# PAPER ON REVISION OF THE EQUITY BROKERAGE COMMISION

## 1. INTRODUCTION

With effect from 1st April 2016, the BSE amended the equity brokerage commission to introduce a floor of 0.60% (60 basis points). Following the introduction of the floor, asset managers and other investors consulted with the BSE to highlight their concerns regarding the amended brokerage and the process involved in amending it given that the BSE was a seemingly mutual organisation with the Main Committee predominantly comprising of brokers. Subsequently, the BSE convened a meeting with asset managers to discuss the matter and engaged with brokers progressively on the matter.

From the BSE standpoint, the concerns about the revised brokerage commission are as follows:

1) Introducing the floor effectively raises the cost of trading and presents an opportunity for brokers to undercut one another in a bid to win trades.

2) It has the potential to result in low trading activity in dual listed stocks as asset managers circumvent the BSE to trade the stocks in stock exchange where brokerage is comparatively lower.

3) The benchmarking exercise which was undertaken to review the brokerage commission relied on information provided by an interested party, a broker, and the exercise could not have provided an independent and objective analysis for the BSE to make a well informed decision.

4) The information presented by the broker was not complete and comprehensive and from that end, it selected higher ends (ceilings) of the brokerage commissions to give an impression that brokerage commission in Botswana is very low compared to the chosen markets to support the introduction of the floor.

5) Neither the BSE nor brokers, who proposed the floor implementation, consulted relevant stakeholders. Naturally, consultation is a necessary procedure in order to enhance the credibility of the approval framework given that brokers, who are the beneficiaries in the increased brokerage commission, also sit on the Board of the BSE.

6) Lastly, when there was no floor brokers could charge anywhere between 0% and 1.85%, including charging 0.60% if they saw fit. This is ideal in a liberal market and can still be practised without the need for a floor.

The observation since the brokerage commission was revised are that:

1) Turnover levels declined in 2016 and 2017, and still remain very low in 2018 compared to corresponding periods.

2) A further analysis indicates that if the impact of the trades in New African Properties (NAP) which accounted for 18.0% and 18.4% of turnover in 2016 and 2017 respectively is removed, trading levels for 2016 and 2017 would have lagged those for 2013, 2014 and 2015. This information is presented in Table 1.

3) On the back of reduced trading levels, particularly in 2018, it is generally believed that this is attributable to the introduction of the floor, and have since expressed to the Exchange that the floor could be revised or removed with expectations of revival in trading activity. In part, their concerns are attributed to the pressure that the brokers are experiencing on their revenues as a result of subdued trading activity.

**Table 1: Comparative Performance**

| **Year** | **Turnover** | **Turnover excluding NAP trades*** | **Coefficient of Variation** | **Standard Deviation** |
|---|---|---|---|---|
| 2013 | P2.3 Bn | Not applicable | 1.7 | 15.9 |
| 2014 | P2.2 Bn | Not applicable | 2.1 | 18.6 |
| 2015 | P3.0 Bn | Not applicable | 1.5 | 17.9 |
| 2016 | P2.5 Bn | P2.1 Bn | 3.3 | 33.8 |
| 2017 | P2.5 Bn | P2.0 Bn | 3.4 | 33.5 |

*NAP traded P457.3 Mn and P456.5 Mn in 2016 and 2017 respectively.

In Table 1, we particularly single out the NAP trades because they constituted the single biggest trades ever on the BSE since inception with the 2016 trade of P457.3 Mn being the highest ever. They were also unique in that they were on account of a majority shareholder diluting their shareholding. Therefore, these trades introduced negative skewness to overall turnover distributions, increased the variance and the deviation of daily average turnover and reduced the stability of turnover. Removing the impact of the two trades in the two years gives a clearer picture of the comparative performance over the years.

## 2. EQUITY BROKERAGE COMMISSION IN OTHER EXCHANGES

In most markets, brokerage commission is on a sliding scale. The scales are such that brokerage declines as the value of the transaction increases. In a few markets, brokerage is negotiable within certain ranges and in some market it is flat. Further, we have noted that the BSE's ceiling of 1.85% is one of the highest in comparative markets.

