

F O C U S



Jesse Drennan, Director,
Product Marketing, Traiana, Inc.

Reconciling Multi-Party Trading Relationships

As the foreign exchange prime brokerage market first began to take shape in the early 1990s, there were very few parties offering the service. FXPB began its growth in popularity and related trading volume later that decade, but remained a narrow niche. It wasn't until this decade, and the past few years in particular, that the sector began to experience explosive growth rates, driven to a great extent by the parallel surge in hedge funds in general, and their increasing appetite for FX as an asset class in particular.

During FXPB's emergence, fund managers and traders would typically interact with a single prime broker. Transactions and give-ups were executed and reported manually, and therefore were prone to inefficiencies and errors, which escalated as daily trading volumes increased. As the FXPB product increased in popularity, more banks entered the space, resulting in more competitive pricing. The expansion

of the FXPB market also fueled the growth of automated processing, as IT investments were used to differentiate product offerings, and banks adapted existing IT infrastructure to support the FXPB product.

Multi-prime relationships

As the FXPB product has matured and the market become more comfortable with it, hedge funds have begun to introduce

additional prime relationships beyond their original prime broker. An offshoot of these multi-prime relationships has been that fund managers face an intricate array of processing options and service levels depending on the capabilities and policies of their various PBs. These options can vary dramatically depending on the size and strategy of the hedge fund manager and/or the leverage held by the bank to mandate certain behaviors.



“The idea that manual processing has been relegated to some museum full of traders with pencils and ledgers is an unfortunate myth”

At a time when automated processing should be simplifying the give-up process, participants on both side of the equation are dealing with a virtual Tower of Babel when it comes to all aspects of post-trade acceptance.

The idea that manual processing has been relegated to some museum full of traders with pencils and ledgers is an unfortunate myth. The result is that, within any transaction, there are multiple parties who have to communicate with each other, system-to-system. Either the hedge fund has to firmly state “this is my protocol and I’m always going to use it”, imposing it on the street, which some of the larger ones can do, or the PB feels that it has the leverage, and will therefore insist on its protocol being utilized by its buy-side customers.

Protocol issues

Complicating this dynamic is that someone trading FX as a subcomponent of a larger cross-border strategy is by default going to employ the processing protocol typically utilized by the main asset class. For instance, a global equities trader will likely default to FIX, while global derivatives players might fall back on FpML or a related protocol. Finally,

there are a significant number of proprietary traders whose sole specialization is trading FX, and for whom there is no standard protocol. These hedge funds end up selecting from FIX, FpML, SWIFT or some other proprietary or industry solution.

In addition, the automation of prime brokerage operations has created an IT overhead for the fund managers. In the case of a single prime broker relationship, the fund manager needs only to extract their trade activity and report it to their broker. However, as soon as additional prime brokerage relationships are added, the fund manager needs to create a more complex trade feed in order to ensure delivery to the appropriate prime broker and appropriate processing, reporting and compliance. And of course, as the number of prime brokers the fund manager is using increases, the complexity, cost and related risks inherent in their IT infrastructure continue to grow.

In an ideal world, how can the inefficiencies inherent in such an alphabet soup of competing protocols be resolved? Ideally, a solution would exist that would allow market participants to focus on their basic business objectives, while making

irrelevant each party’s preferred message formats and protocols. This solution would no longer make adherence to protocol a requirement for successful submission of transaction information while ensuring that all parties received all of the trade details necessary for processing.

Traiana solution

Traiana’s solution, quite simply, is designed to consolidate the number of connections the fund manager needs to make through a single pipe into Traiana Harmony™. In this scenario, the hedge fund builds a single trade feed to the Harmony™ service, which directs the transaction to the appropriate prime broker. This includes both the initial give up as well as allocation information. Such a solution has the benefit of reducing the number and complexity of interfaces that the fund manager needs to manage, reducing internal costs, while also benefiting the prime broker, which then only needs a single connection point to manage all such customer interactions.

Beyond the initial messaging problem, Harmony™ provides standardized reporting back to the buy-side on behalf of the sell-side. Effectively this outsources

the hedge fund data quality standard responsibilities to Traiana, which consumes data from the prime brokers and custodians and presents it back to the fund managers. In addition, Harmony™ shows deals being alleged against the fund manager, utilization of tri-party limits and status updates to indicate where the prime broker is in the acceptance process.

Another, key buy-side feature provided by Traiana focuses on transactions between the custodian bank and the fund manager. Addressing the communication of financial transactions between the fund manager, their liquidity provider and their prime broker only covers the initial execution, and ignores the rest of the processing that the fund manager requires in order to ensure timely and accurate reporting to their investors.

This chain of events begins with the investor making an investment with the fund manager. The fund manager then invests the money based on its investment strategy with a liquidity provider; and both parties then give to a prime broker who provides credit for the fund manager. Once the prime broker agrees to accept the trade, the fund manager notifies the PB of the custodian that is overseeing the fund. The custodian typically assists the fund manager by providing oversight of the fund, assisting in allocating proceeds across investors and performing all other, necessary fiduciary activities. The custodian then allocates the trade to the fundlets (or investors), managing the money they receive as part of the fund manager's investment strategy.

To simplify this process, Traiana offers a managed service that assists the fund manager in reconciling with the custodian. The goal of the service is to ensure that the custodian has the correct details from the execution and that the allocation to the investors is in proportion to the investments the fund manager expects. The first part of this solution takes in a statement of trading activity from the custodian bank, supporting both infrequent and real-time passing of information to the service. The second part of the solution accepts an independent feed from the fund manager, and then reconciles the custodian's trade data against the fund manager's data, reporting any trades that fail to match.

While it may not now or ever be a perfect world within the FXPB sector, the post-transaction landscape can be a lot less intimidating for PBs and those on the buy side, as well. As the complexity of their trading relationships continues to grow and evolve, it should be comforting to consider processing options that include a single point of integration, increased operational efficiencies, state-of-the-art security, increased trade visibility and significant, ongoing reduction of costs.