acuiti management intelligence

WHITEPAPER

Breaking down the trading silos

Challenges and opportunities on the long road to greater trading efficiency

Sponsored by:

Broadridge®

For broker-dealers, collapsing the traditional silos across asset classes, geographies and internal functions can be an effective way to create trading workflow efficiencies and simplify the process of meeting exacting regulatory demands. But, while the end point of integration is clear, the path can be extremely complex to navigate. Integration encompasses everything from technology to culture and choosing where to integrate desks and workflow is not the same decision for all firms - firm size, strategic priorities and attitudes to outsourcing all enter into the equation.

In confronting these challenges sell-side firms are often taking on multi-year legacies, built up through mergers and the isolated build-out of business lines at a time where growth was prioritised over concerns about costs and complexity. Today, in an environment where senior management's focus is on efficiencies, firms are seeking to combine capacities and infrastructure wherever possible.

In this report, commissioned by Itiviti/Broadridge, Acuiti surveyed or interviewed 58 sell-side firms on their approach to collapsing silos, the motivations for doing so and the progress made to date. In addition, the report sought views on attitudes to technology for managing derivatives trading.

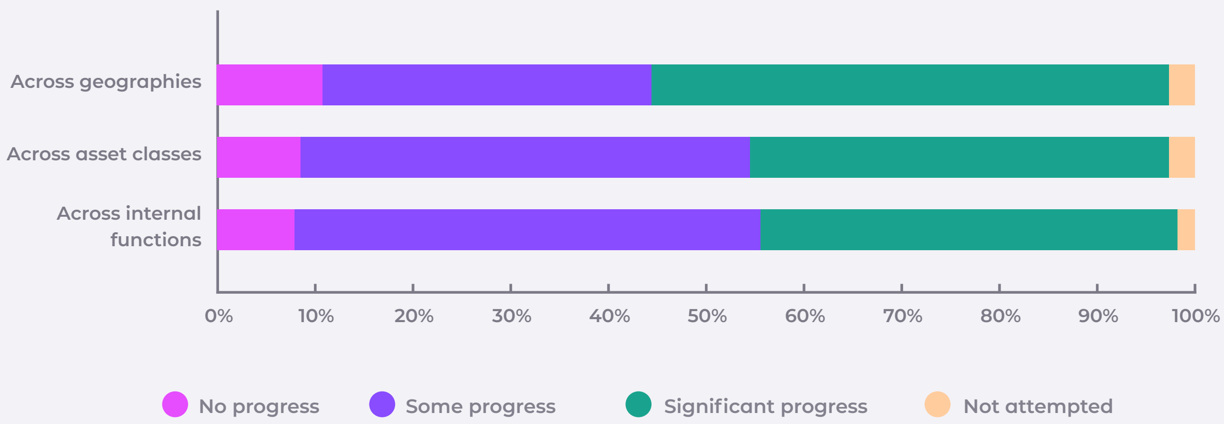
The key findings are:

- Scale gives firms a significant advantage when navigating multiple jurisdictions' regulatory frameworks and consolidating across geographies
- Collapsing silos across the front-office is often held up by the complexity of differing workflows across asset-classes
- Consolidating workflows delivers tangible and rapid improvements in client service while firms can also expect technology cost reductions of around 10%
- Firms are moving towards vendor consolidation, with efficiency gains outweighing concerns about consolidation risk
- There is very strong demand from the sell-side for front-to-back integration within derivatives businesses
- Attitudes are warming to using the cloud, but data security concerns are still prevalent

Regional consolidation

Consolidation of silos to achieve operational efficiency has long been a strategic goal for the sell-side and the survey found that all respondents had implemented an integration programme in at least one of the three areas: regional, across asset classes and across internal functions.

Over the past five years, how much progress has your organisation made in consolidating workflows and improving operational efficiencies in the following areas:



Over half of respondents reported making significant progress in consolidation across geographies including almost 70% of tier 1, 2 and 3 banks. This has been driven by the dual forces of regulatory and client demands.

