www.thevalueexchange.co

2020 in Perspective

Regulation + Innovation = Collaboration

January 2020

actionable
commercial
insight

in cooperation with

Standard Chartered

asifma Growing Asia's Markets

THE NETWORK FORUM Connecting Financial Institutions Worldwide

1. Introduction

The ValueExchange: building transparency between buyers and sellers

Welcome to the first branded report from the ValueExchange. For the last 10 years we have been building expertise in **using crowd-sourced wisdom to deliver actionable, commercial insights to the financial services industry**.

We're really excited about sharing these insights with you in this report!

We exist to **transform the relationship between buyers and sellers in our industry:** bringing transparency, empathy and efficiency to every commercial interaction.

Visit us at **thevalueexchange.co** to learn more about how you can source these insights for your customers.

You, your customers, your colleagues and your competitors

It is rare to enter a new year with such uncertainty. Financial market outlooks appear uncertain, with a 'cooling' likely. Trade-wars and anti-globalisation cloud the horizon. Equally, disruptive technologies will shape new winners and losers. Global investors will turn to safe markets for growth.

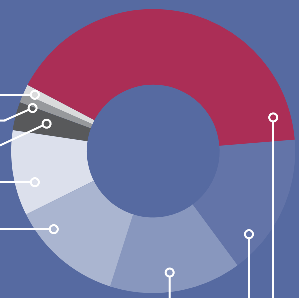
We may not know how these themes will play out in 2020 - but what we can know is how we are each dealing with them. Where are we spending resources, where do we have aspirations for transformation, what markets are we betting on in 2020? Most importantly, where can we carve out a unique edge?

This research paper aims to give new guidance to participants across the entire investment cycle. Focusing on macro-priorities, regulatory projects, internal priorities and market structures, this project is designed to give you complete clarity on where you should be concentrating in 2020: by incorporating your views with those of your customers, your colleagues and your competitors.

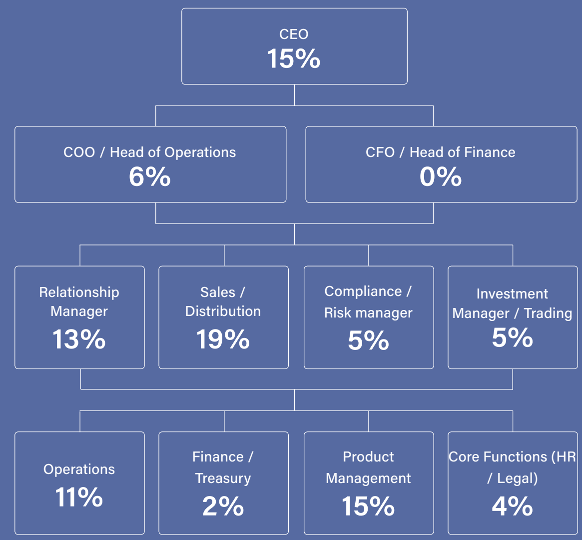
Thanks to the active support of Standard Chartered, ASIFMA and the Network Forum, our survey reached over 5,000 investors around the world (across all markets, segments and profiles) giving us a uniquely comprehensive view of the industry's views of the year ahead. As part of "the most complex data exercise we've managed" we have gathered over 150,000 data points in order to give you **actionable, statistical insights to help you plan for 2020.**

Respondent profiles

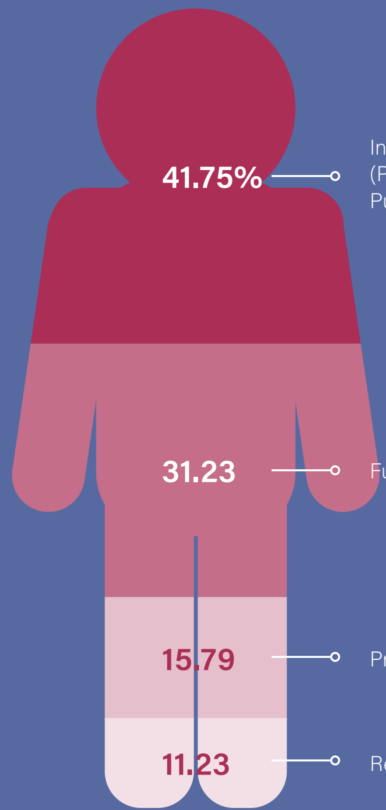
Industry segments



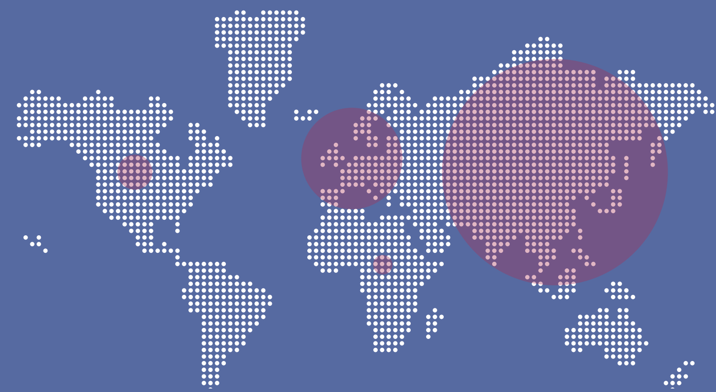
Job profile



Customers served



Location



2. 2020 at a Glance

62%
of the industry is positive on 2020

#1 objective:
Top line growth

#1 challenge:
market downturn

>60%
growth from China
Emerging Markets Ex-China

23%
of spend available for new projects

22%
of spend on the regulatory "tax"

41%
of new project spend is on innovation

24%
of the industry is focused on Collaboration

Page

Banks:
Heavy regulatory costs +
Mood for change =
Digitisation and collaboration

Brokers:
Regulatory overload +
Business model disruption =
Cost control

Fund Managers:
Delivering safe growth +
Challenging market conditions =
Positive conservatism

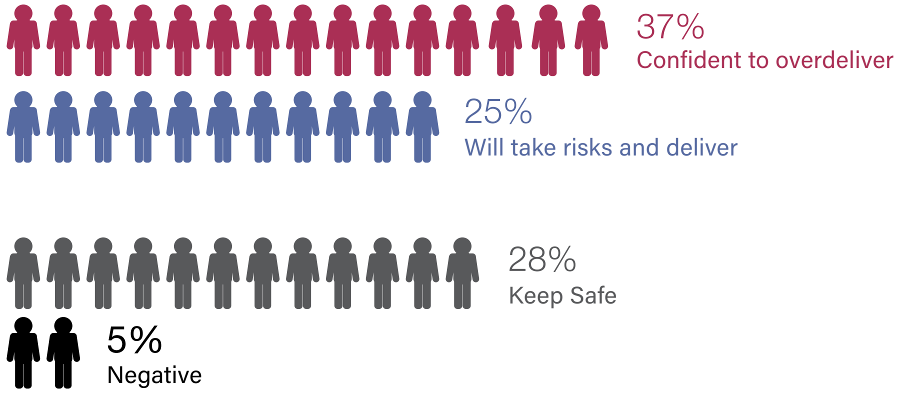
Insurers:
Cost cutting +
Transformative regulation =
Internal change

3. How do we feel about 2020?

62% **of the industry expects** to hit or exceed their performance objectives in 2020)

Segment views on 2020

Your personal outlook for 2020



Whatever 2020 holds, we are surprisingly bullish. In a context of trade wars, cost cutting and market cooling, a striking 65% of the industry is still expecting next year to be a good year for them, with 37% of this segment expecting even to over-deliver against their performance objectives. Only 28% of the market expects to 'keep safe' and a mere 5% expect to fall short.

But we don't believe it's going to be easy 25% of the industry expects to have to take risks and drive change in order to deliver next year. 2020 is set to be a year for getting on the front foot and driving fundamental change.

How will we achieve this change and who will drive it?

Bankers as the new disruptors

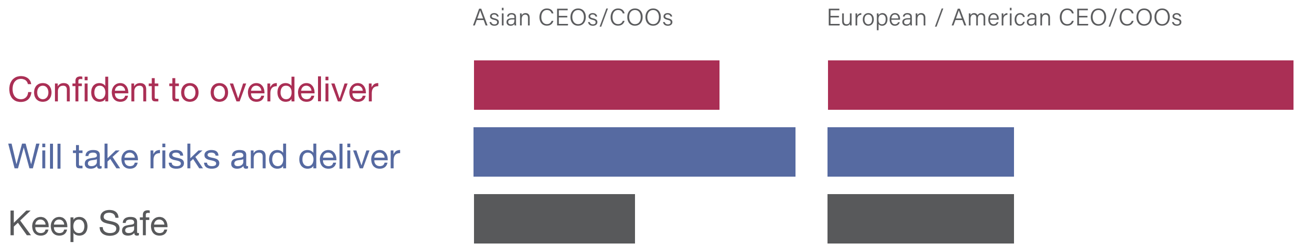
How are you feeling about 2020?

Brokers Exchanges / CSDs	Confident to overdeliver
Banks	Will take risks and deliver
Fund Managers Regulators	Keep Safe

This focus on change is strongest amongst those who are typically most conservative: the Banks. After years of imminent or active disruption, Bankers now see themselves as the new disruptors: with 36% of them expecting to have to take risks to meet their objectives in 2020. With investors looking to keep safe and intermediaries expecting to simply over-deliver (without taking risks), the Banking segment's focus on transformation stands out as a major theme for the year ahead.

Frustrations looming as Asia powers ahead?

How are you feeling about 2020?



But change is never easy and large, multi-national organisations will have to contend with a range of internal and external stakeholder views in order to realise transformation. Whilst Asian CEOs and COOs are the most aggressively pro-risk in the global spectrum, those with headquarters and managers in Europe and North America may struggle to secure backing and additional capital to support their ventures – owing to the fact that 28% of Western CEOs and COOs want only to keep safe in 2020. Equally, 71% of regulators (key stakeholders in facilitating market-wide change) are focused on keeping safe, creating a key dependency on those looking to transform in 2020.

