The evolving relationship between asset servicers and FinTechs: Unlocking efficiency and collaboration

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Abstract

Significant transformations are underway as asset servicers and FinTech companies forge new alliances. As asset servicers refocus their operations on value added services, they constantly seek adaptation. Innovative technologies, refined methodologies and data-driven insights hold immense potential for boosting operational efficiency. FinTech companies have emerged as valuable partners to asset servicers, enhancing efficiency, fostering operational excellence and driving customer-centric new solutions. This paper explores the exciting opportunities and novel strategies shaping the asset servicing landscape, shedding light on evolving custody services. Legacy processes, burdensome paperwork and obsolete technology have prompted asset servicers to pursue smoother interactions and more satisfying client experiences. Fortunately, the realm of FinTech offers a fresh avenue to address these persistent challenges. A central theme here is that evolving client expectations have spurred an imperative for asset servicers to embrace technology in order to maintain their competitive edge. Clients now demand greater flexibility and comprehensive services, driving a shift towards automation, streamlined workflows and data-driven insights to lower costs, manage risks and provide tailored client solutions. Nevertheless, various hurdles stand in the way of successful collaboration. Effective communication, transparent partnerships and proactive engagement emerge as critical elements for maximising the benefits of this relationship.

Keywords: risk management, data management, regulations and compliance, post trade services, global and local custodian banking, operational excellence

INTRODUCTION

Collaborations between asset servicers and financial technology companies (FinTechs) are transforming the finance industry. Asset servicers grapple with operational complexities that demand adaptation, and the integration of new technologies, better practices and data insights carry significant promise. FinTech companies have emerged with the purpose of collaborating with asset servicers, thereby enhancing efficiency and developing client-centric innovations.

This paper dives into the opportunities and new ways of working for asset servicers and sheds light on changing attitudes towards custody services. Legacy processes, paperwork and technology systems are all factors that have driven asset servicers to look for more seamless services and positive client experiences. Fortunately, asset servicers now have the added option of utilising financial technology solutions to address these long-standing complexities.

An essential theme here is the impetus, driven by client expectations, for asset

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servicers to embrace technology that can sharpen their competitive edge. As clients are looking for greater flexibility and holistic services, FinTech products offer automation, streamlined workflows and rich data that enables servicers to cut costs, minimise risks and offer tailored client solutions. But hurdles stand in the way of successful collaboration. Effective communication, transparent partnerships and proactive collaboration are all critical to maximise gains.

UNDERSTANDING ASSET SERVICERS

The term 'asset servicer' encompasses a range of entities — including custodians, agents and outsourcers — that deal with specific asset classes and offer services within their own expertise. Custodians have historically been vital in asset servicing. Some focus on safeguarding assets, while others offer comprehensive solutions covering trade settlement, corporate actions, cash management, collateral, securities lending and reporting.[1] They manage and protect client assets in capital markets.

Beyond custodianship, asset servicers provide a variety of functions, including tax management and proxy voting services to assist shareholder voting for investors. Asset servicers are also essential in the buy-side and outsourcing sectors. On the buy-side, they serve institutional investors such as investment managers and pension funds, aiding with trade execution, asset valuation, performance measurement and compliance reporting. Through outsourcing, FinTechs assist financial institutions and asset servicers with back-office operations, allowing them to focus on core strengths.

The term 'asset services' was less common in banking. Services related to asset management and custody were grouped under various labels such as custodial services, trust services, securities services or general banking services. But as finance grew more complex, comprehensive terms became necessary for a wider range of asset-related services. Banks were pioneers in developing in-house technology, offering tailored solutions, unique systems, security, compliance and potential cost savings. But this also included drawbacks, such as the need for skilled IT professionals, increased cost of maintenance, delays in new products, limited exposure to external innovation and scalability issues.