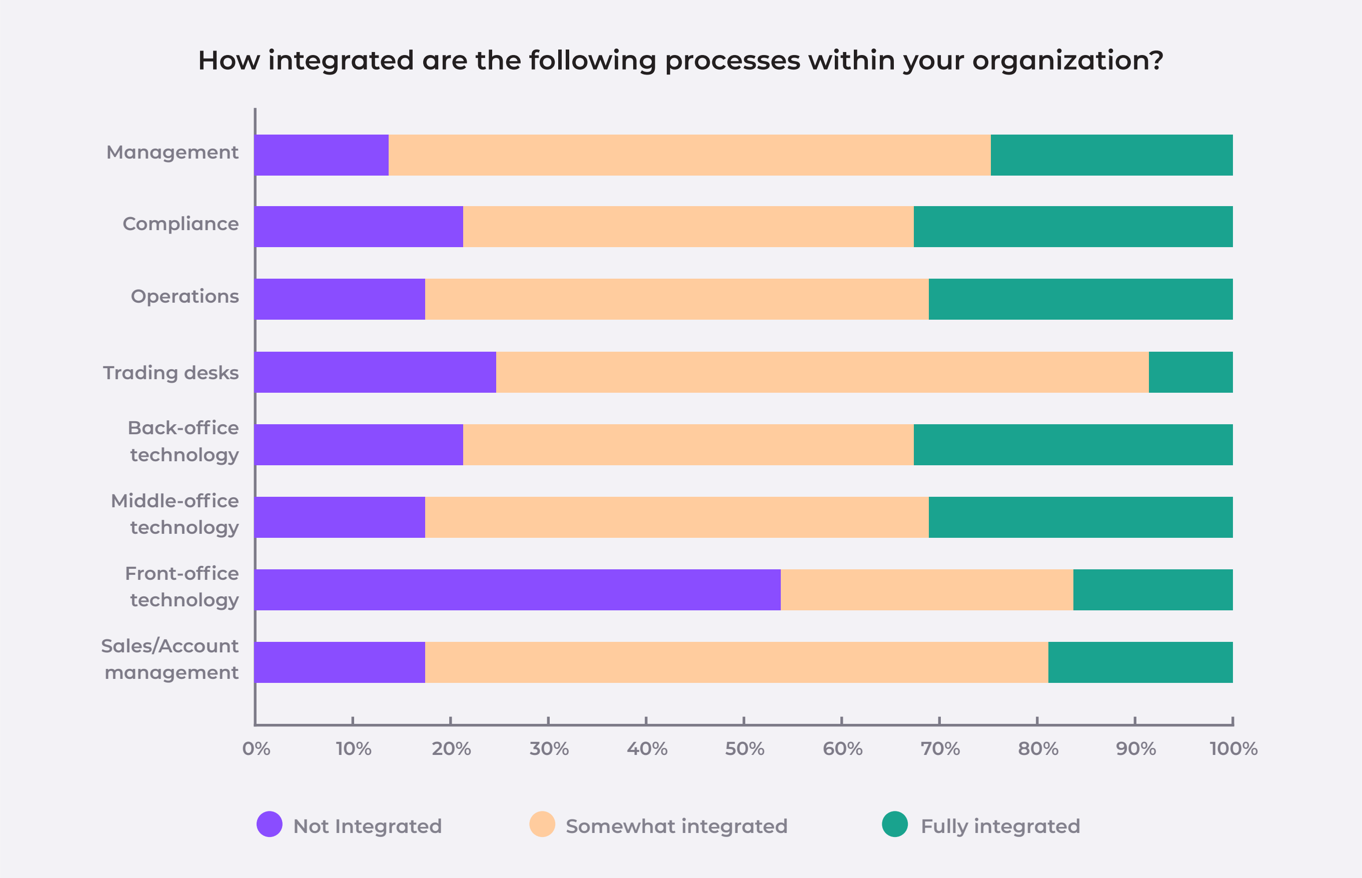
Fragmented post-crisis regulatory reform has made it more difficult for smaller firms to scale across multiple jurisdictions. Larger banks have built up the capabilities to operate effectively across multiple jurisdictions and to code different regulatory frameworks into their systems. These firms often also tend to apply best practices across jurisdictions to combat regulatory divergence. This inevitably requires the standardisation of workflows and functions across different regions.

At the same time, top tier banks tend to serve larger clients with global operations. These clients increasingly demand a single service across global offices and banks have invested in technology platforms with functions such as “follow the sun” order management to ensure a harmonised offering to multi-national clients.

