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December 15, 2004

VIA HAND DELIVERY

Jonathan G. Katz
Secretary
US Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: Response to SR-NSCC-2003-21

Dear Sir:

We represent CheckFree Corporation ("CheckFree") and, on its behalf, we hereby respectfully submit the enclosed independent research report in support of our comments on Release No. 34-48846: Notice of Filing of a Proposed Rule Change Relating to the New Separately Managed Accounts Service dated November 26, 2003 ("Proposed Rule 59"), proposed by the National Securities Clearing Corporation ("NSCC"). CheckFree submitted its comments in three letters dated December 23, 2003, June 22, 2004 and August 13, 2004.

The enclosed research report was prepared by the TowerGroup, an independent research and consulting group specializing in the financial services industry. TowerGroup researches and reports on issues affecting the financial services industry. The TowerGroup research reports are available on a subscription basis. CheckFree did not commission the enclosed TowerGroup report. The TowerGroup report is consistent CheckFree's position that the Money Management Institute's ("MMI") Separately Managed Accounts Operations Communications and Data Standards ("MMI Standards") are not open standards. The report provides a well-balanced review and explanation of the MMI Standards. The report concludes that, although the separately managed account industry would benefit from uniform open standards, the MMI Standards are not open due to the reliance on the NSCC's proprietary protocols. We continue to urge the staff and the Securities and Exchange Commission to reject the NSCC's Proposed Rule 59.

We appreciate your careful consideration of this matter. Should you have questions or need additional information, please do not hesitate to contact me at (202) 756-3305.

Sincerely,

Margaret A. Sheehan

Enclosures

cc: Office of Commissioner Paul S. Atkins
U.S. Securities and Exchange Commission

Office of Commissioner Roel C. Campos
U.S. Securities and Exchange Commission

Office of Chairman William H. Donaldson
U.S. Securities and Exchange Commission

Office of Commissioner Cynthia A. Glassman
U.S. Securities and Exchange Commission

Office of Commissioner Harvey J. Goldschmid
U.S. Securities and Exchange Commission

Laura E. Binion
CheckFree Corporation

TOWERGROUP℠

The Power of Knowledge

MMI AND NSCC: THE PURSUIT OF STANDARDS IN MANAGED ACCOUNTS

Matt Schott
Senior Analyst
November 2004
V41:170

Report Coverage

In March 2003, TowerGroup estimated that managed account assets would increase over the next few years at a compound annual growth rate (CAGR) of 22.6% from $398.7 billion in 2002 to $1,105 billion in 2007. The substantial increase in assets and new accounts is putting pressure on sponsors and money managers to enhance operational capabilities for better scale and improved efficiency. This TowerGroup Research Note reviews the efforts of the Money Management Institute (MMI), the industry organization for managed accounts, to create uniform and open data standards. The proposed National Securities Clearing Corporation (NSCC) SMA Service, a messaging hub that implements the MMI data standard, is described and analyzed. Included is a discussion of the challenges involved in implementing industry standards in general as well as the potential for implementing the SMA Service in particular.

Vision

Assets in managed accounts continue to grow, spurring the entry of new sponsors and money managers into the business. In March 2003, TowerGroup estimated that managed account assets would increase at a CAGR of 22.6% from $398.7 billion in 2002 to $1,105 billion in 2007. MMI data for year-end 2004 shows $507 billion in assets, 10.5% ahead of the $458.5 billion predicted by TowerGroup.

TowerGroup Take-Aways

- In March 2003, TowerGroup estimated that managed account assets would increase over the next few years at a compound annual growth rate of 22.6% from $398.7 billion in 2002 to $1,105 billion in 2007.
- The operating environment for the managed account industry is characterized by many-to-many communication of high volumes of data with no existing or adopted data standards.
- The Money Management Institute (MMI) has undertaken an ongoing and well-organized leadership role in defining data standards to support the specific needs of the managed account industry.
- The MMI chose the National Securities Clearing Corporation to provide protocols and a messaging hub in an approach that has the advantage of a controlled technical implementation but may complicate future efforts, especially with other standards bodies.
- Challenges to adoption include resolving questions about openness, rationalizing the initial cost to industry participants of implementing the standard, addressing different modes of business, and coordinating efforts with other standards bodies.
- Trade and reconciliation data represent the bulk of potential message volume in the managed account arena; gaining cooperation of existing standards bodies or rationalizing a go-it-alone approach will ultimately decide the success of MMI's efforts.

Despite this growth, money managers face many challenges to profitable participation in the managed account business. The money manager's world is a hodge-podge of interfaces and downloads to and from multiple parties all held together by an expanding operations staff requiring significant training. To meet its responsibilities as a fiduciary to the retail customer and to comply with industry and regulatory reporting requirements, many money managers mirror post and reconcile accounts from many sponsors to their own portfolio accounting systems. The implementation of data standards for the managed account industry is critical to keeping a diverse set of money managers profitably engaged and competing for this business.

The MMI has defined a set of data standards for new account opening and for various account activities. Standards for trading and reconciliation are in development. TowerGroup predicts that adoption will proceed slowly as vendors respond with infrastructure to format and interpret messages and as applications such as portfolio accounting and trade order management are enhanced to utilize the standards. The largest sponsors, with developed infrastructures, are unlikely early adopters. Instead, adoption will be driven by smaller sponsors working with money managers who are seeking ways to profitably add distribution. This will take time to develop mass and drive down unit cost.

The MMI has chosen to work with the NSCC to design the technical protocols and implement a standard messaging hub. This approach has advantages in ensuring a consistent implementation of the standard for traffic flowing through the NSCC hub and in using existing telecommunications connectivity to the NSCC. The NSCC can point to a history of reduction in fees as volumes have increased in a similar type of service for mutual funds. According to the NSCC, the per-transaction cost for NSCC's Mutual Fund Services has dropped from $0.50 in 1986 to $0.175 today.

