IHS Markit®

Global Custodian

FROM LEGACY TO DIGITAL

the challenges ahead for custodians

Over February and March 2021, IHS Markit and Global Custodian undertook a survey designed to explore the current operating landscape for banks engaged in transaction processing. With the ever-present demand from clients for speedier and improved services along with micro-opportunities to exploit technological advances, the aim was to identify the key issues that they are facing today and the practicalities of moving to a more digital, data and automated environment.

The core target was senior managers in commercial banks with a regular engagement in post-trade processing. The data that informs this paper is drawn from the results of the survey, based on the responses of 195 participants.

Figure 1 shows the aggregated results of a query on what priority participants gave to particular challenges.

Figure 1: Top of the in-tray

A quick reading of this chart suggests that client demands for digitization and the replacement of legacy technologies and manual processes to enable digitization to take place rank high, though the practicalities of meeting those expectations are for the moment a lesser consideration.

The push to digitization is a result both of client pressure and internal demand. Clients are, after all, unlikely to see digitization as an end itself, but rather as a means to a more efficient flow of actionable data. This is, however, impeded by existing operational silos. Providing a holistic view of customer data from onboarding through post-trade to full settlement and reconciliation is a challenge across client entity and trade processing systems that were not built for interaction.

The need to reduce settlement times and provide a more efficient end-to-end information flow must increasingly encompass a broader range of data sets, covering, for example, Know Your Customer (KYC) and tax processes, to name two. The need for cross-department sharing of information and seamless access to critical client and trade data is reinforcing the drive for digitization.

The opportunity for self-servicing capabilities and real-time access to valuable post-trade data, coupled with the headwinds of continuously evolving regulation and market infrastructure are further strengthening the case for digitization. An investment manager's ability to build an Investment Book of Record that reflects the latest securities and cash balances and projections for informed decision making depends on the ability to pull real-time data from their provider's post trade systems.

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In an effort to test attitudes to the urgency of progressing to a more holistic digital environment, participants were asked to agree or disagree with a set of assertions about digitization. Aggregated responses can be seen in Figure 2.

Responses suggest a nuanced and undogmatic approach to the issues with 60% or more agreeing to each proposition. Of particular note is the idea that digitization may reduce the scope for competitive differentiation. This has been a concern of service providers since automation began to encroach on manual processes in securities and payments processing. Platforms will after all be based around market standards and practices.

Differentiation has therefore come to reside in the added value that automation enables providers to deliver, such as more timely, accurate and personalized content. The argument can, however, be reversed.

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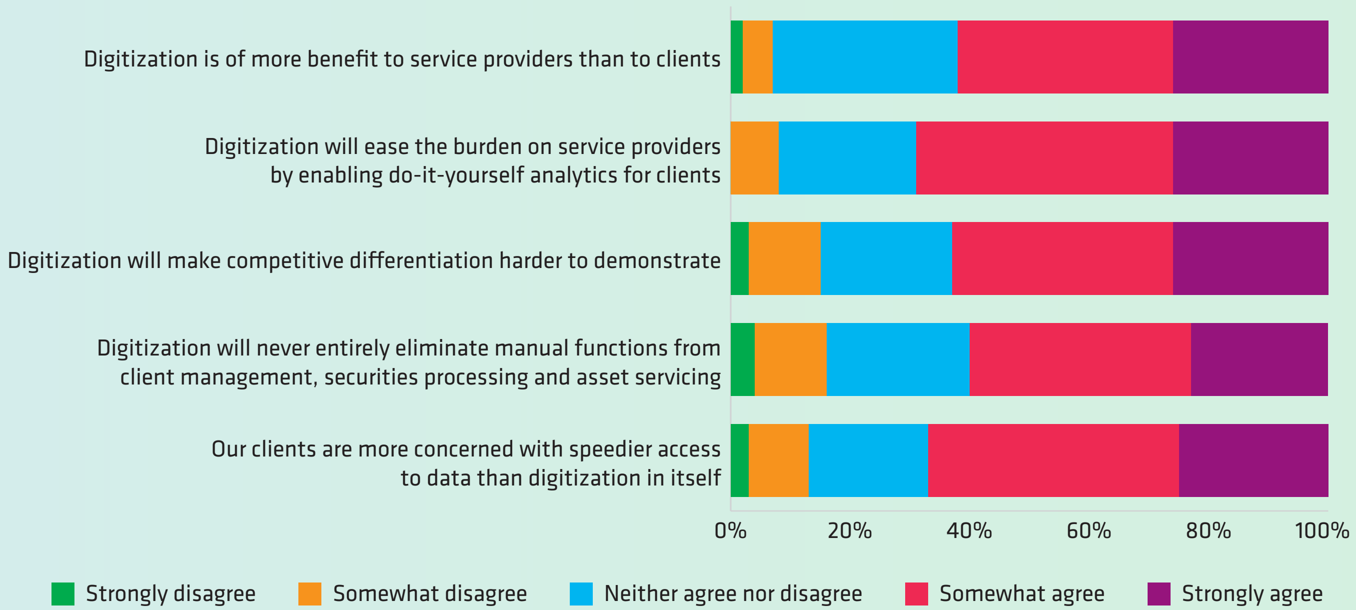
Lack of digitization can be seen as a competitive disadvantage. A lack of easy-to-use technology enabling simplified client engagement with data and services can be a huge competitive differentiator when coupled with appropriate relationship management. Customer engagement remains a key factor in the client's overall experience. Even from a strict technology perspective, providers are unlikely to be judged on digital offerings alone, but on the data flows that result from it.

