

## THE PARTICIPANTS



**Philippe Chabadal**  
 CEO,  
 Smartstream



**Michelle Price**  
 Business editor,  
 The Banker

# POST-TRADE PROCESSING: THE NEW IMPERATIVE

## *Masterclass*

*Banks' back offices globally were exposed by the recent crisis as inefficient, lacking in scalability and ripe for increased regulatory scrutiny. Policy-makers and regulators, meanwhile, began to call for the creation of centralised industry utilities, in a bid to reduce the systemic risk associated with the trading, processing and clearing of a variety of complex products. In The Banker's second Masterclass on the subject, Philippe Chabadal, CEO of SmartStream, a middle and back-office processing technology provider, discusses in more detail the scope and depth of the emerging regulatory agenda, the growing pressure on the back-office cost structure, and the ever-more compelling arguments for moving post-trade processing towards a utility model.* **WRITER** *Michelle Price*

### ■ WHAT LESSONS DO YOU THINK THE CRISIS HAS DELIVERED TO BANKS' BACK OFFICES GLOBALLY?

It has offered a number of lessons. The first is that, while obviously the financial services industry has a huge IT spend, the IT spend did not work and some of the business processes had to be retaught. The other aspect is that the risk controls in place were also lacking and it was impossible for the system to isolate problem banks. That calls for new regulations.

### ■ IN TERMS OF REGULATORS, WHO IS EXERTING THE MOST PRESSURE ON THE BACK OFFICE AND IS THIS PRESSURE STRONGER IN ANY PARTICULAR REGIONS?

The UK's Financial Services Authority (FSA) is certainly very active: it has pushed for new regulation in terms of cash management and liquidity management and these are benefiting the industry as a whole.

The Federal Reserve is also looking to introduce similar rules. At the same time, the European Central Bank is pushing very hard for new initiatives in terms of managing the reference data – which is a huge problem for the industry.

### ■ YOU MENTIONED THE FSA LIQUIDITY RISK REGULATIONS: CAN YOU EXPLAIN A LITTLE MORE ABOUT HOW THESE PARTICULAR PROVISIONS ARE AFFECTING THE MANAGEMENT OF THE POST-TRADE PROCESS?

A recent study suggests that some 75% of banks do not have appropriate tools to manage collateral and cash and the new rules are going to push the banks to retool in terms of their liquidity risk management operations. This will impact all the back-office processes and tools.

### ■ ARE THERE ANY OTHER PIECES OF REGULATION IN THE PIPELINE THAT YOU BELIEVE WILL DIRECTLY IMPACT THE POST-TRADE PROCESS OR IS THE PRESSURE MORE INDIRECT?

The regulators are going to push for straight-through processing (STP). This used to be a bad word but it is becoming a very topical buzz-word. I think everybody needs to move towards STP: there is no excuse to take three days or three weeks to process a trade. Everything needs to be sorted intraday.

### ■ WHAT KIND OF KEY PERFORMANCE INDICATORS ARE THE REGULATORS GOING TO LOOK FOR IN TERMS OF JUDGING BACK-OFFICE IMPROVEMENTS?

The first one is the STP rate. If you have 95% or 98% of throughput, you obviously do not have a major problem. But it depends on the asset classes. For US cash equities, banks have a very high rate of STP throughput, which is usually in the high 90s. If you look at the over-the-counter (OTC) products, however, especially where these are cross-border, you may have a throughput rate of about 70%. In the OTC world, half of the post-trade processes are performed by hand and that is clearly unacceptable.

■ **WHAT IS DRIVING THE BANKS TO RETOOL IN THE BACK OFFICE: OPERATIONAL RISK OR COST?**

Today, cost and efficiency are the big drivers. The costs have risen in the past 10 years. The ratio of front-office costs to back-office costs has gone the wrong way. It used to be a ratio of 1 to 0.5 but now the ratio is 1 to 1.5. The front office is footing the bills for the back office. As costs rise dramatically, the banks just cannot afford not to become more efficient. They have to make drastic changes in the cost structure.