Yet TowerGroup believes that the choice of NSCC to implement the technical aspects of the standard means that an open standard exists only as it relates to the business content aspects. The MMI's preferred method of implementation from a technical perspective is through an industry utility's (NSCC's) proprietary protocols. The involvement of the NSCC in the MMI standards efforts may complicate the development of trade and reconciliation standards where potential substitute standards already exist. Because trade and reconciliation will represent the greatest volume of message traffic, achieving wholesale adoption of MMI standards through the NSCC will depend heavily on working with other standards bodies for trading and reconciliation to include the NSCC as a conduit or will require a sound rationalization to proceed independent of the other standards efforts.

Overview

The managed account business continues to grow at a healthy clip. This growth will bring new sponsors and money managers into the managed account arena and strain the industry infrastructure already stretched by growing volumes. The largest sponsors have automated much of their process and provide interfaces for trading and data files for transaction posting and reconciliation. The major money managers generally mirror post all client accounts to their own portfolio accounting systems. However, beyond the major players and particularly in regard to account activity, there is still a high degree of phone, fax, and e-mail communication and manual effort.

In terms of technology vendors, CheckFree APL is the dominant force in the industry. A major technology provider to both sponsors and money managers, it provides over 1,400 customized interfaces. That CheckFree supports 1,400 interfaces speaks both to the lack of data standards specific to managed accounts and to CheckFree's leadership in providing connectivity. In instances where CheckFree provides technology to both ends of the sponsor-to-money-manager relationship, it supports a high degree of automation. In TowerGroup Research Note V36:04O "Chasing CheckFree: Portfolio Management Systems for Multidiscipline Accounts," TowerGroup cites the level of connectivity achieved by CheckFree as a competitive advantage for CheckFree and a marketing challenge for its competitors.

To implement data standards and address connectivity issues, the NSCC has submitted a rule change to the Securities and Exchange Commission to establish a standard messaging hub to support the managed accounts business and provide connectivity between sponsors and money managers. CheckFree has been the only significant industry player voicing opposition. This TowerGroup Research Note describes the development of data standards for the managed account industry and the proposed NSCC SMA Service. A discussion of the regulatory ramifications of the proposal and the objections raised by CheckFree is beyond the scope of this Research Note. However, the Research Note does explore the challenges to adoption should the proposal receive SEC approval.

Exploding Growth in Separately Managed Accounts!

The managed account business is riding the crest of a sea change in retail brokerage from a transaction and product orientation to an asset fee-based advisory orientation. As shown in Exhibit 1, managed account assets increased throughout the late 1990s at a CAGR of 26.9%. Growth leveled off from 2000 to 2002, yet even this is an impressive performance considering the market declines during those years. In March 2003, TowerGroup estimated that managed account assets would increase over the next few years at a CAGR of 22.6% from $398.7 billion in 2002 to $1,105 billion in 2007. Indeed, recent MMI figures reflect actual 2003 year-end assets at $497 billion, far exceeding the $458.5 billion estimated by TowerGroup for 2003.

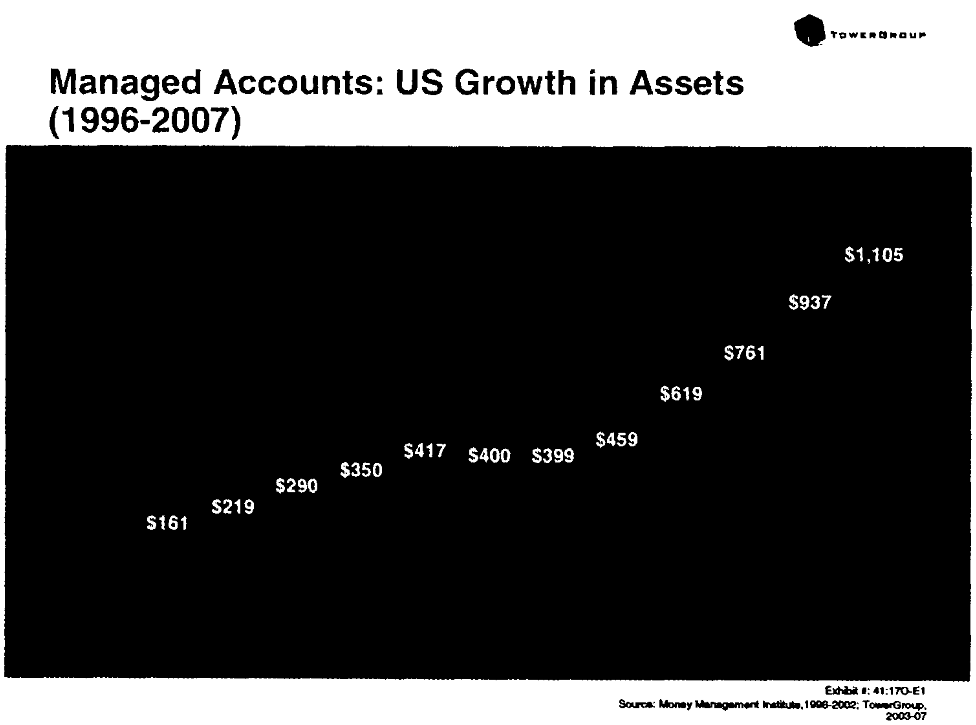

Exhibit 1
Managed Accounts: US Growth in Assets (1996-2007)
Source: Money Management Institute, 1996-2002; TowerGroup, 2003-07

Oh, What a Tangled Web!

