Through the Looking Glass

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"Ronald Coase, the economist, famously observed that private companies are different, because they are not the only place to do business. **An alternative to costly and complex banks is an atomised market, where individuals and institutions do business without a large financial intermediary.** Banks may merge to survive this inevitable transition; but in the long run many of their functions will disappear... **the core functions of any Wall Street Bank cannot remain inside the same complex and costly shell forever."**

Frank Partnoy, FT, April 5^{th}, 2005

■ One year after going public, **Google passes TimeWarner to become the world's most valuable media company**.
■ Ten years after it's creation, **eBay has over 150 million users**, 500,000 people that make their living using their markets and $60 billion of turnover and growing.
■ Fifteen years after being founded in a college dorm room, **Dell dominates the business of selling personal computers**, knocking off industry giants like IBM and HP on the way to annual sales of $51 billion and a 19% global market share.

All of this has come to pass. In 1990 who would have predicted any of these outcomes? To date, the financial services industry has remained relatively unscathed by new disruptive entrants. Will that always be the case? Perhaps – barriers to entry are many - but possibly not. Below is a fantastical and purely speculative fictional scenario, as might be observed by a Euroweek reader looking back ten years from now in June 2015.

London, United Kingdom – June 23^{rd}, 2015
(The audience settles into its seats as the annual Global Borrowers & Investors Forum kicks off with a hybrid live/virtual plenary session with a keynote speech by Jeff Bezos, Chairman Emeritus of the world's dominant trading and transaction processing company – AmazonBay. The lights in the room dim and the screens linking in San Francisco, Shanghai and new for 2015, Mumbai – light up…)
"Ladies and gentlemen, welcome to the Euromoney – GoogleCorp Global Borrowers & Investors Forum and may I say I am delighted to be speaking to you for the first time given that my firm has managed transactions over the past year for every single delegate institution here today…"

How did we get here? The transformational hurricane of the past decade in global financial services seems obvious in hindsight but was brutal and unforeseen by most in the sector as events unfolded.

Historians and academics assessing this turbulent and unprecedented period of change are only now able to pinpoint the pivotal events of the first 15 years of the 21^{st} century that have rendered the sector almost unrecognisable from its 20^{th} century incarnation.

Gone are the global securities and investment banking groups that dominated the sector in the 1990s. In their place, we have an intelligent galaxy of new specialist advisory, investment management, and algorithmic software and consulting firms inexorably networked with a universe of powerful transaction facilitation exchanges. Banks primarily exist now as giant regulated pools of capital.

Given the current lack of perspective, it is difficult to say with certainty which events were more or less important in effecting this transformation. However the following key events are a good starting point for future historians.

■ 2004 (August) – **Google goes public** and performs remarkably well, going on to become the world's most valuable company for several years before being surpassed in 2011. Its rise and concurrent development of the semantic web fundamentally changed the nature of knowledge distribution, effectively dissolving the traditional historical advantages of large companies in knowledge-based industries such as media, technology and finance.
■ 2005 (June) – **DrKW**, the investment banking subsidiary of the Allianz Group, **launches Revolution** – a cross-asset class electronic trading and analytics platform, foreshadowing the move towards automation and lowest unit cost delivery of most capital markets products and services.
■ 2005 (October) – **NYSE / Archipelago close merger, thereby** jump-starting the consolidation of liquidity pools and electronic exchange technology after several years of stagnation in the battle between old and new trading methods.
■ 2006 (February) – **JPMorgan acquires Morgan Stanley**, reuniting the House of Morgan after more than 70 years. CEO Dimon heralds the acquisition as an opportunity to take significant costs out of the combined operations and respond more aggressively to declining margins in many core markets.
■ 2006 (May-September) – Catalyzed by the JPMorgan deal, and having considered seriously various opportunities since the UniCredito / HVB marriage in 2005, **a number of copycat banking mergers occur within Europe: BNP Paribas / ABN Amro, and Deutsche Bank / SG** being the most significant.
■ 2006 (September) – **Betfair prepares for an IPO.** During the marketing period the press and public opinion latch on to comparisons with global securities exchanges like NYSE/Arca; Betfair comes out on top in terms of transaction volumes and speeds. Benefiting from the positive publicity and growing knowledge of sports 'trading' surrounding the IPO, **MAN group launches the first ever publicly available Sports Trading Hedge Fund**, extolling its virtues as a liquid and diversifying asset class.
■ 2007 (April-November) – Looking to cement its position as the world's leading source of information, and armed with its highly-rated stock, **Google** embarks on an aggressive acquisition drive to buy companies owning valuable proprietary data across a variety of industries. In financial services, this includes acquiring **Thomson Corporation, Euromoney Plc and Markit Group**.
■ 2008 (March) – After two years of tortuous negotiations, **NYSE/Arca, Euronext and LSE agree to merge** forming the world's largest equity exchange. It is baptized **ArcaNext**.
■ 2008 (September) – Sending shockwaves across the globe, **eBay** – the world's largest exchange for most goods

and services - breaks its longstanding policy of staying out of the financial services sector and **buys ArcaNext**. The newly-formed SEC/FSA-regulated subsidiary is named **eBay Financial Markets and overnight becomes one of the largest financial services firm in the world with over 1 billion unique registered users.**

■ 2009 (January) – Reacting to the arrival of a completely new competitive force, **Goldman Sachs becomes the first major 'traditional' full service investment bank to break itself up**. The securities trading and distribution infrastructure and business is sold to eBay FM, and the remaining activities are split into two new companies, – GSAS (GS Advisory Services) and GSCM (GS Capital Management.) The first contains their traditional corporate finance advisory skills augmented by the new business of electronic transaction consulting, while the latter is a multi-fund platform deploying both proprietary and third-party capital across a large number of asset classes and investment strategies.

