

Realizing Value from Global Multi- Asset Post-Trade Processing

A CEB Insight Brief Commissioned by
Broadridge

Summary

Reducing the cost and complexity of global settlements is the main driver for investment in post-trade technology. At the same time, there is an underlying need to build stronger foundations for the front-office drivers of multi-asset trading and client centricity. Trade execution and account servicing are becoming more commoditized functions. In order to unlock differentiating value, firms must support scalable, multi-asset workflows from the front to back office. This is central to eliminating functional and asset class fragmentation, which has created information silos. To realize the value of post-trade processes and transform the fundamental economics, operating models, technology workflows, and business management capabilities underlying their organizations, forward-looking firms are making foundational investments in the following four drivers: functional fragmentation, regulatory compliance spending, customer centricity, and multi-asset strategies.

Functional Fragmentation Is Resulting in Direct and Indirect Costs

The financial and IT burden of compliance drives firms' desire to leverage investments across multiple functions in the front, middle, and back office. They want to share expert teams and systems to handle common post-trade functions such as confirmation matching, settlement, accounting, and reporting, in part because functional fragmentation results in overspend on hardware, software, and an overall duplication of resources.

Effectively managing the operational complexity that arises from back-office functions is a perennial challenge. A good example is firms' response to new central clearing requirements. Some have expanded their existing post-trade infrastructure. Others have put together a bespoke trade management system capable of connecting to multiple central clearing counterparties and swap data repositories. This second approach often produces a fragmented and siloed post-trade architecture that duplicates resources, systems, and processes. Functional fragmentation is increased, and firms are missing out on potential benefits, such as improved position management. After all, if process silos are spreading the information that is available, creating a consolidated source of position data is that much harder.

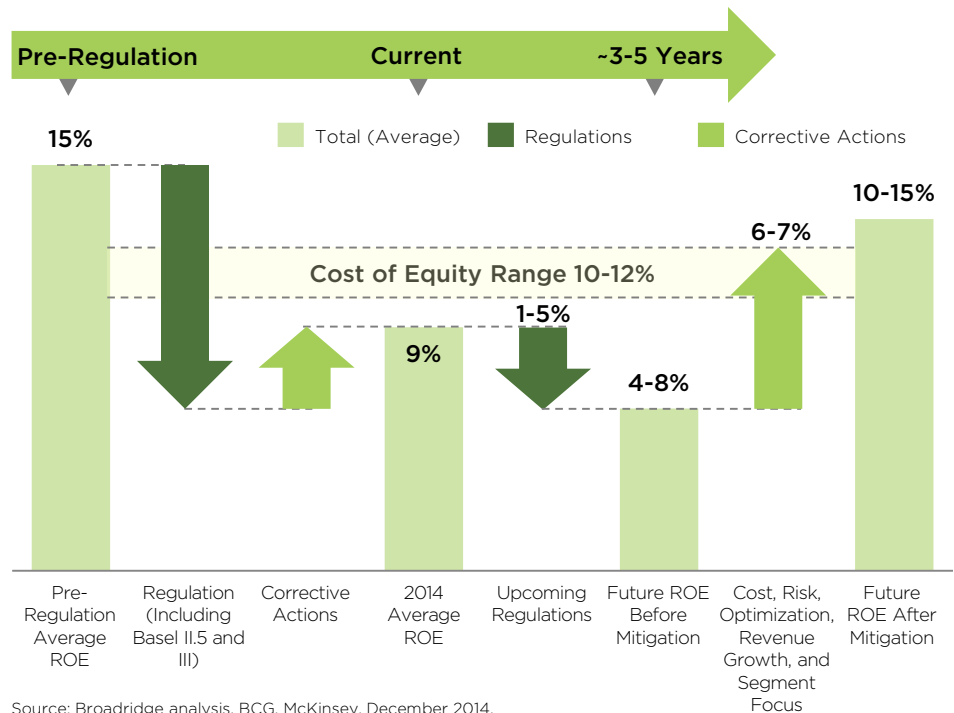
Building a single consolidated platform for post-trade is a high-level objective for all firms across all market segments. This strategy is even more important considering that structural changes resulting from declines in margins for products that shift to central clearing—in addition to increased liquidity and funding costs—have translated into reduced return on equity, particularly for sell-side firms (Figure 1). The impact on the effectiveness of IT and business executives is clear. In interviews with market participants about post-trade convergence, three common themes emerge:

- 1. The current level of fragmentation is creating information silos.**
 - Information flows are segregated by asset class and trading/clearing venues.
 - Collateral management functions live in isolation, characterized by data transfer inefficiencies and limited views of overall collateral, repo, and securities lending positions.
- 2. Market participants need better information to manage margin and capital demands.**
 - Centralized recordkeeping and a single source of information is essential for up-to-date P&L, margin, and capital requirements.
- 3. The IT impact of market complexity is misunderstood and under-resourced.**
 - Diversity of requirements for confirmation/clearing is an implementation and maintenance challenge.
 - Incremental addition of asset classes/markets is an ongoing challenge.

