Digital Transformation in Corporate Services, Trust and Alternative Fund Administration

A dichotomy between belief and behaviour

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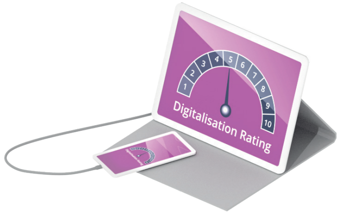
A DICHOTOMY BETWEEN BELIEF AND BEHAVIOUR



DIGITALISATION

5 out of 10

is how firms score themselves in terms of digitalisation

INNOVATION

92%

said that technological innovation in the industry needs to accelerate

CLIENT EXPERIENCE

8 out of 10

said their firm could be better at delivering a digital experience for clients

foreword

Welcome to TrustQuay's latest Future Focus Report, examining the drivers of industry change and the challenges and issues facing firms in the corporate services, trust and alternative fund administration sector.

In this year's survey, we find an industry acknowledging it is lagging behind other areas of financial services in terms of digital transformation, with a clear recognition that the industry needs to do more to accelerate technological innovation in order to increase efficiencies and deliver a better digital experience to clients.

However, our research finds an emerging dichotomy between belief and behaviour - while firms believe that automation and innovation should make them more competitive and more valuable, their current behaviour reflects a lack of definition and understanding of the return on investment from digital transformation, resulting in a barrier to action.

We hope you find this research paper interesting reading and please do get in touch if you would like to discuss any findings.

Keith Hale
Executive Chairman
TrustQuay

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Industry challenges remain

Top three business challenges:

- 1. Regulatory burden
- 2. Increasing efficiencies / reducing costs
- 3. Improving data quality

When we look at the business challenges facing corporate services, trust and alternative fund administration providers, it's interesting to find that the top 3 highlighted - regulation, efficiencies/costs and data quality - are all core business-as-usual issues. The same issues were highlighted in our 2020 survey, showing that the industry is still dealing with getting the basics right and there remains much to be done to address these fundamental issues.

The strain on firms to deliver the requirements of regulators was named the top challenge this year, cited by 78% of respondents. While regulators have made strides to digitalise their interaction with firms, many firms have not kept pace, trying to fit old manual processes around new regulations. For firms who have successfully digitalised their business models, the regulatory burden can be reduced, for example by automating workflows associated with the likes of Economic Substance compliance reporting, as well as other automated interactions with regulators such as the JFSC and CSSF.

> ***The root cause of these business challenges lies in poor data quality, lack of automation and wider digitalisation within the industry. The technology needed is largely already available today but firms need to proactively invest to make the fundamental changes to reap the benefits.***

Second on the list of challenges was the need to increase efficiencies and reduce costs, chosen by 66% of respondents. When it comes to the issue of efficiencies and costs, again the reliance on manual processes creates limits on what can be achieved, creating a situation where some firms are simply allocating an ever-increasing amount of human resource to cater for current manual unautomated processes. For example, automating KYC and AML processes through digital onboarding is not only more efficient but also delivers a better client experience.

Coming in third was the need to improve data quality, named as an issue by 44% of those surveyed. This problem often stems from firms relying on unautomated functions combined with numerous, fragmented and poorly connected legacy systems, a situation that is often exacerbated greatly due to mergers and acquisitions.

These top business challenges highlighted are endemic across the whole of the corporate services, trust and alternative fund administration industry. While some players have made more progress than others in terms of automation, including some regulatory functions, there is a lot more to do particularly with digital engagement with end clients for the industry as a whole.

Consolidation is increasing

81%

think industry consolidation will increase over the next 2 years

A key aspect of acquisition is integration. I think today when making an acquisition or considering one, the technology aspect in terms of the platforms can perhaps be as important if not more so than the brand being acquired.

Phil McIlwraith | *CEO and Group Head of Trust & Fiduciary Services*
Kleinwort Hambros

Consolidation remains a continuing trend in the corporate services, trust and alternative fund administration sector.

The industry remains very fragmented compared to other parts of financial services, consisting of the top 50 larger global or regional players largely born out of private equity backed mergers and acquisitions, plus thousands of much smaller independent firms which focus on one or a very few jurisdictions or specialist functions. Alongside these, there are several banks who have chosen to retain an in-house trust administration division, often associated with their wealth management or private banking function, who are typically less engaged in the ongoing industry consolidation.

