

Insights into Fee and Commission Management in Asia

A Look at the Key Challenges, Trends and Solutions

A Report by Kapronasia sponsored by Broadridge

This Page intentionally left blank

Contents

Foreword	1
Methodology	2
The Macroenvironment	3
Shifting Focuses & Challenges	5
Current Commission Management Approaches	7
Benefits of an Automated System	10
Moving Forward	11
Commission Sharing Agreements in Asia	12
Conclusions / Recommendations	14

Foreword

Although the Asian economy is growing faster than Western economies, competitive pressures and more tempered economic growth continue to compress fees and drive Asia-based financial institutions (FIs) to seek further reductions in costs and greater working capital efficiency. One area garnering increasing attention, and surprisingly often overlooked, is the accuracy, reliability and visibility of fees and commissions, the bread and butter of the brokerage industry.

The challenge for FIs operating in Asia is the sheer complexity and number of relationships and fees that they have to deal with on a regular basis. One FI may have multiple relationships with another FI covering the same financial instrument, all with different commission and fee structures. The level of complexity involved makes it increasingly difficult for FIs to manage their current trading relationships as well as control costs and risks.

Described by many as the final missing element of Straight Through Processing (STP), commission and fee management continues to be a thorny issue with no clear or easy solution. However process improvements based on credible commission and fee management solutions offer opportunities for FIs to overcome these challenges effectively.

With this in mind, the Insights into Fee and Commission Management in Asia report, published by Kapronasia and sponsored by Broadridge Financial Solutions, takes a detailed look at the challenges for Asian FIs in more detail, identifying areas where technology can help, and provides examples of how FIs measure the success of their technology investment.

We hope you find this report as interesting to read as it was for us to research.

Nick Perry
Senior Director
Broadridge

Zennon Kapron
Managing Director
Kapronasia



Broadridge[®]

kapronasia

Key Findings

- **The ongoing financial crisis has greatly increased the need for transparency and risk reduction.**
- **Successful Asian markets have brought along an influx of new brokers; commission and fee management is nascent in Asia.**
- **As the broker pool expands and becomes more complex, an adequate commission and fee management system is a must.**
- **Most companies acknowledge the issue, yet continue to use labor-intensive methods of managing commissions and fees.**
- **Automated commission and fee management systems have proven ROI and allow companies to improve efficiency, lower costs, and reallocate resources.**

Methodology

The Insights into Fee and Commission Management in Asia report focuses on the challenges that Asia-Pacific financial institutions (FIs) are facing in the fee and commission management space and the solutions that they are implementing to overcome these challenges.

The findings are based on a combination of secondary and primary research. Secondary research sources included Kapronasia's internal knowledge database, external government reports and published reports from vendors and FIs themselves. Primary research included interviews with FIs involved in the trading space, vendors and industry experts. The purpose of the research was to gather insight into:

- How FIs are managing commissions and fees today
- Business and technology challenges currently faced by financial institutions in fee and commission management
- Benefits of a fully automated commission management system
- Methods of measuring ROI

Financial Institutions - A Definition

Fee and commission management is an area that affects every participant in the capital markets industry. For sell-side firms, it involves ensuring that they are billing their customers correctly as well better managing fees and commissions they are being charged by other brokers; for banks, it is ensuring that they are paying correctly and forecasting for the future and for buy-side firms it involves a bit of both.

In order to avoid repetition, throughout this report, we collectively refer to these players as financial institutions or FIs which we mean to include banks and buy-side and sell-side institutions. Their challenges vary, but each has a vested interest in ensuring that they are actively and accurately managing their fees and commissions.

The Macroeenvironment

Today

Volatility has returned to markets as financial stability risks have increased and with weaker growth prospects adversely affecting both governments' and private companies' balance sheets.

The global financial crisis has essentially gone from individual US consumers not being able to pay debts to the situation we are in now where the concerns are if entire countries will be able to pay their debt. Although short-term fixes have been implemented, there is still a lack of long-term political solutions needed to ensure financial stability.

In the European Union (EU), confidence has shrunk rapidly as the true situation of sovereign debt comes to light and the solvency of several countries has come into question. The Euro-zone is not alone in its lack of a political solution as the United States struggles to define, gather support for, and implement the medium-term reforms needed to ensure financial stability.

Emerging Asia

The Asian economies have remained relatively buoyant recently with strong, but more measured economic growth. Most were somewhat insulated from the global financial crisis due to a smaller exposure to many of the economic instruments that burden FIs in Europe and in the US. However, they are currently facing structural challenges of their own as economies in the region reach full capacity. There are signs of overheating, including rising asset prices and inflation. This has prompted many governments to slow stimulus spending and increase monetary tightening.

