

POV: Trade Expense

Inviting Cognizant to present their POV

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With the establishment of the International COO Community (iCOOC), Armstrong Wolfe created an obligation to support the COO community in their business efforts.

Our purpose is to empower the COO community to lead the banking and asset management sectors into a new era of global influence and respect. This is to be achieved by the providing of our services designed to establish a COO standard and commitment to conduct and ethical behaviour, bolster employee care and development, support the causes of equality and sustainability, and to exceed customer expectations.

Adopting this role, we became the de facto close stewards of the COO community were mandated as gatekeeper through iCOOC's membership. To this end, we court the opinions and listen to observations and requests from the COO community on areas they wish to discuss and investigate. Areas that are invariably a problem for all, a challenge for all, and to address them would benefit all. The role we adopt aligns to our purpose to help the industry exceed customer expectations.

Amidst the pandemic crisis, we sought to draw attention beyond present challenges born from COVID-19. Several COOs asked for us to return to the ever-present necessity of cost and efficiencies, but to make it targeted and solution based. More specifically, we were directed to the matter of Trade Expense.

An email was sent to half a dozen COOs within iCOOC to validate interest:

"Trade Expense: our view is it is the second largest expense to a bank after people and yet remains in places an archaic process utilising complex bilateral rate agreements and calculations supported through manual monthly invoicing processes.

As a result, banks struggle at a macro and micro level to understand cost drivers and how to optimise them.

Our conversations with various technology houses and consulting firms suggest that through the central digitalisation / normalisation of data and trade expense calculation, there is an opportunity to drive operational efficiency, whilst providing businesses with holistic analytical spend transparency to make significant contra revenue savings/business decisions and demonstrating compliance to regulation.

Is this a correct assumption, and would this be a good subject for debate?"

The first two replies were representative of those that followed, with a NYC-based GBM COO commenting:

"Expenses in general would be a topic of interest, and trade expenses as a specific deep dive – especially if there are interesting solutions in the space would be of interest for sure."

This was echoed by a London-based markets COO:

"Thanks for reaching out. I think by 'Trade expense,' we mean brokerage costs/execution fees. Trade expense will of course mean Brokerage and Execution to people in the FICC business, but other things to people in the cash securities markets, [e.g.] Execution fees, Agent bank fees, etc.

As you suggest, however, there is value in the standardisation of broker billing for transparency and comparison. We have outsourced broker management but with mixed results. I'd be interested in hearing from one or two of these firms and hearing how others view the challenge."

Once validated, usual practice is to revert to the COOs engaged in the ratification process to request introductions to a third party, which may have a perspective or solution that would add content to the planned debate and COO Cluster Call. In this case, I was already aware of Cognizant's potential broader capability in areas such as Capital Market solutions via an old friend, whose career I had followed from Goldman Sachs, through Morgan Stanley to Credit Suisse — Alex Duggan.

Our paths had crossed accidentally at Paddington one morning last summer. "I've moved to Cognizant," he informed me, and over an opportunist coffee I established that his area of expertise and current focus was in building solutions, more specifically in the Brokerage, Fees and Billing area. Cognizant may not have been an expected voice to bring into the in-business COO community's consideration, but in some ways, this is what makes such an introduction more compelling, as bringing new views and voices to the community is the responsibility we embrace.

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"I recall from your previous roles that Trade Expense and cost management is something you have always been involved with, Alex?" I asked inquisitively.

"Yes indeed," he quipped. "It is now my primary area of focus when delivering solutions to clients. As you know, other industries understand the cost of everything, from the basic cost of materials, the cost of a basic widget, and the impact of any bespoke or additional requirements.

Through the art of logistics, they understood the cost of defects in their front-to-back process and the impact of funding where clients and vendors were late in paying the bill. As a result, they can:

- Focus on opportunities to optimise the cost of different components of their product
- Drive investment decisions and operational efficiency through analytical data
- Understand pricing and profitability of current clients, allowing future business to be modelled

For investment banks, Trade Expense is typically the second largest cost after people. Banks, however, have historically struggled to effectively manage the front-to-back Trade Expense life cycle or understand their cost drivers at a macro or micro level, limiting their ability to make informed strategic or business decisions."

This prompted me to ask, "So what has the impact of the last decade's wave of regulations had on trade expense?"

"More than one person could have been heard saying, 'there goes our discretionary project budget!' In fact, 10 years ago I was asked how much contra revenue can be saved, how much budget would you need to achieve it, and how quickly could you do it? Twelve months later, the same conversation followed a different path. 'Can you ensure the bank will not be fined \$100m, that we do not end up in the papers or stop me from losing my house and going to jail'? If not, it is not a priority."

Alex went on to explain that regulation and legislation have homogenised and centralised much of the derivative markets to reduce market risk but increased the complexity of brokerage calculations that remain OTC. Rate agreements remain complex bilateral, bespoke contracts that are difficult to interpret or validate. Banks must deal within the region of 1,000 nuanced invoices as part of the archaic monthly manual invoicing process, which is challenging.

"It is interesting to look at the knock-on effects of the swathe of regulation we have seen. Aside from consuming discretionary budget and capacity, it has also continued to challenge business profitability, but in an indirect way," Alex added. These are summarised as follows:

- Payables and receivable cash compensation process on the back of Brokerage, Coupons and Dividends, Research, CSDR, etc. has a material impact on the balance sheet and funding optimisation.
- FTT tax is expected to expand across Europe whilst derivative-related taxes such as 871m are other taxes to contend with.
- CSDR in Europe will have a material impact to contra revenue cost in the form of fines and penalties and buy-ins for cash securities fails."

