How FMIs are improving operational efficiency in the Asian fund industry

Asian fund markets are growing, and flows between them are bound to increase as a trio of regional fund passport schemes come into effect, but variations in communication standards and levels of automation between markets will obstruct progress unless they are addressed. The recently formed Asia Funds Standardisation Forum (AFSF) is doing exactly that. Alexandre Kech, Head of Securities Markets and Standards for SWIFT in Asia Pacific, discussed how financial market infrastructures (FMIs) are driving operational risks and costs out of the Asian funds industry with Isaac Wong, Director, Product Management, Investment Funds, Euroclear; Supranato Prajogo, Director of KSEI, the Indonesian central securities depository; Joong Hoon Park, Head of Fund Planning at the KSD, the Korean central securities depository; Kitti Sutthiatthasil, Head of Strategy at the Stock Exchange of Thailand; and Boon-Hiong Chan, Director and Head of Market Advocacy, Asia Pacific, at Deutsche Bank.

Kech: What is the state of domestic fund automation in Asia as a whole and your market in particular, and how important is the ISO 20022 standard to your efforts to increase the level of automation?

Sutthiatthasil: Thailand is seeing a lot of improvement in terms of the level of automation. Although there is as yet no standard agreed for communicating orders, the exchange is working with market participants, the regulator and the distributors on standardising mutual fund order processing. We expect to launch our new fund platform next year. At present, the agreed standards are local, but we are considering adoption of international standards for funds distributed across borders.

Park: We already use international standards for cross-border trades. Korea Securities Depository (KSD) has operated a domestic fund platform called FundNet since 2004, when it was created in co-operation with the asset management industry and the government. FundNet automates the whole process, from subscription, redemption or switch, through trade matching and delivery instructions, to settlement and delivery. But in the domestic market FundNet uses proprietary local standards tailored to Korean participants only. However, the Offshore fund Service Platform (OSP), which KSD has offered since 2012 to asset managers and fund distributors selling to domestic investors in Korea, does use the ISO 20022 standard. By converting domestic proprietary standards into ISO 20022, and vice versa, OSP facilitates communication with transfer agents and other fund service providers based offshore.

Prajogo: Indonesia has explored the automation of domestic fund processing by establishing a fund platform called S-Invest. It drew on the experience of our colleagues at the Korean central securities depository (CSD) and on local market participants, to make functional adjustments specific to the Indonesian market. The system was launched in August this year. The new system will provide an integrated solution for automating the whole process of order routing - subscription, redemption and switching - as well as automating post-trade exchanges between fund managers, custodian banks, fund distributors and brokers in electronic formats. In terms of message standards, ISO 20022 is not used at this point, mainly because S-Invest initially supports domestic funds only. ISO 20022 is likely to be used once offshore investment services are introduced.

Chan: Asset managers and fund distributors in Asia face varying levels of automation. As we have just heard, there is an established market utility in Korea, and we will soon have something similar in Indonesia and Thailand. These utilities promote high levels of automation. But in many other markets in Asia, the level of manual processing remains a challenge. So Asian markets are mixed in terms of automation, although trending in the right direction. On the adoption of standards, we see two types of clients. The banks that are servicing global custodians adopt ISO standards to ease their connectivity to offshore fund and client groups, while the local and regional players are not yet under intense competitive pressure to adopt them, although ISO formats such as 20022 will be adopted gradually by local and regional banks. The Asia Fund Standardisation Forum (AFSF) is helping the industry to attain a higher level of standardisation.

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Kech: Does the limited take-up of international standards reflect the language barrier and, if so, are the global custodians happy to use domestic standards as well, or are they pressing for international standards instead?

Sutthiatthasil: In Thailand, language is not the barrier. Most of the communication is actually done in English. The problem is that local market participants cannot see a real need to adopt international standards for a domestic process. Of course the leading houses all use international standards. As a Thai clearing house, we ourselves accept SWIFT message formats from international players, but use the local version of SWIFT when connecting to domestic players.

