PERSPECTIVE

All the Right Moves

Part II – Delivering Transformation by Creating the Right Internal Utilities

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The financial crisis left a lasting impression on the structure of participants in the financial services market and almost all players, large and small, were impacted in one way or the other. Significant consolidation resulted in fewer players dominating the market. The change was evident across banks, broker-dealers and custodians, amongst others; but it was more evident amongst the global investment banks and custodians. This was due to greater focus on risk, controls, and shrinking margins – they were the first ones to adopt newer operating models in the form of process utilities.

The creation of a utility makes perfect business sense for financial institutions, but its success will depend on choosing the right kind of utility, and taking the right approach and managing internal change.

An internal utility, if implemented the right way, holds the promise of delivering significant bottom-line benefits, robust controls and unified view of risk.

This paper highlights the critical building blocks which financial service institutions will need in creating the right internal utilities and the benefits associated with the same.

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Utilities Move Up the Value Chain

The financial crisis left a lasting impression on the structure of several industries, with almost all players – large and small – absorbing the impact in one way or the other. Nowhere is the change more evident than banking and financial services – due to greater focus on risk, controls, and shrinking margins. They have been the first ones to adopt newer operating models in the form of process utilities.

Process utilities are of two kinds:

Internal utility — Servicing different lines of business within a client organization

External utility — Servicing multiple clients

External utilities are more complex to implement and manage, as they require effective collaboration and participation of multiple financial institutions for a defined business area. While it is rare to see such utilities, most large banks and financial institutions are making, or have made, rapid strides in adopting internal utilities.

An internal utility is a centralized facility across business lines or products for the timely, accurate, and cost-effective delivery of services, and is supported by a common suite of technology platforms and operations teams. The primary objective of such a utility solution will be to drive process and cost efficiencies across lines of business or products by capturing economies of scale and enabling standardization.

Internal utilities have witnessed increasing adoption by banks and financial institutions over a period. Listed below are different kinds of utilities and organizations who have adopted them.

Internal utility	External utility
Settlements, Collateral Management, Reporting, Derivatives Operations	Confirmations in Corporate Actions, Reference Data Management, Reconciliation
Most global investment banks	There exist well-known service providers who have created external utility offerings

- Global investment banks have leveraged their captives or third-party vendors to set up internal utilities
- Service providers commonly have market offerings that combines product, processes, policies and people into a data management/reconciliations/corporate actions utility

External utilities functions in the banking and financial space do exist. However, the latest trend sees large organizations creating internal shared services utilities.

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Why Utilities, Why Now?

Although there are many drivers for the creation of internal utilities, four in particular stand out:

1 Cost reduction: Utilities not only help from a process standardization and best practices perspective – they also help in the consolidation of staff across lines of business or products. The consolidation exercise can result in critical mass which can then be evaluated from an outsourcing/offshoring perspective. This can then result in a further cost savings opportunity for financial services organizations.

2 Operational risk reduction: Through process and platform standardization, a utility introduces a risk and control structure around key operational processes. This results in reduction of operational risk. Besides risk reduction, a utility — through its consistent reporting capabilities — enables a bank's management to identify operational issues at the business, departmental, and global level.

3 Regulatory compliance: Regulatory requirements have tightened in recent years. Acts and Standards like Sarbanes–Oxley, Basel III and Dodd–Frank are forcing banks and financial institutions to put in place the right systems and procedures, so that they can effectively manage and control operational risks.

4 Greater focus on core competency: Centralizing functions in a utility enables operational teams to spend more time on client-related activities, while the utility staff focuses their specialized expertise on certain activities to ensure that they are being performed in an efficient, timely, and cost-effective manner. Greater efficiency can also be achieved with a constant feedback loop between the utility and line of business (LOB) operations team.

Challenges in the Creation of Internal Utilities

Complex system landscape: Most client organizations across LOBs and products typically house multiple systems and applications which perform similar work, resulting in process inefficiencies and a lack of standardization.

Insufficient automation: Similar functions across LOBs and products are often processed differently – some on best-of-breed platforms, some on home-grown platforms, and some manually.

Capacity and scale issues: Volume fluctuations across LOBs and products is a regular feature of servicing today's financial services markets. From an operations perspective, many organizations lack the ability to ramp up or ramp down depending on business needs.

Cost issues and pressure on margins: Most financial organizations in the post-credit era have large cost savings targets. This requires the need to look at operations costs and adopt newer operating models.

Reduced appetite for large capital outlays: Given today's business environment — where many organizations face acute budget constraints — individual LOBs or products may not have the appetite for capital investments related to large-scale transformation involving platform changes for common processes.

Change Management: Moving from product- / line-of-business-based structure to functional structure requires managing expectations of key internal stakeholders.

Sponsorship of the program: A utility needs to be championed by senior business stakeholders, as buy-in and hard decisions need to be made cutting across products or lines of business.