Facing margin compression, the finance industry has found great value in cloud computing.[2] Microsoft's research shows transitioning legacy apps to platform-as-a-service yields a 228 per cent return on investment (ROI).[3] A Bank of England study suggests migration could cut technology expenses by 30–50 per cent, especially physical equipment.[4] Asset servicers collaborate with FinTech, making strategic investments and adopting their strategies.[5] Indeed, in 2023, J. P. Morgan announced its collaboration with Snowflake,[6] a financial services data cloud, to enhance its data management capabilities, and BNY Mellon and Lunate invested in Alpheya, a cloud-native, AI-powered wealth management technology based in Abu Dhabi.[7] Nevertheless, the prevailing momentum towards cloud integration is tempered by the implications of entrusting critical operations and sensitive data in remote digital infrastructures. Asset servicers continue to need environments where prudent risk assessment becomes critically important. While the allure of streamlined operations, enhanced scalability and potential cost efficiencies looms large, there is an imperative to safeguard clients' proprietary data. The cloud migration debate encapsulates a balancing act, which all asset servicers are compelled to perform, between modernisation and data protection.

So, implementing FinTech solutions in asset servicing requires foresight. Asset servicers aim to enhance efficiency, cut costs and improve customer outcomes. But they also need to think beyond the core back-office operations. Challenges include risk management, growth planning and addressing investments and returns. Around 80 per cent of technology budgets manage existing infrastructure including the maintenance, repair and updating of legacy systems. This is a significant figure, given the industry's annual technology investments; the wealth management sector was projected to spend over US$24bn in technology in 2023.[8]

Asset servicers interact with numerous areas and counterparties, making them central to the financial ecosystem. Collaboration and data normalisation enrich insights to enhance trade settlement and reduce inefficiencies. Aligning technology with diverse buy-side needs, asset servicers must effectively use technology across asset classes for comprehensive solutions.

THE ROLE OF FINTECHS IN ASSET SERVICING

In recent years, FinTechs have held considerable influence over the asset servicing industry. Forecasts indicate that by 2030, FinTechs could generate an annual revenue of roughly £1.5tr, constituting a quarter of global banking appraisals (see Figure 1). This rise contrasts with the present 2 per cent market share.[9] Solutions have been introduced by FinTechs that effectively address challenges posed by outdated legacy systems and complex operational processes. Building on technologies like cloud computing, microservices and distributed ledger technology, FinTechs can offer increased operational capacity underscored by optimised processes, streamlined workflows and bolstered efficiency. This has steered many asset servicers away from conventional in-house technology development, embracing external proficiency through partnerships with FinTechs. Many of those are now equipped to overcome legacy system restrictions, enjoying a more agile, scalable and cost-efficient foundation. BNY Mellon and Goldman Sachs's successful utilisation of the HQLA^x distributed ledger technology (DLT) platform attests to this: 'As part of the combined series of 35-day term transactions with a total size in the hundreds of millions of US dollars, HQLA^x created

