



The path to a post-trade utility

Shared utilities could save institutions as much as 40% of their current processing costs, but there are challenges to implementation, writes Tim Gokey, COO, Broadridge

Global capital markets banks have cut costs significantly and restructured since the financial crisis, but they continue to struggle to post returns on equity that exceed their cost of capital. It won't get easier during the next five years as they confront new regulations and market structure changes that could shrink returns by up to an additional five percentage points.

Transforming the middle and back office, where new regulation and technology requirements carry high costs, could significantly improve returns for many institutions. For some time, market leaders have been discussing the idea of utilities that would share, or mutualise, trade processing activities. This would create significant benefits from economies of scale and network effects, but the challenge has been defining an approach that can work.

The industry spends \$17-24 billion annually in processing trades, with \$6-9 billion representing the processing cost in highly standardised asset classes such as equities and fixed income securities. Based on a recent comprehensive Broadridge analysis, a utility that handles highly standardised trade processing functions could wring out up to 40 percent of costs and save \$2 billion to \$4 billion annually.

Specifically, this analysis foresees a 20-40 percent reduction in annual spending on highly standardised asset classes within core post-trade (clearance and settlement, custody, financing, books and records), and related functions (reference data, reconciliations, corporate actions, client life cycle management, tax and regulatory reporting). In addition, it

includes an 8-10 percent reduction in annual industry spending on trade expenses linked to executing broker fees.

Within the trade lifecycle, core post-trade processing is the natural starting point for a utility. It is a relatively standardised function with significant room for increased efficiency and

“Transforming the middle and back office could significantly improve returns for many institutions.”

is critical to other areas, serving as the system of record for securities transactions. It also delivers a range of data useful to other key functions, such as corporate actions, tax and regulatory reporting, reference data and reconciliations.

The potential benefits of a post-trade utility go further. Such an approach to the function could boost overall productivity and innovation as well as strengthen regulatory compliance and risk management – thus quickening the path to recovery and resolution and a shorter settlement cycle. At the highest level, a post-trade processing utility could turn a major cost centre into a more efficient operation that frees up dollars to reinvest in other areas.

Given these benefits, what has been keeping the industry from adopting a post-trade utility? Several significant issues must be

addressed including: aligning on governance, ownership and pricing models; setting achievable scope and functional priorities; identifying a viable technology and operating model for multiple banks, each with unique requirements; and managing conversion risk and multibank technology delivery.

These are not insignificant challenges. The time and cost of re-architecting one bank's proprietary platform to create the basis for a utility is likely to be prohibitive due to the complexity of adapting one system to meet the diverse needs of many other firms. Beyond this, the effort of converting banks onto the platform could account for nearly two-thirds of the overall cost associated with creating a post-trade processing utility.

Despite these hurdles, the industry is nearing an inflection point where many of these issues can be resolved and the potential benefits outweigh the hurdles. That point is based on two factors: 1) a greater willingness by leading institutions to evolve to new operating models as they look to the future, and 2) proven performance of post-trade processing managed services offerings, which have proven themselves since the crisis as feasible and transformational lever for forward-thinking institutions.

Charting a Path Forward

Any post-trade utility needs to support multiple institutions under a common technology platform and operating model; provide outcomes-based pricing based on agreed service levels; and enable shared governance. Mapping out a quick, effective path will require a carefully scoped

approach – starting with the most liquid and standardised asset classes and focusing on regions where the market structure is most centralised.

Success requires highly configurable multibank technology and skilled conversion-and-delivery resources. It demands an operating model that delivers high-quality service to multiple institutions while providing appropriate regulatory reporting and governance. To ensure ongoing investment and innovation, it should operate under a commercially driven model with outcomes-based, service-level agreements.

