DIGITIZATION IS DRIVING VALUE IN SECURITIES SERVICING

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Whether through more efficient trades with less friction, or creating an auditable digital register where none existed, technology is filling the value gaps in the investment world

Asset owners and managers hear a lot about inflection points, whether in the context of yield curves, volatility, or any number of topics directly connected to investment returns. But within the infrastructure of the investment industry itself – core technology, data analysis, trade execution, i.e. the tools and gears that make it all happen – there is a prolonged and underlying inflection point being driven by digitization, and it is steadily creating new value for investors and their asset managers.

The pace of this movement has accelerated as technologies that have been foundational to exchanges, central depositories, and banks, for example, near the end of their life cycle.

"It's a bit like a car that has served you well for a long time," says Justin Chapman, Global Head of Market Advocacy & Innovation Research at Northern Trust. "Do you opt for an entirely new car, or do you replace parts of the car as they wear out? As an industry, we've been at that inflection point for the last four or five years."

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New business models emerge

According to Chapman, a new viewpoint is behind the increased tempo of digitally driven change. In the immediate aftermath of the 2008 financial crisis, the focus was on shoring up the industry's infrastructure, making certain it was safe and sustainable, standardized, efficient, and better regulated. More recently, however, the arrival of new technologies and ideas from "outside" environments such as retail has been accompanied by new opportunities.

"As the potential of AI, big data, cloud computing, and Blockchain become more apparent, the next logical step in the context of the investment industry has been to explore their use in new business models," says Chapman. "We're at a moment in time where we can perhaps reinvent some existing business models as we look at digitizing the entire environment, quite possibly resulting in completely new opportunities and a change in what constitutes value and where we find it."

Blockchain, for example, has the potential to change how the issuance of securities is captured. What historically has required multiple intermediaries can now be significantly streamlined with fewer actors in the value chain together with real-time, immutable data in a digital environment. "digitization is creating environments that allow for us to codify and digitize assets to reduce transaction friction in terms of reporting, and getting data associated with those environments, " says Chapman.

This newer technological viewpoint has evolved alongside an overall industry shift toward being more investor-centric. A firm such as Northern Trust, for example, isn't just looking at what it does for its clients, but rather how it and its clients are interacting with the bigger investing landscapes, and how those various landscapes could change in the coming years.

Filling the gaps, creating efficiencies

Where there are process gaps in the investment landscape, technology moves to fill them and create greater efficiencies almost as if by natural law. A case in point is the private equity (PE) market, which institutional investors have turned to with greater frequency in recent years. In doing so, investors found that the transparency and efficiency of the PE market didn't measure up to what they were accustomed to in public markets.

To address this challenge, Northern Trust teamed with IBM and others to develop a blockchain-based private equity ecosystem. The ecosystem provides real-time insight and transparency to all parties, including the fund managers and investors, as well as allowing regulatory access when required. In fact, the ecosystem was designed to support compliance, with regulators kept in the loop during the development process.

“The blockchain solution for private equity allows the fund to transfer ownership stakes and be managed, serviced, and audited throughout the investment lifecycle on a transparent platform that offers one version of the truth to participants,” says Chapman. “What we really created, for the first time, is a digital register for a very illiquid asset that didn't have a register. That's a prime example of how digitization can disrupt the status quo, and create a much more efficient, automated environment within a more transparent regulatory environment – all for an asset that previously wasn't operating in the digital space. In that sense, some new uses for technology will compete against existing infrastructures, others will be new.”

The PE ecosystem isn't an isolated example of how digitization is changing the state of play in securities. Exchanges themselves are creating digital platforms for the issuance of securities, as is the case in Switzerland, Germany, and Hong Kong, for example. In Australia, the stock exchange is currently replacing its cash equity settlement system with blockchain technology. Other developments include digital solutions for fractional ownership of fixed income bonds, broadening investor access. In some cases, the investment product itself is a result of digitization, such as bond-i, a debt instrument issued by the World Bank, and the first bond to be issued on a blockchain.

In its role as a custodian and more broadly as a partner in investment strategy, Northern Trust is always fully engaged and active in pursuing both the newest and potential-filled uses for technology, and keeping pace intellectually, as well.

“What we really do is make sure we advocate for the development of new technology within the marketplace – and that, in turn, can mean significant benefit to issuers and investors in terms of improved governance, improved data flow and efficiency, and increased availability of real-time information,” says Chapman. “We get buy-in from our clients, counterparties, and regulators, and gladly invest that time to create alignment that can deliver opportunities.