Summary of Current State

Capital Markets businesses have experienced significant changes in the regulatory environment governing their business operations since the last financial crisis in 2008. The enactment of Dodd Frank reforms and the Consumer Protection Act, in 2010, necessitated significant operational changes to protect investors and large financial institutions that house bank and broker dealers.

While there have been significant changes in the regulatory environment, businesses operations and the underlying software running significant portion of those operations have not undergone critically needed overhaul, over the last 10 to 15 years.

The environment is a legacy operational environment, with limited agility, trying to manage the pressures/deadlines to support regulatory changes in LIBOR, SWIFT, FRTB, and GDPR, not to mention advanced fintech offerings, delivering new, innovative, fine-tuned and agile instruments for today’s market needs.

The Burden of Legacy Operations on Changing Capital Markets

The Capital Markets business portfolio of products has been revolutionized over the years from simple equity to diverse and complex portfolios including multiple asset classes. The marketplace has become highly competitive with a number of private firms competing with Banks and Financial Institutions powered by more nimble and creative solutions, thus changing the operational landscape.

This situation is further exacerbated by the current COVID crisis with associated disruption in the financial markets, resulting in a credit/default risk. The risk is impacting businesses’ capital needs, debt servicing/default increases, business operational continuity and alternate workspace needs. This has resulted in the expansion of additional compliance and monitoring requirements (e.g. trading activity from home desks etc.).

With so many factors requiring attention, organizations find themselves buckling under the stress of legacy operations that lack transparency and agility.
Transparency Is Key to Understanding Current State

To meet increasing demands, organizations are accelerating efforts to define and implement a digitally transformed environment which delivers agility and operational effectiveness. However, not having a baseline of current state of operations has made the change not only cumbersome but has the potential to introduce significant risk and operational failure.

The typical capabilities and value streams of capital markets businesses and their related business processes are a complex maze of activities spanning a multitude of front office, middle office and back-office systems supported by a varied mix of software applications combined with manual interfaces. The situation is only exacerbated by risk and regulatory agility required to support current and future operations.

Understanding this operational flow is critical to ensure both changes in regulation and digital transformation efforts are data driven and operationally effective.

One example of such an effort is settlement and recording in the general ledger (GL), with business data traversing through multiple process steps (manual or automated) from the time a trade is executed in the front office to final steps of reconciliations, settlement and recording in the GL in the back office.

Significant amounts of resources and time are needed to execute the example transaction flow described above, not to mention the ever-changing regulatory framework which impacts such transactions, resulting in razor thin business returns as well as risk of regulatory non-compliance or out of date compliance.

In addition, operation flow is contextually specific to each organization’s activities. An example of one such fast approaching regulatory change is the scheduled phasing out of LIBOR and transition to alternative RFR before the end of 2021.

The Capital Markets businesses are in a scramble to race to the finish line to meet fast-approaching LIBOR deadlines. The challenge is not only understanding new requirements and ensuring a solid governance and operational framework required for implementation, but also how these requirements are represented across operational software to ensure effective and profitable performance.

Again, operational transparency is critical to ensure one understands current state of implementation, new requirements, the LIBOR/IBOR phase out needs, and the transition to alternative RFRs. (See our Paper published on Leveraging the Operational Knowledge of Knowledge Refinery® for Regulatory and Audit Needs of Capital Markets).

Data characteristics such as prioritization, accuracy, integrity, privacy and traceability are key drivers for ensuring that appropriate quality and governance requirements are met, establishing more comprehensive and timely business decisioning, and ultimately, successful business performance in the marketplace.

**To meet increasing demands, understanding operational flow is critical to ensure both changes in regulation and digital transformation are data driven and operationally effective. Businesses need a baseline of current state of operations which Knowledge Refinery® delivers.**
Four Challenges impacting Capital Markets’ Ability to Achieve Operational Agility and Effectiveness

The above discussion regarding the Capital Markets landscape describes both a dynamic regulatory and market environment. And in order to keep pace with this environment, understanding the challenges involved requires both the reliable comprehension of risks as well as related dependencies to ensure successful outcomes.

The challenges below show a common thread of a pervasive need for Operational Transparency for understanding risks, dependencies, and for the delivery of a data driven and successful outcome whether addressing audit/compliance or digital transformation efforts.

Fast Evolving Competitive Market Environment

The Capital Markets environment has evolved over the last two decades from a small number of players providing a limited set of debt and equity product offerings to a dynamic and rapidly growing marketplace with many new players comprising of both banks and private equity firms. These firms, over the years, have introduced a variety of inventive equity, debt and complex derivative products.

However, the operating environment and infrastructure in these organizations has not kept pace and remains legacy. To stay competitive, businesses need to become more agile and prepared to adopt new technologies swiftly, enhance operational processes and create more transparency in the end-to-end process.

