

F Post-trade ETD

Where all the sticking plaster got used!



Over the past ten years, the fund management industry has seen net flows into passive funds and, with the rise of the smart beta funds, yet another competitor in this already competitive space. With these new businesses operating on paper-thin margins, operational efficiency for the existing players is not just important, it is a business imperative and one that is shining brightly across the industry. David Pearson, Head of Post-trade at Fidessa, looks at the challenges in achieving post-trade efficiency and explores the advances that are now delivering ETD trade matching on trade date.

Front office technology across all the main asset classes has transformed, and in turn been transformed by, the huge changes in market structure driven largely by innovation and in part by regulation. The same cannot be said for post-trade operational processes which have typically had to play catch-up with the evolving front office business, and have become the primary user of sticking plaster in the industry.

The world of cleared derivatives for the buy-side operation is in the unenviable position of having almost no technology to hand to manage the reconciliation and matching workflow. This is not to say that the FCMs are not doing an excellent job; on the contrary, they have invested a great deal to ensure their services meet their clients' expectations. But the buy-side challenges now take different shapes and require a step-change in the method and technology to meet the goals of efficiency, accuracy, and regulatory compliance.

So where are we today?

The pain points

Fragmentation

Each clearing broker offers a bespoke service to its client, providing whatever is required to ensure the relationship is fruitful. Where the buy-side has 5, 10, or maybe more such relationships, the operational process is fragmented across the various custom methods each of the brokers use for data delivery. Data from each broker gets handled independently so the buy-side process is centred around resource-intensive data administration.

T+1 settlement

The systems used by brokers in their back offices hark back to the last century, relying on batch processing to create data sets for their clients. Added to this, the final clearing data is often only available on T+1, creating a significant delay for the buy-side to get final confirmation of the trade and position.

The dreaded data files

The current and widespread method for supplying data to the buy-side is by file. Whilst buy-sides are able to access their clearing account information via web portals now, inevitably, the data downloaded still comes as a file. Industry-agreed standards that define the workflow and the data

on which a messaging solution can be built have not been available to the participants, and technology vendors historically have not driven the definition and adoption of standards here.

Error levels

The buy-side back office function relies on the data provided and is therefore completely beholden to the accuracy, completeness and timeliness of that information. With manual data processing at the centre of the workflow, the data quality will always be prone to errors, however meticulous the process, and this is compounded by the further manual processes required to correct these errors.

Commission

Commission rates are agreed as a per-trade value at a product or exchange level, but the post-trade process has not traditionally included the checking or reconciliation of commissions at the trade level. The economic reconciliation of the trade remains separate to the main trade requiring the buy-side to put the trade back together again for fund administration and client reporting.

Price

Traditionally it's the brokers who calculate the price attributed to each allocation of a trade; the buy-side does not have the systems available to provide the correct pricing algorithms for what can be a complex part of the process. In reality, buy-sides have tended to stick to simple single account trading, so that all the fills are allocated to a single account. However, the buy-side trader's increasing preference for more of a block trading capability, where the order may be executed for several funds, is leading to a requirement for a 'best fit' average price calculation. Is it satisfactory for the sell-side broker to apply the pricing to the allocations per the status quo? If the buy-side starts to use a best-fit model, will the broker accept the buy-side price? Or will the workflow need a method of matching and reconciliation? If the post-trade process moves to greater levels of automation, then the industry needs to agree how allocation pricing and price reconciliation should be handled.

These pain points directly impact the downstream back office processes for the buy-side and, in particular, the service they provide to their clients. It is a classic industry scenario of 'garbage in, garbage out'. Trades that are unconfirmed, or corrected on T+1, and commissions values that are added later to the client account, all add up to compromise the buy-side's clients' experience.

The challenges

The operational challenges are coming both from the regulator and from the commercial operation. The status quo is no longer acceptable as it simply does not provide sufficient, timely and accurate data for the clients, for the regulatory reporting, or for the asset managers.

So what are the business drivers that will see the industry transform its operational processes?

Margin and collateral

Managing the margin and collateral process has become a hot topic in the exchange-traded derivatives industry. Getting the numbers right and the eligible products in the right place at the right time is an imperative for the buy-side along with their clearers, but the process suffers acutely from the garbage in, garbage-out routine.

