Global investing: Considerations for building an end-to-end solution

An executive briefing on enabling individual investors to invest globally

Broadridge®

EXECUTIVE SUMMARY

Why go global? Simply investing in a range of US stocks, bonds, and cash instruments is no longer an effective strategy to properly manage portfolios.

Over the last ten years, many international market indices have outperformed US indices. The disparity becomes more dramatic when looking at a sampling of emerging markets. Individual investors – often active and high-net worth – may have interests in markets outside of the US.

Traditionally, firms have faced cost, complexity, and time-to-market hurdles when considering how to offer foreign securities to their clients. Core processing technology must connect with multiple markets, support different currencies, cover tax nuances and produce the economies of scale to make global investing cost-effective. Similarly, brokerage operations need to span time zones and meet professionals' need to understand the trading and clearing requirements of each foreign market, including regulatory impacts. Additionally, firms must deliver a consistent client experience across international and US investing.

This paper discusses the critical capabilities brokerage firms need to support international investing. We also offer insights on key considerations for technology, operations, and client experience, plus self-assessment questions that will help you evaluate strengths and gaps.

US Clients Are Missing Out on 90% of the World's Opportunities

Of the approximately 50,000 stocks available for purchase in world markets, fewer than 1 in 10 can be found on US Exchanges.
Although approximately 50,000 stocks are available for purchase in world markets, less than 10 percent of them can be found on US Exchanges. Even so, millions of American investors have not yet begun to invest in foreign securities or cash instruments.

The importance of international mutual funds and exchange traded funds (ETFs) is demonstrated by the fact that the U.S.- based emerging market mutual fund and ETF Universe alone has increased by more than 150% over the last ten years, with assets up over 2,200% to $425 billion. This still represents a small percentage of investors' portfolios, as almost 90% of US investable assets are not international. Too much domestic concentration exposes American investors to US dollar risk and lack of market diversification. This situation can expose clients to missed opportunities and potentially lower returns, as illustrated by the lagging performance of the US index compared to other countries over the last three, five and ten years in Exhibit 1.

US vs. Developed Markets: Missing Out on Diversification

As dramatic as the performance disparity of the US Index compared to other developed nations may be, it pales in comparison to the performance of the US Index compared to a sampling of emerging market indices. This heightened disparity is displayed in Exhibit 2.

US vs. Emerging Markets: Missing Out on Opportunity

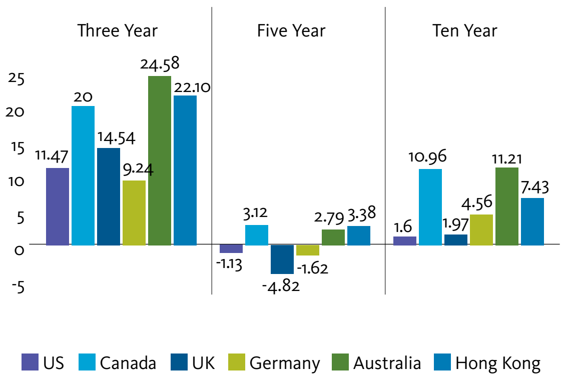
The IMF forecasts that emerging markets will grow faster than developed economies by an average of 4.2% annually over the next 5 years.

Not only are emerging markets outperforming the US Index, but they are also outperforming many of the other developed country indices. This trend is likely to continue as the International Monetary Fund (IMF) is forecasting that over the next five years, economic growth in emerging markets will average 4.2% higher annually than in developed economies.

To take advantage of these potential opportunities, firms should determine how they can best offer their clients access to global markets. ADRs have traditionally been used to access selected large-cap stocks, denominated in US dollars. However, direct investing in local emerging markets can increase access to more foreign stocks denominated in local currencies.