Figure 3 indicates the areas that participants felt could derive most benefit from further automation.

Interestingly, processes such as clearing and settlement, where significant automation has been taking place over decades, are still perceived as candidates

Figure 2: Attitudes to digitization



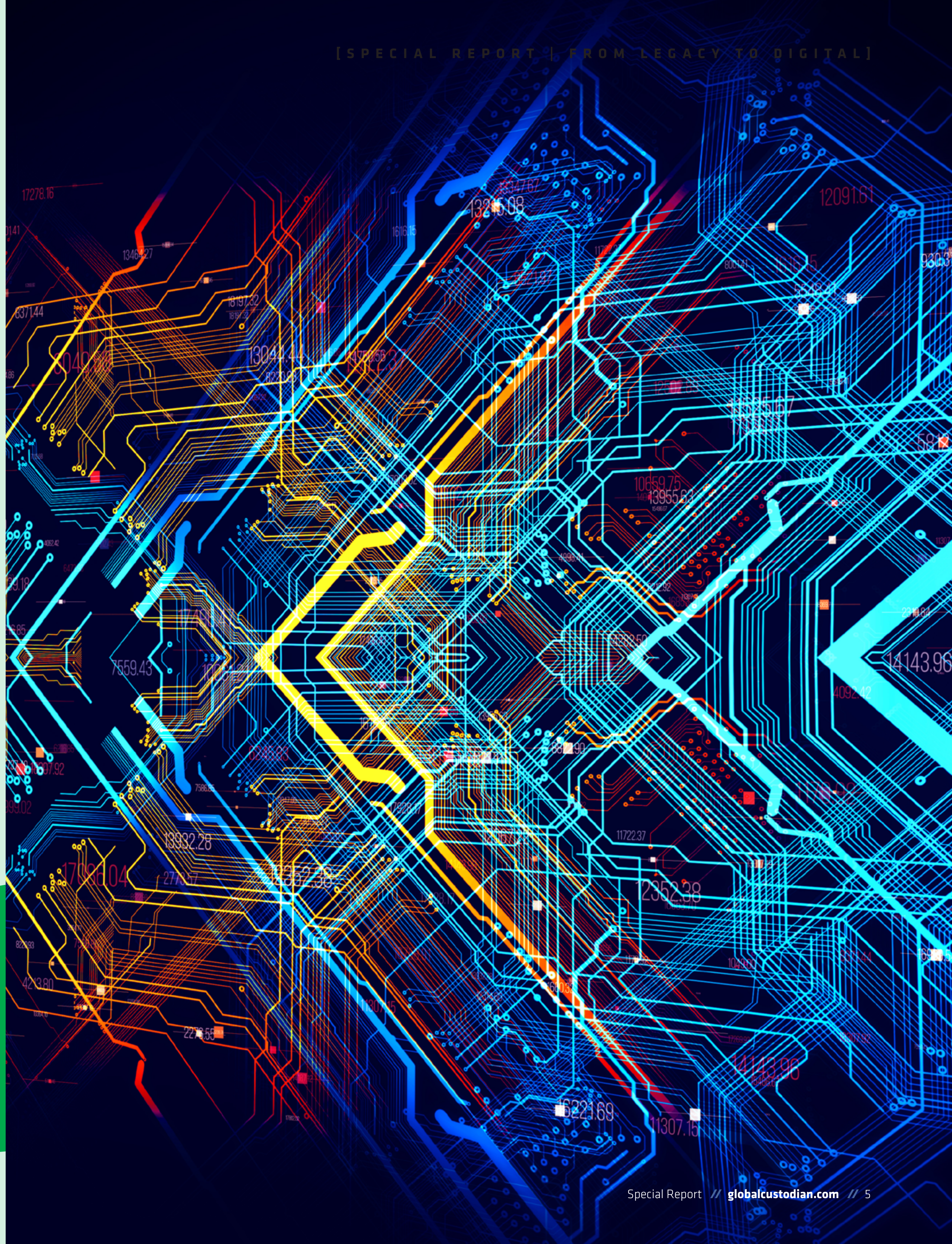
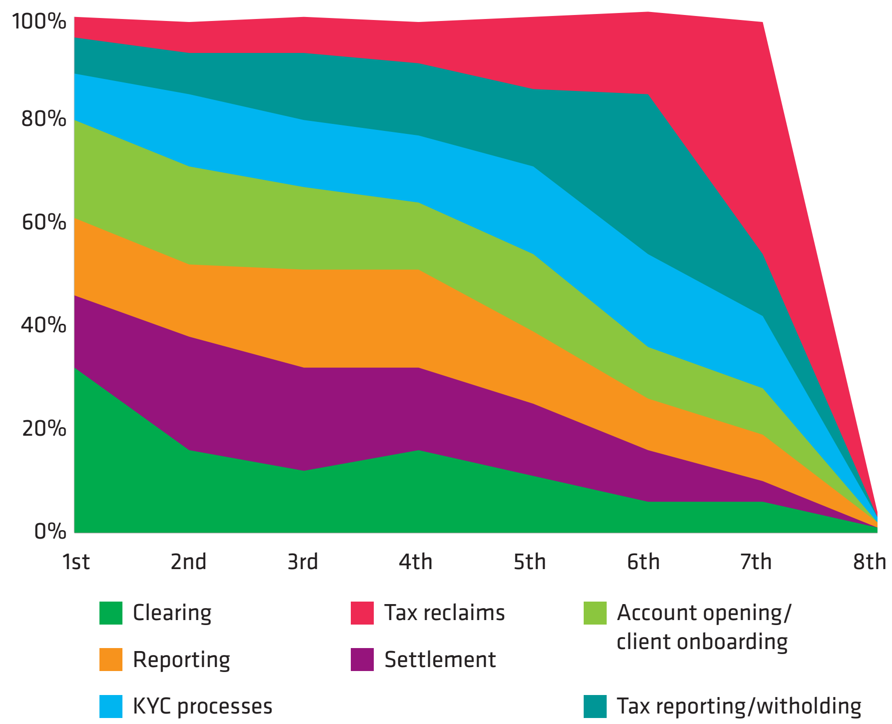


Figure 3: Most benefit from further automation



"Customer engagement remains a key factor in the client's overall experience."

Straight-Through-Processing (STP) and which result in a continued prevalence of manual excel and email based processes.

The position of tax reclaims in Figure 3 is at first glance counterintuitive. It does, not, however necessarily reflect a lack of interest in further automation, but, on the one hand, a lack of expectation of what can be achieved in a workflow environment with multiple manual touchpoints, and, on the other, a possible feeling that digitization will add marginal additional benefits to existing investment in automation.

The issue is ease of data flow resulting from digitization and the availability of APIs, for example, may allow service providers to engage specialists to focus on specific areas of information requirements without having to engage in a more extensive contractual relationship. From a tax perspective, the validation of tax-related data may be a candidate for such an arrangement without requiring changes at the client front end.

for further work in that direction. Settlement in the securities lending market, for example, with an average of T+20 settlement dates and challenges matching principle and interest payments are an identifiable candidate, but even when it comes to cash markets, incorrect settlement instructions during onboarding can lead to settlement breaks, misdirected cash settlement, and reclaim notices for fails. Post onboarding, if account data is not properly maintained, inefficiencies can me multiplied by incorrect codes, names and other standing settlement instructions.

