

MARKET COMMENTARY

Capital Markets: The Three-Part Transformation Journey (2008 – the Future)

The past ten years have seen financial industries grapple with a tsunami of change. Capital markets organizations have been forced to overhaul their legacy technology to compete and remain relevant.



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The Transformation Journey

Traditional business models are no longer viable for today's landscape. Technological advancements are driving drastic changes in the competitive landscape and client behavior. These changes are the subject of research undertaken by Celent. We'll take a look at their findings later. However, first, let's take a look at what's been happening, what have been the drivers for change, and how organizations are reacting as a result.

Big Bang or Evolution?

At the time of the financial crisis, the knee-jerk reaction for many organizations was to dive headlong into resource-intensive, large-scale projects. The intention was to attempt to simplify their system architecture and improve performance.

However, these big bang transformation initiatives delivered mixed results. Organizations found their Return on Equity (ROE) failed to reflect their cost-cutting efforts, making it clear this approach wasn't going to provide the innovation and agility needed.

Therefore, capital markets firms are now embarking on a transformation journey by adopting a more evolutionary approach to overcome new challenges and future-proof their organizations.

Keeping Up with Moving Goal Posts

Of course, nothing is ever that straightforward. As their transformation journey continues, the drivers of change are evolving. Banks, therefore, need to adopt a flexible approach to their evolution so they can react quickly to regulatory or business needs.

By opting for smaller, incremental projects, organizations benefit from simplifying and rationalizing systems and processes resulting in greater agility and flexibility, decreasing risk as each step of the project focuses on specific targeted components or micro-services.

The Drivers of Evolution

As part of Celent's ongoing coverage of technology evolution in capital markets, they've researched the transformation journey at leading capital markets institutions.

Technology

Technology is revolutionizing trading; forcing banks to adopt electronic capabilities around connectivity, pricing, distribution, execution, and post-trade services.

As a result of digitization, it's altering client behavior, making client acquisition and retention more challenging. The flexibility and scalability of the Cloud is proving invaluable to resource-constrained firms. Especially considering the traditional concerns about security are being overcome by strengthening data security practices and strategic deployment by cloud providers.

Technology Transformation Initiatives at Top Capital Market Institutions

Capital Markets Transformation	Illustrative Bank Initiative	Bank
Business model change driven by regulatory and macro economic changes	• Exit from private banking in some markets, focus on core capabilities in equity derivative and cross asset trading	Tier 1 investment bank
	• Enhancing commodities trading capabilities for corporate clients and hedging products for private banking clients	Leading European Bank
	• Brought the equities and debt trading operations together for increased cross-selling opportunities and cost savings	Global Investment Bank
Operational and workflow adjustments to adhere to transparency new regulations	• Over half of technology spend is dedicated to safety and soundness controls driven by regulatory pressure	Tier 1 global bank
	• MFID II is a big challenge requiring changes in interfaces to over 30 FI trading venues	Regional European Bank
	• Multi-billion dollar investments including upgrading regulatory, conduct systems	Tier 2 global bank
Cost optimization to boost sub par RoE	• Multi-billion euro cost cutting plan over 5 years	Leading European bank
	• Billions of euro cost savings by 2018 through the digitalization of commercial distribution model	Tier 2 European bank
	• Efficiency programs including migrating all derivative infrastructure in a single platform	Large European bank
Digital capabilities to stay up to date with client behavior and market structure evolution	• Development of new algorithms to add to main execution offering for client value add	Regional European bank
	• Investments in eFX trading and mobile trading capabilities	Tier 1 global bank
	• Multi-billion dollar investment in emerging technology	Emerging market specialist



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Industry

The Financial Services industry has a long history. The legacy of numerous mergers and acquisitions are becoming a significant drag on performance. Many disparate systems and processes that are adding pressure on operations and workflow management weigh down organizations. Therefore, the need to adopt platformification of services has never been greater to give the flexibility needed to deliver the catalogue of services demanded from today's tech-savvy clients.

Regulation

Regulations are impacting business lines such as fixed income, currency, and derivatives. Regulations such as MiFID II and T2S are disrupting traditional business models. As a result, many banks are moving from the primary providers of liquidity and market-making to connected service providers. This creates challenges and opportunities for market players, but responding to them requires operational flexibility due to the rapid pace and high uncertainty over regulatory evolution.

Conclusion

Compelled by the impact of the financial crisis back of 2008, many of the world's leading capital markets firms have embarked on a technological and operational transformation journey in the last three to five years.

To compete effectively in this new ecosystem, we are seeing leading banks adopting a leaner and adaptive approach. Instead of 'ripping' out the old, they are gradually replacing legacy IT by developing new solutions and seamlessly integrating new assets through open APIs and microservices.

Of course, these new developments carry an element of risk. However, the risk of doing nothing opens the door for FinTechs and incumbents from adjacent industries.

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Source: Celent, 'The great transformation in capital markets: Revolution to evolution,' November, 2017.

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