

21st ISSA Symposium

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Disruption in Securities Services – the Opportunities and Challenges

Securities Services – on the Immediate Horizon – *Phil Brown, Clearstream, ISSA Board Member*

Introduction

Phil focussed on our industry and the challenges that are on the immediate horizon. He also shared the efforts that ISSA has made, since the pandemic, to help prepare for this dramatically changing world. He reflected on the fact that, in most of our working lifetimes, our post-trade world has gone from rolling settlement of physical securities - through immobilization and dematerialization - to the world now, where we are seeing the first forays into natively digital securities. The change has been dramatic.

He observed that, in the earlier years, as global investing exploded, the industry was dominated by fledgling regulation, industry consolidation and the pursuit of scale economies. The industry was also dealing with very rapid growth and how to cope with it. The recent past and present – the era after 9/11 and the Financial crisis - has been - and is - dominated by increasing regulation, the hunt for revenue growth in a low interest environment and the complexities of geopolitics and sanctions. To adapt to this, the Securities Services industry has needed to transform to become a sophisticated and complex ecosystem of participants, technologies, and processes.

Considering the current day, our industry is being influenced by many trends – not least the current triumvirate of digitization, ESG and data. Our membership had told us that the work done mid-Covid on the Future of Securities Services was extremely well received by the industry. Phil therefore wanted to share some personal views now, some two and a half years after that initial piece of ISSA work, on what might be upcoming for the next three years and beyond.

The Macro Environment

In considering the future direction of the securities services industry, Phil outlined that it has to be done in the context of the wider macro environment.

- Firstly, **monetary policy:**

The era of low interest rates has come to an abrupt end

Despite the fact that we became accustomed to this low rate environment, this period should certainly be seen as an outlier, and likely would have ended sooner had it not been for the pandemic keeping rates temporarily low. The current environment, where higher rates are used as a tool to combat high inflation, and for this to be the case over an extended period, is a return to normality. This has profound implications

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for the financial industry, and we note this already, through what we can see happening in the securities finance business. Caution is the watchword now, and investors are seeking banks or CSDs with fortress balance sheets. Our industry's ability to help our clients deal with this changing world will be critical to the health of the financial system. This will not just be about bringing the right products to market, it will also be about industry professionals acting with cool heads and with an understanding of their roles and responsibilities in a fragile, global financial ecosystem.

- Secondly, **geopolitics and the risk of deglobalization**

How do we respond to geopolitics, instability and volatility?

Most of us have enjoyed the fruits of an increasingly connected world, both personally and professionally. In fact, the whole global Securities industry developed on the back of cross-border capital flows, and the increasingly rapid flow of capital from developed into developing markets. However, more recently, geopolitics have caused material global fragmentation and division.

The impact of this on financial sanctions, and what this means for global capital flows, has already been profound and could become increasingly challenging.

How we all seek to respond to this, and hopefully with maturity and without emotion, will be critical in the short to medium term. In this context of rising instability and volatility in capital markets, the need for central intermediaries that instil trust, neutrality and stability within the capital markets ecosystem remains more important than ever. The role of ISSA to act as a central facilitator of this trust network has never been more important

On the Immediate Horizon

With this macro background in mind, Phil shared what he believes will be the key drivers of our industry in the near and mid term.

Themes driving post-trade:

- Creating Value
- Digital [r]evolution
- ESG & Sustainability
- Regulation
- Investor Demands and behaviour

Theme 1: Creating Value

Do you help your clients make better decisions?

One of the outcomes of an increasingly challenged economic environment in banking has been far greater pressure on fees or, more correctly, the value created in our relationships. This has increased pressure on securities services

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providers to either reduce costs and offer more competitive pricing, or be able to display true value accretion to their clients.

There is a strategic pivot that is taking place in the Securities Services industry – the organizations that invested into the pandemic period, that moved quickly from run to change, which realistically meant bringing your people back to the office quickly, have seemingly developed a strategic advantage. These organisations are leading with new capabilities; capabilities such as settlement prediction tools, using big data, AI and machine learning to accurately enable clients to predict failing settlements and thus to zero-in on higher risk items. The need for big data, and the power to leverage it, will start to drive further industry consolidation. It goes some way to explaining the high valuations of data businesses in the pre trade and post trade space.

Theme 2: Digital Revolution

How do we make the most of digital to solve real world problems?

