

# THE FUTURE OF SECURITIES PROCESSING IN GERMANY AND AUSTRIA

**Securities processing in major European markets, such as Germany, is following the trend of consolidating and outsourcing business processes to centralized external providers. In this article, Patrick Zauner and Andreas Thäwel, experts for securities processing, examine this trend and consider whether the Austrian market can expect a similar development.**

Across all major banks, brokerage and post-trade processing functions have always faced severe regulatory, optimization and other challenges tied to their operating models. However, the possibilities offered by new technologies and reduced cost of trade execution on the one hand, and declining margins on the other, have raised the pressure to optimize and standardize both products and processes. This trend has reached a stage where most organizations now use one of the few standardized software products available on the market for processing their securities.

In the next wave, we expect that organizations will cut costs and headcounts in their operations divisions and partly outsource those services to a separate service entity.

The Austrian market, however, appears to be trending in a different direction, with the bundling of operations activities into internal service units, mainly within major Austrian banks. By contrast, smaller organisations have already adopted a different model, choosing to outsource existing operational activities to external utilities. The potential for the consolidation of respective internal processing units into a centralized cross-institutional utility has been on the agenda for Austrian financial services for over a decade, though no major decisions have been taken so far.

## WHEN IS OUTSOURCING DESIRABLE?

A long-term securities processing strategy of a bank can only be defined in the context of the overall banking strategy. The main aspects of such a strategy are the organization's positioning, its IT strategy, and the growth strategy.

The major question for a firm to ask here is: **Do we see ourselves more as a sales, product, and client focused organization or as an operational powerhouse for processing and back-office excellence?**

The analysis and strategic insight required to answer this question can be used to think about the potential desirability of outsourcing of securities processing. This would involve a review of the IT architecture, the cost and margin situation as well as a process review to identify potential room for automation and optimization.

As long as the organization does not position itself around scaling operations or offering transaction services to other firms, the securities processing unit is mostly likely to be a cost centre and will therefore be under continuous pressure to significantly cut costs and optimize architecture, processes and resources.

While the synergies of outsourcing are frequently discussed, the potential pitfalls must also be carefully examined and carefully integrated into strategic discussions: loss of control in regards to processes and technology, set up of additional governance structures as well as increasing complexity and costs.

# THE OUTSOURCING POTENTIAL

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An obvious reason to outsource is the **cost base optimization**. Financial institutions can expect long-term cost cutting from outsourcing their securities processing to a highly standardized provider, thus reducing the internal involvement in this area. This process is driven by economies of scale and synergies, as a transaction service provider can bundle securities processing for various institutions. In contrast to this short-term optimisation, the long-term cost impact on the end-to-end value chain needs to be considered diligently, as an increase in internal costs arising from managing the utility, as well as ensuring oversight within the organisation, will also have to be factored in.

Furthermore, the cost of regulatory change that affects securities processing can be split between all members of a servicing organization, therefore significantly decreasing the individual change-the-bank (CtB) cost. At the same time, the run-the-bank (RtB) side can be shared between multiple organizations, significantly reducing the required headcount per firm.

Aside from the direct cost implications, **technology** is another reason for considering the potential of securities processing outsourcing. Software has become an increasingly complex and fast changing component of long-term success in all

industries, including financial services. Each financial institution must develop a strategy for the handling of software and technological innovation. Building in-house capabilities and overcoming any scarcity of relevant expertise by attracting the right talent is becoming a significant cost factor and challenge, while outsourcing, on the other hand, could reduce dependencies and create flexibility.

Between those extremes, each bank needs to identify what technological know-how is a core competency and must remain internal, and which parts of the value chain can be outsourced, from a software and process perspective.

**Cyber security and IT compliance, data governance, data quality** and other factors are also increasingly becoming cost drivers that, when conducted in-house, create massive overheads to the underlying processes.

Outsourcing processes and systems can help reinforce the emphasis on key infrastructure within the firm and build excellence around that. Financial institutions will also benefit from being able to focus on major processes and client-facing interactions, while outsourcing the fulfilment solutions.

# THE NEXT STEPS FOR AUSTRIAN FINANCIAL INSTITUTIONS

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We believe that we are seeing similar developments in the Austrian market, but the local conditions are forcing Austrian institutions to take a different path, while heading in the same direction. Obtaining a better understanding of these

differentiating factors is key to determining the path forward for processing securities in Austria. Accordingly, a careful and fully transparent investigation of local conditions needs to be performed as a baseline for further strategic discussions.

The next steps for long-term securities processing strategies in the Austrian market, therefore, are:

1. Perform an assessment of current processes. This includes gaining clarity about the current operating model, dependencies, infrastructure, and team size. Also scrutinising the local conditions of the Austrian market and the specific situation and environment within individual institutions is a necessity to define the relevant steps for decision making.
2. Explore optimisation opportunities – as well as potential pain points associated with further consolidation efforts – to ensure all decisions are made on the basis of careful scrutiny, while also ensuring alignment with internal IT and business strategies.
3. Develop a clear picture about securities products (commercial banking products vs institutional products), including their impact on post-trade processes.
4. Calculate the cost of margins for securities processing, especially for non-standardized products. This would help create a view on sustainability and profitability of the business to the bank.
5. Drive strategic alignment of the overall strategy and IT strategy at senior management levels.

Once the above steps have been actioned, Austrian banks can initiate the actual review of a potential business case for outsourcing, supported by a detailed future target operating model design and clear cost calculations for the total cost of ownership across various potential scenarios.

The review of existing architecture and processes performed as part of the initiation effort can also be used to assess the potential for process optimization through harmonization, standardization, automation, or a reduction in product offerings. Conversely, the initial review and analysis for process optimization can create synergies for the case of outsourcing, as this is beneficial regardless of the outsourcing decision outcomes.

Capco has proven expertise and success record in supporting our clients along the securities processing journey and can support your teams in exploring the future of securities processing within your firm.

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