A comparison of brokerage commission structures is presented in Table 2.

**Table 2: Equity Brokerage Commission in selected Stock Exchanges**

| Stock Exchange | Brokerage | Value |
|---|---|---|
| Dar Es Salaam Stock Exchange | 1.70% | Up to TZS10Mn |
| | 1.50% | Next TZS 40Mn |
| | 0.80% | >TZS 50Mn |
| Stock Exchange of Mauritius | 0.75% | <3Mn |
| | 0.70% | >3Mn but <6Mn |
| | 0.60% | >6Mn but <10Mn |
| | 0.50% | >10Mn |
| Namibian Stock Exchange* | 1.00% | <NAD 10,000 |
| | 0.85% | NAD10,001-NAD 20,000 |
| | 0.65% | NAD20,001-NAD100,000 |
| | 0.55% | NAD100,001-NAD500,000 |
| | 0.40% | NAD500,001-NAD5,000,000 |
| Malawi Stock Exchange* | 2.00% | K0-K50,000 |
| | 1.50% | K50,000-K100,000 |
| | 1.00% | K100,000-K9,999,999,999 |
| Uganda Stock Exchange | 1.70% | First UGX200Mn |
| | 1.50% | Next UGX800Mn |
| | 0.80% | >UGX 1BN |
| Rwanda Stock Exchange | 1.50% | <Rwfs 100Mn |
| | Neg. with a floor of 1.25% | >Rwfs 100Mn |
| Nairobi Stock Exchange | 1.78% | <KSHS 100,000 |
| | Neg. up to 1.50% | >KSHS 100,000 |
| Nigeria Stock Exchange | 0.75% - 1.35% | Negotiable |
| Lusaka Stock Exchange | 1.00% | Flat |
| Zimbabwe Stock Exchange | 0.92% | Flat |
| Swaziland Stock Exchange | 1.00% | Flat |

Source: Individual stock exchanges websites
*Illustrations provided under 2.1
Commission is charged on both legs of the trade

We have also noted that in Zimbabwe, where brokerage is flat, there are rebates on brokerage commission that are afforded non-members of the Exchange. These are institutional investors who are not brokers and have applied to the Exchange, and paid an application fee, to qualify for rebates gazetted by the Exchange. In Zimbabwe, rebates amount to 20% of the brokerage commission. A number of markets do not have gazetted rebates although these practises are said to happen unlawfully.

## 3. EQUITY BROKERAGE COMMISSION PAID IN BOTSWANA

As part of the evaluation of the concerns around the introduction of the floor, the BSE requested asset managers to submit the average brokerage commission paid on trades they executed in 2015 for the ranges of trade values that the BSE gave them. The BSE also asked for the same information from the BSE brokers but the information was not submitted at all by the BSE brokers.

Table 3 below presents the brokerage commission paid by asset managers in 2015 while the brokerage was completely negotiable between 0% up to 1.85%.

**Table 3: Brokerage Commission Paid by Asset Managers in 2015**

| Value Traded (BWP) | AM 1 | AM 2 | AM 3 | AM 4 | AM 5 | AM 6 | AM 7 | AVG |
|---|---|---|---|---|---|---|---|---|
| <5M | 0.49% | 0.60% | 0.51% | 0.55% | 0.55% | 0.60% | 0.55% | **0.55%** |
| 5M-10M | - | 0.58% | 0.50% | 0.52% | 0.50% | 0.55% | 0.45% | **0.52%** |
| 10M-20M | - | 0.48% | 0.70% | 0.49% | 0.48% | 0.40% | 0.40% | **0.49%** |
| 20M-50M | - | 0.43% | 0.53% | 0.51% | 0.38% | 0.35% | 0.35% | **0.42%** |
| 50M-75M | - | - | - | 0.24% | 0.38% | 0.30% | 0.30% | **0.24%** |
| 75M-100M | - | - | - | - | 0.37% | 0.20% | 0.25% | **0.20%** |
| >100M | - | - | - | 0.15% | 0.27% | 0.10% | 0.10% | **0.12%** |
| **AVERAGE** | **0.49%** | **0.52%** | **0.41%** | **0.42%** | **0.36%** | **0.34%** | **0.56%** | **0.36%** |
| **Book overs** | **-** | **0.25%** | **0.30%** | **0.25%** | **0.30%** | **0.40%** | **0.29%** | **0.30%** |

