ASCENDANT STRATEGY

The Economic Imperative for Post Trade Resilience in Capital Markets

– Why & How

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The Economic Imperative for Post Trade Resilience in Capital Markets – Why & How

As the world reflects upon the impact of the last 6 months and starts to revise strategy based upon the 'new normal' that it now finds itself in, we look at what C-level leaders should be doing to catalyse change across their middle and back office domains.

As the reality of the global pandemic sparked volatility in global markets, many organisations found their post trade infrastructure placed under significant duress. Fails and margin call volumes rose exponentially as a response to increased trading activity, with ESMA reporting equity fails volumes reaching 14% during early March (versus a historic rolling average of about 5%[1]). And in the US, it was SIFMA that co-ordinated weekend meetings for organisations across both buy and sell side to resolve settlement backlogs[2]. This magnified the challenge that C-level leaders have typically battled against – the need for automation and standardisation within post trade processes, to provide scalable and cost-efficient processing.

Cost/income performance had driven much of this pressure historically, where the operating cost of maintaining post trade infrastructure and processing – almost 25% of revenues for some[3] – was already making business economics untenable. Offshoring as a trend had delivered some short-term relief to the cost problem, but merely moving heavily manual processes did little to help scalability in the face of market stress. And for some, this increased length of supply chain actually exacerbated the problem of maintaining oversight and control. Adding fuel to this fire was now the question of resilience, as external regulators start to question the systemic risk associated with low levels of process automation – creating more cost pain with the potential for capital add-ons for those organisations that cannot mitigate this risk.

Whilst the challenge is not new, the economic imperative for solving it has now been compounded by a renewed focus on resilience. And whilst short term regulatory pressure may have eased – with the CSDR fails regime and UMR waves 5 and 6 being pushed back 12 months – the impact of this market volatility would have been hugely magnified had they been in force. To learn from this experience and take proactive steps to future proof their post trade environments, what should the C-suite be doing to drive progress?

1. **Bring Budget Owners Together**. Many underestimate the extent to which the post trade process and the technology supporting it are inter-twined. Rather than compete with each other, Heads of IT and Heads of Operations need to be brought together and incentivised to deliver a consolidated end state outcome, enabled by their cost bases becoming fungible.

   'My challenge is one where the CTO has already delivered their budget forecast, meeting year-end cost targets through reduction of change the bank spending. I am now under pressure to reduce budget by a similar amount, but with no levers for automation in what is a heavily offshored, people driven cost base'. Global Head of Equity Operations, European Investment Bank

   Creating a shared understanding of the cost drivers (and owners) is the first step in being able to move forward. And avoiding internal cost competition is the second.

[1] ESMA Report on Trends, Risks and Vulnerabilities No. 2, 2020
[2] Market 'distress' over virus sparked emergency Wall St measures. Financial Times May 26th 2020
[3] Five themes for transforming wholesale banking operations and technology. McKinsey September 2019

2. **Create Financials for Success.** Strategic decision making requires financials to inform the process by creating a full picture for benefit realisation. Reliance on functionally siloed (back office IT or Operations) cost allocation methodologies won't deliver this. Organisations must demand from the finance function the data to derive strategic insights and not be constrained by what is available, rather than what is needed. ROI modelling of future cost of change, scalability benefits on risk events, process cost drivers and automation levels must be created. And where this is not possible, leadership must be bold around using proxies or making judgements based on experience rather than hoping that (generally backward-looking) data can make the decision for them. Unwinding legacy complexity and future-proofing processes requires a different mindset from the short-term horizons that budget cycles typically operate on. This doesn't mean transformation will not be financially viable, but it will require long term thinking and recognition that investment will be over a multi-year cycle.

3. **Create Clear & Common Objectives.** Competing internal agendas – business or function led – are a common cause of frustration when driving enterprise wide transformation agendas. This has to be resolved by leadership – which could be a management exec or even a board – driving the agenda and recognising the criticality of the task at hand. Silo mentalities dominate in the absence of these objectives being clear which over time erode the value proposition. Objectives must link clear outcomes to value, which is bought into and committed to by the whole enterprise. Engagement cannot be optional.

4. **Leadership Not Management.** Transformation agendas require extensive cross-functional collaboration to be successful. This requires leadership and project teams to collaborate on delivery of the outcome, rather than this be seen as 'IT-led transformation' or 'Ops-sponsored change' which reinforces a mindset of 'someone else's job'. Cross-functional leadership teams driving transformation change is an obvious concept, but even where IT and Operations exist under a single leadership structure this rarely occurs. Leadership in these situations needs to be recognised and rewarded, to avoid functional management agendas dissolving good intentions.

5. **Challenge Perceptions of Core Competence.** C-level leadership can add value from a high-level vantage point by challenging what is truly a competence to be retained within an organisation. This is a valuable counter to what can sometimes be risk-averse decision making based on vested interests from internal stakeholders. Innovation in supply chain management for other industries has been driven by a ferocious focus on what is truly core to the value of the organisation, versus what should be handled better and more efficiently elsewhere. Post trade leaders often have the mindset of being a monopoly supplier, where competition for their services doesn't truly exist. This level of challenge is necessary to optimise the supply chain and truly extract value from what is still, in the main, an uncompetitive landscape.

'The successful investment bank of the future will look quite unlike many existing banks today. The retained organization will likely be stronger and leaner, augmented through external collaboration with FinTech firms, market utilities and managed service providers. The technology landscape will likely be modular and interoperable, and ultimately, simpler. The culture will be one of collaboration, not protectionism' Capital Markets: innovation and the FinTech landscape. EY & Innovate Finance 2016

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