

Opportunity Knocks for Bache Commodities

AS THE FX MARKET PROVIDES AN INCREASING NUMBER OF OPPORTUNITIES, THE COMMODITIES ARM OF US-BASED PRUDENTIAL FINANCIAL IS BUILDING ITS BUSINESS, BASED UPON TRADITIONAL VALUES AS COLIN LAMBERT DISCOVERS.



It is generally unthinkable that the traditional powerhouses of the foreign exchange market – the banks – are at once being turned in even greater numbers while their very existence in some quarters is being questioned. The efforts by the US authorities, among others, have taken some of the heat out of the debate over certain financial institutions' creditworthiness, but stopping short selling only protects them in the short term. Longer term, clients are asking questions – many of them difficult.

Just as traditional multi-participant platforms are under the spotlight – especially those that are based upon the single counterparty (but also the multi-prime brokered model) – so too are the core providers of FX services. This means that opportunities are emerging for firms outside the banking world.

Diversification has long been a by-word in the financial markets industry, especially the investment sector; however, clients are now seeking diversification when it comes to their core service providers – including accessing FX market liquidity. This sea-change, driven by (as this is written) the inability of US lawmakers to agree a bailout package for the banks, represents an opportunity for other firms to show their worth.

“I think the current credit crisis has highlighted the fact that hedge funds and asset managers are now looking at their counterparts under the same due diligence microscope as banks did with them years ago,” says Matthew Ardizzone, global head of FX sales based in New York. “This has presented opportunities for service providers that are less associated with the problems of the banking industry.”

Certainly Bache Commodities Group, part of Prudential Financial (which is not affiliated with the UK's Prudential plc), has sufficient degrees of separation from the banking

industry and as far as Ardizzone is concerned it is the make up of the group that provides its real strength. “We are enough of a niche player to be able to move nimbly when our clients require it, but at the same time are backed up by the tremendous financial strength of our parent company.”

As if to prove its nimbleness, the firm is in the midst of building its business globally, through prime brokerage services and more vanilla liquidity provision services. In Europe, Scott Harrison, head of FX trading based in London, says that clients are attracted to the depth of liquidity the firm can offer. “We were already attracting clients that preferred to execute some of their business ‘out of the spotlight’ so to speak. We are now receiving a lot of interest from clients looking to add to their existing liquidity providers. This means we can demonstrate our value proposition clearly.”

“We are not an agency execution shop,” agrees Ardizzone. “We are a full FX market maker, and our level of proprietary risk is limited strictly to providing liquidity to our clients and overall risk transference from clients to Bache Commodities Group. We are looking to grow our core CTA/hedge fund business via consistent pricing, anonymous order execution and prime broking/clearing.”

TRADITIONAL VALUES

In terms of its evolution, Bache Commodities Group has benefited from an early decision to fold its FX business into its futures and commodities group. “Our multi-product approach has really helped us attract clients from the alpha-driven segment of our industry,” says Ardizzone. “If a client needs to trade multi-products across FX, over-the-counter and listed futures products, and needs consolidated margining and reporting, we are one group that can provide the full spectrum of service.”

“We have created an open architecture so our clients experience a seamless approach to trading FX both in cash and in futures,” he continues. “In addition, where other firms have departed the futures business, siloed it within a separate business unit, or found no value, we have integrated futures as an

important component of our business. We do not target one specific strategy – for example high frequency – but rather strive to lead with dedicated customer service in, what I see, a customer service-lagging FX space.”

Service to Bache Commodities Group, means a focus on traditional values. “We are not a volume-driven business,” Ardizzone stresses. “We place a high value on the relationship with our clients – because we think this is what customer service is really about.”

“We prefer to differentiate ourselves by tailoring our service to our clients, be a niche player to a degree but one with tremendous financial support,” he adds. “This means we offer e-trading solutions to clients that require them but we ensure that we focus strongly on every single relationship we have. It is about the end client not the volumes.”

The lack of serious focus on volumes does differentiate Bache Commodities Group significantly in the eyes of many. Several clients of banks spoken to by *Profit & Loss* over the past 12 months in particular have suggested, as one put it rather cynically, that a “focus on the client is only available for those clients already doing significant business”. Bache clearly sees some veracity in this, for as Brian Jaspers, global head of FX in New York, observes, “Platforms go only so far and a lot of clients do not want to manage risk, they want to position themselves for an extended duration in their chosen asset. This is where we can help – we help them manage the FX component of their overall risk.”

That is not to say that the firm is ignoring the e-channel; Jaspers acknowledges that as clients become more e-savvy, that portion of the firm's business will grow. “Currently I would estimate that our business is tilted in favour of voice to about 70-30,” he says. “As our e-business continues to grow I expect the balance to move towards the 50-50 mark – and that it is why it is important for us to be committed to taking the relationship aspect of what we do very seriously.”

PB AS A PB

An area of the FX business that Bache has moved into aggressively over the past year or two is prime brokerage. As Ardizzone

acknowledges, the firm was “a little late to the party”, however this has had perhaps unintended benefits. “We have been able to learn from others’ experiences,” he states. “This means we have been able to take a well-judged and well-informed call on what technology we need to develop, and how we roll that into our overall client proposition. We have also been able to do this at a competitive price.

