GOING ON 30

Societe Generale is celebrating 30 years in the derivatives industry. We sat down with the bank's head of global markets, Frank Drouet, to discuss the evolution of the business and its position going forward.

In comparison to its rivals, Societe Generale was relatively late to the game.

It carried out its first derivatives trade in 1986 after it put together a team of five options traders within its foreign exchange and treasury department.

Throughout the years it began expanding into more complex products in order to keep up with the pace of trading.

"The development of the derivatives business over the past 30 years has been strongly linked with the development of being able to trade faster," says Frank Drouet, head of global markets, Societe Generale.

"This has given us the possibility to create new products while better managing risk."

Beginning in equity derivatives, it decided it wanted to operate a multi-asset derivatives house, evolving from plain vanilla products in the 1980s to creating a range of structured products that have continuously evolved.

"Most recently, we have seen the rise of more hybrid products combining different asset classes. Over the years we have been able to absorb more volume and develop our digital offering for clients," says Drouet.

A new edge

Societe Generale now finds itself in a unique position compared to its other US and European counterparts. Whereas many banks have had to face up to increasing pressures following the financial crisis by retreating from the derivatives business, the French bank has increasingly bolstered the unit.

In 2015 it finalised the acquisition of Newedge, the huge listed derivatives broker and clearer it had co-owned with Credit Agricole. The tie up with Newedge also gave the French bank a reputable prime brokerage business, expanding its hedge fund client range in both Europe and the US.

The combination of clearing and prime brokerage is a trend that is sweeping across European banks which, Drouet explains, will give them "a more holistic point of view."

"That is, to review the relationship across all of the different activities, from equity to fixed income, from prime brokerage to financing etc, to see if we have a well-balanced relationship in terms of revenues, on the one hand, to the commitment we are willing to give in terms of balance sheet, on the other," he says.

One key area Societe Generale has evolved is in the listed derivatives space, in which it was one of the earliest backers of swaps futures products.

Following the integration of Newedge, Societe Generale continued to expand its US listed

A NEW VIEW ON GLOBAL MARKETS

Societe Generale named Frank Drouet as head of global markets in April last year, following the departure of Daniel Fields, who decided to leave "to pursue other opportunities outside the bank."

Just three months later, its deputy head of global markets and former CEO of Newedge, David Escoffier, left as part of a larger reshuffle within the division.

Now Drouet heads up the unit himself, with the role of deputy head of global markets being retired.

As one of Societe Generale's longest-serving bankers, Drouet was previously head of global markets for Asia-Pacific, based in Hong Kong. He began his career with the French bank in 1990, initially working in Tokyo and then in Zurich as an equity options market maker. He transferred to Paris in 1996 as head of warrants trading, before moving back to Asia as head of derivatives trading for Hong Kong a year later.

From 2005, he took up the position of head of volatility trading Europe within the equity derivatives division based in Paris. Once again, he moved back to Asia in 2007 as head of equities and derivatives, and following the creation of the global markets division in 2009, he headed up the unit for the Asia-Pacific region.

> **"For execution we can use vendor systems because we prefer to focus on the part of the system where we bring something special."**

derivatives capabilities, increasing its customer segregated margin from $13.9 billion at the beginning of 2014 to $15.2 billion at the end of September last year, according to CFTC data.

