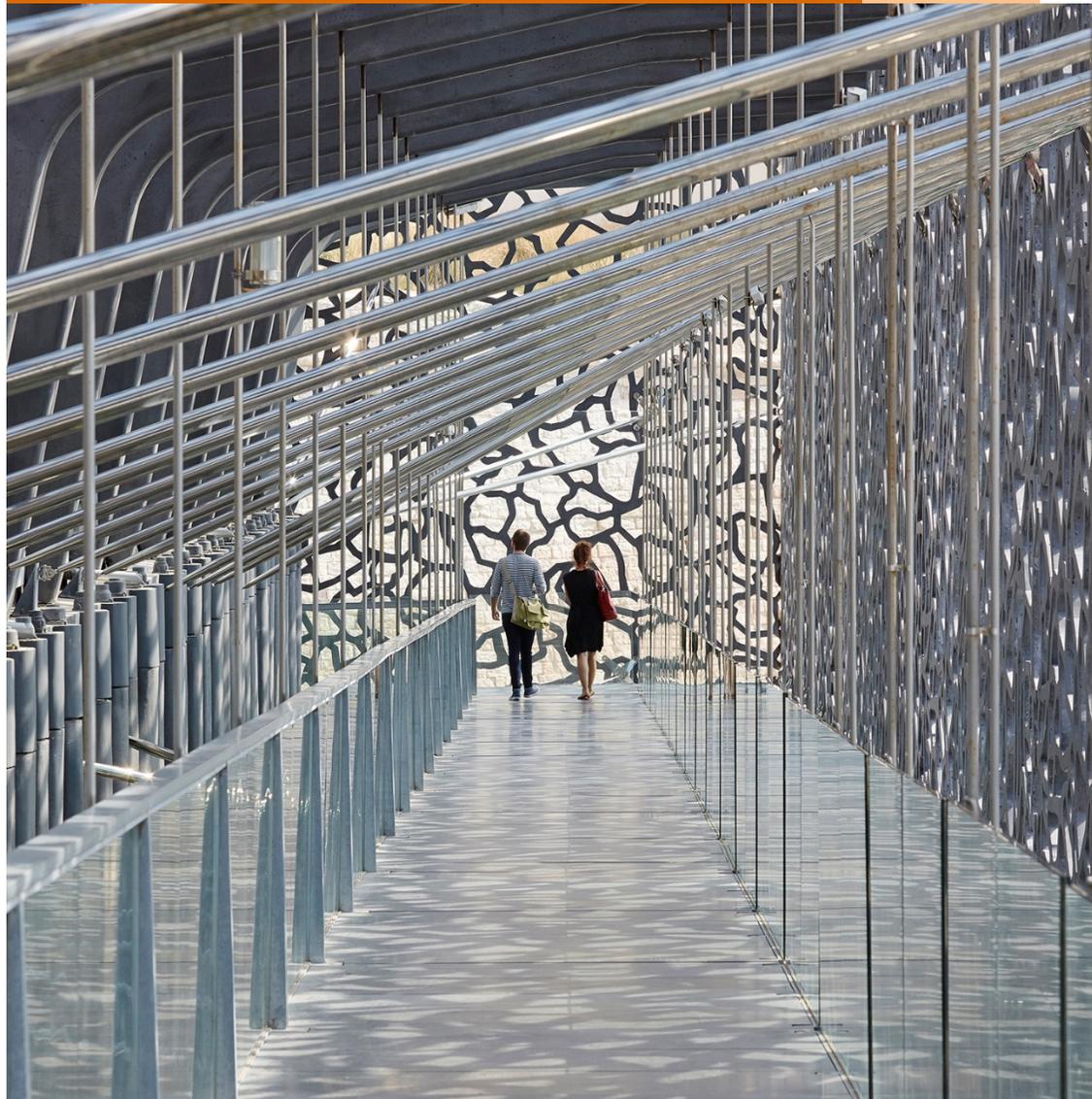


# ***To share or not to share:*** The single- vs. multi-dealer platform choice

*As capital markets evolve, investment banks are rethinking their client-facing platform strategies.*



# The heart of the matter

*Most sell-side financial institutions consider their front office a key point of differentiation. To this end, they invest heavily in proprietary technology to create an advantage. But it may not be sustainable; some shared technology utilities could make their investments obsolete. We look at the trends spurring firms to rethink their client-facing technology and suggest that single- and multi-dealer platforms can co-exist at the same institution.*

CTOs and CIOs at capital markets firms are trying to offer their clients more value by replacing legacy portals with gateways that make it easy to navigate a bank's entire range of offerings. These fully integrated "one-stop-shop" platforms are the latest incarnation of the single-dealer platform (SDP), evolving from execution-only trading applications to those featuring sophisticated pre- and post-trade capabilities.