Functional consolidation

Collapsing silos across internal functions such as sales and operations has become increasingly important in the relentless drive towards cost reduction and greater efficiency. This was an area where sell-side firms reported the most progress with 91% of respondents having made some or significant progress.

Firms had made most overall progress on integrating sales and account management, with 65% saying they were somewhat integrated in these functions and 19% fully integrated. Management and operations were also reported to be relatively highly integrated.



Broadly the integration of management, compliance and operations functions was similar across company types. However, when it came to technology there was significant divergence. In the back-office, over half of non-bank FCMs and brokers reported full integration across asset classes compared with just 15% of tier 1, 2 and 3 banks.

The front-office and trading desks remain the least integrated functions for the sell-side. Just 9% of respondents reported full integration of trading desks and 16% full integration of front-office technology. Notably, no tier 1 banks said they were fully integrated in the front-office.

For middle office technology, 53% of respondents said they were somewhat integrated, 17% not integrated and 31% fully integrated. As with front-office responses, the great majority of tier 1 banks were either somewhat integrated or not integrated. Tier 2 and 3 banks had made progress overall in the middle-office, with most reporting some levels of integration.

This reflects the major challenge inherent within collapsing workflows and technology across asset classes. While several middle and back-office processes can be served effectively across asset classes, the complexity is much higher in the front-office.

Different asset classes have very different workflows when it comes to order and trade management, and historically third-party vendors have evolved focused on offering best-of-breed in a specific asset class. At the same time, different clients often trade via different systems so a bank has to be able to offer a full-suite of platforms, which often service a single asset class.

This has resulted in sell-side firms, in particular larger banks, having to manage multiple systems across multiple asset classes. This creates over-lapping software and higher costs for firms. Attitudes, however, are starting to change as vendors consolidate and develop greater cross-asset functionality.

What were the main motivations of consolidating workflows and improving operational efficiencies?

1. Improved client service
2. Technology costs reduction
3. Elimination of overlapping functions internally
4. Headcount reduction

Different asset classes have very different workflows when it comes to order and trade management, and historically third-party vendors have evolved focused on offering best-of-breed in a specific asset class.

Costs and clients

Asset class and trading desk integration can be further complicated by regulatory tensions within banks. Clear delineation required between a dealer's agency offerings and principal trading activities adds complexity to integration.

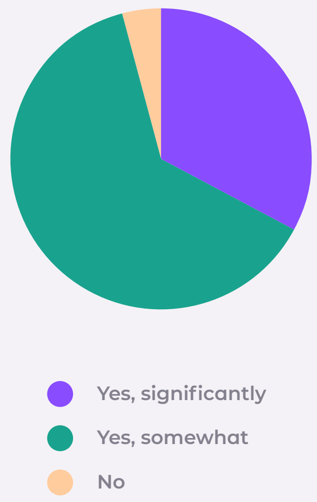
But greater integration across asset classes creates significant efficiencies within sales teams, which can leverage better access to market colour and information from other asset teams and trading desks to improve client service.

One example is improving lines of communication and coordination between new issue swap and DCM desks to achieve best overall execution for a corporate client issuing a bond. Information exchange on factors like liquidity in a certain part of the curve were seen as key to supporting the overall client experience of deal or trade execution.

Respondents ranked improved client service as the most important motivation for consolidating workflows and improving operational efficiencies, followed by technology cost reduction, elimination of overlapping functions and finally headcount optimisation. Client service was also the easiest goal to realise with 96% of respondents saying that it improved somewhat (63%) or significantly (33%).

Interviewed banks cited client service as a significant motivation for collapsing silos and necessary for winning mandates over intense competition. This is true for tier 1, 2 and 3 banks although the approach to how integration can improve client experience can vary. While larger banks need to present a holistic product suite, interviews suggest that for smaller firms the benefits can come more from the cost savings of streamlined internal functions, which allows them to be price competitive.

Did client service improve?



Information exchange on factors like liquidity in a certain part of the curve were seen as key to supporting the overall client experience of deal or trade execution.

