

Market infrastructure

Regulation and technology overhaul financial market infrastructure

Technology and tougher regulation are reshaping the infrastructure the financial services industry relies on to function. The four pillars of financial market infrastructure: payment systems; trading platforms; financial benchmarks; and custodians are all unique in the trends that are influencing their M&A activity.

Our 2018 M&A forecast

Payment systems/e-money providers



Compounded by new regulation and innovators, the disruption will continue to drive M&A levels to new highs.

Stock exchanges/clearing houses



MiFID II expanding the types of regulated trading venues will result in an uptick in market consolidation.

Financial benchmarks



A lull in M&A as many benchmark administrators concentrate efforts on EU Benchmark Regulation compliance.

Custodians



Some consolidation M&A as Central Securities Depositories (CSDs) continue to encroach on custodians.



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The high tide of new regulation has passed, but a long implementation period is yet to come. M&A is on the horizon

Competition among payment systems intensifies

Competition in the payment systems space is increasing as technology opens the door for new entrants to challenge established operators. Regulators have been paying more attention to the space too, encouraging competition and thereby adding pressure on profitability. Businesses in the sub-sector have had little option other than to scale up to mitigate the risk of regulation and competition eroding margins further.

M&A has been an obvious strategy, prompting deals like Vantiv's merger with Worldpay, Blackstone's and CVC's acquisition of Paysafe and Hellman & Friedman's takeover bid for Nets.

Feeling cost pressures, financial benchmarks take cautious approach

Operating costs for the producers of financial benchmarks have increased substantially post-financial crisis, as new regulation bites and the risk of tougher enforcement action from EU and non-EU regulators intensifies. Regulators now expect benchmark administrators to police their data submitters and only a few have the infrastructure to fulfill this role.

Administration of financial benchmarks has consolidated in the hands of a few institutions, as the new EU Benchmark Regulation nears its effective date.

Consolidation in trading platforms continues

New regulations like MiFID II, which will expand the types of trading venues that are regulated, will ensure that consolidation remains a theme in the trading platform space, as will ongoing efforts to promote co-operation and harmonisation between exchanges through joint ventures and strategic alliances. Although the proposed merger between LSE and Deutsche Börse was aborted earlier in 2017, both LSE and Deutsche Börse have subsequently reported active inorganic strategies.

Some trading platforms, however, are now curbing their global ambitions in favour of building themselves up as "home grown" champions, as evidenced by Euronext's acquisition of LSE's French clearing business.

Custodians with stronger balance sheets seek consolidation

Global custodians like BNY Mellon, State Street and J.P. Morgan continue to dominate, but there are signs of entrants like BNP Paribas making inroads.

Custodians with stronger balance sheets, such as Bank of N.T. Butterfield and Northern Trust, continue to grow inorganically.

Market infrastructure (continued)