Know-Your-Colleagues & Compliance as a business builder

How does each position see 2020?

Traders, Product Mgt, Compliance	Will take risks and deliver
CEOs, Compliance, Relationship Mgrs	Confident to overdeliver
COOs, Core functions, Finance, Operations	Keep Safe

The same challenges are evident inside organizations. On the one hand, the significant majority of CEOs see their role as being change-makers, teaming up with Product Managers to build a new business in 2020. But core functions such as IT, HR and Legal – as well as the COOs and Operations functions - whose job it is to realise change - are very much in 'keep safe' mode, creating potential barriers to progress in the year ahead.

Importantly, Compliance managers see themselves on the change-side of the divide: ready to take and manage risks in order to see their organisations flourish in a complex, regulatory environment.

For those that are looking to instigate or drive change (as buyers or sellers) in 2020, empathy, cooperation and stakeholder management will be more crucial than ever.

4. Strategic priorities in 2020

#1 strategic priority: Top line revenue growth
#1 obstacle to success: Market Downturn

In global strategic terms, top-line revenue growth is the industry's priority in 2020, as a counter to the widely-expected macro-economic cooling that is seen as the #1 obstacle to our success next year.

Viewed through a geographical lens, all regions share a common focus on these priorities – ahead of internal transformation and even cost-cutting. Given the predominance of 'efficiencies' and 'productivity' in strategic agendas across the industry over the last few years, the lack of strategic focus on costs is striking. However, as one industry specialist said, this may simply be because "cost cutting is no longer a strategy: it is the new norm".

Not every part of our industry has a common view of 2020. Whilst Banks are clearly the most pre-occupied globally by a market downturn, insurers are heavily focused on driving their own, internal change, whilst brokers find themselves in the eye of a regulatory storm.

Your hopes and fears

	#1 Strategic Priority	#1 Obstacle
Global	Top Line revenue growth	Macro-economic conditions
Insurers	Cost Control	Internal Change Internal Delivery
Fund Managers	Top-line revenue growth	Macro-economic conditions
Brokers	Top-line revenue growth	Regulation
Banks	Top-line revenue growth	Macro-economic conditions
Exchanges	Internal transformation	Macro-economic conditions

Insurers look inwards – except in Asia

Insurers are unique in being heavily internally focused, as they focus on cost-cutting and managing change within their own organisations in the face of a uniquely comprehensive range of pressures:a supply chain that spans pain-points with retail policy-holders (where product distribution rules is the #1 regulatory pressure, behind KYC/AML pressures); internal accounting (where the implementation of IFRS 17 is a dominant change); cash mobility; and lengthening liquidity horizons. The result is that insurers are driving more change, on more fronts, than many industry players.

Only in Asian markets, where generational, demographic changes are driving record growth for insurers, is the internal focus secondary to pure revenue growth.

"**IFRS17 is huge** and goes straight to foundations of our operating model. It's going to be as big as Solvency II for us."

"**Things are very bleak indeed**" according to one European broker.

Broker Dealers: The Great Re-bundling

At the other end of the spectrum, no one is focused on or traumatized by regulatory change as much as brokers, 24% of whom cite it as their primary concern for 2020.

In the last 18 months, Brexit and UMR (Uncleared Margin Rules or "Initial Margining") have added huge project costs to the industry, as brokers have scrambled to repaper client agreements (either to new, future-proof EU entities or revised ISDAs); whilst regulators have significantly increased KYC requirements on brokers (triggering significant remediation efforts across the industry).

$18.3bn:
total value of prime brokerage industry in 2019.

BNParibas / Deutsche Bank Prime Brokerage sale

€ 400m
Top-line revenue impact

$165bn
Cash balances transferred

1,000
Staff to be transferred

At the same time, successive MIFID regulations have created a rupture on both sides of the brokerage balance sheet. In the front office, established research/brokerage revenue models have been forced apart. In the back office, operational infrastructures have had to be redesigned. What was designed as regulation to promote investor protection and best execution has become a major regulatory "tax" or cost burden to the brokerage industry, adding to an already swollen cost-base. No wonder then that brokers' regulatory spend is 26% of their total 2020 investment spend versus only 15% on the buyside.

This high-cost, post-MIFID landscape has created new winners and losers. Whilst research and execution have been forcibly unbundled, prime brokers have again come to the fore, re-bundling core execution with financing (amongst other offerings) in order to gain flow and drive up cash balances at the expense of agency- or broker-only businesses.

Recent M&A activity highlights the significant power of the prime brokerage model in a post-MIFID world: whilst also raising the question of how agency-only brokerages can survive without it. The biggest winners of unbundling will be those who have been quick to rebundle.

Looking to 2020, the increased cost pressures of increased settlement discipline (in CSDR) will no doubt accelerate this polarization: leaving very little time for growth.

Whilst fund managers face signficant cost pressures in 2020 they appear to have it easy by comparison: but not everyone in our industry will have the luxury of focusing on customers as they respond to the challenges of a market downturn in 2020. Where investors will be able to allocate significantly more resources towards growth and to their customers, the sell-side will spend 2020 preoccupied by significant market and regulatory changes happening around them. How they deal with these changes is a core question for the year ahead.

5. Market Growth in 2020

China ++ & EMxC

Where is the money coming from?

If a global cooling is to come next year, then where do we think the safe bets are around the world?

From an investment flows perspective, China stands out in every measure as the leading growth market for 2020: measured by strategic importance, volume expectations or by numbers of new entrants. After a frantic year of index inclusions (including MSCI, FTSE Russell and Bloomberg-Barclays), 2020 looks set to be another year of massive growth. Thanks to continued index rebalancing by Bloomberg Barclays and JPMorgan's planned inclusion of China in 2020, volumes are expected grow by over 60% next year (more than 15% higher than the second-fastest growing market, Indonesia; and 30% higher than India).

"**There is no other China** right now"

Expectations of China seem to vary around the world: although no one is more positive on China than investors in Asia. Overseas, those looking to 'keep safe' (particularly in Europe) remain slightly cooler on China than those who are looking to take risks and deliver in 2020 - although those same European investors have the highest expectations of volume growth. By contrast, North Americans treat China with a higher strategic importance – whilst expecting lower volume growth in 2020. With the London-Shanghai Connect closed in January 2020 due to political reasons, do Europeans still view China as a more volatile (high risk, high return) market than those in North America?

One China statistic that may not rise in 2020 is the number of large institutions that are entering China: with only 2 organisations of over 50,000 staff looking to enter China (versus 27 institutions with less than 50,000 staff). We may be reaching the 'end of the beginning' for China – with almost all major financial houses now already participating in their markets.

China in 2020

$13trn
Size of China's bond market

$700bn
predicted asset transfers through index inclusion

30%
annual growth in foreign participation in Chinese markets

$745m
profitability of Chinese securities market by 2030

+62%
growth in volumes predicted year-on-year

North America: **58%**
Europe: **64%**
Asia: **61%**

51%
cite **China as Top 3** Board-level priority

China: **66%**
2nd market: **52%**
India: **46%**

75%
of new China entrants in 2020 will have **less than 5,000 staff**

<50,000 staff
5,000 to 50,000 staff
500 to 5,000 staff
Less than 500 staff

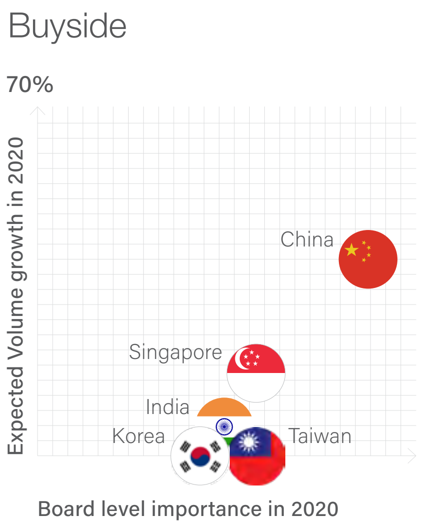
2020 Index inclusions for China:
- Bloomberg Barclays Global Aggregate Index inclusion: continues to August 2020
- JPMorgan Government Bond Index – Emerging Markets: February 2020
- FTSE / Russell World Government Bond Index: TBC

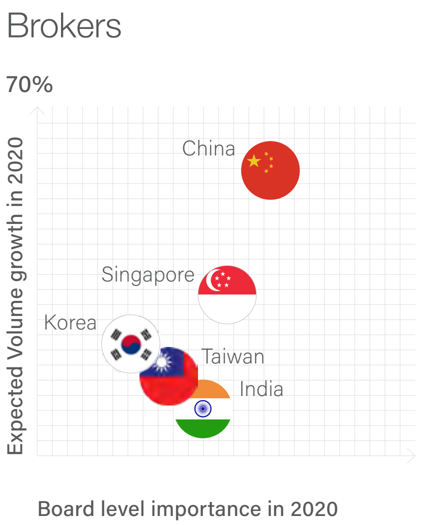
Singapore: a key growth market for investors in 2020

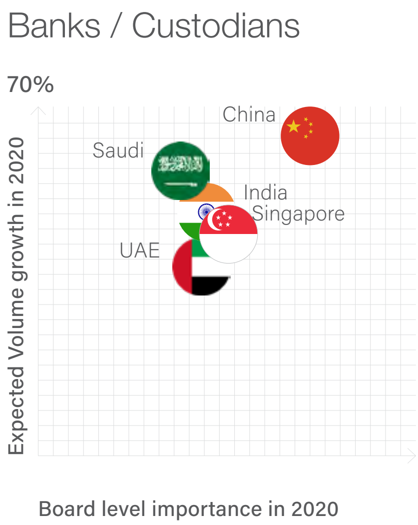
The Year of "Emerging Markets ex-China"

But the Emerging Markets story for 2020 is not only about mainland China: particularly given recent tensions surrounding China's trade negotiations with the USA. There is a strong agreement amongst all members of the investment cycle that the "Emerging Markets ex-China" (EMxC) strategy is a robust diversification play for 2020: with Singapore, India, South Korea and Taiwan at the centre of Board-level attention. Although other markets, such as Indonesia and Vietnam, may present opportunities for higher volume growth in 2020 (both predicted to grow by over 40%), Korea, Taiwan and Singapore are benefiting from a flight-to-quality investors seek out 'developed' markets in the year ahead.

