

Risk Management Advisory Firm of the Year

Derivative Path

From a start-up seven years ago to boasting a client list of 130 commercial banks across the US, Derivative Path is our Risk Management Advisory Firm of the Year for the technology-led way in which it has shaken up the delivery of interest rate hedging solutions.

Derivative Path was founded in 2013 by a group of seasoned executives from a money centre bank, after they spotted a gap in the interest rate derivatives market created by the implementation of the Dodd-Frank Act. The regulations left smaller banks underserved by their larger peers and in need of technology support.

The firm has grown to the point where it has become an established player in its chosen space: regional and community banks with assets between \$1bn and \$50bn that are managing interest rate risk for their own balance sheets, and/or offering hedges to their commercial borrowers. In addition to the regional and community bank space, the firm has a number of non-bank financial clients and commercial end-users using the platform, which it sees as an area of future expansion. It says it has opportunities for some much larger banks as well.

“There were two key factors in 2013 that made us decide it was worth taking the risk to start the company,” says Zack Nagelberg, head of business development in the company’s New York office.

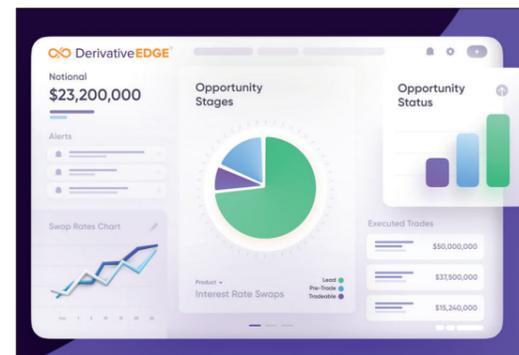
“One was the market challenge presented by the introduction, for the first time in the US, of detailed and complex regulations governing the derivatives industry under Dodd-Frank,” he says.

“While some saw Dodd-Frank as overwhelming

“We are trying to solve problems with solutions that are highly scalable and technology-driven”

and a reason to freeze their activity, we saw it as an opportunity for more banks to get involved,” Nagelberg continues. “The new rules were complex but there was then, for the first time, a clear roadmap that we could use to help these banks feel confident using derivatives.

The other catalyst was a general absence in the marketplace of a comprehensive technology solution for interest rate derivatives that could be used by anyone other than the largest market participants able to afford the upfront and operational costs of



Derivative EDGE: “An Apple-esque experience”

implementing an enterprise platform. “Regional and community banks around the country just didn’t have the business scale to make it worthwhile,” he says. “On the other hand, the advisors that served these banks didn’t have the desire or wherewithal to build an end-to-end infrastructure with straight-through processing.”

Derivative Path offers an impressive technology platform that encompasses the entire life cycle of an interest rate derivatives transaction, in what one observer calls an “Apple-esque user experience”. But while it leads with technology, it also offers hands-on support for those that need it.

“We are differentiating with technology but we recognise that you can’t replace the need for people and expertise,” says co-founder and co-CEO Steve Hawk at the company’s headquarters in Walnut Creek, California. “We are trying to solve problems with solutions that are highly scalable and technology-driven.

“We have taken dozens of banks that had no hedging capability and provided full service support, which includes access to our state-of-the-art technology platform but also help in areas such as negotiating swap documentation with dealers, creating marketing materials to share with their commercial borrowers, completing hedge accounting documentation, and helping their operations teams understand how to manage reset notices and other client facing documentation.”

A key differentiator for Derivative Path is its rejection of a one-size-fits-all approach, says Hawk. It can offer the full-service solution, or provide a software-with-a-service solution for those that want a little help on top of the technology platform. And

more advanced capital markets banks can license the technology as a software-as-a-service solution to give them a straightforward, cost-efficient way of running a hedging programme operationally.

“We have a price point and an offering that meets all of those needs,” says Nagelberg.