Keeping up with competition and ensuring support for new product offerings dictates a change in the operational software to ensure proper front-, middle- and back-office operations to support these offerings. A rush to deliver services to market has resulted in an increase in cost per trade or transaction, reducing earning margins because the supporting operations are not structured for an agile operating environment.

Additionally, customer experience is adversely impacted because operational effectiveness is not achieved. Having a foundation of operational transparency enables a structured, planned and data driven approach needed to keep pace with market demands.

Rapidly Evolving Regulatory Environment

In recent years, regulation governing the marketplace have undergone significant changes with the tightening of existing regulation and the introduction of new ones. Additionally, with increased cross-border activity, new regulation addressing governance, contract management, record keeping, and reporting are changing daily (e.g. KYC, AML, LIBOR, EU General Data protection regulation, CCPA). Penalties for non-compliance are significant.

As these regulations evolve and penalties rise, organizations realize the need for an end-to-end process to support operational needs that is more automated (residing in software) and provides operational transparency across these processes to ensure both traceability and agility.
Governance and Transparency

Rapid market growth, coupled with the resulting data explosion from transaction volumes, has driven the need to establish a good corporate governance framework to ensure appropriate operational transparency for both investors and shareholders.

For example, a contract warehouse, housing client contracts and detailing contract terms, has critical needs for tracking and reporting performance against requirements, assessing risks and tracking timely action to mitigate risks.

This effort drives the need for an integrated and automated solution bringing together various business capabilities that represent contract life cycle, data management, accurate and timely data analytics and reporting for reliable decision making. The results need to show governance of contract management and transparency of operations to ensure traceability and data driven decisions.

Technology Acceleration

Over the past 10-15 years, the rapidly evolving need for technology to automate existing human operations, and new product feature/functionality has led to a dramatic rise in both organically grown in-house custom software as well as use of PaaS solutions with significant customization, all residing on-premises and in the cloud.

This has resulted in:

- A ballooning of the number of custom applications running business operations
- Significant operational redundancies and obsolete processes which continue to be maintained
- Operational ineffectiveness from lingering manual efforts and operations in outdated software
- Significant on-premises costs and unvalidated cloud savings from the transition of operational software to cloud

Realization of the lack of operational transparency and in-turn documentation across operational software, both at technical and business layers, has made embracing transformational change extremely costly, risky, and in many cases, operationally ineffective.

These four challenges, in which operational transparency plays such a significant role, have made it difficult for organizations to not only achieve operational agility and effectiveness needed to retain both a leadership position and lean into a differentiated competitive advantage to ensure operational profit and growth.

Operational transparency, the common thread, plays a significant role to achieve agility and retain a leadership position to ensure profit and growth. Knowledge Refinery® delivers this common thread to address the challenges faced by Capital Markets.
Knowledge Refinery® Delivers Operational Transparency, the Common Thread to Solve Challenges Faced by Capital Markets

The common thread discussed in this paper is that Capital Markets businesses are going through a significant operational transformation which is being dictated by regulatory, audit, operational, customer/competitive needs.

To ensure these changes are met with successful outcomes and continuity of outcome in this dynamic landscape, requires a need for operational transparency and operational agility.

With the significant dependency on software to run operations and speed to move away from human processes to software/PaaS processes, the need to ensure full documentation of operations is more critical than ever.

Hatha Systems® Knowledge Refinery® (KR) software suite delivers this transparency through the documentation of both technical and operational knowledge residing in an organization’s operational software.

This knowledge can quickly connect human operations, to business capabilities and value streams, enabling key decision makers to use a data driven approach to understand current and future state of business operations. The result is a taxonomy for ongoing needs in audit/compliance as well as digital transformation.

The uniqueness of KR, with its patent pending technology, is its ability to document and retain the knowledge of operations, whether it is business processes traversing multiple applications with a link back to value streams and capabilities, or data lineage providing traceability of business data records (e.g. GL, GDPR) and their comprehensive intrinsic and extrinsic characteristics for proof of compliance.

These unprecedented traces and views across a portfolio of applications within a business capability become the foundation for root cause, compliance verification, and financial audit readiness. This is done with the combination of KR’s Application Analyzer, Integrator and Business Mapper solutions.

Additionally, KR can reduce duplication of operations and thus reduce the footprint of operational software, and human activities, while delivering operational effectiveness.

Whether looking to retire legacy applications and move to a modern environment, moving from on-premises to the Cloud, or rationalize or reduce portfolios, KR can provide the relevant and traceable operational and technical layer comparisons to deliver a data driven approach for optimizing operations. This is done with KR’s combination of Application Analyzer, Integrator and Rationalizer solution.

Only KR delivers the solution that ensures data driven and agile management of operations across multiple front office, mid-office and back office applications and automation and transparency to understand operational flow.

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