Trading Commissions:
Rising Above the "Race to Zero"

07

In Short

Average Equities Trading Commission in the US

2.64 cps

CENTS PER SHARE

Emerging Applications

41%

On average, 41% of Gen D investors are looking for simulations and/or gamification tools from their banks

Number One Reason Why Gen D Investors Switch Institutions

To reduce the cost of transactions and fees

The commoditization of trading services, fueled by technological advances, market changes and increasing competition, has resulted in a long-term downward trend in trading commissions. Across all markets, pure trading commissions are racing to zero. Facing shrinking commission revenues and being buffeted by the cyclicality characteristic of the flow-based business, investment banks must evolve their business models to remain relevant and transcend the "race to zero."

Trading commissions have been declining across different geographies for a number of years (see Figures 1 and 2). Equity trading commissions in the United States now average around 2.64 cents per share (cps) for all-in rates and as low as 0.97 cps for algorithmic trades, net of tack-ons for research.[1] In emerging markets, such as China, online trading commissions have dipped as low as two basis points (bps).

A perfect storm with ripple effects

Broadly speaking, this decline in commissions has been fueled and accelerated by technology-led disruptions and structural shifts in the market, including regulation. More specifically:

- **Deregulation** heralded the end of fixed brokerage commission rates and ushered in a new regime of negotiated rates. In the United States, deregulation opened up equities trading across many different trading venues, increasing competition and downward pressure on costs.
- **Low-cost passive fund managers** have gained market share held by traditional active asset managers and increased pricing pressure on brokerages by favoring lower-cost execution options that align with their low-cost business models.
- **Electronic trading** has shifted trading from people to computers. Together with widespread use of the Internet, it has also given rise to low-touch, low-commission discount brokerage models. Research suggests that between 63 percent and 73 percent of all trades across instrument types are now conducted electronically.[2]

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- **The Markets in Financial Instruments Directive II (MiFID II),** which is scheduled to come into effect in Europe in January 2017, proposes to unbundle research from trading commissions to protect investors from overspending on research. Once implemented, this directive would further reduce trading commissions and could drive sell-side revenue down by as much as one-third.

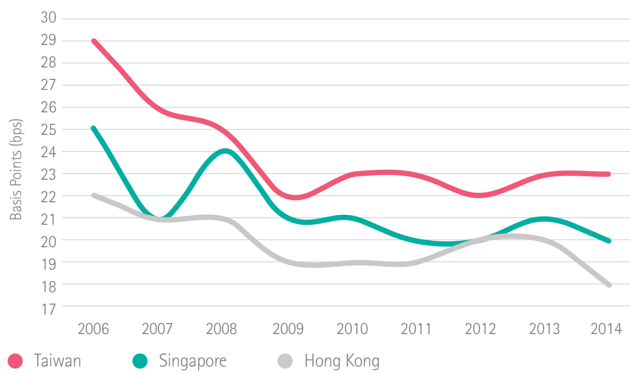
This trend of shrinking trading commissions extends beyond equities. Fixed income trading is experiencing similar electronification and technology-led disruption, which is expected to enhance transparency in bond pricing, enhance liquidity, boost efficiency and lower transaction costs. Coupled with regulatory requirements that make it less attractive for banks to carry the risk of trades on their balance sheets, these structural changes are eroding revenue and returns in a traditionally lucrative market.

Together, these market developments have helped lower barriers to entry, level the playing field and enhance transparency. The result has been increased competition, the commoditization of trading services and a relentless march toward zero commission.

Facing shrinking commissions and an increasingly challenging operating environment across the globe, investment banks are trimming their trading activities or leaving the trading business altogether. For example, 40 investments banks, including Bank of America and Nomura, annouced more than 68,000 job cuts in 2012, with equities bearing the brunt, Deutsche Bank announced plans to downsize equities in Latin America in 2014, and Standard Chartered closed the bulk of its global equities business in 2015.[3] A similar pattern of consolidation can be observed in fixed income, currencies and commodities (FICC), with a number of major banks—including Deutsche Bank, UBS, Credit Suisse and Barclays—exiting parts of this once-lucrative business.[4]

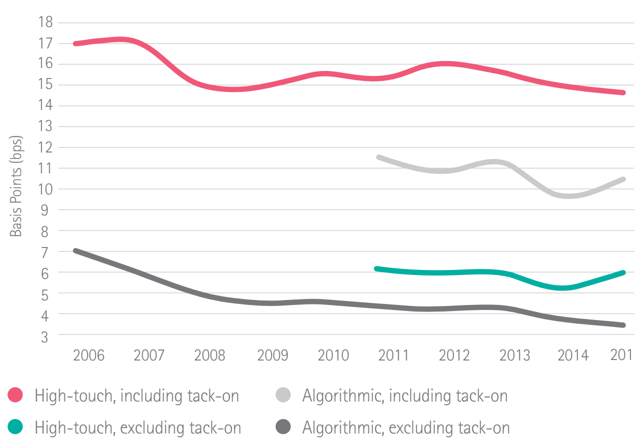
While investment banks should continue to optimize their trade execution capabilities and reevaluate their involvement in the brokerage business, innovating on the current business model presents a viable way to remain relevant and rise above the race to zero.

