Capital markets industry viewpoint

Key challenges and best practices in trade expense management

Margin compression, the drive for cost reduction and increasing regulatory pressures have forced banks to seek ways to reduce trade execution expenses and gain transparency. Over the past year, we held quarterly roundtables in North America and Europe with forty participants representing operations, finance and technology from leading global banks to discuss best practices and the key challenges in trade expense management, as well as its effect on the bottom line.

Trade expenses are not only exchange, brokerage and clearing fees, but can also include things such as settlement, FIX connectivity, back-office operations and market data. The most sophisticated banks have centralized the management of these expenses to promote greater efficiency. This approach can provide data that allows a bank to lower costs, negotiate favorable vendor agreements and better allocate and forecast expenses to create more accurate P&Ls and budgets.

While almost all participants agreed on the need for internal centralization, very few banks have achieved it. Most still struggle to understand their trading expenses on a holistic basis, and to allocate them accurately across business units, trading desks and clients. Some are able to gather accurate data on expenses relating to one or two asset classes, such as equities, but few can do this for all assets and across all jurisdictions. This is a pressing problem, since the cost of trading is the third largest expense for these businesses, behind people and technology.

The following summarizes what we learned about the current state of trade expense management from those roundtables.

Priorities and challenges

Lack of invoice transparency

The roundtable participants unanimously agreed that the lack of invoice transparency and data accuracy from brokers, custodians and exchanges is one of their greatest challenges. With these crucial pieces lacking, the reconciliation of trade data for transaction charges and additional fees is increasingly difficult.

Broadridge®

This can lead to inconsistent results due to poor or irreconcilable invoice data from different vendors, which in turn can lead to overpayments or under-credits. As trading expenses continue to grow in complexity and regulators continue to push for greater transparency, better fee visibility will become an increasingly valuable competitive advantage.

Data accuracy

Although many of the attendees believe that data analytics drive valuable changes in business and culture, there is a high degree of frustration about its lack of accuracy.

There are often different codes for the same broker on different systems and traders are often named differently on the various systems they access. This leads to many inconsistencies and a data management nightmare. Bankers believe that this problem needs to be handled up front with proper data management mapping tools to normalize all the relevant codes. Also, small and mid-sized brokers often are unable to send data in the particular formats needed by the banks.

Despite a widespread desire for consistent reports with key data that banks can compare, contrast and analyze, data accuracy obstacles have handicapped efforts to achieve this goal.

Fee accuracy

Because of the lack of data and the possibility of hidden charges, most banks are not confident in the trading fees they are charged. One firm is creating a central reporting system to compare vendor agreements and run comparisons to analyze their fees. The roundtable participants agreed that having a system to provide daily reporting would be helpful in analyzing fees, as well as understanding their own trading behavior.

One large firm reconciles cash equities with 90-95% degree of accuracy, but the rest of the asset classes it trades require further work, which tends to be manual. For those expenses, it reconciles them on a monthly basis.

Regulatory pressures

In the environment since Dodd Frank and the Libor scandal, it was agreed that increasing regulatory pressures and scrutiny are helping to drive the move toward automated trade expense management and transparency.

Despite this, roundtable participants said cost reduction remained their highest priority for trade expense management. However, they believe that the technology and processes that will be the most effective at lowering costs will also go a long way toward satisfying regulatory requirements.

Best practices

The roundtable delegates had a broad variety of approaches to managing trade expenses but some common themes emerged.

Negotiating global agreements

Despite the appeal of having “global” standardized contracts, this is a difficult ideal to achieve. Some banks negotiate fee agreements regionally but take into account existing contracts and conditions in other regions or elsewhere in the bank. These banks do not think it is possible to negotiate global agreements because there are specific requirements within each region.

Other banks have created a central team that negotiates contracts. This provides useful information because, for each vendor, the bank knows where it ranks on both volume and cost. These banks have experimented with global contracts, but have found it hard to capture all the necessary nuances. They worry that global agreements could reduce the amount of useful detail, which can make it harder to complete tasks such as the allocation of costs.

All indicated that traders are no longer allowed to negotiate agreements due to compliance issues.

A single central utility for trade expense management

The trend is to build a centralized expense management utility to promote greater efficiency and achieve cost reductions. Some banks have already done so, but the majority lacks the centralized, unified systems and processes to support such a utility.

For example, at present a leading global bank indicated that they have a dedicated expense management team with multiple control systems, and that this structure is fully operational for cash equities. They are now at the point of looking to either build or buy a centralized expense management system to unify all of those control systems and achieve greater efficiencies and cost reduction. However, different systems are still maintained regionally and they rely on their regional teams to provide transparency into the expenses and for analytics. The major challenge they face in moving forward with a unified system, therefore, is data availability.

A small proportion of banks actually have set up this type of centralized utility with global systems. They are ahead of the market and they view this as a way to create expertise and operational excellence that will be a competitive advantage. Previously these banks managed trade expenses on a regional basis but say that the effectiveness was "hit or miss". A critical factor in moving forward was that senior executives within these banks made implementing a centralized expense management control a mandate; this helped overcome trader and vendor pushback.

Looking forward

Challenges around complex fee schedules are nothing new for capital market firms. But increasingly large amounts of data and the acceleration of execution orders make the assessment of trading costs extremely difficult. While banks face challenges with invoice transparency, data and fee accuracies, and regulatory pressures, ultimately a drive for trading cost reduction represents the greatest compelling need for banks to assess their current practices for establishing agreements and calculating expenses.

Although adopting global standardized trade agreements is alluring, consensus emerged among the participants that regional requirements made this practice nearly impossible to achieve; they have gained efficiencies by tasking a central team with all negotiations.

The business case for implementing a centralized utility for trade expense management was illustrated when one bank that successfully implemented a structure to address this issue reported a "massive" payback in a short period of time; and others quickly agreed that it is well worth the effort required to gain visibility into and control of trade execution expenses.

About Broadridge

Broadridge Financial Solutions, Inc. (NYSE:BR) is the leading provider of investor communications and technology-driven solutions for broker-dealers, banks, mutual funds and corporate issuers globally.

Call us: +1 617 960 2576
Visit us: **rev-exp.broadridge.com**

Broadridge