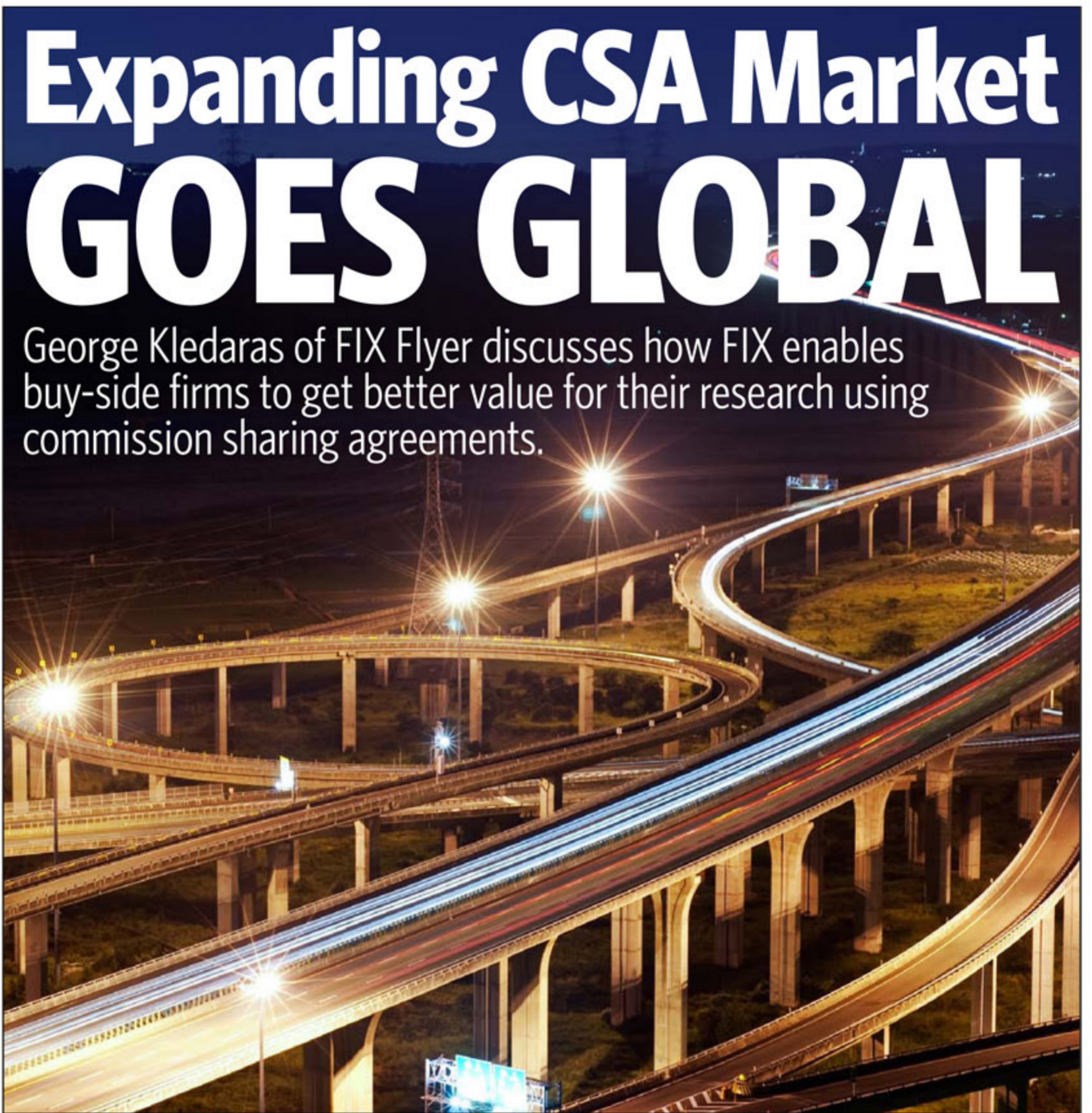


Expanding CSA Market GOES GLOBAL

George Kledaras of FIX Flyer discusses how FIX enables buy-side firms to get better value for their research using commission sharing agreements.



There was overwhelming interest from the buy-side member community at the FPL Americas Electronic Trading Conference to discuss Commission Sharing Agreements (CSAs), also known as Client Commission Agreements (CCAs) depending on your buy-side or sell-side perspective. CSAs allow asset managers to separate the fees paid for trade execution from the fees paid for research and other services such as FIX connections and market data.

A survey of the buy-side conducted

by Integrity Research Associates reports that in the US, "CSAs have gained in popularity over the last five years, and now account for 30% of research commission payments on average. Respondents [to the survey] typically use 5 CSA providers, although some large investment firms use 12 or more." In the UK, this number is 70% of research commission payments on average.

CSAs allow asset managers to "unbundle" the sell-side trade commission into separate execution

and research spending, so that the manager may pay for the execution service with a portion of the commission fee, and use the rest to pay for research or research related services to one or more places. Often this is because the research provider is not necessarily the broker that executed the trade.