The Stages of the Global Financial Crisis

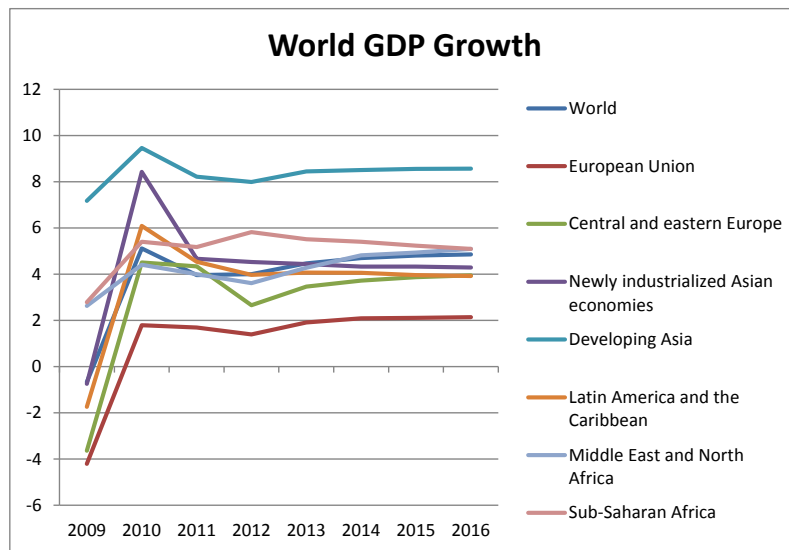
1. Private debt - Subprime crisis originates with U.S. consumers and banks
2. Banking – Systemic crisis spreads from the United States to Europe
3. Sovereign – Immediate problems in euro area sovereign debt; medium term debt burdens in core advanced economies
4. Political – Difficulties in reaching political consensus on fiscal consolidation and adjustment

Source: IMF, Kapronasia

The Future

So where does that leave us? Essentially the current global economic situation can be viewed as a two-speed recovery in which advanced economies continue a path of anaemic growth as they sort out their internal structural and financial issues and developing economies grow at a strong yet more subdued rate limited by monetary policy and decreased demand from developed economies. Most economists and organisations expect this two-speed global economy to continue in the future driven by increased domestic consumption and increased business demand.

Asia will continue to be a key part of the story both as a source of regional growth and as a stimulus for the global economic recovery. Already we are seeing signs of key economies in Asia, such as China, gradually driven more by domestic consumption rather than export growth. This will continue in the future, but keeping inflation and credit in check will be key to keeping Asian growth on an even keel.



Source: Kapronasia, IMF

Shifting Focuses & Challenges

With economic growth very slow or stagnant in many developed economies, the focus of many financial institutions (FIs) and their customers has shifted to emerging markets. For capital markets, this means finding new products, markets and investments where the economic conditions or at least outlook is much stronger, which for many, means Asia.

Asian capital markets have investment pouring in from all sides, becoming more crowded as the region continues to grow. Accordingly, financial transactions in Asia generated US\$3.8 billion in commissions last year. Even though commission rates in Asia have decreased by more than half since a decade ago, they have historically been higher than many Western markets, including the United States. To get a footprint in Asia, many top-tier FIs look to strengthen their teams by appointing more staff with regional experience.

This focus has of course been beneficial for FIs with an Asian presence, but has also brought a number of challenges for organisations especially in the current industry climate. The volatile market conditions have increased the focus on maintaining profitability and in an uncertain environment where revenues are anything but certain, many organisations are starting to take a hard look at their costs.

As a result, there is an increased demand in Asia for aggregation services and global commission management platforms. Financial institutions typically have numerous trading relationships which can be inefficient, extremely complex, and time-consuming when it comes time to pay, allocate and receive trading fees and commissions. To reduce risk and costs, Asian firms are looking for better transparency, accuracy, and efficiency with regards to both paying and receiving brokerage fees and commissions.

FIs we spoke with listed some or all of the following as their top four key challenges in the commission/fee management space:

Increasingly complex and duplicated agent relationships

With an increasingly complicated marketplace with more non-traditional agent brokers and an increasing number of alternative trading venues, many FIs have developed a complex web of relationships with their brokers. In many cases these relationships are duplicated between businesses and in some cases, even between desks.

