MEMO# 14161

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PROPOSED AIMR TRADE MANAGEMENT GUIDELINES

[14161] November 19, 2001 TO: SEC RULES COMMITTEE No. 91-01 INVESTMENT ADVISERS COMMITTEE No. 26-01 COMPLIANCE ADVISORY COMMITTEE No. 57-01 EQUITY MARKETS ADVISORY COMMITTEE No. 46-01 RE: PROPOSED AIMR TRADE MANAGEMENT GUIDELINES The Association for Investment Management and Research ("AIMR") has published for comment the attached "Trade Management Guidelines." The Guidelines are a compilation of best practices that AIMR encourages investment management firms to adopt. In recognition of differences among firms, AIMR recommends that each firm tailor the procedures in a manner that fits its specific needs and circumstances. The Guidelines are divided into three areas: processes, disclosures, and recordkeeping, each of which is discussed in more detail below. Comments on the Guidelines are due to AIMR no later than February 12, 2002. If you have any comments you would like the Institute to consider including in its comment letter, please provide them to the undersigned by phone at 202-371-5408, by fax at 202-326-5839 or by e- mail at aburstein@ici.org no later than December 10. I. PROCESSES A. Trade Management Policies and Procedures The Guidelines recommend that a firm establish formal trade management policies and procedures designed to maximize the value of client portfolios. In particular, based upon a firm's size, structure, and organizational complexity, AIMR recommends that a firm: 1. Establish a trade management oversight committee ("TMOC"). The TMOC, which should meet formally on a regular basis, would have responsibility for developing, evaluating, and changing (when necessary) a firm's order routing practices. It also should make reasonable efforts to ensure that a firm's employees adhere to the stated trade-management policy and procedures and should delegate compliance responsibility to an appropriate, designated party within the firm. 2. Implement a firm-wide trade management policy. Policies should be in writing, available to all clients upon request, and distributed to all applicable 2 employees. Firms also should educate employees as to the requirements and recommendations contained in the policies. 3. Develop trade management procedures that adequately describe how a firm will implement its trade management policy. In particular, the firm's procedures should: help identify and manage actual and potential conflicts of interest resulting from trading activities; assist in the regular review of the quality of services received from brokers; and adopt the AIMR soft dollar standards. 4. Implement a trade measurement process. The Guidelines do not recommend any particular trade measurement process. The Guidelines note, however, the importance of having a process that enables the firm to analyze its total trading costs and execution trends and to compare this information from period to period, against appropriate objectives and benchmarks, and by broker, trading venue and trading method. B. Broker Selection The Guidelines recommend that a firm establish clear firm-wide guidelines on broker selection and develop an approved broker list. In establishing the firm's guidelines and broker list, the Guidelines recommend that firms: 1. Identify the

broker characteristics necessary to meet client-trading needs and select brokers according to these qualities. The Guidelines set forth specific factors for firms to consider when evaluating a broker's ability to obtain best execution. These factors include a broker's: (a) ability to minimize total trading costs while maintaining its financial health; (b) level of trading expertise; (c) infrastructure; (d) ability to provide specified information or services; and (e) ability to provide services to accommodate special transaction needs. 2. Explore realistic and achievable alternative trading options. This evaluation should consider technological developments and market changes that may help a firm seek to achieve higher quality execution. 3. Develop an approved broker list. This list should include those brokers that can execute trades at the lowest possible total cost while still meeting client portfolio needs. 4. Establish a brokerage target allocation plan. A firm should project annual trading activity and respective compensation for each broker on the approved broker list and periodically compare the actual quantity of trades executed to the projected amount. Large discrepancies discovered during this comparison should be evaluated to determine, for example, whether there are opportunities to obtain more trading value or if there have been violations of the firm's trade management policies and procedures. 3 C. Monitoring and Evaluating Broker Performance and Execution Quality The Guidelines recommend that a firm establish controls to monitor and evaluate broker performance and execution quality. In doing so, the Guidelines recommend that a firm compile and review: quarterly broker trading reports including, but not limited to, commission summaries, transaction reports, and failed trades; information (e.g., audited financial statements) adequately illustrating the broker's financial condition; feedback from employees having significant substantive contact with the broker; and trade measurement performance information. D. Fair Treatment of Clients The Guidelines recommend that the firm's policies and procedures ensure that all clients are treated fairly in the execution of orders and allocation of trades. II. DISCLOSURES The Guidelines recommend that firms disclose their trade management practices as well as any actual and potential trading-related conflicts of interest to all current and prospective clients. Such disclosures should be transparent and made on a regular basis of not less than once a year. In particular, the Guidelines recommend that a firm: disclose its order-routing practices and any changes thereto to clients and prospective clients; ensure that the brokerage arrangements and order-routing practices are consistent with the information disclosed on Form ADV; and disclose actual and potential conflicts of interest. III. RECORDKEEPING The Guidelines recommend that a firm maintain meaningful and complete trading records to assist it in evaluating whether it has achieved best execution. The Guidelines note that firms should determine the appropriateness of making these records available to the public and to clients. With respect to particular recordkeeping requirements, the Guidelines recommend that a firm should: A. Document the process used to select brokers and to oversee broker performance. The Guidelines suggest that the firm's records be able to: demonstrate that it affirmatively considered factors during the broker selection process; list the broker characteristics and other factors believed to benefit clients most; and, document the post-trade analysis of execution quality and any steps taken to improve the process. B. Document the reasons for choosing a particular trading system. C. Document actual and potential conflicts of interest and the controls in place to prevent or mitigate any adverse effects these conflicts may cause. D. Maintain documentation of the materials prepared for the TMOC and the summaries of the TMOC's deliberations as part of its oversight responsibilities. 4 E. Maintain records that support negotiated brokerage commissions. Firms should establish an acceptable commission range for trades; document any deviations from this range or from the approved broker list; retain client instructions authorizing practices that may interfere with obtaining the most favorable commission rate or net price; and document the nature, value, and sources of soft dollar services obtained. IV. INVITATION TO COMMENT In connection with the proposed Trade Management

Guidelines, AIMR has published an “Invitation to Comment,” which lists specific questions that AIMR suggests commenters focus on when preparing their comments. A copy of the Invitation to Comment is attached. Among other things, the Invitation to Comment asks: if establishing a trade management process will help firms analyze best execution; whether the Guidelines’ definition of best execution is accurate, and, if not, to suggest a better alternative; if it is appropriate to have the TMOC assess a firm’s capability to deliver best execution; if the Guidelines have focused on appropriate broker characteristics to consider in developing approved broker lists; whether there are any disclosures that firms should make that should be added to the Guidelines; and whether there are any recordkeeping recommendations that should be added or deleted. Ari Burstein Associate Counsel Attachment Attachment (in .pdf format)