This growth in assets will attract new sponsors and money managers to the business. Managed accounts in the retail world grew out of institutional consulting and the institutional money management business. Institutional money management is a classic financial services industry challenge of interfacing many broker-dealers to many investment managers to many custodians. Institutional money managers deliver a high degree of customization but service only a few hundred high-net-worth individuals, corporations, pension plans, or foundations. The account size and revenue flows from these accounts can justify a degree of inefficiency and manual effort on the part of the various parties.

In the case of retail managed accounts, the requirement for customization is still prevalent, but the ability to scale operations to thousands and tens of thousands of accounts becomes the overriding challenge. Any account may be customized based on an investor's preferences. In addition, achieving tax efficiency in taxable accounts will increase the level of customized servicing required.

The fact that the sponsor in retail managed accounts is often but not always the custodian does simplify matters somewhat. Yet each money manager may be active with 20 to 40 different sponsor programs, and each sponsor program may entail 30 to 50 money managers, 50 to 100 products, and tens of thousands of accounts serviced by hundreds or thousands of advisors. Each dividend, each corporate action event, and each trade allocation in the managed account business will generate ten times to hundreds of times the number of records in the institutional business.

The industry has achieved some level of automation to deal with this complexity. In many instances, sponsors provide data files of balance, position, and transaction information so that money managers can mirror post account data and reconcile to the sponsor's books and records. For trading, sponsors are more likely to require money managers to use sponsor proprietary front-end systems to enter trades and allocations. This requires that trades and allocations generated on the money manager's portfolio management system be manually entered on the sponsor's trading front end. For account opening and maintenance instructions, a higher degree of manual effort and methods are used, including phone, fax, and e-mail.

Regardless of the level of automation, the many-to-many challenge still exists as shown under "Current Environment" in Exhibit 2. The sponsor sends data files in proprietary format to many money managers. The money managers divide trades by sponsor and enter the trades on multiple sponsor systems. At the request of the Money Management Institute, the NSCC has proposed the SMA Service messaging hub to implement industry standards with one-to-many data connectivity as shown under "Proposed Environment" in Exhibit 2.

TowerGroup

Managed Account Connectivity Challenge and the NSCC Response

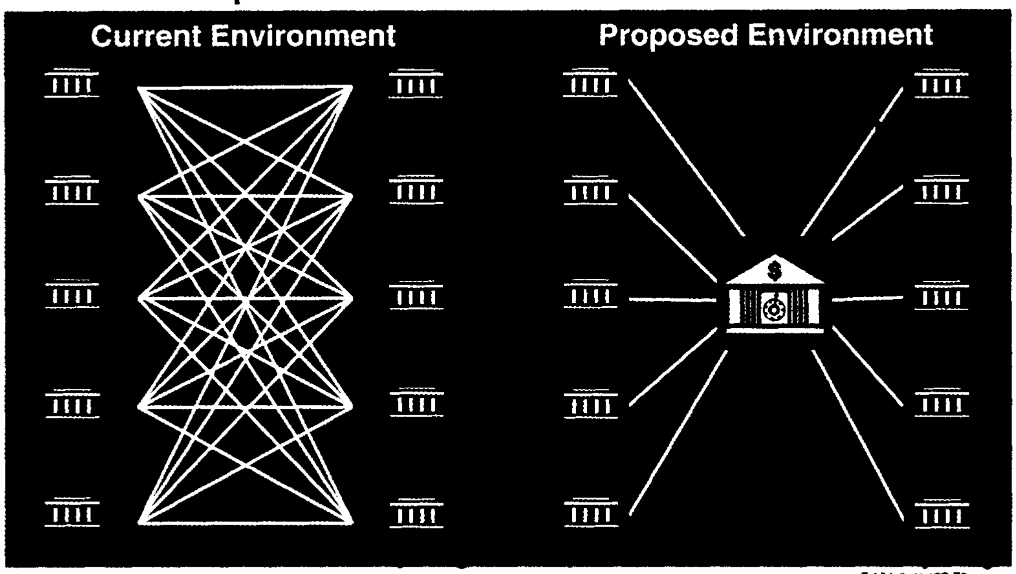

Exhibit #: 41:170-E2
Source: TowerGroup

Exhibit 2
Managed Account Connectivity Challenge and the NSCC Response
Source: TowerGroup

MMI Data Standards

Founded in 1997, the Money Management Institute (MMI) is the industry body supporting the managed account business. Its membership includes money managers, sponsors, and third parties supporting the industry, including technology vendors. The Technology and Operations Committee (TOC) of the MMI began addressing standards in 2000 using International Organization for Standardization (ISO) guidelines.

The TOC defined a business need for each message type, defined the process and workflow for each function, and finally documented the data elements required by the process. Sponsors and money managers were involved in this part of the process. Then a separate Tech Working Group took the data elements and defined more detailed specifications around field length, field format, required fields, reoccurring data, and possible field values.

Published under the name Separately Managed Accounts Operations Communications and Data Standards, the first set of standards for data related to account opening was released in 2002. Three message types (account initiation, funding notification, and authorization to trade) provide the necessary data for the money manager to open the account. Three account maintenance message types (deposits, withdrawals, and termination) round out the first set of messages. The second set of standards for account maintenance is currently under review by the committee. The final two sets of standards, for reconciliation and for trading, are currently in development, with a draft for review scheduled for the first half of 2005.

The MMI standards define a required message flow. For each message type sent, the receiver must provide an acknowledgment to the sender that the message was received. The standard establishes a guideline for the acknowledgment to be sent within 60 minutes. After evaluating the contents of the message, the recipient must send an "accept" or "reject" notification. The reject reason codes, defined by MMI, indicate why the receiver is refusing to process a message. The sponsors and money managers negotiate their own guidelines regarding time limit for sending of the accept/reject message. All three messages are required to complete the message cycle. For each message type, the standards define who can send the message; who receives the message; the field name, field format, and field description for each data element; and the required fields.

