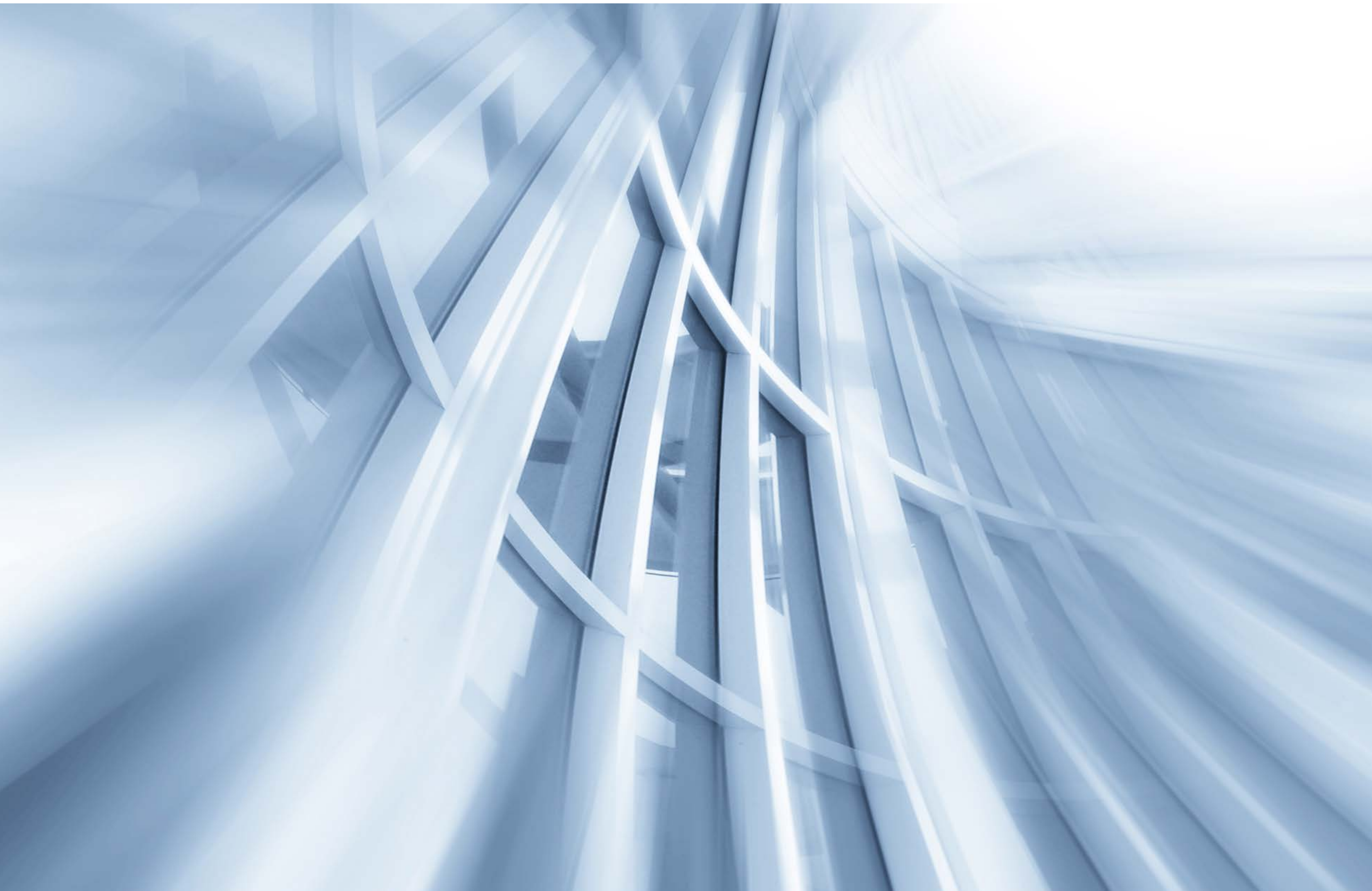
STRATEGY FOR CAPITAL MARKETS IN A TIME OF CRISIS



