Best Execution

## Trading : trade expense : Gill Wadsworth

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# Turning a brighter light onto trade expense.


### *Gill Wadsworth looks at the challenges and solutions being developed to tackle the thorny issues of trade expense.*

Across the trading lifecycle, post-trade costs represent a significant pain point for financial services organisations struggling with squeezed margins and ever-growing regulatory demands.

The Central Securities Depositories Regulation (CSDR) scheduled for next year, but more likely to come into force in February 2022, will add to this burden yet further. Meanwhile, the Covid-19 pandemic which clattered the market with severe volatility and increased trading volumes only served to highlight just how crippling these costs can be if not managed properly.

And failure to manage the costs is a major part of the challenge for everyone from broker dealers to asset managers and custodians. Research from Torstone Technology, which surveyed 126 firms, found 67% of firms are unable to cite a total cost per trade.

The lack of automation and standardised procedures across the piece acts a serious barrier to effective post-trade cost analysis and management, yet attempts to modernise the infrastructure through large scale technology projects have suffered, according to a Deloitte white paper, from 'cost overruns and delivery risk'.

The consultant adds, "Additionally, as market structures evolve and business strategies shift, human capital, application, and hardware spending costs tend to creep back in, primarily due to legacy business architecture and processes."

Deloitte says the industry needs to agree on a simplified target state and develop data and process standards to realise it through technology enablers. In other words, it is time for the industry to build, digitise and automate systems collaboratively if they are to better manage costs.

**Overcoming major hurdles**
The challenge here is twofold. First there is a demand for all organisations to invest in improving systems which represents a drain on the very margins they are trying to protect.


However, to take such a view is according to Chris Smith, head of post trade services at MarketAxess, a possible false economy. If a failed trade is detrimental to the P&L, then failing to prevent such inefficiencies will ultimately cost the business more than investing in effective post-trade systems.

Smith says: "So, to improve post-trade systems and processes, and deal with the ever-rising complexity of trading, there needs to be investment both by the firm and across the industry."

The second challenge is finding those resources to invest in making such improvements, particularly as the regulatory burden grows ever larger.


Alex Duggan, head of investment banking – capital market solutions at Cognizant says: "Over the last decade the swathe of new regulatory rules has meant that while trade expense is a priority, there has often been limited discretionary spend to focus on it. Increasingly complex agreements and calculations continue to be handled through legacy platforms and spreadsheets on a best-efforts basis. As a result, businesses struggle to get the detailed, transparent reporting and analytics to make business decisions on their second largest expense after people."

However, there are solutions, and where organisations have already taken the plunge the spoils are evident.


Bharat Malesha, executive vice president, fees and expense management at SmartStream, says: "The goal is to identify various day-to-day costs that typically affect financial services firms' profitability, while also looking at the technologies that they can deploy to help them better identify the sources of their costs, especially hidden costs. There is a need to focuses on the tangible business benefits that firms shall appreciate through managing those costs in a more systematic, disciplined and transparent manner."

It is this latter aspect that Bharat argues is most important. With so much data coming from multiple sources, it is critical that financial institutions can analyse it in a meaningful way.

He says: "Efficiency can be achieved through transparency. That is one aspect, but on an ongoing basis you need to have an ability to monitor the changes in behaviour within the marketplace and ensure that you are extracting the best value out of that."

Daniel Carpenter, head of regulation at Meritsoft, agrees that investing in digitisation to improve transparency is critical if organisations are to achieve post trade costs saving.

"It appears that every organisation has the same rates, but you need to be able to compare costs and that means stripping them down. You can only get that transparency once you digitise data," Carpenter says.

There has been genuine progress in being able to quantify just how much is saved through digitisation. Duggan says: "Typically for banks this has been the real challenge, which has impeded building a business case to renovate. Without a structured counterparty hierarchy or digitised rate repository, full calculation, transparent reporting and analytical comparison and modelling is very manual, if possible at all."

However, he says that it is far easier for organisations to make that assessment using today's solutions.

Duggan says: "With our digitised broker hierarchy and rate repository we have the ability to provide direct comparison of rates across brokers at a macro and micro level. As trades are calculated and reconciled through our solution, we are then able to provide organisations with a detailed analytical view as to opportunities to move flow or renegotiate rates, as well as future business modelling."

The same is true at DTCC which provides clear analysis of the savings made through its no-touch technology. Analysis by DTCC shows that for organisations willing to use utilities and make an investment in automation, millions of dollars can be saved. It says that for large global broker-dealers, who typically spend in the range of $150m-$175m on post-trade services, implementing a no-touch processing workflow can reduce headcount, repair charges, and technology expenses as well as claims and fees.

For example, reducing manual input in the pre-settlement strategies using no-touch processing, created cost savings of 35% on average for organisations spending $34m. Meanwhile, in asset servicing, streamlining workflows and eliminating fails resulted in an average saving of $2m for institutions spending an average of $30m.

**There is no straight line**

Although the solutions are there the move to automation is in no way straightforward. The disparities between the way in which organisations process trades – some with full automation using their proprietary systems, others using utilities, some still plugging data into spreadsheets and trading by email – means a harmonious move to technology remains incredibly complex.

MarketAxess's Smith says. "Most firms find themselves with a plethora of systems and databases and this complexity of storing and creating clean workflow for a trade through those systems adds risk and complexity which can cause operational risk and failure."

To counter this, Matt Stauffer, managing director and head of institutional trade processing at DTCC, says the industry will need to unite and create an ecosystem that makes post-trade automation accessible to all parties.

He says: “To achieve cost efficiencies, the industry – institutional clients, broker dealers and custodians – needs to come together and aim for best practices in post-trade automation.”

However, while Duggan accepts that using utilities will help bring the industry together, he counters that for some organisations data is proprietary, creating some resistance to collaboration.

He says: “There is a feeling that much of trade expense data is proprietary. There is a recognition from organisations that standardisation needs to happen and that the different vendors need to be engaged to move the archaic invoice management process to a more modern medium, but without central or regulatory direction this may take some time, but is something we are actively looking to drive.

Achieving post-trade efficiency has been a lesser priority for financial institutions battling with maintaining the bottom line, but there has been a gradual acceptance that this can no longer play second fiddle to other considerations. The Covid-19 crisis reminded organisations just how costly failed trades can be when they are tackling large volumes and high market volatility.

Now is the time to take advantage of the solutions on offer but this needs to be done using a collegiate approach which benefits not just the financial industry itself but also the underlying customers.