International Securities Services Association

The New Norm

Operational Resilience

Welcome

Welcome to the third of a series of short articles, prepared by ISSA's New Norm Working Group, that deal with the impact of the global pandemic on the Securities Services industry.

Most in the industry already know the challenges that the Securities Services business faces. The pandemic, though, has brought these starkly into the spotlight. This is therefore a defining moment for the industry. If the key players come together - and act now - there is an opportunity to drive forward and effect real change. If they don't, there is the risk of having the same discussions in another five years.

Resilience: (*noun)* the capacity to recover quickly from difficulties

1. Introduction

The focus of this paper is 'resilience', a topic which is growing in terms of regulatory importance and scrutiny. The unprecedented and disruptive events of 18 months ago highlighted exactly why firms must review and challenge their approach to, and understanding of, resilience in the future.

The securities services industry operates in a complex and continually evolving environment, and the degree of interconnection and dependency between participants throughout the value chain – including agent banks, custodians, market infrastructures and, increasingly, fintech providers - adds another layer of complexity.

In March 2020 the knock-on impact of high volatility and high trading volume led to severe challenges in ensuring effective settlement – exacerbated by the disruption of many critical team members, particularly those in offshore locations, suddenly unable to work from the office but without adequate remote working capabilities. This combined challenge demonstrates the importance of industry wide coordination and response and will, particularly in relation to provider relationships, lead to requirements for visibility of resilience plans and capabilities (beyond traditional Business Continuity Management (BCM)).

It should be noted that, despite high fail volumes, the industry was able to quickly adapt and recover, demonstrating both agility and responsiveness. However, the dramatic changes in transaction volumes experienced during the first months of the pandemic highlighted how, whilst the vast majority of securities transactions are STP, better levels of scalability still need to be achieved. Even a small additional percentage of failing transactions can lead to significant operational impacts, with ripples felt across the ecosystem.

This paper explores different angles that firms must consider when discussing resilience, including people & process, geography & strategic sourcing and – critically - technology decisions.

September 2021

2. Technology

A recently published ISSA White Paper "The Future of Securities Services" highlighted that larger-scale adoption of Artificial Intelligence, Machine Learning and DLT, new business models based on new technologies, as well as new entrants to the industry from the technology sector was not a matter of 'what' but rather a matter of 'when'. The past 18 months have proved to be a fertile ground for technology innovation and the industry has witnessed an increased adoption of existing technologies, as well the launch of new products and technological capabilities.

According to a recent McKinsey survey, responses to the pandemic have speeded up the adoption of digital technologies by several years and many of these changes could be here for the long haul. Besides the obvious increase in remote working, the largest trend seems to be the digitization of customer interactions.

In the context of securities services and resilience, the New Norm WG believes this will drive a significant acceleration on the adoption of three specific technology capabilities:

2.1 API

An API is a software intermediary that allows two applications to talk to each other. In other words, APIs enable the flow of information between applications and provide financial institutions with the ability to easily access and evaluate customer data and create innovative products tailored to consumer, market and regulatory needs. APIs are increasingly being used by financial institutions to expose business data, functionality and services to the outside world crossing the internal borders that existed traditionally, with the goal to create better customer experiences. In the context of the pandemic, the WG participants believe that by accelerating the adoption of APIs, the industry can reduce complexity, risk and more importantly the reliance on people by enabling automated digital B2B interactions.

Data shows that reliance on APIs accelerated during the pandemic and will continue to increase in 2021 and beyond. 61% of developers used more APIs in 2020 than in 2019 and 71% plan to use even more this year.

2.2 RPA

RPA (Robotics Process Automation) is a form of business process automation technology based on software robots or on artificial intelligence (AI)/digital workers. The use of robotics in emergency situations was apparent during the early pandemic period where stories emerged of urgent large-scale processing requirements – one large financial institution was faced with the need to update 6 million loan records immediately. Without RPA, this project would have taken 2 years and 100 people to complete.

RPA originally faced challenges due to the lack of understanding of the exact role it could play in digital transformation, as well as ultimately how its ROI could be measured when compared to other competing initiatives. However, the pandemic has changed this. It has thrust into the spotlight those processes that need scaling and showed that the opportunities for automation are practically infinite. According to cio.com, before the pandemic it estimated that as much as 80% of manual front-and-back office business processes that could benefit from automation were still undiscovered.

2.3 Public Cloud

The pandemic has also highlighted the need for the type of flexibility that - for many years - financial institutions have been cautious to adopt, especially for mission critical applications. There have been numerous firms struggling to rapidly provision capacity to ensure the shift to near-full time work from home, which has led to numerous performance challenges at the onset.

This global crisis has therefore proved to be a huge opportunity for the cloud market, with a definite surge in cloud adoption globally across diverse industries. According to Gartner, in the aftermath of the pandemic, the worldwide, end-user spending on public cloud services is forecast to grow 18.4% in 2021 to total $304.9 billion.

Many of the conversations about public cloud computing in the past were about enabling innovation, faster time to market and cost savings. However, the pandemic has brought additional factors to bear - like elastic computing (ability to rapidly adjust resources to meet capacity), high availability, disaster recovery and business agility – all of which enable further operational resilience.

After more than a decade of a steady-increase in maturity, both on the technology front as well as with the skills required to take full advantage of Public Cloud capabilities, it is expected that CIOs, CISOs, Regulators and Public Cloud providers will tackle the last remaining concerns that are preventing the securities services sector from fully taking advantage of Public Cloud capabilities for its most critical business applications, beyond productivity tools, low risk applications and test environments.

