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European Financial Firms: It's Time to Partner Up

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Working together is not something financial firms have always found easy to do. In the regulatory era of MiFID II, Brexit and Trump, however, there is a renewed need for the capital markets industry to share costs on duplicative tasks, particularly through utility-type models. Furthermore, partnerships with fintech companies – which offer access to emerging enterprise-ready technologies such as cloud computing, blockchain, and big data – can act as key enablers of beneficial change.

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Working together is not something financial firms have always found easy to do. The risk of leaking competitive information to rival firms, the potential of losing revenue they might otherwise have been able to keep to themselves, or just plain old hubris have always held firms back from collaboration.

But times are changing.

In the regulatory era of MiFID II, Brexit and Trump, there is a renewed need for the capital markets industry to share costs on duplicative tasks, particularly through utility-type models.

Furthermore, the emergence of enterprise-ready technology – such as cloud computing, blockchain, and big data – is enabling a level of change that did not previously exist. Once viewed as a threat in wholesale markets, partnerships with financial technology (fintech) companies, which offer access to these new technologies, act as key enablers of beneficial change, helping companies provide a better experience to clients and freeing up resources for other long-term business initiatives.

TABB Group believes greater collaboration is one of five key themes that will dominate Europe's capital markets industry in the coming years. The others are consolidation, specialization, electronification and globalization.

The main catalyst of these changes is coming in a little over six months' time, when the European securities market will be turned on its head by the revised Markets in Financial Instruments Directive and attendant Markets in Financial Instruments Regulation, collectively known as MiFID II. The first MiFID brought competition and greater transparency to equities markets; this second version applies to all asset classes, and affects everything from the way investment research is purchased to how trades are reported.

But there's more: New clearing mandates continue to take effect under the European Market Infrastructure Regulation, designed to shore up derivatives markets. Add in new capital and market abuse rules, the upheaval caused by the UK's decision to leave the European Union, and new political administrations across the globe, and it is the perfect recipe for creating challenged business models.

One thing is for sure, though: Complying with new regulations is at the top of every firm's agenda – and it is driving key strategic decisions.

Doug Cifu, CEO of Virtu Financial, said recently that MiFID II was a driver behind his organization's acquisition of rival trading firm KCG Holdings. The comments reflect just how onerous MiFID II will be – the rulebook will accelerate existential decisions within organizations – about which activities to focus on, and those they should exit altogether.

A picture continues to emerge in the capital markets industry of a barbell structure, with a handful of truly global banks at one end, and niche providers at the other – both enjoying profitable businesses. Life is most difficult for the firms languishing in the middle, unable to gain scale or a specialist focus.

The regulatory agenda in Europe is dominated by a need for greater transparency, which has translated into a dramatic desire for more data, not only on transactions, but on trading counterparts, including clients and vendors.

Under MiFID II, for example, the number of fields required in end-of-day transaction reports will increase from 26 to an eye-watering 65. The new fields include personal details of the fund managers responsible for each trade. Given that many buy-side firms are expected to be reluctant to share such sensitive information with their brokers, it is highly likely that many will resort to reporting transactions themselves for the first time.

Such moves will cause significant shifts in the trading landscape, and it will come at a cost. The one-off cost for becoming MiFID II-compliant is expected to reach between €512 million and €732 million for the industry as a whole, according to estimates by the UK's finance ministry, HM Treasury. Ongoing compliance costs are set to hit between €312 million and €586 million.

This is not all bad news: It is clear there are competitive advantages for those firms that can get ahead of the changes, and for the technology firms that can help facilitate them.

The environment is ripe for more utility-type models – whereby a group of participants can come together to perform a necessary but non-differentiating task, freeing up resources for services that play to a firms' individual strengths.

The massive structural changes that are now sweeping the industry are also creating common needs in a much wider range of areas, such as trading, liquidity, and data sharing. The explosion in data volumes and new data requirements under incoming regulations, for instance, will be difficult for any single institution to manage alone.

Technology advancements have also reduced the barriers to entry of partnering up, allowing banks and others to join multiple initiatives to ensure they "back the right horse."

To learn more about the European regulatory environment, and how organizations are responding to it through partnerships and new technologies to meet compliance challenges and create competitive advantage, download a complimentary copy of TABB Group's latest research note, *"European Financial Markets – Preparing to Profit From Change,"* ***courtesy of SmartStream Technologies.***