In early 2002, the MMI asked the NSCC for information about the NSCC's Mutual Fund Services offering and subsequently asked the NSCC to participate in the data standards effort for managed accounts and implement a messaging hub using the standards. As a clearing agency regulated by the SEC, the NSCC has filed a Proposed Rule Change with the SEC to provide a standard messaging hub to address this many-to-many connectivity challenge. Called SMA Service (SMAS), the proposed service would leverage existing NSCC technology to provide a one-to-many conduit for communications between sponsors and money managers, as illustrated in Exhibit 2. SMAS would also implement the present and future messaging content standards being developed by the MMI.

NSCC SMA Service

The National Securities Clearing Corporation was formed in 1976. In 1999, along with The Depository Trust Company, NSCC became a wholly owned subsidiary of The Depository Trust & Clearing Corporation. Today, the NSCC provides a variety of clearance and settlement services to broker-dealers, banks, money managers, insurance companies and other financial services institutions. As shown in Exhibit 3, SMAS would be the third service provided by NSCC Distribution Services. Mutual Fund Services started in 1986 and today offers a variety of mutual fund processing and messaging services supporting approximately 30,000 CUSIPS. Insurance Processing Service, formed in 1997, today provides processing and messaging connectivity to over 50 major insurance carriers and close to 150 distributors of annuity products.

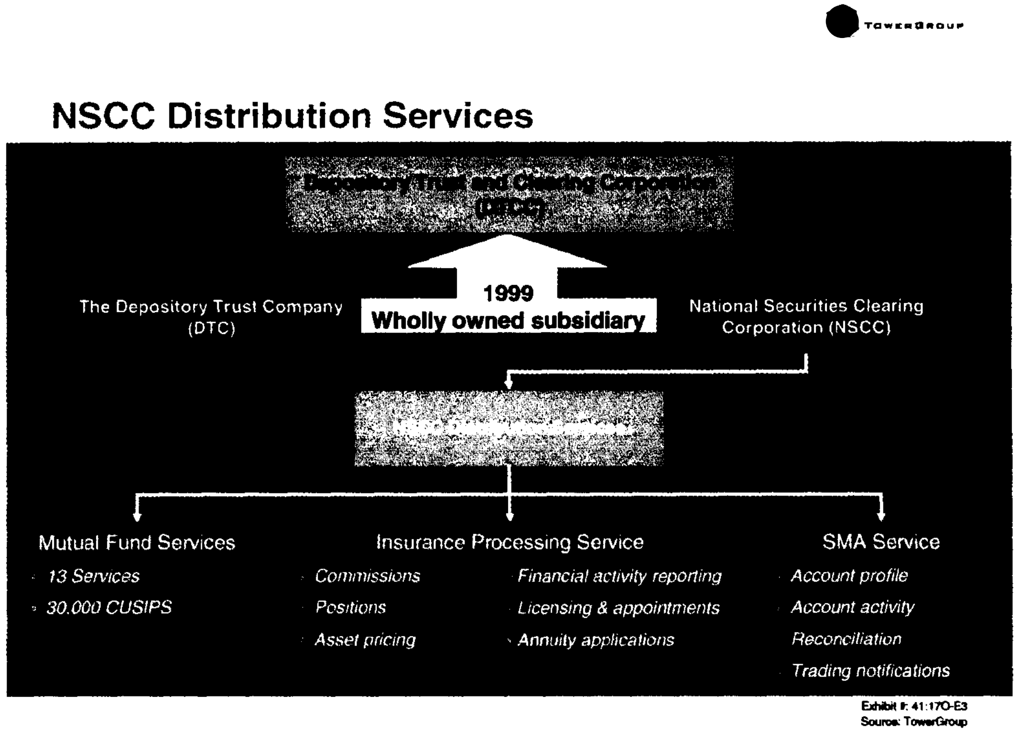

Exhibit 3
NSCC Distribution Services
Source: TowerGroup

It was the success of NSCC's Mutual Fund Services that prompted the MMI to ask NSCC to participate in the standards effort and to implement the message hub. The number of participants in Mutual Fund Services among mutual fund companies and broker-dealers grew from a handful in 1986 to 652 and 437, respectively, in 2003. It is the MMI's hope that implementation of the SMA Service will facilitate similar growth in managed account assets.

The SMAS System

SMAS borrows technology from NSCC's Fund/SPEED mutual fund account inquiry and order entry system. Fund/SPEED is an extensible mark language (XML)-based service providing real-time connectivity. Managed account sponsors and money managers can connect to SMAS through the Internet via HTTPS (Hypertext Transmission Protocol, Secure). They can also connect across leased lines via HTTPS, HTTP (Hypertext Transmission Protocol), or FTP/NDM (File Transfer Protocol/Network Data Management). Institutions may use existing leased lines to the NSCC. Exhibit 4 illustrates the connectivity options and major components of the SMAS system.