STRATEGY FOR CAPITAL MARKETS IN A TIME OF CRISIS

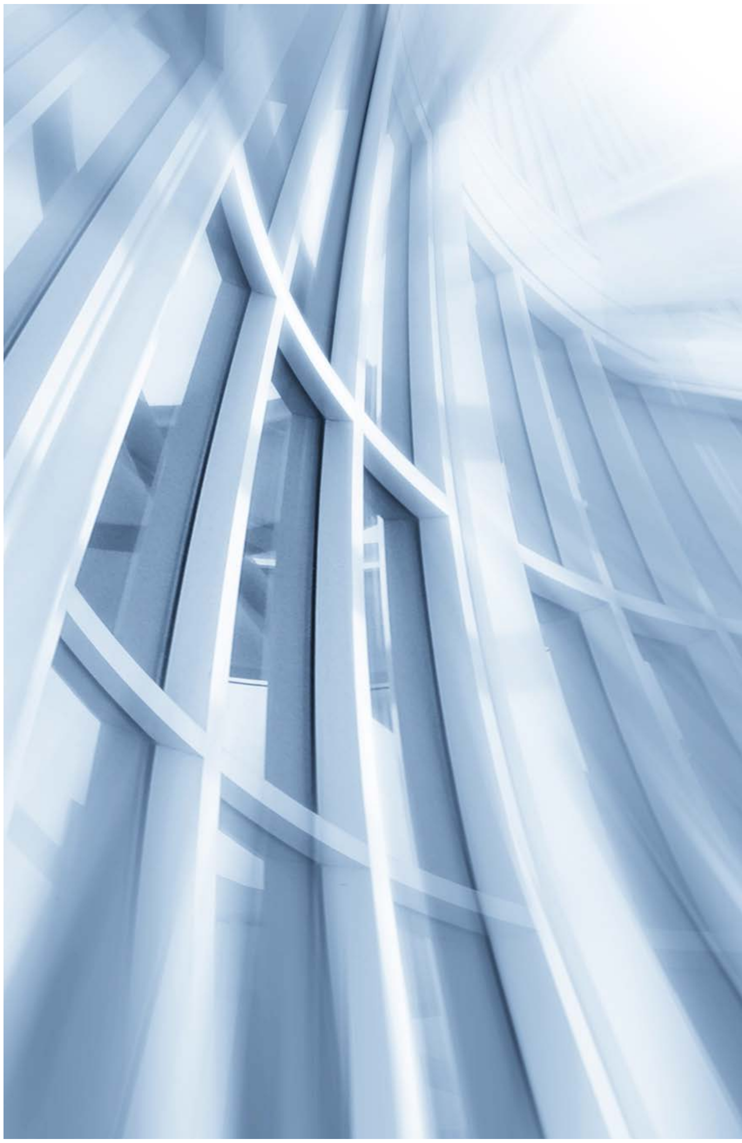
Broker-dealers need to navigate near-term choices for clients, shareholders and employees while developing longer-term strategies to position for growth once the crisis subsides.

Like all business leaders, in recent days, capital markets executives' attention has dramatically shifted to the unprecedented public health and financial crises resulting from the Coronavirus. In the immediate term, leaders are rightfully prioritizing employee health and safety, business continuity, and protection against extensive downside risks and threats to the financial system.

The COVID-19 global pandemic has led to significant market volatility swings, remote working constraints, changes in trading practices, and general uncertainty. How can capital markets executives help their clients and lead their organizations through this turbulent time, while thinking about longer-term strategy?

We believe that in addition to the urgent crisis management underway, broker-dealers should not put their strategy efforts on hold. This may seem counterintuitive, given the current climate. However, as the crisis unfolds, the fundamental challenges are not going away, and some will be exacerbated. Capital markets firms that focus only on crisis mitigation and cost-containment will be left further behind coming out of the crisis.

While it is difficult to think about strategy in times of crisis, that is exactly what the best organizations do. They can make tough near-term choices, while also investing through the downturn. Here are the opportunities that we think that capital markets firms need to start pursuing right now.



NEAR-TERM STRATEGIES

We believe that if capital markets executives employ a balanced, disciplined and deliberate approach to near term challenges, it will allow them to navigate the COVID-19 pandemic effectively for clients, employees and shareholders.

- **Proactive Institutional Client Engagement** - Sales and trading desks should be proactively working with distressed clients, offering advice on methods to mitigate losses, assist with access to capital, and maintain effective hedging positions.