Figure 1: High-touch equity trading commission rates in selected Asian markets*



* Includes tack-on rates for research and capital
Sources: Greenwich Associates, Accenture Research

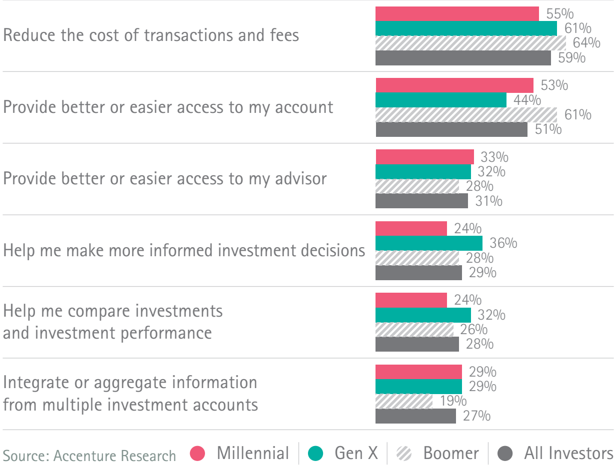
Figure 2: Equity trading commission rates in Europe



Sources: Greenwich Associates, Accenture Research

Figure 3: Institutional change motivators

Fewer fees, lower transaction costs and ease of account access are a few of the drivers behind investors' willingness to switch institutions.



> Rather than view digital innovations as threats, banks and brokerages should seek to harness these innovations to their advantage to appeal to Gen D buyer values, provide options for customers to interact on their own terms, drive automation and encourage customer stickiness.

Rise of the digital customer

In parallel with these changes in the brokerage environment, a broader shift has been taking place in the behaviors and preferences of retail customers. As the digital revolution sweeps across all aspects of daily life, customers have come to expect "anytime, anywhere" convenience and personalization from the businesses they interact with. An Accenture study on the digital generation (Gen D) dispelled the myth that this generation is mainly made up of young people, pointing to investors of all ages who are demanding more from both traditional and digital options, with the propensity to switch for better experience.[5]

Gen D cuts across age groups and varies by geography. In Europe, it comprises over a quarter of all millennials, more than a third of Gen X and 64 percent of baby boomers. Members of Gen D are generally successful and highly educated, tend to be more entrepreneurial and self-reliant, have higher incomes, are highly digital in their daily lives and are active investors. They value digital tools as a way to augment traditional investing and view such tools as complements to rather than substitutes for human advisors. Many members of this group—particularly those who identify as millennials or Gen X—are willing to switch providers to gain access to a digital tool, service, channel or application that their current institution is unable to provide (see Figure 3). They look to these digital tools to reduce transaction costs and fees, improve access to their advisors and help them make more informed investment decisions.

This shift in customer behaviors and preferences, along with digital-driven advancements in technology, creates unique opportunities for innovation.

Evolving the business model

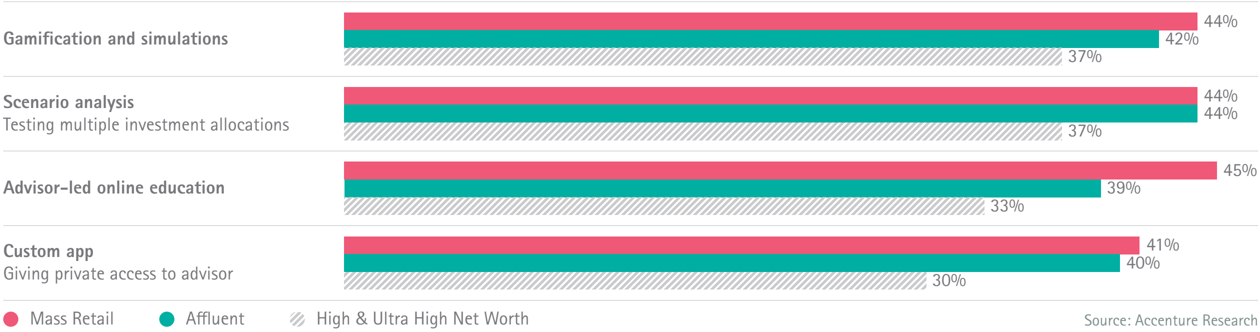
Investment banks and brokerages can redefine their value propositions while still leveraging their existing trade execution capabilities. In the United States, and later in Europe, traditional retail brokerage has evolved from a stock-picking, trading-focused business model into one that is oriented around gathering assets under management (AUM) and providing investment advice. Such a shift in the business model, from flow-based to AUM-based, diversifies revenue dependency on volatile and shrinking brokerage commissions to include more stable advisory and asset management fees, and sales commissions from funds. Investment banks and brokerages around the world can certainly learn from this experience when responding to the race to zero.

