Fees & commissions

Denis Orrock, CEO, GBST Capital Markets examines the growing challenge of dealing commission transparency.

Fees and commissions management continues to be a pressing issue for capital markets firms. Recently, the FCA released a consultation paper focused on the use of dealing commission rules, while the Investment Management Association's (IMA) pending report from Guy Sears also highlights the importance being placed on this area. With an estimated £3bn of dealing commissions being paid last year it is not hard to see why regulatory bodies are targeting this area, especially in light of the intense scrutiny that the financial sector continues to experience since the onset of the global financial crisis.

Adding to the challenge is the emphasis that asset managers are placing on the quantum of commissions that they are paying today, what value they are receiving in return and how they themselves meet harsher internal and external compliance requirements. The response from asset managers has been the introduction of increasingly complex commission payment structures.

Put the buy- and sellside challenges together and consider the multifarious systems architectures that have arisen out of a 'best of breed' approach, and you have a significantly compelling requirement for a centralised fees and commissions platform, one that can readily feed downstream and upstream IT systems.

Evolution of a problem

The multiple trading systems methodology that many capital markets firms employ (either from choice or from growth by acquisition, and therefore inheritance) is one of the origins of the current fees and commissions conundrum. These multiple systems have created a 'siloed' approach to technology. In the area of fees and commissions these silos compound maintenance and servicing problems, as it is extremely common that these front and back offices utilise different databases of fees and rules; ones that are not synchronised.

From a transaction processing perspective, we know that certain business lines need to be able to segregate commissions, such as ETFs and other Index-related products whose volumes continue to grow exponentially. Similarly, firms require tiering and ranges of commission levels, all accentuating the problems.

The growing need, in an industry that continues to expand its market offerings, is for a central tool to act as a fees and commissions repository, one that will provide a scalable solution and reduce manual processing and workarounds. Few investment banks have a single service based architecture that will allow all the consuming systems to interact with the fees and commissions data held in a central repository.

Drivers for change

Transparency and clarity are, of course, key issues for the financial services industry as a whole. Within capital markets, articulating the breakdown in fees and commissions being levied – between execution charges, research, corporate access and so on – has become a point of controversy. In the retail and wealth management space, understanding the commission structure has been a bone of contention since before the credit crunch. That debate ultimately resulted in the UK's Retail Distribution Review (RDR) and the Markets in Financial Instruments Directive (MiFID).

Irrespective of the above drivers, unsettled trades due to incorrect commissions also carry a heavy financial burden for capital markets houses. The cost of rework related to incorrect commissions can be immense. SWIFT and agent related charges alone can cost investment banks in excess of £1.5m a year if fees and commissions processing are not properly managed and centrally resourced.

Operational burden

Capital markets firms have to deal with a myriad of operational issues associated with fees and commissions. One requirement is to handle the amendment and rebooking of trades to capture the correct fees, and then calculate the correct fees to match the trades.

Beyond the setting up of fees and commissions on systems, banks now wish to reconcile figures intra-day; waiting for month end, or batch, processes is not acceptable. If a firm can agree the commission sharing agreement (CSA) element on each trade, it will be able to provide its traders with a true P&L (inclusive of cash) at the close of business.

There is also the number of fee sharing arrangements to consider. These arrangements are struck on an individual client basis and can frequently be unique, or appear to be so. Operations teams have to manage these fees, inputting them into a system. Ensuring similar fee rates are not duplicated and that a fee structure is assigned to multiple clients means fewer rates in the system and makes the process manageable. Indeed, system limitations on handling the fee structure can restrict striking business deals and will certainly add to the cost of trading as more manual intervention is required – making the process more expensive.

The scale of this type of agreement continues to grow; therefore if banks do not have an automated solution in place now, the operational burden may become intolerable. More and more resource will be required, as incorrect trades remain outstanding for longer.

Being in a position to audit all fees and commissions is not only for the benefit of the accounting, finance and management teams. The sales team can also see the fees they are going to generate and therefore what commissions they are going to earn.

Conclusion

It is widely anticipated that a number of industry announcements will be released on the issue of fees and commissions early in 2014. One contributor to the debate will be the IMA, where Guy Sears has been leading research into commission breakdowns and corporate access. The other will be from the FCA, which is also looking into the same issue.

With new requirements coming into play, legacy solutions and technology will continue to struggle to meet demands for a centralised and versatile fees and commissions hub. Whether it is going to be a directive or regulatory, capital markets firms need a system that is capable of: easily managing all fees and commissions structures; delivering regulatory compliance; provision of better client servicing information and daily visibility of CSAs.

Irrespective of the pronouncements of the industry's top brass, the reality is that a robust fees and commissions engine will reduce overheads and improve customer servicing, thereby increasing the likelihood of repeat business. For this last reason alone, the capital markets industry needs a new approach to commission management. ■