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Figure 1: Effect of Regulation on Return on Equity
Pre-Regulation to 2020, Estimates



Leverage Regulatory Spend to Adapt to Market Changes

Spending on regulatory initiatives like the Dodd-Frank Act, Basel, FATCA, and EMIR, combined with the ongoing pressure on banks' profitability, has led firms to focus on extending the value from their technology investments. But there are significant obstacles to achieving efficiency gains. Between connectivity, matching, position keeping, and reconciliation, there are too many functions in the trade-to-settlement lifecycle, adding complexity and costs at every step. This has made securities trading and settlement significantly more expensive than it needs to be. Structural efforts to simplify and shorten the settlement process are ongoing, driven by regulatory risk management objectives. Figure 2 shows the impact of shorter settlement cycles on counterparty exposure, an important measure of systemic risk.

These planned harmonization efforts have the potential to transform current operational and technical practices across the entire capital markets value chain. In time, they will allow for post-trade functions to deliver on long-term straight-through processing opportunities. There are three areas of systemic investments in post-trade technologies that are crucial to improving long-term efficiencies:

- 1. Invest in Data Management:** The data delivery and reporting requirements on financial institutions have never been greater. Not only are complex and diversified portfolios driving investments in valuation, risk management, and client reporting, but regulations are also compelling firms to offer more granular data to their customers, regulators, and boards.
- 2. Harmonize Settlement Practices:** The processes to trade, settle, and report are widely divergent. While it is possible to automate, the cost of managing exceptions erodes the value behind straight-through processing very quickly. Therefore to develop a scalable and cost-efficient post-trade architecture, firms are moving to more unified processing models, featuring reduced training, resources, and support costs. Minimizing settlement risk by shortening the time between trade and settlement is crucial to mitigating counterparty exposure and helps maximize operational and capital liquidity. Examples of systemic risk reduction include the T+2 efforts in Europe and DTCC initiatives in the US.

Figure 2: Impact of Shorter Settlement Cycles on Counterparty Exposure

Illustrative

Decline in Buy-Side Counterparty Exposure					
Settlement Cycle	T + 3	T + 2		T + 1	
Stress Scenario	\$300M	\$190M	-35%	\$80M	-70%
Major Failure Scenario	\$2,600M	\$1,600M	-40%	\$600M	-75%

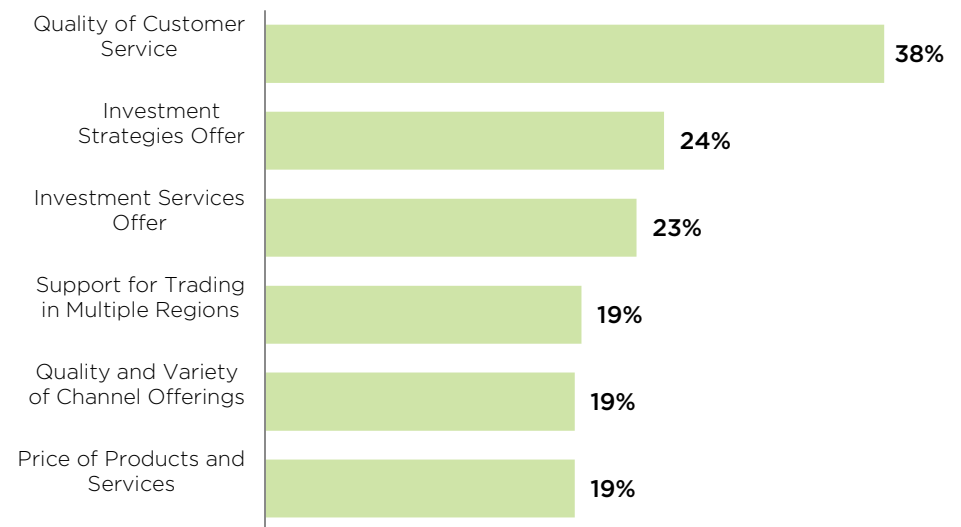
Source: DTCC, "DTCC Recommends Shortening the US Trade Settlement Cycle", April 2014.

