



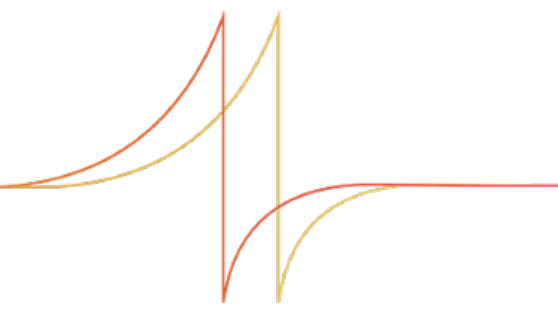
October 2020

# Post-trade Operations Realities

## Challenges and Priorities for 2021

Produced in collaboration with





## Coping with a crisis

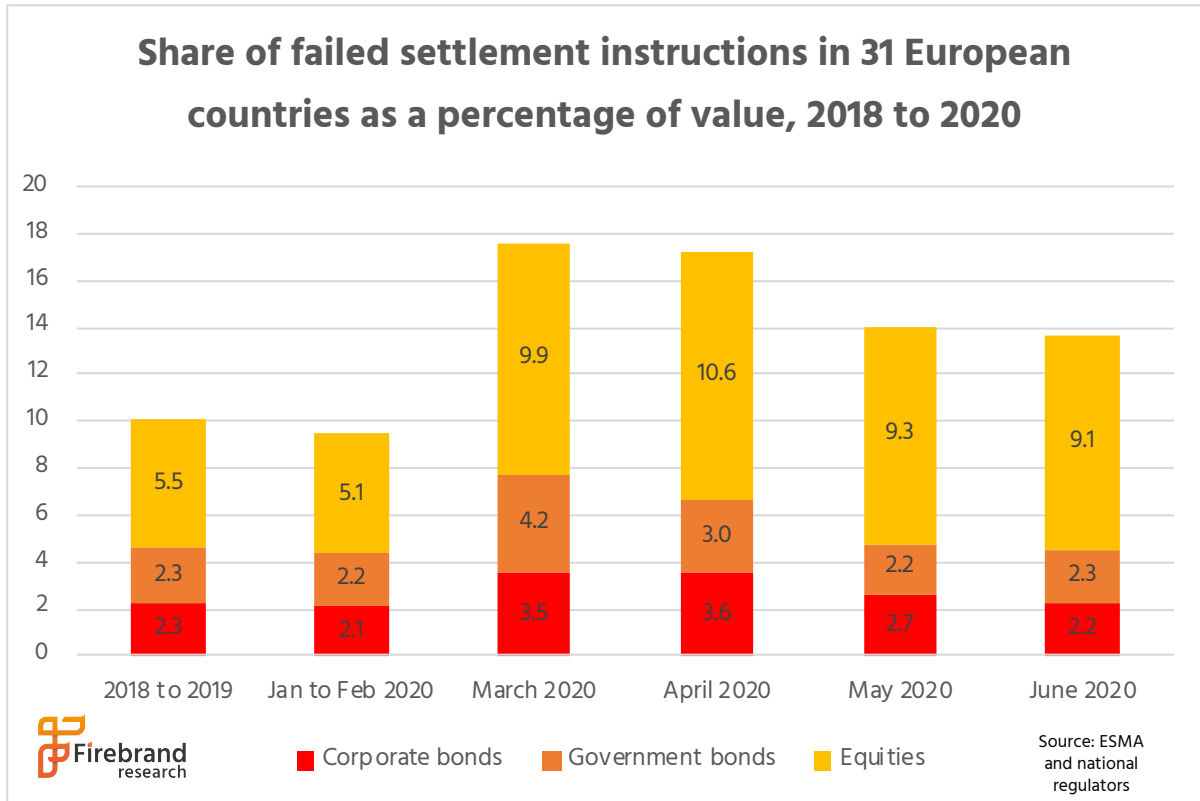
The unique circumstances of the financial markets in 2020 have taught the industry a range of lessons about everything from remote working to coping with periods of intense trade volatility that surpassed the global financial crisis of 2008. While the global markets experienced a financial crisis in 2008, 2020 has brought with it a global pandemic that has impacted every aspect of people's lives. The industry has displayed remarkable resiliency and demonstrated that some of the key reforms post-2008 have improved market transparency and risk management, with no significant financial institution failures. There have, however, been numerous post-trade challenges for firms to overcome and even the UK settlement system experienced a system outage in September that took it offline for two days.

