It’s about what you bring

There are many benefits to integration – particularly when it comes to the provision of prime services. Societe Generale has followed this path, which has allowed it to improve cost efficiency and improve the range of products it can offer. The bank has placed itself at the front of innovation in prime services by presenting cleared repo for the buy side

Societe Generale reinforced its global markets offering at the end of last year by opening a clearing capability in Paris for clients on listed derivatives and over-the-counter (OTC) products. The bank has also further strengthened its prime services sales teams in continental Europe. By the end of 2018, the bank’s offering included the option to clear client trades directly from the Paris platform, in addition to those of London, New York and Hong Kong.


Richard Deroulede


Vincent Maury

Further plans to improve integration in prime services at Societe Generale are based on two further advances. “First, we want to leverage on existing systems coming from the principal side as much as possible and share fixed costs, rather than having a very independent set of systems for the agency business,” says Richard Deroulede, global head of prime services at Societe Generale in London.

“One example is our foreign exchange prime brokerage side, where we are going to use our internal principal system, Cross One – developed from the principal business used for forex prime brokerage as well,” says Deroulede. “It does not mean everything will be open to everyone. We will be extremely cautious about protecting client data and not mixing anything.”

Having a single operational system and a single IT support team, rather than duplicating everything, is a very concrete example of cost-efficiency. “It is the same story on the financing side, where we want to leverage on the existing principal repo system to provide financing to clients,” says Deroulede.

The second element of improved integration is about expanding prime services with clients to whom the bank is already providing various principal services, while maintaining the business conducted with existing clearing clients.

“We want to provide our agency product services to existing clients of the bank’s markets division and its traditional client set, which are more institutional clients – in particular large asset managers, insurance companies and pension funds,” says Deroulede. “All of those clients are looking for prime business and need a clearer view of listed products to execute and to get OTC financing. These are the main clients we are targeting worldwide.”

Overall, the integration the bank has been working on is all about sharing operational trading costs, mutualising operational change to improve the economies of scale and concentrating on offering existing clients an extended range of products.

Playing to product strengths

That enhanced product set is being refocused on derivatives. “We want to be the reference house on any type of derivatives-based prime service,” says Deroulede. “We want to focus on our core strength, which is listed derivatives clearing, where we are offering clearing and execution. We also want to focus on derivatives and repo for the financing space. Playing on our derivatives angle is an important step, because that is where we have our strengths and where we can be meaningful from a prime services point of view.”

The bank is well recognised in derivatives and already provides a lot of prime services based on these wrappers. “This is our strength and we must better advertise it to clients,” says Deroulede. “We are well established in North America and Asia thanks to the equity derivatives franchise. We are also well established in Europe, and are maintaining a stronger presence in the UK, despite Brexit, because we feel there is more growth potential there. Our ambition is truly global.”

Traders, data and tools

As well as the efficiency that the bank’s SG Markets portal offers, “it’s about what you bring”, says Deroulede. “It’s about trading data and any type of trading tools that can bring added-value services to clients. We have a lot of strong trader capabilities and are known on the street for these capabilities, and our goal is to use these trading capabilities to provide more transparency to our clients about the costs of doing business. The whole story around transparency is about providing the data, the analytical tools, the expertise and the advisory, and putting this expertise in the hands of clients so they have a better understanding of the market. We help them master their cost. That is more readily available to them now.”

Prime services activity is leveraging on trading data to better understand the market, and not using client data. This service has been considerably bolstered this year by its provision through application programming interfaces (APIs) and includes the cost of rolling futures, the implied costs of financing assets embedded in derivatives and the pricing of collateral schedules.

"To differentiate ourselves, we have tried to bring added value to clients by assigning senior traders to work on improving the link with clients," says Vincent Maury, head of trading analytics at Societe Generale in London.

The tools built by Maury's team were based on representational state transfer – known as Rest API. "The beauty of APIs is that you can respond to different types of clients – from those that want to consume the analytics to those that have adopted the latest technology and want to download data," says Maury.