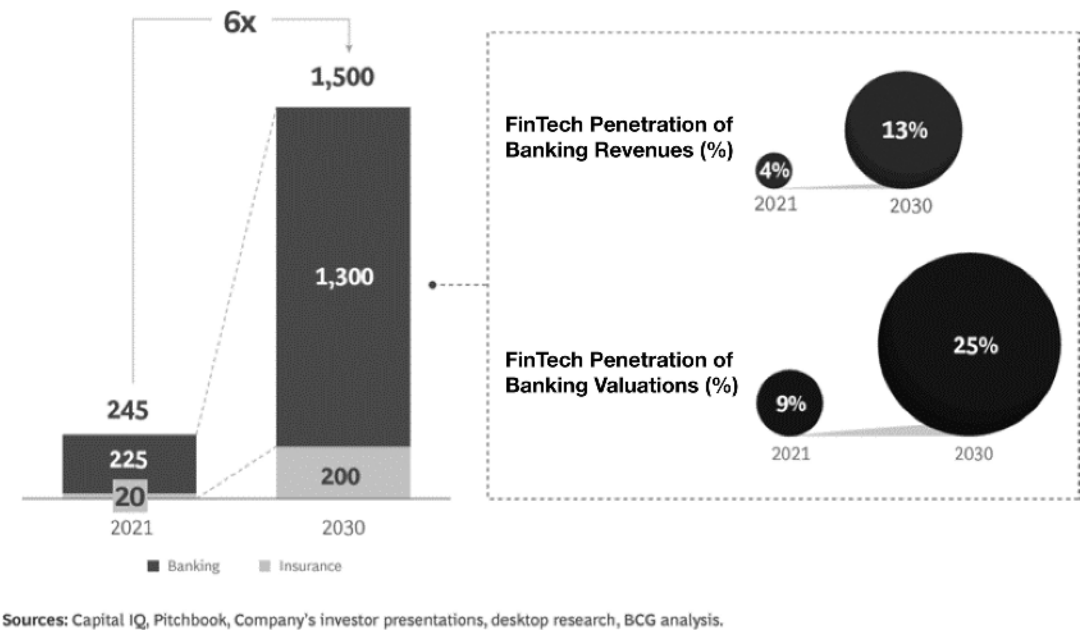

Figure 1 Global FinTech revenues (US$bn), split by banking and Insurance[11]

ISIN-level securities trackers called Digital Collateral Records (DCRs) from loaned securities it received from BNY Mellon, giving Goldman Sachs a digital copy of those trades.'[10] This adoption of DLT by traditional financial institutions underscores how innovative technologies can be used to drive up operational efficiencies.

Asset servicers often find themselves under a range of pressures to deliver ROI stemming from various sources. Naturally, market competition forces asset servicers to pursue quick gains as a strategic imperative to outperform their industry peers. In a race for superiority, these companies are under constant pressure to maintain a competitive edge. Secondly, the expectations of investors carry considerable weight in shaping the asset servicing sector's priorities. Clients, whether individual investors or institutional entities, often demand immediate returns to meet various financial objectives, such as retirement planning or project funding. This puts the onus on asset servicers to generate returns that align with these diverse goals. The volatility inherent in short-term economic conditions also underscores the importance of focusing on immediate returns.

Whether the market presents favourable opportunities or confronts the challenges of an economic downturn, asset servicers must adapt to optimise returns or protect against potential losses. Moreover, the regulatory and compliance landscape further intensifies the pressures on asset servicers. Regulatory demands often necessitate agile responses, and compliance requirements frequently mandate a focus on immediate returns to ensure ongoing adherence to stringent rules and regulations. Lastly, fund liabilities, encompassing commitments to disburse funds to investors at predefined intervals, exert substantial pressure on asset servicers.

But pursuing immediate returns comes with drawbacks. It limits the room for in-house IT professionals to explore and develop new ideas, as the need for quick solutions stifles creativity and the exploration of emerging technologies. In contrast, FinTech companies excel in fostering innovation and transformation.[12]

Attracting and retaining top IT talent is a significant challenge for the asset servicing industry. The emphasis on swift ROI frequently constrains opportunities for young professionals to expand their skills. FinTechs, with a stronger culture of innovation and exploration, offer an attractive option for talented individuals seeking to make a meaningful impact. Through partnerships with FinTechs, asset servicers can tap into this talent pool, creating a more dynamic and forward-thinking environment.

In the prevailing era of data-driven decision making, effective data management is critically important. FinTechs provide solutions that support asset servicers, streamline data processes, enhance data quality and comply with regulatory requirements.

In 2022, the Central Securities Depositories Regulation (CSDR) introduced the Settlement Discipline Regime,[13] a set of requirements for central security depositories to enhance settlement procedures and address issues such as settlement failures, delayed settlements and penalties. This posed fresh challenges for asset servicers, as stricter requirements and penalties could have an impact on settlement processes, leading to higher operational costs. To avoid penalties for settlement failures and manage potential complexities, compliance, risk management and system adjustments all became crucial. By November 2022, the Bank of England's Securities Lending Committee noted the unexpectedly sizable nature of CSDR settlement fines and slow resolution.[14] To facilitate compliance, companies such as Merisoft and AccessFinTech devised CSDR and penalty management solutions.[15,16] Custodians saw the benefit of working with buy-side banks and prime brokers to facilitate eligibility determination, cash penalty management and a structured process for raising queries and appeals.

Through advanced analytics, FinTechs empower asset servicers to extract valuable insights from their data, enabling informed decision making and delivering positive client experiences.

