

Podcast only intro:

Julia Schieffer: Hello everyone. Just a quick head's up. This coming podcast is based on a video that we have published in November so please feel free to listen to the podcast or to go to our YouTube channel or DerivSource.com to watch the video. Thank you.

Podcast/video transcript:

Julia Schieffer: Hello and welcome to this DerivSource industry insights video. I'm Julia Schieffer, the founder and editor of DerivSource.com.

It's been 10 years since the financial crisis, and since then the industry has undergone radical change with the introduction of new financial regulation impacting trade and post-trade processing for both the buy and sell side. Looking ahead to 2019 and beyond, the industry faces a whole new set of challenges including geopolitical change, and of course including Brexit. But at the same time the industry faces a new set of opportunities in the form of financial technology innovation. And with me today to talk about both these challenges, but also the opportunities is Dr. Kay Swinburne, vice chair of the Economics and Monetary Affairs committee at the European Parliament. Welcome to the video. Thank you for joining us.

Kay Swinburne: Thank you for having me.

Julia Schieffer: I want to focus on the safety of the financial markets now. It's been 10 years since the financial crisis. Do you think that the financial markets are in fact, safer now?

Kay Swinburne: So, I guess 10 years has passed. A lot has happened in that 10-year period. In particular, a lot of global work has happened, so global coordination amongst regulators, supervisors, and indeed the politicians also talk; which has made a huge difference I think, to the way that we approach global financial regulation. In particular, I think our banks are definitely safer with much more capital held and anti-cyclical measures being put in place. But also, we've done an awful lot with regards to some of the infrastructure, so the central clearing facilities and other issues with regards to market infrastructure where things are safer. And data means we now know a lot more about what's going on. So hopefully that means that with those three things: with more capital in the system, increased emphasis on market infrastructure, and improved data, and the analysis of that data, hopefully we've got a better idea of what systemic risk is coming around next time.

Julia Schieffer: Kay, you were one of the architects of MiFID, and we've been focused on MiFID II obviously, with the deadline in January this year. Do you think that the regulations has been implemented and has the effect in the markets as it was intended to be?

Kay Swinburne: I think it's too early to tell in all honesty. I think we were seven years in the making of MiFID II. It took seven years for us to get it onto the statute books and to be implemented. It covers of course, all asset classes so I think it's very early days for us to tell what effect we're gonna have on the market itself. And particularly in the fixed income space and derivatives space where it is new ground. The equities is much more of an evolution, and therefore I think it's easier to tell with the data in the equity space. But it's very early days. The principles, of course, still hold. It's about fair and effective markets, making them much more transparent, and that transparency leading to greater investor confidence and investor protection. So, all of those principles are there.

We're seeing a little bit of innovation in the marketplace particularly, in the equity space and the derivatives space where maybe that's not what was intended. But the reality here is that I think if people start thinking about their customers more and how they serve those customers better then that's the type of innovation that would be positive rather than sometimes just trying to arbitrage the rules.

Julia Schieffer: So looking ahead, what do you think are really the biggest unknowns for 2019 and beyond and that will impact that way the market and market structure evolves?

Kay Swinburne: I think for the first time in my adult life geopolitics is up there as the biggest threat to the financial markets. There's geopolitics of all kinds, so Brexit being a very key one. It's obviously had a major impact not just in the UK and the City of London, but it is obviously also having an impact on EU 27 neighbours who now are noticing and realising that the large global financial center may indeed be outside of its agreement, and outside of its rule book going forward. That will create all sorts of changes and they believe that they now need greater and enhanced supervision of all third countries, which the UK will become.

That has a knock on impact in terms of geopolitics to other regions around the world who maybe thought their equivalence decisions were done and dusted, so in particular the US are getting a little nervous right now as the EU is revisiting EMIR 2.2; which looks at the equivalence decisions for CCP's. That may mean that in the future the US CCP's and DCCP's, which are systemically important from around the world may need to be directly supervised in some way by the EU if current proposals are adopted.

But that extends to other areas too. I think there's a mood in Brussels right now, that they would like to see some form of enhanced cooperation on the supervisory front for trading venues and indeed for every form of data collection, and anything that involves post-trade market infrastructure. So, I think there's gonna be a bit of a bumpy road ahead.

Julia Schieffer: And do you think for 2019 the focus will be very much on these geopolitical changes as you mentioned far more than new regulation or anything else that might come down the pipeline?

Kay Swinburne: So, I think the politics will dominate, and therefore many of the pieces of legislation with work done in the past decade will be revisited through a different prism. And that I think, causes a bit of an issue. We're seeing the U.S, revisit their roles too. What we need to make sure is that everybody stays in line, and that we keep this global regulatory forum alive, and that people start talking and continue to talk throughout all of the changes that they're proposing. But of course we've got an overlay over the top of this of technology. So, where you have new technological advancements particularly, in things like the distributed ledger technology. With the advent blockchain for post-trade, who know where we'll go in the future? That global dialogue's going to be very, very important going forwards.

