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The sun shines on Malta

Industry participants explain how the country's custody sphere is growing

Facing the future

Industry participants share their outlook on what trends, challenges and opportunities the market will see this year

Becky Butcher reports

The beginning of last year saw the introduction of the second Markets in Financial Instruments Directive (MiFID II), shortly followed by the General Data Protection Regulation (GDPR) in May. While the industry is not being kept awake at night with MiFID II nightmares, there are still many challenges.

One of the biggest challenges financial services firms will face this year is the UK's departure from the EU—the industry's biggest challenge is undoubtedly the uncertainty around Brexit.

It's not all doom and gloom for 2019, however, as industry participants predict that there will be many opportunities to be had. One of the biggest opportunities is technology. As firms continue to adapt to the new regulatory landscape, there is a big opportunity to replace traditional processes and implement new technologies to optimise workflows.

What will be the biggest trends in the asset servicing world for the year ahead?

Paul Stillabower: This year I believe the industry will see the use of data-driven technology increasingly being the primary way that custodians service their clients. Custodians will be looking at specialist ways to deliver and integrate data into the services they provide for asset managers to enhance the client experience and improve control and efficiency.

Asset managers will no longer be looking to buy just custody and investor services, but the data and analytics service that goes with that.

I would expect custodians to be looking at ways in which they can commercialise the data that they hold. They will do this by perfecting the ways in which they ingest, analyse and examine data to add predictive insights and visualisation tools to help asset managers oversee, govern and grow their business.

David White: We've found that asset servicers are increasingly looking to move away from inbuilt systems which can be costly to maintain and can struggle to keep pace with regulatory developments. Instead, they are more open to engaging with specialist vendors and tend to favour web-based solutions over installed software—a trend we expect to continue well into next year and beyond as clients look to cut costs and keep pace with market best practice.

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> **David White**
> **Global head of sales, triResolve**

Kevin O'Neill: I think the industry will see an improvement in the end client/investor experience and improvement in productivity through digital transformation.

Client onboarding is typically manual and bureaucratic, including lots of duplication of information request to investors. This makes the onboarding and offboarding experience a challenge when working with investors and funds. As the market becomes increasingly competitive, the need to streamline and reduce the time it takes to onboard new clients has never been more pertinent. This will be the year when the sector is challenged to digitalise the entire customer journey end-to-end. Centralising data to achieve a single-client view and digitising the account opening process will not only improve the client experience for faster onboarding and opportunities for revenue, but huge efficiencies will also be gained from a productivity perspective. This will give asset managers the freedom to re-allocate employees to more value-added tasks within the business. I think we will also see firms using technology and a community-based approach to deal with regulation. Currently, most organisations are trying to deal with existing regulations while also keeping track of future regulations that could impact their business. The cost of dealing with changes in regulation is a big deal and financial institutions are always seeking a better and easier way of managing the constantly evolving landscape.

This year, asset management firms will be looking for automated processes for dealing with regulatory change as well as a strong reference point within a community of peers. By adopting a community approach to regulation, asset managers can share and learn from different ways of dealing with the new regulation. In the past, organisations handled this in a siloed approach. By forming communities, organisations can leverage best practices that are already in place, such as technology, as well as share intelligence, product development initiatives and ultimately be better prepared for upcoming regulatory change.

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> **Kevin O'Neill**
> **Global head of buy-side division, Fenergo**

Tony Freeman: The slow but inexorable rise of Target2Securities (T2S) will continue to shape the asset servicing market. Further, I expect that throughout the coming year more global custodians will consolidate their asset servicing with a single provider for all T2S markets in order to ensure operational efficiencies and reduce costs.

Brian Collings: Banks are increasingly looking to provide greater value to their clients, and the richest source of value is data. By mining the information that banks have about their clients, they can create new insights and differentiate their offering. As the finance industry is pushed towards transparency and competing for quantifiable advantages, the data that banks can offer potentially makes a big difference to their own efforts to service their clients. For banks, providing data as a service only works if they are able to aggregate information into a single point, and mask it where necessary, to ensure compliance with data privacy laws.

