



Improving Business Performance





Introduction

FACED WITH A BARRAGE OF REGULATION, MARKET-DRIVEN CHANGES AND EVER INCREASING GLOBAL COMPETITION, THE FINANCIAL SERVICES INDUSTRY OPERATES IN A DEMANDING ENVIRONMENT WHICH IS OFTEN IN THE SPOTLIGHT. FAILURE ON ANY FRONT CAN BE VERY COSTLY. THIS SPECIAL REPORT AIMS TO ADDRESS A FEW OF THESE IMPORTANT TOPICS AND TO CONTRIBUTE TO DEBATE AS THE INDUSTRY LOOKS FOR THE RIGHT SOLUTIONS.

In virtually every organisation, the relationship between IT and the business is complicated. On one hand, technology sits at the heart of business strategy as it is both a tool to achieve efficiency and an engine for growth. On the other hand, IT departments are a major cost centre. Good businesses recognise the value of well thought out and smartly targeted IT projects and are prepared to make the investment. Increasingly, however, there are many calls on sometimes scarce resources.

Unsurprisingly, regulation continues to be amongst the biggest drivers for change in financial services. For example, the January 2015 deadline is looming for the introduction of the Basel Committee on Banking Supervision's new rule for intraday liquidity monitoring. In this new environment, banks will be faced with three important challenges related to timed data availability, centralisation and aggregation. To meet the deadline in today's budget constrained environment, banks will need to take a pragmatic approach that leverages existing infrastructure.

Other market-driven projects are requiring banks to change infrastructure, processes and even business models. Sometimes, this can crowd out projects designed to boost customer offerings or improve efficiency. The smartest players are ensuring that projects not only address any technology replacement, and regulatory and market changes, but also deliver better client service and increased efficiency at the same time.

The need to find solutions for industry-wide challenges or change also calls for greater collaboration. The move to central clearing for over-the-counter derivatives is putting ever greater pressure on collateral pools and means that collateral management must now deliver on three fronts: risk reduction, capital efficiency and regulatory compliance. The time is ripe for a cross-industry solution based on common standards.

Elsewhere, cloud technology has changed the economics and rhythm of technology investment, facilitating a shift towards 'consumption' economics. A growing range of services, providing flexibility in terms of both cost and capacity, is proving increasingly persuasive for many, not least small and mid-sized companies, who find that new technologies and new services previously seen as unaffordable are now open to them.

Financial institutions face shrinking budgets but greater expectations for improved business performance. The ability to harness technology and to streamline processes to deliver on these objectives is critical.

SWIFT is an ideal partner to help institutions navigate these issues. We provide expert knowledge through our wide range of consulting services, including benchmarking, operations and technical advisory services.

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Intraday Liquidity Reporting: No need to reinvent the wheel

As the 1 January 2015 deadline looms for the Basel Committee on Banking Supervision's Intraday Liquidity Monitoring, time is ticking away for banks to resolve important issues that will affect their ability to comply with the Basel requirements. To meet this challenge banks will have to take a pragmatic approach, leveraging existing infrastructure and data formats.

The management of 'intraday' liquidity risk is a central element of banks' overall liquidity. In an environment of increased volumes and value of real-time payments, interconnected payments and settlement systems, and a higher concentration of payments flows, managing the intraday liquidity and its related risks is increasingly important.

In April 2013 the BCBS published a set of quantitative tools that will enable banking supervisors to monitor internationally active banks' intraday liquidity risk and their ability to meet payment and settlement obligations in a timely manner. The paper envisages that from 1 January 2015, all these banks will have to implement and report on the monitoring tools at global and legal entity levels, across all currencies.

However it will be up to each regulator to further define the reporting requirements and to set the exact date (no later than 1 January 2017) by which the reporting bank will have to reach the full scope of the tools.

"Liquidity has to be considered according to different timeframes: while Basel III liquidity ratios look at the level of liquid assets required to cover future needs, the intraday monitoring tools require the aggregation of retrospective liquidity measurements, which can be calculated only with real-time data. The related data points are to be found at the transactional level, which creates new challenges for the industry as a whole," says Catherine Banneux, Senior Markets Manager, Banking Markets, SWIFT.

A three-pronged challenge

In this new environment, banks will be faced with three important challenges related to timed data availability, centralisation and aggregation.

The BCBS tools do not require real-time management of the liquidity positions, but rather the availability of timed information on all individual liquidity entries.

"A crucial condition for the production of accurate monthly reporting is the delivery of a debit/credit confirmation by either the account servicing institution or the payments settlement



“ THE LACK OF DATA CENTRALISATION IS A MAJOR ISSUE, NOT ONLY FOR BANKS REPORTING THEIR OWN FLOWS, BUT ALSO FOR BANKS REPORTING THE AGGREGATED USE OF CREDIT LINES BY CUSTOMERS ”

Catherine Banneux

system for each movement on the account," says Banneux. "To date only 20% of all SWIFT correspondent banking payments feature a real-time debit and credit confirmation message. In value however, the coverage reaches 55% at a global level." Global coverage has increased by 4% in the past year and the use of the confirmations messages has increased in volume by 14%. However, Banneux says more progress must be made in order to meet the BCBS reporting requirements.

It is "absolutely essential", she adds, that these confirmations are provided to build the intraday liquidity usage curves required for the reporting.

Pooling data will enable bank group treasurers to build a liquidity usage curve at a global level. But this too is a challenge because many banks have decentralised the management of their Nostro accounts relationships. Different entities around the world will clear currencies with different Nostro providers. "The lack of data centralisation is a major issue, not only for banks reporting their own flows, but also for banks reporting the aggregated use of credit lines by customers."

Reporting on flows at the entity level also poses a question of how data received should be aggregated. Data has to be translated from the operational, or BIC, level to the Legal Entity Identifier level, which also may prove to be challenging for financial institutions.