Where are the volumes coming from in 2020?







Volume growth or contraction: it depends who you ask

What the industry doesn't agree on however, is how much we can expect from these markets in 2020. Whilst Custodian Banks expect over 50% growth in all of these strategic markets; intermediaries foresee closer to 20% growth on average; whilst the ultimate customers (ie. investors) expect only 10-15% growth in these strategic markets, with some markets even expected to contract. Whilst this may reflect different priorities across the investment cycle (custodian banks tend to focus on facilitating market entry and asset growth, whereas brokers focus entirely on flows for example), there appears to be a strong mismatch in expectations of where and how we will make our money in 2020. What if the fund managers are right?

Where are the volumes coming from? It depends...

Saudi: moving beyond Aramco

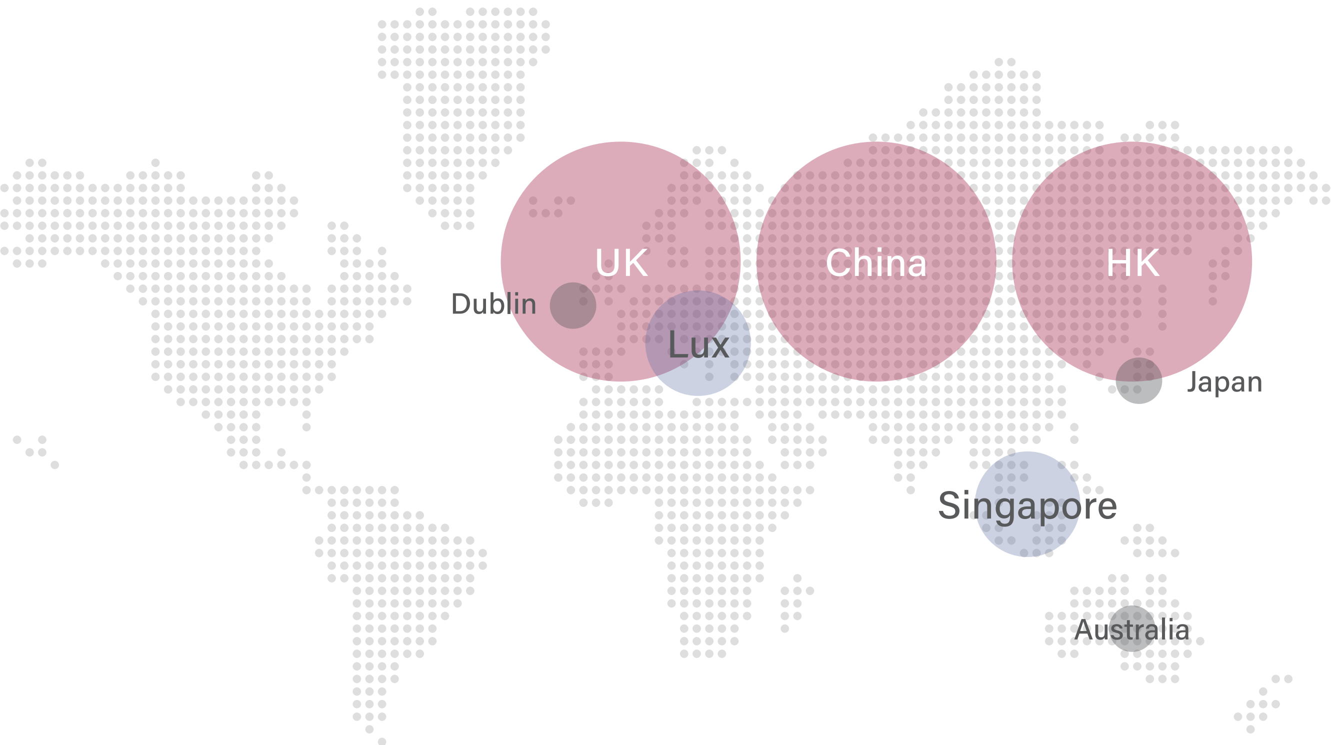
Nowhere is this mismatch more clear than with Saudi. Recent news coverage and index rebalancing through 2019 has spurred solid interest in this market, with custodian banks expecting it to be the second fastest growing market in 2020 (with a 63% growth in volumes and the 2nd highest number of market entries behind China).

However, investors seem undecided: seeing Saudi as the 9th most important to their Board members in 2020 and many even expecting a contraction in volumes there. The challenge for this market in 2020 will be to turn this market into one suited to deeper portfolio-building.

"Even after the (domestically-focused) Aramco IPO, **we only have 3-4 lines of stock in Saudi**"

Fund set ups: the localisation effect

From a fund-structure perspective, 2020 looks set to be a year of continued localisation: with China, Hong Kong and the UK leading the list of domiciles that will see most new-fund activity in the year ahead.



China represents a growth market for all foreign managers (despite trade war concerns): with locally managed funds the only possible path to reach onshore investors. Equally, in the alternative space, Singapore's SVCC platform appears to be rapidly 'coming of age' as an excellent response to the challenges of substance in Cayman and other domiciles. By contrast, the UK's growth in locally domiciled funds is a direct (and not necessarily growth-based) cost of Brexit.

That does not mean that the major 'passporting' domiciles are being left behind. Luxembourg's appeal continues to grow, with Japanese alternative investors leading the way in Asia as they begin to establish funds there for the first time.

An interview with Margaret Harwood-Jones

(Global Head of Securities Services at Standard Chartered Bank)

International managers have been trying to target Chinese investors for over 15 years: but expected reforms in 2020 should bring them ever closer to full access.

How have global fund managers been able to target Chinese investors until today?

Since December 2002, international insurers, fund managers and brokers have run minority-owned joint ventures with local partners as they sought to access the China market. Although some succeeded, these projects ran into challenges around management control, IP protection and distribution obligations – and so global managers have been asking for more ever since.

Experimental, municipal schemes (such as the outbound 'QDLP' and 'QDIE' programmes) haven't really materialised – but that all changed with the advent of the nation-wide PFM (Private Fund Management Company) license.

Why is China opening its markets now?

Historically, China has probably the world's highest ratio of direct, retail investors in the securities markets. Coupled with a consistently bullish economic climate, this participation has shaped China's asset management industry as needing to offer high, quick and low-risk (if not guaranteed) returns.

Given the rise of the Chinese middle class, regulators are now keen to cultivate a more rational and sophisticated investment mentality, supporting an investments industry that is driven by long-term investment horizons and where investment risk is understood to exist.

The increased presence of international expertise and players in the market is expected to help drive that change.

In a much broader perspective, this change in attitudes will then help to accelerate the shift in capital raising from bank loans to public markets: fuelling growth in enterprises and hence driving a key policy objective for China

What can foreign managers do today?

Since 2013, global managers have been offering customer support or research through their WFOE (Wholly Foreign-Owned Enterprises) onshore (mostly) in the Shanghai Free Trade-Zone.

In 2016, they were allowed to use these WFOE entities to secure a PFM license and target institutional and high-net-worth clients in China: effectively China-stock picking for Chinese investors. That has been a huge development.

When we ran our RMB Investors Forum survey (with the ValueExchange) in the summer of

2019, 45% of the global managers we polled said they were setting up a WFOE - and 75% of these planned to use it for PFM. With around 20 PFM licenses already issued, a large number of foreign managers are ready and waiting to launch in China.

What will change in 2020?

This liberalisation looks set to continue this year: helping foreign managers to participate in China's USD2trn fund industry. On April 1st, international managers will be allowed to use the WFOE structure to apply for a "Mutual Fund Company" license, which will then enable them to target the full scope of retail, corporate and institutional investors – expanding their access to the same client base as local peers. On the same day, managers who are already participating in onshore joint-venture companies will be free to increase their ownership as they like. (For reference, brokers can do the same from January 1st 2020 and insurers from December 1st 2020).

The pace of this change could obviously change given the ongoing trade negotiations between China and the US but these moves would substantially alter the role and potential for foreign managers in China.

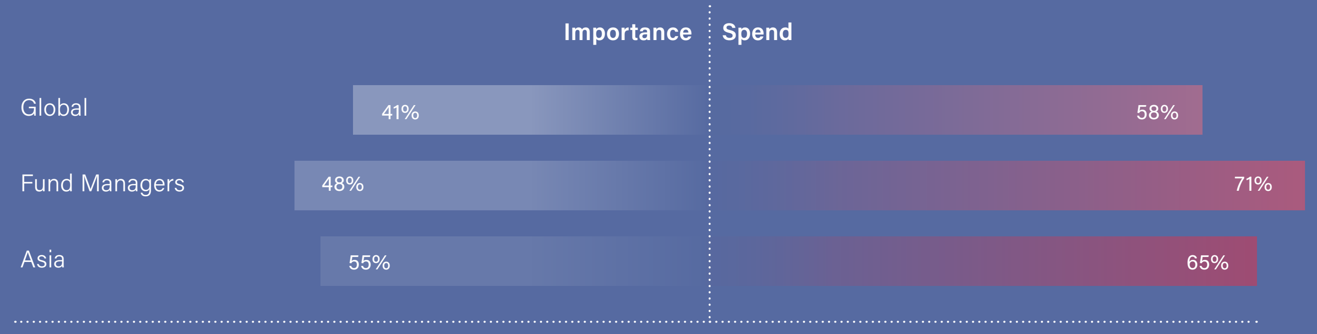
What does this mean for global managers looking at China in 2020?