■ 2009 (February – July) – Moving quickly as a new entrant to the financial services market, **eBay FM** uses its considerable financial flexibility to **buy up leading electronic agency brokerage platforms** across the globe, most notably the market leaders in North America and Europe respectively, **TD AmeriEtrade and Revolution.**

■ 2010 (February) – Reacting to what Senator Barack Obama calls "a clear and obvious breach of our position as leaders of global commerce and progress" the US Congress easily passes long awaited legislation – **the Obama-Ensign Act – legitimizing sports and other 'outcome trading'** (as it has been euphemistically labelled in order to differentiate it from the semantically unacceptable 'betting' or 'gambling'), in the hope of bringing onshore and regulating this multi-billion dollar industry. Pundits point out that Obama's last election victory margin was correctly predicted by the 'outcome' markets to within 1,000 votes.

■ 2010 (June) – **eBay FM buys Betfair** consolidating the world-leading outcome trading exchange with their existing platform.

■ 2010 (August – November) – In relatively quick succession, **JPMorgan, Lehman Brothers, HSBC-ML and BNP Amro withdraw from traditional wholesale intermediation businesses** in the face of growing losses as their market share dwindles vs. intelligent electronic exchanges and their competitive position disappears. Others follow.

■ 2010 (December) – HFR reports that in the 4^{th} quarter of 2010, **sports trading is set to top all hedge fund strategies in terms of fund inflows for the first time**. MAN Group's global football fund becomes the first single-strategy sports fund with over $10 billion under management. GSCM's motor sports fund raises $2 billion at launch in under 48 hours.

■ 2011 (January) – Two of the largest corporations on the planet - **eBay and Amazon - merge creating AmazonBay**. With a combined market capitalization of over $2 trillion, the merged company surpasses GoogleCorp (formed by the merger of News Corp and Google in 2009) to become the world's largest by market capitalization. AmazonBay handles over 100 billion transactions per day across all types of products and services.

■ 2011 (October) – **AmazonBay acquires SonyApple Xchange** and in so doing captures substantially all of the trade in virtual goods for Xstation games. (In 2010, the virtual Xstation economy passed Germany to become the 10^{th} largest economy on the planet.)

■ 2012 (May) – **CitiDeutsche Bank** becomes the last significant global investment bank to throw in the towel on its financial markets intermediation business.

■ 2013 (July) – Several years after the idea had first been considered**, the first ever ad-hoc 'deal-specific' banking team advises on and finances the Blackstone/Citadel-led consortium buy-out of IBM** for $200 billion, making it the largest ever public-to-private transaction in history. Taking a page out of Hollywood's book, deal 'producers' Plaza Partners assemble a one-off team of corporate financiers, lawyers, capital markets specialists and underwriting agents and use AmazonBay's network to price and distribute the 76 classes of securities with over 500,000 unique pay-out structures in 31 different jurisdictions. In total, over 9 million distinct investors (from insurance companies to individuals) participate in the financing. The deal production team insure their fee payout through a syndicate of insurance providers and in addition to fees paid by Blackstone/Citadel consortium, receive royalties based on future cashflows of IBM meeting certain hurdles.

■ 2014 (August) – Advertising rates for the World Cup final plummet as longshots Denmark and Iraq make it through to finals knocking out favourites Brazil and China. GoogleCorp's stock sells off sharply until CEO Lachlan Murdoch reveals that they have hedged their exposure with Eu3.4 billion of payer positions on a basket of favourites in what is described as **the largest ever single sports trade disclosed to date.** The complex hedging strategy was designed by Allianz Sport Risk Solutions group and entirely executed using a proprietary algorithm on AmazonBay's sports trading exchange.

■ 2015 (March) – Treasury Secretary Thain and President Obama today announced the most far-reaching reforms of US government finance and savings "since Hamilton created the First Bank of the United States and laid the foundations for the American financial system." Taking advantage of the recent complete overhaul of intergovernmental IT and IM systems, the **US Treasury announced that - starting in the new fiscal year - it will switch to a new system of debt management called PALM** (Perfect Asset/Liability Management.)

PALM will allow any investor to craft an exact set of cashflows (insofar as the minimal nominal value of each 'bond' is at least $100, with an NPV of at least $10.) At the same time each government program will be expected to submit an exact funding requirement with monthly cashflows. The Social Security system will equally project cashflows on an individual basis, taking into account all salient information for each existing and future recipient.

Using the latest version of AmazonBay's trade matching system, the estimated 8.3 trillion cashflows will be managed and matched dynamically in real time allowing the Treasury to offer perfect liquidity in every instrument. Additionally a syndicate of over 2000 global capital providers has been formed to offer backstop liquidity to the system. An effective yield for the traditional benchmark Treasury maturities will continue to be calculated based on prices in the system in order to provide an well understood benchmark and maintain historical continuity in terms of interest rate time-series and derivative contracts. It is expected that this approach to capital raising and asset/liability management will be adopted by all issuers over the coming year or two.

(Mr. Bezos, coming to the end of his speech…)

"…and so I conclude my remarks with a feeling of great optimism; the innovation and resiliency of the global financial system has contributed enormously to raising a further third of humanity out of poverty over the last decade as transaction costs have been reduced to infinitesimal levels and access to the global capital markets has been democratized to an extent hardly imaginable at the turn of the century. This is in no small part due to your efforts and talents and I look forward to the incredible innovations the next decade will inevitably bring. Thank you all for your attention, enjoy the rest of the forum."