

## MARKET COMMENTARY

# Electronification of Trading Operations – The Advantages, Challenges, and The Way Ahead

Trading is an area of differentiation for banks. That's why many have completed (or are close to completing) significant upgrades in their FX trading platforms.



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### Industry Backdrop

Spurred on by the imminent implementation of MiFID II in Europe, banks are finalizing the automation and electronification of their sales and trading workflow in rates and credit, connectivity and pricing capabilities, and reporting tools to comply with the regulation.

Beyond Europe, with other regulations such as the Fundamental Review of the Trading Book (FRTB), banks anticipate that rates trading will also continue to see increased volumes of e-trading and are getting ready with new tools and technology.

The surge in e-trading is reflected in the investment we are now seeing in FX. Some banks are reporting that over 80% of overall volumes are currently conducted electronically, and e-FX trading is growing at 50%. Some are going further to support new channels, such as electronic FX trading using mobile devices.

### The advantages of electronification

Let's start by looking at the digitalization of client services. Client acquisition and retention compel banks to give more importance to understanding evolving client behavior in response to rapid technological advances. Those banks that are ahead of the game are consolidating client-facing technology platforms and tools into a single, new platform that can be personalized based on the type of user with behavioral finance analysis and smart robots that will offer the right products to the right clients.

Then there's the operational side and optimizing post-trade functions. Post-trade, especially in cash equities and fixed income, is primarily considered noncore, so banks are mainly looking for cost reduction through rationalization, outsourcing, mutualization and utilization. Some banks are planning to use automation and robotic process automation to reduce manual workload in this area (e.g., in reconciliation, operational risk management such as trade breaks and trade fails) to achieve higher STP rates and improved efficiencies.

However, at the top of the pile is its ability to improve risk management and reporting. Capital adequacy and derivatives reform regulations are putting pressure on increased and more frequent margin calls and risk calculations making risk and collateral management of critical importance for banks. Regulations like MiFID II are pushing for more transparency in trading across asset classes. Electronification satisfies these needs by creating fast and effective workflows.

No one can doubt the advantages electronification brings, but it's not all smooth sailing. As you would expect, this type of transformation presents various hurdles that must be overcome.

### Challenges in the transformation journey

Regardless of their transformation journey, banks will struggle with many challenges.

#### Regulatory change

Speed of change and uncertainty are major pain points because there is often concern that the finished implementation may not be compliant with the regulations at the time, and may require further changes.

#### Budget constraints

Getting a budget can be a challenge because planning for regulatory changes takes up a disproportionately high amount of mind and wallet share, leaving planners with little for strategic initiatives.

#### Technology evolution

Speed of technology development is becoming a challenging proposition in the planning and execution of projects. Banks need to have the flexibility to adapt to new technology, but this can be difficult with many legacy platforms and different functionalities from numerous third-party providers. Also, control is a big issue for most large institutions, making them conservative and slow to react to new technology.

### Changing client needs

Client behavior and preferences are also rapidly evolving with advancements in technology. Therefore retaining key clients requires better understanding and anticipation of developing client needs.

#### Data management

Implementing a system is easier compared with getting the data model and strategy right, without which the systems become of limited use. It is a big challenge regardless of the technology or approach adopted, but more so with new technology like cloud computing or AI. Some banks are still undertaking year-long initiatives to get their data management aspect right, after which they plan to start focusing on mining the data.

#### Organizational inertia

Convincing management and staff to change continues to be a big challenge. For example, voice traders disagree that electronification can be beneficial; others think all new requirements can be built in-house, while others are scared of making themselves redundant by adopting new technology (e.g., salespeople who don't want to use a CRM tool). However, Cloud and FinTech are proving to be helpful here, as Cloud drastically lowers the cost of experimentation, and FinTechs can teach valuable lessons.



Regulatory Evolution



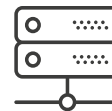
Budget Constraints



Technology Evolution



Changing Client Needs



Data Management



Organizational Inertia

### Overcoming the challenges

Many of the challenges are easier to overcome following an evolutionary, flexible approach. Furthermore, with most banks having already undertaken some revolutionary big-bang initiatives, they are now looking to adopt the evolutionary path for future transformation.