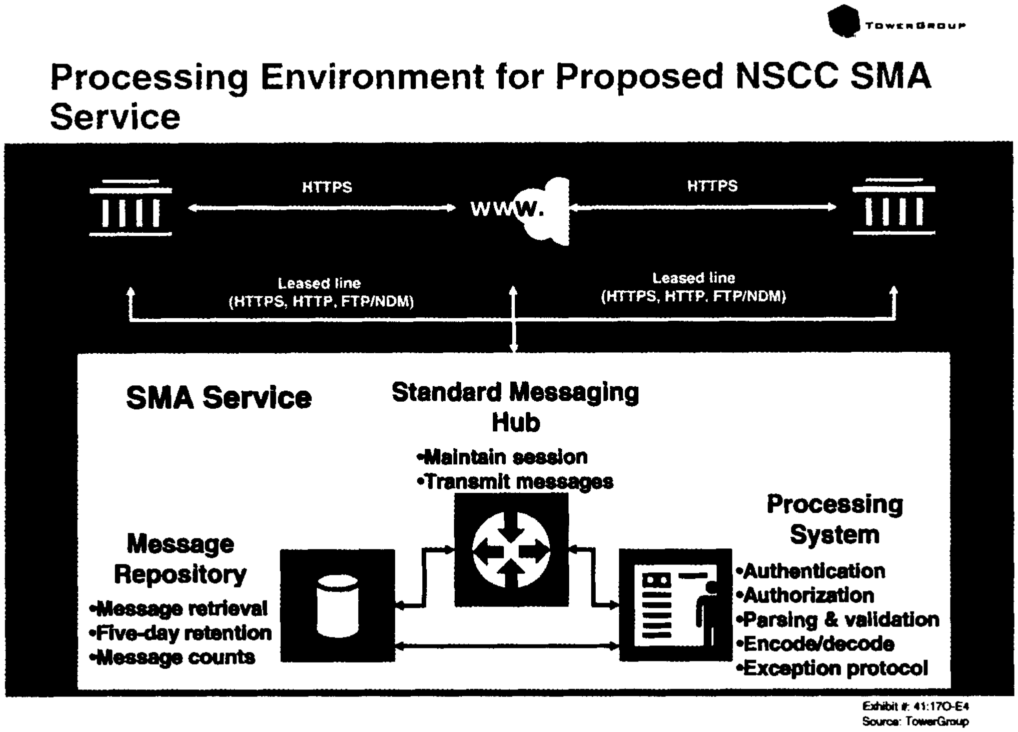

Exhibit 4
Processing Environment for Proposed NSCC SMA Service
Source: TowerGroup

The operating environment includes both an IBM mainframe running OS/390 and Sun servers running Sun Solaris. The repository is on a Sybase database. The system was programmed in COBOL (mainframe) and Java. NSCC supports primary and secondary sites for disaster recovery.

The Standard Messaging Hub (hub) maintains communication sessions with the various SMAS participants and sends and receives messages. NSCC proprietary SMAS processing protocol defines how communications between the various parties will be established and maintained. The SMAS messages themselves are constructed with NSCC proprietary XML schemas based on the MMI content standards.

The Processing System (processor) performs a variety of functions:

- **Authentication.** Each participant accessing the system sends a digital certificate and password that the processor uses to verify the identity of the sender or receiver. The digital certificate is issued by the NSCC once the participant is approved to use the service and has been assigned a participant number.
- **Authorization.** The processor checks the participant number, participant type (money manager or sponsor), and message type to ensure that the sender or receiver of the message is approved to process that particular message type. With the "account setup" message, for example, the system would allow only a sponsor to send this message type and allow only a money manager to acknowledge or reject such a message.
- **Parsing and validation.** The processor parses the message and validates that the message complies with the SMAS XML schemas as to content and syntax. It also ensures that all required data is provided. An exception message will be triggered to the sender if the message does not comply with

the schema. The exception messages as defined in the NSCC protocol will identify the fields that are in error.

- **Encode/decode.** The processor will encode the message before storing it on the repository and decode it when it is retrieved for transmission to the receiving party.
- **Exception protocol.** The processor determines how technical messaging exceptions will be handled. The system uses the semantics of SOAP (Simple Object Access Protocol) fault reporting standards and HTTPS status codes for exception messages.

The message repository retains messages for five days in encoded format and provides message counts up to five days back. Messages can be retrieved by a variety of methods, including 20 messages at a time on a first-in-first-out basis, by participant number, by message type, or by reference number. Message retrieval can be interactive or batch.

SMAS Message Flow

The MMI standards require that for each message sent, the receiver must return both an acknowledgment that the message was received and a separate message that the original message was accepted for processing or rejected. The SMAS provides not only the messaging utility but also a data store to retain records until the receiver establishes a session and requests any messages being held in its name. The implementation of a complete message cycle therefore requires six steps as shown in Exhibit 5.

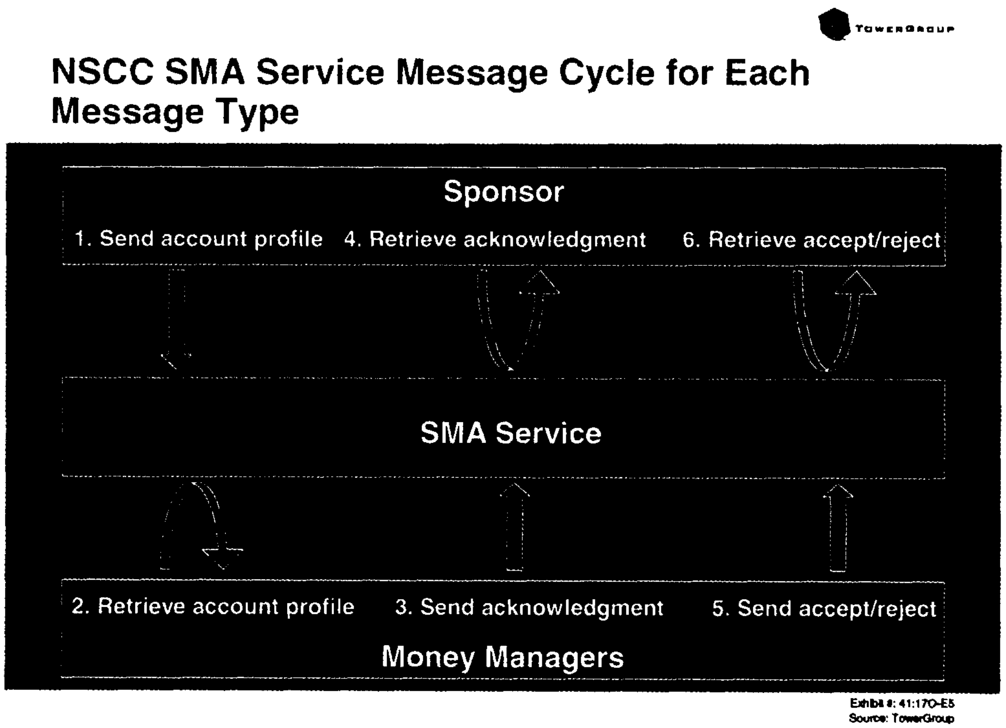

Exhibit 5
NSCC SMA Service Message Cycle for Each Message Type
Source: TowerGroup