Julia Schieffer: With the experience of the last decade behind us, where do you see the opportunity line in the future? Is it in innovation, like you mentioned? Or any other significant changes that will impact the market going forward?

Kay Swinburne: So, for me it be, exciting opportunities are in the innovation with financial technology; so FinTech and RegTech. I think using the framework of regulation that we have, people finding more efficient solutions, people finding better customer services, and delivering for their customers in a much more appropriate way.

For me, trust and confidence was lost during the financial crisis. Certainly, 2007 and '08 were certainly dark days for us as politicians to come in and try and look at what we could do to restore that trust in the marketplace. So, now that we have restored it, I think innovation is the way that people can now actually further enhance that trust and confidence. I get more people exposed to investments. More savers becoming investors; made our economy grow across Europe and across the world.

For me, there's a huge opportunity. But innovation needs to be used with a social conscience. It needs to be there to serve customers. It needs to be there not for short-term maximising a profit for the company, but to actually maximise the return for that customers. And I think if people remember that, then we're going to have a much better financial market that serves customers and makes new customers new investors, out of everyone.

Julia Schieffer: You mentioned distributed ledger, and focusing on that in particular, how can that practically be applied in the financial markets going forward?

Kay Swinburne: I'm spending a lot of time at the moment, discussing the location of central clearing; where CCP should be located. For me, the real opportunity would be if we could use DLT or any form of technology to actually take away that location argument and actually use it for the post-trade space, for clearing, for

settlement and potentially gain those efficiencies for global investors. Why do we have to worry about where it's located? When actually that technology might take away that need going forwards.

Julia Schieffer: Do you think that financial institutions and the market in general is just not focusing enough on the innovation, rather than some of the kind of political changes and maybe it should be reversed? They should be thinking as you said, where technology can aid where it might not be used currently.

Kay Swinburne: I think there's a huge expanse of regulation out there that is putting off some of the smaller companies from participating. But actually, my advice to them would be to use the regulation in their favor. All of the regulation that we have written in Brussels over the last decade, is technology neutral. Therefore, those new entrance should be able to gain traction very quickly, if they bring an offering that serves customers better.

Julia Schieffer: That regulation definitely is more future-proof for that reason if it is as you said, technology neutral.

Kay Swinburne: Absolutely. Fintech is the way that we should be thinking of these things, and there are lots of solutions out there for both incumbence and new-entrance.

Julia Schieffer: Focusing still on 2019, what are some of the other concerns that you think financial institutions should be concerned about? Is it fragmentation? For instance, about the market or the changes in way regions talk to each other; communicate or a lack of harmonisation perhaps, going forward?

Kay Swinburne: We've accepted over the last decade that a global rule book is close to each other's rules as possible; is the optimum situation. And it's been a given, for the last 10 years that that's where we're aiming at and particularly, 2009 Pittsburgh Agreement on derivatives and in particular, central clearing and the trading of OTC derivatives was a seminal moment where people accepted that it was better that we had similar rules, similar outcomes.

For the first time, I think with the geopolitical outlook at the moment, we're starting to see what could be a fragmentation in the markets. The U.S is looking at doing particularly, a review of its rules within Dodd-Frank. We're seeing a change here in the EU, post-Brexit with changes in the way that they might go forwards. And then what the UK itself, chooses to do for its financial regulation depending on its future relationship with Europe. All of these are potential points of fragmentation. And then we lose that global outlook, and actually start to have regional markets all over again. Then you start to have arbitrage opportunities and we get back to where we were; potentially pre-2007 and '08.

For me, that is biggest risk to the system. Fragmentation as opposed to the globalisation that we had seen over the past decade.

Julia Schieffer: That's quite significant, given what we've done for the last 10 years then if it can be all undone pretty quickly if people aren't focused.

Kay Swinburne: Globalisation has become normalised, and we now expect it to happen. We expect our regulators to talk, we expect the supervisors to communicate on a regular basis, we expect the politicians to have a similar view on where the direction of travel is going. That may not be as given a destination as we have had in the recent past.

Julia Schieffer: Other than that warning? Is there something that you'd recommend the market do to make sure that, that potential risk doesn't come to be?

Kay Swinburne: Well many of the players obviously, and the global derivatives markets in particular, are global in their nature. Therefore, they do have contact with all of the politicians and each of those jurisdictions. They do communicate with the regulators and are overseen by them in those different regions around the world too. So, I think the role of the global company in making sure that all of these risks of fragmentation are well-known, well-rehearsed, and don't therefore, happen because people are aware of what they might be doing as



an unintended consequence. Those global players really do need to step up and actually help with our activities.

Julia Schieffer: And take the lead. Definitely. Thank you for joining us in this video today, we really appreciate you sharing your insight for us as we move into 2019.

Kay Swinburne: Thank you.

Julia Schieffer: Thank you for watching this video. To find out more information on the topic or related topics, please go to derivsource.com to read our articles, listen to our podcasts, or sign up for our various webinars. You can also subscribe to our YouTube channel or follow us on social media. Thank you again.