2020 will be the year when foreign managers will be able to offer their expertise to all profiles of onshore China investor – for the first time.

But this isn't a quick trade. WFOEs are ideally suited to those with a long term interest in China: as it takes a long time to build local insights, track record, brand-recognition and distribution networks to reach Chinese investors. There are also some key operational and staffing requirements that need to be met: and so the value of a truly local-global partner is key.

As the first and only foreign bank with the local fund custody license, we have had the pleasure of helping more than 20 managers structure their China strategies through this route: all of whom expect this to be the first of many capabilities they will build in the coming few years.

China onshore: 2020 is the year



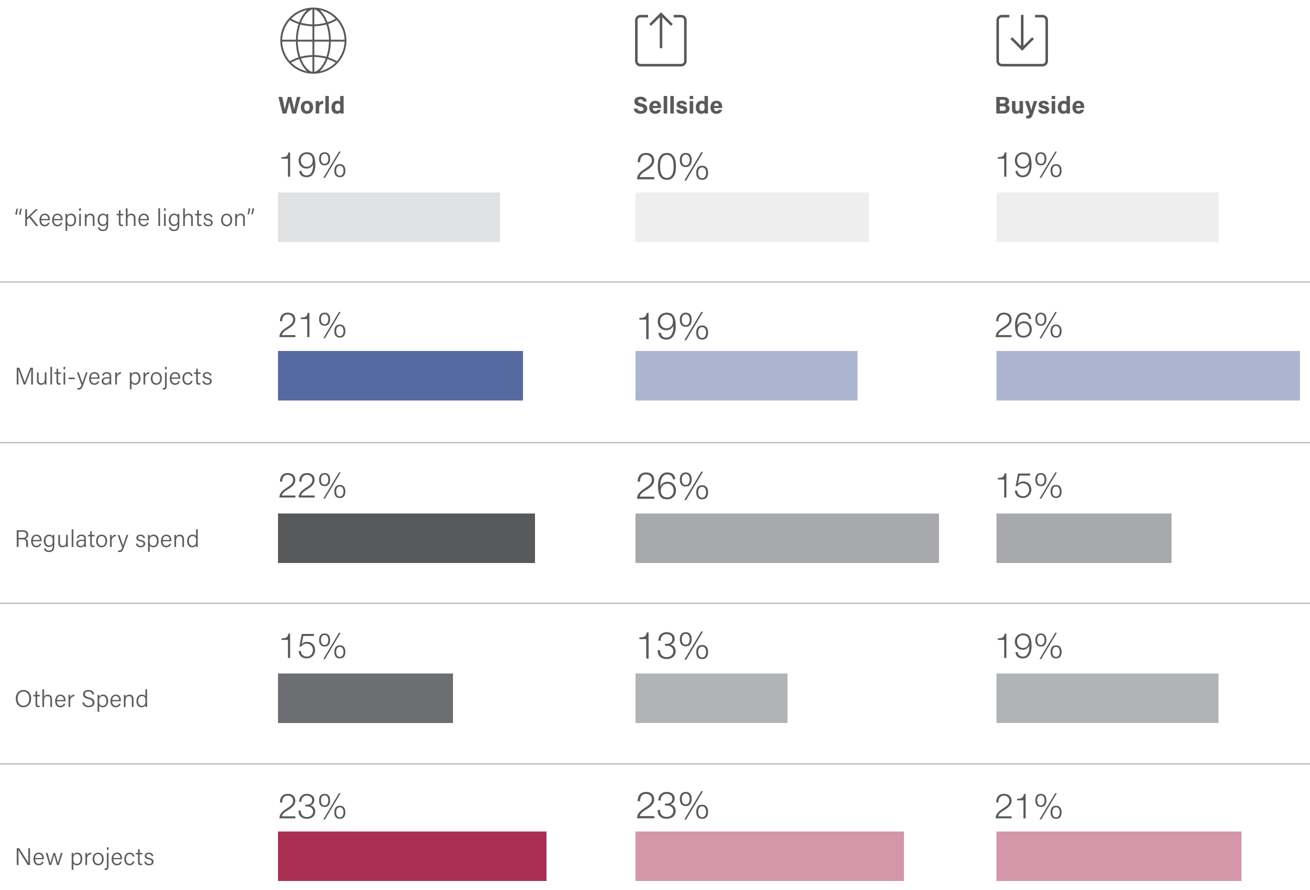
6. Our Costs in 2020

The more things change, **the more they stay the same?**

As an industry we seem optimistic on 2020, aiming to deliver change and grow top line revenues thanks to robust, Emerging Market flows – even in the event of a global market downturn.

But what about our costs? How are we going to finance the risk-taking and transformation that we personally want to achieve? This is a central question for 2020: a year in which we will have only 23% of investment capacity available for new or growth projects.

Technology Investment in 2020 by area



The costs of simply continuing to exist (supporting legacy infrastructures and sustaining previous multi-year investment plans) constitute around 40% of total investment spend, although anecdotally these legacy costs can often rise to 70% of spend. A decade-long aversion to large-scale technological change has accentuated this, as we struggle to maintain ageing systems and an increasing volume of work-arounds and quick fixes: higher in Asia than any other region.

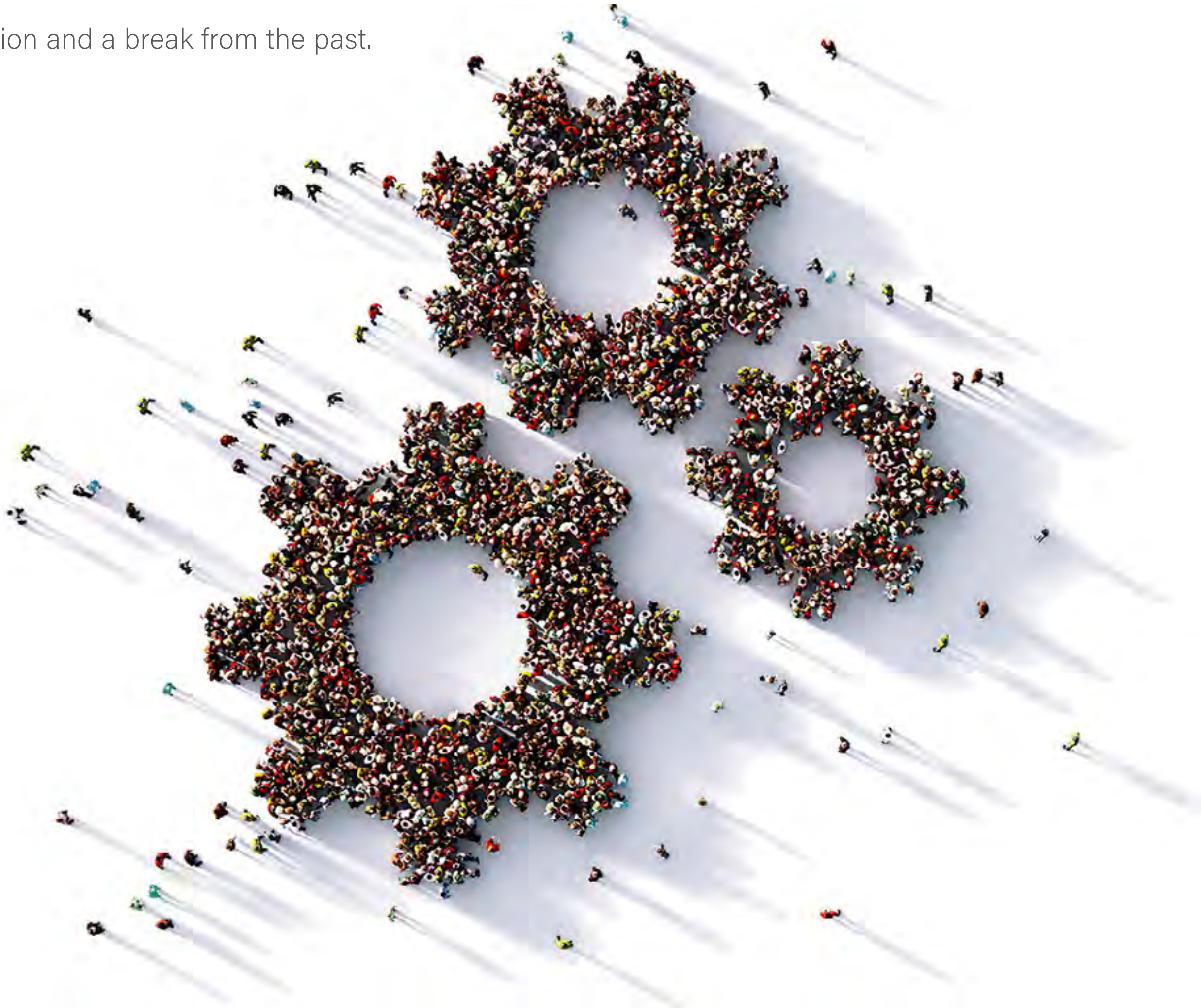
Meanwhile, the regulatory "tax" on financial institutions consumes 22% on average (26% on the sell-side; 15% on the buy side), disproportionately weighing on organisations with more than 5,000 staff.

"We're still much more worried about getting a fine than we are about getting a shiny new system"

None of this is new and, at first glance, the scene is set for 2020 to be a year like many others. With legacy- and regulatory costs consuming all resources, the inevitable transformation that would set the industry on a new path towards more profitable growth remains an impossibility. Faced with this viscious-cycle, staff will continue to move to industries with a more optimistic outlook and fuel a continued brain-drain.

