The Asset Management Industry
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PROPOSED AIMR SOFT DOLLAR STANDARDS

[9698] February 20, 1998 TO: INVESTMENT ADVISERS COMMITTEE No. 8-98 SEC RULES COMMITTEE No. 15-98 RE: PROPOSED AIMR SOFT DOLLAR STANDARDS ____ As many of you are aware, a Blue Ribbon Task Force of the Association for Investment Management and Research (AIMR) recently issued proposed voluntary Soft Dollar Standards. AIMR has requested comments from its members on the Standards by February 28. Several ICI members have expressed concern about them and suggested that we circulate AIMR's proposal, and identify some of the potential problems with the Standards. It is important that, to the extent the Standards present problems, AIMR members submit comments identifying them. Therefore, please encourage employees at your firms who are AIMR members to do so. We would appreciate receiving copies of letters submitted to AIMR. Set forth below is a summary of some of the potential problems that we have identified with the AIMR Standards. This summary is not intended to be an exhaustive list. 1. Definition of "Research" - The AIMR Standards define "research" as "services and/or products provided by a Broker, the primary content of which must, if used by the Investment Manager, directly assist the Investment Manager in its Investment Decision-Making Process." In contrast, the SEC defines "research" as a service or product that "provides lawful and appropriate assistance to the money manager in the performance of his investment decision-making responsibilities." Although it is unclear how AIMR's definition will be interpreted and applied, it appears to be more restrictive than the SEC's. In any event, different definitions are likely to be confusing. The AIMR Standards set forth the following four-step analysis for determining whether a service or product is "research": a. Define the product or service - The investment manager must identify the service or product it desires to purchase with client brokerage, including each component of the service or product (e.g., the Bloomberg service and the Bloomberg terminal). This step may present a problem with respect to proprietary research. b. Determine the content - The investment manager must determine that the primary content of the service or product will directly assist the manager in its investment decision-making process. All component parts of the service or product must meet this standard. It is unclear what this requirement means. c. Determine usage - The investment manager must determine that the service or product directly assists the manager in its investment decision-making process. This is a burdensome requirement. In addition, in many instances it may not be possible to substantiate that determination since research often indirectly assists the investment manager. d. Mixed-use analysis - An investment manager can use client brokerage to pay only for that portion of the service or product actually used in its investment decision-making process. Therefore, an investment manager must determine what portion of the service or product is used to directly assist the manager in its investment decision-making process. In many instances it is not practicable or even possible to track actual use. Under the Standards, an investment manager is required to document the basis for the determination that a service or product is “research” that may be paid for with client brokerage. Although it is unclear what type of documentation would be required, this requirement appears to be overly burdensome. At the very least, this requirement should be clarified. 2. Recordkeeping Requirements - The proposed recordkeeping requirements are extensive and appear to be quite burdensome, particularly the records required to be kept so that certain additional disclosure can be made to clients upon request. For example, an investment manager must be able to provide clients with a description of the research (including proprietary and third-party research) and its separate components, and the producer of the research. Many advisers may not track this information with respect to proprietary research. Another concern with the recordkeeping requirements relates to the brokerage reports required to be maintained. This requirement is problematic because “brokerage” includes both commissions on agency trades and mark-ups on principal trades. Many brokers do not report the amount of the mark-up on confirmation statements and even if they do, many advisers do not have the systems in place to capture it. 3. Disclosure Requirements - The Standards require an investment manager to provide clients with extensive disclosure, much of which is probably not of significant interest to clients. For example, in addition to disclosing the types of third-party and proprietary research that an investment manager receives, an investment manager is required to disclose whether the research is used and, if so, the extent of such use and whether an affiliated broker is involved. Providing too much information to clients will likely obscure material information that clients should be aware of. * * * Amy B.R. Lancellotta Associate Counsel Attachment