The NSCC supports a two-step testing process. A testing simulator is available through NSCC's PC Web Direct system. The simulator enables a participant to cut and paste sample message content from a sample pack in order to test the schema integrity of the participant's implementation. The test router then enables participants to submit actual messages through the message hub to a test partner. Prior to testing, the participant must have an approved membership, have selected its connectivity option, have received its digital certificate, and have completed programming to create and transmit the messages.

Benefits to the Industry

The NSCC SMAS implements a set of industry standards via the establishment of a standard messaging hub. However, TowerGroup feels the benefits of industry standards and the use of an industry utility to establish a messaging hub should be discussed separately.

Benefits of Industry Standards

Participants in the managed account industry largely agree that having industry data standards is good. It is difficult to implement straight-through processing without data standards. Crafted well and uniformly implemented, standards can ensure that all data necessary for processing is provided with a subsequent reduction in error rates and exception processing. The requirement for acknowledgments and accept/reject responses and the implementation of time frames for these responses will lead to more timely processing. All this should lead to increased rates of automation and a reduction in manual effort and staffing costs. Simply put, industry data standards offer the possibility for each industry participant to create an interface structure once that will forever more be able to interface efficiently and effectively with other industry participants without the need for customization.

Data uniformity also creates opportunities for technology vendors and can spur new cycles of technology innovation. The evolution of FIX standards for trade communication has spawned the creation of FIX engines and FIX networks. Application vendors such as trade order management system providers have embedded FIX engines in their products. In the managed accounts arena, a number of vendors are already evaluating opportunities to provide message transformation and transmission services to act as a link between senders of SMAS messages and the SMAS itself.

Benefits of a Utility for Implementation

Once an industry agrees on data standards, the next challenge is to ensure that the standards are adopted and implemented uniformly. Differences in the way messages are transmitted, in adherence to the formatting of the standard, or in the completeness of data provided can all undermine the benefits of the standard. Utilizing a utility such as the NSCC provides an enticing option for implementing a standard in a way that will ensure uniformity of interpretation.

The use of an industry utility virtually eliminates any issues around the economic viability of the institution providing the service. The NSCC is well equipped to provide a messaging service that is scalable and dependable. Subject to bandwidth, many participants already have leased line connectivity to the NSCC that can be utilized for transmitting messages. It is the NSCC's practice to set fees based on cost and volume, with any excess revenues beyond operating costs returned to participants. This approach ensures that participants benefit as volumes increase and per-unit costs decrease. It also ensures that the NSCC's costs will be covered. In such an environment, the industry that spawned the utility must be vigilant to ensure that continuing innovation of current services occurs and that every effort is made for aggregate and per-unit costs for each service to be minimized. As utilities expand the services they offer, there is also a concern that such expansion can dampen innovation from other industry participants and vendors.

Challenges to Adoption

Openness of Standard

For standards to spur innovation, there must be a mechanism to guarantee uniform implementation that also ensures that the standard is open to all on what the industry calls a "reasonable and nondiscriminatory basis." Ironically, the MMI's choice to work with the NSCC has raised questions in this regard. The MMI standard addresses the business content and flow of messages. The standard is copyrighted by the MMI to ensure its integrity and prevent alteration, but the use of the standard is free and open to all.

However, the SMAS schemas and processing protocol implement the format and metadata of messages and the technical session aspects of communications, relying on standards such as XML and SOAP. The schemas and protocols are proprietary to the NSCC and available only to NSCC members using the SMAS. TowerGroup would not define this situation as the implementation of an open industry standard. In discussing the SMAS proposal, both the MMI and the NSCC tout the benefit of the NSCC as a utility organized by and for the benefit of the industry. The NSCC wants to protect a proprietary interest in the SMAS protocols the same way it protects its interest in other industry processes it supports. Yet this makes the technical aspects of the standard openly available to the industry only to the extent that the industry is willing to go through the NSCC and pay the NSCC fee.

As the proposal stands and to the extent traffic goes through the single NSCC hub, a consistent and standard implementation is ensured. Should another vendor wish to compete with the NSCC, it is highly likely that the second hub would not be interoperable with the NSCC hub because the second hub would need to develop its own protocols. Separating business content from technical implementation threatens the ability of any single industry participant to build infrastructure once and seamlessly interface with many other participants unless all traffic goes through the NSCC hub.

Costs Versus Benefits of Adoption

Although there is general acceptance of the benefits of standards, gaining adoption usually comes down to defining a business case showing that money will be raised in new business or saved in operations compared with the cost of establishing and maintaining the new infrastructure. This case must also compete with other technology needs in each participant institution. The sponsor institutions have invested heavily in their managed account infrastructures, and the value proposition for conversion to the SMAS will not be as strong as it is for many money managers.