Yet that is not the full story. This survey has highlighted a different spirit to 2020, where those focused on driving change see new opportunities to fund and to realise fundamental transformation in the industry.

A new equation and a break from the past.



7. Market and Regulatory Spend in 2020

22% of our 2020 spend will be on regulation: probably at the last minute

The burden of external market change weighs heavily across the entire financial services industry. Brexit has touched every part of the financial spectrum in nearly-equal measure; product distribution rules are impacting every manufacturer of financial products; index changes and rebalancing impacts almost every passive investor globally; and liberalization in China has almost every broker, bank or investor busily formulating a Board-level strategy on how to benefit from it. The impact of these developments has been felt globally and across every profile of respondent.

Regulatory impact: how strongly are we feeling market change in 2020?

	Industry	Fund Managers	Brokers	Banks / Custodians
Global		China onshore 48% Index changes 44% Product Dist 42%	Brexit 46% MIFID2 40% Initial Margining 38%	Brexit 40% CSDR 38% SRD-II 38%
Asia	China onshore 46% Exch / Mkt : 42% Product Dist 42%	**China onshore 50%** Index changes 44% Product Dist. 42%	Mifid II 44% Brexit 42% China onshore 42%	Brexit 42% Index changes 40% CSDR 1.938% SRD-II 34%
Europe	**Initial Margining: 50%** **Index changes: 50%** Product Dist: 44%	Brexit 46% Initial Margining 46% Mifid II 46%	**CSDR 54%** **Brexit 54%** Initial Margining 46%	**SRD-II 50%** CSDR 42% Brexit 40% STFR 38%
Americas	**Index changes: 60%** **Liq Risk Mgt 50%** Initial Margining 46%	**Liq Risk Mgt 50%** Prod Dist 46% China Onshore 46%	**Brexit 60%** **CSDR 50%** **Mifid2 50%**	**Index changes 60%** SRD-II 40% Brexit 40%

Growth versus Survival

The contrast in outlooks for investors versus their sell-side partners is striking. While we all struggle with industry-wide change, fund managers look set to focus on driving their 'competitive advantage' through initiatives such as China onshore and index rebalancing in 2020. Whilst impacted by many of the same regulations as the sell-side, fund managers are feeling the impact 10-30% less – as they prioritise their own market change (active to passive, etc.) ahead of regulatory development.

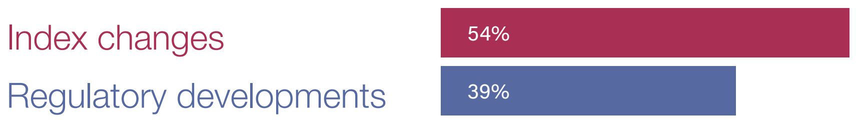
For Banks and Brokers however, Brexit, CSDR, SRDII, MIFID2 and UMR dominate the agenda as players struggle to cope with change that has a material impact on their end-to-end trading infrastructures. Unable to move out of the 'survival' zone in 2020, financial intermediaries will spend the year accomodating imminent regulation simply to avoid the risk of penalties.

Index Companies: the biggest movers of all

Yet the leading external change in 2020 isn't even regulatory. The impact of benchmark index changes (i.e. changes to country-weightings in leading investment indices) is considered to be almost 50% higher than that of any single regulation due to hit in 2020. Cost-wise, the implications of these changes are significant, as operational, legal, compliance and risk departments across the industry (not just amongst fund managers) scramble to adapt to new markets or to add essential capacity ahead of rebalancing weekends.

With index companies still unregulated, a small number of (commercial) organisations are wielding enormous power over the world's financial industry: more than any single regulatory authority.

Index changes: the largest market developments in 2020



Product Distribution: Protecting Investors from themselves

But regulators are keeping busy. From a global regulatory perspective, Product distribution rules and Liquidity Risk management are not only considered to be most impactful developments in 2020, but they are also the most costly to investors internationally. Whilst this has been a dominant regulatory theme since the failure of Lehmans in 2008, recent crises (such as the Woodford scandal) have underlined the inability of the current global framework to prevent mis-selling and fund closures. With one regulator recently stating that "our job is to protect investors from themselves", we can clearly expect more rules in this space in 2020 as markets raise the bar ever-higher in this key space.

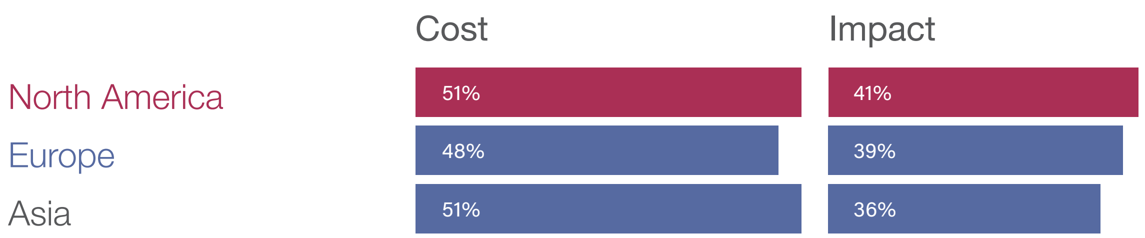
"**The Woodford experience has probably been the final straw** for regulators on product distribution rules"

Extra-territoriality: A global regulatory sandwich centred on North America

With almost all leading regulation in 2020 extra-territorial in nature (ie impacting investors around the world) it is not surprising that their impact is felt as strongly in North America as it is in Europe. American institutions also have their own rules to contend with though (notably in Product distribution and Liqudity Risk Management), which is why they feel the hardest hit by the global costs of regulation: sandwiched as they are by what is happening on both sides of the Atlantic. Whilst it is ironic that the US' lead in extending local regulations globally is now costing them more than most, we are all moving further and further away from a globally harmonised regulatory framework.

Eastwards, Asian respondents feel less strongly impacted by global regulations (strikingly out of step in its views of LRM or CSDR for example) and yet, they do not escape the regulatory tax entirely. Asian respondents feel disproportionately hit by a very localized form of market cost: exchange and depository changes. After Singapore's costly CDP platform change, major market change is imminent in Hong Kong and Australia: creating an unavoidable external cost burden for all members and participants.

Where is regulation hitting and costing us in 2020?



Global custodians: caught in the middle

The theme of 'sandwiching' is equally applicable to many banks: whose combined roles as depositary banks, global custodians and middle office outsourcing providers make them critical dependencies for new and emerging regulation.

As UCITS-regulated depobanks, they are under increasing pressure to act as 'policemen' for new regulations (such as LRM and CSDR). As global custodians they must be ready to quickly offer investors the benefits of market liberalisation around the world (including in China, Saudi and others). And as middle office infrastructure providers, they must be amongst the fastest to operationalise new regulations – well ahead of individual investors. All the while catering to investors' need for customisation and solutioning (the #1 buying criteria for fund managers globally). No wonder then that these banks feel more impacted by more regulations than any other segment: highlighting a key risk in our global, financial supply chain.

"Are we [depobanks] **meant to be policemen for the regulators**"

Operationalising Regulation: pay attention

After ten years of intense regulatory change, today's single largest challenge is not the volume of new regulatory market change, but rather the operationalisation of new regulation. Despite the growth in regulatory authorities and increased specialism in market advocacy, the industry appears to continually fall victim to the same basic errors: too few realise that they are impacted by new regulations; a small-but-informed minority is left to define their operational rules; and practitioners are then unable to accommodate these rules once they realise that they are indeed in-scope.

In Q4 2018, MIFID2 triggered an industry-wide, global last-minute dash to accommodate new reporting requirements ahead of the January deadline. Looking ahead, the industry's surprisingly cool views on the impacts of CSDR, SRD-II and SFTR (seen even by Europeans only as having a 'medium' impact) should be a warning flag to many in this context.

Are we set to witness a similar rush as we prepare for UMR, CSDR, SRD-II and SFTR deadlines: driving up the cost and prolonging the insecurity around each regulation?

Remember growth?

In a context of prolonged and renewed regulation, the regulatory 'tax' doesn't appear set to decline through 2020: leaving organisations with scarce resources to fund growth. As the European Commission (and others) begin again to focus on its core priority of "jobs and growth" (their Green Paper on Capital Markets Union cites an EUR315bn investment package to drive growth), the central regulatory question to this year though will be how authorities manage the inevitable trade offs of driving investor safety and industry profitability at the same time.

One piece of good news: "whilst the [regulatory] bucket isn't emptying as fast we'd like, at least it's stopped filling up".

