The Future of Financial Markets in Asia Pacific

How banks and financial institutions are responding to an increasingly challenging market

A report from Kapronasia in collaboration with Broadridge
# Methodology

The Future of Financial Markets in Asia Pacific whitepaper from Kapronasia produced in collaboration with Broadridge is based on both primary and secondary research. Secondary research sources include both internal and external public and private databases. Primary research includes interviews with bankers, financial institutions, technology providers and industry experts.
Challenges for the financial industry are growing. Third party non-bank financials threaten the core businesses of traditional banks and institutions. Trade tensions are escalating between the US and China, and even the US and Canada, and threaten to take the global economy on a different path, which may ultimately have a dramatic effect on the business of banks. Further, as interest rates rise, the stark realities of a worsening economic environment may threaten existing loans and products. Finally, the biggest challenge for financial institutions over the next five years: regulations.

One might think that it is a difficult time to be in the markets.

Yet despite uncertainty, markets have done well. Global stock market capitalisation hit US$79 trillion in 2017, a nearly 25% increase from 2016’s US$65 trillion.¹ Growth brought significant profits to the global investment banking industry, with the top-9 investment banks globally combining for US$78.4 billion in net income in 2017, finally above pre-global financial crisis levels.² Banks across Asia Pacific are maintaining their return on assets (ROA) and return on equity (ROE) despite increasing interest rates and competition.

Along with the challenges are new opportunities. Potentially game-changing technologies like blockchain and artificial intelligence could change everything from settlements to the way that consumers interact with their bank. And entirely new business models, like initial coin offerings (ICOs) that raised more money in Q1-2018 than traditional venture capital funding, are redefining markets. Financial institutions are also becoming more sophisticated in their approach to the market through a better understanding of costs and which operations are core or not core to their business.

In this *The Future of Financial Markets in Asia Pacific* white paper from Kapronasia, in collaboration with Broadridge, we take a look at the key challenges, opportunities and potential for the future across Asia Pacific markets today, as well as some of the key financial centres across the region. We examine the potential impact of new technology, like blockchain and AI, on financial institutions addressing their legacy technology challenges. Finally, we look at some of the key opportunities across the region and approaches that organisations can use to deal with the constant change defining their future in this dynamic market.

We hope you find this report as interesting to read as it was for us to research.

Zennon Kapron
Director

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¹ World Federation of Exchanges
² Financial Times
Key Findings

• Asia Pacific’s financial services industry continues to grow as markets mature and the number of participants increases. Industry growth has led to healthy capital markets performances as well as record profits across the industry.

• Despite the performance, banks and financial institutions face increasing pressures as the markets are undergoing a massive transformation as a result of innovative new market entrants, new technologies, and ongoing market changes.

• Regulation remains a crucial issue across the region. Pressure from extraterritorial regulations (e.g. FATCA, MiFIDII) continues to affect the operations and profitability of banks while the lack of a cohesive regulatory strategy in Asia Pacific means that multi-national financial institutions need to have a piecemeal, country by country, approach to compliance.

• To meet these regulatory, business, and operational challenges, financial institutions are increasingly relying on technology and shared services to support the underlying business and keep operational costs low.

• Financial institutions continue to experiment with blockchain technology, but most deployments are still in the proof of concept (POC) stage, especially as firms reconsider whether they should be investing in the technology.

• Artificial intelligence (AI) however, continues to make an impact on the industry as AI-enabled solutions help manage wealth, interact with customers, and cross-sell products and services.

• China still retains an outsize influence on the region. Despite unanswered questions about a number of trade and economic issues that might directly affect China, further market opening up will help the country's mainland economy expand but will leave other economies like Hong Kong, questioning their role in the future of financial markets.

• Financial institutions continue to look to collaborate with partners to help them navigate the market complexities. External partners often have the benefits of scale, global reach, and industry experience working with similar institutions to help reduce cost and increase operational efficiency.
For the past decade, Asia Pacific has been the best performing region in the world. China, the world’s leading investor, is playing a central role and is backed-up with a supporting cast of rapidly growing emerging markets across the region. The consumption and investment of Asia Pacific have helped drive growth across the world. Emerging Asia’s GDP has increased an average of 7.4% per annum over the past decade, over double global GDP growth.

A key enabler of that growth is the financial industry. Banks and financial institutions provide the critical liquidity that has helped the region grow and has driven organisations to a new level of profitability. Banks have also done well, with Asia Pacific bank ROE averaging over 10% for the past decade.

