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COMMISSION SHARING ARRANGEMENTS  
AND CLIENT COMMISSION AGREEMENTS

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# Executive Summary

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Commission Sharing Arrangements (CSAs), also known as Client Commission Agreements (CCAs) in the US, have grown in popularity by allowing investment firms to consolidate their trading with "best execution" partners rather than trade with a firm just to pay for their research.

Regulatory developments have helped spur growth in CSAs. In the UK, CSAs replaced soft dollars as a result of the Financial Services Authority's implementation of Rule CP 176 in July 2005. Regulators in Europe, notably the Autorité des marchés financiers (AMF) in France, have followed the UK's lead in abolishing traditional soft dollars, promoting the adoption of CSAs. The Markets in Financial Instruments Directive (MiFID) also reinforced adoption of CSAs through its best execution requirements. In the US, the SEC has taken steps to facilitate the use of client commission arrangements (CCAs) but has not gone as far as European regulators in requiring mechanisms conducive to the adoption of the CCAs.

Integrity Research conducted a survey of 105 investment firms, including hedge funds, mutual funds and investment advisors, in the fourth quarter of 2008 to determine their usage, preferences, and projected use of commission arrangements. As part of the survey, Integrity asked users about the strengths and weaknesses of CSA brokers used by the firms to determine which CSA broker platforms were held in highest regard by users.

The overall trend in CSA/CCA uptake has been strongly positive, and our survey presented no evidence of retrenchment. However, in spite of this overall positive trend, the actual proportion of commissions flowing through CSA/CCA mechanisms remains relatively low - for nearly two-thirds of buy-side clients, 20% or less of their commission flow is currently being directed to commission-sharing arrangements. This indicates that there is room for growth in absolute CSA usage rates, as well as in the relative share of commissions that are directed through CSAs.

Counterparty risk has become a major issue for CSA users. The concern with counterparty risk may lead buy-side clients in one of two possible directions:

1. Clients could become more likely to diversify their CSA balances by increasing the number of executing partners with whom they have commission sharing relationships;
2. Clients could become more likely to consolidate their CSA/CCA balances with a centralized counterparty that would have its assets insured and/or segregated from trading counterparties.

Small hedge funds and investment advisors are highly likely to aggregate their CSA balances with just a few execution partners in order to obtain the highest levels of service given a small commission pool. On the other hand, large firms tend to have 8-12 CSA / CCA providers in use. Although there are very few such large money managers, they are responsible for generating the bulk of commissions and trade flow for their CSA brokers.

Trade reconciliation/reporting and financial strength are two of the most important criteria to the buy-side when it comes to choosing a CSA/CCA broker. In addition, customer support and service are also perceived as very valuable. These factors are followed by compliance, timeliness of payments, web site interface, and other value-added services, all of which were identified as being important factors by a roughly equal proportion of our survey participants. To select the *Integrity 2009 Top Picks for CSA Brokers*, customer feedback on all key attributes in selecting a CSA broker were weighted and scored.

In polling CSA clients about the strength and weaknesses of specific CSA brokers, Integrity separated responses into three categories: North America, Global/Multi-regional and Overall. The *Integrity 2009 Top Picks for CSA Brokers* are presented for each category, with a winner, runner-up and honorable mention in each.