Unfortunately, firms haven't been seeing the hoped for returns on these investments. Why? Because while these SDPs address a financial institution's desire to hold onto clients, banks may have difficulties adapting to their clients' changing demands.

These days, far more customers want basic and low-cost products. An all-encompassing SDP has value, but this option may not be enough to maintain client brand loyalty. With parts of the investment banking value chain looking increasingly like utilities, delivery platforms could offer more value as a series of bite-size "apps." These apps can be developed internally using proprietary technology or externally by peers or other third parties using shared technology. This approach enables banks to plug-and-play apps as needed and to improve their agility in meeting clients' changing demands.

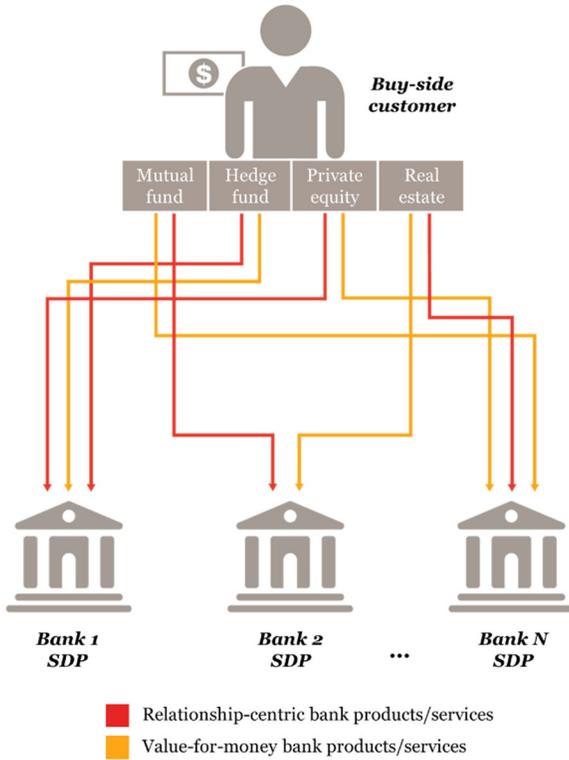
To avoid a race to the bottom against low-cost providers, financial institutions should become more strategic about proprietary technology, focusing custom development in areas that really bring value to a relationship. Where financial institutions aren't adding value, it makes more sense to collaborate with peers and third parties to create value. In these cases, firms can better serve their clients at a far lower cost than is needed to maintain everything they do within an SDP. Customers can easily select which products and services they want to buy from a multi-dealer platform (MDP). In fact, MDPs have now evolved to become transactional "supermarkets" that aggregate products and services across multiple firms.

In this paper, we look at trends driving the convergence of SDPs and MDPs. We then suggest ways for firms to analyze their product and service offerings to develop the best SDP/MDP strategy. For many financial institutions, this will be a hybrid approach that balances their specific needs with those of their clients, like the example shown in Figure 1. Treating SDPs and MDPs as complementary enables a hybrid approach that combines the best of both: the customer relationship intimacy of the SDP and the greater liquidity, shared cost, and diversified risk advantages of the MDP.