Park: In Korea, the low use of the ISO 20022 standard reflects history. When we developed FundNet, we did not consider it necessary to adopt SWIFT messages, because no local participant used SWIFT messages. It was only when we launched OSP in 2012 that we had to start converting messages into the ISO 20022 format because we were connecting our users to international banks that used SWIFT.

Kech: There are now three passport schemes in Asia: the China-Hong Kong mutual recognition scheme (MRF), the Asia Region Funds Passport (ARFP) and the ASEAN Collective Investment Scheme (ASEAN CIS). What is the state of implementation of the passport schemes in your country, in terms of regulatory changes and automation initiatives?

Prajogo: Indonesia is not, at the moment, participating in any of the three passport schemes. However, non-participation does not mean there is nothing to be done. We observe what is happening when passport schemes are adopted and implemented by other countries. At the same time, our regulator is reviewing and amending the existing regulations, and issuing new regulations with the aim of improving the mutual fund industry. From the point of view of infrastructure, we established S-Invest to achieve a better process in funds-related transactions.

Park: Korea signed the ARFP Memorandum of Co-operation (MoC) in April this year, along with Australia, New Zealand and Japan. In line with the MoC stipulation that signatories amend their legal and regulatory frameworks within 18 months, the Korean regulator is now reviewing current regulations. The law specifies at present that orders in Korean regulated funds must be processed via FundNet, which creates a difficulty if the funds are sold outside Korea. So the imminent launch of the AFRP has led to discussion in the Korean asset management industry over how best to automate the distribution of Korean funds in foreign markets, through linkages between FundNet and fund processing platforms abroad. For foreign funds distributed in Korea, OSP already provides a solution.

Sutthiatthasil: In Thailand, we are looking at both the CIS and the ARFP. Like Korea, Thailand has signed the AFRP MoC, and we have up to 18 months from June 2016 to implement new domestic arrangements. Under ASEAN CIS, five Malaysian funds are being offered already in Singapore, and one Singapore fund is being offered in Malaysia. One Thai-regulated fund is seeking approval from the Singapore regulator, and a Singapore fund is seeking approval in

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Thailand. Other funds have been registered but are yet to be approved.

Chan: The three Asian initiatives are a natural evolution. Domestic markets have grown and players are now seeking a regional presence and branding. This has implications for fund domiciliation and fund service providers, as well as increasing fund choice for investors. It is the start of a long journey that will need commitment, vision and drive. We will need to learn from the early Asian experience too. The ASEAN CIS entry threshold of US$500 million, for example, may be too high, especially when it is compared with the RMB200 million threshold for China funds in the China-Hong Kong MRF. But passports are definitely a step in the right direction for investors, fund managers, distributors and service providers.

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- Isaac Wong,
Director, Product Management, Investment Funds, Euroclear

Wong: At the moment, most of our cross-border business is helping channel investment into international funds domiciled in major cross-border centres such as Ireland, Luxembourg and Cayman. Five or ten years from now, we expect much greater intra-regional flows within Asia, and we see ourselves playing a role in helping the investment community achieve that. We are looking into how we can enhance our coverage and connectivity within the region to enable the passport arrangements to work. It would definitely help to have more business-friendly regulations. This is particularly important for the ARFP, because it is the most regional and inclusive of the three arrangements, and still at the formative stage. Another interesting possibility is a mutual recognition agreement between China and any one of the countries in the European Union (EU), or United Kingdom, so Chinese investors can invest in European funds and European investors in Chinese funds.

Kech: There is a trend in Asia Pacific that we do not see elsewhere, of financial market infrastructures (FMIs) helping domestic markets sort out the automation of their funds business. Why do you think that is the case in Asia, what is the current state of your own fund platform, and what are your future plans?

