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Evaluating Broker Effectiveness for Performance: “Vote Early and Often”

By Jay Rooney

The Challenge for Today's Managers

Today's traditional asset managers and hedge funds find themselves increasingly beset by demands to monitor and measure their activity, to which they must respond. These activities are fundamentally divorced from their core business – generating performance for clients. As the regulatory, operating and due diligence environments ask for more tracking, more monitoring, and more reporting, management firms are diverting human and capital resources to IT, infrastructure, and operations, in order to respond to and keep up with the external requirements.

While the requirements are burdensome for many exercises, the question for managers ultimately becomes - “Since this is a ‘must do’, how can it be leveraged to gain insight into the effectiveness of various brokers, thereby providing benefit to the firm? (E.g. – the tracking of broker commissions, research events and overall performance.)

When considered in a wider frame, the ability to measure brokers is in fact an opportunity for managers, because they now can accurately monitor their brokers' contributions to the firm. This encompasses both performance of an individual broker as well as cross-comparisons between brokers. While the range of measurements varies, firms can now have available a robust suite that gives them insight and guidance on broker performance.

All of this means that a manager can satisfy regulatory requirements, have a mechanism for better broker selection and have data as the basis for a discussion with each individual broker. Through broker event tracking and commission data capture, sell-side meeting and execution information across multiple periods is automatically and easily retrieved. Such data and analysis is essential to the broker rating or “broker vote” process, and is integral in assessing future allocations of execution and research dollars.

Thought of in this way, commission, event, and broker tracking is a solution to a business challenge that the firm might want to deploy absent any obligation to do so. This business-challenge/business solutions approach frames the conversation in a completely different way. So transparency around commission and research dollars and measurement of the effectiveness of various brokers (in both quantitative and qualitative terms) is beneficial not only for compliance and investor purposes, but for the management of the firm itself.

Evaluating Brokers: What is the Business Problem?

As regulatory requirements grow, there is a mandate to justify and rationalize broker utilization. What is required for managers is a combination of commission tracking, event tracking and broker voting. The goal is to have a commission and broker suite of applications that utilizes a firm's data not only to meet regulatory requirements but also to help managers in the entire range of relationships with brokers and with each individual broker they use. It makes the relationship between firms and their brokers equal and provides a means to engage brokers based on analysis. For portfolio managers, traders, analysts and relationship managers, access to the effectiveness of various brokers can guide the research and execution decisions. Especially as firms find themselves overbrokered in today's environment, such a tool can also serve to evaluate the effectiveness of broker by type - be they full service, research or execution only.

As a commercial proposition, the ability to view broker commission data across regions, asset types, commission rate types, etc., enables managers to have critical information about how closely commission payments for the current period are adhering to the most recent broker ratings from the last broker vote. Here managers require detailed reporting, trend charting, alerts and other tangible measures to assist in the periodic review process.

The broker tracking and evaluation process is one that allows fund and asset managers to conduct conversations with their brokers about the manager's use of research and execution services. It can also provide data across an array of metrics that serves as the basis for rational business discussions and decisions.

Directly related to this evaluative capability is "ease-of use". If users of broker tracking can do so online, with automated updates and report capabilities rather than through cumbersome paper or legacy electronics methods, the process is easier from inception through reporting. Thus, all aspects of the process are ideally automated, including soft credit tracking, meeting tracking, voting and reporting needs.

The MIK Approach

MIK Fund Solutions, a leading provider of software solutions for hedge funds, provides a comprehensive and integrated broker tracking system for hedge funds and asset managers. The offering is designed as a suite of applications for the tracking and reporting on hard and soft dollar commissions (Commission Tracker), sell-side research services and event access tracking (Event Tracker), and the periodic rating of all brokers that drives future commission allocations (Broker Vote). The functionality is delivered in one integrated application, but the components can also be used separately.

By deploying the full application, MIK clients obtain a sophisticated view into all of the interactions with their execution and research brokers, thereby creating a powerful analytic tool for managers to monitor, measure, and evaluate broker performance across a customized array of categories, defined and chosen by the fund.

In addition, managers have the opportunity to open dialogues with brokers based on ranking, rating and total commission scales.

Of particular concern to managers, the application suite includes:

Centralized broker and commission data capture and reporting system - time series data and audit trail (Commission and Voting History)

- Data collection and integration (MS Outlook, OMS, Accounting)
- User defined views for commission data and trends based upon multiple input criteria.
- Workflow management for online voting and automated event integration with MS Outlook
- Tracking, analysis and reporting on soft dollar commissions and provides the capability to exclude soft payments from the commission totals for those brokers handling the commission sharing
- Reporting and charting for commission trends over time, including rate-per-share analysis, total commission dollar trends by broker, broker's share of firms commissions paid, etc.
- Commission allocation management and alerts
- Ranking and rating ability on user defined objective and subjective criteria (Multiple Methodologies)
- Elimination of the need for time consuming MS Excel based reporting

Conclusion

MIK's commission and broker suite of applications works a firm's data not only to meet regulatory requirements but to help managers in the entire range of relationships with brokers as a whole and with each individual broker they select. It makes the relationship between firms and their brokers equal and provides a means to engage brokers based on analysis.