# Getting to T+0
## How can companies drive further efficiencies in post trade processes?

Over the last couple of years, most trading organisations have made significant changes to their post-trade processes to ensure that they comply with Dodd-Frank and EMIR regulations.

Businesses that are seeking to make further efficiency gains are finding that they are having to dig deeper for even small improvements.

To make a significant impact, banks will have to expand their horizons beyond their existing post-trade processes, and seek to leverage efficiency savings from the front office.

In this paper, we look at the current issues facing banks in the back and front office; and how these challenges can be met by looking at the trade lifecycle as a single transactional journey, rather than as a series of independent processes.

In doing so, we believe that banks can continuously push down the process cycle time to get close to T+0 or T+1 levels, in even the most complex asset classes.

# The journey to T+2

In response to the financial crisis of 2008, legislators decided that greater transparency was needed over transactions to reduce counterparty, market and liquidity risks.

In the US, the Dodd-Frank Act implemented centralized exchanges for swaps trading, and also required greater disclosure of swaps trading information.

In Europe, the European Commission harmonised the practices of Central Securities Depositories (CSDs), ensuring that securities settlement periods were harmonised with foreign exchange settlement periods of a maximum of two business days after trading day (T+2).

These twin initiatives have forced major change programmes on banks to ensure that they are able to meet the tight timelines and audit requirements. Further regulations (e.g. MIFID 2) are continuing to make more demands on post-trade processes.

There are benefits that accrue from these improvements: getting to T+2 has reduced counterparty and liquidity risks, has reduced collateral requirements; and has reduced operational cost in many cases. These are the benefits that banks are seeking in going beyond their regulatory duty.

However, these change programmes have meant that there are no more quick wins when looking for further improvements - the “low hanging fruit” has already been picked from the tree to get the bank to T+2. There are a number of challenges for any bank seeking to make further efficiency gains.

# Barriers to improvements

The settlement date of T+2 was chosen because the Settlement Cycles Working Group of the EC felt that this was achievable and that T+1 was an unrealistic target because of the high use of paper documentation in the process, especially for OTC trading.

The need to handle large volumes of paper is responsible for low levels of straight-through processing, especially for the more complex asset classes. This makes reducing the settlement date below T+2 more difficult to achieve.

A further barrier is the complex infrastructure of legacy systems that typifies the set-up of many global banks. A patchwork of multiple booking systems, document storage facilities, spreadsheets has to be assessed and unpicked in order to yield potential efficiency savings.

This analysis process often turns up a seemingly logical reason for keeping the constituent parts of this system in place. For example, one booking system works well for 1 asset class, but not for another asset class; or a particular geographic region has an internal system which can’t be decommissioned and can only talk to a particular booking system.

The inertia of system requirements means that banks are unable to create a global standard for any process, making it difficult to drive down process cycle times and make efficiency savings in an effective manner.

Given those challenges, is it reasonable to expect any further large improvements in confirmation and settlement cycle times? Can banks genuinely aspire to get below T+2?

# Getting to T+0

Xceptor has been implemented at a number of global investment banks to solve exactly the types of problems mentioned previously, making significant improvements to the STP rates of the confirmation process for those clients.

An analysis of the problems, blockages and delays in the confirmation processes at these clients identified the following common issues:

- *Identifying and matching counterparty agreements:* The manual process required to identify the incoming contracts and match them to the outbound contract was a significant overhead for all of our customers.
- *Changes to the agreements:* Once the agreements had been matched together successfully, a large percentage were found to contain amendments to the underlying economics of the contract. These had to be investigated to ensure the correct information was included and agreed upon.
- *No internal clarity over agreed terms:* Investigations into the amendments were held up when trying to find the correct information. Often, no central repository of information was available, meaning that investigators had to search through multiple email accounts to find the correct information.
- *Review of contract by legal:* The contracts often had to be passed to legal teams for assurance that they complied with the legal guidelines of the organisation.

Xceptor was able to make significant improvements by solving these problems. For example, a barcode system allowed incoming agreements could be scanned and automatically matched to the outbound document without manual intervention.

Another improvement was the creation of a document and clause library that automatically inserts relevant pre-approved clauses into the document depending on the counterparty, asset type and underlying economics. This removed the uncertainty around whether the document was suitable and met legal and business requirements.

These improvements have boosted STP for even the most complex asset classes. One client boosted their STP rates for physical commodity derivatives from 28% to 85% within a couple of months of the completion of the project.

However, we believe that we could boost that rate even further by looking at the root cause of these issues: a poorly defined upstream set of procedures that the back office has to remedy against the clock to conform to regulatory time limits.

Our contention is that fixing these issues at the source removes the need to fix issues, boosting levels of straight-through processing and reducing the average cycle time.

By widening our horizon and viewing the total trade lifecycle as one process, rather than concentrating on post-trade in isolation, we have identified a number of steps that offer excellent opportunities for efficiency savings in post-trade.

# Starting post-trade in the front office

The front office has been largely untouched by previous attempts to optimise trade lifecycle processes because the impetus to get to T+2 has meant a laser-focus on improving post-trade activities.

However,our analysis showed that there are a number of issues that stem from the initial creation of the term sheet ahead of booking the trade. These have a disproportionally detrimental impact on the performance of the back office. These include:

### 1. Extensive manual data entry

Term sheets are often created by front-office staff in Word documents or via an Excel spreadsheet. These are sent for internal and counterparty review, and amendments are made by hand.

