Time for an Overhaul
Network Management at a Turning Point

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EXECUTIVE SUMMARY

The role of the network manager within global custodians, broker-dealers and other financial institutions has changed remarkably over the past few decades. The nature of the work has expanded from the selection and periodic monitoring of a network of agent banks to encompass significantly higher levels of governance, risk management and cost control. In the face of increasing commercial and regulatory pressures, the network management function is becoming critical to an increasing number of areas – operations, legal, tax, finance, risk and compliance – yet practitioners often lack the tools to rise to the new challenges.

Network managers are fast becoming responsible for the complete command of information, conducting its flow from market origin to its application as intelligence for managing external relationships, risk and fees. It is now imperative for these executives and their institutions to drive better co-operation across departments – and to apply new tools to reduce their day-to-day administrative burden so that they are best placed to add value to the institution and its clients.

The network management function is at a turning point: it must become a focussed and organised department which is front and centre of the new banking generation.

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Introduction

How has network management changed over the years? How successful has the function been in meeting new demands? Which perennial challenges have gone unaddressed and which opportunities remain untapped?

Here we will address these questions, setting out the context in which the role of the network manager has steadily evolved and the critical business issues driving the need for further change.

We bring to bear direct experience gained at leading banks, working in and with network management teams. This combines with our firm's 15-year track record working exclusively for financial institutions of all flavours, shapes and sizes on projects with network management at their core.

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Context

From a support role...

A generation ago, network management was most commonly an *ad hoc* function performing a support role. One individual, or a small team, would typically oversee a wide array of agent banks, taking responsibility for reviewing and selecting new providers, collating local market information and performing due diligence on a periodic basis.

Growing demands

As the universe of investable markets and assets has grown, so networks and network teams have steadily expanded. But there have been several much more significant step changes in the demands placed on the network manager. Increased attention to custody and depository risk, along with the advent of Service Level Agreements, has introduced more rigorous monitoring of each supplier. The 1990s saw the advent of in-region network management teams to cater for enhanced day-to-day responsibilities.

The emerging markets crashes of 1998 and beyond hit revenues, as did the 2000 to 2002 dotcom crash, and pressure came to bear on network management departments. Many faced structural change, as banks and brokers typically sought to implement more targeted and cost-effective arrangements for their agent networks. Counter-intuitively, this presented network managers with a chance to flourish – as their organisations began seeking to manage more effectively their relationships with affiliates, partners and providers.

In the early days, a network would handle only equities and bonds; the growth of derivatives and other instruments has added layers of complexity to the network manager's obligation to possess a fundamental understanding of each market and its settlement and clearing models.

Information is all

With the volume of data increasing exponentially, often accelerated by technology, the immediate availability of information soon became the key to a successful network management department. But the 2008 financial crisis threw into sharp relief the fact that the information was often poorly organised, fragmented and incomplete, failing to provide a comprehensive picture or to make available at short notice the level of detail required.

Post-crisis, the new regulatory regime presents a quantum leap in the network manager's obligations and adds yet another layer to the challenges faced by each organisation.

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The challenges

During the last 15 years, the network function in many institutions has struggled to find its rightful home. The migration from support role to a governance and control function, while gradual, has been significant. Crucially, network management has become inextricably linked to an increasing number of areas – including compliance, risk management, legal, tax, finance and operations. This has placed ever-increasing demands on network managers and their staff.

The standard response to the increasing workload has been to hire more staff, with productivity-raising measures limited to the use of spreadsheets and simple databases. Too little has been done to help staff work smarter, not harder – to command, control and coordinate all the associated information.

With regard to agent bank networks, organisations face a series of critical challenges.

Command and control

Sound management principles require command, control and co-ordination of all static data on agent banks and all information on each market and its clearing and settlement models. Key drivers of efficiency include the standardisation of procedures for selecting and monitoring agent banks along with effective fee negotiation, control over invoices and recharging of fees.

Risk management

Guarding against the potential loss of client assets, the potential loss of data, the potential inaccuracy of data and, ultimately, risk to the organisation's reputation, is becoming increasingly important. The availability and efficient organisation of information is essential for effective risk management.

