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In Europe, New Regulations Drive Dealer Strategies, Sap Market Liquidity

2015 Greenwich Leaders: European Fixed Income

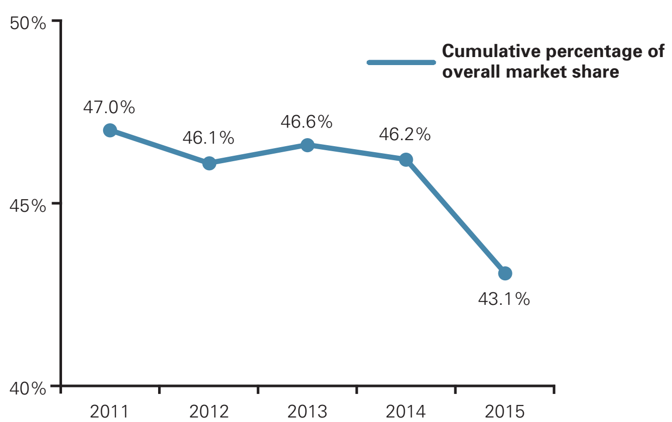
Q4 2015

The competitive positioning of Europe's leading fixed-income dealers is increasingly defined by regulations and banks' strategic responses to new rules that have altered the economics of the business.

A quick glance at the list of Greenwich Leaders in our 2015 European Fixed-Income Study might suggest that regulators have achieved a key goal by reducing the concentration of fixed-income trading business controlled by the handful of very large banks that have traditionally dominated the business.

Today's European fixed-income market is much flatter than the market that existed as recently as 2011. In that year, the top five dealers controlled an aggregate 47% of institutional fixed-income trading volume. Today the top five control 43%, with the remainder divided more broadly among a group of European and foreign dealers.

Declining Share of Institutional Fixed-Income Trading Volume Among Top 5 Dealers



Note: Based on 1,132 respondents in 2011, 1,241 in 2012, 1,269 in 2013, 1,265 in 2014, and 1,210 in 2015.
Source: Greenwich Associates Annual European Fixed-Income Investor Studies, 2011-2015

But this broader distribution in trading volume does not necessarily reflect a safer or more stable market. To the contrary, reductions in concentration have been achieved largely as a result of the voluntary pullback of some top dealers from their prior roles as market makers across all products and for the investor population at large. Tougher capital reserve requirements and other new rules have cut deeply into profit margins in trading. As the business becomes less attractive, banks are shrinking their increasingly expensive inventories and the overall scale of their franchises.

"Dealers that once amassed huge market shares by providing coverage and liquidity to investors broadly across most or even all fixed-income products have been setting new strategies that seek to exploit their comparative advantages," says Greenwich Associates consultant Andrew Awad.

Banks Focused on Profitability

Instead of fighting for market share, banks are increasingly focused on profitability. Banks are working to preserve margins by improving productivity through cost reductions and by becoming much more selective about when and where they deploy capital.

To that end, dealers are focusing on businesses and products in which they think they have a competitive advantage, while retrenching or even exiting other areas. Within the business lines and products they elect to pursue, dealers are rationalizing their capital expenditures by directing coverage and liquidity mainly to large or active institutional clients with the potential to generate sizable profits for the banks.

The result of these shifts has been a meaningful reduction in overall market liquidity that is not likely to reverse itself any time soon. "Few banks are enthusiastic about making any major new investments right now, given where we are in the credit cycle," says Greenwich Associates consultant James Borger. "In fact, dealers are preparing for a new round of regulation that could squeeze margins and reduce liquidity even further, such as pre- and post-trade transparency requirements contained in MiFID II."

Liquidity: Searching for Alternative Sources

Nearly 40% of study participants are concerned with the lack of liquidity in fixed-income markets. With liquidity declining, investors have started searching for alternative sources. The European fixed-income market is currently seeing an increase in the number of alternative liquidity platforms, some of which allow investors to trade directly with other investors. While domestic dealers may now be stepping up as alternative liquidity providers, the void left by some of the global dealers pulling back will be a hard one to fill.

