2015: the rise of the investment service provider
Introduction

The global capital markets industry is going through a period of significant change and only the strongest and smartest players will survive. In the Nordic region, the pace of change is accelerating with the introduction of more regulations, the transformation of both the front and the back office and greater competition as new market entrants and major international firms get in on the act. The old rule book is being ripped up and those firms that want success must invest in the expertise and technologies that will help them to keep their competitive edge.

With the sector also facing criticism for its lack of transparency, many in the industry are now wondering how it will respond to this unprecedented upheaval and evolve. As a leading IT solutions provider in the region, Tieto realizes the importance of securing the future business interests of this sector. So it has engaged with stakeholders to create a vision of how firms in this sector can ensure they develop into stable and profitable businesses by 2015. A number of its key recommendations are detailed in this paper.
Business changes

As the regional marketplace adapts to the increasingly global nature of the industry, capital markets firms need to be more aware of what their counterparts are doing around the world. In the US, for example, turnover of stocks on the US NASDAQ is very high compared to other exchanges, with the liquidity ratio on the NASDAQOMX in 2009 varying from 800% to almost 1400% compared to just 100-250% for leading European exchanges. However, Tieto expects to see increased turnover on the Nordic exchanges along with significant shifts in market practices as the effects of a number of infrastructure changes such as the implementation of the Central Counterparty Clearing (CCP) model and the launch of NASDAQ technology in the region kick in.

Change is affecting all areas of the market. The whole of the securities market infrastructure and approximately 70% of Finnish banking are now foreign owned. Even the majority of brokers are in overseas hands. But Nordic investors remain proud of their home nations and their heritage, so this increasingly globalized sector has to cater for their needs. And with the financial sector being shaken up still further by the advent of new small niche players, the firms with the real desire to win are focusing on delivering solutions that meet their clients’ specific needs while at the same time remaining competitive in a globalized and high-tech market.

“Those with solid client relationships and traditions rooted firmly in the Nordic securities market will be well placed not only to survive but also to thrive.”

Source: WFE
CCP model allow significant cost efficiencies due to the netting of transactions. They are already prevalent in other parts of Europe and involve the deposit institution holding asset management accounts rather than end client accounts. But in Finland, regulations require the end client to have an account with the institution. So unless this restriction is removed, only foreign players will be able to take advantage of Omnibus accounts in the Finnish market. This has created an unusual situation in which Finnish players, both brokers and investors, face a barrier to operating in their own market place rather than abroad. The answer could be to create a single platform that takes account of the market's local needs. And Tieto believes firms operating in the sector have no choice: they simply have to innovate!

Nordic Region

The Nordic region has many proud financial traditions, and it is respected worldwide for its innovation and can-do attitude. But it has not all been plain sailing. Its finance sector was shaken by the global economic crisis of 2008 and 2009 and business remains fragile, especially in Sweden. With new market entrants adding to the already considerable competitive pressures and a host of new regulations being applied nationally and internationally, the industry in the region is having to address the operational and business risks that it now faces. Complying with the raft of rules and directives set to come into force in the next five years is an ongoing task for financial firms, and they are dealing with this by ring-fencing the necessary funds. Tieto estimates that firms in the region will have to comply with around 14 new international regulations including the Market Abuse Directive and Over-The-Counter Derivative authority reporting, as well as national rules such as the domestic laws for long-term pension savings. But it’s not just about

European securities industry

Investment Service Providers (ISPs) are starting to emerge, each with their own particular niche in the business environment. The ISP-client relationship and the potential to build business are of critical importance to firms in the Nordic region. But both establishing and developing this relationship is a challenge because one of the biggest effects of the market changes has been infrastructure fragmentation, which has hit front and back-office systems as well as messaging interfaces. Consequently, seamless and efficient one-entry operation between the front and back office is a must-have. But that’s not all: firms are now running best-of-breed multi-system architectures that need to be managed rigorously – a tough requirement when the systems themselves are often inflexible by nature and can generate huge extra costs.

The rise of alternative market places such as Chi-X, the transfer to the NASDAQOMX trading platform and the introduction of the London Stock Exchange (LSE) trading platform in Norway are all changing the appearance of the front office in firms in the region. In the back office, it’s a similar picture as the central counterparty CCP model, Target 2 Securities (T2S) and the Euroclear Single Platform come into effect.

