ANALEC

The "Unbundled" Model - As a broker-dealer is your CRM ready for the challenge?

Indy Sarker
CEO, ANALEC

Institutional stock brokers globally are facing significant business transformation pressures from the market place, driven by economics, technology and regulatory change. Their customers want more transparency in their commission payments ("unbundling") while turning more selective in their service needs from broker-dealers. We believe a traditional CRM approach will fail to deliver the necessary results to aid the business of a broker-dealer.

To put things in perspective, it is estimated investors worldwide paid around US$30 billion annually in stock trading commissions to brokers in 2015. Out of this amount around US$20 billion is assigned to "research and related services" provided by brokers to their clients (i.e., investors). This Commission Pool (as is commonly referred to) is a function of the brokerage commission rate (on each trade) and the value of trades executed in the market place. In other words, higher the stock market turnover (all things being equal) the higher the commission pool.

Over the last 10-15 years, both technology innovation and competition have driven down commission rates on stock trades, and of recent phenomenon has been the clamor from the investor community for broker-dealers to provide transparency on what the commission charged pays for (i.e., calls for disaggregation or "unbundling" as it is popularly referred to) in terms of execution services and other research and research related services.

In the "unbundled" world, it is imperative for a broker-dealer CRM to remain active and dynamic in the client service value chain. It must be intelligent, adaptive and insightful in terms of the analytics and decision-making tools to arm the business to fight its corner.

Commission Unbundling: Not just a research challenge

For those of you who have been following the "commission unbundling" discussions, will agree that it poses a challenge beyond the investment research "service or product". It raises a whole series of client accountability and servicing challenges that brings a broker's CRM investment into mainstream focus. With unbundling broker-dealer clients will be more specific in terms of what they want as a "service" from their broker-dealer and what they are willing to "pay" for such a service.

With unbundling taking center stage and MiFID II taking operational significance from 2017 onwards in Europe, one can safely assume compensation for research and research related services will increasingly move to a "price tag" format which will also bring about the separation of research payments from the volume (or value) of shares traded (via the broker). In other words, research payout divorced from market turnover related activities of the client is here to stay under MiFID II and the various "unbundling" initiatives underway across the world.

Consequently, it is no longer sufficient for a CRM to ensure the client gets a service most relevant to their needs but also to ensure the magnitude of the service is not in excess of what the client has agreed to pay the broker. In other words, while previously a CRM was merely interested in customer preferences (on research and service) and then ensuring content distribtion and "services" are alligned to meet that requirement, in the future there may be a top level filtering criteria based on customer subscriptions, before leading to "customer preferences". In other words, a customer's service preferences cannot be outside of the customer subscription universe, without re-setting the commercial terms.

If you are less familiar with the "commission unbundling" phenomena, my previous piece on MiFID II and the "unbundling" issue throws more light on this: MiFID II and the Pricing of Investment Research. In a nutshell, "commission unbundling" will lead to the full service brokerage commission payout (from an institutional investor to its broker) to be split into its various components of services consumed by the investor. These include, trade execution, research services, research related services like analyst and research-sales people access, and corporate access. Under the unbundling practice, each broker-dealer will now have to split the commission received on trades transacted (on behalf of their clients) across these services. Typically, research and related services account for around 70-80% of the total full-service commission pool; according to some estimates.

CRM and the New Pricing Model for Research

This brings us to the new world of research pricing and its impending impact on the CRM needs of a broker-dealer organization. The final delegated acts for MiFID II were released by the

European Commission in early April 2016 and it has given research service providers some comfort, in the form of brokerage commissions still being admissible for use to pay for research (via CSAs or similar arrangements). However the ruling is very clear that all research providers (banks included) will have to now put a price tag on their research.

While MiFID II the final document has not come out to be entirely draconean in their approach (to the relief of many), one cannot deny the fact that pricing of research services are getting more competitive and that payout for research services would be divorced from trading volumes and related activities at an asset manager.

Given that research will not have the ability to benefit from a bull-market in the markets in the same way it has in the past, it becomes all the more important that the intellectual capital embedded in the service is not "wasted" and that only "paying" customers get the necessary service.

What remains unclear at this stage is the specific detail on MiFID II as to what constitutes a "price tag" on research. Specifically the questions that need to be answered are as follows:

- Is it the pricing of research in a way that each report subscribed by the client is charged a specific price or is the "service" priced for a specific set of activities (that constitutes the service)?
- Revisions to such charges or "price tags" for research, how will they be institutionalised and legitimised in the client service process?
- Does Corporate Access still fall within the remit of "research and research related services" and therefore warrants a price?
- If research does require a "price tag" from the provider to the consumer, then how does one reconcile the broker review process within asset managers and the notion of a variable payment over time despite maintaining service level points in the broker review process?

The pricing philosophy and the specifics around the details on how it would be administered and re-set periodically have implications for the CRM platform and its ability to administer the engagement. We believe we will see and hear more on the specifics of delivering on this front over the course of the next year.

The customer takes center stage

With "unbundling" comes the need to measure in accurate terms (a) what the customer wants; and (b) what is delivered against that "want". The CRM has to cope with both depth and breadth of coverage, and "coverage" being increasingly defined on the basis of either markets, or specific sectors or industries (in specific markets) and beyond that the magnitude of the service (i.e., limits on number of analyst meetings and/or corporate access meetings, in any given billing cycle etc.).

The new reality of the investment research market place with "explicit pricing" arrangements between investors and brokers, clearly brings the customer into the limelight. In this instance, like any other recurring service business model that is paid for upfront or on a set of predefined terms, there is the added dimension of managing renewals and consequently addressing customer retentions. Additionally, since there is always the possibility of up-selling other (related) services during the subscription (engagement) period. The CRM therefore not only has to be adept at not only delivering on the existing subscription (or service commitments) but also to be able to "grow" the business with the client by showcasing other capabilities outside of their subscription horizon in a way that does not compromise the "service relevance" criteria set by the customer.

"New" CRM – Not just a repository, but an active decision-making partner

Traditional broker-dealer CRMs have over the years have come to become gigantic information repositories with little regard or attention to the storage rationale of such large amounts of data (beyond of course compliance requirements). It can be characterised as a black-hole that sucks in millions of data points across the business, in all probability over 95% of such data never used again in any decision-making process. In other words, CRMs become an end in themselves as opposed to a means to an end.

We believe the "new" CRM has to be frugal in its appetite for data, but really focus on the relevance and significance of the data capture over the active client service value chain. In the context of a broker-dealer, securing payment for research services in an explicit pricing world will require data-points and transparency to help present the best case for renewals or incremental payments to the client base. We believe for a broker-dealer CRM to remain active and dynamic in the client service value chain, it must be intelligent, adaptive and insightful in terms of the analytics and decision-making tools to arm the business to fight its corner in an "unbundled" world.

Client Profitability Increasingly Important

Given the explicit pricing of investment research under an "unbundled" regime, there is increasing pressure on management teams within broker-dealers to measure or attempt to quantify the profitability of each customer account, in the context of revenues secured and cost of service (delivered) or measure the "service intensity" of the revenues secured from each customer organization. We believe traditional broker-dealer CRMs fail to deliver the much needed capability to make this assessment.

We believe the need to discriminate service levels across customers, coupled with the ability to capture every touch point of the client service in an electronic form to aid the profitability assessment of an account. The latter will become increasingly important to a broker-dealer organization to hold their clients' accountable and/or look to rejig their client service format in order to optimize their internal cost structures to remain profitable.

Indy Sarker is the CEO and Co-Founder of ANALEC, a global financial technology firm focused on the investment research and resulting client servicing industry. (www.analec.com).