Fintech and the development of capital market access

Fintechs, start-up companies that focus on financial technology, are very much everybody's darling nowadays. Every financial centre as well as many banks have their own Fintech incubators or accelerators. Clearly, Fintechs can bring enormous benefits unconstraint by legacy systems and processes. Fintech usually claim to be disruptive and we have seen this primarily in the retail sector so far, for example in consumer loans with peer-to-peer lenders such as Zopa, robo-advisers such as Nutmeg and in other areas such as FX transactions by companies such as Transferwise. These Fintechs have benefited and made use of technology and economies of scale that weren't available before or that incumbents were not able to leverage because of idiosyncratic restraints. In retail markets Fintechs have been able to promote their services directly to customers and have been able to make market gains against incumbents by being more cost efficient and easier to use but also due to a focus on very particular niches.

In a wholesale environment such as capital markets these methods are less obvious. Fintechs must overcome considerable barriers such as the complexity of regulations, IT systems, capital requirements and a need for accepted standards. In addition to these hurdles research suggests that Fintechs supported by banks or other strategic players such as exchanges tend to reach maturity faster and become more successful[1]. Disruption in wholesale environments is therefore less common and much harder to achieve but also less desirable than an evolutionary approach. Disruption in itself is not a value. Fintechs can work alongside banks and help them across the value chain by monetising existing assets, e.g. data, much better or by mutualising industry costs. The latter approach exists already for a long time, e.g. SWIFT, the payment system, or the DTCC in the US for settlement issues. A similar approach has been taken by collaborative start-ups such as the R3 consortium in the blockchain environment. Others such as Trustbills are looking more at the commercial banking sector rather than capital markets. However, the concept of establishing industry utilities is an infinite much harder approach than offering a new product in a very specific niche to retail consumers.

At DZ BANK we have now taken the rare opportunity – together with many other banks - to support a new industry utility that will revolutionise debt capital markets not by disruption but by working with the banks to mutualise costs that so far have been carried by banks, issuers and investors alike and which have been hindering the efficient development of debt capital markets. The European private placement facility S.A. ("eppf")[2] has been born out of conversations between investors, banks, law firms, accountants and borrowers that all had specific needs. Through significant industry cooperation eppf is already helping to realise and to release significant industry benefits in the DCM space.

eppf is a neutral platform that allows borrowers – SMEs, large caps, municipalities, regions, sovereigns and agencies – to issue debt securities in a fast, standardised and cost efficient way, thereby helping the banks restoring their ROE, improving existing client relationships and optimising regulatory compliance. It is, however, also beneficial for other stakeholders such as borrowers which can tap markets in a way not possible before, investors which will find a stringent quality control in eppf, can rely on a standard documentation and can get help in conducting due diligence via centrally available data hubs, as well as regulators and the overall economy by bridging national borders that still limit markets to smaller regional pockets.

[1] BCG – Fintech in capital markets Nov 2016.

[2] www.eppf.eu

By offering the complete value chain of a bond issuance and involving the relevant stakeholders and using their strengths in an orderly process, eppf allows each stakeholder to concentrate on what it does best – banks originate and place bonds, investors analyse credits and make informed investment decisions, borrowers tap a large universe of potential investors to meet their funding needs and regulators supervise efficiently. eppf on the other side is the link between all of them, being an independent platform, regulated by the Luxembourg CSSF and providing all the necessary "plumbing" in between all market participants. It is a Fintech that supercharges the value chain for all stakeholders and thereby provides benefits to the entire market. Not being disruptive but rather evolutionary, eppf enables nevertheless new outcomes which cannot be described other than revolutionary. Due to the immense economies of scale that eppf can achieve it is possible to settle trades at T+1 which not even many sovereigns can achieve. This will be improved to T+0 in the future which will basically make the difference between primary and secondary markets disappear. Furthermore, by standardising bond documents they become better comparable and consequently will be easier understood by traders and investors contributing to improved pools of liquidity. Reducing the costs for issuance in such a way that new issuers can access markets will reduce an economy's dependency on bank funding and can thereby break feedback loops between sovereign funding and banking crises increasing the overall resilience and stability of an economy. Considerably lower funding costs for borrowers as well as lower transaction costs for banks and investors speak for themselves. Opening up a whole new borrower universe for investors and tearing down national borders to establish a real capital markets union will also allow investors to provide better opportunities to their clients.

Overall, we think that this is an excellent case study and model to follow on how Fintech can be used to the advantage of a whole market and even entire economies. It nevertheless takes an open mind from incumbents and current stakeholders to actually tap these efficiencies and to leverage such benefits. We hope that many more industry utilities in the same manner make their way to market and provide revolutionary services in a collaborative way.

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