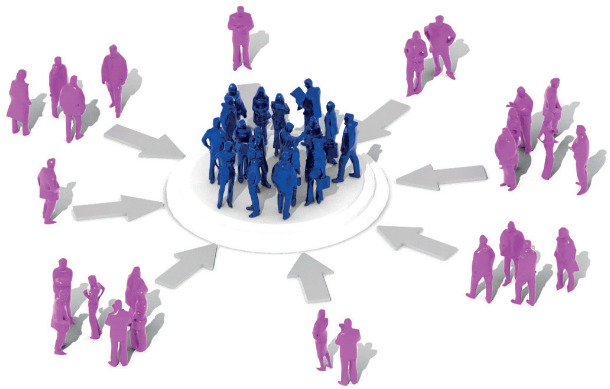
In this year's survey, 81% of respondents said they expected industry consolidation to increase over the next two years, but only a third (34%) saying they expected consolidation to increase significantly. This compares to our 2020 survey, where significantly less (only 59%) of respondents said they expected an increase in consolidation.

> ***While it is clear that the ongoing industry consolidation will be a continuing trend, the potential for a highly accelerated feeding frenzy of M&A is yet to materialise.***

We also asked respondents how many acquisitions their firm had completed in the last year, and the results point to accelerating polarisation between larger and smaller players.

Nearly two-thirds of firms reported no acquisition activity. Of those firms active in M&A, the majority (61%) had only completed 1-2 acquisitions, 22% did 3-5, with relatively few firms (17%) executing more than 5 acquisitions. These results are linked to the size of firms - smaller firms are being less acquisitive, instead focusing on being specialist providers offering a very high value, high touch service to clients. Larger firms are actively using M&A as a means of building global scale or strong regional/specialist capability.

For some time to come, it appears that M&A will therefore remain an ongoing theme within the marketplace. Industry feedback suggests that a key factor in the success of M&A projects is the ability to successfully integrate different businesses in order to rapidly deliver the hoped-for synergies and cost savings, thereby continuing to outpace fellow consolidators.



Technology investment is lagging behind

- **5 out of 10**
  is how firms score themselves in terms of digitalisation

- **Half**
  of the industry believes it does not invest as much in technology as other sectors of financial services

I am still amazed to see how manual the industry is when it comes to consolidating financial information for clients. However, there is no doubt that digitalisation and automation will accelerate in the coming years.

Stefan Liniger | *Chief Executive*
Kaiser Partner Wealth Advisors

We asked corporate services, trust and alternative fund administrators to rank on a scale of 1 to 10 how digitalised their firm was currently. The average was still a modest 5 out of 10, which shows no improvement on last year's industry self-assessment. This indicates that the industry knows it still has a long way to go on its digitalisation journey.

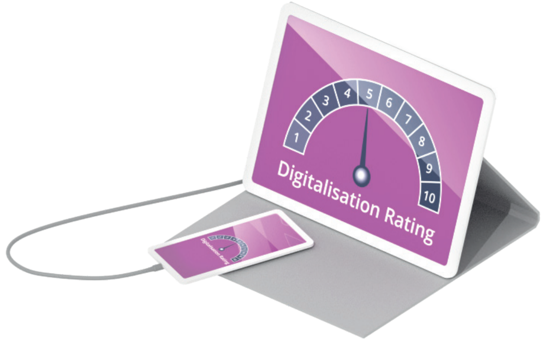
We also researched the industry's views on its investment in technology compared to other sectors of financial services. The results were very interesting, and divided; 47% of respondents felt the industry did not spend as much as other sectors, but a majority of 53% thought the spend was similar or more, which simply isn't the case.

Research in the banking sector has found that the typical spend of companies as a percentage of revenue was between 7%-12%. Our research based on customer feedback has identified the typical corporate services, trust and alternative fund administration spend is at best between 4%-6%.

> ***Industry comparisons show that the corporate services, trust and alternative fund administration industry lags way behind other sectors of financial services in terms of investment in technology.***

The relevance of this is that research by Bain & Company concluded that financial services companies that spend in the upper quartile to become digital leaders delivered higher revenue growth - more than double that of digital laggards - with a similar pattern for margins and profitability.