In conclusion, the recommendation of the New Norm WG, from a technology perspective, is to embed those lessons learned from operating businesses during the COVID-19 pandemic into future operating models. This should be achieved by reviewing and rethinking existing digital transformation programmes across the full value chain of activities, critically reviewing costly and manually intensive - but non value-adding - activities and adopting new ways of remote and resilient working into Business as Usual (BAU) capabilities.

3. People & Processes

Along with the generic industry-wide learnings around flexibility and enhanced communication, which have played a key role in supporting all staff throughout the pandemic period, the main observations around the resilience of people within the securities services industry involve ensuring coverage of critical tasks and the continued availability of knowledge. Core takeaways include minimising key person dependencies and ensuring ease of deployment of resources into areas of need. Not only will these actions increase workforce sustainability in times of crisis, but they will also add value and agility in a BAU context. Concrete examples of how to achieve this within the management of processes include:

- Structured cross training and inventory of skills (within and outside immediate responsible team)
- Robust procedure and process mapping, including use of consistent tools to map processes against underlying system infrastructure
- Flexibility of system access requests in BCM scenarios in order to enable speedy ramp up
- Review of the distribution of tasks across teams/locations and review of existing BCM plans
- Understanding of wider knowledge and capability resources within the organisation, several firms reported calling previous subject matter experts back into former processes to bolster team strength
- Linked to the technology points above – reduction in manual processes (either through RPA or increase in STP) is also critical to reduce the variability and demand on the operations and client servicing teams
- Using data to better understand work drives and enable more accurate capacity planning

4. Geography & Sourcing

Geographical resilience has traditionally focussed on the notion of proximity - or lack of - between resources and infrastructure. Throughout 2020 though, organisations have expanded and stabilised remote working capability, challenging the established requirements for alternative and distributed sites.

If the securities services industry can continue to make strides towards the automation and digitalisation of activities, then the considerations of nearshoring/offshoring become laser focussed on other pertinent factors - such as the availability of talent and implications such as tax and localised geopolitical concerns.

The ongoing pandemic has also brought considerable scrutiny to sourcing decisions, raising fundamental questions about how firms should conduct their third-party selection and due diligence in the new world.

Whether there will be a gradual return to face-to-face due diligence - and travel in general to pre-pandemic levels or not - is a subject of speculation in the industry. Whilst there will not be a one-size fits all approach for participants, it seems logical to expect that despite the frequent lack of mutually recognised platforms for virtual meetings - and the recurrent occurrence of connectivity failures which have proven to be a practical issue during the past 18 months - onsite due diligence will be reduced in future, although it should be noted that many firms still see benefits of travelling onsite.

Regardless, securities services providers should expect to see an increased focus on operational resilience factors in due diligence questionnaires, with the potential that firms expect a certain level of demonstrable resilience. This is predicted to become a significant decision factor for third-party selection in the future. The recent addition of pandemic-related questions, and of a new Operational Resilience section in the AFME Due Diligence Questionnaire, is a representative case of new concerns and priorities in the industry.

Finally, The WG participants expect there to be increased focus on concentration risk - whether at a geographic or a provider level. Even before the pandemic many institutions were reviewing their contingency plans to reduce their dependency in specific areas and insource some of their core activities. However, the pandemic's impact has further accelerated this review process. .

Accordingly, we anticipate an increasing number of market participants to reassess their set-up in order to seek adequate protection against concentration risk – whether at a country, regional, city or provider level.

5. Regulatory Considerations

In December 2019 - and only months before the crisis hit - the FCA, PRA and Bank of England launched joint consultation papers on the topic of Operational Resilience. Megan Butler, of the FCA, specifically defined Operational Resilience as "the ability of firms and FMIs and the financial sector as a whole, to prevent, adapt, respond to, recover and learn from operational disruptions" and, in this context, asked firms how they would be looking to prevent harm from a "severe, but plausible, scenario".

The pandemic crisis was a timely reinforcement of the underlying criticality of the exercise and associated risks.

The final FCA rules and guidance will come into force on 31 March 2022 as per policy statement PS21/3:

By 31 March 2022, firms must have identified their important business services, set impact tolerances for the maximum tolerable disruption and carried out mapping and testing to a level of sophistication necessary to do so. Firms must also have identified any vulnerabilities in their operational resilience.

As soon as possible after 31 March 2022, and no later than 31 March 2025, firms must have performed mapping and testing so that they are able to remain within impact tolerances for each important business service. Firms must also have made the necessary investments to enable them to operate consistently within their impact tolerances.

Source: FCA Website

With this in mind, ISSA believes that there is an opportunity for the industry to collectively consider practical responses, across the securities services value chain, to effectively demonstrate and evidence operational resilience between providers and clients. There is a chance, at this stage of the industry response, to ensure that any future processes are aligned, standardised and pragmatic and minimise the overall administrative burden. This will be driven by, and require response to, regulatory developments in all jurisdictions and will become an important element of future provider selection and monitoring.

6. Conclusion

The COVID-19 pandemic has, without doubt, driven cross-industry insights and learning around resilience and there is now a real opportunity for the industry to work together to ensure readiness for future crisis events and collaboratively reduce associated impacts. Such disruptive scenarios are no longer seemingly unlikely paper-based exercises, but very real events in the industry's collective memory, which it is believed will - and must - encourage cross-industry cooperation and improvements in operational processes.

ISSA is considering forming a working group to discuss the specific topic of Operational Resilience in more depth and would appreciate any feedback from members.

Should you, or your organization be interested in joining these discussions, please contact Karen Zeeb at karen.zeeb.issa@six-group.com