- **Balancing Capital and Liquidity Reserves** - Regulators have been encouraging banks to utilize their capital and liquidity buffers to support lending activity[1]. A balanced approach should be adopted - accessing capital for customer benefit while ensuring sufficient reserves are maintained to protect the bank from adverse conditions. Leveraging contingency funding plans and focusing on continuous re-forecasting/re-balancing should allow for a reasonable reserve position to be maintained.

- **Methodical Risk-Based Operational Processing** - The intense market volatility and continuous changes to trading practices due to COVID-19 (e.g., DTCC suspension of physical securities processing[2]; following exchange circuit breaker processes[3]; closures of trading floors[4], etc.) will prevent a firm from completing all desired operational activities for a given trading day. Regulators are trying to reduce the operational processing burden by providing temporary relief on regulatory reporting obligations (e.g., CFTC no-action relief on certain swaps reporting[5]). However, non-regulatory operational processing (e.g., margin calls, settlements, etc.) are still intense for operations divisions to handle. Executives should focus on accelerating process automation efforts to assist with the increased transaction volume. Technologies such as robotic process automation and machine learning have matured in recent years, decreasing the deployment times. In addition, employing a structured risk-based approach that cascades from completing vital operational activities (e.g., settlements) to other less critical activities will help operational executives manage the increased volumes and reduced capacity.

- **Protecting Talent and Culture** - Given the financial pressure that broker-dealers are under today, many executives' first instinct might be to institute furloughs or layoffs. Large tier 1 firms have recently committed to zero layoffs in 2020, setting a high bar for the industry[6]. Smaller firms with less balance sheet protection should look to creatively exhaust alternative options before considering furloughs or layoffs. Over the long term, this will pay enormous dividends in terms of winning the war for talent and creating a differentiated culture. It will also be important to stay connected and strengthen remote working culture and connectivity.

BROADER STRATEGIC CHOICES

While broker-dealers should rightfully focus on navigating near-term decisions, they should not abandon their longer-term strategies and will need to consider the following questions.

- **What is the vision?** Broker-dealers need to stay focused on their long-term financial and non-financial goals through the crisis. For example, leaders should evaluate (and re-evaluate in light of the crisis) their multi-year vision for organic or inorganic growth. Only after clarifying the vision, can firms consider some of the harder-hitting strategic choices.

- **What is the target market?** An institutional client's geography, industry sector, and asset class structure are just a few of the many parameters that will influence how it is ultimately affected by the crisis. Analyzing client impacts will help broker-dealers understand the post-crisis financial service needs and help clarify where they should play in the new landscape.

- **What is the right mix of products and services?** Broker-dealers should be gearing up their products and services for a low-interest rate and early-cycle recession recovery environment, as this will be the likely scenario once normality returns. In the near-term, Institutional clients that provide non-essential services will generally be looking to broker-dealers for services to help them get out of difficult situations (e.g., debt restructuring, liquidity, loans, etc.). The expectation is that equity and credit markets will recover quickly, helping institutional clients return to a growth agenda. Broker-dealers should be ready to handle shifts to their products and services based on a fast business cycle turn.

- **What's the digital strategy?** The sell-side has been lagging behind other areas of financial services in terms of digital transformation. However, this is starting to change as new technologies are beginning to be used for full trade lifecycle processing (e.g., In February, Citi and Goldman Sachs transacted the first blockchain equity swap[7]). Crisis events like COVID-19, strengthen the business case for digital transformation, as increased automation should allow broker-dealers to operate more smoothly in a time of emergency/disaster.

- **What is the target operating model?** Shareholders and executives will likely expect broker-dealers to enhance operational resiliency based on the lessons learned from the COVID-19 crisis. Adaptions to the operating model (i.e., people, process, and systems supporting the trade lifecycle) will be required to reduce operational risk for future crisis events. Stringent but more adaptable controls are necessary for crisis events to mitigate risks, e.g., the ability to monitor trades and traders via various methods. In addition, risk frameworks are expected to be enhanced to mitigate risks, e.g., internal stress testing to include additional black swan crisis events, e.g., global warming event, next virus, etc.

Naturally, some of these broader strategic choices have been pushed to the side by the current crisis. But it is possible to take decisive action on near-term priorities to protect clients, employees, and the business while also keeping the bigger picture in mind. Doing so can help capital markets firms from avoiding short-sighted mistakes in a crisis while positioning for growth coming out of it.

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