	Payment systems/ E-money providers	Stock exchanges/Clearing houses	Financial benchmarks	Custodians
 <p>2018 outlook</p>	<p>High M&A levels. Main motivation is likely to include competition with other established participants, compounded by disruption by new regulation and innovators</p>	<p>An uptick in market consolidation. Main motivation is likely to include regulatory change (e.g., expanding the types of trading venues which are regulated under MiFID II)</p>	<p>Many businesses have already up-scaled their operations. Strategic investments into fintech is likely to continue</p>	<p>Continued rise in outsourcing arrangements. Global custodians are likely to continue to remain dominant, though regional players may expand (possibly through sub-custodian arrangements)</p>
Current market	Upward, very high levels of activity	Upward	Flat	Flat, with a dip in the levels of M&A
We are seeing	Strategic M&A, financial sponsor-led M&A, established bank deals and successful fundraisings	<ul style="list-style-type: none"> □ Strategic M&A: <ul style="list-style-type: none"> – Market consolidation globally and regionally, with some signs of platforms concentrating on ‘home continent’ markets – JVs and other forms of strategic alliance – Vertical integration, through fintech and financial information service acquisitions 	Strategic M&A	<ul style="list-style-type: none"> □ Strategic M&A: <ul style="list-style-type: none"> – Rise in outsourcings. While global players (namely BNY Mellon, State Street, J.P. Morgan and Citi) continue to dominate, there are early signs of inroads by smaller players – Some custodians with robust balance sheets execute inorganic growth strategies
Key drivers/challenges	<ul style="list-style-type: none"> □ Market participants being forced to scale up to meet reduced profitability resulting from: <ul style="list-style-type: none"> – New EU regulations – Increasing operating costs from additional regulatory burden and multilateral interchange fee litigation risk – Competition from innovators and alternative services □ Market participants expanding their offerings (e.g., banking services) □ Upward demand trajectory for payments services 	<ul style="list-style-type: none"> □ Increasing co-operation between exchanges □ Mega-mergers are unlikely to secure regulatory and anti-trust clearances 	<ul style="list-style-type: none"> □ Changing market requirements (e.g., LIBOR to be phased out by end-2021) □ Increasing operating costs from: <ul style="list-style-type: none"> – New regulation – Increasing litigation risk (e.g. heightened enforcement action risk from EU and non-EU regulators and end-user lawsuits) □ Investment in fintech 	<ul style="list-style-type: none"> □ Competition from Central Securities Depositories (CSDs)—as CSDs face increasing competition under the EU Central Securities Depositories Regulation, they are seeking to cannibalise custodians □ Increasing operating cost bases and heightened regulatory enforcement risk □ Identifying new revenue streams given low net-interest income
Trends to watch	<ul style="list-style-type: none"> □ Interest in payment services from financial sponsors, market participants and established banks □ Regulatory intervention in the payments sector □ Regulator acceptance of fintech—if stability and security can be demonstrated 	<ul style="list-style-type: none"> □ Impact of Brexit on London’s euro-clearing business □ Impact of efficiencies derived from Target2-Securities, the single pan-European platform for securities settlement in central bank money 	<ul style="list-style-type: none"> □ A smaller number of market participants having sufficient infrastructure to support benchmark administration □ Uncertain profit margins 	<ul style="list-style-type: none"> □ Smaller custodians chipping away at global players’ businesses

Market infrastructure – Key deals and situations

Payment systems/E-money providers

Market participants scaling up	<ul style="list-style-type: none"> □ Ingenico Group's acquisition of IECISA (<i>October 2017</i>) and Bambora (<i>July 2017</i>) □ Vantiv's merger with Worldpay (<i>August 2017</i>) □ B+S Card Service–PAYONE merger (<i>May 2017</i>)
Expansion into banking services	<ul style="list-style-type: none"> □ PayPal's deal with Visa to issue debit cards in Europe (<i>July 2017</i>) □ Klarna (<i>June 2017</i>) and Adyen (<i>June 2017</i>) both successfully secured European banking licences
Established bank interest in payment service providers	<ul style="list-style-type: none"> □ CaixaBank's agreement with Alibaba to support Alipay (<i>August 2017</i>) □ Swedbank's acquisition of PayEx (<i>May 2017</i>) □ BNP Paribas Fortis's acquisition of PaySquare Belgium (<i>May 2017</i>)
Private equity interest in payment service providers	<ul style="list-style-type: none"> □ Hellman & Friedman's takeover bid for Nets (<i>September 2017</i>) □ Blackstone's and CVC's acquisition of Paysafe (<i>August 2017</i>) □ Neptune's acquisition of Transact Payment (<i>July 2017</i>)
Favourable market conditions	<ul style="list-style-type: none"> □ The World Bank projects 3-4% annual growth in the coming years (<i>August 2017</i>) □ TransferWise's projected revenues of £100 million in 2017 (<i>August 2017</i>)
Competition from new entrants and innovators	<ul style="list-style-type: none"> □ Payconiq's acquisition of Digicash Payments (<i>August 2017</i>) □ Stripe's tie-up with WeChat Pay and Alipay (<i>July 2017</i>)
Increasing litigation risk	<ul style="list-style-type: none"> □ Revival of class action against Mastercard alleging anti-competitive behaviour (<i>August 2017</i>) □ US Consumer Financial Protection Bureau published proposals to restrict use of out-of-court arbitration clauses (<i>July 2017</i>)
Regulatory intervention	<ul style="list-style-type: none"> □ UK Payment Systems Regulator's plans to alter fee calculation and collation methodology (<i>August 2017</i>) □ Bank of England's widening of access to UK payment systems to non-bank service providers (<i>July 2017</i>)