Focus on Client Centricity Necessitates Post-Trade Investments

Differentiation is no longer driven by core capabilities such as settlement and accounting. CEB research shows that capital markets firms point to customer service quality as the top competitive differentiator (Figure 3). But customer service cannot be improved without underlying strengths in core post-trade processing. Robust back-office data and processes underpin firms' ability to deliver innovations and advanced operational analytics. At a strategic level, banks have taken reactive approaches to data. In doing so, they are overlooking the enormous growth potential offered by better data management: customer acquisition, up- and cross-sell opportunities, and stronger client retention. Being able to uniquely identify products and customers will allow firms to improve customer service and commercial opportunity. Firms that achieve these objectives will also have improved access to global data across asset classes and markets. As legacy systems are often incapable of delivering high-quality, customer-specific data, firms must invest in post-trade processes, as well as customer-facing technologies.

Figure 3: Top Preferences of Capital Markets Firms

Percentage of Capital Markets Firms, 2014



n = 238.
Source: CEB 2014 FSI Survey.

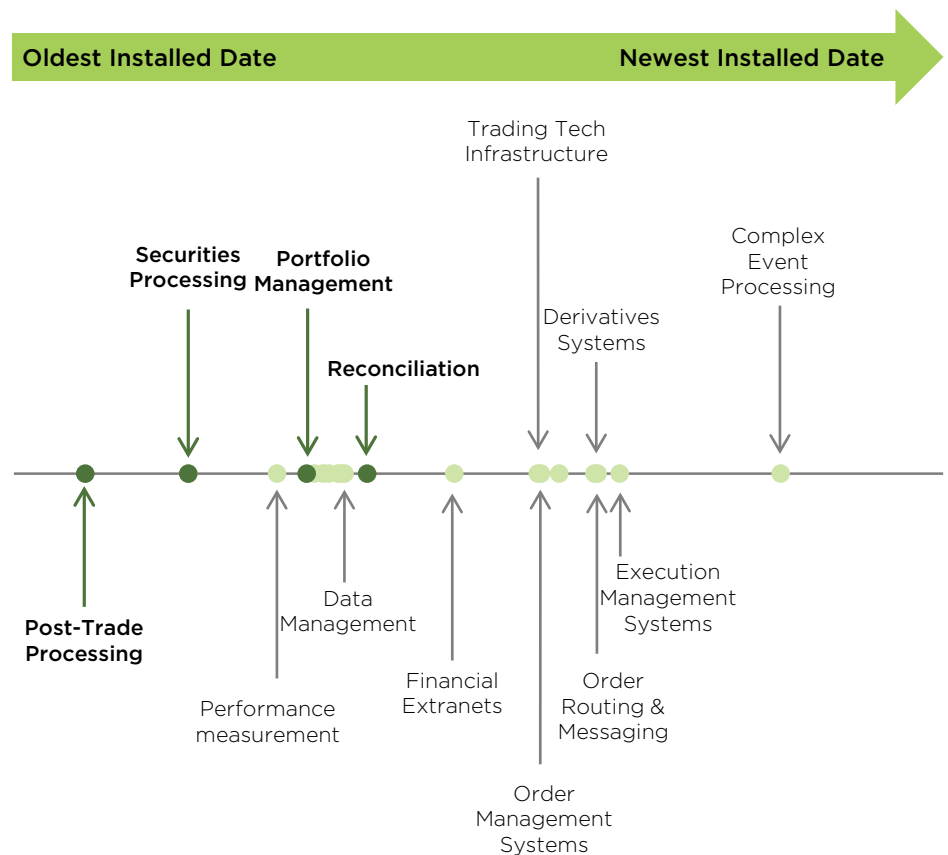
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Post-Trade Technology Needs Upgrades to Data, Messaging, and Workflow Capabilities

Capital markets firms are presiding over an aging IT portfolio. That is particularly the case for back-office technologies: according to CEB's annual Adoption and Investment Survey, most post-trade processing systems were installed in 2007 or before. Many have become outdated as rapid data growth has put pressure on existing processes. Buy-side post-trade processing, portfolio management, reconciliation, and sell-side securities processing systems all perform critical back-office processing functions that can compromise client service over time. Without upgrades or innovation, these systems will become increasingly difficult to integrate with more modern client-facing platforms (Figure 4). Add in the complexity of online and mobile interfaces, and such a platform mismatch can lead to service disruptions for clients, ultimately harming loyalty.