The NSCC has yet to define the cost structure for the service but can point to a history of lowering per-transaction costs for distribution services as volumes increase. According to the NSCC, the per-transaction cost for NSCC's Mutual Fund Services has dropped from $0.50 per transaction in 1986 to $0.175 today. Should the NSCC SMAS proposal be approved by the SEC, getting adoption by a few of the top sponsor firms will be crucial to driving the early success of the initiative. As Exhibit 6 shows, as of Q1 2004, the top two sponsor firms in managed account assets controlled 45.7% of the SMA business and the top 8 controlled 75.1%. Since the sponsor is the source for much of the data being transmitted through the SMAS, getting the major sponsors to adopt will be critical to increasing the volume of SMAS transactions and bringing the per-unit cost down.

The largest sponsors have certainly benefited from the success of the NSCC's Mutual Fund Services. However, this very success likely contains a precautionary warning to those same sponsors regarding the SMA Service proposal. Does a sponsor institution, with sunk costs in managed account systems that for the sponsor works reasonably well, want to support a new networking system that makes it easier for other sponsors to eat into its market share? The Mutual Fund Services supports over 600 mutual fund companies in an investing environment where there are only 8,000+ equities. TowerGroup questions whether today's market-leading sponsors want to facilitate such a high level of competition in the managed account space.

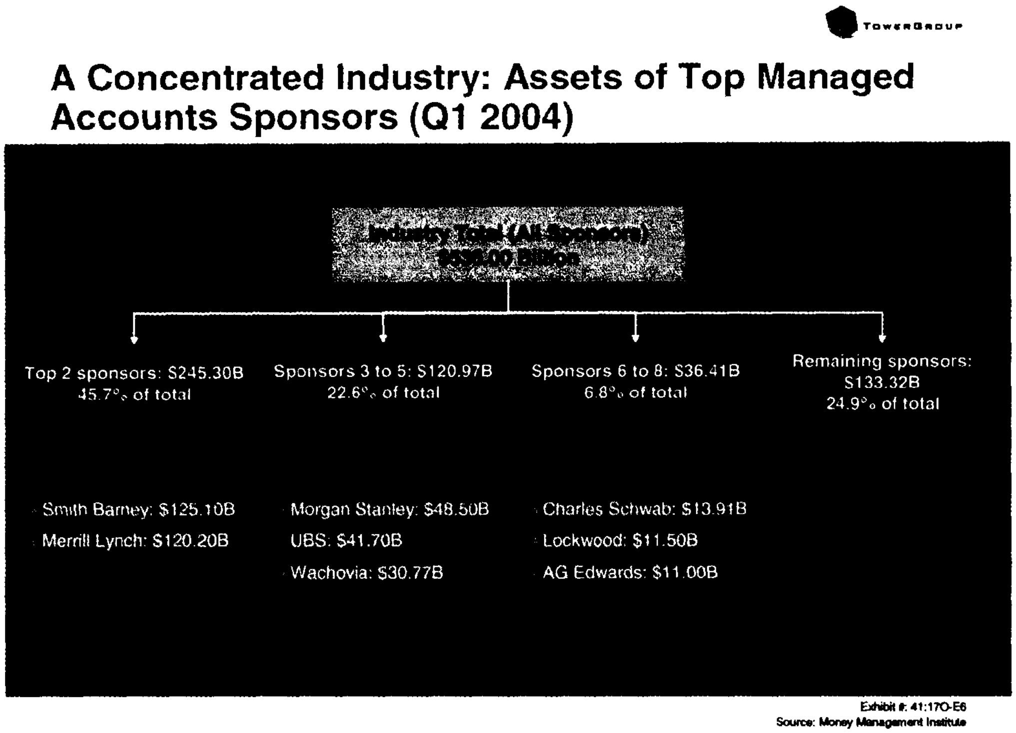

Exhibit 6
A Concentrated Industry: Assets of Top Managed Accounts Sponsors (Q1 2004)
Source: Money Management Institute

For the money managers, the business case will be more clear-cut because much of the rising operations cost driven by the increased volumes and expanded distribution falls into their basket. The potential for savings will be clearly evident, although the savings may be difficult for many to quantify. Here again, the prospect of savings for money managers will be metered by the willingness of their sponsors to provide standard messaging. In addition, much of the data is coming from the sponsor to the money managers, so the cost of automating the handling of that data once it is received is likely to be higher on the money manager's end.

In managed accounts, the sponsor is the customer of the money manager, and the sponsor can be cavalier about the operational strains that money managers face. However, sponsors cannot be totally cavalier without putting the goose that laid the golden egg at risk. For example, being in the managed account business creates headaches for money managers in regard to maintaining account data for performance reporting that meets CFA Institute (CFAI) standards. There are ongoing discussions between the MMI and CFAI regarding the application of standards to the managed account business. Money manager performance paves the road to managed-accounts gold. It would be shortsighted of sponsors if inefficient access to account data meant money managers choosing between sacrificing their managed account business and sacrificing CFAI compliance.

Money managers, particularly the larger ones, are already beginning to rationalize the number of sponsor relationships. It is possible that these money managers can drive adoption from the bottom up without adoption by major sponsors. Rather than simply stop doing business with lower-volume sponsors, the money manager can insist that utilization of the standard is a contractual prerequisite. It will take longer for messaging volumes to grow through this mechanism, but it also may be the lever required to get the larger sponsors on board.

New Demands to Be Addressed

Another trend that bears watching is the evolution of a variety of multidiscipline accounts for which the money manager simply registers a model with the sponsor, but it is the sponsor or an overlay manager that is responsible for replicating and executing the model for individual clients. In relinquishing discretion over the assets, the money manager has a dramatically reduced operational responsibility and concurrent reduced need for customer data. In this instance, standards around registering the model would be helpful but do not appear to be addressed currently.

In this model of managed account, trading would be the primary function in which the money manager might still be involved. The sponsor may want to utilize the money manager's trading expertise, particularly in less liquid market segments. In this case, the business flow for trades might be reversed so that block orders would be sent from sponsor to money manager and executions sent from money manager to sponsor.

