

COMMODITY TRADING AND RISK MANAGEMENT IN A MULTI-ASSET CLASS PORTFOLIO



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INTRODUCTION

After a period that saw commodity prices and volatilities broadly collapse, there is every indication that commodities are once again an attractive asset class. Prices and volatilities have been rising again across almost all commodities, and investors have been returning in droves. This was demonstrated by the S&P GSCI, having reached a low point in 2016, before climbing relatively steadily ever since. Meanwhile, low interest rates, solid economic growth across the globe and rising corporate earnings have hoisted equities to record levels early in 2018, before losing some luster recently. Commodities, the basic building blocks of civilized life, are again in demand – both from consumers as well as investors.

The rise in commodity prices and volatilities impacts everyone as this comes at a time when there is increased regulatory and stakeholder oversight, geopolitical uncertainty, and fundamental shifts in technology and industry structure are taking place. All aspects of risk are important, but operational risks and cross asset

risks/opportunities in particular, have increased in importance. Many companies are also seeking to reduce costs and engage in digitalization programs while seeking system consolidation and a reduction in total cost of ownership of solutions.

A PAUCITY OF SOLUTIONS AND PROLIFERATION OF SOFTWARE

The software market for Commodity Trading and Risk Management (CTRM) software is crowded. Commodity Technology Advisory tracks over 100 vendors – many offering multiple products. Despite this, larger corporates, financial merchants and banks seeking to manage complex multi-asset-class portfolios find that they often have little choice in terms of solutions; in most cases, what choice they do have is suboptimal. As a result, many end up with any number of different solutions deployed for trading and risk management for various asset classes and in the treasury area. This in turn results in difficulties in gaining a view of consolidation exposure and requires expensive integration or off-system calculations.

For many larger corporates, banks or financial merchants, the last couple of years have also been fraught with change. Change is the only constant as wave after wave of new regulation has increased the cost and complexity of operations and added significant burden to the systems that support trading and risk activities. Furthermore, the velocity of trading has also increased, particularly in markets where automation has taken off, leading to an increased requirement for close to real-time information collection and consumption, and risk management in particular. Many existing solutions lack a true capability to generate real-time reports requiring long and complex overnight batch jobs to calculate exposures, PnL and VaR, for example, for example. For those trading or hedging across multiple asset classes, the picture is worse since many utilize interfaced suites of solutions, which makes real time almost an impossibility.

One key issue is the lack of availability of commodities as an asset class in many solutions. Commodities, even

financial commodities, have their own issues and complexities. These involve a different set of exchanges and instruments, the vast differences between each commodity in terms of its physical characteristics, supply chain, units of measure, price curves and pricing properties, to name a few. Many commodities are now also subject to commodity-specific regulations, including trade reporting, position limits and more. The addition of this attractive yet complex asset class has often proven to be lacking the depth of functionality truly required in many solutions on the market.

Yet, as costs have risen and profits fallen, and given the renewed interest in commodities as an asset class, many firms are seeking to consolidate solutions and reduce costs of ownership. For some, this has meant seeking to consolidate treasury and trading/risk management solutions, while for others, it has been in terms of reducing the total number of solutions and interfaces installed across their portfolios.

FIS AND ITS MULTI-ASSET-CLASS SOLUTIONS

FIS is one vendor that has specific energy and commodity solutions for various tiers and segments of the market, including Kiodex, XDM and Aligne. These software solutions have a large installed base in the commodities world and the company benefits from having a long track record of delivering and supporting energy and commodity-specific CTRM solutions around the globe. However, in its large portfolio of solutions, FIS also has two products that offer a potential solution for those engaged at the top end of multi-asset-class trading, risk and treasury – or are looking for real-time risk overlays on top of multiple, already existing platforms.