Prajogo: As a self-regulatory organisation, KSEI always looks to participate in and contribute to the development of a more efficient capital market infrastructure in Indonesia. Some participants in the funds industry – such as custodians and brokers – are already participants in KSEI, and adding the other two – fund managers and fund distributors - creates an integrated solution for the market. Concerns related to data confidentiality can be managed, since participants recognise KSEI as an independent and neutral party. As funding is required to establish the new fund platform, KSEI has the capabilities to do so.

Park: As I mentioned, we created FundNet in collaboration with market participants. That helps enormously because, when we propose improvements, we get a strong response from the market participants because they want to increase efficiency further. By making order processing more efficient, we do not just provide a service to the asset managers, but help improve their profitability. In that sense, the KSD has a mutually rewarding relationship with its fund market participants.

Sutthiatthasil: The Stock Exchange of Thailand has for many years taken a leadership role in establishing market infrastructures. For example, 15 years ago we launched an Internet trading platform so that brokerage firms can offer the service to retail investors. It started small, but now accounts for more than 60 per cent of retail activity. We want to lay a similar foundation for domestic fund investment, which we think will grow, chiefly because we have an ageing population. Mutual funds will be an increasingly important investment vehicle for both retail and institutional savers, and we like to think that in ten years' time the infrastructure we have built will be the natural place for them to process orders. We are also in a neutral position, so we are well-placed to facilitate discussions among asset managers, distributors and regulators.

Chan: It is not surprising that FMIs play a different role in Asia to that in Europe. In Europe, the development of FMIs was led by the single market policy. From 1993, when the Investment Services Directive (ISD) first liberalised financial firms to access stock exchange memberships and financial markets across different EU markets, there was a focus in infrastructural development on connectivity and inter-operability. In Asia, the focus of the FMIs is more domestic. They step in to improve the competitiveness and capacity of their domestic market. That said, FMIs in Asia are forging cross-border connections, but it is by asset class rather than by policy – in this case, the connections being forged are between domestic fund markets. Regional forums like AFSF play a key role in facilitating this communication between FMIs and, in the process, are creating a degree of transparency into the market risks, so that investors can better manage them when they invest in Asian markets. That transparency is important because FMIs, such as CSDs, play an important role in mitigating risk, and so help build confidence among global investors.

Wong: As an international CSD (ICSD), we welcome the contribution of the local CSDs in putting the whole funds community together in one place. We share that vision. As a global player, our contribution is to link funds markets to funds markets, and that means being highly

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adaptable and connected. In Europe, for example, funds settle in CSDs in some markets, such as France, while in other markets there is a more complex, tiered model consisting of transfer agents and banks. We support either model, but it is obviously more costly to maintain multiple connections. The beauty of a local CSD is a single point of access through one connection. Here in Asia, we would like to help the local CSDs make efficient international connections.

Kech: The AFSF has come up several times. Why does your organisation support its work and what should its role be?

Wong: The AFSF helps the whole community achieve higher efficiencies, lower risk, and lower cost, more quickly. It is a place for us to share our experience from Europe and other parts of the world, and to learn from the local expertise here in Asia.

Prajogo: The key success factor for automation of the funds industry depends on the engagement of the market participants. The AFSF, however, is a good forum to learn from other markets about the current state of their own automation projects, the ingredients of success, and the challenges that remain. All that information is helpful to us in Indonesia, because we are in the early stages of establishing our platform.

Chan: The AFSF brings together experts from each country who know their domestic funds businesses. We are a customer of the CSDs, and at the AFSF we can communicate to them our views on operational and other risks, so that they can be resolved. This helps to build a more resilient and competitive industry that is

attractive to overseas investors. Asset manager clients of ours welcome the work of AFSF because regional standardisation helps reduce operational risk and increase productivity. That said, it is important to focus first on the domestic building blocks before we seek to advance on connectivity and inter-operability between domestic fund platforms.