Although significant cultural, technological and operational hurdles remain, the path to a global trade processing utility is becoming clearer. To maximise the chances of success within a reasonable time frame, the industry could adopt the following approach:

- **Start with a small group of globally oriented institutions under a commercially oriented model.**

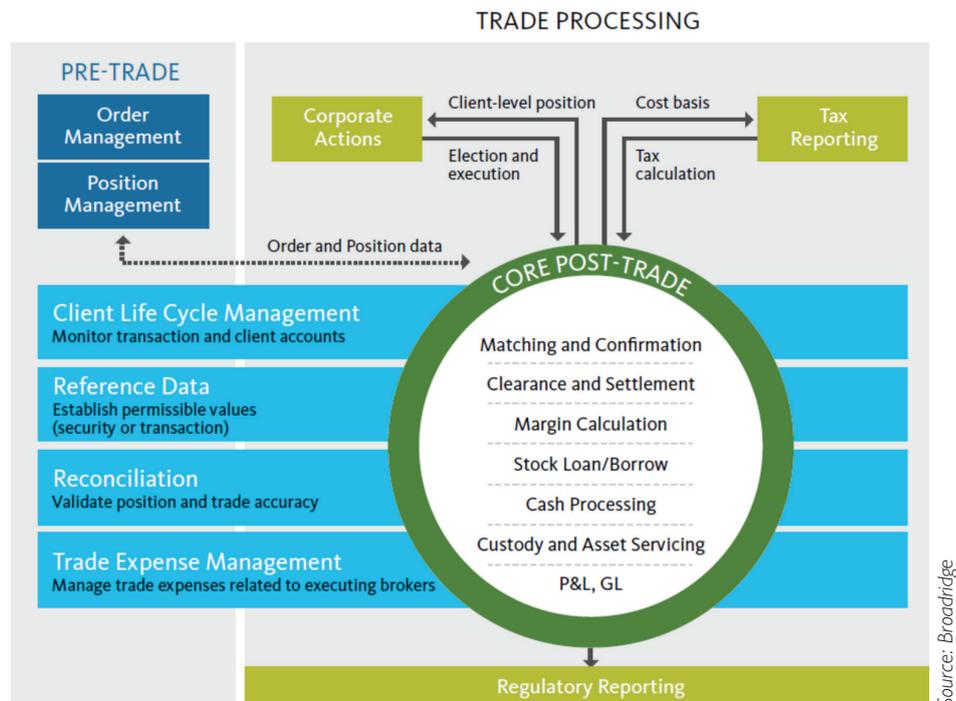
They should be capable of delivering quickly on the scale necessary to establish a minimum cost per trade. They should establish a partnership structure with outcomes-based service-level agreements that leverage the pricing models and contract terms of the commercial partner.

- **Set a targeted and phased scope, first focusing on highly standardised and liquid markets.**

Ultimately, the utility should drive global multi-asset functionality. Among asset classes, the smoothest path would start with listed equities, fixed income and repos. From a geographic perspective, starting with a region with the intention to expand globally is the most feasible approach and can deliver early savings to fund expansion over time.

- **Build from scalable, configurable technology and operations to support multiple banks.** Sound technology selection is critical. The industry can limit cost overruns and integration risks and greatly reduce time to market by using

CENTRAL TO THE TRADE LIFE CYCLE



Source: Broadridge

technology and an operating model proven to deliver high-quality service to multiple institutions while adapting to their discrete business models.

- **Leverage experienced conversion and delivery resources.**

It's complex and risky to convert banks onto a common post-trade utility platform and provide ongoing service delivery across multiple institutions. Leveraging existing workforces with deep experience in dealing with multiple bank environments and post-trade systems integration and technology delivery can smooth the path.

Following this path, banks could nearly halve the investment, time and risks associated with building a post-trade utility versus constructing a platform from an existing single-bank platform.

Risk of Doing Nothing

For the industry, the biggest risk lies in doing nothing given return pressures and other longer-running challenges. Without more aggressive changes to their cost structures,

banks will continue to confront the challenge of recovering ROE. A utility model that navigates this path could unlock significant economies of scale; improve compliance and risk mitigation; and help drive innovation and productivity.

Banks have a window of opportunity to adopt a more sustainable operating model. Charting a timely and effective path will require a tightly scoped and phased approach that leverages configurable multi-bank technology and operations, and experienced conversion and delivery resources.

But, by following this viable path forward, the industry could lift profitability and future-proof trade processing activities for many years to come. **BT**

About the author

Tim Gokey is chief operating officer of Broadridge and co-author of the recently published whitepaper, Charting a Path to a Post-Trade Utility; How mutualized trade processing can reduce costs and help rebuild global bank ROE.