Regulations Breakdown

	Description	Responsible Authority	Key Dates in 2020	Impact		Cost		
Product distribution rules	Multiple local regulations to protect investor interests and to prevent mis-selling	Multiple	Multiple (per market)	71%	High	95%	High	High importance globally. Very high costs in Europe, Americas.
Brexit	The United Kingdom's departure from the European Union and creation of subsequent free trade agreement	UK Government; European Commission	TBC	58%	Medium	84%	High	More expensive to US firms than to those in Europe
Liquidity Risk Management (LRM)	Provisions for insurers and fund managers to have (access to) sufficient funding to meet all levels of liquidity events	"US Federal Reserve France AMF"	Multiple (per market)	73%	High	69%	High	Asian investors are significantly out of sync versus other regions on impact and cost
Central Securities Depositories Regulation (CSDR)	Improved settlement discipline in European markets through settlement fines and mandatory buy-ins	European Commission / ESMA	**September (implementation)**	50%	Medium	60%	Medium	Impact is middle-ranking in Europe althoug costs are perceived as relatively high. Asia is completely unaware of the costs implied here
Local exchange changes	Ongoing changes by exchanges and depositories as they upgrade or adapt their rules and platforms	Exchanges and CSDs	**"Stock Connect / China-Hong Kong: 2020 ASX / Australia: April 2021"**	38%	Medium	60%	Medium	Least impactful in Europe; most impactful in Asia, where the costs are perceived as highest
China onshore	Liberalisation of foreign fund managers' access to private and retail investors in China	CSRC / AMAC	**April (first applications for WFOE retail fund licenses by foreign managers)**	48%	Medium	59%	Medium	Europe most conservative on impact; yet single-biggest driver in Asia
Common Reporting Standard (CRS) / FATCA	Automated cross-border exchange of information for tax calculation: new jurisdictions implementing the standard all the time	OECD	**Ongoing**	22%	Low	58%	Medium	Consistent impact globally: but North American investors see a uniquely high cost
Uncleared Margin Rules ("Initial margin" requirements)	Bilateral posting of (segregated) collateral to support all non-cleared derivatives	The Basel Committee on Banking Supervision (BCBS)/IOSCO	**"March 2020 (AANA calculation perion for phase 5) 1 September 2020 (Phase 5) 1 September 20201 (Phase 6)"**	56%	Medium	55%	Medium	Big deal in Europe and US; significantly underestimated in Asia
MIFID2	New requirements for pricing transparency; unbundling of research and execution.	European Commission / ESMA	**Live**	43%	Medium	41%	Medium	Impact felt more strongly outside Europe than within. Cost perceived to be highest in Asia
Benchmark Index changes	Changes to leading investment indices in order to reflect current global economic conditions.	"MSCI, FTSE Russell (Equities) Bloomberg, Citi, JPMorgan (Fixed Income)"	**See Chart**	100%	High	40%	Medium	Big deal for Europe and Americas (top 2). Americans disproportionately focused on index changes
Shareholder Rights Directive (SRD-II)	New requirements on disclosure by issuers; new voting requirements by holders	European Commission / ESMA	**September (implementation)**	40%	Medium	31%	Low	Middle-ranking in importance in Europe; not a priority for Asia and North America
Fund passporting	Asia Region Funds Passport from APEC & Mutual Fund Recognition programmes (primarly with Hong Kong)	APEC, Hong Kong SFC and others	**Live**	22%	Low	24%	Low	Low impact globally; including amongst Asian managers.
Securities Transactions in Financial Reporting	Reporting regulation designed to further elimate the scope for 'shadow banking': by requiring mandatory reporting of Securities Lending and Repo transactions	European Commission / ESMA	**April (implementation)**	34%	Medium	21%	Low	Seen by many as 'only' a reporting requirement: so lower business impact than CSDR (for example).

8. Investing for growth in 2020

Cyber, Digitisation and Cash efficiencies lead the way

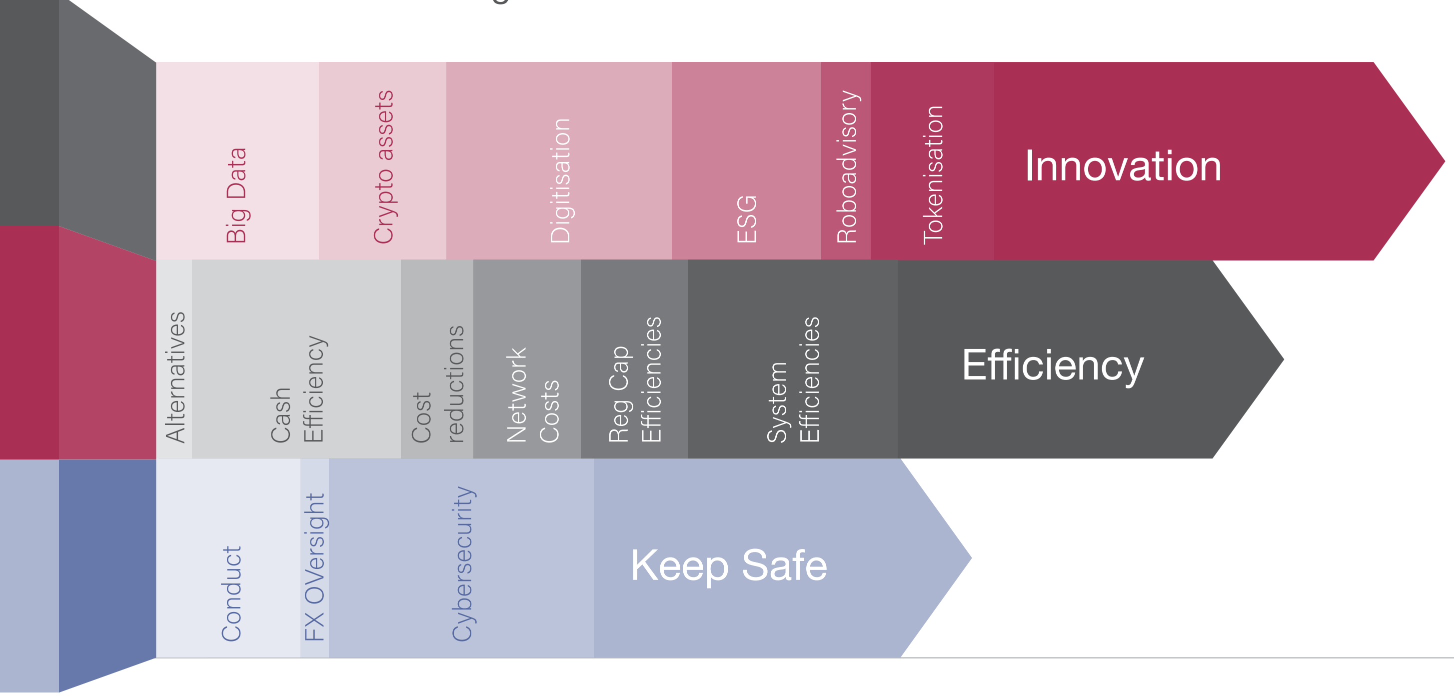
Since 2008, the industry has been characterised by two objectives: keeping safe from new regulation and driving efficiencies (a.k.a. cost cutting). Innovation has had to take a decade-long back seat as financial services professionals have sought out savings in every area.

2020 is different. Investments in cyber-security, digitisation and cash efficiencies are now the top three investment priorities - far ahead of cost cutting.

You can't cut your way to growth: so innovate

This year looks set to be the year when the industry acknowleges that you cannot cut your way to growth: and that innovation holds the key to transformational efficiencies in the years ahead. For that reason, institutions are spending more on innovation than on any other area in the year ahead (41% of total spend on new initiatives): as part of a balanced approach that sees efficiencies and keeping safe also playing strong roles (38% and 22%) respectively.

Where are we investing in 2020?



LegacyTech: the new target

Within the large 'innovation' space, Digitisation (automation and use of APIs), Big data and Tokenisation are the three most noticeable areas driving change in our industry in 2020: ahead of roboadvisory, crypto-currencies and ESG.

There is a global correlation between those who spend the most on legacy technology and those who are now investing most heavily in transformative technologies: underlining the fact that we are undertaking a generational change in industry platforms. Leading this technology charge are respondents in Asia (where legacy spend on technology is highest), then Europe and then the Americas: with the latter prioritising "Big Data" over digitisation as a core investment priority for the year ahead.

In this context, the new role of the COO as 'Chief Transformation Officer' is emerging as a key subject-matter-expert and dependency in the urgent path towards transformation. This group (whose job it is to deliver on this technology transformation) leads the pack in 2020 as the most bullish on adopting these new technologies quickly.

Who's worrying?

CEOs	COOs	Compliance
China onshore	Initial Margining	SFTR
Mifid2	Liquidity Risk Management	Brexit
Product Distribution	Exchange changes	
Cyber	Digitisation	Cyber
Digitisation	Tokenisation	ESG

Cyber-security: You can't innovate without staying safe

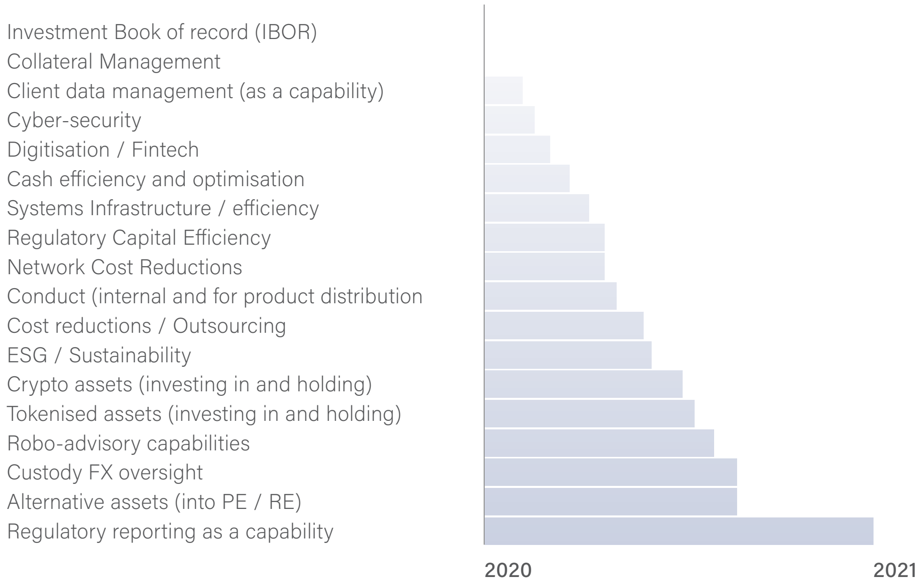
There is no financial sector if there is no safety: and so it is no surprise that Cyber-security is set to be the single biggest recipient of investment spend next year (ahead of digitisation and realising cash efficiencies). With the average cost of each data breach now estimated to be USD4million, every part of the industry and every segment will spend this year grappling the governance and technological aspects of cyber-security in order to avoid the dramatic consequences of failures (most notably ost customers). Europe seems set to lead the cyber-charge, whilst Asian CEOs seem least inclined to spend in this key area: and this single reason seems to be one of the best suited to collaboration.

