FX prime broker are very much influenced by the technical link-ups needed but cross all aspects of the business.

He says: “Selecting an FX Prime Brokerage provider is a substantial decision as it entails close operational linkups that are often essential for the conduct of a client’s business. Clients committing to this degree of operational dependence increasingly emphasise financial and operational excellence. And in an increasing crowded and competitive landscape they want to see demonstrable, tangible examples of excellence in all areas of the business including IT capabilities, sales and client service personnel, client on-boarding, risk management methods and reports, collateral management services and cross product PB capabilities.”

Regulatory uncertainty

David Reid, director, Global Head of FX PB Sales, at Citi believes that the increase in demand for FXPB is coming from regulatory uncertainty, which is encouraging clients to examine the different clearing solutions that prime brokerage provides access to, as well as a continued recognition that FXPB provides an efficient way of managing both risk and collateral.

For this reason, Citi has placed a greater focus on increasing on-boarding efficiency. Reid says: “This is both about technology and people. Technology is important in making sure the APIs are flexible and simple to integrate to with well specified coding and testing environments, but it is the people who make the difference. Dedicated on-boarding teams, who navigate clients through the process efficiently, with expectations well managed, and an ability to cut through the various bureaucracies inherent in banks, are highly valuable and make a huge difference to the clients’ initial relationship experience.”

Regardless of whether the client is a newcomer or a highly experienced multi-prime client, Reid says that flexibility, and the ability to integrate clients in the way that works best for their workflow, is crucial.

In terms of growing volumes and processing capacity, Reid adds that Citi constantly examines its internal capacity to ensure it is building well ahead of the curve. “This is within both prime brokerage and the wider FX infrastructure. We also work with the broader industry to ensure that the industry wide conduits have the capacity we believe will be required,” he adds.



David Reid

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Conclusion

Reid believes that, in many cases, FX prime brokerage is the doorway to the whole bank and with the likelihood of increased regulatory demands for the treatment of OTC instruments, how well the prime broker services these complex areas will become a differentiating factor for clients choosing a prime broker, to fulfill more onerous clearing requirements and in the race to provide multi-asset services.

He says: “Client service will always be the key differentiator. Clients are ever more discriminating in their choice of prime brokers and rightly demanding of high levels of service and technology to meet their needs. Prime brokers who don’t meet these requirements, and make the investments in people and technology that support them, will inevitably suffer.”