**Figure 1: Finding the right mix of proprietary and shared technology**

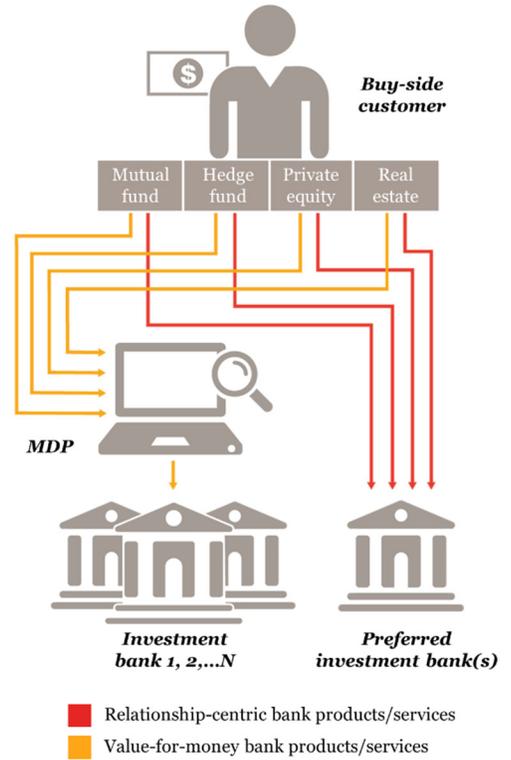
**Sub-optimal:**

Banks have invested heavily in proprietary technology trading platforms, but their clients are starting to resist this approach



**Balanced:**

Banks will succeed by investing in their strengths and sharing technology where they don't have a natural advantage



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# An in-depth discussion

If you're in New York and you need to get to Los Angeles, odds are good that you'll look at an online travel agency. These aggregator sites let you compare airfares and schedules to find what best matches your needs; they're basic and low cost. So, should airlines stop developing their own websites?

Of course not. Airlines offer a variety of different services, as well as serving different markets. Some capabilities aren't unique; others (for example, chartered flights) can be quite specialized. As they set their distribution strategies, airlines consider both business and technology trends, and one size doesn't fit all.

In investment banking, this fact is even truer. Some product offerings are more commoditized, with lower margins per transaction. Others are highly differentiated, making it harder for intermediaries to offer the service that clients demand.

To understand the strategic options, then, you need to look at the characteristics of all the product sets you offer, as well as your relative market position for each. Here are some prominent trends that might affect a bank's decision to team up or go it alone:

## Trading

While many investment banks feel that trading is a core strength, this view is starting to face serious pressure. With many of their clients beginning to explore the use of market utilities, it's harder for banks to keep investing heavily in developing their own proprietary trading platforms. There are good reasons for this, starting with a bank's own pursuit of electronification<sup>1</sup> to drive down costs. Costs *have* dropped—but in many cases, the fees and commissions

banks earn per transaction have fallen even more quickly, squeezing margins tightly.

As electronic trading has spread, it has created opportunities for tech disruptors that compete on price and speed. We've seen market utilities emerge for cross-asset trading, particularly in asset classes that are more standardized, more easily accessible, and have very high volumes. But every bank has different strengths, and some asset classes are more vulnerable than others:

- **Equities:** This asset class has the highest degree of electronification, and electronic trading has become the overwhelmingly dominant way equities are bought and sold. The systems that enable this trading are specialized, depend on scale, and require a technology culture to operate and develop; it's not a casual effort.

In response, some leading banks have already given up proprietary ownership of their trading platforms and exited the single-dealer model. These financial institutions have come together and formed a consortium to set up a multi-dealer platform owned by a new, independent technology company. Many of these banks' clients find the diversification of ownership attractive, because it supports broker neutrality. We expect more firms to follow this lead as the equities trading business continues to move toward a utility model. In the future, it's possible that only a few large players will be able to maintain profitability by executing faster, better, and cheaper.

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<sup>1</sup> Electronification in financial services refers to the rising use of electronic or automated trading. Electronic trading already has replaced floor trading or phone trading for several asset classes due its ability to improve market liquidity and price efficiency. As compared to more traditional forms of trading, there is little to no human involvement in the buying and selling of securities among market participants.