Enhancing execution

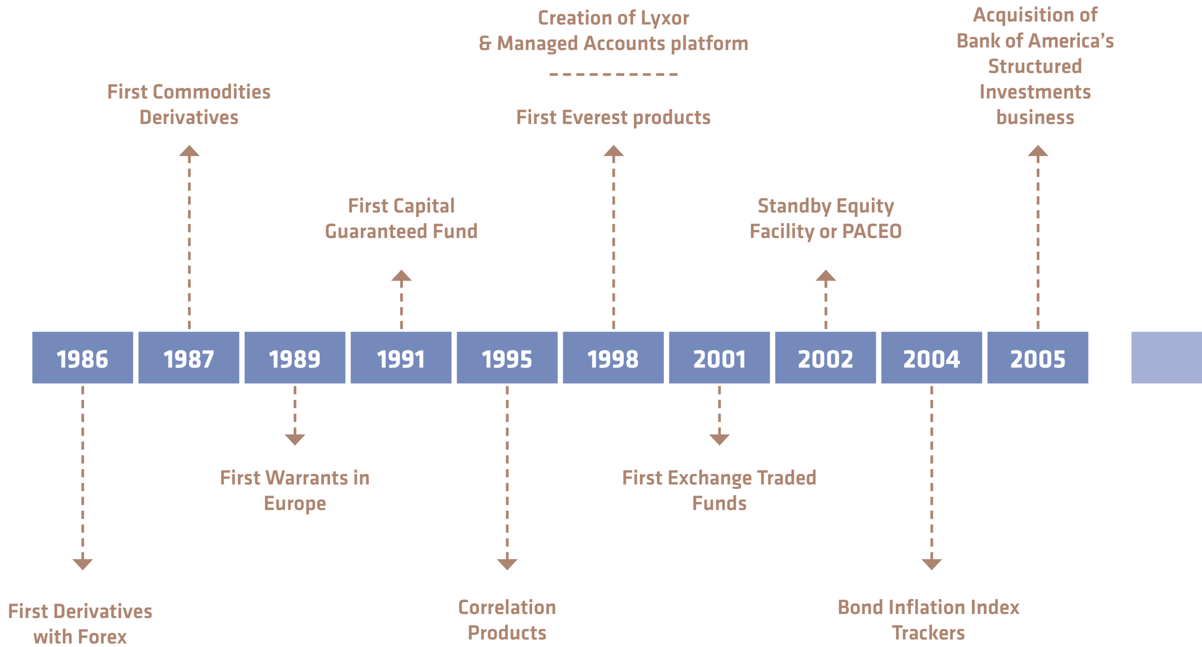
Drouet expects further migration from OTC derivatives to futures, particularly with stricter collateral rules around swaps and other non-cleared products, and is therefore looking to enhance the firm's electronic execution capabilities for clients by bolstering its technology.

"Outside of direct market access, there is the development of new tools for clients in terms of execution of their orders. We are developing new algorithms that can be plugged into our main execution offering, which brings added value for clients," he explains.

Banks are all taking different routes to meet these technological developments. Many have begun implementing changes to their front-office trading platforms over the past two to three years, with Barclays, BNP Paribas, Citi and RBC all opting for vendor-based solutions. Other banks have gone for the homegrown in-house platform, such as Goldman Sachs, Morgan Stanley and JP Morgan.

The consensus at Societe Generale is a solution that could combine both in- and out-sourcing solutions. It has had plenty of experience of maintaining its own in-house software, particularly for equity derivatives trading.