Increasing Third Party Competition
Asia Pacific’s banks and financial institutions, in general, are experiencing increased third-party competition, specifically from fintech start-ups. With a massive population, high smartphone penetration, fast mobile networks, and several emerging economies around the region, this interest in Asia Pacific is unsurprising.

Indeed in 2016, Asia Pacific led the world in fintech investment with 23% of global investment. This investment was driven by a few significant funding deals, especially for fintech in China, but in 2017, Asia Pacific investment into fintech dropped to 7.5% of the global total.\(^3\)
Although a considerable amount of this flow went to China, including Ant Financial (the world’s largest unicorn with a valuation of US$150B), the remainder, somewhat unsurprisingly, went to the other big financial centres around Asia Pacific including Hong Kong, Singapore, Japan and Australia.

Fintech and the financial industry in general have also seemingly come to a ‘settlement.’ Some years ago, the view was that fintech would completely disrupt financial institutions, an almost ‘disrupt or nothing’ approach that led to numerous innovation labs, hackathons, and incubators.

These still exist today, but we also see increasing cooperation. In China, the tech-giants are syndicating loans to traditional banks. In ASEAN, companies like Ripple and Grab Financial are working with banks to streamline payment and financing services.

The challenges for these fintech start-ups in Asia Pacific are no different than they are in other markets. Often the fintech start-ups have good ideas but struggle to scale. This happens for many reasons, but often the most critical is a lack of understanding of the real challenges of financial institutions. As a result, most of the success that we have seen around fintech start-ups in Asia Pacific has been on the retail end of the market, solving pain-points in retail payments or peer to peer (P2P) lending as examples.

This tends to be because these points of friction are reasonably open and transparent, and more easily addressable. Most people would know the challenges of using cash or card to pay at the counter but may be less aware of a financial institution’s problems of settling over the counter (OTC) derivatives.

That is not to say that we have not seen progress on the commercial markets side. There are plenty of inefficiencies, but a significant amount of the work at solving these issues is coming from within the banks themselves rather than third-party fintech start-ups.

Some established technology providers with global scale and broad industry experience are also often better equipped to provide relevant solutions to the market. It may be these more established players who understand the market needs that are better able to leverage new technologies like AI, blockchain, and data analytics to solve the industry’s problems.

**Changing economic tides**

There are geopolitical changes in the US (America First policies) and Europe (Brexit) at the moment that have started to impact financial markets in a significant way. There are a few different ways that we may see the global economic story change.

Firstly, trade, which is a critical part of the Asian economic success story, will likely shift. There are some global trade discussions underway, and tariffs and trade barriers will likely change flows across the region. The initial industry impact will probably be around trade finance. As

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4 CB Insights
trade slows, the need for financing will naturally slow as well. And with this, we expect to see a reduction in “traditional” cross-border investments. We already see this with China pulling back from its cross-border activities into Europe and the US, but intensifying efforts on its homegrown ‘Belt and Road’ initiative, a regional infrastructure investment and trade platform that has received significant attention.

Secondly, after multiple years of quantitative easing, economies around the world are awash with cash as governments have effectively printed money. Governments, corporates, and individuals have borrowed significantly and often in USD. As US interest rates increase, and market returns decrease, many of Asia Pacific’s corporates and financial institutions may find it difficult to pay back USD denominated debt. This could lead to a more acute financial deleveraging than governments would have been planning for.

**Regulation**

Not all of the challenges to Asia Pacific’s financial industry growth are within its control. Although it seems that the current US administration may be looking to roll-back some of the requirements of the more comprehensive banking regulations such as Dodd-Frank, the general consensus from market practitioners is that regulations will continue to develop in Asia Pacific and will need to be at the forefront of financial institutions thinking.\(^5\)

Asia Pacific, due to the diversity in language, culture, and political models, has had a relatively un-coordinated approach to regulation across the region which has led to a lack of consistency in regulatory procedures and coordination. Although there are many smaller regulatory pushes on a country-by-country basis, there are a couple of overall regulatory themes that we expect to play a continued prominent role in Asian markets.

Interesting to note, most of these initiatives are extra-territorial, coming from the US or EU markets and then adopted by Asian markets to provide an element of consistency globally.

An excellent example of this is the current global push around OTC derivatives reporting and clearing which is being regulated country-by-country and is at different stages across the region. Aimed at reducing systemic risks, improving transparency and protecting investors against market abuse, OTC derivative reporting, and centralised clearing is a focus for the region.

