Case Study

Fee Management issues offer utility opportunity

How a vendor's acquisition of a big bank's platform has led to the development of a utility

CREDIT SUISSE

Credit Suisse was founded in 1856, it has a global reach with operations in over 50 countries and 48,200 employees from over 150 different nations. Headquartered in Zürich, it serves its clients through three regionally focused divisions: Swiss Universal Bank, International Wealth Management and Asia Pacific.

Business situation

Credit Suisse built a commission fees and expense management system nearly a decade ago with the goal of improving efficiency when it came to handling brokerage, clearing and exchange fees accrued by the Swiss bank. SmartStream acquired the platform in December 2014 with the goal of transforming the system into a utility model.

Solution

TLM Fees and Expense Management has been developed to drive savings to the bottom line and enhance profitability. It does so by using an end-to-end automated process, capable of substantiating variable expenses accurately across high volumes of transactional information and apportioning fees exactly.

The solution supports:

- Variable expense reduction
- Business and client profitability
- Dynamic service pricing
- Automated accounting
- Operational efficiency

In 2007 Credit Suisse went live with a fees and expense management platform called Excalibur, this was subsequently sold to SmartStream in 2014, with the eventual goal of building it into a utility. Waters speaks to those involved in the platform since its inception, about its history, what lies ahead and why the sell side is in such desperate need of this type of utility.

It is, to put it bluntly, a multi-billion dollar headache.

That is how Credit Suisse's Matthew Brown illustrates the difficulty around the management of brokerage, clearing and exchange fees incurred by banks' sales and trading businesses. Brown, who serves as the Swiss bank's global head of brokerage, clearing and exchange, wasn't using hyperbole to describe the trouble the sell side faces handling the plethora of fees that are incurred throughout the trading lifecycle.

In fact, a headache might be the best metaphor for the type of angst suffered by banks sorting through various fees every month. The process isn't likely to completely cripple a bank, but just like an annoying headache, it is bothersome and time-consuming. More often than not, firms struggle to get an enterprise-wide view of the fees accrued across multiple asset classes, according to Brown. Instead, they are stuck dealing with manual processes or product-specific software.

And so what might not seem like a big problem at first glance can increase exponentially with the amount of trading a firm does.

"Within the sell side organizations, you've got a lot of vendors that you agree contractual commitments with, and you have no real way of tracking and making sure that when that vendor invoices you that the invoice is going to come in on the amount agreed. If you think about the hundreds of vendors and thousands of bills received every month, all of sudden you've got a huge reconciliation challenge and it becomes a very manually-intensive process to check and validate the accuracy of the bill." Brown says. *"Have you got proper core process? Do you know what the rate was you originally agreed to? Furthermore, has that rate actually been authenticated and invoiced appropriately? Have you reconciled it? Have you paid it correctly?"*

Building a platform that manages fees and invoices a firm receives isn't unique, as there are already vendor solutions on the market. But what about several firms sitting on the same platform and sharing information to increase operational efficiency? The entire industry would benefit instead of just one firm.

That was the concept behind **SmartStream's acquisition of Credit Suisse's platform back in December 2014**. Now, less than two years later, SmartStream has two Tier-1 banks on the platform, including Credit Suisse, and is looking to add more as it hopes to build a utility model for the industry, says Bharat Malesha, director of fees and expense management at SmartStream who previously worked at Credit Suisse, where he was involved in the development of the platform from its inception.

"The key purpose of this platform is around being able to manage all expenses for banks," he says. *"So when you talk about variable expenses, I'm talking about transactional fees around brokerage, exchange, clearing, regulatory, settlement and custody, so various kinds of transaction-based fees that are related to the execution of trades and settlements of trades. It provides the ability for banks to capture those fees, at the interaction level, and manage that from an accounting standpoint."*

Dayle Scher, a senior analyst at research and consulting firm Tabb Group, authored a paper in January looking at the buy side's ability to identify and calculate the relative value of processes, products, vendors and people. The paper, titled **Buy-Side Business Attribution: Assessing Costs and Quantifying Value**, focuses on the need for senior decision-makers to be able to do some kind of attribution of their costs. Scher spoke to CFOs for her report and says the majority of them voiced similar concerns as Brown regarding the type of view they were getting from their invoices.

"You need to know exactly where your expenses are coming from, where your revenues are coming from. You need to be able to calculate the value of your processes, your products, your vendors in order to measure the profitability of the organization," Scher says. *"My research indicated that this was not happening to the degree of granularity that you would expect. It's unclear why that's not happening. I think perhaps a utility model would give that accessibility to capital markets firms."*

Beginnings

When Credit Suisse first developed a tool for its expenses in 2007, its goals were simple: Maximize cost reductions, optimize trading flow and enhance profitability. The platform, branded Excalibur, was an augmentation of the brokerage, clearing and exchange fees that were taken by the global sales and trading businesses of the Swiss-based bank, according to Brown, who was involved in the project from the start.

The bank was able to build a system that created flow optimization strategies across exchange-traded and centrally cleared asset classes, Brown says. It soon became clear that what Credit Suisse had made was something of significant value to the bottom line and overall benefit of the firm.

Brown says that while the tool was initially developed for brokerage, clearing and exchange fees, the possibility of it being used for front-to-back control of processes was soon recognized. Foreign exchange (FX) was the first product to fall in a domino of asset classes that were eventually run through the system.