What's emerging from our research is a dichotomy between current beliefs in the industry and firms' subsequent behaviour with regard to the perceived value of digitalisation. We examine this in more detail in a later section.



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Accelerating innovation

92%

said that technological innovation in the industry needs to accelerate

Top 3 areas of innovation:

1. Automating manual processes and workflows
2. Client reporting
3. Client portals

Like increasing consolidation, accelerating innovation is becoming a clear and growing trend in the corporate services, trust and alternative fund administration industry. When we asked respondents whether they felt technological innovation needed to accelerate, a resounding 92% said it was an issue that now had to be addressed. The top 3 areas of innovation for firms identified over the next five years were automating manual processes and workflows, improving client reporting and increasing engagement with clients through portals.

When we asked firms which areas of their business would benefit most from automation, the responses were things that are now commonplace within financial services. The top areas named were either to do with regulation (regulatory filings and compliance monitoring) or client reporting and engagement (client accounting, AMC/KYC checks and client onboarding).

Using automation to reduce the reliance on people increases the accuracy, reduces the need for operational staff, and is less repetitive for those working within the firm, while also reducing costs for the business and for the end-client. However, the challenge is that there remains much room for improvement in terms of digitalisation and automation within the industry.

> ***In other sectors of financial services, automation has become almost a hygiene factor rather than an area of specific innovation. But for corporate services, trust and alternative fund administrators, while better automation through technology is available, this is an area where the industry is behind.***

In terms of end-client engagement, there appears to be a clear desire within the industry to accelerate improvements, but improving automation of operational functions to be on a par with other sectors of financial services is a key focus. The benefit of automation will significantly improve business processes through digitalisation and become a cornerstone for firms to remain competitive, profitable and attractive to clients in the future.

A move to SaaS

An additional area of innovation we researched in this year's survey was the industry's attitudes with regard to cloud applications and firms' preferences for deploying software. The results were interesting and show a wide spectrum of preferences, from proprietary server rooms through to a full software as a service (SaaS) model.

Currently, a third of firms surveyed say they prefer to retain their own server room, however half of firms now have a preference for cloud deployed applications, split between either a private cloud hosting or public cloud infrastructure as a service (IaaS) deployment such as AWS or Microsoft Azure.

For fully-fledged software as a service deployment, where not only the infrastructure is shared but the full application is used on a multi-tenanted basis across firms, currently only 15% of firms named this as their preferred method of deployment. However, moving forward we would expect to see an increasing preference for a SaaS model as has happened in other areas of financial services.

While IaaS and particularly SaaS deployment are at an early stage of acceptance, firms surveyed fully recognised the benefits, naming automatic and continuous upgrades, ease of access, not having to manage hardware and lower total cost of ownership as the significant benefits over more traditional on premise or hosted deployment. These major benefits will no doubt increase the preference for these models in the coming years.

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Clients are now expecting more

- **8 out of 10**
  said their firm could be better at delivering a digital experience for clients
- **Half**
  of firms plan to digitalise their business and client engagement in the next two years
- **Only 16%**
  of firms have a client portal in place... but nearly half of firms are considering implementing a client portal

Increasing client engagement through client portals not only improves the client experience, it also optimises running costs by allowing employees to focus on other types of work that add more value, grow revenues and improve margins.

Christelle Theurillat | *Partner - Head of Operations*
Stonehage Fleming

A key catalyst that is driving forward the digitalisation of the corporate services, trust and alternative fund administration industry is the rising expectations of clients.

Our survey found that 8 out of 10 respondents felt their firm could be better at delivering a digital experience for clients, with half of firms planning to digitalise their business models and engagement with clients in the coming two years.

> ***As the intergenerational transfer of wealth moves to digital native generations, corporate, private wealth and fund clients expect the ease of access, speed of response and intuitive digital interaction they experience as standard in other parts of financial services as well as other industries.***

Increasing engagement through client portals is now firmly on the agenda. Three-quarters of firms have now recognised the benefits of a client portal, but only 16% already have a portal in place so far. Another 14% are in the process of implementing and a further 46% are considering doing so in the future.

The top features of client portals that were seen as the most valuable were functions such as entity information, document sharing and billing and invoices. There is also growing interest in 2-way digital interaction with clients such as onboarding through KYC document scanning and identity verification, and other interactive digital workflows.