EXHIBIT 1
Performance of US Index Compared to Sampling of Developed Countries

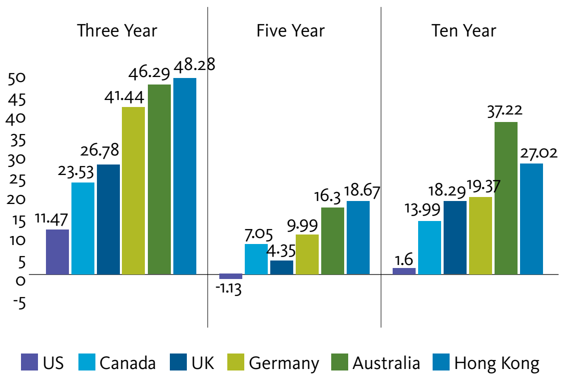
COUNTRY PERFORMANCE (IN PERCENTAGES)



Source: MSCI, TowerGroup

EXHIBIT 2
Performance of US Index Compared to Sampling of Emerging Markets

COUNTRY PERFORMANCE (IN PERCENTAGES)

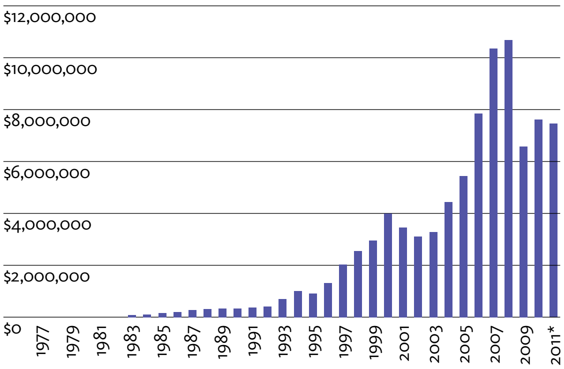


Source: MSCI, TowerGroup

Interest in owning foreign stocks has increased substantially over the last ten years.

EXHIBIT 3
Gross Transactions in Foreign Stocks by US Residents (1977–2011)*

(In Millions USD)



* Includes gross purchases by foreigners from US residents and gross sales by foreigners to US residents through August 2011

Source: US Treasury International Capital System

Gross Transactions
Interest in owning foreign stocks has increased substantially over the last ten years.

Exhibit 3 shows that foreign stock transactions by US investors peaked in 2008 and appear to be on the rise again.

Although institutional investors have the option to pick stocks in markets around the world, most individual investors have fewer choices. In addition to ADRs, individual investors have access to pooled products in the form of mutual funds and ETFs that provide international diversification. But fund management fees and expenses may produce higher transaction costs, which impact the cumulative rate of return.

Individual investors who want direct ownership of specific companies in a brokerage account generally are able to choose from American depositary receipts (ADRs) on US exchanges and foreign ordinaries listed over-the-counter in the US. The main disadvantage of these direct ownership choices is that selection is usually limited to large-cap companies and developed countries. We expect that demanding individual investors will seek institutional portfolio strategies to drive performance, resulting in growing interest in investing directly in foreign markets.

Some securities firms offer the option of trading in local markets as a means to increase the access to a number of companies and countries available to their clients. But many of these firms lack the capability to hold foreign securities in a single account. We believe that in addition to increasing access to securities in global markets, competitive differentiation among brokerage firms will create a cost-effective offering that provides a seamless global client experience.

However, firms that can manage costs and minimize the number of separate business processes that clients must navigate to invest in foreign securities will have an edge.

Going Global in Three Steps: Technology, Operations, and Client Experience

Firms must address the interdependencies of the financial markets, their own capabilities, and the expectations of their clients.

The complexity increases when offering individual investors access to international markets. Exhibit 4 describes the various processes that firms must manage to expand globally while satisfying the wide spectrum of needs from clients – including active traders and buy-and-hold investors, and ranging across all wealth segments from emerging mass affluent to ultra high-net worth.