Park: With the expansion of cross-border fund flows in the region, and the three fund passport initiatives, automation and standardisation of post-trade fund processing is more important than ever. There is also a mood among Asian CSDs that fund processing is an essential service for CSDs to provide. This is why we have seen fund processing platforms emerge, such as our own FundNet, the CSDC Central Data Exchange Platform, the TDCC Fund Transmission and Payment Service and the HKMA CMU Fund

Order Routing and Settlement Service. It is also why, when KSD proposed a new consultative body on the standardisation of fund processing at the Asia-Pacific Central Securities Depository Group (ACG) meeting in China in 2014, it was welcomed by the CSDs of the region. The AFSF was launched in November 2015, and we currently have 13 CSDs from 12 economies participating as regular members, and five global fund service providers contributing their expertise as advisory members. The output of our knowledge-sharing workshop in Seoul in June this year is now being turned into an Asia Fund Market Report, and we are working with the Asia-Pacific Financial Forum (APFF) to help fund market regulators in the region understand the importance of standardisation to the success of the passport schemes. The AFSF continues to study various fund transaction models in the region, and we will eventually publish our view of the optimal fund processing model for Asia.

Sutthiatthasil: We are building a fund platform, and there is no better forum for us to learn from the leading experts in the region and from around the world than the AFSF. So AFSF is a must-go-to forum for us. In addition, as fund flows increase, infrastructural investment is going to have to be regional, even global, in nature. If we do not work together now, it is going to be very challenging for us to support the type and volume of business being transacted in the future.

Kech: So what do you think that future will look like? What will the Asian funds landscape look like in 2025?

Sutthiatthasil: Most countries are working on standardisation and automation. This will relieve market participants of the burden of investing in costly infrastructure in the future. Asset managers will be well-positioned to deliver higher returns to their investors. Distributors will not only sell funds at lower cost, but be able to tailor investment solutions to the needs of their clients.

Park: If we project forward the major trends in the Asian funds industry, such as fund passports, increasing investment in funds, and deregulation of the fund industry, we can look forward to an era of border-blind funds. With the ARFP in full swing, and the growth of the ASEAN CIS and the MRF, fund investors across the region will have access to a much more diverse range of funds than those which were available before. The passports will integrate the Asian fund markets, forming a de facto single market in the region. In time, this will generate wealth for investors in emerging markets, rather than exporting it to developed markets. I also expect greater demand for private funds that invest in innovative technology start-ups. To encourage them, the Korean government is already streamlining the regulation of private funds. For all this to happen, fund market infrastructures that adhere to global standards such as ISO 20022 are essential.

Chan: My vision of the future includes the emergence of one or more regional fund domiciliation centres, like an Ireland or a Luxembourg for Asia; the growth of regional funds based on an open distribution architecture that maximises choice for investors; and, as ARFP, ASEAN CIS and MRF develop, that there will be some interest from Europe in making it easier for investors in Europe as well as Asia to switch between UCITS funds and ARFP-ASEAN CIS-MRF funds.

Wong: By 2025, I hope an efficient fund infrastructure will be in place in every country, so market participants can spend less time on processing and more time on building a creative and productive funds industry that offers investors a broad range of investment choices. I have four other predictions. One is that the funds industry in Asia will grow. The second is that international funds from European fund centres (such as Ireland and Luxembourg) and cross-border fund centres (such as Hong Kong and Singapore) will continue to thrive because they have the skills, people and the infrastructures that served Asia well in the past. That said, my third point is that domestic funds will gain in weight, because the authorities in markets such as Hong Kong, Korea and Taiwan have the ambition to grow their own markets. My fourth prediction is that, five years from now, there will be more bi-lateral mutual recognition arrangements, like that between mainland China and Hong Kong.

Prajogo: The funds industry in Asia will grow. As a result, there are pressures to automate the fund industry to keep up with the increasing volume of transactions. Once an automated infrastructure is established, asset managers will be able to focus more on product development and enlarging their investor base.

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