"Our view is to have an execution platform backbone which



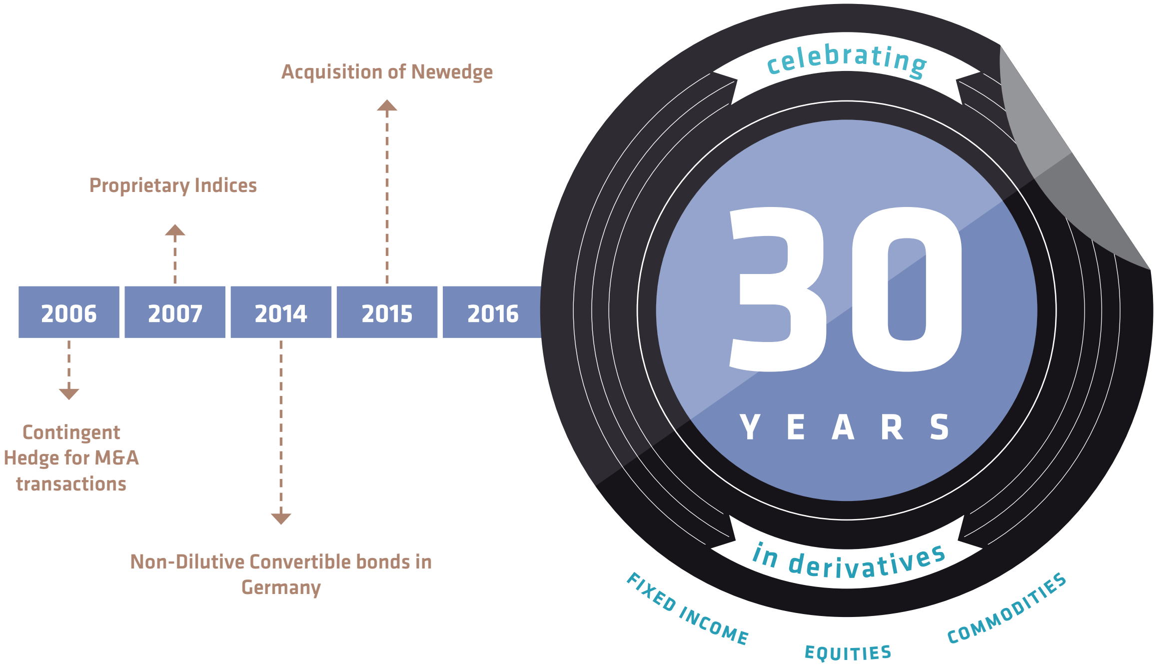
could come from vendors, but this platform should be open enough for us to plug in models that add value to our clients," Drouet adds. "For example we are bringing algos for execution, and we want to have a system where we can apply this. So, we would like a platform which combines vendor solutions with tailor-made add-ons.

"For OTC exotic derivatives we have developed in-house software. For execution we can use vendor systems because we prefer to focus on the part of the system where we bring something special."

Drouet believes enhancing its technological capabilities will be one of the main deciding factors for potential clients, as banks look for new ways to differentiate themselves with competitors.

"Technology will be part of the differentiating factor because clients value the quality of the service, and if you have a very strong STP solution from dealing to clearing to confirmation, that will add value not only for listed products but also for OTC derivatives," he adds.

"A client will appreciate a solution where cross-margining occurs across different products and different types of complexity. It's all about the added value you can bring to clients."



New client models

Like its rivals Societe Generale has also had to face up to a challenging market in the post-financial crisis era. It has had to adapt its services in line with stricter regulations.

Both clients and banks have had to review the relationships with their counterparties, both in derivatives and prime brokerage. Immediately following the financial crisis, hedge funds and asset managers significantly increased the number of prime and clearing brokers they use as a way to mitigate risk. However, many are beginning to realise that they do not have enough capital to maintain such a large network, causing many to scale back to having just two or three brokers.

This is a by-product of the increased levels of understanding among buy-side clients, and banks are having to adapt their models to meet this.

"Clients understand more and more that accommodating their business requires balance sheet and the usage of scarce resources, and the fact we need to work in partnership," says Drouet.

"We are having more and more dialogue with clients where there is transparency of the revenues and resources used, and the fact that there is a give-and-take relationship. It is more balanced than it used to be, and I think it will be more beneficial for both sides."

Balance sheet is a massive concern for both banks and the buy-side alike. Banks want to make sure that allocating their balance sheet to clients is worth the capital hit. In addition, a primary concern for clearing banks is how the Basel III leverage ratio framework treats collateral, in which client segregated margin is treated as part of the total leverage ratio calculation, requiring more capital from banks.

Yet Societe Generale is hoping that a proposal by the European Commission to amend the capital rules will give European banks respite and perhaps a competitive edge over US banks.

In the meantime, it is creating new ways to generate balance sheet efficiencies and to ensure its clients are limited to the capital impact.

"Balance sheet is a scarce resource and we have to utilise it in the right way and be remunerated for it. We have a large team of financial engineers that are looking at ways to optimise our balance sheet consumption, and create products that are capital efficient," adds Drouet.