The chart below highlights some of the key objectives banks are looking to accomplish in the near term.

As you can see, an evolutionary approach is a better fit in realizing these key objectives, driving wider acceptance in the industry going forward. However, there are still some banks that have done little transformation and are in dire need of a significant overhaul, but they are the exceptions rather than the norm.

Revolutionary “Big Bang” Approach	Transformation Objectives	Evolutionary “Flexible” Approach
<ul style="list-style-type: none"> <li>All at one go approach risky and burdensome for organization</li> </ul>	<b>Converging business models</b>	<ul style="list-style-type: none"> <li>First move to an intermediate state with businesses with similar value proposition then evolve from there</li> </ul>
<ul style="list-style-type: none"> <li>Too many changes in short time can be overwhelming for customers; integrating changes in the front end with mid-back office can be daunting</li> </ul>	<b>Consistent customer experience</b>	<ul style="list-style-type: none"> <li>Simplification and digitalization of client offering across geographies, products, and devices</li> <li>Unified client portal but modular programs in the back office for integration</li> </ul>
<ul style="list-style-type: none"> <li>Hard to decommission legacy in one go as there are complexities and dependencies</li> </ul>	<b>Integrating with legacy IT</b>	<ul style="list-style-type: none"> <li>Integrate new solutions over legacy wherever possible</li> <li>Overhaul outdated parts nearing end of life with new full-capabilities first when</li> </ul>
<ul style="list-style-type: none"> <li>Mutualization/ utility participation, risk increases with scope and less standardize processes</li> </ul>	<b>Smart sourcing</b>	<ul style="list-style-type: none"> <li>Focus on building differentiating capabilities totally in-house or on top of good third party platforms</li> <li>Outsource no-differentiating aspects</li> <li>FinTech partnerships</li> </ul>
<ul style="list-style-type: none"> <li>Large scale infrastructure and process changes spanning multiple functions and businesses</li> </ul>	<b>Improves efficiency</b>	<ul style="list-style-type: none"> <li>Review and eliminate redundant</li> <li>Simplify and rationalize the apps, vendors</li> <li>Share across organization where possible</li> <li>RPA tools for more automation, STP</li> </ul>
<ul style="list-style-type: none"> <li>Lengthy projects and not suitable for initiatives needing quick regulatory, business needs or client demands</li> </ul>	<b>Time to market</b>	<ul style="list-style-type: none"> <li>Develop faster at the front end, integrate better in the back office</li> <li>More cloud and API-fication</li> </ul>



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### Future-proofing electrification

While banks are building flexible capabilities as they move towards the electrification of their trading operations, it is becoming increasingly apparent that they must also be future-proofed so they can adapt to evolving technologies.

Distributed Ledger Technology, while having huge potential, is not yet mature or commercially viable. Also, there is no clear indication of how industry practices will evolve around them.

Other new age technologies that are more realizable in the near term, and are already being used by some banks, are RPA and AI. While these can bring significant benefits, they also have their own requirements in terms of infrastructure, data storage, and computing capabilities. Therefore, even those banks that are not using them yet are keenly observing the developments and thinking about how they can be easily adapted.

Another possibility is the Cloud, which is becoming more prevalent in capital markets. While the journey typically starts with the private Cloud, the extreme economic advantage of the public Cloud is making it appealing. In Celent's recent report about The Great Transformation in Capital Markets, a representative from a large regional bank noted:

**Source:** Celent, 'The great transformation in capital markets: Revolution to evolution,' November, 2017.

*"We are starting to use Cloud more than before. For all new developments, we evaluate Cloud first, especially in FX. Cloud is more agile and has a faster speed of implementation. We are using both private and public Cloud; for non-sensitive information, such as distributing prices, we use public Cloud. When it involves sensitive client information, we have to use private Cloud."*

There is also a growing interest in partnering with FinTech players who are building innovative solutions in several areas of the value chain.

Whichever road banks go down, adopting best-of-breed technology and tools will require an adaptive and open architecture with flexibility to connect new tools with existing components.

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Through our open, secure and reliable solutions, customers are empowered to accelerate growth, optimize cost, mitigate risk and continually evolve to meet the changing needs of their customers. 90 of the world's top 100 banks use Finastra technology.

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