Taking a pragmatic approach

While it is not yet clear what national regulators will specifically require from day one, Banneux says banks should take a pragmatic approach to the intraday liquidity monitoring environment. It is unlikely, she says, that regulators will require the full scope of the reporting for all currencies by 1 January. Banks should therefore focus on the key currencies that represent the largest share of their liquidity flows.

“Most banks will need to report on several currencies at both global and local levels which explains the need to define a global data collection model with common aggregation rules and to build a central transaction database. This would avoid multiplication of different implementations across different entities of a group. It would ensure reporting consistency at global and local levels and would reduce costs,” she says.

Another consideration is data sourcing and the types of messages that are needed for reporting. “The messages banks decide to use will have a very significant impact on the data that is reported to the regulators. The difference between using messages that include an individual confirmation on a transaction versus batch messages with only one timestamp on several transactions could mean a substantial difference on the calculated position.”

The first step in a pragmatic approach should be an assessment of the bank’s current intraday liquidity flows for the top currencies, which will include an in-depth data gap analysis for a representative number of accounts. The aim is to measure current reporting coverage and identify the types of transactions not reported on an intraday basis or not yet made available internally. This will help the bank determine the project’s priorities and next steps very precisely.

Combined with better internal integration, the rationalisation of the correspondents network will help resolve data centralisation issues. However, in most cases this will prove very time and

resource intensive. In the short term, other pragmatic and cost effective solutions might be considered such as a messaging copy mechanism to centralise the intraday liquidity data flows.

Industry collaboration

The main lifting work on intraday liquidity reporting will be very much an individual exercise for each banking group as it defines its data models and assesses its requirements. But there is scope for collaboration, says Banneux. The industry as a whole will benefit from a collaborative approach to increase the pace at which progress is being made to resolve intraday liquidity data issues.

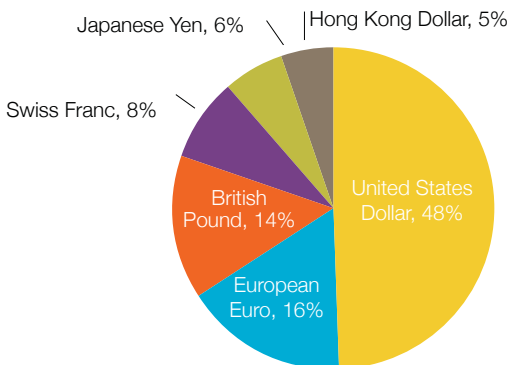
Standardised intraday liquidity data will enable banks to ensure consistency and to reduce the overall implementation costs. In this context SWIFT has been supporting the Liquidity Implementation Task Force, an industry group of 19 banks and nine global brokers with the development of the group’s reporting rule book. The rule book aims to create and support the adoption of a common industry business practice for intraday liquidity messaging.

A collaborative approach to the challenges of intraday liquidity promises to lower development costs and deliver benefits for all players in the longer term. “These regulations will not go away – there will be more of them and more need for transparency at the level of transactional data. This is why beyond individual implementations, banks should contribute to industry-wide collaborative efforts to ensure cost effective and sustainable implementation models and solutions, and to achieve longer term scalability and adaptability across market segments,” says Banneux.

Please visit SWIFT.com to read SWIFT’s white paper on Intraday Liquidity Reporting

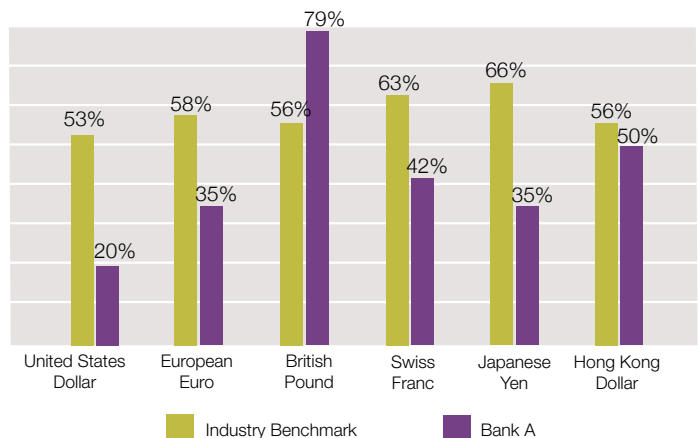
Bank A payments by currency

Value of correspondent banking payments sent



Bank A intraday reporting coverage

Value of correspondent banking payments sent covered with credit or debit confirmation, top currencies



Managed services: Drive to cost efficiencies

The financial industry's move towards managed services, or even full outsourcing, has been gradual. Fears about loss of control over processes and uncertainty about what is, or isn't, core to individual institutions have held back a widespread move. However, a number of trends are emerging to bolster the managed services market and prompt some institutions to think again about what they can delegate to third parties.

Cost pressure on IT departments is one of the main factors underpinning any move to managed services. Driving out costs is becoming more urgent as some financial institutions move expenditure off their balance sheets in order to meet the capital restructuring required by Basel III.

"A move to managed services can help institutions to manage complexity and risk in a cost constrained environment," says Leo Punt, Head of Services and Support, EMEA, SWIFT. Most financial institutions, he adds, would target cost savings of around 30% to ensure a move to managed services is worth the short-term disruption in handing over IT operations.

At the same time, the managed services market has matured and providers are offering a very high degree of operational excellence and flexibility to their clients. A decade ago outsourcing was considered to be an "all or nothing" approach, with institutions handing over an entire IT infrastructure and the associated staff to third parties. In the past ten years, however, as experience and expertise has been built up in the managed services industry, providers have begun to develop new business models based on a mix of onshore and offshore resourcing and a more modular approach.