Interestingly, conduct (as a technology investment) is not seen as a major priority: ranked in the lower 50% of priorities by almost all respodents.

Cyber spend versus other Technology spend in 2020

Digitisation: More haste....

When do we need our projects to deliver?



But this transformation is not without its challenges.

In both digitisation and cyber-security, practitioners are investing with great urgency: expecting to see significant milestones being delivered in the next 12 months. The question is whether the industry can evolve to employ these technologies on a large scale in the next year.

Technology vendors have a lot to contend with. Organisationally they are dependent on institutions' risk, legal and operations managers to embed the offerings into their ecosystems. And in an era of such intense innovation, they face significant risks of failure: if new initiatives (especially those based on DLT) fail to achieve market-wide scale "then they're just offering another model – and that makes it even worse." (Matthew Blackshaw - Ninety-One Asset Management).

Only Asian respondents seem to be comfortable in expecting slower returns from digitisation, at a higher cost. Are the rest of us being unrealistic in our hopes of digitisation in 2020?

Cash and FX: Efficiencies still count

Whilst the limelight shines on cyber and digitisation, driving efficiencies in 2020 remains a major priority for many- particularly in North America. Heading the list is the need to optimise cash flows and returns, as insurers, investors and intermediaries all seek to acclerate the speed of their cash and to transform unrenumerated pools of cash into income-accretive investments. The larger the organisation, the more pressing this need – with organisations of over 50,000 employees spending 30% more than their smaller counterparts. This spells bad news for (custodian) banks, who have so far survived without having to incentivise many of their customers to deposit cash balances with them.

More bad news for custodians is the continued intention amongst investors to increase their 'custody FX oversight' as they look to move towards direct interaction with trading desks for competitive exchange rates.

> "We've wanted to do this for several years but it's now **a real priority for us in 2020**"

Finally, a sobering note on ESG: which apears to be a victim of scale. A top-5 priority for smaller organisations (<5000 staff) globally, it sadly disappears off the radar amongst larger companies. Is ESG being pushed out by regulation? Or is ESG only relevant to small and medium-sized asset managers as a priority?

#vxbeat insight on tokenisation: **Disruption or Demat v2.0?**

Tokenisation: targeting Banks' home turf

Digitized assets are no longer a future trend. 60% of our respondents claims to have already dealt in or with digitized currencies: a market that has been transformed by this technology in almost no time. Once the exclusive domain of the world's banks, cross-border payments are, today, up to hundreds of times faster and cheaper – thanks to the blockchain backbone that allows them to be tokenized.

And the revolution is beginning too in illiquid, paper-based assets (such as venture capital or physical assets). Growing numbers of live projects are increasing participation in and liquidity of previously niche and hard-to-trade assets.

But the real target is core banking territory. The world's listed securities markets are cited by 35% of respondents as their core focus for digitization: as they seek to replicate the radical cost efficiencies and increased liquidity from the payments industry in this new market.

What do investors expect from tokenisation?

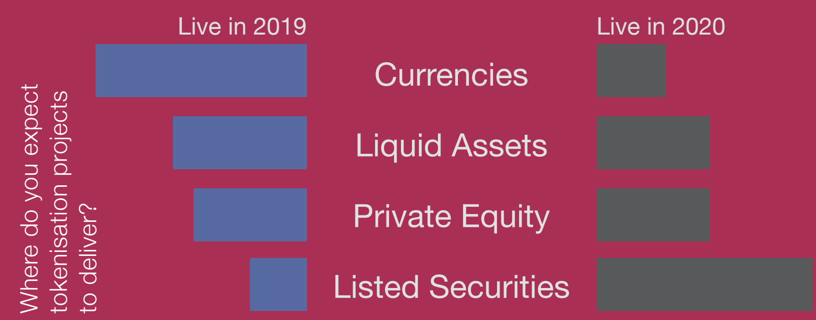
Currencies	Liquidity
Liquid Assets	Security
Private Equity	Investor
Listed Securities	Cost

Whilst cost reductions and security improvements are seen as the two headline benefits behind digitized assets, these different usage cases are making progress for different reasons.

Successes in the payments industry have indeed led to increased financial inclusion (particularly amongst the world's unbanked), with lower costs driving liquidity exponentially. In the 'paper' space such as venture capital and real estate, the key perceived benefit is investor access and security (for 29% of respondents): as investors seek to diversify their investments into these new assets without having to price-in significant amounts of operational and market risk.

The listed securities industry appears ready to re-invent itself. In a context of cost-cutting and cyber-attacks, the hope is that digitized assets can bring efficiencies of a scale not seen since dematerialization began in the 1960s: where massive cost efficiencies (cited by 25% of respondents as priority) and security improvements (17%) combine with increased liquidity to deliver a huge jaw effect.

What do investors expect from tokenisation?



Judging by the speed of transformation in the word's payments industry, it is not surprising that over 60% of respondents are planning to be trading and holding digitized (listed) securities within the next 15 months. People are counting on rapid change.

But can exchanges, banks and regulators change at the pace that they need to (in a post-subprime and post-GFC world) – in order to bring transformation to the securities industry? Can regulators forge a consensus on how these assets should be classified? Can Central Banks mobilise their currencies to the levels required? Can commercial banks and institutional investors teach themselves how to supervise and manage the risks of this new world? It seems like a very big ask when dematerialisation took 40 years.

What do I do now?

We need to be getting ready. Could we complete an in-depth due diligence on tokenized asset safekeeping? Do we know what risk indicators we need to be tracking? Aside from saving some money when we send money abroad, we all need to be preparing ourselves to hold digitized assets very soon. We probably can't afford not to.

9. Partnership in 2020

Regulation vs Legacy vs Transformation: Collaboration is the new answer

The finance industry is at a crossroads in 2020. Individuals are focused on change and we believe we can deliver on our 2020 objectives. Moreoever, we acknowledge that now is the time to employ new technologies to transform our industry. But how will we effect this change with only 23% of budgets available for growth and in a market downturn?

How can we spend our way out of trouble when so much of our funding is already committed? Much like our technology investment, the answer lies in doing things differently.

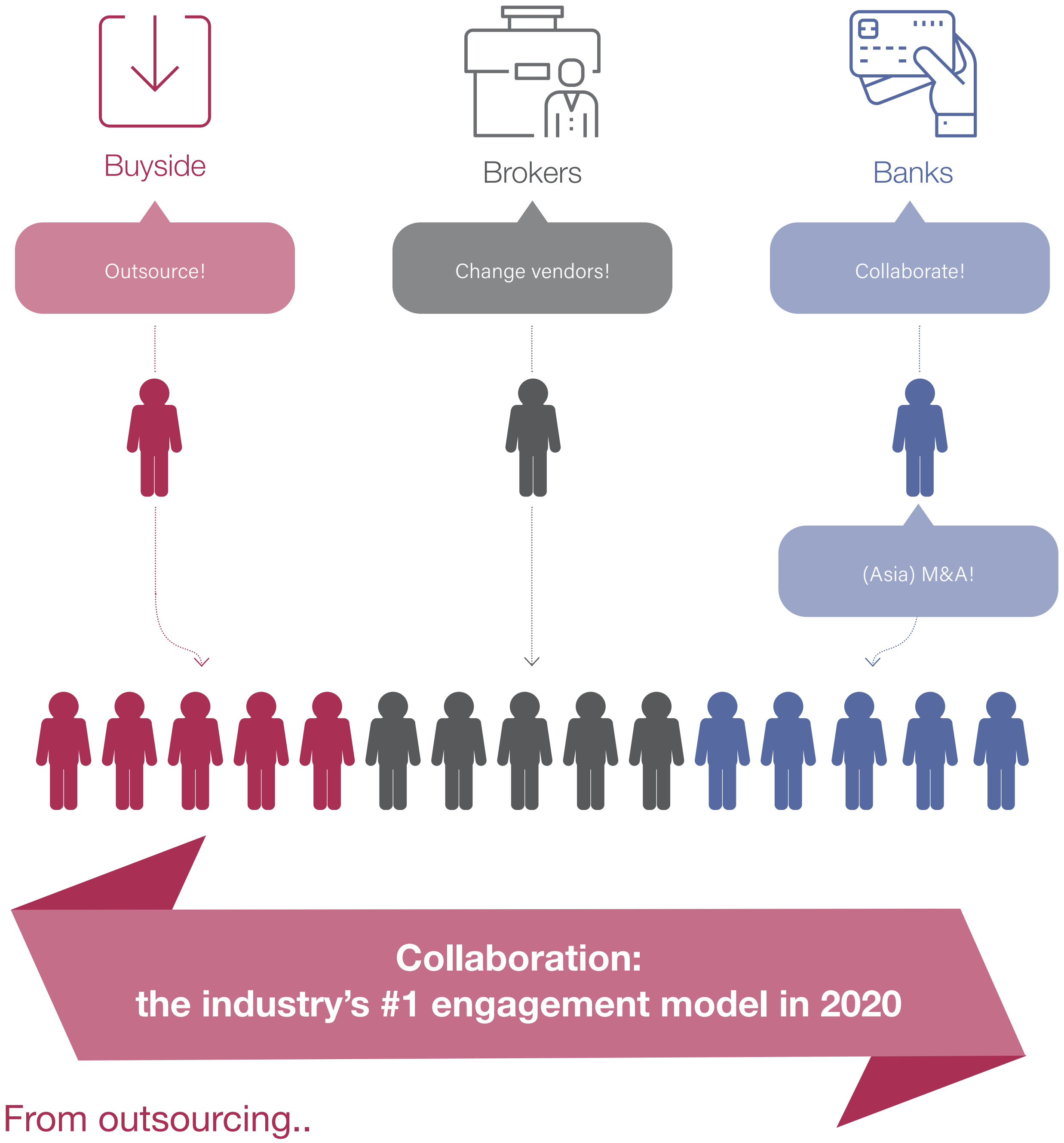
Renegotiate and then transform…

The prevailing view across the industry is that there is little point in continuing to squeeze existing partner relationships harder – and that we have probably reached a point of diminishing returns. Whilst 'renegotiating existing agreements' is the first choice for the industry in 2020 (as we seek to realise the change and efficiencies that are so needed), 'changing vendors' is often the least desirable option if those renegotiations don't deliver.

