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Trade failure: prevention rather than cure



BUY-SIDE BELIEVES PREVENTION RATHER THAN CURE IS BEST WAY TO TACKLE TRADE SETTLEMENT

Many people are aware that the European Central Securities Depositories Regulation (CSDR) that introduces a Settlement Discipline Regime (SDR) has been delayed by another year to February 2022. The deferment, however, should not be seen as a reason to avoid introducing better controls and processes now. On the contrary, firms are recognising that preventing trade failures rather than managing them is best practice, irrespective of SDR being implemented.

From conversations with major asset management and asset servicing firms, corfinancial discovered that the creation of an avoidance-based operational model is the preferred option, with effective exceptions management forming a key component in the solution.

AVOIDANCE THROUGH EXCEPTIONS MANAGEMENT

Typical of this preventative viewpoint is specialist provider of asset services, RBC Investor & Treasury Services.

"Whilst I know that some middle offices are still looking at dealing with the outcomes of failed trades, I think that the majority are shifting toward an avoidance strategy," says Ben Pumfrett, Director, Product and Profitability, Middle Office at RBC Investor & Treasury Services.

"Whilst it's impossible to totally eradicate failed trades, we have been looking upstream to achieve best practice post-execution in order to minimise the number of fails. Proactive settlement tracking relies on real-time transparency over trade exceptions."

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OUT OF EUROPE DOES NOT MEAN OUT OF SCOPE

All parties in the settlement chain involved in transactions processing in European securities will be affected by the Settlement Discipline Regime, including where the executing parties are not located in the European Economic Area (EEA). This fact has not been universally recognised by a number of companies outside of Europe.

Pumfrett: "From our own conversations we have found that a number of global US or Canadian asset management firms did not initially fully recognize the impact of SDR on their firm, despite the fact that they regularly trade in European securities. These firms will find proactive settlement tracking critical due to time zone differences - they may not be well placed to deal with urgent issues raised by custodians in Europe early on the morning of the proposed settlement date.

Many of these firms are now reviewing their operating models and choosing to work more with service providers or extending their operating models internally to create a solution that would incorporate European time zones."



What we have heard from the market is that 'prevention rather than cure' is the best way to manage settlement and avoid trade failure.

COMMUNICATION ISSUES PERSIST

Automated and standardised communications are critical components of an effective exceptions-based process. We have observed that, at the heart of the future SDR proposals, is a communications conundrum that unfortunately has typified many recent attempts at regulation. In this case there is uncertainty surrounding the method with which custodians will communicate the breakdown of penalty fees to asset managers.

Buy-side firms are hoping that all parties will agree on a standard for communicating the penalty information, and this is key as an asset manager may deal with only a few to several hundred custodians. If all custodians send penalty information to the asset manager in SWIFT messages, at least there will be some structure in the way the data is utilised and presented.

This approach has been discussed by the EU but lingering doubts concerning communication standards remain. **With structured data comes opportunities to automate processes and introduce exception management benefits.**

Furthermore, clarity is still required around the timing of penalty notices. It appears that some custodians may provide daily updates on a trade by trade basis, along with month-end summary data, potentially netting the costs. How this data will relate back to transaction records is not yet clear, which leads to concerns associated with the extensive efforts required to reconcile the charges with underlying portfolios, funds or accounts.

As with most regulatory changes, it is the specification of the operational processes required to comply with them that creates uncertainty and concerns relating to the impact on operational resources.

CONCLUSION

The best practice approach to failing trades is avoidance, not management, and the route to avoiding failed trades is automated exception management.

Effective exception management and action prioritisation helps removes the risk of human error, provides scalability and gives support teams capacity to deal with critical issues.

David Veal, Senior Executive: Client Solutions at corfinancial: "What we have heard from the market is that 'prevention rather than cure' is the best way to manage settlement and avoid trade failure, and market participants should be asking themselves: 'Why wait to adopt best practice in this area?'"



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corfinancial provides software solutions and advisory services to banking and financial services organisations worldwide. The firm has offices in London, New York and Boston.

There are five key problem areas corfinancial looks to solve through its primary software and service offerings:

BITA Risk provides end-to-end private client suitability, portfolio management, risk, ESG and monitoring oversight solutions; brought together in BITA Wealth to mirror and systemise the investment process of wealth managers and private banks and available individually for CIO and investment teams.

SureVu empowers buy- and sell-side firms to efficiently monitor and track security trades throughout the settlement lifecycle, enabling users to proactively manage and oversee settlement exposure.

salerio is a post-trade processing solution that enables asset managers, hedge fund managers and securities/fund services firms to automate the flow of securities and treasury trades from matching through settlement.

costars is an investment administration platform for third party administrators, fund supermarkets and wealth management companies.

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 **costars.**


Retail fund/transfer agency solution providing end-to-end administration for collective investments.

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