## Room for improvement

The market volatility and remote working environment has shone a spotlight on significant areas for industry improvement such as the inefficiencies of the post-trade realm and the over-reliance on legacy technologies and manual processes. In its 2020 Report on Trends, Risks and Vulnerabilities, the European Securities and Markets Authority (ESMA) highlights the notable spike in equities settlement failures experienced in March and the succeeding months of lockdown as market participants were unable to scale up to meet the sharp increase in trading volumes.

As you can see from the chart from the ESMA report below, which shows the share of failed settlement instructions in 31 European Economic Area countries as a percentage of total settlement value, the comparison of the previous two years versus the first half of 2020 is stark. Equities settlement fails doubled from the start of the year in January and February where they were around 5.1% of total value to the start of the lockdown in March when they increased to 9.9% and in April when they were around 10.6% of total value. The succeeding months until June saw equities fails continue to be above 9%, much higher than the average over the preceding two years where they were 5.5% of total value. Government and corporate bonds experienced a shorter peak of

settlement fails in March and April, where they increased to 3.5% and 3.6% from 2.1% in January and February, but have since come back down.



The range of impacts caused by the switchover to remote working and the higher settlement activity included:

- Pressure on collateral management as firms were required to engage in a significant increase in collateral substitutions and margining activity.
- Longer settlement chains where a failure to deliver at one point in the chain caused a catalogue of failures downstream.
- A higher number of exceptions to resolve within the trade processing lifecycle within a shorter timeframe than business as usual.
- Industry over-reliance on staff in offshore locations where infrastructure limitations and a lack of access to basic work-from-home necessities such as laptops caused certain settlement processing activities to slow or halt for a

certain period of time. This was especially problematic for Tier-1 outsource service providers with a high percentage of clients in those locations that were required to ship laptops for in-country staff.

- The physical separation of middle-office trade support staff from front-office staff due to the remote working setup, which meant communication was more challenging in the short term as firms had to setup new communication technologies and protocols. Processes such as manual exception resolution to prevent trade failures were significantly impacted as they rely on real-time communication between trading and trade support teams for swift resolution.
- Greater cybersecurity threats resulting from quick-fix approaches to providing access to legacy core systems in a short period of time.
- Teams reliant on manual processes working late into the night to resolve the backlog of operational processing caused by market volatility. This caused a negative impact on morale and staff stress levels increased, which in turn, also caused operational risk to increase.
- Challenges related to legal requirements for wet ink signatures on client onboarding documents.

The short-term impacts of 2020's events are clear but what of the longer-term impacts? Bank and broker interviewees indicate that while some firms are already back in the office, others are unlikely to be back until early 2021 and some are considering a longer-term flexible working setup. Many C-suite executives have been surprised by the ability of the majority of their staff to effectively and efficiently work from home. The main challenges around staff communications have been largely resolved through the introduction of phone conferencing and instant messaging applications, but there are other areas of technology support that need to be reviewed in light of the ongoing settlement challenges and the uptick in regulatory oversight.

## Regulatory oversight of operational resilience

Overall, there is increased awareness across the capital markets community about operational resiliency, including within regulatory quarters. Many of the key regulators

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## Technology adaptations

There has been a slow pace of change within the post-trade realm to digitally transform operations and move away from legacy technology platforms that tend to cause outages like the one experienced by the UK central securities depository in mid-September. Banks and brokers are likely to come under increased client and regulator pressure to move onto platforms that have been designed to scale up to meet market demand and can be accessed safely and securely from anywhere in the world.

