A Marketer's Guide to Negotiating the Maze in Capital Markets Regulation

EMPOWERING B2B MARKETERS

FinTech MARKETING

Introduction

The FinTech B2B Marketing Community (FinTech Marketing) has written this paper to better support marketers in their responses to financial regulation. Keeping a close eye on regulatory announcements can enable an informed marketer to change tack on messages ahead of clients and lead them towards a more positive engagement.

Going forward FinTech Marketing plans to offer a subscription service for members, detailing new regulations and their potential impact on different players in the market. This guide outlines how to use that information to advance or modify marketing messages.

New regulation can bring in sweeping changes across entire industries or sectors of industries. Changes can be seen with the introduction of new operational methods such as clearing trades, changes to existing ways of operating for example changing capital requirements, or the creation of new categories of operation that may restrict or widen the definitions of acceptable activities, such as creating new types of trading venue. But regulation can also have unintended consequences.

Capital markets have experienced a tsunami of new regulation across the globe, starting from the early 2000s and peaking in the mid-2010s, as governance concerns grew and regulators moved away from the light touch oversight popular in the late 1990s. The ecosystem of markets and market participants is so interwoven that each element had far-reaching consequences.

For suppliers of services and software to the capital markets, the change resulting from new regulation creates a potential opportunity to support clients in their new operating model. They may need new systems, better data, lower costs or greater analysis in order to conform with new rules and to weather the storm that the changes bring.

This paper assess how financial regulation might be useful to marketers, in order to bring their product or service to market. It will cover:

- Players in capital markets;
- Their roles, relationships and tensions;
- Major themes in regulation, e.g. investor protection, transparency etc;
- Specific rules and categories, e.g. capital rules, market supervision;
- Where change occurs - operational impact, initial costs, technology support and timeframes for change;
- How services and tools can support that process of change;
- Key elements to understand, including positive and negative impacts on different stakeholders.

The players in capital markets

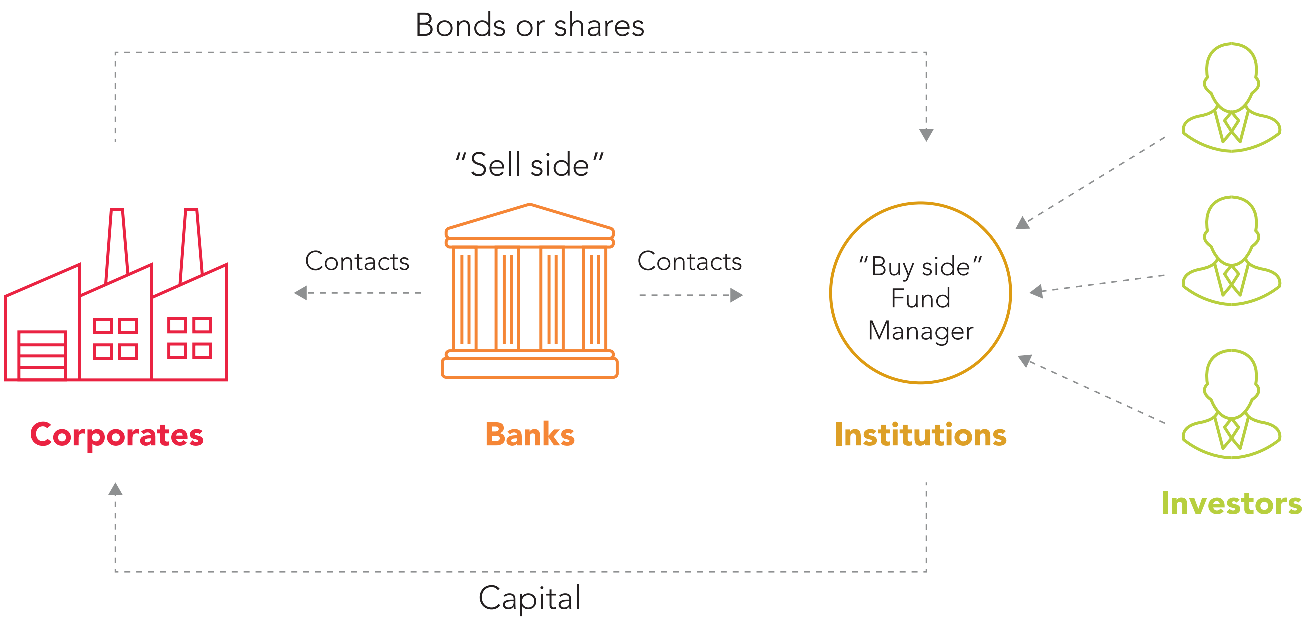
Capital markets are a complex clockwork of interlocking parts, and moving one piece has an effect on many others. A marketer may work for any one of these firms, so understanding these relationships is a precursor to analysis of regulation itself.

