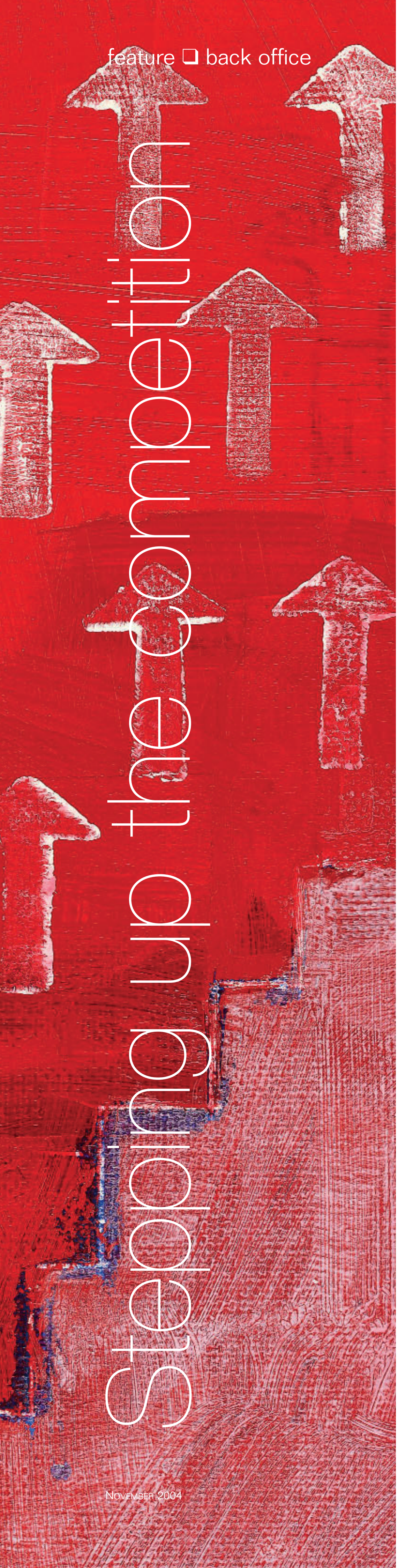

Stepping up the competition

New back office technology is threatening the old guard duopoly. The quiet evolution is taking the industry to new heights, as **Emma Davey** discovers

Changing dynamics in the exchange traded derivatives arena have resulted in renewed focus on the back office. With reducing commissions in clearing, the only real fat in the trade comes from the efficient use of collateral and margin on deposit. Combined with the need to cut costs in the back office to improve performance, this trend has led to demand for increasingly efficient back office systems, offering a variety of functions, with flexible delivery.

Unlike the front office, however, which witnessed a revolution in trading software with the rise of the independent software vendor (ISV) in the late 1990s, as electronic exchanges opened up access to their platforms, the back office has experienced a quieter change. Where traders can choose from a dozen or so front-ends, the back office has been dominated by two major suppliers, Rolfe & Nolan and SunGard, for much of the past two decades. Two younger, and some would say more nimble, suppliers, Exchange Systems Technology (EST) and Ubitrade, meanwhile, have extended their reach to provide alternatives to the old guard duopoly.

One of the difficulties with the existing set up is that clearing firms have traditionally settled on one provider and stuck with them through thick and thin, holding to the view that a wholesale change in supplier would be an expensive and painful process. As Patrick Thornton-Smith, md of MarginClick, the ASP margin calculator offered by EST, suggests, the common view is that changing front end systems is like changing your girlfriend or boyfriend – it might be tricky and uncomfortable, but you'll get over it. Changing your back office system, however, is like having a sex change – you'll only do it once and it will be painful, so you had better think long and hard beforehand.

Yet changes in technology architecture are making that decision process a less difficult one and leading to a wider choice for back office managers. Today, they can pick from complete in-house systems, such as SunGard's GMI or Rolfe & Nolan's RANsys; facilities management; or a bureau service, which in turn is increasingly offered in an ASP environment; or separate modules for individual services.

Given the age of some of the systems available, and the comparative cheapness of delivery through ASP, why are vendors still offering in-house products? As Steve Auerbach, president of SunGard Futures Systems says, a firm's choice of in-house solution or ASP delivery depends on its business environment, business model and, particularly, its IT infrastructure. "Many firms are outsourcing the IT infrastructure to our ASP environment," says Auerbach. "However, many firms find it more appealing to keep the application running in-house, due to security concerns, infrastructure consistency, etc. SunGard Futures Systems provides the same application for both these solutions and offers the flexibility for a firm to choose whatever solution fits their needs."

He agrees, however, that the concept of standalone products is something of the past. "What we are finding is that creating a solution that is easily integrated into the firm's upstream and downstream functions for the internal infrastructure, as well as the external world, is paramount."

Rolfe & Nolan has a similar stance in offering clients the choice of in-house, through RANsys or RISC, facilities management, the bureau option or ASP, depending on the client's needs. "It is geared a lot by volume," explains Colin Wade, European sales director. Paul Miller, European coo, adds: "As volumes go up, people are less inclined to stick to a good 'start-up' service (ie the bureau) and migrate seamlessly to our FM and in-house solutions."