Efficiency and scalability

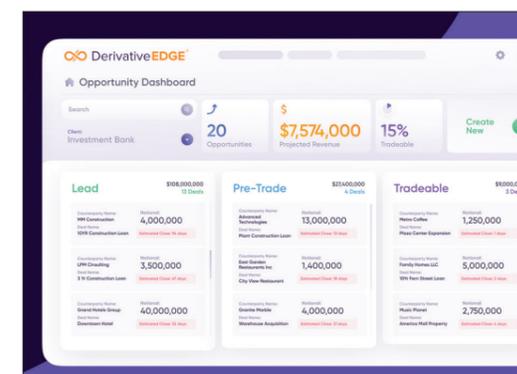
The firm’s technology platform, DerivativeEDGE, is at the centre of its offer to all its clients. Designed to be an intuitive, logical and straightforward user interface, it provides a single point for customers to perform front-, middle- and back-office functions, encompassing pricing and valuation, trade management (such as white-labelled confirmations), reset notices and mark to market statements, hedge accounting reports, global trade repository submission, comprehensive reporting and a document repository.

Talk to chief technology officer John Fleming about the platform and the conversation is likely to be peppered with the word ‘efficiency’, something the firm clearly takes pride in.

“Since we use the platform every day, just like our clients do, we get direct feedback from our company’s own users as well as from our clients,” says Fleming in Walnut Creek. “It means we can take a very nimble approach to making modifications — so as people identify areas that could be improved or need new functionality, we can quickly turn those around and make the system more efficient.”

Scalability is another concept that is central to the offer, with the firm using technologies such as AWS that allow it to add capacity whenever required by client growth, and all this is neatly packaged to make it straightforward to use.

“We spent a lot of time up front thinking about the business processes we had to support and the user’s interaction with that process; and then we created a system to make it as efficient as possible,” says Fleming. “We worked with user experience and user interface designers to build a very clean, logical user interface that is easy to use. In addition, we have added elements of artificial intelligence and automation for more repetitive tasks that a derivatives desk needs to perform every day, reducing the time



Simple and efficient interface



Zack Nagelberg, head of business development

spent on operational work by as much as 75%-80%.”

The firm has proved to be adept at meeting the challenges encountered along its journey, starting with its roots as a solution to the implementation of Dodd-Frank. When new hedge accounting rules (ASU 2017-12) were introduced for derivatives users in 2017, it was quick to deliver a fully compliant system; it has integrated hedges for floating rate loans with zero floors amid worries about negative

rates and is being proactive with client discussions around the looming transition from Libor to Sofr.

“We are a source of information and can strategize with our customers about how to deal with the Libor transition,” says Nagelberg. “Meanwhile, we can refine our products to be able to respond to changes as they come about. Our trading application is capable of pricing trades using the Sofr index, currently in beta, which we will continue to enhance as clients start to execute transactions based on Sofr instead of Libor.

“Our technology is not just a great static product; we continually adapt and evolve.”

The company is not resting on its laurels. An FX hedging product has been through rigorous beta testing and is now very much part of its offering, allowing clients to access the same, simple interface to execute FX spot trades and also manage FX forwards, windows, swaps and NDFs.

It is also taking its experience of working with corporate and asset manager end-users — which until recently came to the firm after hearing about the product from their own banks or other users — to market directly to a wider range of customers.

The firm, which started out as six people, is now up to 24 full-time employees in Walnut Creek, New York and Chicago, and nine contractors. It is now poised for expedited growth, announcing its first outside institutional funding round in June 2020 having raised \$35m from growth equity investment firm FTV Capital.

The investment will underpin the company’s product development and expansion into the new client segments. “We have built out the sales and structuring team, the hedge accounting team, the compliance and operations team and the technology development team, and we have big plans to continue to add more talent in the rest of 2020,” says Hawk. “We have grown the firm methodically by focusing first on interest rate derivatives for banks, but as we’ve grown and we’ve expanded and added to our capacity on both the technology side and the people side, we are starting to expand into new asset classes, such as FX, and different client areas such as non-bank clients.

“It’s an important part of our growth story.” ▲