The first of these solutions is **Front Arena**. Front Arena is a robust and scalable platform that handles all asset classes – it is widely used by banks, asset managers, hedge funds, etc. – and yet already has a significant number of those customers utilizing it for any type of commodities as well. With trading and treasury coverage, the solution was initially used by banks for equities, FX, IR and more. It incorporates an order management system that connects to over 30 exchanges, which differentiates it from other similar platforms. On the commodities side, not only is it a proven solution for precious metals trading but it also supports a wide range of other commodities, such as power, natural gas and LNG, crude and refined products, coal and biomass, emissions and certificates, and gas and softs. It is a multi-unit of measure, supports multiple types of price curve, volatilities, many instrument types, and has a robust risk engine.

Many large merchant/traders, banks and industrials already utilize it. Indeed, one large bank switched to Front Arena from a legacy system to better support

commodities, including some trading with physical delivery. Front Arena has front to back office functionality and includes functions like trading, position and risk management, P&L, settlements, confirmations and accounting. Front Arena is a solution that multi asset managers can switch to in order to reduce both the total number of solutions they use across trading and treasury and the total cost of ownership.

FIS also offers **Adaptiv** – a real-time risk platform. Adaptiv supports market risk, counterparty credit risk and comes complete with superb analytics. The analytics side includes the ability to do front-office pricing cost of trades (XVA), CVA capital requirements, and supports various IFRS regulations – for example, IFRS31 accounting regulations and others. Its market risk engine is an aggregation solution and supports the advanced risk models that larger multi-asset-class traders need to perform to make better decisions. On the credit side, it helps manage counterparty credit risk (CCR) for internal risk management and helps to reduce capital by using advanced capital models.

The combination of Front Arena and Adaptiv with support for commodities backed up by an organization with extensive experience in physical and financial commodities, means that larger entities involved in commodities and/or commodities and other asset classes now have a solution platform that can meet many of their needs in terms of offering real-time calculations, origination, hedging, treasury and trading support, and more. Adaptiv can also be deployed

stand-alone or by hosting on top of an existing trading infrastructure to provide best in-class market and credit risk in real time.

FIS also offers services supporting the trend of firms outsourcing model valuation and/or risk calculation – and so, provides business process outsourcing offerings in this area with corresponding service level agreements (SLA).

ABOUT FIS

About FIS Solutions for Energy and Commodities

FIS' energy and commodities solutions help energy companies, corporate hedgers, hedge funds and financial services firms to compete efficiently in global energy and commodities markets by streamlining and integrating the trading, risk management and operations of physical commodities and their associated financial instruments. Through real-time data, connectivity, and analysis, FIS' energy and commodities solutions help customers achieve transparency and regulatory compliance, address end-to-end transaction and operational lifecycles, and meet time to market needs with flexible deployment options.

For more information, visit www.fisglobal.com or email us at getinfo@fisglobal.com

About FIS

FIS is a global leader in financial services technology, with a focus on retail and institutional banking, payments, asset and wealth management, risk and compliance, consulting and outsourcing solutions. Through the depth and breadth of our solutions portfolio, global capabilities and domain expertise, FIS serves more than 20,000 clients in over 130 countries. Headquartered in Jacksonville, Fla., FIS employs approximately 53,000 people worldwide and holds leadership positions in payment processing, financial software and banking solutions. Providing software, services and outsourcing of the technology that empowers the financial world, FIS is a Fortune 500 company and is a member of Standard & Poor's 500[®] Index.

For more information about FIS, visit www.fisglobal.com

ABOUT

Commodity Technology Advisory LLC

Commodity Technology Advisory is the leading analyst organization covering the ETRM and CTRM markets. We provide the invaluable insights into the issues and trends affecting the users and providers of the technologies that are crucial for success in the constantly evolving global commodities markets.

Patrick Reames and Gary Vasey head our team, whose combined 60-plus years in the energy and commodities markets, provides depth of understanding of the market and its issues that is unmatched and unrivaled by any analyst group.

For more information, please visit:

www.comtechadvisory.com

ComTech Advisory also hosts the CTRMCenter, your online portal with news and views about commodity markets and technology as well as a comprehensive online directory of software and services providers.

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