The Securities and Exchange Commission (SEC) in the US and the Financial Services Authority (FSA) in the UK both encourage the use of CSAs in order to allow the manager to optimize the services



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George Kledaras, Chairman, FIX Flyer

Payment Workflow for Broker Research

INVESTMENT MANAGER		BROKER	
Request payment	>		
Receive approval and update balance	<	Approve and update balances	
Handle reject	<	Reject	
		Send payment record to accounting system	>

that they receive, and at the same time, increase the transparency of these fees to the end investor.

The most critical element to understand is how commission breakdowns could be reported to the buy-side with FIX, in order to comply with CSA regulations and describe the workflow from the buy-side that tells the sell-side what research and other services that the sell-side pays for. The significance of CSAs to electronic trading is evidenced by the recent FPL Americas Electronic Trading Conference panel on CSAs.

How FIX facilitates CSAs

Commissions generated by the buy-side are reported using back office systems that feed into settlement. After settlement, the broker keeps a breakdown of what portion of the commission is going to be used for execution versus research using rate tables agreed upon with their asset manager clients. While CSA systems right now are based on T+1, delivering commission breakdowns in FIX will allow OMS vendors to provide commission systems in real-time, leading to increased

service for the buy-side and further growth in the CSA market.

If a trade is marked as a principal trade (P) in FIX using the OrderCapacity (tag 528) versus agency (A), the commission is separated by the broker into its components. For CSA purposes, a new value for OrderCapacity could be called Mixed, in order to designate that the trade has separate execution and research. This tag is used by back office systems to apply the appropriate commission rate table and report the correct ratio of execution service versus research service.

The Commission (tag 12) and CommissionType (tag 13) need to be expanded in order to be able to report the breakdown from the broker to the buy-side in real-time. Currently, breakdown information is kept by the buy-side in their own commission tables, and the broker reports this information at the end of the day via a web portal or email, which can be prone to errors. If commission breakdown

information can be reported at the time of the trade, the buy-side can feed this information into their decision process, and further optimize their research and services spending from their earned commission credits.

Payment Workflow

Another aspect of significant manual processing is communicating to the broker regarding payable invoices from a research provider or service vendor, and checking the status of those payments. Right now, most people are using broker-supplied, web-based systems, and if firms are working with several brokers, it can be difficult to get an aggregated view of outstanding payment balances.

The best way to do this would be to build this functionality into the trading systems and use FIX as the messaging standard between the buy-side and the broker. These messages do not currently exist in FIX, but many of the tags can be reused.

There are two major workflows for payment: one for a broker that has their own research, and one for brokers who are paying third party research or service providers.

FIX could be used to communicate all of the payment details between the buy-side and the sell-side in real-time. The benefits would improve chances for the buy-side to optimize their spending on services and to process them efficiently, with fewer errors. If the buy-side accepts

Payment Workflow for Vendors and Third Party Research

INVESTMENT MANAGER		BROKER		VENDOR
Send invoice	>	Accept invoice		
Approve invoice	<	Reject invoice		
	<	Send payment record to accounting system		
		Process invoice	<	Send invoice
		Send check or wire	>	Receive check or wire
Receive approval and update balance				

“If the buy-side accepts CSA workflows into their OMS, then they will get an aggregated view of their balances, leading to informed decisions regarding their research credit spending and monitoring.”

CSA workflows into their OMS, then they will get an aggregated view of their balances, leading to informed decisions regarding their research credit spending and monitoring.

Preserving Research Credits in the Age of Algorithmic Trading

Due to the growth of algorithmic trading and increased competition for low touch services, the buy -side is discovering new ways to optimize their commission budget in order to apply their commission credits to the best research and services. At the same time, the challenge to the sell-side is to provide a la carte options for the ‘just-in-time’ services that the buy-side needs and ultimately, this benefits their investors. The buy-side continues to use research to capture alpha as the opportunities to become more efficient are getting harder.

FPL Americas Electronic Trading Panel on CSAs

On October 21st, 2010, at the

FPL Americas Electronic Trading Conference, a panel entitled Trading and Research: Bridging the Gap was moderated by Brian Ross, CEO of FIX Flyer, with representatives from: Gartmore Investment Management, Bank of America Merrill Lynch, Morgan Stanley and Mayer Brown. Among the interesting discussion points, it was mentioned that in order to optimize choices, the buy-side often keeps a healthy mix of large and niche brokers, with different capabilities for execution and research. This mixing of brokers also helps to diversify the amount of research credits at any one firm. When Lehman Brothers and Bear Stearns went bankrupt, the court ruled that any client balances would not be recoverable, and no buy-side wants to have all their eggs in one basket anymore.

From the sell-side perspective, buy-side trading volumes are down significantly. Despite this, the buy-side expects or negotiates for the

same level of service. The end result is increased competition for sell-side services, with decreased volume from the buy-side. Some sell-sides include trades from other domiciles, asset classes, or program trading desks. Managers are being much more careful about the use and management of commission dollars, and sell-sides with the best service offerings are gaining market share.

CSAs are actively used in the US, UK, and Canada, and their use in Hong Kong, France, Germany, and Japan are increasing rapidly. The opportunity is now for the industry to better manage credits earned using trading commissions. Using FIX simplifies the reporting and better integration into the workflows to support the increasing use of CSAs.

Any thoughts about this or other articles?
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