To remain competitive in the ever-evolving financial landscape, organisations must adopt a ‘change the bank’ mindset, transforming both operations and technology infrastructure. Asset servicers must be open to adopting the best solutions from different providers. Wells Fargo’s partnership with ChargeAfter,[17] a US-based multi-lender point-of-sale platform, underscores how traditional finance institutions are embedding contemporary solutions into their operations. Although this may pose challenges in terms of data transfer, the benefits of improved efficiency, reduced costs and enhanced customer experience outweigh the complexities. Embracing the changes brought about by FinTech and incorporating their solutions into their operations position asset servicers for continued success in the financial services industry.

‘Proactive management’ represents a significant shift in process ownership, where responsible custodians leverage technology and expertise to accelerate operational cycles towards real-time processes. This shift complements FinTechs, rather than competing with them. The emergence of penalties due to CSDR has created an opportunity for custodians to work collaboratively with clients to prevent these penalties. This requires substantial technological investment, corresponding with FinTech innovation. The goal is not to replace outsourcers, but to combine efforts for maximum efficiency. The catalyst for this change lies in the financial landscape, especially regulatory frameworks like CSDR. Penalties for non-compliance have caused custodians to rethink strategies. Custodians can proactively avoid pitfalls through stronger client collaboration and technology, ensuring compliance while enhancing performance. Building a robust tech infrastructure accommodates immediate operational demands, establishing custodians as forward-looking leaders navigating regulations adeptly. Custodians can also innovate the onboarding process, enhancing the operational framework. By identifying areas for improvement and introducing creative solutions, custodians integrate expertise into evolution, offering enhanced value to clients.

COLLABORATION AND PARTNERSHIP OPPORTUNITIES

The evolving relationship between asset servicers and FinTechs offers benefits and opportunities for both parties.

FinTechs allow for a symbiotic relationship with asset servicers, where ideas can be improved over time. The former thrives in a more adaptable environment, hampered less by stringent regulations and risk-averse mindsets. FinTechs adopt a ‘sandbox’ approach that encourages iterative refinement before final deployment. This not only accelerates innovation but also ensures continuous enhancement, resulting in a final product that aligns seamlessly with market demands.

The inclination to invest in FinTech companies has grown significantly in recent years (see Figure 2). Notably, the asset management sector has garnered substantial interest from venture capital and private equity companies, drawing around US$11.4bn in private investments between 2010 and 2017.[18] Following an impressive peak of US$225.8bn in 2021, global FinTech investment experienced a dip in 2022 with total investments reaching US$196.6bn and deal volume totaling 7,515 (see Figure 3). While this downward trend continued in 2023 with total global FinTech investment dropping to a five-year low (US$113.7bn and a total deal volume of 4,547), there was an uptick in investment between H1’23 and H2’23. Notably, AI-focused FinTech solutions attracted