Given an environment in which returns are critical and the common denominator for all clients is cost optimisation, the purpose is to help them in the whole investment process, regardless of whether they are a hedge fund, an asset manager or a sovereign fund. "In each case, clients are giving them money that they have to manage," says Maury. "They have portfolio managers who think about allocations and then go to trading desks that invest in the market.

"When investing, the question becomes: 'Should I physically buy, or should I keep the cash and seek leveraged products, such as derivatives products?'," asks Maury. "When they opt for synthetic, they choose a derivatives product that, logically, is the cheapest. At the moment, everything is very blurred if you want to compare futures, swaps, notes and exchange-traded funds. No one has a clear understanding of how to optimise this investment decision, nor does anyone have the data to do it."

The bank has also developed tools to help investors optimise the collateral they are obliged to post when trading derivatives. For example, when buying futures, investors need to post collateral covering 10% of the initial amount and adjust it daily as the mark-to-market changes, meaning they may need to post more collateral.

"All of these elements are very complex in terms of understanding what you can post and do. The whole idea of the tools that we provide is to improve transparency," says Maury. "We used to focus on our own trading strategies, but now we need to embrace this new flow business. The more you educate and give transparency to clients, the more comfortable they will be trading."

"For any clients looking to get expertise around trading, we are here to help," says Deroulede. "Let us do the work for you, because we have traders that can fight hard to provide the best service."

CLEARED REPO FOR THE BUY SIDE

Cleared repo has been used by the interdealer community for many years, conducted by financing desks to manage positions and hedge client activity. Trades are given up to the central counterparty clearing house (CCP), reducing counterparty risk and the cost of risk-weighted assets, enabling a reduction of leverage because of increased netting opportunities.

Over the past two years, Societe Generale has built a platform whereby it can introduce buy-side clients – such as asset managers, pension funds and insurers – to cleared repo services. To make this happen, the bank has worked with Eurex and LCH, which have both introduced a new level of membership for these clients, called basic clearing members and sponsored members, respectively. Clients become direct members of the CCPs, being sponsored for default funds and default margins by a clearing member. "We sponsor the clients and are the only organisation with clients live on both LCH and Eurex," says Nicky Parsons, product manager at Societe Generale in London.

Nicky Parsons

The catalyst for client interest may have been the market dislocation experienced at previous year-ends where greatly reduced liquidity and increased volatility were observed. Recent repo-market gyrations confirm that financial institutions must have a wide range of tools in their liquidity arsenal during times of market stress.

Clients benefit from increased liquidity and improved term pricing. They also note a large reduction in the bilateral capacity of their liquidity providers at certain times of the year, as well as real pricing efficiency gained by cleared repo. "Although liquidity is pretty good in the current market, without a repo option, they are probably not guaranteed a stable level of liquidity or the amount of repo they need over those periods," says Parsons. "We have clients with multiple global master repo agreements who expressed concerns about the lack of liquidity at month-ends for their bilateral trades."

FACING THE SAME COUNTERPARTY

Access to clearing through the CCP means liquidity providers can net down their balance sheet. There are two sides to the trade: the first is the client side, which – when cleared with the CCP through the Societe Generale platform – can be offset with the second side. This is then traded with the CCP, providing netting benefits and reduced balance-sheet consumption as well as reduced costs for the liquidity provider. This translates into better pricing for the client – especially in longer-term repos, with clients often surprised by the difference in pricing between bilateral and cleared repo in tenors out to six months.

There is also a benefit for liquidity providers. While clients have confirmed they enjoy more capacity and better pricing, liquidity providers have noted a reduction in leverage and reduced regulatory charges, allowing the provision of more stable funding to customers.

There is a strong case for clients to fix the roof while the sun is shining. "It is a valuable tool to provide an assurance of liquidity and to potentially improve the pricing for our clients," says Parsons. "We are moving to a two-tier market: a cleared price and a bilateral price."

Balances have risen rapidly. "One European pension fund told us it was a far bigger success that they ever expected," says Parsons. "We sponsored a money market fund's first trade in the summer, which is a big step, and has been followed by further transactions and interest from other eligible counterparts."

Societe Generale is also at the forefront of designing a structure that will allow other classes of buy-side clients to access the platform.