Demi Derem: I expect to see growth in outsourcing both technology and operations as asset servicing teams get more comfortable with the use of specialist vendors to help counteract the combined pressures of large-scale regulatory compliance and a high expense base, while simultaneously seeking to drive efficiency and optimise service standards. We also anticipate continued growth in securities lending activity and, as a result, expect to see new governance practices emerging and solutions being developed.

Arzish Baaquie: Continued topsy-turvy performance of the emerging markets, doubtlessly throttled by the China-US trade war; the volatility will present some opportunities for emerging market fund managers to pick up high-quality assets at discounted valuations but, overall, the investment managers will be relatively conservative with their outlook in the first two quarters of 2019.

Where will the big opportunities be?

Collings: In Europe, MiFID II has created a demand for reporting and data around pricing that simply did not exist before. Similar regulatory frameworks are being implemented in other jurisdictions, where end investors and regulators are keen to demonstrate the highest standards of performance and transparency.

Consequently, change is taking place across the US and the Asia Pacific which will create opportunities for banks with the right data infrastructure.

Paul Roberts: We see big opportunities for organisations who can eliminate the current inertia in their infrastructure, enabling them to respond quickly to new business opportunities plus harness scale across their businesses. This will inevitably involve a shift enterprise infrastructure and application platforms in the cloud.

Stillabower: There's been much discussion about fintechs disrupting the asset servicing industry, creating new products and eroding the revenues of the traditional custodians. I can honestly see room for both to co-exist, but instead of creating solutions which are looking for problems, I expect to see asset servicing providers partnering with fintechs to identify the best solutions to specific industry challenges.

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> **Paul Stillabower**
> **Global head of product management, RBC I&TS**

Derem: Asset servicers and custodians need to transition away from complex and costly legacy technology infrastructures and become more nimble and cost-efficient. As a result, we expect to see real traction in outsourcing, especially from historically in-house entrenched institutions.

For the first time, European regulation around proxy voting through the chain of intermediaries will be a driver for significant change. While there are certainly challenges to be overcome, there is a real opportunity for those focused on investor communications to use this as a springboard for collaboration to build a better process for all participants in the process.

New rights and obligations, such as the right for issuers to know the identity of their shareholders, will create new product and business opportunities for participants that are strategically placed to benefit.

Freeman: I anticipate that while large institutional investors will continue to avoid investing in cryptocurrencies and digital assets, custodians will begin to build the capability to process trades and holdings in real assets that can be tokenised.

To enable this, however, clarity will be needed with regards to the regulatory environment for tokenisation of assets.

White: Market participants have spent the last few years tailoring their operational processes to meet the demands of new regulation. In the race to be compliant, many firms implemented tactical solutions. By prioritising compliance to continue trading, the solutions devised were often sub-optimal.

As firms continue to adapt to the new regulatory landscape, there is vast opportunity to overhaul their traditional processes and consider the use of new technologies to optimise their workflows.

By working with specialist partners to meet impending regulatory deadlines (such as the uncleared margin rules), those stuck using manual and fragmented processes will be able to reevaluate their approach and ensure their processes are both cost and operationally efficient.

What developments do you think we will see in the technology space?

Derem: In terms of technology innovation, we expect to see continued large-scale IT systems and infrastructure replacement projects—both at an individual financial institution level as well as at a market level. We also expect to see real advances in response to the industry's drive for solutions in artificial intelligence (AI), blockchain, cloud and digital technologies.

Taking blockchain as an example, last year was significant for advances in proxy voting with participants throughout the proxy lifecycle taking part in pilot processes. Looking ahead, there are clear opportunities for firms to capitalise on the enhanced transparency, efficiency and security that this technology can enable.

Regulation as a driver for process change is also placing pressure on existing messaging standards. For example, tighter compliance deadlines in the issuer communications space mean the need for straight-through processing (STP) has never been greater.

Existing message standards such as ISO15022 either need a significant change in order to manage these flows, or newer standards such as ISO20022 will need greater adoption across the industry. So standards discussions will likely intensify.

Certain vendor solutions for management of corporate actions are starting to become industrialised and are now better able to cope with sourcing data, calculating entitlements and interfacing with elections.

The combination of stronger applications and availability through cloud hosting solutions is another driver causing firms to re-think their internal and legacy third-party platforms.