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Delivering Transformation with Internal Utilities

Besides people, process and technology, an internal utility needs the following critical building blocks:

- An effective operating model
- A common organization and governance structure
- Standardized platform and other tools
- A pricing/charging model which gives LOBs enough flexibility to move towards a "pay-as-you-drink" mode

Defining the Utility Operating Model

The operating model lies at the core of the utility. Two common approaches exist in moving towards a common operating model:

1. Identify common tasks across the organization and move them to the utility unit — initially different tasks can be on different platforms, which are then standardized from a utility perspective
2. Identify a common platform, and then migrate the tasks across the organization to the same

Common Utility Organization

Structuring of teams and providing an effective governance framework is an equally important task which will enable leveraging economies of scale and best practices across the organization. A common approach which can be adopted includes:

- Common Level 1 Team and Utility Managers / Supervisors shared across LOBs
- Dedicated Level 2 Teams per LOB
- Dedicated Level 2 Supervision Layer
- Common Support teams across Risk, Change and Technology requirements

Governance & Reporting

To supplement utility governance, a dedicated interface/reporting layer will be required to provide the required customized views to various stakeholders.

Key features of the reporting layer need to be focused on:

- Real-time reporting
- User-interactive reporting, which provides users with the flexibility to vary metrics and views
- Ability to provide information across levels

Standardized Platform

A standardized common platform is the critical requirement for any utility. The extent of IT services which can be offered by the utility can vary, and can consist of:

IT Strategy / Architecture

- Manage delivery of overall IT vision
- Determine appropriate application strategy working with Business and Operations Team
- Manage relationships, contracts and service level agreements with external vendors

Core Support – L1 / L2 for the platform

- Support core platform and other production applications
- Manage delivery of infrastructure changes for the platform set to ensure continued support for business

Change

- Develop new functionality and components in order to deliver the IT platform strategy / future-state architecture

Infrastructure

- Infrastructure Management Service with integrated helpdesk (for both platforms and hardware)

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Why Creating an Internal Utility is the Right Move

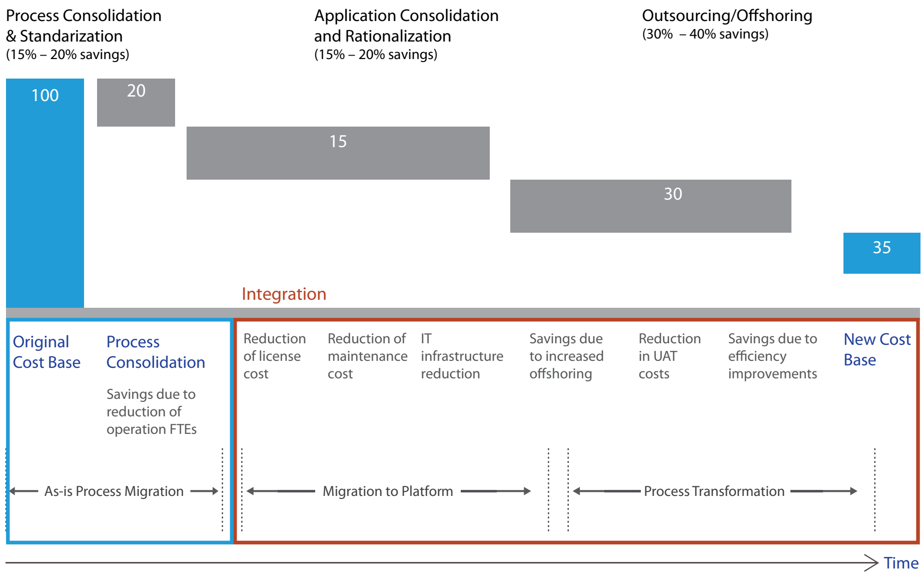
An internal utility has the following benefits over traditional outsourcing and other options:

- It is usually based on an existing or acquired platform
- Internal/vendor staff organized into a new operating model to support a global approach
- Offered as an internal "Centre of Excellence" or "Shared Service" to other LOBs/products within the organization
- Internal/vendor IT and staffing costs still incurred, but leveraged over a wider consumer population

The Utility Journey: Benefits beyond Traditional Outsourcing

Internal Utilities can provide significant cost benefits through a 3-step process of :

1. Process Consolidation
2. IT Rationalization
3. Outsourcing/offshoring of centralized functions



Note: *Savings depicted above are applicable for internal utilities with large FIs.*

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The Way Forward

Internal utilities, which have been not received due attention till date, are now being viewed in a different light. Financial services organizations realize that key functions like reconciliations, fraud and payments can be brought under this umbrella; and that internal utilities present important opportunities for cost savings with improved controls.

Utilities, if done correctly, represent the next level in outsourcing by combining IT + Operations, and hold the promise of delivering significant bottom-line and process impact over a period.

About the Author

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Abhijit leads the Financial Services Solution Design team at Infosys BPO. He has close to 12 years of experience in the IT/ITES industry. Abhijit has been instrumental in developing BPO solutions in the Banking & Capital Markets space, besides handling RFP/RFI responses and client visits. He is a Post Graduate in Management with a graduate degree in Physics.

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