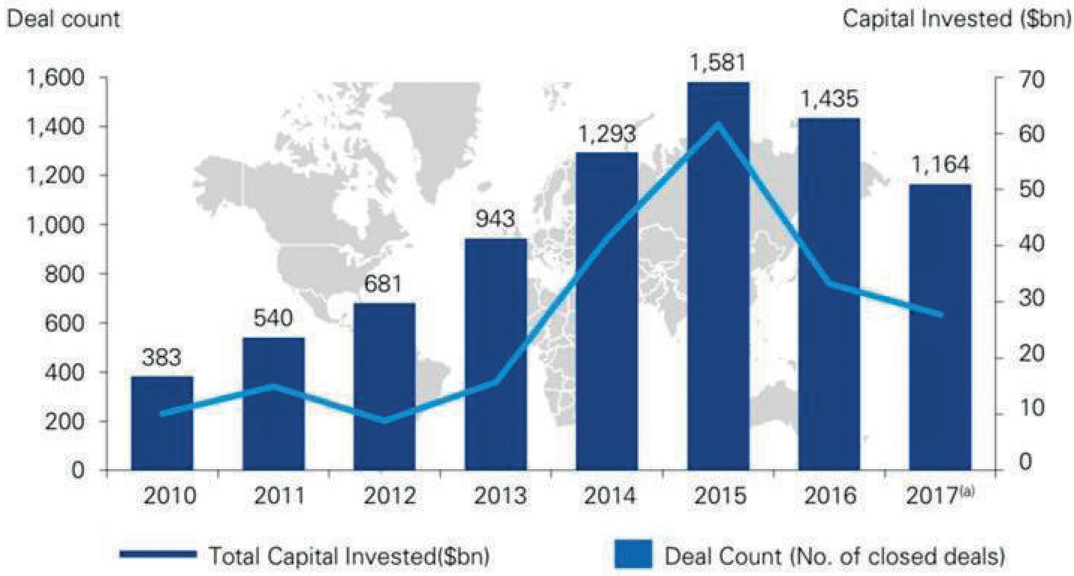

Figure 2 Total global investment (VC, PE, and M&A) in FinTech companies[20]

Note: (a) Estimated value and number of deals for the whole year, based on first three quarters' figure.

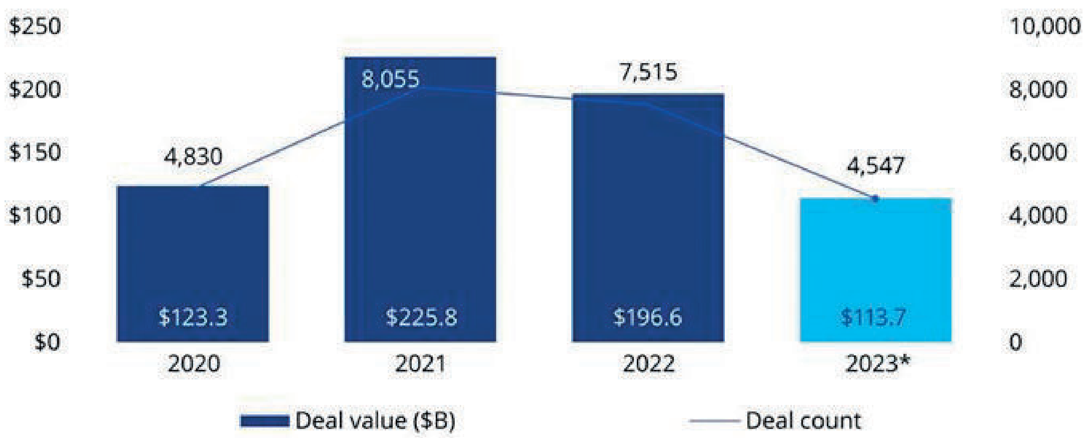

Figure 3 Total global investment activity (venture capital [VC], private equity [PE] and mergers and acquisition [M&A]) in FinTech 2020–23[21]

Note: *as of 31st December, 2023

US$12.1bn in investments while wholesale enterprise solutions remained a major focus.[19]

Another advantage of collaboration is enhanced competitiveness. In 2021, 95 per cent of asset management executives anticipated their company's digital capabilities would be pivotal in setting them apart from competitors by 2025. But as this milestone approaches, many companies continue to encounter hurdles in effectively bolstering these capabilities. A mere 8 per cent of asset managers have effectively transitioned to cloud-based operations, highlighting the gradual pace at which the adoption of cloud-centric solutions is evolving within the financial landscape. This strategic transition presents a range of challenges for asset servicers, particularly in delineating decision-making responsibilities between client data entrusted to their care and client-owned data. Additionally, while a significant 74 per cent of companies intend to implement an artificial intelligence (AI) strategy, a mere 26 per cent have successfully integrated these advanced capabilities into their existing systems. This indicates a discrepancy between the initial expectations and the actual progress of AI adoption and integration.[22] Such technology empowers asset servicers to analyse extensive datasets, identify underlying patterns and extract insights into market trends and investor behaviour. By applying it strategically in portfolio management, risk assessment and investment decision making, asset servicers can navigate choices confidently, differentiate themselves from competitors, achieve superior investment outcomes and expand their client base.

Collaborating with FinTech companies provides asset servicers an opportunity for staff augmentation, as they can access specialised experts for specific projects without making long-term commitments. This flexibility allows them to leverage the expertise of FinTech professionals in areas such as technology implementation, cyber security and data analysis. For instance, Citi, J. P. Morgan and State Street's collaboration with Capitolis,[23] a software-as-a-service platform that drives financial resource optimisation for capital markets, represents an opportunity to free up capital and remove trade barriers. By supplementing their workforce with specialised talent, asset servicers can accelerate project timelines, enhance skill sets and efficiently address complex challenges, ultimately leading to improved outcomes.