Unsurprisingly, technology cost reduction was a key motivation for silo consolidation. This trend was particularly strong among tier 1 multinational banks. Interviews backed this, highlighting senior management pressure to reduce costs increases year-on- year. This was also cited alongside the elimination of internal overlapping functions as an area where banks could become leaner operations.

Pressure to keep down costs can stifle in-house innovation in systems, especially in the back-office – where executives pointed to business historically being conducted on a 'lights on' basis – with firms allowing enough expenditure to keep operations rolling over and keep up with regulatory mandates and/or exchange updates but not enough for significant innovation. This, however, is starting to change as firms invest to address the frailties exposed during periods of intense volatility in 2020.

What the survey demonstrated clearly was that investment in consolidation can result in significant savings to overall technology spend. Over half of respondents sought to bring their technology costs down by more than 11% as a result of the consolidation programme. Typically, the smaller the firm, the higher the cost reduction targeted with tier 1 banks generally targeting cost reduction of 10% or less.

All respondents that were targeting a technology cost reduction of 10% or lower said that they had achieved that goal. As the cost reduction target increased, the success rate lowered significantly with just one firm reporting a successful cost reduction of more than 20%.

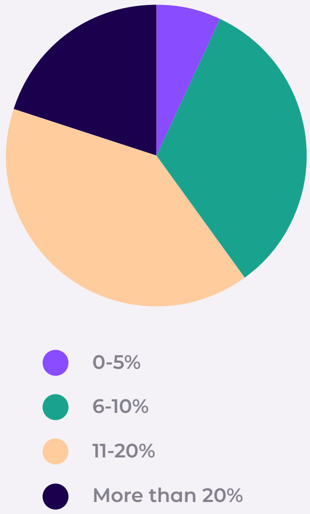
However, even a 10% cost reduction can result in significant savings. Tier 1, 2 and 3 banks generally reported annual budgets of over $5m in all of the front, middle and back-offices. Reducing spending on this scale by 10% can result in very significant overall cost savings.

When it came to reducing headcount as a goal of silo consolidation, firms reported being more focused on optimisation than reduction. Targets were also much lower with around 40% of firms targeting a reduction of 0-5%. They were also harder to achieve with fewer firms reporting successfully meeting targets.

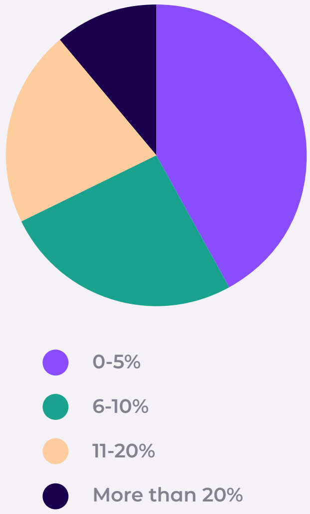
This reflects the fact that consolidation and simplification programmes are designed more to allow staff to focus on higher value functions than to cut overall levels of staffing.

When it came to reducing headcount as a goal of silo consolidation, firms reported being more focused on optimisation than reduction.

What percentage reduction in technology cost were you targeting when implementing a consolidation programme?



What percentage reduction in headcount were you targeting when implementing a consolidation programme?



Finding efficiency through front-to-back integration

While efforts to consolidate across asset classes can run up against cultural, technology and regulatory challenges, consolidation and simplification of workflows within derivatives was said to be a far more achievable goal to improve operational efficiency.

Front-to-back integration for the derivatives trade lifecycle was seen as a key opportunity by respondents to the Acuiti study with just 9% of respondents saying this was not a strategic goal for their business. It is also a significant opportunity for vendors as 78% of respondents were targeting front-to-back integration with just 13% having already implemented it.

In previous research reports, Acuiti has found that sell-side firms, in particular larger banks, are seeking to reduce the number of vendor relationships that they operate. This reflects a shift of opinion from a concern over vendor concentration and risk to one in which simplification of third-party contracts, agreements and supplier monitoring is prioritised. In addition, having more services provided by smaller vendors gives the bank greater commercial leverage with each vendor.

Just dealing with one vendor that can manage multiple parts of the OMS, execution platform, middle ware and back-office chain also has the potential to significantly reduce the costs of data mistranslation between systems. This can be a particular issue in the back office, where vendor codes vary (at the front end, systems take the lead from exchanges so there is less room for confusion).