Unfortunately, this fragmented and siloed approach has become the standard modus operandi of middle- and back-offices worldwide. When a new financial product is brought to market, trading often starts without any upfront consideration of confirmation, clearing, settlement, accounting, and reconciliation. Because of unique product characteristics and operational workflows, existing middle-office and back-office systems are not reconfigured to accommodate the new business. Instead, new systems are developed or acquired, and more people are hired. This creates the perfect conditions for a duplicative and inefficient operating model.

Figure 4: Relative Age of Capital Markets Technologies
Percentage of Capital Markets Respondents, 2014-15



n = 109.
 Source: CEB 2015 FSI Survey.

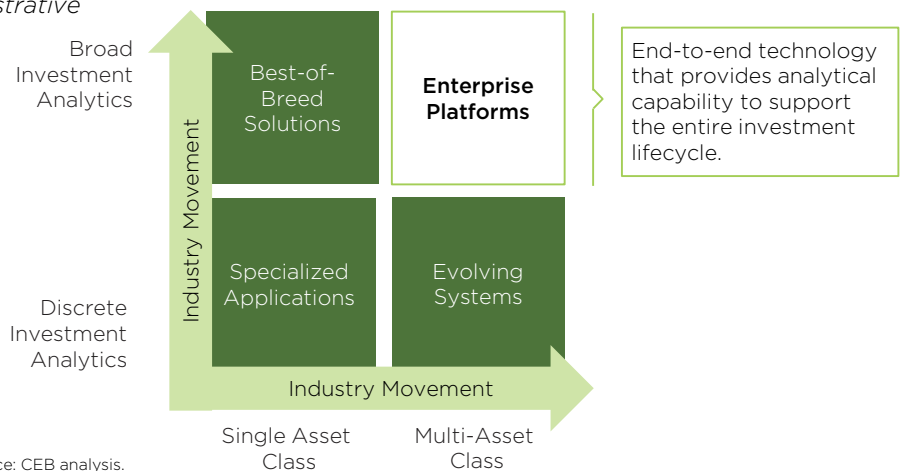
Multi-Asset Investment Strategies Demand Realignment of Front, Middle, and Back Office

It has always been easy to find sponsors for asset class convergence in the back-office and technology functions. The case for simplification and re-use is obvious if your metric is operational efficiency and cost reduction. But in recent years, there is an increasing level of support from the front office. This trend is driven by trading and investment firms' focus on multi-asset strategies. With rates of return on vanilla portfolios at all-time lows, traditional investing is losing ground. Within the next five years, passive and alternative products are projected to account for nearly one-third of global assets, up from one-fifth in 2012. In this current investment climate, in which investors seek returns from global markets and alternative products, firms must future-proof their business and operating models to support multi-asset risk and return strategies.

The diversification of trading and investment strategies means more markets and asset classes are traded, increasingly on one multi-asset trading platform. When these trades go through the post-trade cycle, they are dispersed across siloed back-office systems. This creates operational inefficiency, and also contributes to increased financial risk and exposure. Effectively capturing the nuances of alternative investments and high-yield assets requires a comprehensive analytics environment that is capable of measuring and reporting real-time risk, position keeping, and valuation of all products (Figure 5). Progressive firms are increasingly executing across a wide range of forwards, swaps, options, and other derivatives. Creating a single view of risk exposure in this interconnected product landscape is critical to compliance and optimized position management. Up-to-date functionality for collateral management, securities financing, and risk management are crucial to a firm's post-trade technology stack. Without credible global multi-asset capabilities, the firm cannot capitalize on clients' appetites for trading these products.

Figure 5: Convergence of Historically Distinct Investment Analytics Technology

Illustrative



Source: CEB analysis.

Conclusion

The industry shift toward post-trade asset class convergence has the potential to yield consolidated position and exposure data, as well as allow for IT portfolio rationalization. When building the business case for post-trade processing automation, firms should avoid focusing too narrowly on the balance between the cost of change and the efficiency savings. While the complexity involved should not be underestimated, the time is ripe to build a smart cost-benefit case that takes into account the cost of change and access to new, high-quality information. While firms have options to build from scratch, extend their existing platform, or partner with a third-party provider, post-trade automation projects must clearly identify the information advantages of having access to a single data source that will help firms maximize their own and their customers' assets.

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