- **Foreign exchange (FX):** FX also has a high degree of electronification, and the largest share of trade volumes now flows through MDPs. MDPs are owned by mass media/information giants rather than market participants. This trend is expected to grow as currency investors increasingly turn to multiple dealers rather than routing all orders through a single bank. There's more regulatory scrutiny than ever, due to past FX fixing scandals, and this places a higher value on transparency. Banks are also becoming less active in currency markets because of rising capital requirements.
- **Fixed income:** This asset class shows a good degree of electronification, although it varies by product and region. MDPs are already attracting large volumes for treasuries and corporate bonds. They are run by software companies in the United States and mass media/information giants in Europe and Asia. We expect this trend to grow, as most banks have seen a steep decline in their bond trading revenues. Dealer inventories have fallen because of rising capital requirements and rising interest rates. To make up for lower dealer liquidity, bond investors have increasingly turned to multiple dealers.
- **Commodities:** This asset class has also seen a fair amount of electronification, but it isn't uniform. We've recently seen a good deal of take-up in automated trading as the products become more standardized. Major exchanges have already closed floor trading pits for futures contracts, with only a handful remaining open for complex options contracts. MDPs are slowly gaining prominence, because traders often feel they offer more price transparency and greater liquidity. This trend is expected to grow, too, as most banks have seen a sharp decline in commodities trading revenues due to regulatory restrictions on proprietary trading.
- **Structured products:** This asset class shows less electronification than other asset classes, because the offerings are the least standardized. They include custom credit and rate products created to meet niche client needs. Regulators have been particularly active, focusing on price transparency, asset and issuer concentration, disclosure, and capital requirements. However, banks can still create opportunities by collaborating with clients on personalized products. SDPs will likely retain technology investments due to the relationship-centric nature of the business.

### *Post-trade processing*

Robust market utilities already are in place for post-trade processing (clearance, settlement, custody, financing, and recordkeeping) to spread cost and risk across participants. These utilities have resulted in significant cost savings for banks as they pool trading volumes from multiple firms over a shared fixed-cost base. Such multi-firm platforms are owned and operated by joint ventures among banks, software vendors, exchanges, professional services providers, depository institutions, and more. Any of these may diversify vertically and/or consolidate horizontally.

### *Collateral management*

Market utilities have been emerging for collateral management and margin transit. These utilities offer a holistic view of risk exposures across multiple firms, a way to potentially optimize collateral allocations and transfers, and lowered risk of liquidity blockages in periods of crisis. Such multi-firm platforms are owned and operated by joint ventures among banks, software vendors, professional services providers, exchanges, depository institutions, and others. More firms are likely to adopt these utilities as the industry looks to overcome product silos and sub-optimal collateral mobility, allocation, and settlement coordination with counterparties.

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### *Reference data management*

Established market utilities exist for reference data management to reduce redundancy across participants in the setup of securities and pricing. The utilities collect securities data from multiple vendors and originators, and then aggregate, validate, cleanse, and enrich the reference data. Such multi-firm platforms are owned and operated by joint ventures among banks, software vendors, professional services providers, exchanges, depository institutions, and others. More firms are likely to adopt these utilities as the industry looks to improve data quality and consistency.

### *Client onboarding*

Utilities for client onboarding standardize processes across products and geographies while complying with local regulatory requirements. They collect client accounts from multiple banks and focus on enhancing digitization, cleansing, validation, standard document management, and delivery. Such multi-firm platforms are owned and operated by joint ventures among banks, software vendors, and professional services providers. More firms are likely to adopt these utilities as the industry looks to manage regulatory compliance using accounts data for KYC, AML, FATCA, Dodd-Frank, EMIR, MiFID, and more.<sup>2</sup>

### *Research and analytics*

Research and analytics have traditionally been areas of proprietary strength. However, we're now seeing companies pressuring their banks to unbundle research from trading. Increasingly, clients prefer objective analysis from independent research providers. Technology-led players are using predictive analytics based on historical market data, as well as news and social media, rather than relying on subjective research. In response, some banks are looking to distinguish themselves through research tailored to

specific client needs, enabling real-time access to market insights, and allowing clients to search across the bank's vast intellectual property. SDPs will likely attract greater technology investments, because many banks see research and analytics as a key point of differentiation.

### *Sales*

We're seeing a growing number of firms creating dashboards that show a single-client view that encompasses exposure, client communications, trading history, and more. Firms are collecting massive amounts of data on portal usage and transaction patterns. They use this data to predict a client's next trade, which might be the next important client, or which might be the next client to leave. They also use it to determine which clients the bank should drop. SDPs will likely attract greater technology investments for sales as banks look to push client relationships. One big area of emphasis: collaborative tools that enhance social networking, enable live interactive chat with experts, and create ways to follow leaders in the research community.

