



Will the Buy Side Shift Trading Relationships to Agency Brokers?

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Last week's panic in the financial markets may cause some buy-side institutions to rethink their trading relationships and shift business away from the bulge bracket toward independent agency models.

Today [TowerGroup](#) released a new research report contending that the unprecedented restructuring on Wall Street will have a lasting and major impact on the investment management business. TowerGroup believes the apparent demise of the independent brokerage model will force investment management firms to carefully reassess their reliance on Wall Street brokerage firms for research, trade execution, market insight, and back-office service. The research firm is predicting less capital commitment and a decline in the extent and quality of execution services.

As reported in "[Wall Street Trader Reaction and CSAs](#)" many buy-side firms that have CCAs (client commission arrangements) for equity trading with bulge bracket firms, were concerned about leaving the commission credits at some of these bulge-bracket firms. Even prior to last week buy-side institutions were already looking into transferring their CCA programs away from Lehman since the firm had been struggling for several months with toxic mortgage securities on its balance sheet.

"We had several buy-side institutions that have contacted about moving their CCA/CSA programs to us," commented Jim Morrow, COO of [Capital Institutional Services\(CAPIS\)](#), a mid-size institutional agency broker, whose core business is client commission arrangements (CCAs).

But can they move the funds or are they tied up in Lehman's bankruptcy filing? "CAPIS has clients that are being told by Lehman that they can move positive CCA/CSA balances to CAPIS to be used for research under 28e," according to Morrow. "As of this morning (last Tuesday), CAPIS has not yet received the transfers of these balances, but we would not have expected the balances to be with CAPIS yet," said Morrow who was interviewed last Tuesday.

However, late Friday afternoon, CAPIS heard back from Lehman Brothers and was told "that all CSA/CCA balances will be transferred to Barclays Capital on Monday, and they will not be transferring balances to other brokers. The investment community will need to work out their CSA/CCA balances with Barclays," according to Morrow.

At the same time, there's a core shift happening in the fixed-income markets, where firms like Jefferies & Co. and First Tennessee, a super regional bank, are stepping up and becoming more of the market, says Morrow. Last week, the largest bond shops, which are the bulge-bracket firms, were not providing as much liquidity. As an agency broker, CAPIS doesn't hold the bonds in inventory, but its institutional clients would call up the firm to ask it for a certain maturity and risk. "We're calling all these bond shops out there to try and find the best bond price," said Morrow. "Who we're calling up is actually changing," said Morrow.

Meanwhile, Lehman, after it filed for bankruptcy last Monday, disappeared from the bond market last week. According to Neil Decker, director of fixed income trading at CAPIS, his

contact at Lehman in the government area, was in the office last Monday but just to clean up and say goodbye. In the corporate area, Lehman was sending out lists of positions they were trying to sell and if they were long and lists of positions they were trying to buy if they were short, said Decker. "They were not in the market to provide liquidity but they were merely in the market to unwind positions," observed Decker. (Today, Lehman re-opened for business under the ownership of Barclays Capital and will resume trading once Lehman's trading and risk management systems are integrated with Barclay's, according to yesterday's release.)

On the fixed income side, Decker said he's seeing unwillingness for bulge bracket firms to commit capital. "If you only have one or two brokers or three and none of those brokers are a buyer of the bond that you're a seller of today, you've got a big problem," said Decker. He said people could branch out to a larger number of dealers, such as a large agency broker. "We find our large customers using us to branch out trying to find the paper they're looking to buy or sell," he said.

Decker contends the super regional banks are both committing capital and in some situations providing liquidity by virtue of what their accounts are trying to do. He finds that when he contacts a super regional on behalf of a client who is selling a bond, they may have a customer who is a potential buyer of the bond.

"I just find the super regional's have developed the relationships with their customers that they can possibly do that more effectively than some of the bulge bracket firms," suggested Decker. "It's both committing capital and creating flow through customer orders on their side," he said. "I find they're more willing to provide a wide range of bids and offers than the bulge brackets these days," said Decker.

On the equity side, "when it's difficult for firms to commit capital, you'll see more of a shift to the agency broker-side," predicted Morrow. If institutions submit lists of trades and ask the firms to bid on the list, they may charge a higher dollar and cents amount than in the past, he said. Alternatively, customers could trade on an agency-basis where the broker charges a commission and calls around to find the other side. "They (buy-side firms) might view any market impact and the commission to be less than what we pay for a principal trade," said Morrow.

In response to rumors circulating last week, Morrow said, "Morgan and Goldman are two of the best firms in the industry." Last week, Morrow said Merrill Lynch was still there as a viable market maker in the fixed-income business, and that Goldman was an extremely strong entity as is Morgan Stanley.

Still, the agency brokers will be competing with the bulge bracket, which are now all becoming banks and moving away from the brokerage model. In the past week, Barclays, the UK bank has acquired Lehman for \$1.75 billion, Bank of America is buying Merrill Lynch for \$50 billion, and Morgan Stanley is selling up to 20 percent of the brokerage firm to Mitsubishi UFJ.

Yesterday both Goldman Sachs and Morgan Stanley announced that they are becoming bank holding companies, which will subject them to more regulation and stricter capital requirements. It's not clear how this change in regulatory status will impact their ability to commit capital or provide execution services.

Meanwhile, the agency brokers are expecting the pendulum to shift their way. "We are pushing our low-risk business model. Our business is a commission business," emphasized Morrow.