Outdated and disparate technology

The financial industry is notorious for having 'big-iron' mainframes and outdated legacy software and hardware infrastructure. Typically inflexible and very expensive to maintain, out-dated systems can severely inhibit an organisation's ability to expand and adapt to changing market conditions. One of the more common limitations with current systems is the inability to input multiple brokerage rates for one broker or client.

An additional issue that is exacerbated by legacy infrastructure is input and output formats. Any large capital markets FI will likely have multiple trading and accounting systems each with their own file formatting and standards. Pulling all these diverse sets of information together and making sense of them all is hugely time consuming as part of a manual process, and adds to the complexity of implementing a best of breed fee and commission management solution.

Siloed business and technology groups

Organisations we spoke to also mentioned the challenge of internal business units that still remain relatively siloed within the organisation. One FI explained how after some internal audits and analysis, they found they had multiple relationships with the same broker covering the same underlying financial instrument, but all with different commission and fee rates.

In addition, many firms' IT groups are, similar to business units or trading desks, segmented by business unit with each business having its own technology group, hardware and systems. This inevitably ends up with duplicated systems reporting into different organisations and a very inefficient and slow moving IT team.

Ensuring continued best execution

Although alternative trading venues in Asia aren't as developed as they are in the US or Europe, the continued economic challenges are creating more demanding customers who are looking for the best prices and therefore best execution both in terms of market pricing and trading costs. Market pricing is always known, but for many FIs, understanding and managing trading costs is more of a challenge and something that very few can do in real-time, making 'best execution' a backward looking exercise at best.

One FI explained how after some internal audits and analysis, they found they had multiple relationships with the same broker covering the same underlying financial instrument, but all with different commission and fee rates.

Current Commission Management Approaches

In response to the commission management challenges, solution providers are creating automated aggregation services that allow clients to make payments and be credited, respectively, through a single portal.

The issue is because there are no regulations insisting on the use of commission management, most domestic financial institutions (FIs) in Asia don't see the need to use it. Often they are more focused on their business whether it be asset management, banking and/or trading; current commission management approaches are seen as having been 'good enough.'

Largely due to these factors, there are very few FIs using automated commission management systems. Most are using one of or a combination of the following six strategies:

Manual checks

This method consists of employees checking all invoices manually by examining relevant documents. It is very time consuming and for a larger organisation, nearly impossible due to the sheer volume of transactions not to mention the possibility of human error. The few organizations that do use it are generally start-ups who have yet to integrate new technology. Through our surveys of different FIs, we found that in surveys asking companies to define their commission management system, "partially-automated" usually means little more than an Excel spreadsheet that performs calculations with user inputs.

Spot checks

Most of the FIs in the market today are doing spot checks. Typically this involves randomly selecting a few incoming invoices and checking information against known trades. Statistically, if done correctly, this does help the organisation to identify potential cost issues in high volumes of trading, but it is still labor intensive and relatively inaccurate.

Outsourcing to non-specialised BPO provider

To increase productivity and efficiency, some organizations have looked to outsource their commissions management. One organisation we examined was taking a similar 'complete manual check' approach that we mentioned above, but had actually outsourced the checking to an off-shore BPO provider who did this sort of commission checking/reconciliation along with a number of other products and services.

This made sense from a cost perspective as the provider was able to provide commission and fee management services at a much cheaper rate than if the FI had done it in-house. However, the process used by the BPO provider resulted in numerous exceptions. The exception investigations delayed payments to the FI's brokers, who then complained to the FI's front office, who then complained to the back office who were managing the payments. This chain of complaints can result in strained business relationships and delayed payments.

Most non-specialised BPO providers do not provide automated commission management. Though outsourcing may take the burden off the firm's employees, this method may be even more inefficient due to loss of oversight and problems with communication.

Value added service from another external provider (e.g. prime broker)

Larger FIs may rely on an external provider for commission management services. This may be a broker which provides commission management as a service, or another external provider. This is another outsourcing method in which the FIs send their invoices to these top-tier firms and their professionals reply with the calculated invoices. While this is a step in the right direction, the solution still may not provide the FI with full transparency and clarity into commissions and fees. The cost of this method is usually higher and may create a conflict of interest if the FI also uses the service provider's brokerage services.

Additionally, the service provider, depending on how they actually provide the service, may have similar fee and commission management issues themselves and in some cases this approach can tie the FI to one institution which is in fact reducing transparency and flexibility.