Moreover, attracting and retaining younger generations (especially Gen Z) is a critical challenge for asset servicers. FinTech partnerships can help asset servicers develop personalised experiences that resonate with this demographic. By leveraging innovative technologies and data analytics, asset servicers can tailor offerings, deliver personalised investment recommendations and provide user-friendly digital platforms. These custom experiences foster loyalty and trust among younger generations, leading to long-term client relationships and sustainable growth. By allying with MoCaFi, a black-founded FinTech platform leading financial empowerment for underserved communities, BNY Mellon has shown both its commitment to innovative partnerships and financial inclusion:[24] FinTechs can thus support environmental, social and governance (ESG) missions too.

Scalability is another valuable advantage that FinTech brings to asset servicing companies. By harnessing technologies such as cloud computing and scalable infrastructure, asset servicers can efficiently handle large volumes of data, accommodate growth and expand operations without compromising performance. This scalability ensures that asset servicers can meet evolving client needs, provide seamless digital experiences, and deliver investment solutions promptly, fostering a sustainable growth trajectory.

CHALLENGES AND CONSIDERATIONS

Integrating advanced technology solutions with existing legacy systems, while adhering to regulatory and compliance frameworks, presents sizeable hurdles for asset servicers. This is particularly true for asset servicers grappling with systems that lack compatibility with the innovative features of new technology solutions.

Examples of these integration problems encompass subpar user interfaces, unsatisfactory user experiences, concerns about security breaches, inconsistencies in data formats and a lack of streamlined automation. These factors collectively contribute to the complexity of merging legacy systems with FinTechs.

The drive towards digital transformation, underscored by significant investments in developing application programming interfaces (APIs) and data accessibility, has encountered an unexpected roadblock. Contrary to initial projections, widespread adoption has not materialised as anticipated. This divergence from expectations can be attributed to a crucial point: the distinct paths chosen by each asset servicer in their own technological evolution. This has led to a proliferation of divergent technology stacks, specialised terminologies and API structures. This diversity across the industry has inadvertently resulted in a situation where the onus of achieving data normalisation and storage standardisation falls on the shoulders of the clients themselves, rather than it being a shared endeavour.

This development has led to a paradoxical outcome. While the goal of enabling seamless data access and interoperability through APIs remains, the divergence in technical strategies has given rise to a fragmented landscape. The task of harmonising and normalising data storage practices has now unexpectedly shifted to the asset owners and investment managers on the client side. This reallocation of responsibility presents significant challenges, as only a subset of these stakeholders possesses the necessary inclination and technological infrastructure to effectively undertake this task. In response to this challenge, the FinTech sector has emerged as a pivotal ally with the potential to facilitate a much-needed resolution.

Leveraging their proficiency in data normalisation and distribution, FinTech companies stand as intermediaries capable of bridging the gap between diverse asset service providers and the data expectations of their clients. By delivering comprehensive solutions that facilitate the translation of disparate technology stacks, terminologies and API structures into a cohesive framework, FinTech entities make significant contributions to mitigating data inconsistencies. This enhances the value derived from the substantial investments made in APIs and data accessibility, enabling the realisation of intended benefits such as heightened efficiency, improved decision making and streamlined operations across the financial landscape.

In addition to grappling with integration complexities, asset service providers confront additional challenges when collaborating with FinTech partners, especially concerning regulatory considerations. The asset service industry operates within a framework of diverse regulations, requiring providers to ensure that new technology aligns with these frameworks. In the digital realm, ensuring the security, privacy and compliance of data assumes paramount importance. Safeguarding sensitive client information and adhering to pertinent regulations and cyber security measures becomes a delicate and intricate balancing act between innovation and operational compliance. Achieving this requires constant vigilance to evolving regulations and the ability to adapt solutions accordingly.