The evolution of the industry has broadened the number of financial institutions willing to consider whether to outsource certain functions and triggered a more serious examination at individual banks of what is core and non-core to their operations.

"In the past, many financial institutions considered certain IT operations to be of utmost importance and not for delegation to others," says Stephen Gilderdale, Head of New Business Development, SWIFT. "But now that there are more refined approaches, institutions can more effectively assess which elements of operations can be given to a third party to handle and which need to remain inhouse."

Reaping the advantages of best practice and flexibility

This much more nuanced approach to outsourcing enables institutions to decide the degree of responsibility they want to take for certain functionality. Managed services providers can match their clients' wishes with various levels of delegation



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and responsibility. For example, some institutions may want to continue to run their IT infrastructure, but may not want to directly manage all of the applications running on that infrastructure. In this instance an institution can outsource just the management of its application stack to a third party that will then manage the stack remotely.

On the other hand, some institutions may choose to hand over all responsibility for managing and maintaining large sections of their IT infrastructure. This trend could accelerate over the next five years. While it is yet to be seen whether larger banks will opt for such an approach and how far it will go, continued cost pressure makes the proposition more compelling. Cost is not the only factor; the sophistication of managed services allows a higher level of visibility and control over operations for banks, which makes the decision to delegate responsibility much easier.



An important benefit of managed services that is often overlooked, says Punt, is the ability to tap best practice standards. Any move to a managed service model will require standardisation and automation where possible in order to reduce the number of manual processes before operations are handed over. An institution can benefit from best practice, established by all of the other institutions that are part of the managed services provider's client base. "Managed services can help banks to achieve operational excellence, which in turn will reduce costs," he says.

A move to managed services will also remove the burden of maintaining and upgrading IT environments. This is not only a cost saving, but also reduces the operational risk inherent in any upgrade or change to the IT environment. "This is an important factor given that many IT departments are now run with fewer resources," says Gilderdale. "Many banks are relying on too few people to operate mission-critical environments. Managed services can ensure banks are not heavily dependent on scarce resources."

Challenges in migrating to managed services

The case for managed services will vary depending on the individual institution and its objectives. Many institutions have already driven out substantial costs from their IT infrastructures and feel they can go no further in their cost cutting. For such institutions, a managed services approach will enable them to develop specific capabilities around, say, messaging, without taking up valuable inhouse resources.

Banks must pay close attention to the credentials of the partners they choose to work with, says Gilderdale. "Those choosing to adopt a managed services approach need to

make sure that they are working with the right application and services vendors who can deliver sufficient competence for the task," he says.

Both Gilderdale and Punt point out that the decision to outsource can be coloured by who is given the responsibility for the decision. Operations teams and management in control of processes that are candidates for managed services may be more likely to want to retain control over those processes compared to decision makers further up the management chain who are more removed from the processes in question and may have a more positive attitude towards managed services. Additionally, senior management has a broader outlook on the banks' operations as a whole and may therefore identify a more compelling logic for outsourcing.

In moving to managed services, banks must also standardise their processes as much as possible and drive out customisation. This can be a challenge for many institutions, but achieving a balance between customisation and standardisation will help to ensure the move to managed services is a success.

If the challenges are overcome, successful outsourcing, says Punt, can deliver numerous benefits to financial institutions. "Managed services solutions can help financial institutions to move into a more robust, standardised operations environment. Such an environment will help them to deal with the increasing complexity of their business environment and achieve best practice in operations."

Collateral management: Time for a cross-industry solution

Collateral managers are under growing pressure. What used to be routine back or middle office processes have become strategic to the business and collateral management must now deliver on three fronts: risk reduction, capital efficiency and regulatory compliance. This requires new investment in technology and expertise.

In an environment where collateral is increasingly required but is in short supply, its efficient management has become a strategic priority for securities market participants. The imposition by financial regulators of stringent collateral and margin requirements and new capital rules, as well as concerns about counterparty credit risk, mean that a manual approach to collateral management is no longer appropriate.

Hervé Valentin, Head of Asset Servicing, Securities Markets, SWIFT, says securities industry participants are faced with an onerous new regulatory regime and a challenging operating environment. Regulation of over-the-counter (OTC) derivatives markets, including the European Market Infrastructure Regulation (EMIR) and the Dodd-Frank Act in the US, has imposed significant changes on process flows and market infrastructures. These include the requirement to clear OTC derivatives through central counterparties (CCPs) and to report transactions to trade repositories.

This means more players – CCPs, tri-party agents and trade repositories – are now involved in the OTC derivatives markets and additional process steps are required for each transaction. “At the same time, the new regulatory requirements have combined with the scarcity and cost of collateral, leading to more frequent collateral exchanges and more complex and precise margin calculation and risk management processes,” says Valentin. “This creates a very demanding operating environment.”

Demand increasing; pool shrinking

Concrete figures about the squeeze on collateral can be difficult to pin down. Estimates for the possible increase in collateral calls in the coming months range from 500%-1000%, driven by the growing need for collateral as OTC derivatives markets move to central clearing.

At the same time, most believe that the pool of eligible collateral is shrinking. For example, *Financial Times* analysis last year showed that the global pool of government bonds with triple A status from the three main rating agencies, a major chunk of the global collateral pool, has shrunk by more than 60% since the financial crisis triggered a wave of downgrades across advanced economies. Because the US, the UK and France have



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been downgraded there has been a contraction in the stock of government bonds deemed the safest from almost \$11tn at the start of 2007 to just \$4tn in 2013. Whilst some other countries have been upgraded, their debt issuance has not managed to fill this hole.

The need to automate

In addition, counterparty risk continues to be a concern following the financial crisis. As more firms transact across borders with an increasing number of counterparties, credit exposures must be closely managed. Manual processes cannot meet these demands. This is an environment in which automated, standardised processes are required in order to mitigate operational risk.