As Euroclear strengthens its position in the European settlements market for securities transactions, it is inevitable that there will be speculation about whether and when a single platform based in the UK and Ireland will emerge. But this fails to take into account the fact that certain areas such as the Nordic region have unique local requirements that need to be considered in both the short and the long term.

The industry needs to adapt to these realities and focus on the business opportunities. One approach has been the use of Omnibus accounts, which together with the
complying with the latest rules by implementing new systems and processes, it’s also about interpreting them correctly and trying to harness their business advantages – a pretty hard task given that parts of some regulations are still not clear.

One of the biggest challenges facing firms is how to address the market infrastructure changes that are impacting every part of the business. The CCP model – under which a single counterparty clears equities transactions – has transformed the way firms work. And the growth of the NASDAQOMX Nordic Exchange is also having an impact on how business is conducted. Multilateral Trading Facilities (MTFs) are being introduced across Europe, systems that are regulated by the Markets in Financial Instruments Directive (MiFID), which aims to bring transparency to the market. Dark pools of liquidity and crossing networks – useful for traders wishing to move large numbers of shares without revealing themselves to the open market – are also challenging the way firms do business.

The old exchange-broker-investor structure is being transformed into a new industry network open to all with many firms choosing to specialize in just a small part of the total trading value chain. Tieto believes that the role of ISPs is set to expand in the European securities industry and that by 2015 they will be playing a key part in Nordic capital markets as they become a gateway or advisor for investors.

This transformation could lead to the development of a more efficient standardized and large-scale infrastructure, something that will benefit investors. In turn, automated systems, open architecture and large-scale processing will be developed, creating economies of scale that will benefit everyone.

Trading volumes are set to soar and wealth management services will evolve, but these opportunities will also attract global players keen to get a toehold in the regional market. Although local firms will face stiff competition from these new players, those with solid client relationships and traditions rooted firmly in the Nordic securities market will be well placed not only to survive but also to thrive.

What is clear is that generic business models are no longer the answer to operating at a pan-Nordic level. Instead, what is needed are niche business models for niche players, able to operate on foreign-owned infrastructure while meeting the needs of domestic investors.

**Tieto's Vision 2015**

With just five years to go, what will the Nordic capital markets landscape look like in 2015? Tieto believes that there could be a number of key developments by this time if T2S and single platform trading are implemented and standardized post-trade processes come into force as a result of globalization and new regulations transforming the market. By 2015, custody services will be provided by large international players only. But that's not all: trading will have consolidated globally to form even larger marketplaces and there will be no market transparency.

These transformations are not unique to the capital markets sector. The payments, pre-trade processes and telecoms industries have all gone through similar upheavals and have emerged stronger and more competitive than ever.
UCITS IV
The funds landscape is set to change with the introduction of the Undertakings for Collective Investment in Transferable Securities (UCITS) IV Directive in 2011. This builds on previous versions of the directive that were introduced to allow the operation of collective investment schemes throughout the European Union on the basis of a single authorization from one member state. UCITS IV strengthens the existing regulations and eases the path for cross-border fund mergers and distribution.

Luxembourg and Ireland have already embraced the changes introduced by UCITS IV and the Nordic region could learn from their approach. Organizations choose to transfer funds to the two countries for many reasons. For a start, both benefit from favourable legislation and regulatory controls. They also offer benign taxation, advanced infrastructures and specialized services. Implementing UCITS IV has given the two nations greater visibility while funds management is boosting their economic activity. It also provides an opportunity to build competence and create a knowledge industry focused on informed investment and arbitrage.

A brighter vision for 2015?
An alternative scenario for 2015 is that a fully automated post-trade process could be in place which is taken care of by large-scale international operators. There could be a multi-layer, open-market structure, where niche players can thrive and provide specialized added-value services. With custody transfer (where custody accounts are transferable between Central Securities Depositories) about to be implemented, and market participants, research institutions and regulators already collaborating, a new-look market is developing and paving the way for a new generation of financial services. As major global companies start to play an even bigger role in the Nordic capital markets sector, the trend will be for more listed companies to be at the heart of all the action.