There has also been broad recognition across the securities industry that corporate actions and proxy voting retain huge potential for further automation, given the vast number of complex market-specific nuances, lack of harmonization and standardization in documentation which impede

Figure 4 indicates the extent to which firms feel they have progressed in achieving a range of strategic objectives.

Of the projects listed, the two least close to completion overall are the client-facing objective of improving the client onboarding experience and, less visible to the client, the issue of partnering with non-banks to deliver a more digitized service. Bringing together the technology and data into a robust, controlled service offering is

increasingly likely to require the pooling of operations, data, and technology functions together with specialized service providers. In this regard, digitization enables the selection of best of breed providers as an alternative to the generic full outsource model as specialty providers in areas such as KYC, tax, asset serving, settlement and legal processing can enhance the efficiency of the entire operation. Full digitization should enable the sharing of data between providers more seamlessly, improving cost effectiveness in delivering solutions for the end client.

For onboarding, specifically, the process is still seen as frustratingly manual by many clients. Even though there are multiple common data points for each new account, differing formats and slight variations in account frameworks can lead to repeated demand for the same information. With increasing data requirements at the onset of the account

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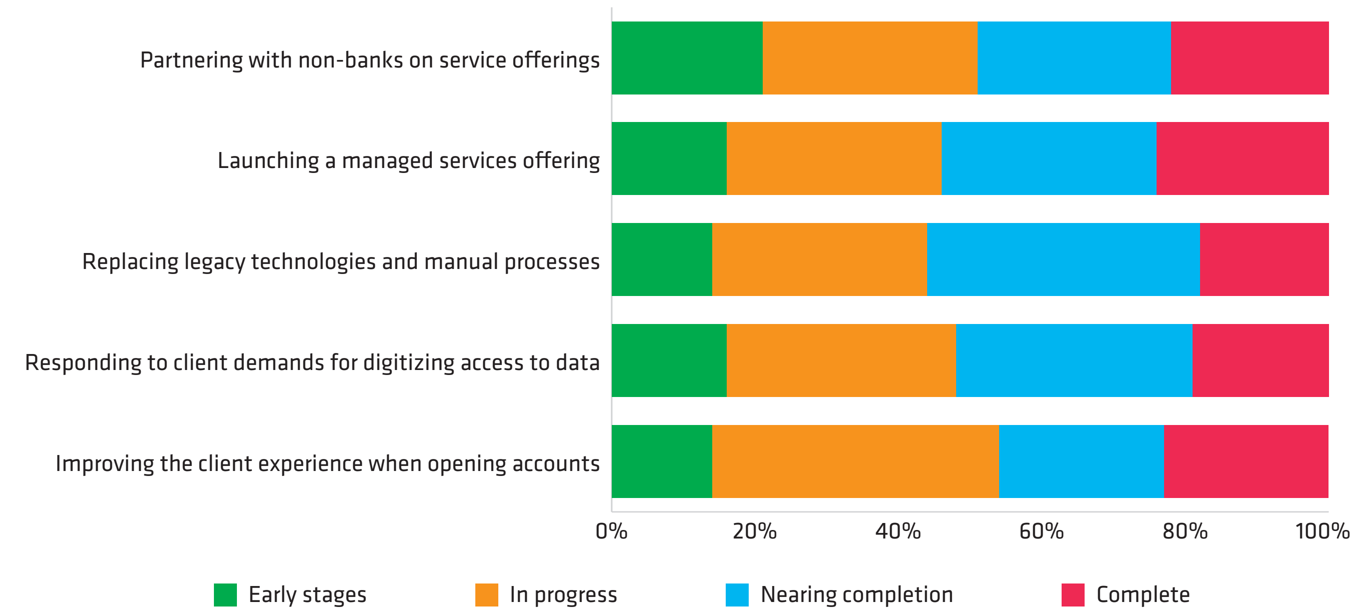
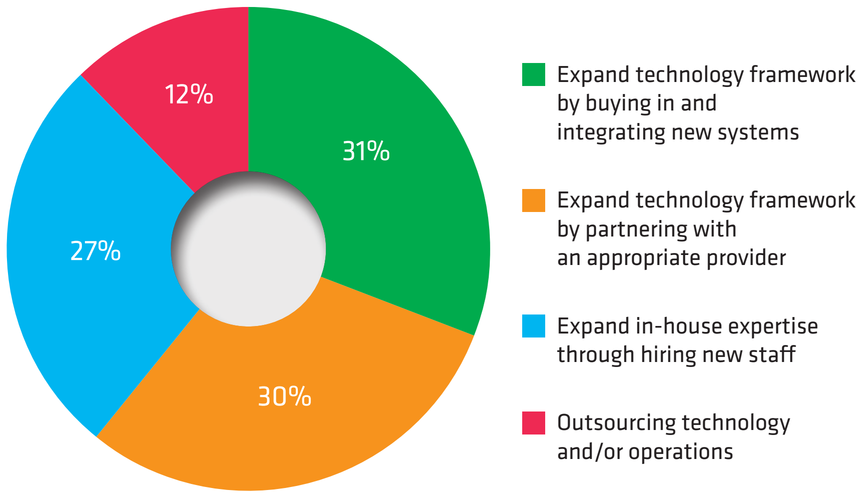
Figure 4: Progress to completion