I was similarly interested to ascertain the other key challenges facing banks in relation to this dilemma, my understanding being that **banks typically use multiple legacy platforms or spreadsheets to validate trade expense at an invoice level:**

- Rate agreements are often out of date
- Typically, there is no centralised rate repository or referential data store
- Systems are not equipped to support complex calculations or strategy trading prevalent today
- Reconciliation and exception management is on a best-effort basis
- Claims management processing is manual

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Alex added more detail:

“Data quality and Lineage - There are several trade data attributes required to support the appropriate calculation of trade expense and the majority are stored in the bank’s front-office systems.

However, data lineage is a real challenge, so by the time trade data is received through the different architectural layers of the bank, much of the data is missing.

Analytical output or transparency - Given the above disparate legacy processes and trade/referential data challenges, banks are unable to generate data analytics that drive transparency into cost drivers or opportunities to optimise spend.

What is the Budget and Transformation paradox? Where, discretionary budget constraints aside, expenses such as Brokerage have been and remain an enigma.

They are the second largest expense, a consensus that there is money to be saved, overcharges to be avoided, and more transparency in reporting, but that is never the top priority.

Add to the conundrum the cost of support is with Operations but any identified savings in contra revenue go directly to the businesses. With no discretionary budget, operational budgets are continually squeezed, where focus on managing the day to day and being compliant to the regulation are the priorities.

The cost of support is already significant and there is typically a lack of SME knowledge in this area to understand what would need to be done to renovate the different complex parts of the process.

My view is that businesses do not have the upfront budget for potential operational saves and cost transparency in 18 months’ time. They have cost-saving pressures today; they should not need to wait on multiyear projects to realise such savings, especially when they are wary of realising such savings based on previous experiences.”

“So why Cognizant and how do you believe you are in a position to work with the banks in overcoming their challenges?” I asked pointedly, conscious of my obligation to validate and prequalify any party we present to the COO community.

“Having been involved in this area extensively whilst working for banks, it has been exciting to join a company like Cognizant and be part of their solutions team. I believe that our core offering, and broader Cognizant capabilities, help us to partner with clients to move to an optimal solution in a cost-effective manner.

At a high level, the key elements of our service are::

Central Digitized Solution

- Digitized rate agreements, counterparty, and client referential data to normalise across entity and product
- - Complex calculation, reconciliation, and exception management workflow in a centralised tool
- - Centralised digital platform provides data analytics and transparency into the underlying spend it supports, which can be used for optimisation, regulatory compliance, or risk management purposes
- - Automated invoice management process from invoice upload through to automated market interoperability and counterparty communication to drive operational efficiency and reduced ageing profile in payables and receivables”

“That’s interesting,” I added. “Send me a summary for consideration.” We parted on good terms and 24 hours later, the following arrived in response to my request:

- **Cognizant has the product and operational expertise to design, implement, and manage the front -to-back digital invoice management process for trade expense.** We are an industry leader in cloud-based design, implementation, and support, as well as intelligent process automation incorporating the decommission of legacy platforms and processes.

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- **We offer flexible pricing models that reduce upfront investment and are tailored to match the client's needs.** We believe that our full offering drives operational and technology cost efficiencies and an opportunity to reduce contra revenue spend.
- **Our core platform can support all facets of Trade Expense from Brokerage, Clearing, and Exchange cost to Tax, Claims management, CSA and research, and the CSDR regime.** We believe that this will subsequently allow banks to understand the holistic cost of doing existing and future business, making informed optimisation and investment decisions, just like the other industries I mentioned at the beginning.

I responded in kind, "What do you think are the hurdles to making progress or indeed what do you believe may frustrate or thwart our efforts to report positive developments in a quarter's time?"

Alex stated, "Access to the right people who understand the complexity of the problem and are charged with managing trade expense. Upon reflection, we could have had more detailed conversations with the individual banks about their specific pain points (problems tend to be generally the same but different pressing needs based on history and business setup). The key is breaking down solutions to drive immediate value whilst demonstrating you have the capability to deliver on the broader solution and that needs to be done on a client-by-client basis."

From Alex's previous career experience, "the in-business COO would be the best person for us to speak to, to work with you and them to move the dial on this problem." Like many such issues, such projects only work with business sponsorship and involvement as they are the ultimate beneficiaries of much of the service benefits, the experts on the nuances of the products traded, and changes generally need to be made in front-office systems, so having someone who can pull the relevant people together is key.

A number of months later and with an agreement in place to work towards a COO Cluster Call in NYC and London (6 to 8 COOs with a specific interest in the agenda), Cognizant have been working with Armstrong Wolfe Partners to help frame the problem from a COO's perspective, to ensure exact relevance of content and presentation, ensuring the outlay in time by all parties has the best chances of a return on this investment.

With upfront investment in time by all participants in preparation for these calls, hopes ride high of enlightenment, but the complexity of the challenge proposed lends itself to us managing expectations accordingly.

The collective aim of Armstrong Wolfe, the attending COOs, and Cognizant is to move the dial in addressing the issue presented. In doing so, benefit for all would be secured and our purpose fulfilled in this case.

We will summarise the key notes and output from the two Cluster Calls in the next quarterly COO Magazine. In the interim, if you require further information and/or would like to contribute to the debate related to Trade Expense, please contact info@armstrongwolfe.com.



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