Another driver towards automation is liquidity, which is under pressure across organisations and transaction chains. The cost of liquidity directly affects a firm's bottom line and the capital rules of Basel III will make some forms of collateral scarcer and therefore more costly. “As requirements for collateral posting with counterparties increase, more collateral becomes trapped within different institutions, systems and geographies,” says Valentin. “This has a direct impact on liquidity as collateral can become ‘immobilised’.”

All of these drivers have created an environment in which operational efficiency is crucial. For example, as counterparties look to more tightly manage scarce collateral, CCPs will likely be asked to accept bonds and equities in addition to cash as collateral for swaps transactions. Similarly, as equity markets can often be volatile, more frequent marking-to-market and variation margin calls will be required.

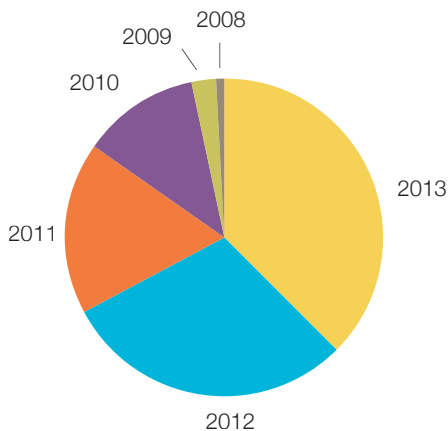
“On a day-to-day basis, the increasing demand for collateral is having a significant impact on both liquidity and risk. Financial institutions are no longer satisfied with a fragmented approach that may realise only limited operational cost and risk management benefits,” says Valentin.

The combination of heightened risk awareness and regulations requiring more margin to be pledged for both cleared and uncleared derivatives, has pushed collateral management to the top of securities market participants’ agenda. Ensuring collateral management operations can be effective in this new environment is a major undertaking. Many financial organisations find meeting new regulatory requirements time consuming and at times overwhelming.

Increasing velocity of collateral

A huge demand for increased automation has resulted from this changing environment, says Valentin. Last year, collateral management-related message volumes on SWIFT grew by more than 26%, compared with average securities traffic growth of about 10%. “There is now 40 times more collateral management-related traffic than in 2008. Many of our clients are investing in automation and new users are also coming into the picture,” he says

Fig. 1: Collateral Management Traffic – the growth in Tri-party messages



In a market where collateral is thin on the ground, automation is the only way to meet increased collateral requirements, says Valentin. By automating, firms can increase the velocity of collateral; ie, be able to rapidly post it with a counterparty and be able to reuse it as soon as possible. “This is not an environment in which you can talk about using fax communications,” he adds.

Both collateral management and collateral movement are being automated. Collateral management refers to the process of agreeing the type of collateral and where it will be posted. Collateral movement involves the transfer of the collateral via settlement of cash or a security transaction. “Collateral

movement is already quite well automated overall,” says Valentin. “Collateral management is the area that is attracting the most interest and is where we are seeing the most new attempts to automate.”

Automation models for collateral management

There are two automation models for collateral management: outsourced or in-house. Outsourced collateral management involves the appointment of a third party, such as a tri-party agent, to handle the collateral needs of an institution on its behalf. SWIFT processes three types of ISO 15022 messages which facilitate the exchange of information between a tri-party agent (CSD, ICSD or a clearing bank) and its service participants (banks, broker dealers and investment managers) around exposure notifications, information on trade matching, collateralisation status and exchange of statements covering collateral and exposure positions.

In-house automation is based on ISO 20022 messages and is used by firms that prefer to conduct their collateral obligations on a bilateral basis. Valentin says SWIFT is now seeing the first adoption of these ISO 20022 messages as firms that previously used faxes for communicating with their counterparties and clearing houses start using automated processes.

ISO 20022 XML standards automate margin call negotiation, dispute and agreement, substitution, interest payment processing and reporting for bilateral collateralisation processes. The standards are suitable for brokers, clearing members, investment managers, hedge funds, custodians, corporates, service providers, CCPs and central banks, enabling standardised data exchange between counterparties, facilitating straight through processing and improving the efficiency and transparency of communications. ISO 20022 is especially valuable for managing high volumes of transactions.

The benefits of automation

The increase in collateral activity makes it vital that information about collateral movements is fully in synch and easily reconciled with the settlement process. In this environment, manual collateral management processes such as phone, faxes and emails are inefficient and error prone. The use of standard ISO messages reduces the risks inherent in these manual communications.

Automation will help firms to increase operational efficiency, which in turn accelerates collateral movement, reducing its overall cost, says Valentin. “A cross-industry solution, based on the use of ISO messages for collateral management is emerging,” he says. Automating the information flow for collateral, including margin negotiation, information and reporting movements, will enable collateral managers to operate efficiently in the new regulatory environment. By using international standards, securities industry participants can connect directly and easily to their counterparties, tri-party agents and other market participants.

Mid-sized corporates: Taking the middle ground

Much of the focus in corporate treasury automation has been on multinational companies with extensive operations and deep pockets. But increasingly, mid-sized corporates are facing the same challenges and cost pressures as their larger counterparts and would benefit equally from automation and standards.

Mid-market businesses survive in a highly competitive market through efficiency – by doing more with less and growing market share through innovation. For many such companies improving processes sit at the heart of this strategy; and for good reason. Treasurers in mid-sized companies, too, are increasingly under pressure to improve efficiencies and gain better visibility and control over their cash positions at any time of the day, anywhere in the world. But they are required to do this in a cost-constrained environment where any investment puts pressure on margins and profitability.