> "Efficient digitization increases the options of an agile approach."

Figure 5: Approaches to meeting demands



opening, often for regulatory reasons, these repetitive requests are being felt more acutely. At the same time, individuals have become more accustomed in their personal lives to the possibilities of digital efficiency, and this is adding to the pressure.

While an overall digital enhancement strategy may be ideal, segmentation by service area may actually make the objective more achievable. An overall strategic approach is highly dependent on signing off a very large business case within an institution. A more agile approach, prioritizing specific service areas such as corporate actions where there is strong

Respondents' stated preparedness

Service area	Mean
Securities lending programs	63.38
Client onboarding	63.66
Tax due diligence	66.31
Securities processing	67.45
Corporate actions	68.10
Tax reporting	68.33
Client management	68.62
Cash management	69.39

potential for efficiency and risk reduction may be more feasible for particular providers.

Faced with a recognized need to anticipate client demand for systems and processes to be implemented to allow for perceived information requirements in the future will involve choices of where to invest to meet those needs. Figure 5 provides a snapshot of how far banks plan to retain in-house control of delivery.

While these options are not mutually exclusive, there remains a slight preference for buying in and integrating new systems (31%), though this is closely followed by partnering with an appropriate provider to achieve similar ends. The hope would seem to be that this can be achieved without adding significantly to the firm's staff quota. Outsourcing, however, appears to be an option that a minority regard as a preferred approach.

The desire to buy in and manage the technology in-house may reflect a perception that to do otherwise would be to cede an uncomfortable level of control. Efficient digitization, however, increases the options of an agile approach where banks retain control of the client front-end, while, as indicated earlier, permitting through APIs the use of logic, validation and rules engines residing elsewhere. This also minimizes the risk of slight differences in look and feel, which, while tolerable to institutional and wholesale clients may unsettle those at the retail end. Even among institutional clients, the individuals engaging in the relationship will be increasingly familiar with expectations formed by their own retail interactions.

While grappling with these challenges, it is clear that most banks are reconciled to further investment in systems and processes. Respondents were asked to what extent they thought their existing processing systems and resources in several areas could meet the needs that they were anticipating, with zero being "totally unprepared" and 100 being "totally sufficient". The results are presented in Table 1.

The table indicates that regardless of the complexity of service delivery in these diverse areas, whether client facing or internal, differences are in a narrow range of 63.38 – 69.39. This can be interpreted as being willing to make do for present requirements but recognizing that managing client expectations in the future will involve some tough decisions. This paper hopefully provides a starting point for reviewing the available options.

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ABOUT IHS MARKIT

IHS Markit (NYSE: INFO) is a world leader in critical information, analytics and solutions for the major industries and markets that drive economies worldwide. The company delivers next-generation information, analytics and solutions to customers in business, finance and government, improving their operational efficiency and providing deep insights that lead to wellinformed, confident decisions. IHS Markit has more than 50,000 key business and government customers, including 80 percent of the Fortune Global 500 and the world's leading financial institutions. Headquartered in London, IHS Markit is committed to sustainable, profitable growth.

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