In addition to the difficult task of attracting investors and actually facilitating trades, alternative platforms trying to develop this scale face regulatory challenges of their

Greenwich Share Leaders — 2015

Overall European Fixed-Income Market Share

Dealer	Market Share	Statistical Rank
Barclays	11.3%	1
Citi	9.7%	2
J.P. Morgan	8.6%	3
Deutsche Bank	7.2%	4
Morgan Stanley	6.3%	5T
BNP Paribas	6.3%	5T
HSBC	6.2%	5T
Goldman Sachs	6.0%	5T

European Fixed-Income Market Share — Credit

Dealer	Market Share	Statistical Rank
J.P. Morgan	12.8%	1T
Citi	12.3%	1T
Barclays	11.4%	3

European Fixed-Income Market Share — Rates

Dealer	Market Share	Statistical Rank
Barclays	11.5%	1
Citi	8.6%	2
Deutsche Bank	7.1%	3T
J.P. Morgan	7.0%	3T
RBS	6.9%	3T
HSBC	6.8%	3T

Note: Based on responses from 1,210 fixed-income investors. Credit includes investment-grade credit, high-yield credit, structured credit and asset-backed securities. Rates includes government bonds, agency securities, covered bonds and interest rate derivatives. Share leaders are based on top 5 overall and top 3 for rates and credit dealers including ties.
Source: Greenwich Associates 2015 European Fixed-Income Investors Study

own—including investors' concerns about their ability to demonstrate best execution when trading on these venues. As a result of these difficulties, these new trading mechanisms are only likely to emerge as an important source of market liquidity after an extended process of consolidation and maturation.

Given that timetable, Europe's fixed-income markets will require significant amounts of dealer liquidity to function effectively for the foreseeable future. The need for a strong dealer market-making presence will become especially apparent in volatile or falling markets, when investors' inability to find counterparties for trades could trigger a broader liquidity crisis.

"Our research results show the market moving in the opposite direction, with a number of dealers responding to disincentives created by the new regulatory structure by moving away from strategies based on providing liquidity to a broad universe of investors," says Greenwich Associates consultant Frank Feenstra.

2015 Greenwich Share Leaders

In this challenging and fast-changing environment, Barclays has secured the top spot in the list of 2015 Greenwich Share Leaders in European Fixed Income. Barclays' 11.3% market share tops the 9.7% share of No. 2-ranked Citi, which is followed by J.P. Morgan at

Greenwich Quality Leaders — 2015

European Fixed-Income Sales Quality

Dealer
Citi
J.P. Morgan

European Fixed-Income Research Quality

Dealer
J.P. Morgan

European Fixed-Income Trading Quality

Dealer
Citi

Overall European Fixed-Income Service Quality — Credit

Dealer
J.P. Morgan

Overall European Fixed-Income Service Quality — Rates

Dealer
Barclays
Citi

Note: Based on responses from 1,210 fixed-income investors. Leading dealers are displayed in alphabetical order.
Source: Greenwich Associates 2015 European Fixed-Income Investors Study

8.6% and Deutsche Bank at 7.2%. The quartet of Morgan Stanley, BNP Paribas, HSBC, and Goldman Sachs are statistically tied in fifth place with market shares of 6.0%–6.3%.

J.P. Morgan and Citi lead the market in credit product trading with statistically tied market shares of 12.3%–12.8%, followed by Barclays at 11.4%. These dealers are the 2015 Greenwich Share Leaders in European Fixed-Income—Credit.

In rates products, Barclays tops the list of 2015 Greenwich Share Leaders with a market share of 11.5%, followed by Citi at 8.6%. Rounding out the list are Deutsche Bank, J.P. Morgan, RBS, and HSBC, which are all tied with market shares of 6.8%–7.1%.

2015 Greenwich Quality Leaders

Greenwich Associates asked 1,210 fixed-income investors to rate the dealers they use for fixed-income trading in a series of service categories. Dealers that receive ratings topping those of competitors by a statistically significant margin are named Greenwich Quality Leaders.

The 2015 Greenwich Quality Leader in European Fixed-Income Sales is shared by Citi and J.P. Morgan. Citi is also the Quality Leader in Trading, while J.P. Morgan claims the title of Quality Leader in both Research and European Fixed-Income Credit Products. In Rates Products that title is shared by Barclays and Citi.

Consultants Andrew Awad, James Borger, Woody Canaday, Frank Feenstra, Thomas Jacques, Satnam Sohal and David Stryker advise on fixed-income markets across Europe and around the world.

Methodology

Between May and July 2015, Greenwich Associates conducted 1,210 interviews with senior fixed-income investment professionals at banks, fund managers/advisors, insurance companies, corporations, central banks, hedge funds, and other institutions across Europe.

Countries where interviews were conducted include Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Malta, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom and selected interviews conducted in Central & Eastern Europe and the Middle East. Interview topics included service provider assessments, trading practices, market trend analysis, and investor compensation.

The findings reported in this document reflect solely the views reported to Greenwich Associates by the research participants. They do not represent opinions or endorsements by Greenwich Associates or its staff. Interviewees may be asked about their use of and demand for financial products and services and about investment practices in relevant financial markets. Greenwich Associates compiles the data received, conducts statistical analysis and reviews for presentation purposes in order to produce the final results.

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