Understanding what constitutes the businesses in the market thus helps marketers to see the potential pain points that regulation can cause for clients, both directly and indirectly.

At a simple level, markets are made up of investors – the buy side – and the firms that sell assets to invest in – the sell side who are traditionally the investment banks who support issuance of securities, brokers and broker-dealers, but can also include firms that make markets for assets electronically.

Supporting those two sides is the ecosystem of trading venues, which bring them together, post-trade infrastructure, which manages risks in the market by providing reliable and resilient processing, and many technology and data providers to help traders and investors increase the efficiency of their actions.

Who are the players in corporate finance?



Source: Corporate Finance Institute

The buy side

Within the buy side is a range of different firms, including investment managers and hedge fund managers, who are largely trying to generate returns for investors by holding assets that deliver a return, by rising or falling in value and/or via payments of interest/dividends.

Buy side firms trade in the market in order to acquire these assets, and their level of trading typically reflects the time horizon over which they are expecting a return on assets. For example, a short time horizon equals higher frequency of trading.

The sell side

Banks that support the capital raising process (primary market) for issuers of equities and bonds also support the trading of those assets in the secondary market. Their clients are asset issuers in primary markets and the buy side in secondary markets.

Banks and other non-bank sell-side trading firms make returns in the secondary market by offering to buy/sell securities at a price that allows them to subsequently buy/sell those assets to make a return. The speed of turnover varies considerably, with some electronic trading firms executing many hundreds of thousands of trades at microsecond speed.

While banks are typically required to hold capital in order to balance their exposure to risk, other sell-side firms are not.

Trading venues

Trading roughly falls into two areas: over-the-counter (OTC) or bilateral trading, and multilateral trading.

A venue may support trading by introducing two firms who then engage bilaterally, as is common in bond markets, or by processing the trade via a central limit order book (CLOB) against all available liquidity in a multilateral manner, thus acting as an intermediary, as is common for listed securities such as equities and futures.

Exchanges are the primary market infrastructure for listed securities and provide access to any instrument listed on them on a multilateral basis. OTC markets typically have no primary market infrastructure, making issuance of instruments more manual and less standardised.

Post-trade infrastructure

Post-trade infrastructures, such as central securities depositories (CSDs) and central counterparties (CCPs) are typically run with limited to no competition for their services, these typically act as administrators for the exchange of assets to ensure that a trading firm’s failure has limited effect on counterparties, investors and the market more widely. They also reconcile records between trading parties in order to spot errors or unauthorised activity.

Technology and data providers

Finance is a digital industry and so trading, post-trade and compliance activity is supported by a great many technology firms who build databases, analytics tools, user interfaces and supply data to populate those systems.

Although these firms are often not suppliers of financial services, they can be impacted by the rules affecting their customer base and the operational risk parameters which customers are required to address.

Finding opportunity between participants

Buy-side firms invest capital on behalf of end investors and spend their own capital to support the investment process by paying the sell-side for services, paying fees to any venues and technology / data they use.

Sell-side firms generate profits by offering services to the buy side (including execution fees) across a range of asset classes, and by helping corporations to raise capital via issuance of securities.

Those sell-side firms are often members of trading venues, to which they also pay trading fees, and of post-trade infrastructure to support the processing of trades, and the sell side employs a considerable amount of technology and data.

Tensions exist in these relationships. There is the natural client-service provider relationship between buy-side and sell-side firms, sell-side firms and exchanges, exchanges and post-trade providers and technology/service providers across the spectrum. There are also tensions based on imbalances in information and risk transfer.

Opportunities for marketers exist within those client / supplier relationships, and at any point where there is a need to redress an information or risk imbalance.