Since the financial crisis of 2008, corporates have held back on efforts to rationalise banking relationships and many – even mid-sized firms – maintain multiple banking relationships. These networks typically require multiple, proprietary channels for communication between banks and corporates, and maintaining such channels is costly and time-consuming. Added complexity for treasury operations has come from the requirements of a growing list of regulations, including Sarbanes-Oxley, the Single Euro Payments Area (SEPA) and the European Market Infrastructure Regulation (EMIR).

To optimise working capital, simplify complexity and manage compliance risk in this environment, corporates are seeking to centralise payments and receivables by automating, standardising, rationalising and improving security. Obtaining services such as payments, treasury, securities orders and reporting from multiple financial institutions via a single, highly secure and standardised communication platform will remove the costs entailed in operating and maintaining multiple, proprietary bank channels.

The appeal of cloud technology

“Mid-sized corporates do not have the IT departments and data centres typical among large corporates,” says Robert Schneider, Head of Corporates and 3SKey, EMEA at SWIFT. “These firms are looking for solutions that are easy to implement and that deliver rapid results. And for this sector, that means cloud-based solutions.”

The mid-sized sector is not straightforward: SWIFT defines it as companies with revenues below \$1 billion. Within that category, says Schneider, are firms with sophisticated treasury technology solutions, but also others with many manual treasury processes. The number of bank relationships can vary, too. Some mid-



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ROBERT SCHNEIDER

sized companies will maintain several banking relationships, particularly if they are involved in global operations, whereas other, more domestically focused enterprises will have only one or two provider banks.

Despite this diversity, cloud technology is the defining trend for all of the mid-sized companies. “Mid-market companies have clearly come out in favour of cloud offerings, rather than on-premise installations of treasury software,” says Schneider.

This is borne out by industry research. For example, a recent survey by Deloitte into mid-market corporates suggests that they are further along in the use of cloud-based solutions than many might expect. In fact, 56% of executives said their organisation was already using some form of cloud-based service and an additional 26% said their organisation was considering moving to cloud-based services.

Treasury management systems, which have been perceived as too costly for mid-sized companies, are now within reach, as cloud or software as a service (SaaS) offerings significantly reduce the costs of implementing, maintaining and upgrading such systems. Put simply, cloud or SaaS are hosted solutions, which enable mid-market companies to outsource their bank connectivity and treasury operations to a third party.

The path to cloud technology for corporates was first opened up via service bureaux, which enabled companies to establish connectivity to multiple banks via a single platform operated by a third party. The benefit of such a shared infrastructure is that the party hosting it will have economies of scale that can be passed on to the end users in the form of lower fees. Costs can be spread between all of the bureau users and the knowledge and expertise of connectivity can be shared.



Bank connectivity is not the only area mid-size corporates are automating. Schneider says in addition to treasury and cash management automation, mid-sized firms are looking to improve efficiencies in their trade operations. The diversification of supply chains by larger corporates means many smaller companies are now involved in export or import activities. “The processing of trade flows is heavily (manual in most companies,” he says. “But trade flows depend on efficient processing. As a result, many mid-sized companies involved in exports and imports are looking to automate trade flows.”

Cloud technology can also support mid-sized corporates as they navigate the sea of regulations that are affecting their operations. Whereas the larger corporates with substantial IT operations can typically develop in-house solutions to the reporting requirements of regulations such as EMIR, mid-sized firms are looking for standards-based solutions from third parties. “The expectation for these firms is that their treasury systems providers will implement compliance solutions supported by the cloud. This will provide seamless and automated compliance processes, particularly for initiatives such as the Single Euro Payments Area,” says Schneider. Some banks have started to offer compliance solutions for mid-sized corporates to help them implement all of the regulatory requirements now being imposed.

Security challenges

The growing prevalence of cyber-attacks on banks and businesses and fears about outsiders accessing cloud data has brought security to the fore. “In security, the authentication of

the end user is absolutely vital,” says Schneider. “Corporates need to be assured that their communications with banks are absolutely secure. Some of the transactions they conduct are for salary payments, which are critical and need to be very secure.”

A common approach, recommended by the European Central Bank, is two-factor authentication, which involves two stages to verify the identity of an entity trying to access services in a computer or in a network. Banks offer this to their corporate clients as part of their electronic banking platforms. The corporates use the authentication method to approve payment files etc. “Individual banks offer these services, but in a multi-bank environment the costs of two-factor authentication soon add up,” says Schneider. The solution, he says, is to standardise security.

Treasury is essentially about effective risk management and this has been high on the boardroom agenda ever since the crisis. Treasurers today have a strategic role with greater accountability and the responsibility to manage enterprise-wide risk. This is just as true for mid-sized corporates as it is for larger firms. To fulfil these expectations, treasury needs to incorporate technology and risk management best practices for their core activities.

Automation plays an important role in addressing these needs, and the trend towards automation is gathering pace among mid-market corporates. Says Schneider: “These firms want to achieve the same level of efficiency as large corporates. In the past treasuries at the mid-market firms were rife with manual processes, but now firms want to be as automated as the big guys. They are doing this in a different environment – not in the premises, but in the cloud.”

Business process optimisation: Thriving amidst the deluge

An enduring legacy of the financial crisis is the lean operations most banks now run. Cost cutting exercises characterised by reductions in staff have sliced much of the fat from operations. Running in parallel with this trend is another legacy of the crisis – an increasing demand for regulatory compliance. When it comes to business processes, banks are having to do more with less.

There are multiple challenges in today's operational environment. Many banking hardware and software systems are becoming obsolete, banks need to comply with a growing number of regulations and more emphasis has been placed on reporting and analytics.

In addition, there is an ever-increasing number of market initiatives. Changes such as Target2-Securities (T2S), the CLS Star migration, implementation of ISO 20022 for T2 and funds as well as existing projects, must be executed with military precision if they want to finish on time and on budget.