Addressing the talent and skills gap presents an additional obstacle for asset servicers who embrace FinTech partnerships. The successful integration of technology relies on specialised skills encompassing data analytics and cyber security. Procuring and retaining talent possessing the expertise in these domains proves to be a challenge. Asset servicers must invest in acquiring and cultivating the appropriate skills within their teams to fully harness the potential of FinTech solutions.

Resistance to change within asset servicing companies has impeded the adoption of FinTech. Some employees may exhibit reluctance to embrace new technologies or processes due to fears of job displacement or unfamiliarity with these tools (see Figure 4). According to a Global FinTech Survey conducted by PwC in 2016,[25] a majority of asset and wealth managers (60 per cent) expressed concerns that aspects of their business

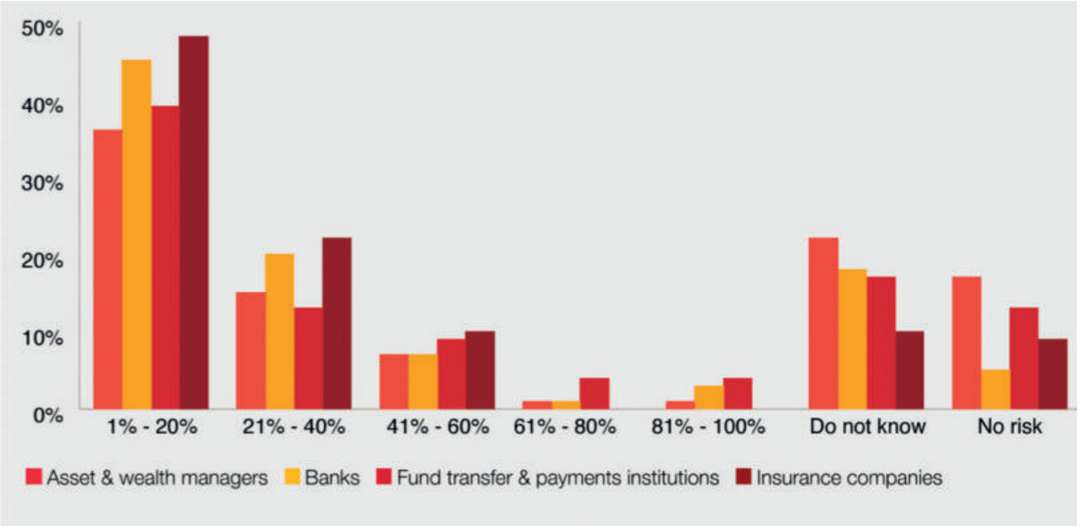

Figure 4 What percentage of your business is at risk of being lost to standalone FinTech companies within five years?[26]

were 'at risk' due to FinTech companies. Furthermore, at that time, 34 per cent of asset and wealth managers (versus 25 per cent of the broader financial sector) stated their reluctance to engage with FinTech at all. Overcoming this resistance and fostering a culture of innovation and adaptability are pivotal for asset servicers to unlock the full potential of FinTech solutions.

The process of selecting vendors and conducting due diligence assumes critical significance in implementing FinTech solutions. Asset service providers must assess potential FinTechs, evaluating factors such as reliability, scalability and security. Thorough due diligence ensures that chosen FinTech providers align with the specific needs of asset service providers and adhere to industry standards.

Despite these challenges, asset servicers acknowledge the value and potential of FinTechs in augmenting operational efficiency, cutting costs and maintaining competitiveness in the evolving financial landscape. By proactively addressing these challenges, asset servicers can navigate the intricacies of FinTechs and fully capitalise on the benefits of their solutions.

THE FUTURE OUTLOOK

The future relationship between asset servicers and FinTechs presents significant potential for advancements and mutual growth. The interplay of regulatory dynamics, technological progress and industry shifts will continue to shape these partnerships. Crucial areas of focus encompass data management, automation and scalability, fostering collaboration and unlocking possibilities for asset managers and FinTechs to join forces.

To overcome FinTech adoption challenges quickly, asset servicers can take proactive measures. They must craft a clear technology strategy that aligns with their business objectives, outlining goals, priorities and desired outcomes while considering specific challenges and opportunities. This strategic roadmap will aid decision making and resource allocation.