Overview of regulation

Regulations aim to create uniform approaches or practices in financial markets, helping them to function in a fair and orderly manner. Rules affect what can be traded within markets, how it is traded and how risks associated with that activity are managed, with any failure in process triggering revisions of existing, or the creation of new, rules.

The main drivers for regulation are transparency and disclosure; support for competition and innovation; risk mitigation and prevention; and standardisation.

Any one regulation will contain elements of each theme. For example, capital adequacy rules, which determine how much capital a bank must hold to mitigate risks it is exposed to, are clearly designed to mitigate risk but the calculations required to make those assessments in 2020 are far more standardised than those required by capital adequacy rules in 2007, prior to the credit crisis. Equally, there are levels of disclosure required, along with stress tests in certain cases to demonstrate or test compliance.

Historically banks had been given more autonomy to implement the rules based on the 'light touch regulation' principle. When it become apparent that risks were being inconsistently or even mismanaged in the 2008 crisis, leading to systemic economic risks, more deterministic rules were imposed.

Categories of regulation

For the purposes of marketing activity, these rules can be broadly categorised into the following areas:

- Democratising markets
- Capital versus risk
- Protection from misbehaviour
- Regulatory regimes

Democratising markets

These remove rules / barriers that limit access to trading and post-trade choices, including access to pricing.

Examples include:

- MiFID I[1] (which allowed trading of listed European equities away from the primary exchange)
- Reg NMS[2] (which required US equity orders to be routed to the trading venue offering the best price)
- MiFID II[3] (which allowed competition between clearing houses)

The removal of barriers typically requires the creation of a new regulatory framework to guide activity. Regulated firms will typically need to change their business models to reflect the new opportunities created, adjust workflows accordingly, and also evidence compliance via reporting.

Capital versus risk

Taking risk is inherent in capital markets, so these rules set costs to that risk taking, in the form of committed cash or assets. These are retained or segregated to minimise the effects of a default, meaning any risk management failures have a limited systemic effect. Examples include:

- Basel Accord Capital Adequacy rules[4]
- Solvency II Capital Adequacy rules[5]
- Central clearing requirements for derivatives trading (across markets)
- Uncleared margin rules[6]

These require the firms to use data to assess the relevant risk, make the calculations needed in the prescribed way, identify and manage the assets necessary to meet the regulatory requirement.

Protection from misbehaviour

Where risks are deemed unacceptable or excessive, these impose supervision over, and occasionally barriers to, activity or instruments.

Examples include:

- Market Abuse Directive and Regulation[7]
- The Dodd-Frank Act[8]
- Anti-Money Laundering rules[9]
- Short-selling bans (typically these are controversial, as short-selling has both positive and negative impacts.)

These usually require reporting of activity, with the threat of severe fines where breaches are found.

Regulatory regimes

The legal systems in different markets often operate on very different principles and have very different supervisory structures across their national competent authorities (NCAs).

The nuances of these legal principles are critical for product development and service offerings, but broader marketing messages can focus on the impact of regulation upon potential clients and therefore the operational effects it has. Therefore, a thorough reading of a regulation by a marketer is useful to understand its potential impact; despite the heavy text it can be helpful to work through the legalese.

Rules can be established via directives – which give greater room for interpretation by the authorities who must enact them – or regulations which leave little room for interpretation.

The process of establishing regulation may be multi-layered; in the European Union, the European Commission publishes a 'Level 1' text that must be adopted before the 'Level 2' text is then published detailing how it might come into effect.

In the US, Acts passed by Congress must be turned into regulation by the Securities and Exchange Commission (SEC) and Commodity and Futures Trading Commission (CFTC), who consult on proposals before refining them and confirming the final rules.

Models such as these, which gradually develop legislation into front line regulation, give service providers a staged process to develop offerings and marketing which might assist clients in their engagement with regulation.

Firstly, tracking the development gives a guide to the direction of travel that authorities will take, based upon the initial framework of rules.

As refinements are made to specifics and timeframes by the regulators themselves, this builds a sense of specific needs and a timeframe to work to that should be incorporated into the marketing campaign.

Finding the marketing message in regulation

Any regulation has a linear operational impact upon regulated firms, followed by a more oblique effect as they adjust to the new way of working, and a knock-on effect for other counterparties and clients.