It also comes down to geography. As Wade explains, the Singapore market tends to go for pc-based products because they are domestic players; RISC is predominantly used by US clients because it is IBM based, whereas Europeans favour RANsys.

Despite this variety, the costs of maintaining systems, and improvements in technology mean there is a definite trend away from in-house system to a facilities management or ASP environment, acknowledges Wade.

ASP benefits

Certainly, the newer vendors in the market, unencumbered by the baggage of history, have recognised the benefit of the ASP environment from the start. EST, founded in 1995, has been harnessing the internet to deliver quickly and securely since inception. Brian Ash, head of business development at EST, comments: "The bulk of people in the industry are using [back office] technology that is very old." The ASP model, he says, cuts down the huge time and cost of change. Because no hardware or internal infrastructure change is needed, EST now looks for a system implementation in weeks, not months.

Minimising the risk of change is vital for customers – it is notable that few announcements of signings are for 'new' customers, particularly for the older R&N and SunGard systems. In addition to the ASP model, one way of minimising risk is through the delivery of componentised services. R&N has made the most of this approach, with its much trumpeted 'next generation' Merlin service.

The aim of Merlin is to provide the 'value adds' that clients are looking for, says Miller. "No one is going to wrest away a tier one bank from any of us," he explains. "The risk of change is significant for people."

Merlin is a suite of modules that are platform independent, standards-based and cross-asset capable. The modules cover a range of key business processes such as commissions, margin and exchange connectivity and have already been adopted by some investment banks and their customers.

The modules approach means that clients will not necessarily take all their services from one vendor. "They will want the things we do best," says Miller.

But R&N is pragmatic. While Merlin may be its ultimate goal, it is all about evolution. "We won't force it on people," Miller adds.

Andrew Hobbs, head of business development at Ubitrade, agrees that it is wrong to expect 'Big Bang' style changes. Ubitrade offers the flexibility for clients to adopt a component based approach if they so choose. "We have the functionality to minimise the risk of change in trying to provide modules that replicate what is being provided at the source." Some migrations can cost, says Hobbs, and Ubitrade is aware of those concerns.

Naturally, not everybody agrees that the full modular approach, such as Merlin, is right or even necessary. At SunGard, Auerbach says there are certain functions that can be broken out in a modular format. "However, after looking at the entire market picture, we concluded that strategically, this is not the best business model to pursue, primarily due to speed of market change," he says. "Modularisation of a multi-functional product such as GMI creates barriers in the ability to deliver a complete system and causes greater expenses in time and resource for the firm, especially in regards to technology and maintenance costs."

Recent events have shown that the listed derivatives exchange community has been very dynamic by introducing many changes to its processes. "In order for a vendor as well as the firm to be prepared for these dynamic changes in an efficient manner, there must be a coordinated effort on all fronts. By adding different modules to the mix, with different technical backbones, dissimilar protocols and varying delivery mechanism cycles, a firm's ability to change is slowed," he says.

"We are always watching for technological breakthrough to help ease these issues. But until then, the cost of integration is just too expensive," Auerbach concludes.

Value adds

It is clear that the value adds described by Miller as a means of introducing change is in many ways also a way of accessing potential new clients. EST itself illustrates this approach. Its launch of MarginClick last year, opened the door to a range of new customers, attracted by the low cost ASP margin calculator. The firm has grown from four clients last year for its Eclipse service to 11, with its overall customer base, including those using MarginClick, growing from just five a year ago, to an expected 35-40 by the end of this year.

The latest product in the EST 'toolkit', RiskWatch, is another example of the shift in positioning among back office vendors. New technology and real time processing enables vendors to capitalise on the growing need for post trade risk management. According to Thornton-Smith, to date, post trade risk management has been pretty basic, with services provided by ISVs very much centred around 'fat finger' and quantity limits. "Electronic trading has changed the world," he says. "We now have a situation where risk is assessed within the sub-second, but the old technology in the back office is still T+1. This disconnect has to change as clients are looking at risk on a far wider basis." Clients want alerts on back office parameters such as cash, collateral, risk based margining.

Post trade risk management is all about putting all the account information together, collecting a variety of data from different sources into one pot and allowing the user to take its own view on risk. Risk appetite varies from user to user, says Thornton-Smith. "A Mac Futures or Schneider will have a different view from Barclays or Deutsche," he points out.

"Once the data is in, you define how the risk is assessed, then we value it for you online," he explains. The service also enables brokers to pass on information to their customers on their respective risk positions. "RiskWatch is fundamentally a data warehouse that brings risk management in to the 21st Century."

Cross-asset

If the vendors are divided about the future delivery of their services, one thing they all agree on is the need for cross-asset functionality. "Customers want single statements," says EST's Thornton-Smith. "They want the equity, the stock options, the single stock futures, all offset on a single piece of paper."