Acronyms:
AM: stands for Asset Manager

The following can be noted from the presentation in Table 3:

1) Conventionally, high value trades attract lower commission compared to low value trades. Historically, asset managers have been paying brokerage averaging 0.36% on the basis of the size of the trades. It therefore could have been expected that introducing a floor that elevated the fees almost twice on average, and by as much as six times what was paid for high value trades would result in a reduced propensity to trade in order to minimise the transaction costs incurred by the funds.

2) In bookovers, where the effort to facilitate the trades is correspondingly lower, asset managers have paid an average rate of 0.30%. An introduction of the floor of 0.60% effectively doubles the rate and doubling the rate would have been expected to curtail trading.

3) In a liberal market and a free market economy, fees have to be driven by competition on the basis of the quality of service and effort and have to be commensurate with the level of services provided. In our case, the brokerage commission was not justified

by any improvement in value added services, such as increased coverage of stocks or increased cost of execution that warrants passing the costs to the end investors. Therefore, this was mechanically engineered and this is against the order of free market economy.

## 4. RECOMMENDATION

Therefore, in the interest of promoting the ideals of a liberal market, stimulating competitiveness and trading activity we recommend the removal of the floor of 0.60% such that brokerage is negotiable up to 1.85% as was the case prior to April 2016. We base this on the following additional points:

1) Asset managers are capable of paying any fees and brokers are free to charge any fees, so without imposing mechanisms in the form of the floor, it is ideal to allow the broker and the asset manager to negotiate any rate.

2) The removal of the floor would positively impact overall transaction costs of the funds and stimulate trading activity.

3) Increased trading activity directly contributes to more income for brokers.

4) This is will avoid situations where brokers are undercutting one another to cannibalise trades.

5) This will also minimise situations where asset managers could potentially seek rebates for the trades they avail to the brokers with lesser broker effort. This activity is not under the purview of the BSE or any regulatory authority but can distort best practise if practised un-gazetted. Where rebate is practiced and is not regulated, it ultimately does not benefit the clients.

6) This will further attract more foreign asset managers who currently view the BSE as expensive .e.g. with reference to the latest FTSE classification published in September 2018, the BSE is rated as having relatively unreasonable and uncompetitive transaction costs and this rating was a result of the introduction of the floor.

7) Further, in  paper titled " What attracts international investors to emerging markets?", the World Federation of Exchanges (WFE) found that reducing trading fees is associated with an increase in foreign trading activity, and that the reverse is true.

8) Hence, it is our overall view that this revision would to make the BSE more competitive relative to other markets.

## 5. CONCLUSION

In recent years the BSE has invested a lot in improving market liquidity and increasing market visibility including introducing the Automated Trading System (ATS) whose costs were not passed onto the market in the form of an increase in BSE fees (fees earned by the BSE from trading). Therefore, the consideration to review the fees in the market should be approached cautiously from a well-researched, objective and non-conflicted position to avoid undoing the positive impacts of the investment that has been made over the years in relation to developing the market. As can be noted from the presentation in Table 1, the stability of turnover has weakened since the brokerage commission was increased and this has hindered unlocking value from the investment and the initiatives of the Exchange with respect to the development of the market. The BSE is not entirely against increasing fees, but is of the view that these increments have to be substantiated by considerable value add from the service providers and should follow an objective and consultative framework that eliminates any perception of conflict of interest particularly as that was the perception at the time the BSE was a mutual entity.