Rather than simply replacing vendors who do not deliver the required levels of efficiency, the industry's preferred path in 2020 is to change the model and 'cooperate' with other industry players. 24% of the industry believes that, if your vendor (and your operating model) can't help: change the model. Nowhere is this more true than amongst CEOs, COOs, Europeans and in the banking sector.

Only in Asia is inorganic growth still considered to be a desirable partnership model (mainly for Asian banks).

How are we delivering on change?



…From outsourcing..

Importantly, cooperation isn't always outsourcing.

On the buy-side, investors have accepted middle and back office outsourcing as a viable partnership model for their future businesses – considering it their #1 partnership model in 2020, with COOs and Operational functions leading the charge to outsource. With large flagship deals (Standard Life – Aberdeen; Jupiter-Henderson; and AXA IM) all having been renewed in 2018/2019, the model appears to have been validated at the largest scale.

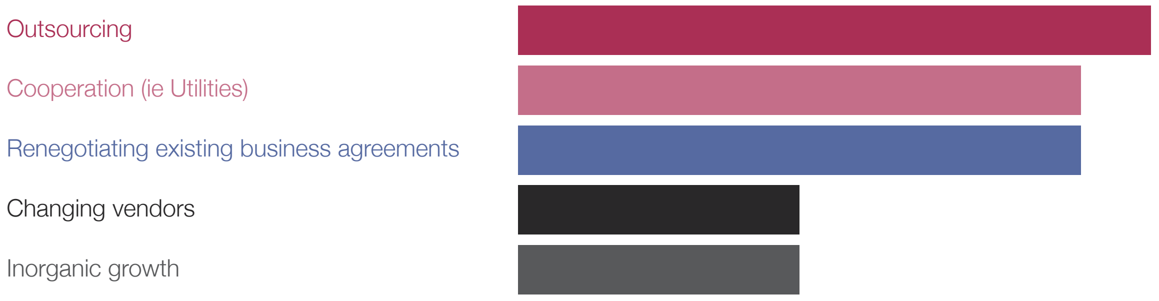
Sadly, the same can not be said on the sell-side, where broker-dealer outsourcing is the 4th most preferable partnership model in 2020. With the proposition still firmly limited to mid-tier brokers, the story here seems to be the opposite of the buy-side: small broker-clients do not pose an existential revenue threat to their providers and so their providers' platforms do not receive the investment that they need to mature and unlock signficant value.

Despite great fanfare and optimistic projections even five years ago, the broker-outsourcing industry now seems to be in contraction (with vendors leaving or reducing investments), leaving brokers with the sole choice of 'changing vendors' as their #1 path for future change.

Outsourcing in 2020: the buy-side and sell-side's views

Fund managers

Partnership model



Brokers

Partnership model

…to co-sourcing…

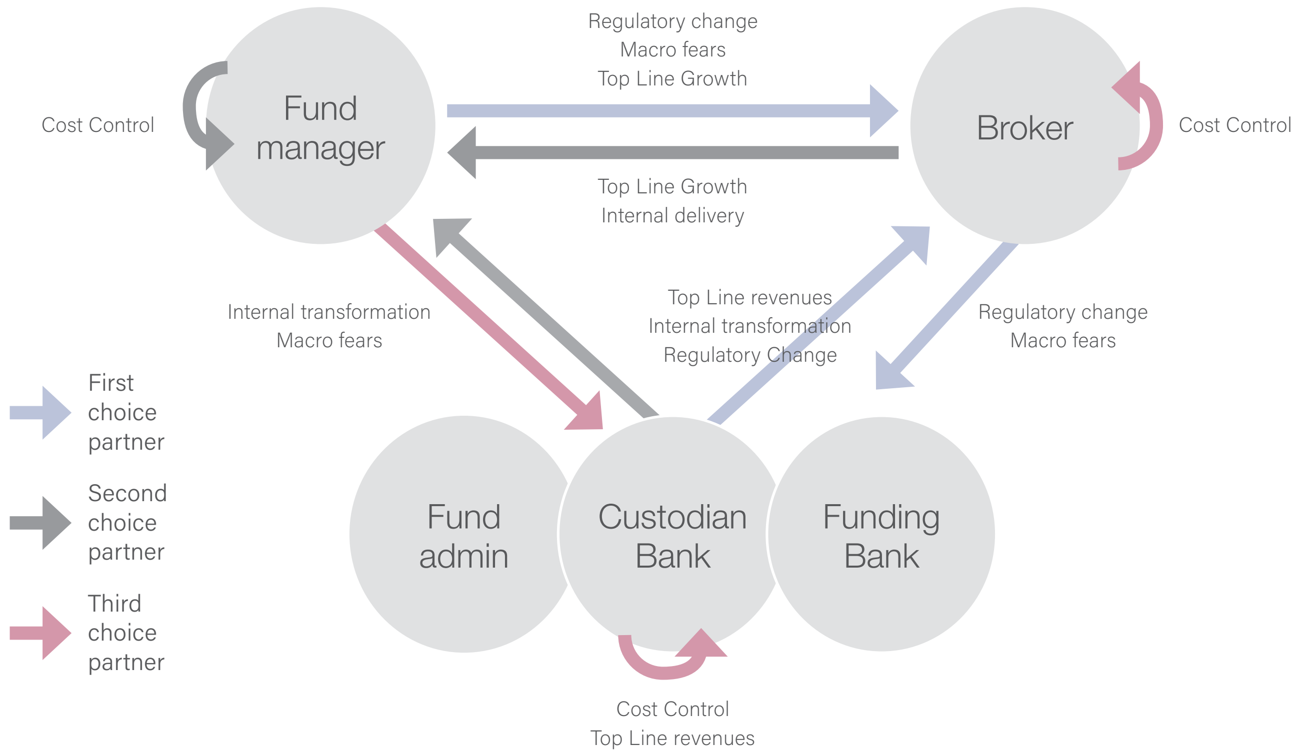
So what collaboration do we have in mind then, if it isn't outsourcing?

For those looking to cut costs, collaboration in 2020 means turning to market peers to create utilities and mutualise processes – in order to create scale.

Yet despite numerous attempts in recent years, the undeniable logic of mutualised cost bases and increased volumes has failed to materialise often falling victim to the 'how':

How to structure the venture? How to balance the control amongst parties? How to make sure that no client data is leaked to the wrong partner? In an era of increased conduct and supervisory risk for each financial player, these questions probably

Collaboration in 2020



… and to collaboration

make this model decreasingly likely to succeed.

The second collaborative model centres on those looking to improve their overall P&L: where collaboration means partnering vertically with clients and providers to remove inefficiencies in the investment cycle.

At the heart of this trend are the organisations that sit in the centre of our industry: both regulators and Exchanges / CSDs see cooperation as their core priority for 2020. Equally, fund managers and brokers are central to this trend, looking to explore opportunities more actively with each other than with custodians or banks.

This collaboration is manifesting itself in multiple ways- and is not always headline grabbing. Broker-custody integration is not new, has been shown to deliver significant savings and has helped custodians to grow market share. More recently, investors and banks have co-developed APIs and bots to simplify and automate hitherto manual processes such as payments and matching. And one need only to look on LinkedIn to see numerous cooperative organisations or ventures (such as R3 or AccessFinTech) employing new technologies to mobilise assets, address new regulation, increase funding liquidity and bring transparency to our markets.

The consistent theme in all of these ventures is tranformative change: an admission that we need to reshape the way our industry interacts if we are to survive the cost pressures and regulations that are thrown at us in 2020, instead of just looking for incremental efficiencies.

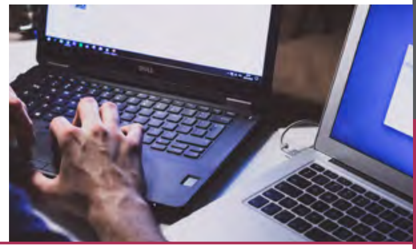
10. What to do now?

Know your colleagues:
form a team of people who you can rely on to deliver.

Take a good look at China

Understand & act on regulation.
Properly and efficiently.

Get cyber right



Collaborate with people near you in the investment process: to explore how you can interact differently and drive efficiencies

Thank you!

The insights in this report are available to you thanks to the generous support of our partners:

Thank you to all of the industry specialists who contributed their time and views for this research: both through our surveys and face-to-face. We hope you feel it was worth it!

Thank you finally to Rob Stewart and Andrea Moitinho for their essential support in producing this paper.

Vote in our "Grey Costs Per Trade" survey thevalueexchange.co/greycostspertrade

Where are you going to be in 12 weeks?

Imagine if you could be ready to...

Tell the whole market about your unique value on a key strategic theme?

Train your front line to deliver unique insights to your clients, in a way that your clients want to hear

Minimise your commercial risk by planning your roadmaps and resourcing around exactly what your clients want

See and measure how your front line is taking your story to the market: using concrete data-based outputs

Identify qualified sales opportunities before you've even spoken to the client

Contact us at thevalueexchange.co to get started!

2020 in Perspective

Regulation + Innovation = Collaboration

www.thevalueexchange.co