Competence counts
Facing up to the new industry landscape of 2015 requires a financially literate partner. Knowledge is key when talking about investments, and it is important that clients, service providers and the rest of the industry learn and work together to get it right. Every player needs to look at how they process information and use the infrastructure. Knowledge is also central to driving innovative ways of thinking. Governments will continue to promote this innovation, providing R&D funding to transform the market. And there will be an inevitable drive towards digitalization as a result of the major technology investments expected. Tieto has vast experience of innovation and change management in the financial and other sectors, and it is well placed to help firms create intelligence for investments and to implement Customer Relationship Management (CRM) efficiently in an ever more digitalized collaborative operative landscape.

One question that companies preparing for 2015 need to consider is whether to build or buy their back office infrastructure. In the Nordic region the trend will be for client data to be taken care of by local niche players, while post-trade processing is handled by an international player.

The fact that the securities market infrastructure is wholly owned by foreign organizations has implications for Nordic brokers and asset managers. Post-trade processing has an international dimension. And the marketplace, CCP, custody, and clearing and settlement are also globally controlled.

Cost plays a large part in the decision to build or buy the service. Tieto believes that buying it is often the most suitable solution, ensuring that it is created by experts to schedule and a tight budget. Building in-house can be a slow process and result in damaging mistakes as well as escalating costs.

Having decided whether to build or buy, companies looking towards 2015 need to consider who does what and how in areas as varied as processes and partner management. They need to look at the technology, systems and processes they will implement for risk management and monitoring.
While Nordic market processing is taken care of by international players, asset managers are also playing a part and working hard to establish attractive investment opportunities. In the future it will be about who takes responsibility for administration. In order to survive, the small players will have to find their niches – and that will centre on developing and selling value-added services. It will also be about which players have the competence to develop financial products, something which very few are capable of doing by themselves.

Progress to 2015?

Progress is being made in areas such as trading, value-added services, risk management and corporate action. (See figure above.)

In the area of trading, 100% automation has already been achieved, helping to make monitoring easy and cost effective. Block trading is still not 100% automated, but this is where sales and development could be boosted in the future.

Value-added services during trading and post-trade are emerging, boosting sales, development and co-operation. Initial Public Offerings (IPOs) have not yet been fully automated, but once this has been achieved, the industry will be able to enjoy better and faster sales and improved co-operation.

Automation is being used in risk management and this will help the monitoring of transactions and the development of products in line with some of the risk-related regulations now being implemented. Automation is also used for corporate actions.

Both custody and clearing and settlement are 100% automated, enabling monitoring and special events to be catered for easily.

Success in 2015 – Tieto can help

Tieto can help its customers adapt to the new market place – and to find their niche in an industry that’s undergoing a rapid transformation.

The company is already compliant – or well on its way to compliance – with the evolving NASDAQOMX trading platform, new market places such as First North, Burgundy and Chi-X, and the new clearing and settlement institutions and procedures of EMCF, EuroCCP, Six X-Clear and Oslo Clearing.

Tieto’s solutions enable banks and other capital market participants to identify new revenue streams cost effectively. Its reliable, modular and quick-to-launch portfolio of solutions has been specifically designed with this in mind. And because every client is different, Tieto has developed these solutions so its customers can create new products with built-in flexibility and take advantage of the fast-evolving market infrastructure – whether they operate as a broker, a dealer, a transfer agency, an IFA, an insurance company, a distributor or an asset manager. Most importantly, Tieto helps its clients to determine which combination of these, or other business activities, gives their business the best chance of success in the future.

When companies operating in the capital markets sector choose Tieto they choose access to success. Tieto has the skills to help firms understand the magnitude of the changes taking place in the capital market – and take advantage of them.
Tieto Financial Services offers value added IT services to banks, insurance companies and financial services providers. We are the leading IT services partner for the financial industry in the Nordics and one of the leading experts in capital markets, transaction banking and front end transformation areas. Our home market is the Nordic and Baltic countries, Russia and the UK.

We have 40 years track record of partnering with major Nordic financial institutions and helping them to meet the challenges of the market. We help our customers to run their business more efficiently, manage risks and boost growth opportunities. With 2400 dedicated employees we currently serve more than 400 customers within the financial industry. Those customers have chosen us for our deep industry knowledge and capabilities to deliver innovative solutions with a solid return on investment.

Tieto is an IT service company providing IT, R&D and consulting services. With approximately 16 000 experts, we are among the leading IT service companies in Northern Europe and the global leader in selected segments. We specialize in areas where we have the deepest understanding of our customers’ businesses and needs. Our superior customer centricity and Nordic expertise set us apart from our competitors.

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