### *Prime financing*

For many firms, prime financing should provide stable profitability through steady security financing and lending activities, particularly in emerging markets. Firms also have strong potential to cross-sell services such as clearing, collateral management, and swap execution. Clients, however, have shown a growing interest in multiple prime broker relationships to diversify their exposure. SDPs will likely attract greater technology investments as banks look to push client relationships through integrated access to portfolio management, financing, and execution tools.

### *Client servicing*

Firms are creating tools to give clients more transparency into end-to-end transaction

<sup>2</sup> Banks are required to comply with a wide range of laws and regulations in the jurisdictions where they operate, including know your customer (KYC) and anti-money laundering (AML) rules, the Foreign Account Tax Compliance Act (FATCA), the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), the European Market Infrastructure Regulation (EMIR), and the Markets in Financial Instruments Directive (MiFID), among others.

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lifecycles. Typical features include real-time alerts and notifications for affirmation, confirmation, and clearing; the ability to monitor cash, trades, and positions, along with news and research; and the ability to generate custom performance dashboards. SDPs will likely attract more technology investments as banks look to push client relationships through better service. Features could include integration across lines of business, live customer support, workflow-based service management with self-help options, and multichannel support (including mobile).

**Proprietary? Shared? Or both?**

Based on these trends, many firms have started to pursue one of two paths: either going deeper into proprietary technology (SDPs) or moving toward shared technology (MDPs).

Some leading investment banks are expanding proprietary technology and custom development for their SDPs. For

example, some have differentiated their platforms by adding new features, such as search engines that allow clients to explore the bank’s knowledge base. They’ve also experimented with social media functions clients can use to connect and collaborate with research professionals. Typically, SDP capabilities are delivered through a website and a mobile app.

Meanwhile, other leading investment banks have been opening up their proprietary platforms and joining with peers and third parties to develop shared technology. They are making this shared technology available to market participants either as a library of open-source components that can simplify a bank’s SDP or as separate MDP utilities that can replace parts of a bank’s SDP.

We don’t see this as an either/or choice. As shown in Figure 2, the technology capabilities of SDPs and MDPs tend to be complementary. In our view, they can be combined in a hybrid model that leverages the strengths of both.

**Figure 2: SDP and MDP strengths can be complementary**

Delivery platform characteristics	SDP	MDP
Access to real-time market insights, research, and analyst views	Stronger	Weaker
Social networking and live interactive chat with experts	Stronger	Weaker
Support for custom pricing and trading abstract products	Stronger	Weaker
Support for flexible trading anonymity or disclosure	Stronger	Weaker
Access to portfolio management and financing tools	Stronger	Weaker
Access to diverse set of pricing sources and address best execution requirements (MiFID)	Weaker	Stronger
Access to multiple sources of liquidity—banking and non-banking	Weaker	Stronger
Access to wider set of trade execution venues and consolidated ticker	Weaker	Stronger
Support for broker neutrality	Weaker	Stronger
Shared cost and diversified risk across participants	Weaker	Stronger

Stronger Weaker

# Our recommendations

Following a pure SDP strategy is a bit like betting big in a winner-take-all card game: there's no margin for error. Yet turning to MDPs can risk giving up the very strengths that have made a bank successful. So what's the best way forward?

Most firms will benefit from a hybrid platform that mixes single- and multi-dealer apps. But the right combination will differ for each firm based on its own unique capabilities and market positioning. To determine the proper mix, we recommend a three-step process:

**Step 1:** Deconstruct your existing delivery platform into constituent apps and evaluate each app against the following:

- The degree to which each offering is unique relative to the competition.
- The relative strengths of existing competitors and potential new market entrants, including newly created MDPs.
- Whether the factors driving growth can be commoditized in the future.

For apps that are truly differentiated, firms should go deeper into proprietary technology (SDP). For the rest, moving toward shared technology (MDP) might be a better path.

At many banks, continuing to invest in proprietary development for relationship-centric functions makes sense. These could include research and analytics, sales, prime financing, client servicing, and structured products pricing/trading. For functions where clients will look for more basic value-for-money offerings, adopting a shared technology model may be more appropriate. This might include some areas of trading, post-trade processing, collateral

management, reference data management, and client onboarding.

Note that these choices reflect averages and every institution will be different.