It seems that while client portals are still in the very early stage of implementation within the industry, firms are clearly recognising the increasing client demand and expectations. The two-way interaction and ability for clients to self-service not only improves the client experience but also significantly increases efficiencies.

In the coming years, we therefore expect to see a rapid increase in the rollout of client portals as firms digitalise their offerings. With increasing demand from digital-native clients to access information and services digitally, we expect the vast majority, perhaps as much as three-quarters of the industry, to offer client portals to enable digital engagement with their end-clients within the next 3 years.

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The value of digitalisation

- **78%**
  believe that companies that are digital leaders are more competitive and more valuable than those that are digital laggards... but only 6% felt that their firm was a digital leader

- **95%**
  believe that technology should be viewed as an investment in growth rather than just a cost... but only a third think their firm spends enough on technological innovation

> *For me, the value of technology is very much driven by how much that technology component contributes and supports revenue growth, improves margin and materially drives the enterprise value of a company.*
>
> Christiaan van Houtven | *Group COO*
> **IQ-EQ**

When it comes to the industry's view on the value of digitalisation, there's clearly a dichotomy between belief and behaviour. The vast majority of respondents (78%) believe that companies that are digital leaders are, as a result, more competitive and more valuable than their peers. However, only 6% felt their firm was actually a digital leader.

The same dichotomy is true when it comes to attitudes to technology. Nearly all respondents (95%) said that technology should be viewed as an investment in growth, but only a third (32%) said their own firm spends enough on technological innovation.

> ***Without the use of specific KPIs, it is not a surprise that many firms agree that they see the wider benefits of digitalisation, but lack a clear definition and understanding of the return on investment it can bring.***

We also asked firms about the KPIs they use to assess the return on investment from technology, and whether they use metrics which are common in other areas of financial services such as technology spend as a percentage of revenue, average revenue per employee and utilisation rate (in other words the percentage of time that staff spend on revenue-generating activities).

It was interesting to find that these metrics are currently not well known or utilised within the corporate services, trust and alternative fund administration industry, with between 45% and 63% of respondents choosing the 'Don't know' option when asked about each KPI in relation to their own firm.

While specific KPIs are being adopted in some parts of the industry, the widespread dichotomy between belief and behaviour appears to be acting as a barrier to action, and therefore an obstacle that is preventing firms from enjoying the benefits to the bottom line that digitalisation can bring.

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Conclusion

The findings of this year's Future Focus Report show an industry that is lagging behind other areas of financial services in terms of technological innovation. But the urgency and importance of automation and digitalisation is clearly recognised among players, with nearly all firms agreeing it needs to accelerate in order to increase efficiencies and deliver a better digital experience to clients.

But progress is slow - only a relatively small percentage of firms have to date implemented a client portal and industry spending on technology as a percentage of revenue is currently well below that of other areas of financial services.

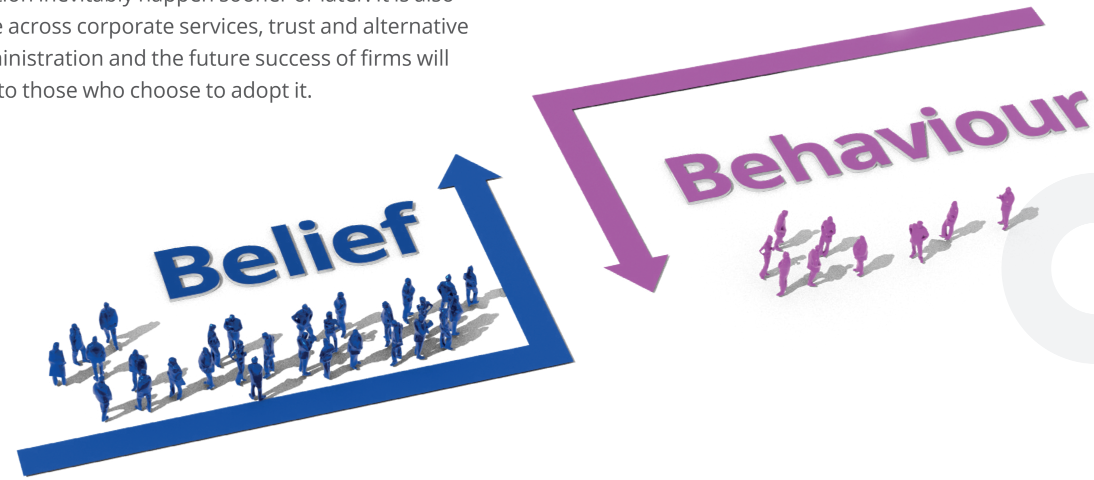
While there is clear evidence from other sectors that digital leaders deliver significantly higher revenue growth, margins and profitability than digital laggards, there appears to be a dichotomy between belief and behaviour within corporate services, trust and alternative fund administrators. Even though nearly all firms believe technology should be viewed as an investment in growth, rather than just a pure cost, only a third of firms feel they are investing the right amount in innovation.