Upgrading existing technology with commission management functionality

FIs in many cases will seek to leverage existing technology systems to improve commission management. This is sometimes outsourced to third party firms when convenient and less expensive, but for the most part companies keep control over their commission management systems.

However, these existing commission management solutions tend to only be a partial fix. Many systems are not able to provide the same analysis that a dedicated commission management system can offer and therefore miss out on some of the more complex analysis and management reporting that a dedicated system can do. A firm seeking to upgrade its existing system also often runs into issues of flexibility, scalability, and compatibility, retarding performance and resulting in a less-than-ideal ROI.

Doing nothing

In many cases, organisations were simply doing nothing due to a lack of internal resources, either human or automated systems. Commission management was seen as a nice to have, but not a critical part of the organisation as the financial impact of a single trade's commission or fee was small. One of the organizations we contacted stated clearly that their commission and fee management system was causing issues and needed improvement, but because their operation was small and the markets moved every day, they could not afford to make it a top priority.

When viewed from the perspective of a single trade, a commission or fee inaccuracy can seem insignificant - if a trader makes one trade and nets US\$1M for the company, then if the commission is off by 3%, it will seem small, but when looking at the total trades across an organisation, brokerage bills can easily reach into the millions where 3% is much more significant.

Benefits of an Automated System

The approach that many FIs have to commission management is changing rapidly as more automated solutions appear on the market. Many of these solutions overcome some of the issues with the manual approaches detailed above and offer unique benefits including:

Reduced trading costs and better cost control

One of the largest benefits of using an automated commission management system is the ability to reduce trading costs in the short term and control costs in the long term. Although a manual process can accomplish this, as we will see later, the ROI from an automated system is much greater.

In the short term, costs can be allocated more accurately between internal desks and business units and incorrect payments can be identified and eliminated as an automated system will match fees and commissions directly to the actual trades.

In the longer term, a system can also monitor trading threshold discounts and brokerage caps to ensure trading is being done as efficiently and cost-effectively as possible. This data can also form the basis of a more over-arching broker rationalisation where efficient brokers can be prioritized and costly brokers de-prioritized.

Real time insight / Better analytics

An automated commission management system also provides better real time insight into the operation of the business. As we mentioned previously, not having real time insight into trading fees and commissions makes determining 'real-time best execution' nearly impossible.

Many commission management systems also have either internal native business activity monitoring systems or have external interfaces that allow them to connect into a company's existing MIS systems allowing measurement of KPIs & KRIs of both individual traders and the overall business.

Optimized working capital and liquidity risk management

This real time insight also gives organisations an immediate view of their global trading costs at any point. This information is useful for understanding the liabilities of the organisation as well as planning for future accruals to enable better working capital and liquidity risk management across the organisation.

Risk Control / Compliance

A commission management system can also help to decrease risk and increase compliance. Firstly firms can be better positioned to avoid scandals similar to many of the recent rogue trading scandals as organisations would have been able to pro-actively monitor brokerage volume per trader/desk and identify abnormal favouring of a particular broker, which can be an indicator of fraudulent activity. Secondly, a commission management system facilitates investigations in case of trading errors.

Moving Forward

One of the key inhibitors for purchasing and implementing an automated commission management system in the past has been the challenge of measuring potential return on investment (ROI). This is largely down to the fact that organisations with commission management systems have been typically reluctant to share ROI information as it is seen as commercially sensitive as many are understandably leveraging systems to develop their own competitive advantages in the market.

Surprisingly enough though, in a few marketplaces in Asia, organisations are starting to share their experience and in many cases we had seen one FI actually recommend a vendor's product to another FI. Although a bit unclear why it was happening, the market seems to be taking a 'rising tide lifts all boats' approach to commission management in an effort that can only bring additional transparency and clarity to the market.

Commission Sharing Agreements in Asia

Another way of improving transparency and efficiency in commission management is through commission sharing agreements (CSA), which have been widely implemented in the United States and the UK. These unbundle commissions paid to brokers so that research and execution accrue separate and distinct credits. It is a soft dollar arrangement that allows FIs to choose the best execution and researcher brokers, avoid conflict of interest, and gain transparency in commission and fees. Currently in Asia, there is a high premium on quality research, which has led many independent researchers to push for implementing CSAs.

CSAs are not yet widely used in Asia as there are no related regulatory guidelines in markets such as Taiwan, Singapore, India, and Korea. Most sell-side participants anticipate the next market to accept and adopt CSAs will be Japan because it trades with top-tier firms and invests heavily in the US and UK marketplaces. The proliferation of CSAs in Asia means that the client-broker base will become more extensive and complex. In anticipation, many firms operating in Asia have begun, or at least have considered, implementing commission and fee management.