Cultivating a culture of innovation is vital for seamless FinTech adoption. Asset servicers can create an environment supporting experimentation and learning from setbacks, motivating employees to embrace change and innovation. Empowering staff with training in digital skills enables them to effectively leverage FinTech solutions.

Conducting prudent due diligence is of utmost importance when choosing FinTech vendors for asset servicers. Thorough evaluations are necessary to ensure that selected vendors not only meet specific requirements and comply with industry regulations but also align with the unique needs of the asset servicing organisation. Key aspects of due diligence should include assessing the vendor's track record, security measures, scalability and system compatibility. In this process, asset servicers must strike a balance to ensure that their due diligence efforts are robust and comprehensive enough to mitigate risks effectively.

At the same time, it is essential not to make the process overly cumbersome, which could lead to a time disadvantage. Finding the right equilibrium will allow asset servicers to maintain their competitive advantage by swiftly implementing FinTech solutions that enhance efficiency and streamline operations. Additionally, conducting pilot projects or proof-of-concepts can serve as invaluable tools in validating the effectiveness and compatibility of the chosen FinTech solutions. These tests can provide real-world insights and help asset servicers make informed decisions, reducing the likelihood of costly mistakes and ensuring seamless integration with existing systems.

Investments in robust cyber security are imperative given the increased reliance on digital platforms and data. Asset servicers must prioritise strong encryption, access controls, firewalls and intrusion detection systems to safeguard sensitive client information. Regular security audits and assessments identify and address vulnerabilities proactively, ensuring system integrity and security.

Staying well informed about regulations is not just vital for asset servicers, but also a catalyst for driving positive change and growth. Actively monitoring and comprehending regulatory changes not only guarantees compliance of FinTech solutions with relevant laws but opens doors to exciting new opportunities. By establishing a dedicated regulatory compliance team, partnering with legal experts and actively participating in industry associations and forums, asset servicers can position themselves as pioneers in the financial landscape. Embracing early partnerships with FinTechs allows them to leverage these relationships to secure new business and lead the way into a thriving digital future.

Collaboration with FinTech partners offers specialised expertise, innovative solutions and ongoing support. Strong partnerships and open dialogue with FinTech providers lead to tailored solutions for specific challenges. Sharing feedback and actively participating in the co-creation process strengthens relationships and enhances the value derived from collaboration.

Developing an agile implementation plan is crucial for successful FinTech adoption. Asset servicers should outline key milestones, allocate resources effectively and include mechanisms for monitoring and evaluating progress. Regular assessments and adjustments ensure a smooth transition, maximising FinTech's benefits while minimising disruptions.

CONCLUSION

In conclusion, collaborations between asset servicers and FinTechs are reshaping the finance industry. Despite ongoing operational challenges, synergy between new technologies and existing practices holds great potential. FinTechs are stepping in to assist asset servicers by boosting efficiency, refining processes and introducing client-focused innovations.

This paper has delved into the difficulties that asset servicers face and how attitudes towards custody services are evolving. Outdated procedures, complex paperwork and technological barriers have hindered smooth service delivery and positive client interactions. Integrating innovative technology, adopting best practices and utilising data-driven insights can unlock significant operational efficiencies and cost reductions for asset servicers. Automation and streamlined workflows help to minimise errors and allocate resources more effectively. Enhanced data analytics provide valuable insights, enabling smarter investment decisions, tailored client solutions and improved risk management.

Yet, this collaboration also brings its own set of challenges. Effective communication, transparent partnerships and proactive collaboration are essential for successful implementation. Open communication with FinTech partners fosters trust and cooperation. Transparent partnerships ensure aligned objectives, promoting mutual understanding and long-term success. Proactive collaboration, involving active participation and continuous improvement, is key to maximising the benefits of this relationship.

By effectively addressing these challenges and embracing the opportunities presented by the asset services and FinTech alliance, asset servicers can position themselves at the forefront of the rapidly evolving financial landscape. They can elevate their services, exceed client expectations and foster innovation within the industry. By embracing technology and staying relevant in an increasingly digital financial world, asset servicers can future-proof their success, drive revenue generation, become industry leaders and pioneer new possibilities.

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