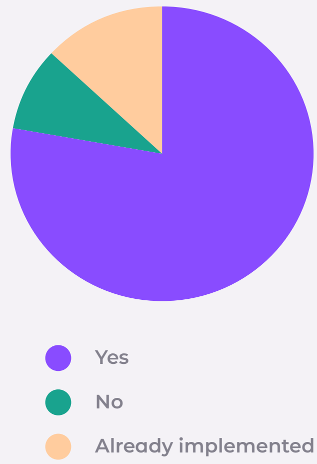
Another advantage is reducing the burden of complying with regulatory oversight by minimising the increasing bureaucracy of dealing with multiple third parties.

One easy route to cost reduction is straight through processing, so it was little surprise that 62% of respondents cited this as the most important issue when thinking about front-to-back integration.

Tier 1 multinational banks were particularly focused on STP in this context. Real-time updates of positions, margins and balances and a single set of data from the front to the back office were secondary considerations. STP significantly reduces the margin for error in the trade workflow. While it involves upfront costs, STP's ability to lower transaction costs over time are a key benefit from the investment.

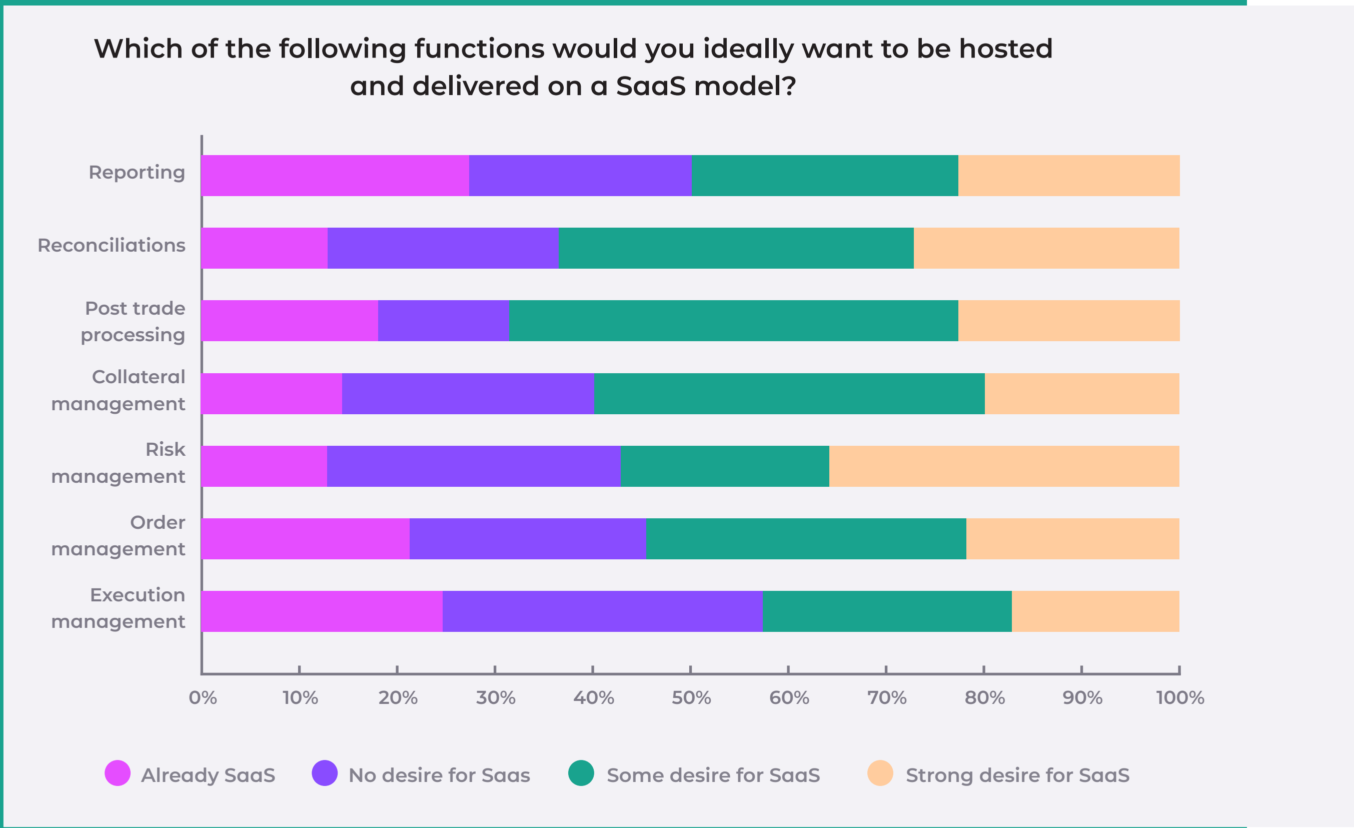
Just dealing with one vendor that can manage multiple parts of the OMS, execution platform, middle ware and back-office chain also has the potential to significantly reduce the costs of data mistranslation between systems.

