# Time is critical

**The financial services industry had several inherent challenges coming into 2020, however, IHS Markit's Michael McPolin says the pandemic has not significantly changed the challenges for financial institutions, but it has amplified the need and time criticality to take action**

### Will the events of 2020 be the catalyst to market change?

The financial services industry had several inherent challenges coming into 2020. These included growing trade volumes, greater regulatory pressure and increasing complexity of corporate events in a period of diminishing tolerance of financial institutions errors. These trends, combined with a sustained period of industry price compression and reducing profit margins, suggested that 2020 was heralded to be a challenging year even before the World Health Organization declaration of COVID-19 as a global pandemic.

The first half of 2020 has significantly increased the human and economic challenges, as many countries are beginning the transition out of lockdown and despite rapid and unprecedented central bank intervention, unemployment numbers are at record highs. This has placed a significant impact on key sectors such as the airlines, motor industry, construction, real estate, retail, travel and leisure. The economic impact has affected investor confidence and resulted in significant market volatility with large drops in major market indices. We have also seen spikes in settlement activity as investors initially sought to move their investments to perceived safe havens of cash and other-risk-averse assets.

In respect of asset servicing as a direct consequence of the economic crisis, the number of bankruptcies and complex debt restructures in the market significantly increased while a record number of companies cancelled, suspended or extended their dividends. Income and distribution events were hit hardest as companies sought to retain liquidity in line with direction from governments and regulators.

The lack of clarity from some companies regarding dividend payment cancellations is compounded by conflicting market information. Some stock exchange closures created investor panic, significantly adding to the operational challenge of servicing clients and obtaining timely and accurate information.

The industry had the additional challenge of responding to this market volatility while operating under a business contingency plan with most offices closed and staff working from home as a result of the global lockdown.

Some would argue that the pandemic has not actually significantly changed the challenges for financial institutions, but it has amplified the need and time criticality to take action.

## How can financial institutions adapt to this challenge?

The industry headwinds of price compression and reducing profit margins remain as the primary driver for change in the financial services industry as financial institutions look to achieve efficiency, risk reduction and enhance their client service experience.

***Changing workplace***

Based on market analysis, remote working has proven to be successful with several major organisations considering revising their operating models to incorporate working from home on a permanent or rotational basis. It is felt that the adoption of this operating model will provide significant savings on real estate and provides staff with a better work life balance. It is envisaged that there will be an increased focus upon new technologies that enhance the robustness and efficiency of remote working along with tools that allow employers to better manage and measure performance.

A key facilitator of the success of remote working has been the adoption of communication technology platforms which have seen monumental increases in volume usage. This virtual world works for some businesses better than others, its ongoing adoption could provide great cost savings on travel and expenses, but the loss of human contact may impact future working and client relationships which have been an important attribute for the industry.

In a crisis situation and specifically with teams working remotely, one of the biggest operational challenges is the need to prioritise workload. This has traditionally been done based on the monetary value, but operations managers also need to consider reputational and regulatory impacts. Therefore, the need to have access to accurate market data and real-time workflow and risk dashboards is essential in order to mitigate risk and maintain service delivery.

***Opportunities from technology***

In response to these industry and market challenges, financial institutions have invested in rules-based workflow automation technology and digitalisation tools, either building or buying market-leading post-trade solutions. These solutions facilitate increased efficiency and risk reduction by automating the end-to-end workflow with the aim to increase straight-through processing rates. This creates time and resource to refocus the operating model to the identification and resolution of exceptions.

Firms are increasingly leveraging cloud technology to lower total cost of ownership (TCO) and simplify the implementation and maintenance of solutions compared to the traditional model of on-premise deployment and upfront licensing costs. The compelling economics of cloud is especially valuable to custodians who struggle to replace their legacy technology platforms, impacting their digital transformation and adoption of modern technology solutions.