At the same time, there are new projects that need to be launched as banks have to ensure and improve quality and consistency in customer service, offer a broader range of products and solutions and address new client needs.

"All of these forces are putting a huge strain on IT staff and on operations," says Kurt Ryelandt, Head of Standards and Technical Services, EMEA. "The main question is how to do more with less. And the answer always boils down to a need for more efficiency; and efficiency means automation. Banks can no longer tolerate high levels of manual processes as business as usual will result in an exponential rise in costs to meet the additional requirements".

To survive – and thrive – in the deluge of new projects they face, banks are being forced to take tough decisions about which projects to prioritise. "It is very difficult for banks because we hear there is no money for efficiency projects that are not directly related to hardware or software obsolescence," says Ryelandt. "Also, market driven or regulatory projects are taking priority over client-driven projects. There is little room left for projects that aim to increase efficiency and, if such projects are considered, the return on investment is often required within as little as 12 months. The key to success is to ensure that projects not only address the technology, regulatory and market changes but also deliver better client service and increased efficiency at the same time."



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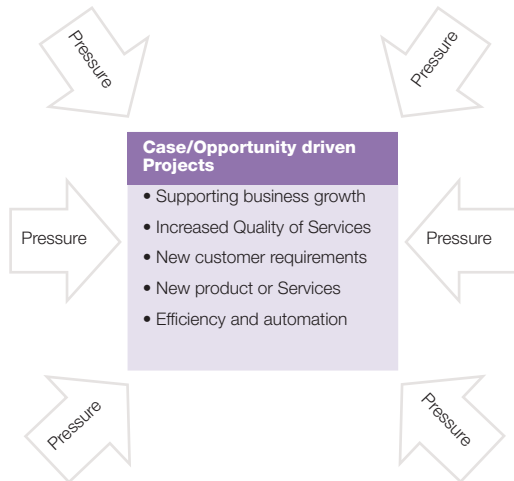
Kurt Ryelandt

Running Projects

- Signed off and budget made available
- Governance in place
- Part of company/IT/ personal objectives

Technology Projects

- Corporate infrastructure upgrades
- Corporate workplace roadmap
- Software maintenance
- System or software migration
- Operating system upgrades
- Hardware obsolescence
- End of life support contracts



Market Driven Projects

- CLS STAR gateway migration
- SWIFT Standards releases
- EBA/Target 2 migration to MX
- Funds migration to ISO 20022
- T2S, Spanish market reform

Risk/Audit/Compliance Projects

- Enhanced monitoring requirements
- Internal or external audit recommendations
- Compliance/Regulation driven (Basel III, EMIR, CSDR, Fatca, Mifid II)

Andrew Muir, Head of Standards Implementation, says initiating a project remains a very difficult task. “The key is not so much the absolute cost benefit of a project, but the relative impact of the investment,” he says. “You could look at 30 projects, searching for the biggest bang for the buck, but often a project also needs the political will of senior management at the bank and endorsement in terms of what peer group banks are doing.”

Muir says many projects are focused on payments in the Eurozone – driven by SEPA – because senior management find these projects more compelling. “It is still much easier to fund a project linked to a regulatory requirement, than to explore opportunities to derive competitive advantage out of an ISO 20022 migration, for example,” he said.

Optimising business processes

A typical project comprises six steps: assessment, analysis, design, implementation, the go-live phase and maintenance. Business process optimisation (BPO), part of the wider business process management approach, ensures processes are optimised and aligned with the business objectives of projects. BPO integrates tools, analytics and experience to provide more insight into business process. As a result, processes should be easier to automate, standardise and improve at a global level.

By taking a BPO approach, banks can assess and document current processes and model and simulate new processes using ‘what if’ scenarios. Banks can govern the entire lifecycle of business processes using policies, standards and guidelines. The deployed business processes can be evaluated against the stated operational and performance objectives to identify areas of potential improvement, and real-time business data can be delivered to senior management.

“Sometimes banks see industry initiatives such as T2S as an imposed change or a burden. However, such projects can also be turned into an advantage by applying a more consistent methodology and implementing processes that match the new reality of their business,” says Ryelandt.

BPO in action

Muir says T2S provides a very good example of BPO in action. Initially, banks should measure process performance in order to understand where there is scope for improvement. For example, can more transactions be processed per second, per CPU or per person? “BPO comes down to squeezing more of what you can do out of a shrinking number of resources,” he says. “For example, book entry transfer, one of the main elements of T2S, was the result of process performance measurement of settlement processes in Europe.”

For some organisations, T2S has triggered further process improvements and the development of new products and services, such as collateral optimisation and management. “There are process optimisation techniques that people are beginning to use to turn T2S into a specific revenue opportunity,” says Muir.



“THE KEY IS NOT SO MUCH THE ABSOLUTE COST BENEFIT OF A PROJECT, BUT THE RELATIVE IMPACT OF THE INVESTMENT”

Andrew Muir

One of the questions banks face when looking at the raft of projects is where best to focus effort and resources; which projects will create business advantage and yield the best ROI? For some banks, T2S has been identified as a project where doing better than someone else will reap real rewards. Says Ryelandt: “Everyone has to implement the market changes, but the trick is in determining whether you want to use a project to create competitive advantage. By intelligently investing in the right business process improvement projects, banks will remain competitive or create advantage.”

The combination of data modelling and standards can help ease decisions about project prioritisation. Muir says that although standards are sometimes seen as a constraint when banks rebuild back office processes, they can in fact be of enormous help.

“Data modelling can help banks to harvest information in order to gauge process performance,” he says. “For example, banks can work out the average value per transaction, measure latency to exchanges, work out how long counterparties have to wait to send instructions, etc. Understanding this data and how it fits within standards and protocols enable banks to identify where their priorities should be and on what their optimisation teams should focus.”

