Asia Securities Industry & Financial Markets Association

The Evolving Business Model in Financial Services: Innovation in Post Trade

RMPG Meeting

7 December 2016

The Financial Industry Innovation

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- From the 1970s into the 21st century, the financial industry was one of the most innovative of any industry in the world.
- Has innovation ended for good?
- If not, what form will future innovation take?
- Can the financial industry regain dynamism, or is will it be the rustbelt of the 21st century?

The Financial Industry has been Stunningly Innovative

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- First Products, concepts and structures:
- Financial futures and options--
  - Chicago produced currency futures, interest rate futures, stock index futures
  - Stock options at Chicago Board Options Exchange (CBOE)
  - Listed energy derivatives, first in New York, then around the world.
  - Etc.

- NY & London produced swaps, options, index futures, weather derivatives, etc.

The Financial Industry has been Stunningly Innovative-Cont'd

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- Next, in the 1980s and 1990s--technology
  - Mutual Offset System, CME and SIMEX, First international link between exchanges.
  - Globex, one of the first electronic trading systems
  - Eurex, first successful wholly electronic exchange
  - Late 90's: Algorithmic trading, later co-location

Innovation ended with the global financial crisis (GFC), replaced by regulation

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- U.S.—Dodd Frank, 2010
- Europe: Emir, MiFid
- Asia – Various
- Even a summary would take many pages
- Most comprehensive regulatory wave since the 1930s.
- Note: contrary to some popular claims, the financial industry as already one of the most regulated of any industry
  - There was no “deregulation”
  - Smart Regulation vs. More regulation

Sound Regulations have Benefits — All Regulations Have Costs

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- Types of costs
  - Compliance costs
    - One off costs, recurrent costs, capital costs, operating and maintenance costs, financial costs
  - Administrative costs
    - “hassle”/”irritation” cost
  - Indirect costs
    - Price changes, ripple effects, substitution effects, transaction costs, reduced competition inefficient resource allocation, reduced market access, reduced investment and innovation, increased uncertainty.
  - Enforcement Costs
- Survey (by ISAITC):
  - 96% say news regulations a “major challenge”
  - 25% expect them to have a “positive impact”

Sound Regulations have Benefits —All Regulations Have Costs

- S&P: Annual Cost of Dodd Frank $34 Billion for eight largest banks.
- Volker Rule: $10 Bill/year for 10 largest
- Macro:
  - BIS says euro 15-32 billion/year
  - Cost of all U.S. regs is 0.8%/year (Mercatus Center study; GDP since 1980 would be 25% higher
  - $10,000 per employee for all businesses (U.S. study 2012)
- Substantial Extraterritorial impacts
  - U.S. "persons" required to report all derivatives trades with names of both counterparties
  - EU rules require exchanges around the world to be deemed equivalent in governance, a form of extraterritorial licensing (article 25, Mifid best-ex)

South China Morning Post, November 6, 2016

Financial regulations have become the modern day Frankenstein's monster

Financial companies in Asia are spent US$50m last year in an effort to keep up with shifting regulations, according to Thomson Reuters

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South China Morning Post, 6 Nov 2016:

Sanjeev Chatrath, managing director of Asia Pacific and Japan of financial and risk of Thomson Reuters, said in the early days tracking regulatory changes meant 100 regulators worldwide and about 10 changes a day.

“Last year, **we were tracking 600 regulator making 50,000 regulatory rule changes annually. This is more than one change every 10 minutes. In Asia, there are 53 regulatory change every day**,” he said in an interview with the *Post* in Central.

The regulatory avalanche has its origins in domestic, international and cross-border policy to address volatile markets. Fintech, which refers to financial firms using technology to do their business in a more efficient way, is another growth areas for new regulation.

Chatrath said **compliance costs in Asia increased to US$50 million last year, a 20 per cent rise from 2014**.

Buried Yet?

The Industry's Innovative Spirit

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- Robert Schiller, 2013 recipient of Nobel in economics:
- ***"It is critical that we take the opportunity of the crisis to promote innovation-enhancing financial regulation and not let this be eclipsed by superficially popular issues… Regulatory agencies need to be given a stronger mission of encouraging innovation."***
- If we're to get a new era of innovation:
  - How
  - Where
  - What

Where to focus to rediscover dynamism:

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- The new innovation needs to help simplify complexity
- It needs to rationalize incompatibility
- The new innovation will have to create transparency where there is opacity and confusion.

It will depend on those who can understand and harness post-trade technology

- Industry developed an E-trading template in response to SFC E-trading rules.
- Then helped developed an electronic utility for efficient interaction with clients.
- Industry coordinated Shanghai Connect
  - There were multiple legal, operational and tax issues; need to meet with exchanges, regulators, ax authorities, etc. all on both sides of the border, develop documentation.
- *Needed: more industry coordination to harness technology.*

Next: Interactive "Utility"
For buy-side and sell-side use

- Industry "utilities"
- KYC
- AML
- Risk management

- Better yet, holistic rationalization of slew of U.S., E.U, Asian regulatory requirements that are too complex

Innovation is by definition unforeseeable

- Looking back 10 years from now, the most transformative force will likely be one that would surprise us.
- But some people will have the foresight and make it happen.

Shiller again--

- The initiatives developed by politicians in response to public anger have been shaped by what the public perceives as the problem, not by the contribution of visionaries.
  - Robert Shiller, Finance and the Good Society

The Role of Post Trade

- Much of the initiative on the necessary change will have to come from post trade professionals.

Questions and Answers

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Additional resources available at:

http://www.asifma.org