Given the reliance on manual touchpoints and processes, developments in new technologies such as robotic process automation, can help increase operational efficiencies by automating the basic repetitive tasks without impacting the technology infrastructure. Using robotics, web scraping and artificial intelligence (AI) techniques to source corporate action data directly from newswires, the web, vendors and other providers to analyse the unstructured data in disparate formats using AI and machine learning, can help firms to reduce manual validation efforts and timeliness issue for corporate actions.

Intelligent automation can also be used to analyse reconciliation breaks and patterns at different steps in the investment lifecycle to help operations in faster resolution of breaks. Modern tools like natural language processing based chatbots can assist in client servicing for basic information queries and assist in the decision-making process with additional information.

Client onboarding and product distribution can also be significantly improved using digital onboarding solutions and workflows with multiple products in the market.

***Messaging and interfaces***

The increasing demand from buy-side clients on self-servicing, real-time information access and modern digital tools, provide opportunities for the industry to leverage technologies such as application programming interfaces (APIs) and open platforms. API adoption is increasing at a rapid pace and can improve the efficiency not only around client communication but also providing real-time data to the front office. This in turn optimises their returns on investments and interactions with the street including counterparties, market infrastructures and solution providers. A number of new entrants are now offering data normalisation and networking sharing solutions.

***Operating models and outsourcing***

As highlighted earlier, before the pandemic there had been significant pressure on costs with financial institutions looking at transformation programmes that involve re-defining and enhancing operating models. Options under consideration included and continue to include combinations of replacing legacy platforms with best-of-breed technology and data solutions. Alternatively, firms can outsource non-core activities to specialist managed service providers who benefit from having developed centres of excellence, process expertise and economies of scale and in most cases delivered on new technology.

The general view in the industry is that there will be more outsourcing with several custodians now offering front to back solutions targeted at the buy-side. More broadly financial institutions are increasingly looking to outsource complete processes under business process as a service where not only technology but also business processes are being externalised to expert providers.

From our own experience, we know that there is a growing appetite for the managed services model where a whole process can be outsourced and mutualised while retaining options for customisation and user-specific integration needs.

For those of us who have been in the industry for some time, discussions around outsourcing and industry utilities have always been topical, but as we look at how the current health and economic crisis will shape the industry, the business case for adoption of these options for certain functions such as event sourcing and validation has become a reality. It is suggested that the next phase of the outsourcing evolution is mutualisation whereby multiple financial institutions outsource technology and operations to an external provider, especially in non-core functions.

***Evolving regulatory change***

The market volatility seen in the first half of 2020 is likely to continue due to uncertain demand and concerns over prolonged economic instability. The challenges around corporate actions complexity will continue to evolve. Capital markets will find new and innovative ways to raise investments and governments will respond to the economic crisis by most likely introducing new austerity measures such as tax legislation.

In addition to the above challenges, history has told us that after any crisis governments and regulators have tried to introduce additional regulations to protect investors and maintain confidence in market integrity. In respect of the COVID-19 pandemic, the cause and impact are not a result of failure to control or regulate the market but an opportunity for financial institutions to work with the regulators to address inefficiencies and risk in the market by using regulation to drive the harmonisation and standardisation agenda.

At IHS Markit, we have seen evidence of this approach used within the second Shareholder Rights Directive in Europe which stipulated performance parameters and the use of machine-readable, straight-through processing capable messages. This direction resulted in the adoption of ISO20022 for proxy voting by the Securities Market Practice Group and the development of a number of market offerings including our IMProxy solution.

In summary financial institutions need to embrace an agile and innovative approach to the global challenges as they evolve. Firms can remain competitive by transforming their operating models and adopting technologies to deliver against the primary challenges of enhanced efficiency and cost reduction. Financial institutions who have invested in new best-of-breed technologies have an advantage over firms operating on legacy platforms and it is essential that these firms progress with their business transformation programmes as the cost of delay in the current environment could be critical.

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