

E-trading: Capturing market share through post-trade execution management

By Rick Schumacher, Director of Products, Wall Street Systems, July 2007

The rise of e-trading over the past decade has led to increased competition in the financial marketplace. Transaction costs are lower and trade execution is more convenient than ever. In this fast-paced environment, banks and their customers are looking for ways to improve the efficiency of post-trade execution. Rick Schumacher, product manager, Wall Street Systems, examines the industry drivers behind this shift in focus and suggests methods for successful post-trade execution management.

The e-trading space

Banks and other financial institutions are taking up e-trading in ever increasing numbers. Recent research by Greenwich Associates shows that “buy side foreign currency traders in 2006 executed more than half of total global FX trading volume through electronic trading, up from less than 30% in 2005”¹. The rise of e-trading has led to increased liquidity, greater competition and easier market access for those unable to enter the market previously, resulting in tighter spreads.

Electronically executed financial transactions bypass many of the traditional logistics and delivery hurdles. E-trading therefore increases the ease and convenience of trading as well as efficiency and productivity, while at the same time reducing the cost of transactions. Lower costs and more market entrants have increased competition and led the buy-side (e.g., corporate customers and financial institutions) to demand better services from banks. Previously, the focus of services was on trade execution. Now, with good network speed and latency, financial institutions and their clients have become accustomed to e-trading and focus is shifting to post-trade efficiency.

Current market demands

New regulatory demands and other corporate governance requirements including MiFID and Sarbanes Oxley continue to drive organisations to improve internal controls and transparency. This is leading the buy-side to look beyond e-trading for solutions that improve data and operational risk management.

Banks enrich systems over time by adding new components and processes. However, during this development, systems become disconnected, leading to redundant sets of data and increased operational risk. Banks seek tools and procedures that can provide a single source of static data for better operational risk management.

Additionally banks want tools that will help their customers manage trades post-execution while facilitating an increase in their own operational efficiency and straight-through-processing (STP) rates. This efficiency can be achieved by shifting some of the non-STP effort involved in back office processing from the sell-side to the buy-side and providing the buy-side with more visibility and control over their transactions. Moreover, it enables the buy-side to benefit from more interaction with their banking partners and gives them more control over their account management.

Post-trade execution management

Currently, most buy-side institutions have an incomplete real-time view of the trades executed with a bank. They often only receive trade activity reports from the bank—which includes an aggregation of trades executed through different execution venues—the day after trades are executed.

With the drive to achieve greater transparency, the buy-side demands a complete picture of their trading activity in real-time, regardless of whether trades were executed via the phone, an ECN, portal, or other execution venue. In response to tightening internal controls and external regulatory requirements, many buy-side institutions have begun requesting maker/checker capabilities that involve one person to input and another to approve a trade.

Banks can meet this demand by making a full repository of trading data available in real-time that shows all trades executed, regardless of execution venue. This repository provides the buy-side with a full audit trail and the transparency they require to meet compliance regulations.

With access to back-office capabilities online, the buy-side takes control of critical processes within a controlled, secure environment while banks benefit from additional cost savings and operational efficiency with higher STP rates. Common processes open to the benefits of web-based tools include:

Mark to market valuations

With online access to mark to market P&L figures, the buy-side gains additional data transparency. For banks, online access eliminates the time and effort required to create and distribute the information in a report.

Trade confirmation matching

Buy-side institutions can view online trade confirmations for all deals they have executed with the bank. This facility allows the buy-side to confirm trades online by approving or rejecting the trade. Not only does this give the customer more internal control and visibility around their trading activity, it improves the efficiency of the confirmation matching process for both parties. The bank's efforts and resource requirements are significantly reduced by delivering this functionality to the buy-side. Additional benefits can be derived by linking the web confirmation matching process to the core back office processing system, enabling automatic updates on trade status and the movement of the trade for settlement or exception processing as required.

Settlement approval

With the ability to assign settlement instructions to a deal online, buy-side institutions can select from a set of predefined settlement instructions or enter a new instruction, making a time consuming process much more efficient. Historically, settlement instructions were agreed over the phone. But as it frequently occurs with FX forwards, the instructions may not be known at the time of trade execution, which means a bank employee has to update the instructions in the settlement system. Integrating the online settlement approval functionality with the bank's core back office system processing eliminates the need for manual intervention and updates. This further reduces the bank's resource requirements and increases STP.

Payment netting and splitting

Similar to the online settlement approval facility, extending payment netting and trade splitting functionality to the customer over the web will make a time consuming process more efficient and cost effective. It also increases the bank's STP rate if the process is integrated into the core back-office processing system.

Conclusion

In a competitive market environment where more than half of all FX deals are executed electronically, banks are under increasing pressure to provide better services, greater internal controls and transparency. With an integrated,

web-enabled post-trade system, banks can meet the increasing demands of their customers and provide value-added services.

Crucially, these services shift non-STP effort to the buy side, simultaneously reducing internal costs and increasing operational efficiency. A web-enabled post-trade system brings mutual benefits to the buy- and sell-side – streamlining interactions between the two and providing cost-effective customer service. Financial institutions that take advantage of new opportunities in e-trading and build on existing technology will have the upper-hand in attracting new market entrants.

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