



Warren Edwardes

Derivatives with attitude

When approached to write about financial products, derivatives guru Warren Edwardes was asked to pen something with "attitude". True to this initial brief, Edwardes' latest book, *Key Financial Instruments: understanding and innovating in the world of derivatives, has attitude in spades. Its aim is to "bring financial instruments to life" and to rid the world of "Derivatophobia"*.

What is the connection between key financial instruments and a farm in the Pyrenean foothills of Northern Spain? Give up? Well, the first is the subject matter of Edwardes' new book and the second is the location in which he wrote it.

It is sad to say that many books on the market that deal with derivatives are either overwhelmingly dull or overwhelmingly complex. Indeed, a derivatives author recently said, rather ruefully, that he had literally seen his title used as a door-stop. Warren Edwardes' book strives to break with this tradition – and succeeds.

His secret is simplicity. *Key Financial Instruments* is neither over long nor over complex. Running through the book is an unmistakable underlying sense of humour. In addition, Edwardes always grounds his text in reality. For example, in the section entitled How to capture the big new IDEA, he charges from the development of Velcro to Honda's most original sports car, to Harry Potter! However, this is not mere digression as Edwardes explains the value of thinking

about new financial products everywhere:

"I was once attending an extremely tediously presented seminar on corporation tax, when my mind wandered to solve a problem a corporate customer was having with currency translation exposure. My lack of concentration led to the creation of the perpetual currency swap! So do think everywhere... don't bother with those contrived brainstorming sessions and working parties! You cannot plan to create on demand. But you can organise your mind to be constantly receptive to new ideas wherever you happen to be."

Ignorance arbitrage

Part 1 of *Key Financial Instruments* provides an approachable introduction to the world of financial instruments and derivatives, clearing away some of the mystique and jargon. Edwardes follows this with his thoughts on what drives financial innovation and asks: "Is financial market innovation largely 'ignorance innovation', or to put it bluntly, 'ripping off the technically less competent'?"

In Part 2, Edwardes examines some of the major risks faced by users of derivatives and goes on to explain what the core derivatives are. He then goes on, in Part 3, to uncover the entire financial product innovation process from conception to creativity to communication and closing: "The secret of financial product innovation is not high technical ability to price and manage complicated financial derivatives. The key

financial instruments are those that reflect customer's need, are simple to put together and can be explained in a 30-second sound bite. There are very few genuine new financial products."

Part 4 deals with risk management. This includes hedge choice and performance measurement, legal risk management, and a look at the taxation aspects of derivatives and risk management. The final part of the book, Part 5, focuses on current developments and trends including the creation and growth of credit derivatives and insurance derivatives. Edwardes then looks at financial market ethical issues and closes with some "crystal-ball gazing" and a concluding section entitled 'Less technophilia – have faith in fools'.

With over 20 years experience in the industry, Warren Edwardes is well placed to demystify derivatives and bring financial instruments to life. He is both the founder and ce of Delphi risk management, the London-based financial instrument and risk consultancy, and founder and director of schoolofbanking.com at the London international school of banking and finance.

Edwardes was previously on the board of Charterhouse Bank and has worked in the treasury divisions of Barclays Bank, British Gas, and Midland Bank. He first conducted research into what were later to be called derivatives in 1975 and was part of the team that executed one of the world's first currency swaps in 1981. ♦

Jane Douglas-Jones