O'Neill: Digitising the client lifecycle should become top of the agenda for asset managers this year. In reality, the opening of accounts is still a costly, error-prone, labourious and 'dated' experience. Fragmented systems, housing several unconnected repositories of data and documentation, mean that asset managers find themselves repeatedly asking investors to submit and resubmit data and documentation required to support the account opening or new product onboarding process.

Most of this data capture is manual, involving paper-based questionnaires—even for existing clients who may be switching or adding new products. This can become a very tedious, lengthy and exacerbated process for clients, and may result in abandonment altogether.

A recent McKinsey report outlined how one asset manager described how almost 300 people were being copied on emails during the onboarding process due to a lack of accountability. Clients are demanding more and more digital capability and experiences from their financial institutions; however, many are seriously underperforming in making this a reality.

According to McKinsey, asset managers that are leading in digital transformation onboard new clients 62 percent faster and 75 percent less in cost compared to the industry average. This is proof that while achieving digital transformation is a long-term endeavour, those already on the path are reaping the benefits.

Freeman: The blockchain technology that underpins the trading of cryptocurrencies will begin to be adopted by traditional infrastructures. The Swedish central bank is pioneering in this area with its e-krona project to allow the currency to exist in its current form alongside a fully digital tokenised equivalent.

Furthermore, we expect other technology applications to continue to advance. Looking at DTCC specifically, this year we anticipate the go-live of our Trade Information Warehouse which has been re-platformed using distributed permissioned blockchain technology, in order to bring further efficiencies to post-trade processing and transform how the industry processes credit derivatives.

Roberts: This year will be a big year for technology, a year when we will see the realisation and unleashing of potential to deliver new low-cost asset servicing options.

There will be disruptors in the asset servicing space using new technologies, combinations of technologies, and new and disruptive infrastructures to deliver innovative asset servicing offerings.

We believe there is the opportunity for new technology-driven entrants powered by the cloud, AI and other production platforms to cause asset owners and asset managers to re-imagine current operating models and cost structures.

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> **Paul Roberts**
> **CEO, Milestone Group**

Collings: The application of AI technology—for example using robotic process automation—will enable far greater data sets to be consumed, and that will fuel the growth of new services.

As a result, many banks will achieve a previously unattainable level of understanding of their own operations and those of their clients, which can help them to create even greater efficiencies.

Connectivity and integration are also not to be underestimated. The use of modular technology changes the prospects for installation and growth of systems within financial services, so the limitations of legacy systems can finally be overcome.

White: As technology advances, firms can achieve real transformative change through the automation of tasks that are often manual and fragmented.

Such developments will help market participants overcome operational inefficiency and streamline their processes. By staying up to date with technological advances, market participants can strive to replace more of their manual processes and focus their efforts on higher value activities that help reduce risk.

What regulations will be the biggest challenge for the industry?

Collings: More than specific regulations, the breakup of consensus on rules between the US and Europe and between the UK and Europe poses the greatest potential challenge for compliance teams.

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Fragmentation of rules is hard to manage from an operational point of view. Even the threat of fragmentation will require firms to think about how their current operational and technology architectures are put together.

We're seeing authorities question the rollout of some rules, such as the Fundamental Review of the Trading Book and the Volcker Rule, which could lead to existing projects being changed significantly.

Furthermore, the European Parliament's elections in May might create a very different atmosphere for financial regulators.

White: This year and 2020 are set to bring potentially thousands of firms in scope for the mandatory exchange of initial margin (IM). Meeting the requirements for IM have proved to be time-consuming and laborious to implement so firms need to begin their preparations now.

Through working with phase one, two and three firms, we've found the main pain points are calculating the inputs for International Swaps and Derivatives Association's (ISDAs) Standard Initial Margin Model (SIMM), finding an efficient way to agree and exchange margin calls with counterparties, and pinpointing dispute driving differences as they arise.

Freeman: This year will definitely be the year during which firms across the buy-side and sell-side begin to prepare for the regulatory avalanche that will take place in 2020.

This includes the Securities Financing Transactions Regulation (SFTR), the Settlement Discipline Regime component of the Central Securities Depositories Regulation (CSDR) and phase five of the mandated implementation of initial margin rules for over-the-counter derivatives.

