



The Depository Trust & Clearing Corporation

# MIFID II – IMPACT OF RESEARCH UNBUNDLING TO POST TRADE PROCESSES

## OVERVIEW

The MiFID II guidelines mean research payments will have to be a pre-agreed amount with each underlying fund the institution manages. Therefore if buy-side firms want to bundle the two charges together the execution commission will stay as a basis point figure but the research payment may need to be a fixed amount.

A Commission Sharing Agreement (“CSA”), or in the US named Client Commission Agreement (“CCA”), is a type of arrangement (previously called soft dollar) that allows money managers to separately pay the executing broker for trade execution and ask that broker to allocate a portion of the commission directly to an independent research provider. CSAs consist of a pre-agreed percentage split between execution fees and research payments, bundled into one amount. The form of a CSA can be as short as one page. One of the disadvantages of CSAs is counterparty risk, in that the cash is held on the broker’s balance sheet and not in a segregated client account. Moves included in MiFID II such as the creation of Research Payment Accounts (RPAs) aim to address this issue.

MiFID II has the potential to be the most significant catalyst for change in the market for investment research in decades. Crucially, the implementation of MiFID II, which is currently scheduled for January 2018, will require all sell-side research to be individually priced and thus affect full price transparency. Investment firms will be required to set and assess research budgets and MiFID II states that that payment must be direct, out of the firm’s own resources, without any undue delay. Research payment fees may still be passed onto the underlying funds of the investment manager and potentially bundled with execution fees. In order to continue doing this the investment firm must put in place a Research Payment Account (RPA) on a fund by fund basis. The RPA will contain strict stipulations regarding the agreed amount of research that will be paid for, the amount to be assessed on a regular basis and be marked as an explicit cost to the underlying fund.

Clients can choose to either maintain the inclusion of research amounts on individual trades, or exclude research from the trades and operate a reconciliation process.

## CURRENT PRACTICE

CTM trade records include fields to specify

- commission amount and
- commission type (There are currently four discrete types)

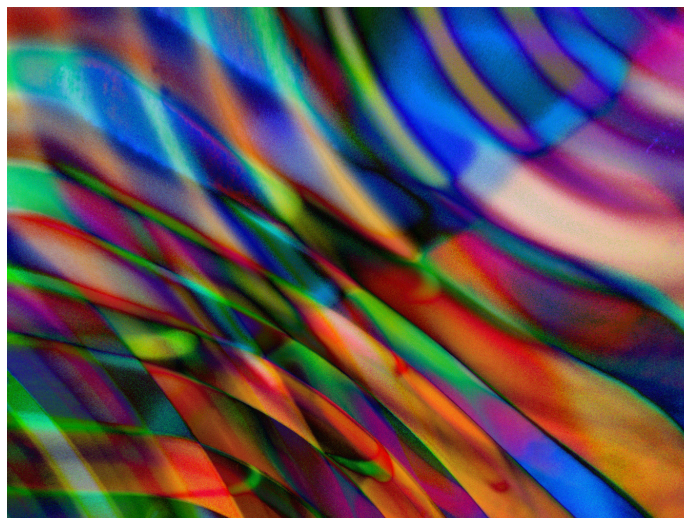
The CTM platform matches on the total of each type supplied. Buy-side firms control whether the total commission is included in matching.

The commission amount applied by brokers on CTM trades typically bundles execution and research together. These amounts are populated on both the block and allocations.

## PROPOSAL: NEW COMMISSION TYPE FOR RESEARCH

Adding a new commission type for research will support the population of both a discrete execution commission amount and a segregated research amount.

The CTM platform will compare the two counterparties’ totals when matching. If one side maintains a single bundled value and their counterparty provides two discrete values this will not impact matching as long as both sides agree to either include or exclude research on trades.



## POPULATING A RESEARCH AMOUNT ON ALLOCATIONS ONLY?

With MIFID II implementation, research is specific to individual funds; hence the proposed implementation is for users to provide

- Execution commission on both blocks and allocations, and
- Research amounts ONLY on the allocations.

This is currently perceived as the most pragmatic approach for the community, based on existing information. However, we ask for any other feedback / guidance to ensure the best solution for the community.

Note: investment managers who wish/need to maintain the research amount on the block could choose to not match on commission at the block level. This would allow the blocks to match on all other trade financials and the commission to be matched at the allocation level.

## WORKFLOW

Specifically for clients who wish to include research amounts on individual trades; the buy-side would need to populate these values on their allocations, and broker counterparties would need to consume these amounts from the buy-side allocation and then incorporate onto their allocation record (confirmation).

## FOR MORE INFORMATION

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