International Securities Services Association

The New Norm

November 2021

STANDARD SETTLEMENT INSTRUCTIONS

Welcome to the fourth 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 the that 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 players come together – and act now – there is an opportunity to drive forward and effect real change. If they don't, the same discussions will be taking place in another five years.

INTRODUCTION

Standard settlement instructions (or SSIs) are one of the most important reference data sets in the financial industry. For a given trade or cash movement, they identify the accounts that assets and money should be credited to, the market or place of settlement and through which custodians/intermediaries the communication should flow. SSIs enable faster and more accurate cross-border transaction flows, help reduce settlement risk and improve straight-through processing (STP) rates.

Unfortunately, SSIs are not always kept up-to-date and are sometimes managed or distributed incorrectly. As a result, SSI-related issues continue to be one of the most common reasons for settlement failure in the Securities Services industry. However, advances in data management technologies, along with broader adoption of a centralized SSI repository solution, could finally offer the opportunity for the Securities Services industry to solve this seemingly intractable problem.

The New Norm

Standard Settlement Instructions

KEY ISSUES

Increasing efficiencies and reducing manual touch points have always been high priorities for the Securities Services industry. However, when it comes to reference data, poor data quality continues to be a major issue, resulting in major downstream issues such as trade breaks, incorrectly valued fund purchases, errors in FX trade confirmations or the inaccurate calculation of entitlements or redemptions. The result of poor data quality is ultimately settlement failure.

Need for Improved Efficiency

As a result of the pandemic, as well as the anticipated implementation next year of the European Union's Central Securities Depositories Regulation (CSDR), many firms have been reassessing their manual processes. One of the main areas of focus for the Securities Services players has been the processing, centralization and automation of reference data such as SSIs. With the global shift to a shorter trading-to settlement cycle, combined with the current and upcoming penalty schemes designed to discourage settlement failure, this focus will be key to avoiding significant costs in future years.

Need to Reduce Risk

Fraud or asset theft risk, as a result of SSI manipulation, is one of the most discussed topics in financial crime compliance working groups. The wide variety of information exchanged between intermediaries in securities markets creates multiple opportunities for fraud. Moreover, these markets provide a host of tempting targets particularly because of the extended chain of intermediation: a typical securities transaction might entail the exchange of valuable information between a dozen intermediaries, any one of which can be compromised. Crucial reference data, such as SSIs, particularly when reliant on manual updates, create opportunities to divert deliveries of cash and securities – particularly when Free of Payment deliveries are made.

In 2018, ISSA highlighted the risk of asset theft by creating fraudulent records of transactions along the intermediary chain: "A malicious party could introduce a fraudulent instruction through either an industry messaging utility or via a custodian's client-facing electronic-portal and instruct the movement of securities from the securities account that the fraudster has opened elsewhere" (ISSA, Cyber Security Risk Management in Securities Services, 2018).

THE WAY FORWARD

Technology Solutions

As already outlined, the reduction of manual processes within the financial industry has so far been derived largely from traditional automation technologies. However, access to data, such as SSIs, through direct integration and APIs, can enable integration of data sets into back-office systems that populate SSI instructions that are sent down the market.

At the same time, the introduction of smart contracts - executable programmes that have their origins in blockchain technology - could also be deployed to monitor interactions between multiple parties with the aim to prevent deviations from an agreed set of rules. Additionally, they could be used to build data governance models to allow for each SSI to be validated by all relevant stakeholders including the data owner, the intermediaries (global custodians, local custodians, prime brokers, nostro banks etc.), as well as the place of settlement and even the central databases that maintain the data in a consistent manner.

The Investment Management Perspective

"The Investment Association (IA) and its Investment Operations Committee members are keen to support and encourage the adoption of a data centralized repository solution by the securities services industry. The IA would like to highlight benefits of automation and centralization and the risk mitigation it will bring in terms of reducing the current handoff process to Investment Managers."

Reference Data Centralization

The greatest benefit of data centralization is the positive impact it can have on data quality, providing consistent data usage and reporting. A single point of entry and consumption - with the correct data and syntax validation - encourages and enables data quality and consistency. Having multiple points of entry or consumption can lead to incomplete, inaccurate, aged, or fragmented data. This is far from ideal, particularly looking ahead at the CSDR's penalty scheme. A single point of entry would also allow the Securities Services industry to enforce unifying standards. Already, some global and regional custodians have coalesced and taken a very active position in data management - with custodians today maintaining nearly 40% of all SSI data - which represents incredible progress for the industry.

However, ultimately, data centralization can only offer benefits to everyone – from data providers to consumers of the data - if it is used by everyone. While centralizing data may require considerable effort and cost initially, it will pay dividends by mutualizing the application, development and maintenance costs in the longer term. In addition, data processing can be automated or streamlined, lowering operational overhead and risk.

CONCLUSION

Increasing the quality of all processes to maintain and distribute SSI data should be a priority for the Securities Services industry. In the short term, this will probably involve the use of company-specific technology solutions – such as APIs and smart contracts –to reduce settlement failure. These will be particularly important given the upcoming settlement discipline regimes that are being introduced.

However - as stated in this paper - the idea of achieving total automation of SSIs through the use of a centralized data repository is becoming more of a possibility as current solutions evolve and emerge. If a centralized solution can be agreed to by the Securities Services industry - supported and used by custodians and other key parties involved in the transaction value chain - poor quality SSI data could finally become a thing of the past.

Tel: +41 58 399 23 68
Email: issa@issanet.org
c/o SIX Group Services AG Hardturmstrasse
201, P.O.Box, CH-8021,Zurich, Switzerland
www.issanet.org