

## Unconventional Wisdom

Banks That Understand Regulation and Fintech Are on Track for Success

By Anthony Caterino

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This month marks nine years since investment bank Bear Stearns Cos. unexpectedly stepped in to provide support for funds that had invested in mortgage-backed securities. Although few of us realized it at the time, this was one of the early tremors of what would become the 2008–'09 financial crisis.

Even after nearly a decade, it's clear that many financial services firms are still working out the right business models in this postcrisis world. In the first quarter of 2016, many large institutions saw performance fall sharply. Global investment banking revenue dipped 36 percent year-over-year from the first quarter of 2015, according to Dealogic.

This reality leads us to two key questions: What are the major forces acting on financial institutions today? And, how can they successfully react, pinpointing their priorities and improving their performance across different business lines? How they respond will separate the leaders from the laggards.

The first major force is a series of heightened regulatory requirements that compel banks to invest heavily in people, processes and systems. In the U.S., the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 has ushered in more than 200 regulations, including capital stress testing, with more to come. In Europe, the Markets in Financial Instruments Directive, revised in 2011, presents new requirements for everything from bond trading to how much banks pay for data feeds. Banks are also dealing with the Basel III Accord, the international agreement covering capital and liquidity requirements.

The second major force, associated with the first,

is a growing demand for cross-border transparency. The Foreign Account Tax Compliance Act, among other requirements, compels financial institutions to report to the Internal Revenue Service information about U.S. taxpayers holding certain foreign accounts. Meanwhile, the Organization for Economic Cooperation and Development has instituted the Common Reporting Standard (CRS) and base erosion and profit shifting. These international programs are designed to enable cross-border tax information exchange as a means of hampering tax avoidance. These new regimes require financial firms to make major monetary outlays to be in compliance.

The low interest rate environment persisting in the developed world is the third major force. Several central banks, notably the European Central Bank and the Bank of Japan, have moved toward negative interest rates, further depressing yields. In February Federal Reserve chair Janet Yellen told Congress she would not take negative interest rates off the table if the domestic economy erodes sharply. At its most recent meeting, the Federal Open Market Committee decided not to raise the federal funds rate.

The fourth major force is innovation and the explosion of financial technology. From robo-advisers to marketplace lending, fintech is shaking up the old ways of doing business. Traditional financial firms that already have been embracing fintech — through smart investments, incubators, acquisitions and other channels — can leverage technology to improve the customer experience and bring new products and services to market.

Blockchain, for example, promises to revolutionize complex institutional transactions such as currency clearing and settlement. Large firms are experimenting with blockchain, which could make these types

of trades more efficient and secure than ever before. Earlier this year, 11 large banks on four continents successfully completed a blockchain test exchanging simulated trades and value via a distributed ledger without the need for third-party clearing or settlement. The experiment ran for five successive days, 24 hours a day.

So how are savvy financial firms laying the foundation for future success? By responding to these forces in a holistic way.

Financial companies are seeing this as an opportunity to simplify their structures, which may bring them not only cost savings but also increased operational efficiency and lower compliance risks. For the past nine years, investments have poured into regulatory compliance and reporting initiatives. The rapid development of disruptive technologies such as robotics and artificial intelligence is helping firms automate many of those

processes and redirect their energy toward growth activities. Big data, analytics and digital technology shed light on what they do best — and most profitably — and enhance the customer experience.

In the end, savvy institutions see this disruption as an opportunity to change for the better. They have recognized the external forces pressing on them and are transforming their business models and operations to thrive in this new normal. The firms that are working to accomplish this holistically across their organizations are the ones to watch for future success.

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