Australia currently requires end of day OTC derivatives trade reporting but may be moving to a trade-by-trade reporting requirement. For firms engaged in OTC trading, this means additional technology to report at the point of order entry, store details around the trade, and perform trade reconstruction as needed.

Many jurisdictions, such as Singapore are following in the footsteps of the US and EU markets by exploring centralised clearing of OTC derivatives, to bring an even higher level of transparency to the markets. In Singapore, OTC derivatives will need to be cleared on central counterparties starting October 1, 2018.\(^6\)

The US’ Foreign Account Tax Compliance Act or FATCA is another example of an extraterritorial regulation that has had a significant impact on Asia Pacific. FATCA requires banks to have a new level of know your customer (KYC) and understanding of customer funds. Non-compliance

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\(^5\) Kapronasia interviews with industry participants

means that a foreign bank may not be able to operate in the US markets. HSBC, in particular, has been on a nearly one-year compliance drive called “HSBC Safeguard” asking both retail and commercial customers to detail more of their businesses, sources of funds, beneficial owners, etc.\(^7\) 

MiFIDII is another extraterritorial regulatory challenge that many financial institutions in Asia Pacific were slow to realise the impact of. Although MiFIDII is an EU set of regulations, any Asia Pacific firm that has 1. An EU counter-party or client, or 2. Is a broker-dealer trading in the EU, would have, at a minimum, data reporting requirements and may also need to consider legal entity structure, systems, and processes. 

The Securities Financing Transaction Regulation (SFTR) is the next EU regulation that will have an impact on Asian markets. The rules aim to increase transparency on the use of instruments such as repos and stock loans, and on the risks of entering collateral arrangements. There is a ‘rolling implementation calendar’ which is likely to start in Q3-2019. 

**The push for coordination**

Ideally, the lack of regulatory coordination in Asia Pacific is something that will change in the future. Despite renewed nationalism in Europe, the standard regulatory framework of the Eurozone has been very beneficial to the development and modernisation of the financial industry. Europe’s PSD2 is an excellent example of this as it provides a standard approach framework for application programming interfaces (APIs) and Open Banking, which will likely be a critical part of the future of the financial industry. 

The lack of common regulation also means that there is a lot of duplication and regulatory inefficiencies across markets for multi-national corporates. A sizeable multi-national bank with branches across Asia Pacific will need to deal with a plethora of rules and regulations, many of which will be inconsistent across markets. 

The consolidation of regulation may come from China’s Belt and Road Initiative. Intended to be primarily funded by the China Development Bank and the China Import-Export Bank, the effort is an infrastructure driven cross-border economic program, perhaps the largest globally, designed to increase investment across a number of Asia Pacific countries. As financial integration happens across the countries involved in the program, we should see more standardised reporting and compliance requirements – potentially driven by China.

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Country Snapshots

Singapore

Throughout its relatively young history, Singapore has always managed to re-invent itself. In the 1990s it was bio-medical technology, 2000s technology itself, 2010 tourism/entertainment and today, fintech.

Given its location at the centre of ASEAN, well established financial industry, low corporate taxes, and transparent legal system, the city-state has become a natural hub for start-ups and specifically fintech start-ups. Although the market opportunity for Singapore itself is relatively small, nearly 3 billion people live within a 5-hour flight.

This, coupled with a very fintech friendly regulator, the Monetary Authority of Singapore, has led to the development of a vibrant fintech culture. Start-up Bootcamp, 80RR, and numerous co-working spaces across the city have attracted hundreds of fintech start-ups, while banks like DBS have put fintech and innovation at the top of their agenda.

Regionally, Singapore has also done a significant amount of cross-border collaboration. The ASEAN Payment Network, of which Singapore is a member, was setup to facilitate cross-border payments within the region. Further, bilateral connections, such as between Singapore’s PayNow and Thailand’s PromptPay will enable real-time cross-border payments.

On the capital markets side, the Singapore Exchange (SGX) is also working with Bursa Malaysia Bhd. on a cross-border link that will give clients access to over 1,600 listed companies with a market capitalisation of nearly US$1.2 trillion. This is in addition to SGX’s proposed shift from T+3 to T+2 settlement times and the recent announcement that the bourse will start dual-class share listing and a new platform for centralised OTC fx trades.8

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8 Singapore Exchange
Australia

Australia’s financial industry continues to develop and grow as it goes through a number of infrastructure upgrades in the banking and capital markets segments.