And the rest of the market has a lot to gain from the exchange traded derivatives sector. As SunGard's Auerbach explains: "The listed derivatives community has the best track record for processing large amounts of transactions in a secure and cost effective environment. The benefits of the clearinghouse, coupled with the advances in technology, have allowed what are traditionally known as OTC products to be cleared."

SunGard has also embraced these changes, he says. "Swaps, repos, bonds and the CCP initiative in Europe are important aspects of our strategy to ensure that our client base can process these instruments as efficiently as possible. Many of our clients are now processing these instruments on GMI."

The other vendors have a similar approach. Rolfe & Nolan has covered repos, bonds, OTCs and so on for many years, says Wade. Contracts for difference (CFDs) are one area in particular where it has seen much success with a number of clients using the vendor for its CFD functionality.

EST also prides itself on its ability to handle a range of products. Eclipse was built with a multi-product environment in mind so its coverage goes beyond futures and options to include swaps, CFDs, equity and bonds. The world's financial markets are converging, says Thorton-Smith, so EST's approach is to allow users to 'decommission' say three silo systems into one.

Growth opportunity

Although there are some new players out there – witness the bids to gain the Icap Futures business for example, ultimately won by Rolfe & Nolan – they are in short supply. And while the long-held view is that change is painful and hard to achieve, there are signs that resistance to change is shifting. Ubitrade's Hobbs suggests that while a lot has been said about being a closed market, the opportunity for change is there. "There is a huge amount of under servicing and people are not getting what they want."

Add to that, he says, the need to mitigate vendor risk – alluding to the threatened acquisition of Rolfe & Nolan by SunGard at the end of the 1990s – and you have a market potentially looking for new suppliers. "There are not too many new players, but there is a big market for migration if the current vendor is not delivering on service and quality."

EST's Thorton-Smith goes further. "Many firms are being massively overcharged by the traditional duopoly vendors," he says. "If you are supporting three systems and writing a new one, all on different platforms and in different languages, then of course the client base is paying well over the odds. Support and maintenance is being passed on for systems enhancements and support that one quarter will never use. It's simple mathematics. One single database application means economies of scale and a far more realistic charging structure."

Certainly the more flexible offerings now provided by back office vendors has threatened the old guard duopoly and is making the market for back office systems a more dynamic one than it has been in the past. ❑

Rolfe & Nolan

History:

Established in 1974, before financial futures were even invented, by Malcolm Rolfe and Iain Nolan. The company was listed on London Stock Exchange for many years, before delisting and undergoing a management buyout in 2003, with funding by venture capital firm, HgCapital.

Products:

RANsys is Rolfe & Nolan's comprehensive real time back office processing system for exchange traded futures and options. It also handles CFDs, OTC instruments and foreign exchange transactions.

The **RISC system** is a fully integrated business solution for global derivatives back office processing, providing firms with high quality trading, clearing and reporting functionality available on the market today.

Merlin is Rolfe & Nolan's suite of state-of-the-art modules that are platform independent, standards-based and cross-asset capable. Merlin modules, covering a broad range of key business processes (eg commissions, margin), provide best-of-breed functionality and operate seamlessly with the Merlin architecture to provide efficient, real time, exception-based trade processing. Because of its design, Merlin modules can be integrated in an organisation's front, middle or back offices.

SunGard Futures Systems

History:

The SunGard division has been providing back office solutions for over 25 years.

Products:

AudiTrade is a web-based order entry and trading application that provides remote access and STP for futures and futures options orders. The system integrates with the GMI back office system.

Devon is an exchange traded derivatives processing system designed for smaller firms participating in European markets and lower volume trading. For use as an adjunct to outsourced services, Devon is a solution with real time processing, multi-currency account management and exchange-interface connectivity.

Exchange Gateway is an interface system for retrieving trade information from the MISS or OM-Net architecture-based exchanges, and populating any back office, middle office or third party system.

Global Margin Server (GMS) is a real time, platform-independent system for intra-day variation margin calculation, providing futures brokers with margin calls throughout the day in T+0 via the internet.

GMI is a clearing and accounting system for exchange traded derivatives, futures, and options, serving futures commission merchants, banks and brokerage firms participating in US markets, while accommodating expansion abroad.

Octagon is a modular settlement software solution for exchange traded derivatives and OTC futures and options with back office and middle office functionality. Octagon is designed for Central Europe and Australia.

Exchange Systems Technology

History:

Founded in 1995 by Rob Lowry and colleagues, frustrated with the existing back office technology on the market. Venture capital funding raised in 2003 to fund expansion.

Products:

Eclipse is a back office clearing and settlements system, which can be used to provide accounting and administrative control for a wide variety of different product types traded in today's global marketplace.

MarginClick is the world's first internet enabled ASP margin calculator for global exchange traded derivatives, fx, CCP, CFDs, OTC, equities and bonds products.

Risk Watch is a post-trade risk management tool. This service delivers intra-day assessment of risk, and is offered for use as a fully outsourced internet solution.

Ubitrade

History:

Founded in 1988 in France. Privately owned with the management team, key staff and financial investors, Banexi and Partech International, as shareholders.

Products:

Ubix is available through service bureau as well as ASP. ❑