By driving the trade confirmation process onto trade date, the process is transformed. Margin payments are accurate and reconcile with the broker; it is no longer necessary to lodge cash with the clearer on a 'just in case' basis; and eligible collateral can be identified earlier to cover confirmed positions.

The benefits reach over to the broker too, as the trade-date process ensures that the margin calls can be reconciled and paid without the broker having to fund overnight. When one considers that the number of clearing members globally has shrunk by over 50% in the past ten years, largely down to the huge rise in the capital commitment required, it shows the sensitivity that a broker has to funding an unconfirmed or disputed position overnight. Reforming the confirmation process so that the trades and positions are handled on trade date allows brokers to reduce the capital required and relieves this particular pressure on the clearing business.

Regulatory oversight

The burden of regulatory compliance places the operational capability firmly in the spotlight. Much of the reporting, data storage and record keeping required has built around the post-trade systems and data flows, exposing the weaknesses in the process. To improve and streamline the regulatory process, the inefficiencies of the post-trade workflow are exposed and need to be removed. With the regulatory teeth now bared, a sticking plaster approach is neither sufficient nor acceptable.

Competition

The impetus to change the entrenched workflow that we find in the post-trade ETD space comes as much from competition as anywhere else. In a fiercely competitive business such as clearing, no one wants to hear a message from a client: "I am getting this new service level from xyz" – that sticks it the throat!

Moving forward - remove the sticking plaster

You know there might be some pain, but it has to be done. So do it smartly, and do it once! What are the options for the buy-side?

Built-it-here

What has stopped the buy-side from building out their own technology to meet their own needs? The answer lies partly in the bitter experience of self-builds, based on a unilateral approach to understanding the requirements and the long progress through development and testing and into production. The costs continue through to a world of software maintenance, releases, rewrites, upgrades and support. Building a unilateral custom solution is an expensive option, and in the operational space the money is rarely available to take this approach.

Vendor solutions

Two issues have hindered the typical evolution of products and services in the vendor space. With a process that is focused so heavily on the bilateral relationship between buy-side and clearer, there have not been the opportunities for industry players to step in and offer a generic solution to all. There is a natural fear that a normalising vendor solution disintermediates the clearers from their clients so it is not seen as a strategic step for their business.

We must also ask where are the industry standards that define the workflow that a solution can be built around? The blunt answer is that, until recently, nobody has firmly grasped this issue with the drive to gain widespread industry adoption. This is changing, however, with the FIX Trading Community having issued their guidelines for the implementation of FIX for the ETD workflow. As some pro-active buy-sides have started to use the guidelines as the basis for change, so the brokers are now seeing FIX as the way forward for data distribution to their clients.

The beauty of the FIX guidelines is that they allow the counterparties to make their own decisions about the technology they deploy, and also that they can adopt a model that services all of their counterparties rather than just one.

These are the standards upon which a solution can be built, and where Fidessa started building its new global confirmation matching utility, AMS.

The utility approach

The real beauty of the utility service approach is its accessibility to the buy-side. All the heavy-lifting is done, the service defines the functional line and the workflow is built. Add a straight-forward integration model, and suddenly the way forward is clear for the buy-side and their brokers.

Fidessa's AMS service for ETD trade confirmation matching is exactly this model. Already live and hooked into the world's largest executing and clearing brokers, AMS offers electronic, automated matching of ETD data sets that have previously been handled manually, relieving post-trade operations of the burden of manual data administration.

The future for post-trade efficiency

Recognising that the post-trade process is an integral part of the asset manager's workflow, the efficiency and effectiveness of the trade matching is a vital component and can allow the fund manager to improve fund performance.

Fidessa's approach has been to recognise the value of the standards now available to define, build and operate a global utility that handles allocation distribution and confirmation matching in an electronic and automated model. The service model lowers the entry level for the buy-side and simple integration points mean that the data can flow easily from Fidessa AMS to the systems that need it. Critically, , allowing asset managers to achieve previously unobtainable levels of service. Firms that are adopting the new workflows are reaping the benefits and stepping forward to a whole new level of workflow capability and post-trade efficiency.