On the capital markets side, the Australia Securities Exchange (ASX) has become the first exchange globally to announce the launch of a DLT enabled settlement platform. The ASX’s CHESS stock clearing and settlement platform will be powered by Digital Asset, a Broadridge-invested company. The system is slated to be live by 2020 and will be one of the largest tests of a DLT-enabled system that the industry has seen.9 The platform development has also caught the attention of other regional exchanges with the Hong Kong Exchange working with ASX on developing its blockchain solutions.10

In payments, the New Payments Platform (NPP) launched earlier in 2018 to much fanfare and some relief. The platform was designed in collaboration with SWIFT and brings Australia into the real-time payment space. At a basic level, the NPP allows companies to upgrade their existing payments infrastructure, but it also opens up the market to a plethora of overlay services that can be layered on top of the platform such as instant P2P payments.

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10 Financial Times
Japan

Despite having the world’s first real-time payment system and some of the best high-speed trading infrastructure globally, Japan has always been a more conservative market, which is evidenced by their approach to fintech. Similar to Hong Kong, the country has been a bit slower embracing fintech but now has a fintech division at the Bank of Japan as well as a burgeoning start-up scene.

Japan’s market infrastructure is also going through some critical changes. The Japanese Government Bond (JGB) market shifted from T+2 to T+1 settlement in early 2018 with equities moving to T+2 settlement in 2019. The 138-year old Tokyo Stock Exchange will be going through a massive technology refresh as the organisation replaces its Arrowhead system over the next few years. The Japan Securities Clearing Corporation (JSCC) is planning to launch a new clearing system in 2020, designed to be a common platform for all JSCC clearing operations, including the clearing of cash products and JGBs.

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Hong Kong

Traditionally, Hong Kong has been the open and efficient market that served as the financial gateway to mainland China. By staying one-step ahead of the mainland regarding liberalisation and reform, Hong Kong has maintained its position as a vital financial centre in Asia Pacific.

However, this is at risk. As mainland markets continue to open up, Hong Kong’s importance will wane. If a foreign institution can trade Shanghai directly, why would they go through Hong Kong to get there? Although it may be a gradual shift, it is a real risk for the city as mainland market liberalisation continues.

Like many jurisdictions globally, Hong Kong increasingly sees its future as a hub for fintech. Despite a slower start than its southern counterpart Singapore, Hong Kong has started to more formally embrace fintech. The Hong Kong Monetary Authority (HKMA) set up a Fintech Innovation Hub and Sandbox in late 2016 and there is now a more established cross-regulator approach to fintech.  

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Technology Innovation

Across Asia Pacific, the common trend is change and innovation as institutions across the region leverage new technologies to create innovative platforms that are often game-changing on their own, but could also serve as the basis for future innovation.

Real-time payments, as an example, has become an essential infrastructure requirement for the enablement of fast, safe, and cheap P2P payments. Countries like Thailand are leveraging these platforms to ‘overlay’ services on top that provide better value for both retail and commercial clients.

Technology and the financial industry have a long relationship and will continue to redefine how transactions are made, and banks do business. Several decades ago it was a shift to electronic trading. Today it’s distributed ledgers and artificial intelligence that promise to change the way the world banks and trades.

Distributed Ledger Technology / Blockchain

Since the Bitcoin white paper in 2008, the financial industry has been fascinated with the idea of how distributed ledger technology (DLT) has the potential of disrupting the way the industry handles everything from insurance policies to payment settlement. In scenarios where there are multiple actors who need a shared, distributed, trusted and non-reputable database, DLT can provide many advantages.

We have also seen companies make big bets on the technology. We already mentioned ASX’s plans to launch their DLT-powered registry, settlement, and clearing system. Firms like Broadridge have been working directly with clients and have advanced from test cases to real pilots. Banco Santander worked with Broadridge to develop a global proxy voting system on DLT, which was used in a live annual general meeting (AGM). Broadridge also worked with Natixis and Société Générale to enhance the operational efficiency and auditability of bilateral repurchase (or repo) agreements.\(^\text{13}\)

DLT is a further iteration of existing technology. We have always had a way of settling trades. At one point it was done on paper, then it shifted to electronic settlement, and in the future, it may be on DLT. All of these are improvements in technology that have helped the industry complete operational practices more effectively and accurately.

In the ‘Blockchain in Financial Markets’ report from Bain & Co. produced in collaboration with Broadridge, 80% of executives at financial institutions believed that blockchain would be transformative and significantly affect markets. The same report indicated that the potential annual cost and capital savings from DLT could amount to 1 to 3 basis points of total global assets under management, or about US$15 billion – US$35 billion. A significant amount of these savings will come from replacing manual processes as well as more effectively accessing and utilising reference data.