"Excalibur is the largest data base in Credit Suisse. It's huge. If you think in terms of trade capture and execution at the individual fill level, you can imagine how many [trades] go through the system. It puts into some context the magnitude and size of what it was we were building" Brown says.

Transition

Technology projects can't be funded forever, however, and eventually the bank recognized the value in selling the IP to an interested participant.

Credit Suisse saw the potential benefit in spinning the system out into a utility, a job it felt SmartStream, with its experience taking technology and evolving it into a utility, would be well-suited for.

In October 2015, **SmartStream announced that Goldman Sachs, JPMorgan Chase and Morgan Stanley were partnering with the firm to launch the SmartStream Reference Data Utility**, also known as Securities Product Reference Data (SPReD), which provides services for instrument reference data normalization and validation across all asset classes.

For Brown, a utility model was the logical next step for significantly increasing the system's efficiency.

"The most important thing was to really share the vision about creating a market utility that would ultimately lower the costs of a wider community of firms and commoditize the processing," Brown says. *"As you get critical mass, you tend to share the technology development costs. Ultimately, building a utility such as that with SmartStream had a lot of attraction."*

SmartStream's Malesha says the platform, which maintained the name Excalibur after the acquisition, isn't a utility in terms of infrastructure or technology, but more so operational. The system standardizes processes and the exchange of information that happens between, for example, banks and brokers, leaving little to interpretation and closing the gaps that so often lead to disputes on the settlements of fees today, according to Malesha.

He uses global cash equities as an example.

"You have 150 to 200 different exchanges or even more publishing rate agreements on their website or in some form of PDF. Every bank has to go and interpret those agreements and convert them into an electronic format so that they are able to now calculate their fees on their internal books and records. But this is public information. This rate does not change for one bank or the other. Of course, every bank's volumes are different, and they could be in different tiers of those volumes, but the fee schedule itself is the same for every bank out there," Malesha says. *"We manage and interpret those rates cards. We put them in a structured format, and make them electronically available to our clients."*

Malesha says the foundation of the platform has three main pillars: cost management, accounting and control. In terms of cost management, he says it's about replicating pricing structures from service providers and establishing a trade warehouse with all the fee information of all variable and fixed costs associated with execution of those trades.

The accounting aspect is about an accrual of all the calculated fees and allocation of said fees based on actual service utilization back to the business within the bank. Cost-sharing agreements can be modeled in a transparent way, acting as a fee sub-ledger for banks.

Finally, firms have the control to confirm invoices.

"The idea is to manage the costs of securities in the market and settlement of those securities. ... It provides the ability to banks for creating accrual for all these calculated fees,"

Malesha says. It also provides the ability to independently verify those invoices, manage all the adjustments and provide dispute analysis around those invoices, he adds.

Going Live

Credit Suisse began the process of outsourcing its over-the-counter (OTC) fixed-income derivatives, US-listed equity options and cash businesses in the brokerage, clearing and exchange transactional fee buckets to SmartStream in January 2016, according to Brown. The transition period lasted until June.

Brown says the move has unlocked headcount efficiencies for the bank, but admits currently there is only a small commercial element to it. The bank is increasing efficiencies in terms of processing bills, with more invoices paid month-to-month. The real value in the platform, though, comes when it gets critical mass via the utility model, according to Brown.

"You can see pretty quickly the benefit if you get four or five big players all of a sudden sharing the same technology, sharing any processing costs, any technological upgrades," Brown says. *"More importantly, if you start to go into other asset classes -something that we hope to work with SmartStream on in terms of future build out of this product - if you were to look at the listed derivatives marketplace where you have the concept of big banks being on the receivable side, if you get to the point where by SmartStream is managing the payable and receivables between banks, you get to impact significantly the outstanding debt that exists there and the inefficiencies in the marketplace."*

In addition to the two Tier-1 bank clients, SmartStream is currently awaiting decisions on three proofs of concept (POCs) done for banks recently, Malesha says.

Brown sees the utility model as the logical next step for the industry. He says some firms might have software geared toward a specific product, but it's not multi-asset class and it's not front-to-back. Based on conversations Brown has had with peers in the space, he says there are still firms using manual processes to handle these types of fees, which opens a firm up to errors.

Malesha says that a lot depends on the maturity level within the organization when it comes to its focus on fees. Some banks do have a good level of transparency and granularity, but it is often in pockets, secluded to certain asset classes, fee categories or regions, according to Malesha. Often times it's a mishmash of internal systems and computing tools to process and manage fees, Malesha says.

Growing the client user base will be key in regards to maximizing its potential, according to Brown.

"If SmartStream can get to that point whereby we get critical mass on the system, you really do start to unlock the efficiency across the Street, across the very extensive crawl space," Brown says. *"I think success would define itself in terms of being able execute against that. That's something that we look forward to working with SmartStream on in terms of getting there."*

Salient Points

- In 2007, Credit Suisse went live with a fees and management platform called Excalibur.
- The platform was sold to SmartStream in December 2014, with the eventual goal of building it into a utility.
- SmartStream currently has two Tier-1 banks on the platform and is awaiting decisions on three proofs of concept.
- SmartStream will look to continue to grow the platform by adding more clients as it hopes to serve as an operational utility that can help banks create cost efficiencies and added transparency into where their costs are going.