Using standards toolkits, banks can model the current and future state of their processes, which will help them to determine how they can reach their ideal future state. Modelling can track information flow to counterparties and also map how that flow will relate to the future state.

BPO, improved modelling tools and consultancy services to help banks choose the projects that will yield the most competitive returns, are beginning to transform project management in the financial industry. Fewer projects are failing than in the past and a new approach whereby processes are tackled in smaller units of work is enabling more agile and rapid development methodologies.

Supply Chain: Entering a new era

Electronic commerce, initially a consumer market phenomenon, is becoming firmly entrenched in the corporate space. The emergence of cloud-based treasury solutions and the digitisation of trade flows represent step changes in treasury and trade finance. Combined, digitisation and cloud technology have the potential to transform the way market participants communicate and transact with each other.

Business is happening between corporates in an increasingly digital way, says André Casterman, Head of Corporates and Supply Chain, SWIFT. “The digitisation of corporate trade flows has come a very long way and now even the most difficult to digitise processes are being transformed.”

Cloud-based treasury solutions are transforming corporate treasuries. The amount of treasury time and effort required to manage a cloud-based solution is lower and implementation timelines are shorter. Corporates that previously could not afford standalone solutions from the main treasury systems vendors now find new capabilities have opened up to them. The subscription based pricing of cloud solutions also offers significant cash flow advantages for these corporates when compared with the large up-front capital cost of a software licence for a standalone system. As a result, a new segment of corporates can afford to improve their treasury processes by using purpose-built treasury management solutions.

At the same time, ecommerce and electronic invoice hubs, which enable businesses to communicate with each other digitally, have proliferated. Such platforms connect buyers and suppliers around the world, enabling manufacturers, wholesalers and exporters to discover trade opportunities. At present the market is diverse, ranging from very large business-to-business hubs through to hundreds of smaller, country-specific or niche industry hubs. Many of these hubs are also based on cloud applications and services.

The digital supply chain

The combination of cloud technology and hubs has set the scene for a new, digital era of the supply chain. The supply chain finance (SCF) market – the term used by banks to refer to approved payables financing or early payment services – has grown significantly during the past five years. The now widely available SCF solutions offered by banks and non-bank technology providers have been built on the fact that buyers and sellers wish to work collaboratively, where both parties gain advantage, as large buyers aim to support their suppliers’ working capital needs.



“ACCELERATING THE LIFECYCLE OF TRADE TRANSACTIONS ENHANCES THE ATTRACTIVENESS OF BOTH THE BUYER AND SELLER AS IT MITIGATES RISK IN INTERNATIONAL TRADE WHILE ALSO ENABLING IMPROVEMENTS IN PAYMENT TERMS. BANKS ALSO STAND TO BENEFIT FROM LOWER COSTS AND REDUCED OPERATIONAL RISKS ASSOCIATED WITH THE MANUAL PROCESSING OF LCS ”

André Casterman



“WE HAVE SEEN A TREND LATELY THAT BANKS AND CORPORATES ARE BEGINNING TO ADOPT TRADE FINANCE MESSAGES TO COMMUNICATE WITH EACH OTHER AND FURTHER AUTOMATE THEIR TRADE FINANCE ACTIVITIES ”

Yves Smeyers

Typically buyers facilitate early payments to their suppliers via one of their banking partners. Buyers therefore approve invoices as early as possible in the process in order to maximise the financing opportunity for suppliers in need of working capital.

SCF services also validate the fact that banks are ready to extend financing to their clients using electronic and automated transaction flows as they have done in payments and cash management services for more than 20 years.

The digitisation of the supply chain is well illustrated by the transformation of one of the most manual processes in world trade – the bill of lading. The document, issued by a carrier, contains details of a shipment of merchandise and gives title of that shipment to a specified party. Bills of lading are important documents used in international trade to help guarantee that exporters receive payment and importers receive merchandise.

Organisations such as essDOCS and Dubai Trade have been involved in the digitisation of bills of lading, working with the freight forwarders that issue them. Because electronic bills of lading are legally and functionally the same as paper bills of lading, they are ideally suited for automated handling by bank systems.

The automated handling is made possible via another new digital trade instrument, the Bank Payment Obligation (BPO). An alternative means of settlement in international trade, the BPO provides the benefits of a letter of credit (LC) in an automated environment. Importantly for banks, it offers the possibility of intermediation earlier in the supply chain by offering risk mitigation and financing services.

A BPO is an irrevocable undertaking given by one bank to another bank that payment will be made on a specified date after a specified event (such as delivery of goods) has taken place. The specified event is evidenced by a match report that is generated by transaction matching applications (such as SWIFT's Trade Services Utility). BPOs can be incorporated into matching applications through a buyer's bank or a third party bank. The BPO is due when data is accurately matched or when all financial institutions involved in the transaction have accepted any mismatches or discrepancies.

This process results in a fully electronic alternative to the letter of credit (LC), which will enable efficiency gains, working capital reduction and cost saving. This electronic alternative can be processed in a much shorter time than traditional, paper-based LCs – estimates are as low as 10-15 days. Reduced processing times result in significant cost savings: Brazilian mining company Vale estimates that a combination of electronic bills of lading and BPOs is saving it \$37 million per year on its exports of iron ore to China alone.

Accelerated cash flow through the faster collections made possible by the BPO can reduce days sales outstanding (DSO) by 50-65%. Furthermore, operational costs can be reduced from 10-30% as fewer full time staff are involved in the preparation of paper documents. Finally, liquidity can be more rapidly released from the financial supply chain to boost working capital and banking fees can be reduced by up to a half as handling fees are reduced.

