Facing the future: how embracing technology can help us keep pace in a competitive world

THREATS FROM THE EAST AND OUR OWN LEGACY ARCHITECTURE MAY LEAVE US LAGGING BEHIND IF TECHNOLOGY IS NOT EMBRACED

This report features commentary and expert opinion from financial stability, technology advances, regulatory impacts, mergers & acquisitions and investment experts from a recent NEX panel discussion in New York hosted by NEX CEO Michael Spencer.
FOREWARD

TEN YEARS ON FROM THE FINANCIAL CRISIS, THE STRUCTURES THAT GOVERN OUR FINANCIAL SYSTEM ARE FAR MORE ROBUST

While banks have grown in size and influence since the financial crisis of 2008, the systemic controls that have been introduced not just to reduce the risk of another major crisis but to deal with its effects are far superior. The system has been reformed substantially and should be better able to cope with future stresses.

THE THREATS THAT WILL FACE OUR FINANCIAL INDUSTRY IN THE NEXT TEN YEARS WILL BE DIFFERENT IN NATURE, BUT NO LESS SEVERE

While much progress has been made in addressing the threats of the past, new emerging threats threaten to undermine the success of our industry and leave it trailing behind newer disruptors. It is therefore crucial that technology be embraced to tackle the staggering inefficiencies that exist in financial services today.

This report highlights some of the key findings and discussions from the panelists:

- **Keynote Speaker:** Steve Wozniak, Co-Founder of Apple
- **Bill Ford,** CEO, General Atlantic
- **Jane Gladstone,** Senior Managing Director for Mergers & Acquisitions, Evercore
- **Doug Cifu,** CEO of Virtu Financial
- **Tim Massad,** former Chairman of the Commodity Futures Trading Commission
HOW HAVE THE WEAKNESSES THAT CREATED THE 2008 FINANCIAL CRISIS BEEN ADDRESSED IN THE PAST 10 YEARS?

The nature of systemic oversight has improved immensely, and today we have what can be described as a much stronger financial system. There is a greater amount of capitalization in the marketplace and today’s market-makers are primarily electronic businesses, not banks.

The markets are more efficient, providing better bid/offer spreads and transparency, and risk is transferred around the system more effectively. At times of poor liquidity, the system is likely to cope better than it did before thanks to the broader range in types of firm that make prices for the market.

Tim Massad, former Chairman of the Commodity Futures Trading Commission, who was one of the key architects of the Troubled Asset Relief Program (TARP) program that helped to save the United States economy from disaster during the crisis, said: “I think we are in a much safer place.” According to Mr. Massad, the reforms that have been implemented have occurred in five key ‘buckets’: Higher capital; better liquidity; stress testing; resolution planning and derivatives testing.

While great progress has been made in all these areas, resolution planning is one area in particular where there is further work to do. However, Mr. Massad also sounds the cautionary note that we have cut back on the emergency powers of the government to deal with future crises, such as the lender of last resort powers of the Federal Reserve bank.

THERE ARE WORRYING SIGNS OF PROTECTIONISM

One of the most effective elements of the response to the global financial crisis was countries around the world coming together to craft a coordinated response. Global support for reforms to the flawed Basel II global risk framework was widespread.

But today there are signs of a different trend. Trade wars between the major nations of the world are attracting headlines, and there are examples of politicians being elected on a mandate of imposing tariffs and other measures in order to put the immediate welfare of their own domestic workforces above global trade for the future.
Doug Cifu, CEO of Virtu Financial, pointed out that China recently implemented the ‘China depository receipt system’ to encourage businesses in the nation to issue shares in domestic markets rather than overseas.

In fact, the Chinese government appears to be resisting international participation in the success of its exciting financial technology innovation and taking all necessary measures to ensure such businesses are owned domestically. According to global growth investor Bill Ford, who invests a portion of his portfolios in innovation opportunities in Chinese businesses today: “I don’t think you will see many Chinese internet companies go public in the United States again – I think that is done.”