“There is a new world in prime brokerage, triggered by the recent financial events, and a lot of clients are interested in our model because we can cross margin and have tremendous capabilities and services in futures which we can leverage in currencies as well as precious and base metals,” he adds. “We seek to become a preferred provider, of course, but we are initially content to have the opportunity to prove ourselves as an additional prime broker/clearer as a non-correlated play.”

Part of this new world involves what Ardizzone terms, “a creeping issue” – that of prime brokers charging minimum monthly fees to clients. “We are hearing this issue more and more from potential clients, who believe that some players are doing this because they need to recoup some of the vast outlay they have made on prime brokerage services,” he explains. “This is a real opportunity for us because we are flexible and have managed to develop our solution at a lower cost. Also, because we are new and young in the business we don’t insist on such fees, we would rather establish the relationship and grow with our customers.

“This approach means we are attractive to younger managers because we can help relieve cost pressures as they build their business, and also to more established managers because we can help them manage their existing costs,” he adds. “Prime brokerage is an area that we are focusing on, because we are able to take advantage of more stringent client capitalisation demands. As the financial strength of a firm is tremendously important to clients, we have found that asset and investment managers are becoming more inclined to place funds with a firm that can provide such security of capital, and also the ability to structure multi-manager platforms.

“On the flip side, managers must also feel comfortable that the prime broker can facilitate all their trading and operational needs. We offer this structure within a Traiana-powered FX prime brokerage solu-

“We offer e-trading solutions to clients that require them but we ensure that we focus strongly on every single relationship we have. It is about the end client not the volumes.”

tion, and we are aggressive in our prime brokerage/clearing fees, which is a real differentiator.”

A NEW ENVIRONMENT

Just as there have been new challenges facing certain banking institutions, so too has the FCM, or broker-dealer space, come under scrutiny. “There is counterparty risk in the broker-dealer space,” agrees Jaspers. “And clients are looking at this more and more. For those that don’t want a bank-only option, we offer a very compelling proposition because we sit very tightly between the two models – we are niche but we have scale.”

To overlay that, there is a new reality in the industry it seems, one where clients are moving back towards a hybrid relationship model using technology and voice interaction. Part of the new reality is also that clients are naturally more suspicious of e-channel reliance – and this is where Jaspers believes Bache Commodities Group really comes into its own. “We understand who we are,” he states flatly. “A lot of institutions in the industry may have lost sight of who they are and what they do in the rush to develop and sell new products or to push new mechanisms at clients.

“Furthermore, we have as much interest in the smaller tickets as the larger. At too many institutions the \$5-10 million business is directed to the platform, and some clients don’t want that. If our clients wish, they can execute that business over the Bache FX platform, but we stress the fact that they can also pick up the phone to execute that business, and they will get the same level of service as if they are executing \$50 or \$100 million.

“We stress the need for our clients to know who they are going to be talking to,” he adds. “For example, if a relationship manager introduces a firm to us they will guide them through the whole process and manage that relationship going forward. It is so much easier to connect to clients that way – customer requests do not get lost in a myriad of IT or legal issues because it is managed by one person; clients really appreciate that.”

The new market environment has also placed attention on who will have the dollars to invest in their FX business going forward,

for while many stress their budgets remain unaffected, several clients have expressed reservations to *Profit & Loss* that this is merely a short term phenomenon and that budgets, in both technology and human resources, will be cut as banks re-adjust to the new world.

Jaspers accepts there will always be these types of concerns in such an uncertain environment, but reiterates that as a fundamentally strong organisation, Bache Commodities Group, is preparing to invest further to seize those opportunities that are emerging, seemingly by the day. “We are in the midst of building out our business both in terms of technology and human capital,” he explains. “We have traditionally had a strong business in North America due to our deep relationships with the CTA client segment, but now we see great potential for what we are doing in Europe and Asia and will build there.

We are always ready to address capital to issues when we see the need and certainly technology is a big part of that,” he continues. “But I would stress, we are a people organisation and our peoples’ skills and depth of relationships is what differentiates us – our hands-on approach. That ensures that we remain predominantly a human capital venture, which has been lost to a degree in parts of the industry.”

Certainly it does seem as though opportunities exist for Bache Commodities Group, mainly due to its relatively unique position in the industry. Equally, its business is growing, as Jaspers notes, “by all measures – ticket numbers, staff numbers and revenues”. The FX group’s headcount was up 20% over the last year, and, he adds, the number of clients is increasing. “That is what I look at,” he stresses. “It is what I am interested in. If we are retaining and gaining clients, we are doing a good job. It is very rare that once on board we lose clients, and I see this continuing to be the case.

Despite the current downsizing environment “we are not sidelined, nor freezing the growth of our business,” he adds. “in fact, we are in great shape and intend to capitalise on this. We are continuing to expand our FX group globally within our commodity franchise, focusing on what we do best and who we are: facilitators of client business.” ■