Not all firms are at the same stage of development when it comes to post-trade processing, however, and some have been better able to adjust to the challenges of 2020 thus far. Some of the technologies that have helped them transition include:

- **Cloud-based platforms that enable access from anywhere and have been designed with security in mind.** Interviewee firms using such a solution have been able to move from working from the office to working from home relatively smoothly as access is already remote-enabled. One brokerage firm anticipates that its staff will spend a couple of days working from home and the rest from the office in the future, which will enable to firm to downsize its office and reduce the cost of operations over the next 12 months. Operations employees have docking stations for their laptops at work and at home and access to their securities processing system is exactly the same for both locations.

- **More automation in the middle office and reduced reliance on manual processes.** The settlement failure rates across Europe could have been mitigated if firms had spent more time automating middle office processes such as trade confirmation and reconciliation. Interviewee firms that have already achieved high levels of STP within the middle office and beyond indicate that their failure rates were much lower than the industry averages highlighted by ESMA. An operations team manager at a mid-tier brokerage firm notes that though its counterparties were relatively disorganised during the early months of the lockdown and the number of exceptions the team had to deal with increased, it was able to handle the increase with no serious challenges.
- **Secure communications tools that support voice, video, screensharing and messaging.** Firms have quickly begun to adopt these tools to enable real-time communication within and across teams for the performance of day-to-day activities. Though most firms expect staff to return to the office for at least some of the week, these tools can even help to reduce on premises-based staff reliance on less efficient communication methods such as reading through long chains of emails.
- **Modern technology that can scale up to meet high processing demands in real time.** Interviewee firms using technologies that have been designed with the volatility of the markets post-2008 in mind have been better able to keep pace with 2020's extreme market volatility. The ability to deal with processes in an exception-based manner is important when volumes significantly increase and staff must prioritise the riskiest and most critical tasks on a daily basis to avoid settlement failures where possible.
- **Technology that allows seamless integration to a wide range of services and other applications using application programming interfaces (APIs).** Interviewees indicate that APIs have become increasingly important for the seamless connectivity of their solutions and services across the firm and beyond to their clients, counterparties and service providers. Being able to plug and play new data services as and when clients or internal teams request them is a


competitive differentiator for sell-side firms operating in an environment of tight margins and high compliance costs.

- **Printers and scanners for the home office.** Several interviewee firms have purchased printers and scanners for the home offices of their staff as the industry, unfortunately, still relies on a lot of paper-based communication between brokers and their clients and custodians. Until the client and service provider becomes more automated, these will remain the realities of working in the post-trade operations space.
- **Electronic documentation management tools that reduce the requirement for wet ink signatures, where permitted.** Though not all jurisdictions allow electronic signatures, automating the process where possible enables more rapid client and service provider onboarding, especially in a remote working environment.
- **Dashboards that provide an overview of operational risk.** The requirement for management information dashboards has increased over time and the current industry and regulatory focus on operational resilience is adding more fuel to the fire. Management teams want to be able to respond to ad hoc regulatory queries on the topic in a timely manner and provide an audit trail for operational risk management and oversight.

## Priorities for 2021

Looking forward to 2021 and beyond, sell-side firms will need to re-evaluate their current operational setup with a view to better supporting remote working and dealing with continued market volatility, as well as the prospect of a regulatory crackdown on operational resilience. To this end, a few key questions need to be answered:

- Will your current operational setup stand up to regulatory and industry scrutiny under the lens of operational resilience?
- Are there legacy technologies within your operational infrastructure that pose a threat to support for business as usual in the longer term?

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- Are you well-positioned to cope with the industry move to a cloud environment?
  - Can clients see the investments you have made to keep pace with your peers in digital transformation of the middle office, especially for client-facing functions?
  - Have you automated as much as you could in the middle and back office to reduce operational risk and increase efficiency?



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