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A Culture of Risk Management

*Canadian investment firms did not have the same exposure to the credit collapse as their U.S. counterparts. Asset manager Natcan shows how even the choice of a trade order management system can help in the quest for greater risk oversight. **By Phil Albinus***

Typically, investment firms buy a trade order management system and then compliance tools. In a switch, Natcan Investment Management, the asset management subsidiary of the National Bank of Canada, opted to purchase an OMS based on the firm's positive experience with a software publisher's compliance tool. In implementing the new OMS, Natcan (US\$24.2 billion in assets) has sharpened its risk management practices as well, according to the asset manager.

Natcan established in 2004 an ambitious program of updating its technology for traders and clients. As part of a vast technology overhaul, code-named OptiNat, the firm sought to standardize the tools traders needed to obtain alpha, keep their clients in the loop and manage their firm's growth.

The project started with a search for a new order management system, according to Charles Leblanc, the fund's then-SVP of operations, who oversaw the search for a new OMS. In looking for candidates, he relates, the Natcan team looked at its risk compliance tool — Fidessa's Sentinel, which the asset manager implemented in 2003.

"In the past, trade management had been handled manually by portfolio managers using spreadsheets and e-mail, but we were keen to move away from that approach," says Leblanc, who has moved to a new division inside Natcan's parent bank. "We recognized the efficiencies and also the risk management benefits of moving to an automated solution."

After years of working successfully with the Sentinel compliance solution, Leblanc and his team

opted for Fidessa's trade order management solution, Minerva, and the vendor's portfolio modeling tool, Tesseract. At press time, Natcan was running the Fidessa solution suite in parallel with its legacy system on the fund manager's 25 equity trading desks in Montreal and Toronto. Natcan officials say they expect to go live with Minerva in early 2011, but they decline to give a specific start date for the migration.

So far, testing has gone smoothly, according to Frederic Blanchard, senior business analyst for Natcan. The firm's traders needed training on the new solution, which also required a modest hardware investment, he says, but the implementation has not experienced any operational hurdles.

Improving Tech to Improve Performance

And the benefits were clear from the start, Blanchard adds. Natcan's traders now can take advantage of the Financial Information eXchange protocol, which was slow to be adopted north of the border. Now that the FIX engine has become a reliable and accepted industry standard, however, more and more Canadian firms are moving to FIX. "Before [our traders] didn't trade via FIX, and now with Minerva they can," says Blanchard. "It will improve their productivity for sure."

It also will help with pre-trade risk controls, says Domenic Pisegna, director of application management for Natcan. "With Fidessa's portfolio manager, our traders' pre-trade compliance will be more accurate," he says.

Technology is a game-changer for traders inside Natcan, Blanchard notes. "The market moves very fast, and we have to follow the game, so the plans can change," he says. "Implementing a new OMS was a huge IT project for a firm like Natcan. Now we can centralize operations so we can go forward with another project."

The asset manager plans to move Minerva onto its fixed-income desks in Phase Two of the IT initiative and then roll it out to money market derivatives traders in Phase Three, but the firm declines to give dates for the Minerva migration.

"So far everyone involved is being rather cautious, which is understandable with a major technology upgrade. There has been a huge amount of change

that happens side-by-side with a large implementation," says Roger Kahlon, buy-side account director, Fidessa. "We agreed with Natcan to get through this phase and spend time fine-tuning the equity portion of it and then move onto the next phase."

Natcan went from a primarily manual Microsoft Excel-based process to an automated, fully compliant workflow, says Kahlon. "There is a significant change in their process that the users go through, and we wanted to give them some time to settle into that new way of working."

Canada Takes On Risk

While the markets in the United States and the United Kingdom roiled with the mortgage-backed financial crisis in 2008, Canadian banks and investment firms fared rather well. According to Paul Volcker, President Obama's director of the Economic Recovery Advisory Board, the two nations that suffered the least in the crisis were Australia and Canada. One professed theory is that Canadian firms, by and large, do not have the huge risk appetites of their counterparts in the U.S. and Europe.

Just ask Renee Colyer, CEO of Forefactor, a financial markets research firm based in Toronto. "In Canada, we are mostly a fairly cautious group of individuals to start with," she says, adding that some Canadian firms have done "deep dives" into counterparty risk and operational risk. "The larger buy-side firms and even the smaller ones to some degree have ramped up their counterparty risk management."

That said, Canada's obsession with low risk exposure might be shifting as the nation's investment firms increasingly enter the global financial marketplace. Colyer notes that Canadian firms are eager to grow their profits but are keeping an eye on unwanted risk exposure.

Along with differing risk philosophies in the U.S. and Canada, the countries also have different regulatory approaches. According to Fidessa's Kahlon, Canadian compliance has a broader pervue among trading operations and risk management than is evident at U.S. trading firms. "In the U.S. compliance is a function, and in Canada it's more involved in operations and trade oversight," he says.

Forefactor's Colyer, however, doesn't believe that the exceptional risk recognition in Canada is stopping the nation's capital markets firms from attaining atmospheric profits. "While we may be a bit modest and happy with what we have — not complacent — we also recognize that this is a global market," she says. Colyer cites figures that Canada comprises 3 percent of the world's market capitalization and is very attractive to investors. "We're very hot right now because we are a commodities market. We are a strong market; we didn't suffer a lot in the financial crisis, we have fairly low unemployment — all good things."

But while everyone might like a piece of Canada, unfortunately there isn't that much to go around.

"Business people in the finance community realize that growth is going to come from outside of Canada — from Asia, Chile and Mexico," says Colyer. "Almost 50 percent of the volume that is traded in Canada is foreign already."



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—Renee Colyer, CEO, Forefactor

A Cautious Approach

Along with an apparent aversion to overly risky investment strategies, Canadian firms also are more cautious when it comes time to adopt new trading technologies. FIX trading, for example, took years to gain a hold in Canada. "FIX connectivity was important for Natcan, but the focus was on getting the risk controls in place," says Fidessa's Kahlon.

According to Kahlon, however, Canadian firms are slowly but surely modernizing their trading infrastructure. In addition to FIX connectivity, "We're seeing more requests for connection to counterparties and execution venues that are often tied to the equity side in Canada and on the fixed-income side," he says. "This is something we wouldn't have expected a couple of years ago."

Algorithmic trading also is coming into its own in Canada. Kahlon says sell-side brokers in Canada increasingly are marketing algorithmic tools and execution services. In response, Fidessa's trading platform can publish out to those algos as part of their normal trading workflow, he says.

It will be interesting to see if Canadian buy-side firms maintain their cautious practices and philosophies as they pursue greater profits and a higher profile in the global markets. ■