Regulatory pressures

The more complex modern regulatory environment (including AIFMD, UCITS V and FATCA legislation) is adding significantly to documentation, processing, custody, issue-tracking and report-generating headaches. It typically falls to network management to govern the operational delivery of regulatory compliance at many points in the service chain, internal and external.

Responsiveness

It's no longer enough for information to be on file; it needs to be directly and immediately available, in appropriate report form, to the departments that require it.

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Limited resources

Banks have to find a way to do much more without a corresponding increase in human resources. The only sensible conclusion to draw is that existing teams, even expanded teams, still need the addition of clever, purpose-built technology which boosts the capacity and productivity of network management and its peer functions.

The solutions that appeared adequate in the past are now widely seen as archaic. In the face of growing commercial and regulatory pressure, they are simply not fit for purpose. Management must put in place a structure which enables network management and its peer functions to meet the significant new challenges, deliver added value and support growth in the organisation's asset base.

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A new emphasis

Network manager as a conductor of information...

In the aftermath of the 2008 financial crisis, as banks rushed to put their houses in order, it became clear to many that the network management function should be the window on the world to the organisation's supply chain of agent and correspondent banks, depositories and other market infrastructure. Organisations looked to the network manager to take on the role of immediately conducting information to senior management on all external relationships – even though the tools to perform this role were, and often still are, dangerously flawed.

...with a key role

The network manager must play a key role in managing exposure to external relationships and manipulating all associated information into intelligence. Those organisations which still regard the network function as subservient to operations are labouring under a misconception. The network manager's role warrants a place on the executive team – an equivalent function to compliance, legal and risk.

The network management team should be better placed to add value for the business, allowing it to monitor, interpret and respond to shifts in the legislative, political and economic landscapes of each traded market and manage effectively the implications of new regulations on investment servicing. Failure to be on top of these changes would likely damage a bank's reputation.

Tactical 'solutions' are no solution at all

In this complex environment, it has become essential that the network management function moves on from makeshift, tactical solutions such as hiring contract staff and using *ad hoc* spreadsheets and databases. These apparent solutions, far from driving down costs, only serve to embed inefficiency, increasing the administrative burden and preventing management from having a clear overview.

Some institutions have tried to build in-house solutions to support their network management function. However, these solutions are still labour-intensive at the operational level, because they address only isolated processes within the function. They also add a fresh layer of cost overhead in the form of technology development, maintenance and hosting. In-house solutions lack the breadth and depth of a purpose-built solution, take far longer to 'get to market', are often obsolete on delivery (if indeed satisfactory delivery is signed off) and, fundamentally, cost more money.

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Ask shareholders a simple question: would you care to fund an in-house development which costs five times as much as an off-the-shelf solution and which delivers one tenth of the functionality over the same delivery period?

Persistent change is the *only* solution

What's required is a long-term solution to facilitate visibility, control and application of all information. It should roll up all aspects of the function into a coherent and integrated platform that drives down both cost and risk, reduces the day-to-day administrative burden and frees up staff to deliver added value. It should also do a great deal to make sure that accumulated knowledge persists and does not walk out the door when a network manager leaves the firm.

With very few exceptions, the industry has failed to grasp the nettle and make persistent, long-lasting changes to underpin the network management function for the next ten years.

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In conclusion

As regulation, risk and control reshape the future of network management in financial services, its practitioners are no longer simply equity-dominated experts on worldwide markets, fee re-negotiators or managers of a support service. They have instead become important components of the risk management process, tightly aligned with the compliance teams, critical experts on global market structures across multiple asset classes and business executives accountable for sound contracts, optimum fees and timely, reliable market intelligence.

Network managers must have the commercial awareness to understand provider balance sheets and structures and decide whether buyer and supplier strategies are compatible. They must oversee knowledge transfer and persistence, and ensure business continuity, often in situations and scenarios which have not happened before.

Banks and brokers need their operations to function more efficiently, sustainably and cost-effectively. Across the institution, investment is required in the right solutions to drive up operational capability and profitability. Network management is one area in which sound technological investment has been missing for years.

Network management needs 21st century technology to meet 21st century challenges, to ensure that custodians and agents provide the best possible service and that risk is kept in sharp focus and to a minimum.

The technology is there: proven, ready and waiting.

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