Stock exchanges/Clearing houses

Market consolidation	<ul style="list-style-type: none"> □ Euronext's acquisition of Credit Suisse's forex platform (<i>August 2017</i>) □ Deutsche Börse's acquisition of a stake in Trumid (<i>July 2017</i>) and aborted merger with LSE (<i>March 2017</i>)
Concentrating on 'home continent'	<ul style="list-style-type: none"> □ Deutsche Börse's sale of International Securities Exchange Holdings to Nasdaq (<i>June 2016</i>) □ Euronext's acquisition of LSE's French clearing business (<i>January 2017</i>)
Co-operation between exchanges	<ul style="list-style-type: none"> □ MSE's collaboration with GMEX to develop high impact initiatives in Indian capital markets (<i>May 2017</i>) □ Nasdaq and Shanghai Stock Exchange rumoured to be in talks over Kazakh bourse stake (<i>May 2017</i>)
Vertical integration	<ul style="list-style-type: none"> □ Fintech: <ul style="list-style-type: none"> – Euronext's acquisition of 90% of FastMatch (<i>August 2017</i>) and 60% of iBabs (<i>July 2017</i>) □ Financial information services: <ul style="list-style-type: none"> – Deutsche Börse's announced interest in index data and analytics M&A opportunities (<i>June 2017</i>) – LSE's acquisition The Yield Book and Citi Fixed Income Indices (<i>May 2017</i>)
Possible impact of Brexit	<ul style="list-style-type: none"> □ MEPs have sought tougher rules on London's euro-clearing business after Brexit (<i>August 2017</i>) □ ESMA plans to increase its oversight of London's euro-clearing business after Brexit (<i>July 2017</i>)

Financial benchmarks

Changing market requirements	<ul style="list-style-type: none"> □ SONIA to replace LIBOR by end-2021 (<i>August 2017</i>)
New regulation	<ul style="list-style-type: none"> □ EU Benchmark Regulations (<i>comes into force on 1 January 2018</i>) expands the regulatory perimeter and is likely to foreshadow a rise in regulatory and end-user litigation
Increased litigation risk	<ul style="list-style-type: none"> □ US Federal Deposit Insurance Corp launched US\$400 billion LIBOR-rigging suit against 9 banks (<i>August 2017</i>) □ Citi, Deutsche Bank and J.P. Morgan paid mega-fines to settle LIBOR-rigging investor lawsuits (<i>August 2017</i>)
Investment in technology	<ul style="list-style-type: none"> □ IHS Markit's acquisition of automotive Mastermind Inc. (<i>September 2017</i>) □ ICE's acquisition of TMX Atrium (<i>May 2017</i>)
Vertical integration	<ul style="list-style-type: none"> □ ICE's acquisition of remaining 20% of ICE Endex from N.V. Nederlandse Gasunie (<i>July 2017</i>) □ LSE's acquisition of The Yield Book and Citi Fixed Income Indices (<i>May 2017</i>)

Custodians

Rise in outsourcing	<ul style="list-style-type: none"> □ BlackRock transitioning US\$1 trillion of AuM from State Street to J.P. Morgan for custody (<i>January 2017</i>)
Dominance of global custodians	<ul style="list-style-type: none"> □ Citi selected by Iberclear to provide global custody services (<i>October 2017</i>) □ State Street selected Deutsche Bank as its T2S partner (<i>October 2017</i>)
Smaller players making inroads	<ul style="list-style-type: none"> □ BNP Paribas selected by UK's Local Government Pension Schemes (<i>September 2017</i>), Mirae Assets Securities (<i>July 2017</i>) and MAPFRE Inversión (<i>February 2017</i>) to provide custody services
Inorganic growth by custodians with strong balance sheets	<ul style="list-style-type: none"> □ Bank of N.T. Butterfield's acquisition of Deutsche Bank's global trust solutions business (<i>October 2017</i>) □ Northern Trust's acquisition of UBS's Swiss and Luxembourgian fund administration units (<i>October 2017</i>) □ BNP Paribas's acquisition of Credit Suisse's fund administration business (<i>August 2017</i>) □ JTC Group's acquisition of New Amsterdam Cititrust (<i>April 2017</i>)