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03

Top Ten Challenges for
Investment Banks 2014

A New Ecosystem: Using
Utilities to Share the Load



03

Fundamental Restructuring

A New Ecosystem: Using Utilities to Share the Load



Industry utilities can meet the demand for process efficiency and cost savings, and sharpen the competitive advantage of participants in capital markets.

The centralised utility model has been examined and adopted in various forms by the capital markets industry over time, as the industry has matured and its participants have continued to strive for ways to navigate new challenges. Central Securities Depositories (CSDs)

were established as specialist organisations to hold securities centrally for market participants, thereby increasing the efficiency of asset transfer around the financial system. These utilities have become part of the essential plumbing of securities markets.

Utility creation has also been part of the regulatory response to systemic industry shocks. The collapse of Lehman Brothers in 2008, which triggered the global financial crisis, has driven subsequent regulation which mandates the clearing of derivatives transactions through central counterparties (CCPs), to mutualise the risks of counterparty default.

Through looking at CSDs and CCPs as examples, it is clear that the centralised utility model carries a number of clear benefits (see Figure 1).

In a fast-moving industry like Capital Markets, the utility model also appeals to firms wanting to create new revenue opportunities, and current structural trends are combining to create these opportunities in the marketplace.

Firstly, securities markets are experiencing a continuing decline in volumes and tightening margins, with Investment Banks having to adjust to a new reality of tighter regulatory controls and lower volatility. Meanwhile, the cost of maintaining processes and technology to serve

these functions remains stubbornly high, despite targeted efforts to reduce the fixed cost base through traditional means, including significant headcount reduction, the use of BPO and captive shared service models. Cost bases continue to be inflated by capital requirements under Basel III, and the burden of further regulatory reform. This combination is weighing heavily on Investment Banks' profitability and contributing to single-digit RoE numbers across the industry.

Secondly, a wider range of non-bank participants in the market are looking to diversify away from their traditional businesses to find new sources of

revenue. Custodians, depositories, exchanges and other third-party providers are all looking for ways to become part of the fabric of the industry. By scrutinising functions throughout the trade lifecycle, the majority of which are currently performed separately by every Investment Bank, these players are recognising that there are opportunities for consolidation.

Homogenous functions duplicated by firms across the industry are candidates for utilitisation, particularly where they represent a fixed cost burden.

Cost Reduction	Standardisation
Through economies of scale & reduced process duplication	Establishing of consistent industry standards and benchmarks
Mutualisation of Risk	Increased Service Quality
Spreading risk across all market participants	Sharing of expertise & best practices

Figure 1: Benefits of industry utility model
Source: Accenture Research

Functions which are repeatable and performed to the same degree by multiple market participants are open to standardisation and consolidation within a utility context. The provision of reference data (client & instrument) is one example:

- Banks still have issues, and expend significant cost and effort, trying to get it right.

- It is imperative, and in everyone's interest, that the data is correct.
- Data is homogenous and used by wide range of participants.
- The greater the number of participants, the more accurate the data is likely to be (for example in achieving consensus on price).

Onboarding and know-your-customer (KYC) is another example of a function

with these characteristics, with Markit & Genpact recently announcing the launch of a centralised client onboarding solution to the market.

Despite these advantages, the challenge for utilities driven by revenue opportunities – as opposed to a utility which is driven by a regulatory imperative, for example – is to ensure that the solution being offered is compelling enough to drive the required industry uptake. Without this critical mass, the benefits of the utility model are quickly negated.

The convergence of cost, regulatory and technological pressures is forcing banks to reassess their securities processing operations

As profitability is squeezed in securities markets by the combination of depressed volumes and a stubborn fixed cost base, Banks are being forced to look at ways of reducing costs and returning to more sustainable RoE numbers. This is especially important given the impending impacts of further regulatory reform: CSDR, T+2 settlement, TARGET2-Securities (TS2) and Tripartite netting promise wholesale market change and significant, costly rebuilding of existing technology platforms.

A bank lacking the scale and technological edge to compete as a Top 5 player is faced with the prospect of either exiting business lines that cannot justify its cost to serve, or finding ways to obtain scale advantages. For this type of bank in particular, the key to a more

