

Complex calculations

Gert Raeves, head of marketing and business solutions at GoldenSource, explains the benefits of using EDM



The innovative marketplace for financial products is becoming increasingly complex and fast moving. In recent years, trade volumes for a bewildering variety of complex structured financial products have undergone explosive growth.

Derivatives, for example, that are traded over the counter lack transparency and can conceal significant unknown risks. Financial institutions cannot easily generate or maintain referential data for such derivatives, particularly since most have built up a tangle of back office systems, each highly tailored to the specific requirements of a single product and offering very little flexibility.

To successfully manage the new generation of complex structured financial products, financial institutions need to be able to gain a clear view across all the facts associated with a product: underlying instruments, customers, counterparties, trades, positions – with a full understanding of how these facts are linked.

Enterprise data management (EDM) provides a rich global financial data model with a high degree of flexibility, enabling financial institutions to create and manage complex financial instruments and understand all the relationships they encapsulate. With instant roll up or drill through from any perspective, EDM provides complete and accurate information on the exposure of any instrument, issuer or counterparty. EDM also enables real-time insight into profitability, and supports low cost operations by automating many data management tasks while adhering to strict compliance standards.

Financial institutions that operate in the derivatives markets share the same key strategic goals: higher speed to market, better risk management, lower transaction costs and improved operational transparency, without introducing risks.

Both the variety and the traded volumes of complex struc-

ured financial products are growing rapidly. The market is becoming increasingly complex, globalised, innovative and fast moving. From June 1998 to December 2006, activity in the over the counter (OTC) derivatives market rocketed by 475%, from 72 to 415 trillion US dollars of notional outstanding contracts.

Many institutions are largely unprepared for the pace of change and innovation in the current market. The historical need to maintain speed to market at virtually any cost has left institutions with a bewildering tangle of specialised systems. These systems – each chosen as the fastest way to respond to the latest trend in the market, with no thought to how they might integrate with other systems – lack the flexibility to deal with the next generation of financial instruments that can cut across traditional silos of equities, fixed income, FX or commodities.

A host of single box solutions for structured products may solve the immediate time to market problem in each individual case, but it also stores up trouble for the future. From a purely operational point of view, the tendency to implement a new point solution for each new requirement has left traders with a set of incompatible and inflexible management tools that are no longer capable of responding to the demands of a global market for innovation. From a strategic point of view, the lack of coherence not only translates into higher cost of sales, but – more importantly – makes it all but impossible to accurately assess risk and manage P&L at the level of the entire enterprise.

Derivatives that trade on an exchange are transparent, since mark to market data can be generated from the daily trading of these products and there is no perceived counterparty risk. This can be stored as referential data and then used for operations, trading, and analytics and so on.

By contrast, OTC derivatives are not transparent, and financial institutions cannot easily maintain accurate refer-

ential data for them. With no clear view across tens or hundreds of siloed systems, the individual desk using a solution may be happy, but the institution will be significantly exposed to unknown risk. To successfully mitigate the risks of the latest generation of complex structured products, financial institutions need to be able to see all the facts: instruments, customers, counterparties, trades, positions – and to understand how they are linked.

Structured products are designed to provide highly tailored hedges or synthetic exposure for both the market maker and the client, and as such, they tend to be both complex and bespoke. The institution as a whole needs to be able to understand all the relevant information around a particular instrument: when and where is this instrument settling? What exposures do we have? What is the credit rating of all the paper? Who is the issuer? Who is customer? What is our position? Who are the transaction partners?

To enable an adequately rapid and low risk response to the challenges of managing complex structured products, institutions need fit for purpose systems based on a centralised, comprehensive financial model that is adaptable to new requirements and that supports very high speed to market.

EDM is based on the creation and maintenance of a trusted golden copy of data, which includes wrappers that define and provide context for that data. An EDM solution enables institutions to immediately see the connections between all the categories of data it controls, allowing rapid and accurate assessments of risk and profitability for even the most complex products.

EDM has been widely adopted for vanilla financial products; the richness and flexibility of its global financial data model also make it ideally suited to the management of dynamic and complex derivatives with unequivocal links to their underlying securities. With an EDM solution in place, institutions can rapidly model new structured products and all of their complex interdependent relationships, delivering both speed to market and a clear view of risk.

The enormous sophistication of an EDM data model enables it to support high speed operations involving bespoke structured products while continuing to deliver a clear top level strategic view. EDM enables the institution to know all the facts about any structured product, and provides the ability to roll up or drill through the data from any perspective to see the potential risk and P&L.

EDM is not just about strategic benefits. It delivers considerable operational benefits, supporting rapid time to market by automating many data management tasks. With built in validation and alerts, EDM can reduce the administrative burden on trading staff and enable them to work more effectively on higher value functions. Much of the often reported operational failures of disputed and double keyed trades in

OTC are the result of poor or missing reference data.

A well-implemented EDM strategy aims to deliver the right data at the right time for the right business purposes. To do so, it needs to be based on a robust, fit for purpose financial data model that can support 24 hour, follow the sun operational capabilities. With a rich and extendable global financial model at its heart, GoldenSource EDM solutions offer the flexibility to trade a new instrument, structure or derivative quickly and easily, with a minimum of modelling work.

By improving transparency and enabling real-time roll up of the position, EDM can significantly improve risk management. Building a new product – no matter how exotic – on a capable EDM platform immediately enables an institution to see all of the underlying links and dependencies, and to understand the credit risk across all components and counterparties for a particular product. EDM can also readily provide detailed insight into the profitability associated with any customer or instrument.

In operational terms, EDM significantly reduces the cost of developing and managing complex instruments that may only ever be traded once. This enables new flexibility in terms of being able to give the market precisely what it wants to buy at any given moment. By lowering the barriers to entry for bringing complex products to market, EDM can open up significant new commercial opportunities for market makers.

The increased quality and consistency of data managed in an EDM solution enables institutions to know exactly what they are holding, who the trading partners are, and what the positions are in terms of mark to market. This new confidence in the data, together with a single view point and the ability to drill up and down, enables better strategic planning and performance reviews. Finally, with the automation of routine data management tasks, and built in, rules-based exception control, users will benefit from reduced administrative workload and improved confidence in the quality of the underlying data.

Managing exotic structured products using a patchwork of legacy systems, point solutions and unstructured spreadsheets is unsustainable. The latest generation of structured financial products is increasingly complex and the market is moving ever faster; traditional approaches to management are both too unwieldy to support fast time to market, and too opaque to reduce risk to tolerable levels. Correct use of EDM cuts time to market for complex structured products, increases clarity, reduces exposure to risk, saves time and money in operations, and improves the global consistency of data.

For more information on how EDM can increase the profitability and reduce the risks of complex structured products, contact GoldenSource