Different firms will have different strategies and approaches to DLT. Overall, it is important for firms to have a data-driven approach to defining a DLT strategy where the business and technology teams work together to set the key direction, objectives, and measures of success. Monitoring external factors such as industry, technology, and regulatory changes is also critical to ensure that projects are effective and drive lasting value.

Artificial Intelligence

In addition to DLT, one of the technologies that will reshape the financial industry is Artificial Intelligence (AI), including Machine Learning (ML) and Robotic Process Automation (RPA). From chat bots to analysing data, to replacing manual processes, financial institutions around the world are looking deeply at how AI can reduce operational cost and increase efficiency.

Just within capital markets, AI can help to streamline trade allocation where requests that may be received in structured or unstructured forms can be processed automatically using AI. Unstructured accounting statements from custodians can be interpreted and automatically handled, saving potential weeks of review. AI can also help with securities finance supply and demand by mining various data sources for indications of finance demand to more predictably assessing financing needs. Broadridge has run a number of pilots around these key areas.

Although the applications of AI in the financial industry are many, one of the most significant challenges for the successful adoption of AI is data. Much like a compliance officer with decades of experience is more effective than a fresh grad in analysing and reacting to market situations and challenges, so can a machine that has more ‘experience’ and access to data be more effective in making decisions. Too often though, data may be limited in scope and fragmented within firms.

One option is to work with industry consortia or service providers that can bring together and make sense of industry data. This allows financial institutions to leverage industry best practices as well as mutualise costs.

One of the most significant questions about the use of AI within the financial industry is how the technology will affect company headcounts and job security. Although some are predicting the impact will be quite large, the industry itself seems to have a more sanguine view. A survey by Broadridge on the topic showed that about one-third (32 percent) of respondents predicted that AI would reduce their organisation’s need for human labour by just 10 percent or less in the next three years, suggesting that there may not be as large of an impact as some might think. Fewer than five percent of the respondents anticipated AI reducing human labour by 50 percent or more in the same time-frame.

Asia Pacific’s financial industry has had a long history of overcoming market challenges. From successfully navigating the Asian Financial Crisis in 1997 and the SARS epidemic in 2002-2003, to coming out of the Global Financial Crisis in 2007-2008 with less balance sheet damage than other regions, the region has always managed to recover quickly and move forward.

There is no reason to expect this expansion will slow in the near future. The region’s continued GDP growth and rapidly opening markets will continue to support industry development, while programs like the ASEAN Economic Community and China’s Belt and Road Initiative, will both continue to strengthen intra-regional ties as well as supplement cross-regional cooperation.

That is not to say that the opportunities are without challenges.

New regulations continue to evolve and expand in Asia Pacific, providing financial institutions an ever-increasing regulatory burden. Competition from third-party companies is reshaping how customers engage with their banks. And new technologies like DLT and AI promise to redefine what is possible in the financial industry, even as financial institutions struggle with legacy infrastructure which can be more of a business hinderance than a business enabler, especially as it continues to fragment.

Navigating this complexity can be challenging. For financial institutions across the region, it is becoming increasingly important to work with regulators, as well as strategic partners that have global scale, can mutualise costs, and help prepare them for what comes next. They need to innovate together. Partners bring to the table decades of experience across multiple companies and can help firms take advantage of new technologies with less risk, while at the same time increasing operational and cost efficiency through efforts like mutualisation.

There is a Chinese proverb that says “a challenge is an opportunity riding a dangerous wind.” In many ways, this describes the Future of Financial Markets in Asia Pacific today. Although there are significant challenges for financial institutions, with the correct strategy and approach there are also many, many opportunities.
Kapronasia is a leading provider of market research covering banking, payments, capital markets, and insurance. From our offices in Shanghai, Hong Kong, New Delhi, and Singapore, we provide clients across the region the insight they need to understand and take advantage of their highest-value opportunities in Asia and help them to achieve and sustain a competitive advantage in the market.

For more information about Kapronasia, please email: research@kapronasia.com or visit https://www.kapronasia.com

Broadridge, a global fintech leader with $4 billion in revenue, helps clients get ahead of today’s challenges to capitalise on what’s next with communications, technology, data and analytics solutions that help transform their businesses. We enable multi-asset post-trade processing in more than 70 countries and deliver over two billion shareholder communications each year. Our unique vantage point lets us see ahead to help firms navigate change and win in a complex landscape. We have over 20 years of experience in Asia Pacific with offices in Hong Kong, Hyderabad, Singapore, Sydney and Tokyo.

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