Furthermore, a new European Parliament and Commission will start work in September and set the regulatory agenda for the next few years.

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Tony Freeman
Executive director, industry relations, DTCC

Derem: The updated Shareholder Rights Directive (SRD II) in Europe and the publication of its Implementing Regulation means that intermediaries now have enough clarity to start evaluating their product offerings.

New requirements, including significantly more stringent processing deadlines and new processes such as shareholder identification, must be factored into their asset servicing capabilities and product development plans.

SRD II also leaves a lot of room for member states to choose different directions or standards. This year, custodian banks will either need to collaborate and lobby strongly for consistency or deal with divergent standards and challenging technical requirements for compliance.

CSDR will also be a high and growing priority. Some of the biggest changes under CSDR have primary impacts beyond the CSDs themselves, to institutional market players and custodians.

Chief among these is a newly restyled settlement discipline regime, which targets timely and efficient settlement in two steps—through the introduction of cash penalties, and by implementing a mandatory buy-in procedure.

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Demi Derem
General manager, investor communication solutions international
Broadridge

O'Neill: The reporting pillar of the SFTR requiring financial counterparties and non-financial counterparties to report their securities financing transactions is expected to come into effect as early as Q1 2020 (on a phased approach).

Asset management firms must start to prepare now by allocating resources or risk being left behind.

The planned European Market Infrastructure Regulation (EMIR) regulatory fitness and performance proposals are also going to be of importance.

A draft regulation is currently undergoing negotiation, however, the first amendments could come into force this year.

What other challenges do you expect to see?

Baaquie: In the UK, uncertainty will dominate, primarily due to the nature of Brexit.

Once the dust has settled on Brexit, the new Britain will undergo some teething pains but eventually find its feet, albeit lacking a large talent pool.

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> **Arzish Baaquie**
> **Managing director, Smartkarma UK**

Derem: Driven by asset owner behaviour, fund managers continue to look for opportunities to differentiate themselves, with greater emphasis on stewardship and environmental, social and governance offerings.

This will lead to pressure to continuously improve services in a regulatory environment, which may remain challenging for financial intermediaries.

The trend of doing more for less has and will continue to present threats. Financial intermediaries have managed to survive in buoyant markets; however, as history tells us, at some point the market will turn and when it does, volume-related revenues will start shrinking.

Those that invest in making themselves more efficient now, and reinventing their own individual economic wheel, will find themselves the real winners in the longer term.

Freeman: I expect the financial services industry to continue to grapple with cybersecurity threats in 2019 and for years to come. It is certainly an area that keeps senior management awake at night.

In fact, according to the most recent findings of our annual Systemic Risk Barometer Survey, cyber risk was ranked within the top five risks by 66 percent of respondents. The next market crisis could well originate in this area.

Furthermore, firms will continue to face challenges with regards to several Brexit-associated issues, including uncertainty about the nature of the withdrawal agreement, the impact of Brexit on access to the UK's capital market by EU investors, and access to the continent's capital markets by those based in the UK.

Collings: Margin and cost pressures will not go away and as such efficiency will continue to be the name of the game.

The big challenge will be to turn that data aggregation cost centre into a profit centre, by repurposing data and making it into business intelligence.

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> **Brian Collings**
> **CEO, Torstone Technology**

O'Neill: GDPR has led to a worldwide scramble to update national data protection policies as the free flow of data becomes increasingly regulated, impeding trade and commerce in a progressively more digitalised world.

Jurisdictions are generally seeking an adequacy decision or just wish to be considered as having the required safeguards in place.

This uptake in data privacy laws can be seen clearly in the Asia Pacific as India, Thailand, Indonesia and Vietnam have all published draft bills in recent months. These are expected to continue through the legislative stages this year.

In March, Brexit will see GDPR continue to be applicable in the UK but will also start a race to obtain an adequacy decision from the European Commission.

The European Data Protection Board is expected to release new guidance this year on particularly sticky points from GDPR, for example, extraterritoriality.

Regulators globally will be focusing on the regulation of crypto-assets and within Europe, providers engaged in exchange services between virtual currencies and fiat currencies will be brought into scope of the Fifth EU Money Laundering Directive, as they will be classed as obliged entities. AST