Measuring ROI

All of the organizations that we looked at over the course of this study had improved their business operations and profitability in a number of different ways through the implementation of a more comprehensive and automated fee and commission management system. These included improvements in the accuracy of their trading fees and commissions as you might expect, but also included a number of other areas including staff productivity gains, IT hardware software savings, reduced operational costs and overall business insight.

Brokerage commission / fee rationalisation and reduction

Perhaps the most measurable ROI is that of brokerage fee rationalisation and reduction. In many cases, organisations may be overpaying or incorrectly paying for up to 20% of all trades. This might have the potential of actually balancing out under vs. over-payments, but in most cases does not.

Staff productivity gains

FIs in many cases indicated seeing productivity gains in both the front office and back office:

Front Office - In the front office, FIs with commission management systems indicated that having an automated system allowed front office staff to focus more on their job and less time on the admin that went along with it including calculating brokerage per trade, P&L for performance management, etc.. One FI indicated that they would save 7-8 hours per month per person in reduced admin.

Back Office / Operations - Organisations also noted the productivity gains to be had in the back office. One FI indicated that their operations team of 10 gained 25% of their time back from increased commission management efficiencies and greater transparency which allowed them to reallocate staff to other areas of the organisation.

Information technology savings

In many cases, and depending somewhat on the functionality of the commission management system being implemented, a new system replaced several legacy platforms resulting in tremendous savings in IT costs. Savings included:

- Hardware costs – existing systems tended to be on legacy hardware that was both out-dated and expensive to maintain. New systems were on commodity hardware that was much cheaper to purchase and resulted in lower running / maintenance costs.
- Software costs – new commission management systems in most cases replaced more than one existing system resulting in an overall cost saving.
- IT staff productivity – organisations were able to also increase IT staff productivity and often re-assign IT staff to new roles as a result of the system rationalisation as the number of systems decreased.

Reduced Operational Costs

Outside of the human-side of operational costs, organisations also indicated savings in more manual paper-based processes such as writing and mailing checks and statements to both service providers and internal employees. These processes were largely paper based due to the limitations of legacy systems and could be streamlined with a new commission management system that facilitated a shift to online bill-payment and invoicing. Not only does this approach reduce cost, but also reduces risk coming from potential paper fraud during the previous manual process and inaccuracies in general.

Conclusions / Recommendations

While STP has been widely implemented, commission and fee management remains a manual and cost-inefficient task for many financial institutions (FIs). As the global financial industry continues to grow, the introduction of new products and the increase of trade volume in Asian capital markets will place a significant strain on financial service institutions. Fragmented commission systems and complex trading relationships are creating communication and visibility issues for FIs of all sizes. With cost and risk reduction at the forefront of corporate initiatives, integrating an automated commission and fee management system should be a top priority.

Based on Kapronasia's observations, piecemeal upgrades will not suffice and a complete transformation of the commission management system is needed. This is because legacy systems are simply not flexible or scalable enough to handle new loads of data. In addition to faster processing and eliminating erroneous charges, automated commission systems will increase worker productivity and allow firms to reallocate their employees.

The good news is that automated fee and commission management systems are a viable solution for FIs to better manage commissions and fees and control costs and risks. From the examples we have seen, assuming proper assessment and implementation, firms are able to realize ROI from a *best of breed* solution within a fiscal year.

As the finance sector matures in Asia, companies should look to concentrate on implementing new systems now to avoid high replacement costs later. A dynamic commission and fee management system will give companies the competitive advantage as they look to extend their business or gain a foothold in Asia.

kapronasia

About Kapronasia

Kapronasia is a leading provider of research-based advisory and consulting services focused on the Asian Financial technology industry. Through market-leading research and customized strategy, we partner with financial institutions and financial technology providers around the world to identify their highest-value opportunities in Asia and help them to achieve and sustain a competitive advantage in the market.

For more information about Kapronasia, please email:

info@kapronasia.com

www.kapronasia.com



About Broadridge

Broadridge is a technology services company focused on global capital markets. Through its PROactive™ Fee & Commission Manager solution, Broadridge offers an opportunity to reduce costs by better managing commission payments and receipts, while driving increased operational efficiency and improving business control.

For more information about Broadridge, please contact:

David Birch +852 2101 9700
Akhter Khan +65 6438 1144

or email: infobcn@broadridge.com

www.broadridge.com