

Buy Side Fintech Challenges

While Capital Markets technology replacements prospects are drying up, we see huge technology renewal opportunities in the Buy-Side to reduce cost, streamline operations and improve risk management. And of course, grow AUM.

Buy-Side firms are finding themselves in the same spot banks were a few years ago!

Buy-Side firms should benefit from the investments in technology made by the Sell-Side.

So, what are these challenges?

The traditional approaches used by Portfolio Managers using typical equities or fixed income strategies are rarely efficient in providing the required return expected by investors. Hence the need to go a little bit outside the Portfolio Manager comfort zone and:

- Use **Plain Vanilla** derivatives to:
 - o Provide better synthetic alternatives to expensive underlying (Asset Swaps, Equity Swaps)
 - o Provide better hedges alternatives (Interest Rate Swaps, Futures, FX)
 - o Take view on market by using Options strategies (Straddle, Strangles, Single Barriers...)
 - o Provide better funding venues (Security finance, collateral)

Multi-Asset active portfolio management is the way to go in achieving the required return by diversifying in non-traditional asset classes. And this is not using exotic derivatives like Power Reverse Dual Currency Swaps or alike, these are traditional OTC products, very simple to use, well understood and managed.

But this cannot be done in a black box manner, investors need to understand how their Portfolio-Manager is performing. They need to understand if their PM is implementing the right strategies, picking up the right sectors, stocks, markets...

To provide better transparency for a Multi-Asset Portfolio management, the traditional Buy-Side tools are not enough anymore. Hence the need to use the Sell-Side tools. In parallel of using Portfolio Attribution tools, the PM manager needs to use P&L explained for the derivative side. A good P&L explained report will give clarity and transparency on where the profit and loss are coming from.

The risk management tools need to be upgraded, it is essential to invest in Flash P&L, “What-if” scenarios, Horizon Shift, Hedge Topographies, Hedge Recommendations/Optimizations and detailed economic P&L.

Also, the traditional allocation optimization algorithms must consider the derivative parts of the equation. Hence a review of the rebalancing algorithms and using more advanced methods.

We add to this (and this is for the traditional part of the investment) a good Index selection. The PM needs to partner closely with index providers to select the right product or create an ad-hoc product if necessary. And with the right index selection, the appropriate risk tools should be provided. If the index is an Emerging Market one, the risk tools must be adapted to the corresponding market and bundled with the Index offering. The risk solution used by the PM has to cater for such new offerings.

Of course, we cannot talk about the Buy Side without invoking IBOR (Investment Book of Record). It is imperative to have a good **Real Time Cross-Assets** IBOR solution for reporting and risk analysis purpose.

Additionally, shadowing banks in margin calculations is very important to keep transparency and fairness. The Buy-Side firm are demanding to understand the fees banks are asking for. There is no more place for “Black-Box” margin requests.

For funding optimization, there should be a need to centralize securities to have better funding options and use a modern collateral solution allowing to optimize collateral allocation. Managing liquidity risk, implementing “what-if” scenarios for liquidity purpose, providing a Liquidity Explained report, ... these are all important tools to have in order to optimize funding.

Finally, regulatory reporting and the impact of MiFIDII/MiFIR. The Buy Side firms need to review their whole deal capture and EMS solutions to comply with these tough requirements.

Needless to say, that investments in infrastructure need to happen very soon in order to adapt to the New Paradigm and stay in the race.

Fintekminds will be publishing on its website “Modern Portfolio Management Functions Topography: What to expect” to help Buy Side firms better select and understand what is the minimum to have in technology for this space.