How Going Global Multiplies Complexity
Step 1: Build a Solid Technology Foundation

Technology provides the foundation for firms to expand foreign investing choices for individual investors. Firms will look first at their existing platforms to determine whether they have the functionality to support access to foreign markets across the trade lifecycle.

Client-facing portals should provide tools and information comparable to what clients utilize today for US transactions. Orders must route quickly to the appropriate market to execute across time zones, so connectivity is an important part of the technology infrastructure. Post-trade processes must enable instructions to pass between counterparties efficiently until transactions are settled and booked correctly. Accounting systems should support multiple countries and currencies, including the ability to have a sweep account hold investment capital and manage corporate action distributions in local currency. The accounting platform dictates how accounts are structured and the available data to feed portals and reports.

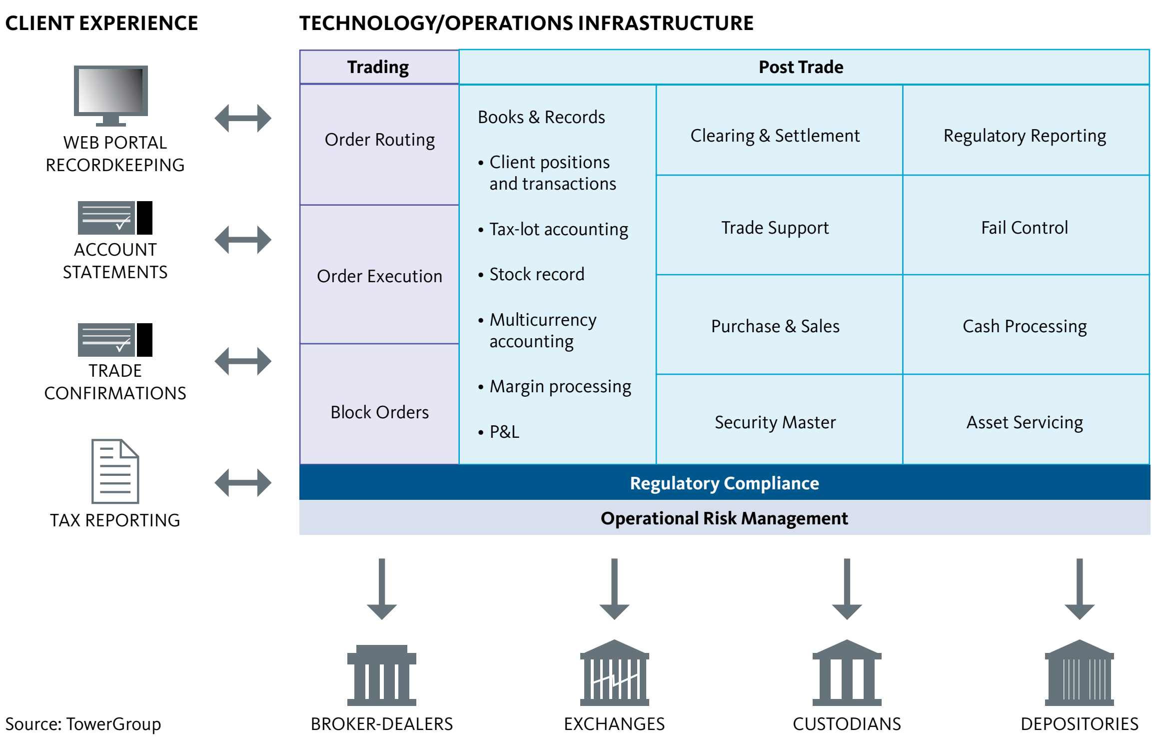
Self-assessment: Technology
Key questions firms should ask themselves to determine their global technology capabilities:

- Does our core system support multicurrency trading, clearance and settlement?
- Can our systems accommodate multiple currencies on a single account?
- Do we have business rule flexibility to monitor and adapt to regulatory changes across countries without relying on manual processes?
- Can we support multicurrency cost basis and performance reporting?
- Do we have a front-to-back office technology strategy that keeps costs manageable?
- How long is the payback for international investing capabilities, and can we justify making the investment in technology and related resources?