This is not down to physical barriers. The technology already exists and is ready for adoption within the sector and other areas of financial services provide a clear template for the business case for digitalisation, and the proven metrics in which to gauge success.

What appears to be the root cause of this lack of progress within corporate services, trust and alternative fund administration is that firms are still struggling to appraise the costs and financial benefits associated with automation and digitalisation. As a result, they are currently unable to fully understand or assess the return on investment delivered and the benefits that will flow through to the bottom line.

More work therefore needs to be done to change attitudes and technology providers need to help corporate services, trust and alternative fund administrators by providing the tools and capabilities to make a clear assessment and business case for investing in technology.

In any industry, the reality is that automation and digitalisation inevitably happen sooner or later. It is also inevitable across corporate services, trust and alternative fund administration and the future success of firms will be down to those who choose to adopt it.



Methodology:

TrustQuay conducted a global survey of 100 wealth managers, private banks, family offices, corporate services providers, trust and fund administrators in July 2021.

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Summary of key findings

CLIENT EXPERIENCE

8 out of 10

said their firm could be better at delivering a digital experience for clients

DIGITALISATION

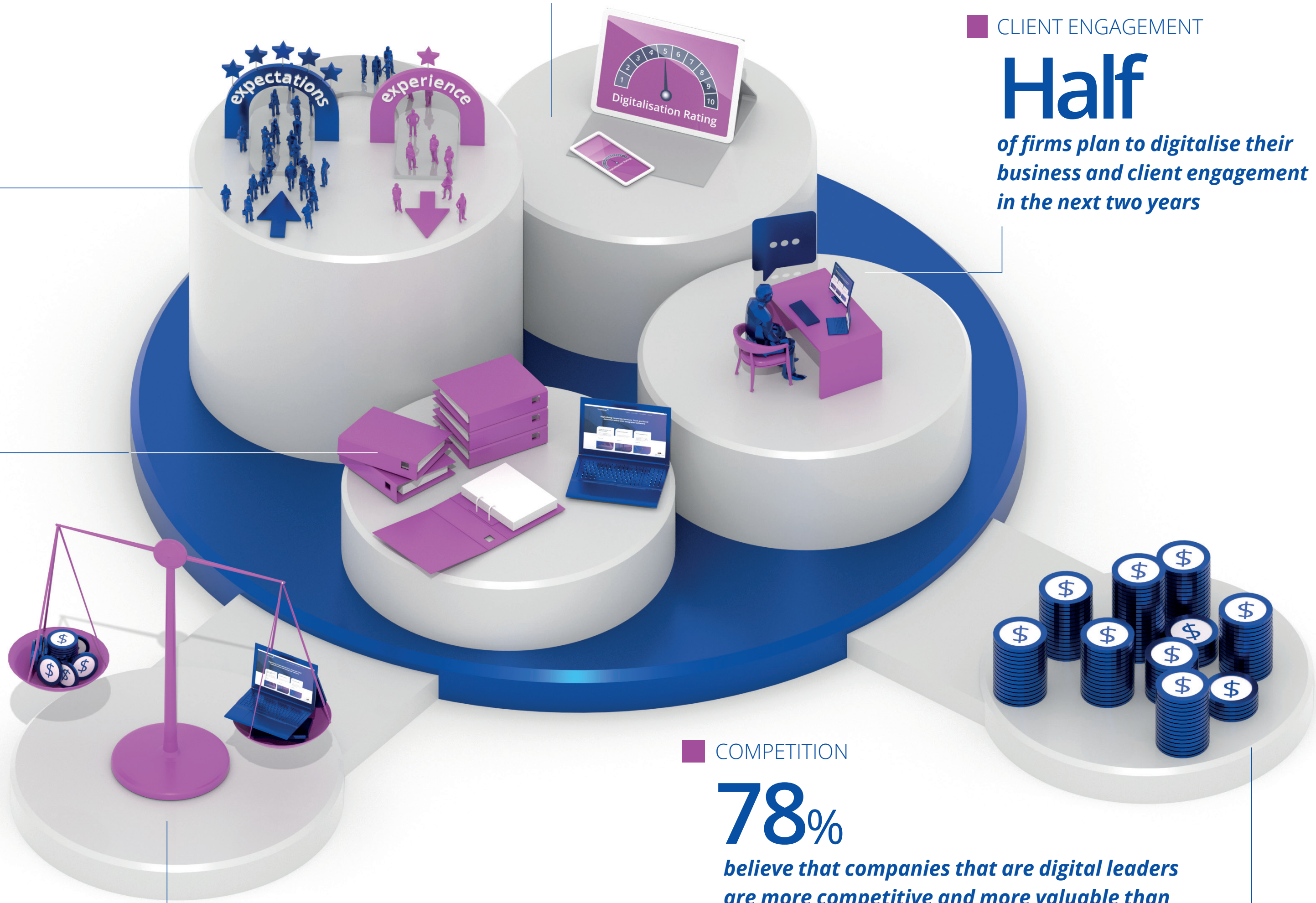
5 out of 10

is how firms score themselves in terms of digitalisation

CLIENT ENGAGEMENT

Half

of firms plan to digitalise their business and client engagement in the next two years



INNOVATION

95%

said that technological innovation in the industry needs to accelerate

VALUE

95%

believe that technology should be viewed as an investment in growth rather than just a cost... but only

32%

think their firm spends enough on technological innovation

COMPETITION

78%

believe that companies that are digital leaders are more competitive and more valuable than those that are digital laggards... but only

6%

felt that their firm was a digital leader

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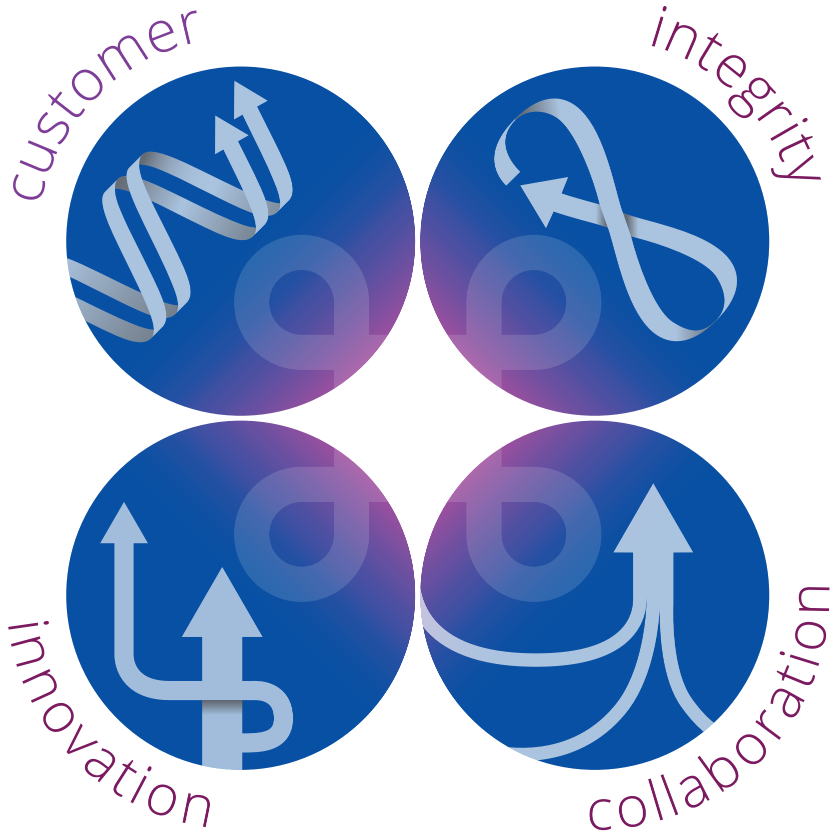
Your trusted software partner for digitalisation



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