All of these changes are opportunities for the marketer to create room to offer appropriate services.

Tracking the expected impact can be accessible for the informed marketer, as it is outlined by the regulators themselves and identified in feedback from clients during consultations on the new rules.

Understanding the less direct effects before clients do – or, at least, at the same time as they do – is the real art of marketing within financial services. This allows the service provider's marketing team to adapt messaging or even the product to fit in the gaps that clients find between existing operations and future operations.

An example of this can be found with the Central Securities Depository Regulation (CSDR). Intended to harmonise the settlement regime across Europe, it was targeted at settlement infrastructure. It also set up a regime for the failure of trade settlement, imposing significant fines and obligatory settlement fulfilment obligations by a trading counterparty.

These fines fell upon brokers who saw the regulation as an additional cost, particularly when trading instruments which were harder to obtain or less liquid. Consequently, they assessed these assets would not be worth trading, affecting investors who wanted those assets.

The trading desks at buy-side firms cried 'Foul', as the liquidity in these instruments would dry up, affecting their capacity to support liquidity obligations for investors and even pricing of those instruments where dealers would not offer quotes.

CSDR became a poster child for unintended consequences in regulation and it was delayed in Europe, while the UK decided not to implement it post-Brexit.

Given that CSDR imposes penalties for securities that fail to settle before an intended settlement date, marketers can promote thought leadership insights about the data analytics available that enable the buy side to see which of their trades could be at risk of failing.

Adapting marketing strategy to regulation

As with the example of CSDR, a rule will create a change and this will be positive or negative for different market participants. The nature of counterparty and client relationships will mean it can have an inverse effect upon other market participants.

For example, increased surveillance of malicious trading will create a direct operational cost for the firm required to implement the new surveillance system. However, the reduced risk of bad trading will improve market conditions for other participants, such as end investors. Increased cost of capital for a bank to engage in an activity may increase its need for risk analytics, and potentially reduce its participation in that activity affecting its clients.

For marketers, tracking regulatory change is vital. Analysing the impact that each new set of rules will have for different firms is the starting point. Feedback directly from clients, or from sales and business development teams who have frontline contact with clients, is the next step.

Working with product and business development teams to understand how your firm can best support clients is then key, as you begin examining whether there is leverage to apply marketing to support a service or piece of software.

Fintech B2B Marketing Community will be providing updates on new rules as a part of the subscription service, with guidance as to who will be affected and how. This will identify where expenditure will be required by regulated firms, and where advantage may be gained.

In doing this, the service will be a one-stop shop for updates on financial regulation and how they can be valuable to the marketer. As a service, this will provide marketers with that first step to begin asking for feedback, and initiate campaigns.

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Payal is the Founder of FinTech Marketing community and is also Global Head of Marketing at Torstone Technology, a leading FinTech company, provider of cloud-based post-trade technology to financial institutions. In her role, Payal oversees planning, development and execution of Torstone's marketing, PR and branding initiatives – across global markets – in UK and Europe, Nordics, Asia and North America.

Payal has been in the financial technology industry since 2004. With nearly two decades of experience in B2B marketing for global financial and technology companies (Microsoft, General Electric, Barclays) in Europe and North America, Payal has a wealth of experience implementing successful marketing strategies. Building brands and subsequently increasing revenues of global businesses, in 2019 Payal was highly commended as 'Best Leader in Marketing' by the prestigious Global Women in Marketing Awards 2019.

Outside her corporate role, Payal lectures in marketing and has delivered Chartered Institute of Marketing (CIM) certified courses to marketing professionals. As an influential thought leader, she also writes blogs, marketing insights pieces and is a frequent keynote speaker at industry forums and public events.

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FinTech Marketing brings together a community of specialist B2B marketers from the financial services and technology industry. We provide our members with a unique platform to build and grow a network of marketing professionals. At FinTech Marketing, you'll have the opportunity to share insights and best practices, to train, learn, and develop marketing careers through the mentoring program in the niche sector that is FinTech.

FinTech Marketing's powerful, all-in-one platform makes it easy to learn FinTech best practices, share your knowledge, experience and achievements, and scale within an industry you already love. Whether you're a marketing leader, a FinTech startup, or a company looking to pivot, feel confident that you've got the best support in the business.

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