More importantly, what's different now are the possibilities afforded by the digital era. The ubiquity of the Internet and advancements in digital technology make it possible to transform business models at lower cost to reach a much wider audience at a much faster pace than ever before. Specifically, investment banks and brokerages could use digital technology to:

- **Appeal to Gen D's buyer values of convenience, anytime and anywhere.** This could be done by fulfilling their investing needs—including trading, investing in funds or other asset classes, or investment advisory/management services—in one place digitally.
- **Drive automation.** Robo-advisory has gained considerable attention in recent years for providing investment management services at a fraction of the cost of traditional models. Robo-advisors, such as Wealthfront and Betterment, provide investment management services by using algorithms to make trades and invest on behalf of customers based on their risk appetite, financial goals and investing styles.

  Another example of investment automation is trade mimicking, which is modeled on the concept of social investing. Here, customers choose to "follow" portfolio managers whose style matches their own. The investing platform automatically syncs the customer's portfolio to reflect each trade made by their chosen portfolio managers.

Figure 4: Generation D investors' interest in both do-it-yourself digital tools and advisor-connected offerings



Source: Accenture Research

By automating a previously human-based service and reducing cost-to-serve, this technology allows businesses to tap into a much wider pool of retail customers for investment management services that were once mainly accessible only to the wealthy. Investment banks and brokerages should consider developing, acquiring or partnering with providers of automated investing technology, as established firms such as Blackrock and Vanguard have done recently.[6]

- **Provide options for Gen D investors to interact on their own terms.** This means providing the right combination of digital tools and channels to enable self-directed investors, or access to a human financial advisor or broker for investors who prefer a higher-touch model (see Figure 4). Video chat, web chat and e-mail are channels that can be used to deploy high-touch models at lower cost than traditional models. There are examples of online trading platforms that provide a rich suite of tools and research content for self-directed customers. Other firms provide a hybrid model that combines digital services with access to human advisors. Investment banks and brokerages can also consider a "platform" approach to provide investment choices to customers.
- **Increase customer stickiness.** Digital technology creates an opportunity for investment banks and brokerages to rethink how to encourage customer loyalty. Innovative propositions like Acorns help create an emotional connection between customers and their service providers. Acorns' investment app provides a "set-it-up-and-forget-it" system that helps customers invest their spare change from linked credit and debit card purchases.[7] When a customer makes a purchase using a card, the spare change from rounding up to the nearest dollar is invested in six different funds based on the customer's risk tolerance. This model helps customers grow their investment portfolios automatically and achieve their financial goals without conscious intervention or effort.

Harness the power of digital

As commissions race to zero, investment banks and brokerages should focus on becoming excellent at what is considered "table stakes" in the trading business—trade execution efficiency. Beyond streamlining costs, investment banks and brokerages should also look to evolve their current business models as a means of realizing new sources of value and profitability. The digital era has not only led to a sea-change in customer expectations, but also brought about technology advancements that innovative banks and brokerages can leverage to redefine their business models at lower cost, faster pace and with a wider reach than was previously possible. Rather than view digital innovations as threats, banks and brokerages should seek to harness these innovations to their advantage to appeal to Gen D buyer values, provide options for customers to interact on their own terms, drive automation and encourage customer stickiness.

While the brevity of this paper would not be sufficient to cover a topic of this scope entirely, it is intended to highlight some considerations for rethinking how investment banks and brokerages can confront the challenges faced in the trading business and, in particular, harness the power of digital to help them evolve with pace and agility.

1 Source: Greenwich Associates

2 https://www.accenture.com/us-en/insight-investment-banking-client-survey-depth-report-summary

3 http://www.bloomberg.com/news/articles/2013-01-14/equities-bear-brunt-of-wall-street-job-cuts-as-volume-drops-18-; http://www.reuters.com/article/2014/04/23/us-deutschebank-latam-employment-idUSBREA3M00S20140423;

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4 https://www.db.com/ir/en/images/Deutsche_Bank_Strategy_2020_27_April_2015.pdf;

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5 https://www.accenture.com/us-en/insight-generation-d-europe-investor-survey-wealth-management

6 https://www.blackrock.com/corporate/en-jp/literature/press-release/future-advisor-press-release.pdf; https://pressroom.vanguard.com/content/press_release/Vanguard_Introduces_Personal_Advisor_Services_Lowers_Minimum.html

7 https://www.acorns.com

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