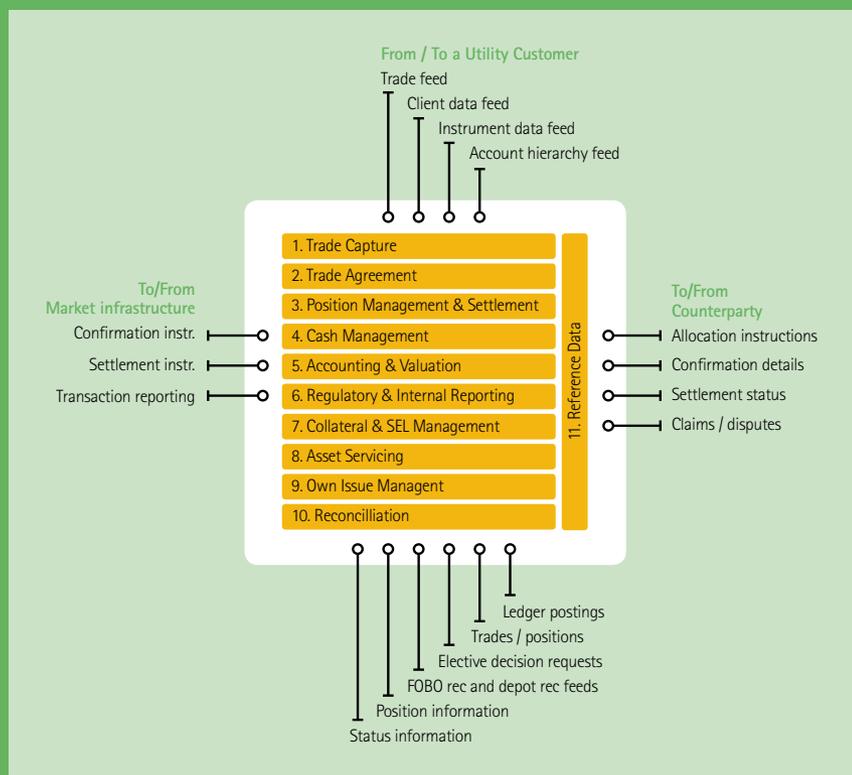


Figure 2: Summary of post-trade processes and information flows to / from utility
Source: Accenture Research

sustainable business model is an ability to fundamentally transform internal cost structures and reduce the overall cost per trade.

Post-trade securities processing represents a significant portion of the trade lifecycle (and cost base) and is made up of exactly the kind of homogenous processes that are open to consolidation. Vendor-operated utilities can provide a scalable and comprehensive option, providing banks with the opportunity for immediate and aggressive fixed cost savings in the near term, as well as the longer term flexibility and transparency of a variable cost model. Across the industry, the huge sums of money spent by different Investment Banks to maintain largely identical processes and technology platforms could be significantly rationalised.

Sharing the load in post-trade processing: multiple clients, same processes, shared cost

Post-trade securities processing covers the wide range of basic functions currently performed in-house by the "back office" in every investment bank. Accenture Post-Trade Processing relies on the centralisation and standardisation of this core processing across different banks and product lines, providing a client-agnostic platform that harnesses uniform technology and resources (see Figure 2).

The business model is underpinned by the benefits of scale:

- Reduction in cost per trade, potentially by up to 30-50%, can be achieved through an immediate reduction in fixed costs, as well as a shift to a variable cost model that

is responsive to scale (see Figure 3). As more banks join, the marginal cost per trade decreases, benefiting existing clients.

- **Mutualised cost of change & compliance** as the utility is required to meet additional regulatory demands from the outset. This is of particular benefit where uncertainties, over timelines or scope, still persist in the regulatory agenda.
- **Improved service delivery:** Delivery of real-time information allows for more informed decisions and better management of collateral for securities operations. Comprehensive support across multiple markets, coupled with trade status information, enables the provision of a higher quality of service internally (to the front and middle office) and externally (to their clients, regulators, CSDs etc.). Management of SLAs and visibility of defined KPIs, monitored against industry benchmarks, provides shared accountability.

Looking to the future, the utility model will continue to be refined as it shapes itself to meet industry demands. Competitive pressures, such as the entrance of additional third parties into the market, utility customer feedback and ongoing performance improvements necessary to expand the client base, promise to further improve the model, drive down the cost per trade and expand the benefits to the wider market and potential clients.

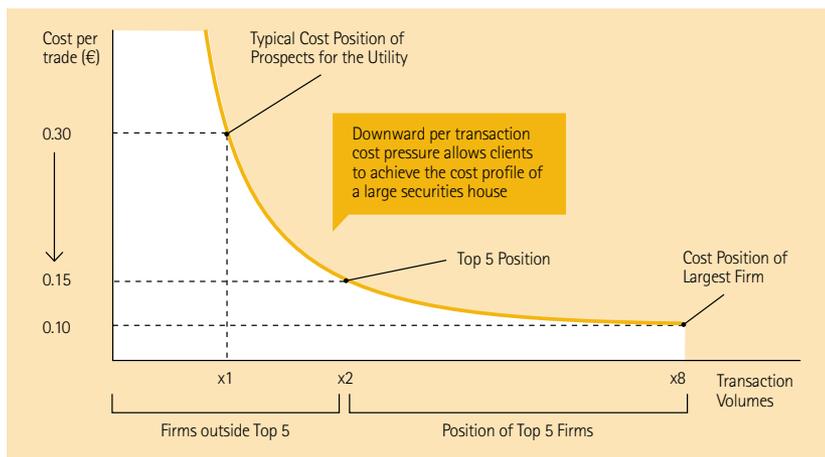


Figure 3: Industry Cost Curve example – Equities
Source: Accenture Research

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