At the end of the term sheet creation, the economics are manually re-keyed into the booking system. There is a high propensity for errors to creep into the trade lifecycle at all of these points, which are only picked up and resolved in post-trade.

### 2. Uncontrolled processes

There is often no set procedure within the front office, meaning that staff have a de facto broad set of discretionary powers, making it difficult to ensure that guidelines are being adhered to. Front office staff can therefore agree to trades that may otherwise have been held up by legal or management.

This makes it more difficult for back office staff to confirm trades efficiently – there is no certainty that the contract terms as agreed are appropriate or acceptable, so often have to be double-checked by legal.

This not only increases the amount of time required for confirmation to occur, but it is often also a duplication of effort if legal had already signed off the agreement during the creation of the term sheet.

### 3. High number of operators

Term sheets are created by a huge number of front office staff, operating across the globe with limited oversight. The result of this dispersal of the workforce is a large variance in the quality of information that is passed through to the back office.

It also means that the information is stored in multiple sources – email boxes, databases and shared folders - making it incredibly difficult to search for the relevant documentation when having to take remedial action.

### 4. No link between front & back office

The pre-trade and post-trade processes are separated by an external booking system - the end point for the pre-trade process, and the start point for the post-trade process.

This system only requires a limited set of data pertinent to the trade when it is entered. It then passes this limited sub-set of information back to the bank after the trade - meaning that a lot of pertinent information that could speed up the process is not shared across the division.

By tackling these issues, banks can generate benefits that will flow through the whole of the trade lifecycle, from pre-trade through to settlement, reducing operational risk and pushing down process cycle times to get many asset classes down to T+1 or T+0 levels.

# Focus areas

To give yourself the best chance of getting to T+0, we recommend concentrating on the following areas:

**Automated capture of data:**
Currently, operators use data from price modelling engines to arrive at a set of appropriate terms: this is often added to a trade blotter or document manually. By setting up an automatic transfer of this information, the bank can remove the possibility of manual error at initiation, meaning no remedial work later on in the trade lifecycle.

**Document and clause library for term sheets:**
The creation of a library of documents and clauses that can be automatically inserted into the term sheet means that organisations can be assured that operators are only using an approved set of words for outbound documents.

This means that the confirmation process will be shortened, as the back office will not need to check whether an agreed contract is correct or within a normal range of options.

**Controlled workflows:**
Where a requirement exists for an out-of-the-ordinary clause or term sheet, workflows can be invoked to track the progress and ensure that it is passed to the correct person for review and amendment. It also means that operators are limited to actions set down by the organisation – important where you have a globally dispersed workforce starting trades on their own initiative.

This level of control also limits duplication in the post-trade space – as SMEs can check the record of what was previously agreed and amended, they do not have to recreate the clause under time pressure.

**Version control and audit log of term sheet process:**
Full visibility and control over the term sheet process, so that management can view the current work in progress and review historical data to assess how regions, desks and individuals are performing. Version control also ensures that the correct information is always used when booking the trade.

**Automated input into the booking system:**
Removing the manual step for inputting the information into the booking system eliminates the possibility of errors creeping into the process which have to be resolved during the confirmation cycle.

**Centralised repository of information:**
By holding all of the relevant information in a central repository, management teams can get an overview of how their teams are working, and can start to optimize processes to spread best practice from one region to all others.

A central store of information also makes remedial work much easier – rather than a back office operative spending time searching through email logs and shared folders, all of the information will be available through a dashboard, with suggested issues highlighted, making exception management much more efficient.

# Benefits

The biggest benefit from making these improvements will be a marked up-tick in straight through processing rates. With errors removed from the lifecycle process at the point they occur, fewer items will be held up in a remediation queue during the confirmation process.

With the detailed elements of the term sheet pulled through into the post-trade environment, the confirmation contract can be generated and signed, with less likelihood that it will be challenged by the counterparty.

Remediation of issues will also be quicker and easier to complete: an accessible central repository will contain all of the information relevant to the trade, so any issues can be resolved without incurring a long discovery process.

This will also remove the duplication of efforts in the pre and post-trade environment which is prevalent where there is limited historical record of prior actions.

A controlled environment for the trading lifecycle will enable and encourage the standardization of procedures and best practices, allowing the organisation to make continual incremental improvements to their processes.

This process standardization creates a global utility that can be used across asset classes by all members of staff, measured against common performance standards. The use of a global utility creates operational latency across the workforce, allowing additional staff to be utilised during peak times if required – not the case where a jumble of local undocumented processes are in place.

The global utility will also ensure the appropriate utilisation of staff: with less administration and checking required, front office staff can concentrate on activities that truly add value for the organisation; it will remove duplication of tasks throughout the pre-and post-trade lifecycle, ensuring that staff costs can be kept to a minimum.

# Summary

In our view, the pre-trade environment offers an organisation plenty of opportunity to make relatively easy changes that would dramatically benefit their operational effectiveness in the front office.

These benefits would naturally flow through into the post-trade environment, allowing organisations to significantly reduce their average cycle time for confirmation and settlement, bringing down their average T+ timing across all asset classes.

*For further information on how Xceptor can help your organisation get to T+0, please contact us at* ***sales@xceptor.com*** *or* ***+44 (0)203 427 3108****.*