The current standards address message flows between sponsor and money manager but do not include flows to custodians. Major institutions and independent advisors alike use a number of advisor platforms for which the platform acts as the sponsor but assets are in custody at other institutions. It is unclear how the messaging workflow might need to be modified to fully support three-way message flow among money manager, sponsor, and custodian.

Competing Standards

The standards for new accounts and account maintenance address a number of issues that are unique to the managed account space, such as trading restrictions and tax loss harvesting requests. Another hurdle will arise as the MMI begins defining standards for trading and reconciliation. The challenges entailed in standardizing these functions may not be unique to managed accounts. The MMI has plans to evaluate the benefits of existing and potentially competing standards such as FIX and SWIFT. These standards have experienced their own challenges on the road to adoption.

As an example, FIX is supported by FIX Protocol Ltd., a not-for-profit organization. FIX was designed to be an open and flexible protocol. Though FIX defined both business and technical standards, differing interpretations of the standard have resulted in inconsistent implementations. In a survey conducted jointly in April and May 2003 by TowerGroup for FIX Protocol Ltd., this problem of differing implementations was identified as a top concern of respondents, particularly vendors.

Problems aside, FIX usage was still reported by 97% of sell-side respondents while 92% of buy-side respondents were either currently using FIX (77%) or currently implementing FIX (15%). Nearly half of all buy-side respondents expected over 50% of their order flow to utilize FIX within 12 months of the survey. Over 50% of sell-side respondents currently have between 25% and 75% of orders using FIX. Based on survey results, TowerGroup believes FIX has emerged as the market standard for electronic trading in the institutional world.

The FIX survey generated responses from 35 buy-side institutions and 27 sell-side institutions across a range of assets under management. It would be inappropriate to interpret these results as a mirror reflection of the subset of money managers and sponsors active in the retail managed accounts space. To the contrary, it appears that FIX has made very little headway in managed account messaging.

At a functional level, FIX provides for many of the message types envisioned for MMI standards, including indications of interest, orders, executions, and allocations. Yet at a technical level, FIX does not appear to be structured to efficiently accommodate managed account volumes wherein a single order might be allocated across more than 10,000 accounts. Although FIXML may address some of these issues, it has achieved limited usage to date.

SWIFT standards may also have applicability, but SWIFT's greatest penetration has been among major custodians and in interbank traffic. Money managers, particularly medium-sized and small institutions, have mostly chosen not to implement the standards primarily because of the cost of the infrastructure. Whatever the applicability of FIX for trading or SWIFT for reconciliation, the mere existence of these standards will complicate MMI efforts.

Vendor Opportunities

Assets in the industry are highly concentrated among a few players. For the smaller players, adopting standards may be critical, but the cost will be high to spread across a small asset base. Vendors will emerge to provide "transmission and transformation" services to sponsors and money managers. These vendors will provide a telecommunications pipeline to the NSCC for the transmission of the messages. More important, they will accept data from the sender in whatever format the sender can provide it. They will then transform the data to the SMAS standard. Upon receiving response messages, they will either send it as received or transform it to the client's own format. By achieving economies of scale across many transmitting clients, these vendors expect to hold down the initial and ongoing cost of adoption for money managers and sponsors alike.

A second opportunity arises for vendors that can develop SMAS engines that will parse the messages and make them available to applications on either end. These engines may be stand-alone or embedded within other vendor applications. Should more than one messaging hub evolve, the engine should be designed to handle any messaging conduit.

Providers of portfolio accounting, trade order management, and overlay management tools have opportunities to enhance their products and facilitate straight-through processing with the implementation of standards. This potential applies equally for money manager and sponsor clients. The use of acknowledgment and accept or reject messages offers the promise of automating status to advisors so that they stay better informed of activity in their clients' accounts.

Summary

In the movie *Field of Dreams,* a mysterious voice prompts an Iowa farmer to mow down his corn crop and build a baseball field. "If you build it, they will come," the voice advises. Defining data standards for the burgeoning managed accounts business and building a standard message hub to implement those standards is considerably more rational than building a baseball diamond in the middle of vast and sparsely populated Iowa farmland. Yet it takes the same leap of faith that the managed account players will come to the game. The sponsors who own most of the data will need to be willing to pitch for the money managers to have anything to hit.

However profitable and strong the sponsors may be, there is no managed account business without the money managers. In the current environment, money managers are hog-tied in their ability to add new sponsor programs or expand product lines in a way that is cost effective and profitable. The implementation of data standards will be critical to addressing this issue.

The ultimate success of any communication hub rests in increasing the number of end points and in increasing the volume of messages. Likewise, standards achieve their benefits only with widespread utilization. The customer is in the best position to drive this transition, and TowerGroup does not envision the largest sponsors being early adopters. Thus, TowerGroup sees a slow and evolutionary process of building mass among smaller sponsors on the one hand and money managers of all sizes who need more efficient and cost-effective ways to expand distribution beyond the major sponsors.

TowerGroup believes the MMI's embrace of the NSCC as a primary implementer of the standard is based on a vision that the industry will adopt the SMAS as the messaging conduit of choice, avoid the fragmentation experienced in other standards efforts, and experience benefits similar to those experienced by the mutual fund industry with NSCC's Mutual Fund Services. The fact that aspects of the implementation are proprietary to the NSCC may forestall the establishment of multiple message hub efforts but will also reduce the prospects of interoperability if competitive messaging hubs do emerge. Though there is no hard data, TowerGroup suspects that the potential volumes for trade and reconciliation messages dwarf the volumes for account opening. Achieving adoption of MMI standards through the NSCC will depend heavily on working with other standards bodies for trading and reconciliation to include the NSCC as a conduit or will require a sound rationalization to proceed independent of the other standards efforts.

TOWERGROUP

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