Step 2: Test Your Global Operational Expertise

Firms should assess their current operational capabilities to identify processing gaps. The starting point should be a firm's expertise in each local market in which it plans to offer trading. Expertise encompasses trading practices, clearing and settlement processes, and regulations. Each exchange sets different parameters on how orders are executed, so firms must be able to adapt accordingly. Clearing and settlement outside the US involves a vast network of depositories and custodians, requiring extensive knowledge of market practices. Regulatory expertise is critical not only to ensure local compliance but also to consider the impact on US clients, particularly tax

EXHIBIT 4
Interdependencies of Brokerage Processes



Source: TowerGroup

consequences. Furthermore, in contrast to the European Union's approach to implementing regulation uniformly across participating countries, countries in the Asia-Pacific and South American regions have fragmented regulatory frameworks.

Self-assessment: Operations
Key questions firms should ask themselves in determining their global operational capabilities are:

- Does our operations staff have the knowledge and experience in the local markets to mitigate risk?
- Is our team aware of global standards and best practices, and do they integrate into our business model?
- Can we provide operational support in multiple local time zones?
- Can we implement risk controls across markets to provide management transparency into brokerage operations?
- How much flexibility do we have to respond to volume peaks and troughs across markets and in individual foreign markets?
- Are we able to achieve comparable levels of straight-through processing across US and foreign securities?

Step 3: Aim for a Seamless , Global Client Experience

A final consideration for offering local investing relates to harmonizing client experiences, regardless of whether securities are US or foreign. The fewer exceptions clients encounter to access foreign markets, the stronger the offering. Ideally, the firm's web portal and statements will consolidate foreign and domestic holdings and provide information on fees, exchange rates, and corporate actions across securities. The overriding objective is to optimize the global client experience.

Self-assessment: Client Experience
Key questions firms should ask themselves in determining their client experience are:

- Can we develop a service model to support international investing, consistent with our client service standards in the US?
- Do our systems enable clients to seamlessly move in and out of currencies at the time of placing trades or corporate action elections?
- Can we adapt our portal to consolidate foreign and local market information?
- Can we consolidate our printed and online information across markets in local currencies?
- Can we offer a differentiated client experience depending on wealth segment and/or active trade status?

Conclusion

Engage a partner to deliver an end-to-end solution for global investing that helps your firm offer clients the potential for greater returns with a reduced time to market and faster payback of your investment.
Offering local-market investment capabilities to individual clients in a cost-effective manner requires a thorough assessment of three areas: technology infrastructure, operational expertise, and client experience. On the technology side, client-facing tools all the way through to back-office accounting must handle access to multiple markets and multiple currencies with straight-through processing. Operationally, firms should understand the practices of each foreign market to manage in-country risk, as well as create a consolidated view of global operational risk. Combining services and information for both foreign and local securities helps clients avoid different methods of doing business in different markets.

Firms that can cost-effectively cross borders with investment options comparable to their domestic offerings open up future growth opportunities for their clients and themselves. With increased regulatory requirements, client demands and the ongoing challenge to manage headcount, firms have limited resources to expand capabilities. Many firms are finding that outsourcing new capabilities such as global investing allows access to the scale and expertise of a third-party provider while keeping internal staff focused on core day-to-day responsibilities.

Finding the right partner to expand these capabilities is critical to uncovering growth opportunities across borders. So, you should look for a partner with proven functional expertise and deep understanding of building infrastructures to support global investing, plus the ability to help your firm get to market quickly.

This is where Broadridge comes in.

Engage a partner to deliver an end-to-end solution for global investing that helps your firm offer clients the potential for greater returns with a reduced time to market and faster payback of your investment.

Contact Us

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About Broadridge

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