Risk management benefits of automation

The cost savings that result from combining electronic bills of lading with the BPO are attractive, but Casterman adds there is an even greater benefit: "Accelerating the lifecycle of trade transactions enhances the attractiveness of both the buyer and seller as it mitigates risk in international trade while also enabling improvements in payment terms. Banks also stand to benefit from lower costs and reduced operational risks associated with the manual processing of LCs," he says.

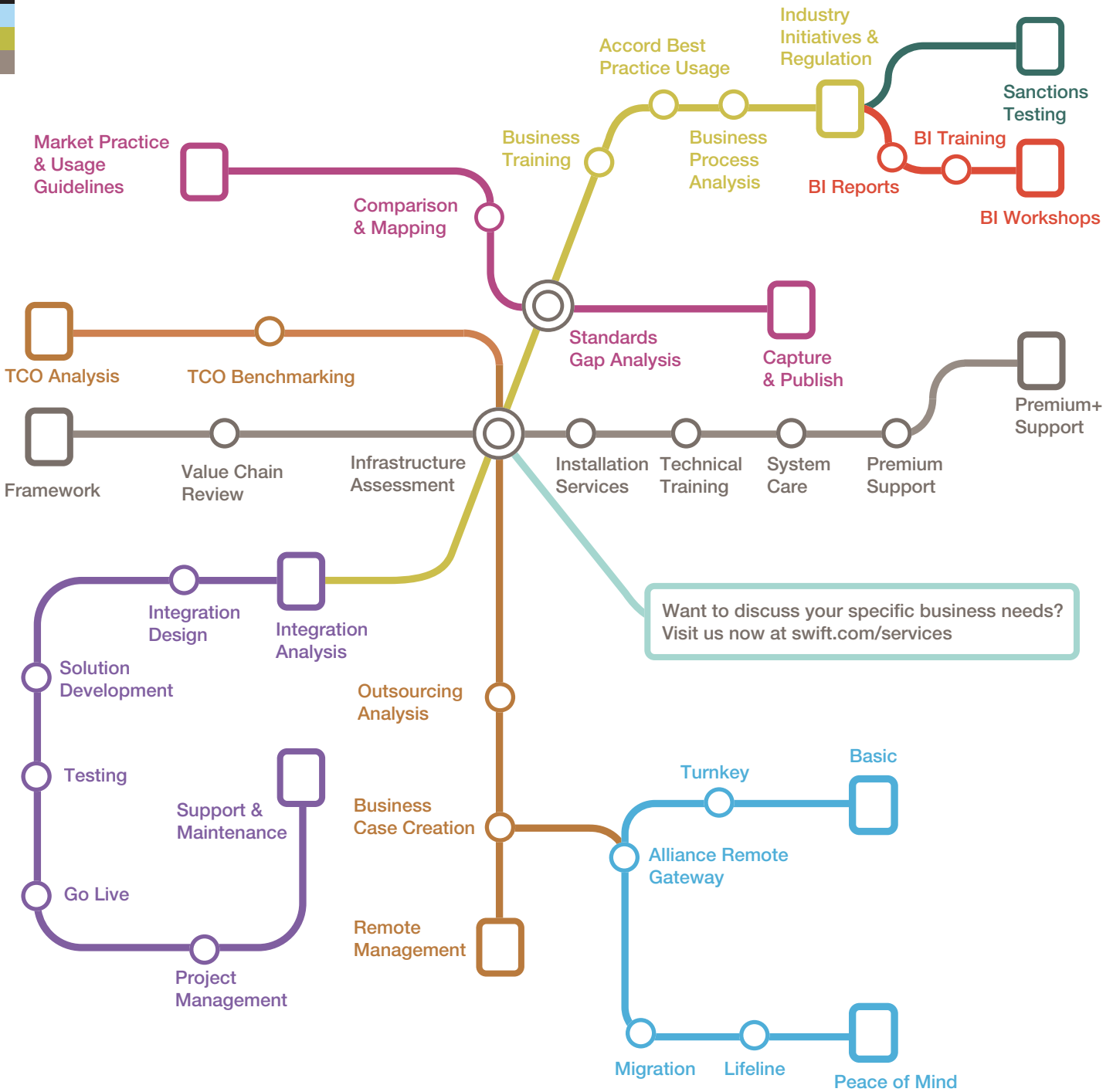
The adoption rate of BPOs is steadily increasing, but it is likely use will be predominantly for ongoing and recurring trade flows where some level of trust has been already established between the counterparties. Industries such as commodities, electronics and retail, which have established trade flows between suppliers and buyers, will represent the greatest opportunity for growth. Cloud solutions and digitised trade flows require economies of scale to really flourish – the more banks that issue BPOs, the more correspondent trade relationships will become electronic and therefore the more trade transactions can become electronic.

"The automation of the supply chain is not solely about technology; it is an area that also requires collaboration between all of the parties involved in trade," says Casterman. "The development of the BPO has proved that the industry can come together to solve a problem and that as a result, everyone stands to gain."

Standards have played an important role in this collaboration as they facilitate competition between commercial offerings while enabling those offerings to interoperate.

In supply chain finance, banks have developed new legal and technology standards to address interoperability challenges and to grow the size of this emerging market. Another automation trend, based on standards, is emerging in the corporate-to-bank space, says Yves Smeyers, Principal Consultant, SWIFT. Increasingly, corporates and banks are adopting the trade finance messages to communicate with each other. "Most of the message flows between corporates and banks are payments and cash management series," he says. "However, we have seen a trend lately that banks and corporates are beginning to adopt trade finance messages as well to communicate with each other and further automate their trade finance activities."

SWIFT Services Metro Map



Key to Service Lines

Compliance	Business Intelligence	Integration	Business Advisory
Operational Excellence	Total Cost of Ownership	Cloud Services	Standards Services