Is front-to-back integration a strategic goal for your derivatives business?



Parting clouds

A growing adoption of Software-as-a-Service (SaaS) is changing how the sell-side approaches technology investment. However, attitudes towards the cloud vary across functions.



The survey found varying levels of adoption of SaaS with reporting and EMS the most likely functions to be operated under this model. Interestingly, risk management was the function with the strongest desire for SaaS and the lowest uptake to date.

However, interviews showed banks still have some caution towards the cloud, with data security still a strong concern. This ties into concerns around regulatory compliance in particular with regards to GDPR. Indeed, with the advent of cloud, bank focus on data storage has often shifted from an issue of capacity to one of how to delete data properly. Data masking or encryption are potential solutions to mitigating these concerns in the cloud.

That's not to dismiss the cloud's storage advantages, with holding large amounts of data now relatively inexpensive for banks. That makes the cloud a powerful tool to eliminate the previously mentioned issues involved in transferring data between systems with varying capabilities in processing data.

Efficiency drive will move up a gear

The fundamental factors influencing efficiency – competition and tighter regulation - are here to stay. While intra-firm consolidation can take years to implement and throw up frustrating hurdles, the pressure to consolidate will only accelerate in the coming years.

The back-office is likely to remain the main terrain for integration, with fewer barriers – both external and internal – to achieving this. But in an environment in which firms are reducing their contracts with third parties, offerings that provide as much opportunity for consolidation as possible – be it across or within asset classes – are likely to grab the attention.

This report finds that big-bang approaches to consolidation with high targets of immediate cost and headcount reduction are rarely achievable. Instead, firms are taking a more incremental approach, collapsing silos across specific functions or services.

Technology investment is key to acheiving silo consolidation. To meet the demands of the incremental process, sell-side firms should take a modular approach to investment in technology allowing them to target efficiencies in specific functions. Silo consolidation is an inevitable trend, but it is a step-by-step process.

"As evidenced by this report, it is more clear than ever that firms across not only the derivatives market but the entire capital markets require highly adaptable, modular solutions to maintain the flexibility demanded by today's ever-changing financial markets. When you utilise agile systems that enable a high level of interoperability, you're better able to serve clients, adapt to change quickly, employ sophisticated trading strategies, and seize on business opportunities as they present themselves. With the markets moving faster than ever, this flexibility is key to staying several steps ahead and represent a critical component to any company's success."

Ray Tierney, President of Itiviti, a Broadridge Business

About Broadridge

Broadridge Financial Solutions (NYSE: BR), a global Fintech leader with $5 billion in revenues, provides the critical infrastructure that powers investing, corporate governance, and communications to enable better financial lives.
We deliver technology-driven solutions that drive business transformation for banks, broker-dealers, asset and wealth managers and public companies. Broadridge's infrastructure serves as a global communications hub enabling corporate governance by linking thousands of public companies and mutual funds to tens of millions of individual and institutional investors around the world.
Our technology and operations platforms underpin the daily trading of more than U.S. $9 trillion of equities, fixed income and other securities globally.

For more information, please visit broadridge.com

About Acuiti

Acuiti is a management intelligence platform designed to provide senior executives with unparalleled insight into business operations and industry-wide performance. Acuiti helps identify market trends, enhance decision-making and benchmark company performance. The platform anonymises and aggregates information from its exclusive network of senior industry figures to provide insightful in-depth analysis.

acuiti management intelligence