



Clearing the paper jam

Markit's trade processing platform has allowed hedge fund BlueMountain Capital to clear its confirmation backlog and consolidate its record-keeping environment

By Michelle Price

Although the front office has traditionally been the chief recipient of technological investment, hedge funds are now concerning themselves with the less glamorous but increasingly important middle and back office processes. Importantly, these processes support their trading strategies, which are growing ever complex with the growth of exotic products and OTC derivatives.

For a number of years, BlueMountain Capital, a New York based hedge fund, has been acting as a close partner in the development of Communicator, an automated solution for OTC derivatives trade processing. Communicator was acquired in May of this year by Markit Group Limited, a provider of independent pricing, data and valuations.

In May 2004, the hedge fund went entirely paperless on its OTC derivatives confirmations, having suffered "massive paper jams in the back office", Jon Anderson, head of operations at the firm told STP. "Two to three years ago, the DTCC was just coming on line with their confirmation business; there was little standard documentation, and the market was essentially the passing of a lot of paper, in a very fast credit default swap (CDS) market, back and forth," Anderson explains.

According to Michele Carlo, Markit's director of product management, the number of staff required to manage the fund's paper documentation was proving a major issue, being neither "clean" nor "scalable". She comments: "Furthermore, BlueMountain worked with a broad range of industry utilities and prime brokers which made it a multiple component process, so they were keen to find a way to interact with each of these sources more efficiently." She adds: "They wanted to streamline the tracking process and move away from paper-based confirmation to automation."

Markit's trade processing platform allows BlueMountain to submit information from the firm's trade blotters either intraday or end of day for all of its OTC derivatives trade activity. "This is a relatively straightforward process for both buy side and sell side, which enables the counterparts to match a trade or spot discrepancies swiftly. When we launched the service, a key goal was to make the confirmation process as simple as possible from both sides of the fence," says Carlo.

The fund receives the documents in PDF form, matches them to its list of outstanding confirmations, and then passes them electronically through its own processes. Anderson explains: "It allowed us to affix our signature and return or send back requests for correction, all the while tracking the current status of each document; that's how we really used the system."

Markit's platform also submits information on behalf of clients to utilities such as the DTCC's Deriv/SERV platform for real-time auto-matching. Anderson comments: "From the start, we loaded all of our trades onto the system, even those we expected to confirm on DTCC. We prefer to confirm trades on DTCC whenever possible, but each dealer was adopting DTCC at its own pace and often one product at a time. As dealers brought DTCC on board for a particular type of CDS, we would also load the trades onto DTCC, but we continued to track the confirm status on the Markit platform. In this way, we could flexibly manage the confirm process."

Because the system captures paper in non-paper form, it is able to handle any product type, up to the most structured kind, says Anderson. "It's a compelling system because anything that doesn't go through DTCC can essentially be confirmed through the Markit

platform." It took the fund less than a month to get up and running on the system, which is provided as an ASP service, requiring "no adjustment" on part of the fund's dealers, who were simply provided with new fax and email details. As a relatively young firm, BlueMountain was not encumbered by numerous legacy systems, which can often prove a major problem for large brokers who have to tie-in all their different systems, Anderson explains. "We have the benefit of being a young and well-concentrated hedge fund; so we have one department which handles all the paperwork and processing."

According to Anderson, the process of consolidating all the confirmation information in the Markit trade processing platform "is paying off in another way", as the platform can now communicate with the DTCC through a direct link. "We can now control our DTCC confirmation process directly through the Markit platform. We will be enriching our data upload to Markit in the near future to take advantage of this," he told STP. Consolidating the record-keeping environment in Markit also allows the fund to produce all its management reporting for confirmations in one location.

BlueMountain is in ongoing communication with Markit and will be working with the service provider on the development of the platform, which will shortly be expanded to include bilateral trade matching and portfolio reconciliation with dealers. "Our clients are actively seeking solutions to resolve confirmation issues," says Carlo. "We do still find significant pain and challenges on the buy side with respect to resolving these issues across all asset classes, however, we are also seeing a lot of commitment to resolving them, and to achieving economies of scale and reducing the risk of unknown trades," she concludes.