■ **AS CERTAIN TYPES OF TRADING BECOME COMMODITISED AND MARGINS DECLINE, OR VOLUMES FALL, DOES THIS EXERT FURTHER PRESSURE ON COST STRUCTURE?**

Yes. When you run these operations in house, your cost structure is pretty much fixed. If you have a drop in volume, the cost structure remains the same which creates a very large cost exposure.

■ **ARE THE CHALLENGES IN THIS REGARD ANY GREATER IN PARTICULAR GEOGRAPHIES? FOR EXAMPLE, IN REGIONS WHERE LABOUR IS CHEAPER ARE BANKS LESS CONCERNED ABOUT MOVING TO A MORE SCALABLE COST STRUCTURE?**

The location of the staff does not matter as much as the sophistication of the bank – and because a lot of the US and European banks have offshored their back offices to India, they have the same cost benefit. The issues relate more to how much legacy IT there is in place, how inflexible or flexible these systems are and how they can adapt to a new asset class and new structured products. That is where the difficulty lies for the banks, so if they are expanding their product coverage then they need to re-tool much more quickly than others.

■ **BEYOND THE REGULATORS, ARE THE BANKS' CLIENTS NOW ASKING MORE QUESTIONS ABOUT THE POST-TRADE PROCESS?**

There is no question about it. The client is a very important factor. Some of the large hedge funds have decided to calibrate the size of the trades according to how efficient the counterpart is and how good its back office is. That is the essence of the problem: you are only as good as your counterparties' systems. So the hedge funds are putting tremendous pressure on the prime brokers and the custodians to improve their throughput rates and their client service.

■ **THAT IS AN INTERESTING POINT: NO-ONE IS ACTING IN ISOLATION. WHAT DOES THAT SAY FOR THE UTILITY MODEL THAT IS BEING CHAMPIONED MORE AND MORE OF LATE? IS THERE A GROWING ACCEPTANCE OF THE UTILITY MODEL FOR BACK-OFFICE PROCESSES?**

Very much so. A couple of years ago the large banks were seeing the back office as a differentiator and that trend has reversed. What matters is having a good back office, but it does not matter if you own it or not, and we see large banks very interested in moving the processes in the back office outside and into a utility-type model. Some banks are still using faxes for order confirmation and that has to disappear. I think the utility model will help move everyone to a higher level of efficiency: even if you spend hundreds of millions of dollars fixing your problem, there is still nothing you can do about your counterparties' systems.

■ **HOW CAN YOU PERSUADE THE BANKS TO THINK IN THE SAME WAY?**

For me it is about 'what is the value-add?' Post-trade processing is nothing unique. So I think if you conceptualise all the business processes you have in the back office and accept that there is nothing unique about it, and you have a bottleneck that needs to be eliminated, moving to a utility model reduces the problem for the whole industry. A lot of the back-office systems, especially when outsourced, are running batch – the opposite of real-time. The world needs to move to real-time processes so if there is an issue, a bank or institution can be isolated so that the problem does not spread out to the rest of the system.

■ **ARE THE BANKS BEGINNING TO WAKE UP TO THE ISSUES?**

Absolutely. If you have hundreds of people and distributed groups working on this, the only way out is to externalise these services.

■ **BUT IS THERE A MIGRATION OR TRANSITION CHALLENGE IN DOING THIS?**

There are two choices. Either banks can move to a software as a service model where they transfer the operations onto an external web-based platform and there is no migration in that sense, or we can lift out the functions. So the migration is very light. The bank will make a choice on how much of its operations it is prepared to relinquish. <sup>TB</sup>

**THE ISSUES**

- **LESSONS OF THE CRISIS**
- **REGULATIONS IN THE PIPELINE**
- **IMPORTANCE OF COST AND EFFICIENCY**
- **INDUSTRY OPINION ON THE UTILITY MODEL**
- **MIGRATION CHALLENGES**



**Watch Now**

*Watch the debate or individual chapters – visit [thebanker.com/media](http://thebanker.com/media)*

Sponsored by   
**SmartStream**