Risk 25 Firms of the Future

MISYS

Risk 25

Risk 25 | Firms of the Future

With over-the-counter derivatives markets in flux, picking winners and losers is a tough job. This is where *Risk's* editorial team nails its colours to the mast. By **Lukas Becker, Matt Cameron, Laurie Carver, Clive Davidson, Ramya Jaidev, Peter Madigan, Mark Pengelly, Joe Rennison, Nick Sawyer, Michael Watt** and **Duncan Wood**

Anyone who wants to understand how OTC derivatives markets are changing should keep an eye on the 74 organisations named overleaf – our *Firms of the Future*. These are the dealers, buy-side firms, brokers, exchanges, technology vendors, clearing houses, regulators, infrastructure providers and trading platforms we believe will be most influential over the next five years.

Compiling this kind of list is tricky at the best of times, but when the OTC market – plus prudential regulation and the banking industry more generally – is changing so dramatically, it becomes even harder. We will undoubtedly get things wrong. Some of the names on the list may fade from view by the time *Risk* celebrates its 30th anniversary, and names we have ignored will surge to prominence.

Two or three years ago, some of these organisations would not have featured – without new trading, clearing and reporting rules, established companies like BNY Mellon, State Street and the Depository Trust & Clearing Corporation (DTCC) had no obvious role to play in the OTC market. As evidence, look at Citadel and CME Group, which had been knocking on the door for years – they too will now have a say. Other names did not exist at all – Eris Exchange, New York Portfolio Clearing (NYPC) and Regis-TR, for example.

The fortunes of many of the listed firms are bound tightly to the market's new rules, which is why we include the regulators as well. One example is TriOptima's new service, triBalance, which has dealers queueing up to praise it, but requires a regulatory safe harbour to work. It may simply be too late in the day for that to be forthcoming. Another instance is Project Trinity, the clearing initiative being explored by LCH.Clearnet, the DTCC and NYPC. It is conceptually elegant, but requires a way of calculating margin offsets across three types of asset at three different clearing venues. That requires careful regulatory scrutiny but if it can be made to work, it could be a genuine alternative to the vertical business models at CME Group and Eurex.

With lots of twists and turns to come, it should be an interesting period – and we're happy to be reminded of our choices in 2017.

Technology

New regulation will force banks to make dramatic changes to their business models, and technology providers are adapting accordingly. Rather than focusing on complex financial engineering, dealers are now more concerned about clearing, liquidity, funding, collateral, documentation and regulatory compliance. This means banks need systems that can provide rapid valuations and real-time risk management – and, crucially, it means storing, sifting through and making sense of huge amounts of data.

But while the demand for computational power and data storage is rising inexorably, IT budgets are not. Gone are the days when bumper profits enabled every trading desk to indulge in a bespoke system. It's not just cost constraints either – the need for aggregated risk analysis will no longer allow fragmented technology silos. Banks need more integrated and efficient IT infrastructures, and system vendors realise they have to provide increased capabilities at lower cost. Hence the continuing consolidation among vendors and the drive towards powerful but cost-effective technologies such as parallel processing and cloud computing.

Misys

When US private equity firm Vista Equity Partners finally won its battle to take over Misys on June 1 – merging it with Turaz, the technology business it bought from Thomson Reuters in February – it created a new giant in trading, risk management and core banking systems. Vista had fended off Misys when bidding for Turaz, then turned its guns on Misys itself, retaining the name for its merged business.

The new Misys portfolio includes the Summit FT derivatives trading and risk system, the Kondor+ cross-asset trading system and an accompanying suite of risk and financial applications. Those products were designed during more buoyant times, but Bret Bolin, the chief executive brought in by Vista to take charge of Misys, believes while nervous markets and incoming regulations may be bad news for banks, they are good news for technology vendors. "Regulatory changes and uncertainties are our best friends. Change means new challenges that need to be addressed and new capabilities that will be required to achieve them," says Bolin.

The most fundamental challenge for many banks will be hitting profit targets – and Bolin argues the industry will increasingly lean on technology to do so. "The industry has already applied all the traditional levers it uses in a crisis, such as reduction of discretionary spending, cost cutting, pruning business portfolios and selling non-core or unprofitable businesses. But it's not enough. Some experts suggest the banking industry as a whole needs to find another 5% margin to return to the pre-crisis return-on-equity levels," he says.

Banks can do that in a variety of ways, Bolin claims – making trading infrastructures more efficient and scalable, improving data management and developing globally consistent, scenario-driven valuation frameworks. Banks also need advanced processing abilities to cope with increasingly large and complex computations. "We don't believe there will be one killer application that solves all of a bank's problems. Instead, there is a need for a consistent drive towards better performance across multiple dimensions," says Bolin.

Bret Bolin, Misys

Credit value adjustment (CVA) is one example of the extra processing capabilities banks need. "New technologies and mathematical approaches are enabling near real-time calculation of CVA on commodity hardware that costs less than $50,000," says Bolin. Misys has been applying vector computing – a form of high-performance parallel processing – to CVA, and Bolin claims the results have been "extremely encouraging".

The company is ploughing its research and development (R&D) resources into a number of other areas: more interactive user interfaces with more functionality (so-called rich internet applications), workflow processes that can cross boundaries between individual applications or even institutions, supporting more flexible and collaborative business models, and the flexibility for users to select at run-time exactly what they want to price, with what market data and for what type of scenario. Another research area is cloud computing. "Cloud is absolutely key to achieving the levels of scalability and cost-per-trade economics the industry is heading for," says Bolin.

The current high price of trading and risk technology is a legacy of the pre-crisis era, says Bolin – when profits were higher and systems costs were less of an object. The performance of systems from this era is "stellar", as far as quants and traders are concerned, he says, but the same is true of the prices. "There is growing pressure for the industrialisation of derivatives trading and risk management technologies, and it is starting to happen," he says.

This does not mean the technologies will be utility-like. "Despite the troubles the industry has been through, it still attracts some of the smartest and most motivated university graduates in the world. There is a huge degree of innovation going on – and the rate is not abating, but increasing," says Bolin. The development of the next generation of lower-cost, industrialised trading and risk management applications will require even more engineering talent and large scale R&D. As a result, vendors will need added heft to succeed, he predicts. "The consolidation of this industry has just started." ■