**Step 2:** Set priorities for remedial actions:

- Buy—invest in strategic apps that support growth and can be expanded to support other business areas.
- Hold—wait and watch apps that could be expanded, updated, or redesigned for better customer experience.
- Sell—divest apps that no longer add much value and evaluate them for sale, replacement, or retirement.

Whether you decide to buy, hold, or sell will depend on how the decision will affect the firm's cost, income, or risk profile. For many firms, certain service offerings or capabilities are particularly vulnerable. For these, a shared technology approach might be a better path.

In Figure 3, we show one example of how an institution could prioritize its technology investments, either toward single- or multi-dealer platforms. In this example, we would encourage the firm to move equities trading toward a shared platform (MDP). In fact, this should be one of the firm's first priorities, and the investment will be one of the more attractive upgrades it can make. Our suggested priority is based on several factors, as discussed in previous sections, as well as on company-specific considerations. In the same example, we would also suggest that the firm consider taking an MDP approach to commodities trading—but not yet. Moving commodities trading to shared technology is likely to have a relatively strong return on program investment, too, but the environment may not be right at

**Figure 3: Getting started with a hybrid SDP/MDP model (example)**



this time. As such, the firm should consider taking the step once there are increased levels of both electronification and available market utilities.

**Step 3:** Design a hybrid SDP/MDP model after having determined where you add value and where you don't.

At a minimum, customers will want login consolidation, easy navigation, personalization capabilities, notifications and alerts, internationalization, and consistent branding. Ideally, the model should also include intuitive persona-based dashboards, live customer service, and accessibility via mobile device, as well as workflow-based service management with self-help options and real-time status tracking.

You should expect that the platform may need to open further over time. For example, it should provide integrated back-end services through a catalog of standard application program interfaces (APIs). This can give clients “always-on,” secure programmatic access to key internal systems and data repositories. Open-access APIs also let clients customize information streams and suggest improvements.

In fact, flexibility is the key to success here, and firms run real risks if they don't adopt open frameworks that can handle a variety of financial message formats. In the near future, users will demand that SDPs/MDPs “crosswalk” among communication protocols such as FIX (pre-trade and trade execution), FpML (complex derivative products), SWIFT (post-trade processing), and MDDL (market data), as well as other protocols for risk management, reporting, and counterparty information.<sup>3</sup>

<sup>3</sup> Financial Information eXchange (FIX), Financial products Markup Language (FpML), Society for Worldwide Interbank Financial Telecommunication (SWIFT), Market Data Definition Language (MDDL).

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# *What this means for your business*

In our view, it no longer makes sense to consider SDPs and MDPs as mutually exclusive. Based on our work with clients and other in-house research, we think a hybrid SDP/MDP strategy can improve a firm's digital cost-to-income ratio by as much as 45 percent. This stems from:

- **Reduced cost**, driven by adoption of shared technology where areas are not differentiated in functions such as trading, post-trade processing, collateral management, reference data management, and client onboarding.
- **Increased revenue**, driven by enhancements focused on where they can have the biggest payoff. For most firms, these will include investments in proprietary technology that supports differentiated functions, particularly in the areas of research and analytics, sales, prime financing, client servicing, and structured products pricing/trading.

We acknowledge that these changes are neither fast nor simple. Firms may be challenged due to aging technology architecture and complex operating models.<sup>4</sup>

We also understand that spending more on platforms when margins are compressing can be a heavy lift. The natural reaction is to wait and see, but this can be a risky strategy. Instead of developing a platform based on a solid understanding of what makes their bank different, firms are likely to keep overspending on proprietary technology. For example, a bank's sophisticated SDP may help clients draw investment insights from tailored research and analytics, but this may not be enough to change client behavior around looking up prices on lean MDPs and trading with whichever bank is offering a lower cost.

As buy-side clients increasingly shop across multiple sell-side providers, we recommend that firms adopt a hybrid SDP/MDP model. To do this, CIOs and CTOs will want to share technology using an MDP that doesn't allow their institutions to add anything unique to the platform. This approach will enable banks to focus on areas where they do add real value using an SDP. It also makes the most of their technology investments in a competitive market.

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<sup>4</sup> For further information on addressing technology architecture challenges, see PwC Financial Services Institute's "Less is more: Leaner, integrated IT platforms for the new capital markets arena," May 2015.

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