Furthermore, the European Union’s reaction to the United Kingdom’s decision to leave the trading bloc has showed signs of protectionism that threaten to undermine the global spirit of shared success.

**TECHNOLOGY ADVANCES ARE BEING UNDERUTILIZED**

One of the most striking problems with today’s financial services industry is its poor utilization of technology. The panelists agreed that the legacy technology platforms powering banks today are at least 20 years old in terms of sophistication.

The banking industry’s ability to compete in technology is relatively weak, particularly in light of the advances being seen in technology sectors not just in the US but in Asia.

*Jane Gladstone, Senior Managing Director for Mergers & Acquisitions at Evercore, said “the centre of gravity of fintech is migrating east.”*

“It is almost like what happened in wireless, where because we had more prolific landlines it took us longer to upgrade our wireless and the same thing is happening here. We are a victim of our own legacy technology framework and, frankly, our balkanized system of regulation. In China and in India they are absolutely leapfrogging us.”

Mobile payments and innovative insurance products are setting the pace in Asia. “We look very quaint in the United States from a fintech perspective compared to China and India,” added Ms. Gladstone.
Meanwhile, in the United States one of the biggest banks in the world currently has 43,000 people working in compliance roles alone. Ms. Gladstone said this was helping to make the banks “too big to manage.”

“If you ask a millennial if they would prefer to go to the dentist or to a bank, they say the dentist,” she said.

71% of millennials would rather go to the dentist than listen to what banks say.

The United States will likely lose its global financial dominance to financial technology innovators in the East if things do not change, according to the panelists. Political dysfunction, amid the drive towards nationalism, is only exacerbating this problem.

As Amazon begins looking to gain a banking license, it is time for financial services to sit up and listen to the need to embrace innovation in technology both from a consumer-services and international efficiency point of view.

**WHICH TECHNOLOGIES WILL BE KEY IN FUTURE?**

The market’s ability to provide liquidity in crunch scenarios is being tested by incidents such as the ‘flash crash’ of October 2014 in the fixed-income markets. Issues such as cyber crime, and so many companies being subject to hacking and distributed-denial-of-service attacks on their websites, are rising to the fore.

But computer processing power has exploded in might in recent years, and this is enabling a vast amount of numbers to be crunched in an infinitesimal amount of time. At the same time, accessing a large amount of computing power is falling sharply in cost.

While some financial institutions in the West are continuing to grapple with legacy systems and thousands of staff performing functions that could already be automated, there are innovative firms capitalizing on the availability of computing power to generate the technologies of the future.

*Mr. Cifu believes artificial intelligence (AI) is a key technology of the future. He said: “The marketplace is just so robust, so electronic and so fast that you have to be adaptive on a nanosecond basis. The AI has to be smart enough to react to what just happened to it.”*

As market-related data accrues at an astonishing rate, the amount of information that is both stored about market activity and that is flowing through markets on a nanosecond-by-nanosecond basis is simply too great for traditional systems to make use of it.
But in order to move into a true AI architecture, it is necessary to invest in systems that are capable of self-learning and teaching themselves to respond better to market events.

*Steve Wozniak, the Co-Founder of Apple Computer, wrapped up the event by pointing to the exciting future opportunities in areas such as blockchain.*

*Blockchain is decentralized and creates a trustable data ledger, and it has been realized that this can have remarkable real-world applications.*

*Mr. Wozniak said that one day a blockchain-type ledger system may even replace companies such as Facebook, with contributions made to a social-media type system such as images able to be priced using a ledger system so that contributors can potentially receive income from producing appealing content.*

Today, self-learning technologies are another example of how financial services institutions are lagging behind their potential interlopers in the financial technology world.

If 10 years ago the need was for better systemic regulation, today the clear risk for the 10 years ahead is the need for the industry to embrace intelligent technologies that can protect the prosperity of both themselves and their clients in the future.

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