

A View on 2007: By Interwoven's Jos Stoop

What will 2007 hold for structured products? In the final part of our series of thoughts on the subject we invited Jos Stoop, general manager of financial services solutions at US technology firm Interwoven, to provide his predictions. Look out for a cover story on technology, and the technology forum, in the February issue of *Structured Products* magazine.

OPPORTUNITIES:

1: New solutions for the over-the-counter (OTC) derivatives market need to be flexible to adapt to forthcoming innovation. Whatever we develop today must have the flexibility to deal with increasing complexity and customisation. Increasing volume throughput will always be an issue, and we must build a high level of scalability into technology for this market.

2: There is a very real opportunity for the standardisation of the communication infrastructure for OTC derivatives processing to allow flexible data formats, rather than waiting for industry-wide standardisation of the data itself. Allowing trade messages to contain any data format - both structured and unstructured trade data - as well as attachments and any custom message content sent between financial parties - is a more readily achievable method of automating OTC derivatives processing.

3: The buy side is a new arena for technology and they have the opportunity to make the right IT decisions the first time round, rather than inheriting an infrastructure consisting of multiple legacy platforms with a siloed operational infrastructure. The buy side is very much interested in automation and implementing relevant systems, and we predict continued progress in this area.

4: Increased competition between clearing and matching systems will create greater opportunities in the market. The ability to connect to multiple systems is necessary for the highest level of automation.

5: A direct peer-to-peer infrastructure for the processing of trades would allow for more efficient communication of these complex trades between trading parties. To help ensure efficient transfer of information, a high level of flexibility is key to volume insensitivity and efficiency, as well as to ensuring technology can keep pace with a fast-evolving market by linking up the processing environments of a firm's operations departments.

6: A high level of technological innovation is to be expected to help the market move towards efficiency in 2007. The growth of complex derivatives contracts means that technology must be specifically developed to meet new challenges.

THREATS:

1: Increased regulatory pressure in the OTC derivatives market is an ongoing threat. Current guidance from the UK Financial Services Authority and the US Federal Reserve has been on self regulation to increase processes and automation to alleviate backlogs of unconfirmed trades. However, the regulators are constantly looking over the shoulder of the market, but as long as

we continue to make progress we can avoid stricter regulation. If we were to rest on our laurels though, it's likely the regulators would begin to get restless.

2: There is a very real potential for more confirmation backlogs and more 'plumbing' problems that inhibit the growth of an institution and their ability to trade. Vanilla products have been worked on to an almost satisfactory level due to the take-up of initiatives such as the Depository Trust & Clearing Corporation's Deriv/SERV solution. More instruments are on the roadmap, however there is a very real chance we will see confirmation backlogs in the more complex instruments.

3: The market continues to get more complex along three dimensions – products, processes and participants. The proliferation of new participants, especially on the buy side, brings with it new issues such as the master agreements process and the sheer volume of counterparties.

4: Automation will never replace the need for a deep knowledge of the fundamentals of a structured product, and there is the danger that automation introduces systemic risk. This occurs where the processing of a derivative product is automated, but all aspects of the product itself are not fully understood. This can cause an institution to make assumptions regarding their processing that allow it to be falsely reassured about its level of risk exposure.

5: The development of increasingly structured products means that automation can be a challenge, with almost all processes for new products being carried out manually. Only when products become established, as is the case with the credit derivatives market, are suitable systems developed and installed. Automation must therefore keep pace with product innovation.