We are at the outset of a digital revolution in global capital markets. How we drive the digitisation of securities and the adoption of new technologies will have a huge impact on our business in the years to come. In support of this change, we have started to see the emergence of new digital asset classes which have the potential to revolutionise the way that we trade and settle securities while also presenting significant future growth opportunities.

Digital Assets and Distributed Ledger Technologz

ISSA has worked hard on these topics, with member firms committing significant resources, to help shed some light in the darkness, especially on the topics of DLT and Crypto, as you will note from the papers on the slide. We will continue to do so, with your support.

Theme 3: ESG and Sustainability

How do we tackle climate-related financial risk and adapt to changing investor needs?

Despite recent issues related to greenwashing in the investment management industry, ESG and sustainable finance continue to be key themes and drivers for financial services. Hence, as investors become more conscious of the social and environmental impact of their investments, post-trade and securities services providers must adapt. However, when we talk to market participants from all around the world about what they would like us to do to help them in the ESG journey, there is still very much a lack of clarity on what role post-trade will play in a world where pre-trade dominates the debate. But much more work and insight is needed - only by developing a deeper and ongoing dialogue on this topic will we move forward together as an industry on these critical themes

Theme 4: Regulation

Regulation

Phil then touched on the impact and consequence of regulation in a global and digital world, increasingly with unintended outcomes. He argued that Securities Services requires regulation and that regulation is especially

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needed in an era of Digital Assets and DLT, to both protect investors and the market. However badly worded, or badly constructed, regulation can have a very detrimental effect on the global marketplace.

Regulation cannot operate in a vacuum, irrespective of how well intentioned it may appear. As an industry, we need to be alert and react to such legislation or regulation (irrespective of where it is proposed) if we want society to continue to benefit from the flow of capital. Western economies desperately need growth, and they need well-functioning capital markets to deliver this.

Theme 5: Investor Demands and Behaviour

Investor Behaviour

As mentioned earlier, in ISSA's Future of Securities Service paper, from November 2020, we made some predictions about the Future of Securities Services – predictions which are generally materialising. Some of these were already captured in the themes discussed so far but he also highlighted that changes to investor behaviour is a trend which is affecting our institutional clients and ourselves in the Securities Services industry.

There is a vulnerability in the market that has never really occurred before – reflected by the marked reduction in loyalty to “historic names”, from (mis-)information spreading and the ability to move assets in near real time. The post trade industry needs to reflect on these changes and make strategic adaptations to be prepared for a new world.

Future of the Industry

What does all of this mean for the future of our industry?

Phil stated that, arguably, the biggest impact on the Securities Services industry in the past 20 years was regulation. Without a doubt, he sees the biggest impact on the securities services industry over the next 20 years will be innovation and digitization, including this theme of data. These will transform the way that we operate, from trading and settlement to risk management and customer experience.

Conclusion

Let's navigate the waves of change together!

Phil concluded with saying:

- We have seen incredible change in some of the industries with which we all interact daily – media, retail, music etc.
- Financial services has largely been untouched by material disruption, as it is not just controlled by regulation but also protected by regulation.
- The same banks we saw 20 years ago are largely still the dominant forces today.

- Attempts at globalization have been hampered by regional regulation or consumer protection, especially in the wake of 2008, and this has meant that we have not seen globally dominant forces in financial services like we have seen in other industries.

However, the new digital securities world, and the new digital customer experience afforded by modern technology, is starting to create platform businesses in financial services, and we already witness this in the post trade space. Two ICSDs dominate the global fixed income market, one custodian dominates the US Treasury market, two players dominate the global proxy voting market, and a further three CSDs represent one third of all fixed income custody and settlement. As we move into a world with digitization, open API and the glue provided by hyper-scalers, such as Google or Microsoft, he envisages an interoperable platform of these dominant market players, delivering a true seamless global experience to investors, one where the financial plumbing is not a barrier to entry but a facilitator of advanced data tools which provide greater insight to investors and enable better investment choices. The platforms which have the right culture to collaborate will be the winners. Those that continue to try to operate behind their own protectionist garden walls will ultimately wither.

Phil felt fortunate, to have enjoyed a 30 year career in post trade services and had witnessed its metamorphosis from a paper based, largely domestic business, to a globally connected, digital one.

He stated he was proud to work in an industry which has moved trillions of capital from investors hungry for returns to countries and businesses hungry for growth, and thought that financial services, and Securities Services in particular, could be justifiably proud of its role in global economic and social development.

He knows we have a great future ahead and is looking forward to experiencing the coming changes as our industry evolves.