The Asset Management Industry
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AIMR ADOPTS TRADE MANAGEMENT GUIDELINES

[15373] November 22, 2002 TO: COMPLIANCE ADVISORY COMMITTEE No. 106-02 EQUITY MARKETS ADVISORY COMMITTEE No. 29-02 INVESTMENT ADVISERS COMMITTEE No. 26-02 SEC RULES COMMITTEE No. 92-02 RE: AIMR ADOPTS TRADE MANAGEMENT GUIDELINES The Association for Investment Management and Research ("AIMR") has adopted final "Trade Management Guidelines."1 The final Guidelines reflect comments received by AIMR on the proposal, including many of the Institute's comments.2 The most significant aspects of the Guidelines are summarized below. In general, the Guidelines are a compilation of recommended practices that AIMR encourages investment management firms to adopt. Based on comments received on the proposal, AIMR revised the Guidelines to reemphasize their voluntary nature. In this regard, AIMR added language to the Guidelines that clarify that they are a series of recommendations and not standards. AIMR also replaced references to "best practices" with "recommended practices." In addition, AIMR clarified the scope of the Guidelines. In particular, AIMR clarified that the Guidelines apply to all types of transactions, including transactions in fixed- income and derivative securities. However, in response to concerns by commenters that applying the Guidelines to these types of transactions may be difficult given the lack of available data for fixed income and illiquid trades, AIMR limited the recommendation to measure the quality of trades to those securities with reliable and readily available comparative data. AIMR also responded to concerns by commenters that the Guidelines' recommendations differed from existing securities laws. In particular, AIMR stated that although existing legal frameworks provide valuable information to the best practices setting process, it viewed the underlying purpose of the Guidelines as being one that provides firms with information as to 1 The final Trade Management Guidelines can be found on AIMR's website at http://www.aimr.com/pdf/standards/trademgmt_guidelines.pdf. The adopting release of the final Guidelines, which includes a summary of comments received on the proposal, can be found on AIMR's website at http://www.aimr.com/pdf/standards/tmg_adopt_rel.pdf. 2 Memorandum to Compliance Advisory Committee No. 14-02, Equity Markets Advisory Committee No. 9-02, Investment Advisers Committee No. 3-02 and SEC Rules Committee No. 18-02, dated February 14, 2002. 2 what they "should do" versus what they "must do." In addition, AIMR stated that the Guidelines may serve as a positive example to regulatory organizations of a voluntary, industry driven form of self-regulation. AIMR also stated that the Guidelines seek to provide guidance to firms globally and to firms that fall out of the purview of the Investment Advisers Act of 1940. Therefore, AIMR decided that, where appropriate, the Guidelines would recommend "a higher practice" than what is currently required by U.S. law and regulatory requirements.3 The Guidelines are divided into three areas: processes, disclosures, and recordkeeping, each of which is discussed in more detail

below. I. PROCESSES A. Trade Management Policies and Procedures The Guidelines recommend that a firm establish formal trade management policies and procedures. 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 would have responsibility for evaluating a firm's trade management policies and procedures and for making recommendations, where appropriate, to senior management to improve a firm's trading practices. In response to commenters' concerns over the proposed structure of the TMOC, the Guidelines include additional language stating that the TMOC may be comprised of one person, multiple persons, or various groups depending on the unique needs of each firm. 2. Implement a firm-wide trade management policy. Policies should be in writing and available to all clients upon request. 3. Develop trade management procedures. The procedures would help a firm identify and manage actual and potential conflicts of interests resulting from trading activities and assist in the regular review of the quality of services received from brokers. In response to comments received on the proposal, AIMR postponed the inclusion of the recommendation to adopt the AIMR Soft Dollar Standards until these Standards are further reviewed and possibly revised by AIMR. 4. Establish policies and procedures that address "client-directed brokerage arrangements." The Guidelines define a client-directed brokerage arrangement as an arrangement whereby a client directs that trades for its account be executed through a specific broker in exchange for which the client may receive benefits in addition to execution services. 5. Implement a trade evaluation process. The Guidelines do not recommend any particular trade evaluation process. The Guidelines, however, note the importance 3 AIMR revised many of the Guidelines' definitions to make them consistent with the definitions of those terms as used in the federal securities laws and eliminated many other definitions altogether (e.g., brokerage arrangement, commission recapture program, internalization, preferencing of orders, strict price/time priority, and order flow arrangement). 3 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. In response to comments that the proposed Guidelines placed too great an emphasis on quantitative approaches to assess the quality of trades, AIMR clarified that it did not intend to emphasize the importance of trade measurement to the detriment of other evaluation factors related to best execution. The final Guidelines therefore include language stating that measurement is one of numerous factors available to firms to help them evaluate the quality of trades. 6. Implement compliance procedures that make reasonable efforts to ensure that a firm's employees adhere to the stated trade management policies and procedures. 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: identify the broker characteristics necessary to meet client-trading needs and select brokers according to these qualities; explore realistic and achievable alternative trading options; and perform an analysis of brokerage commission trends and comparison of brokerage commission forecasts with actual brokerage commissions paid. This final recommendation replaces a proposed recommendation that firms establish a brokerage target allocation plan in response to concerns by commenters over the difficulty of implementing such plans. 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 consider: quarterly broker trading reports including, but not limited to, commission summaries, transaction reports, and failed trades; feedback from employees having significant substantive contact with the broker; and trade evaluation process information. In response to objections by commenters, AIMR eliminated the recommendation that firms review information adequately illustrating the broker’s financial condition. D. Fair Treatment of Clients The Guidelines recommend that a 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. In response to concerns from commenters regarding certain of the conflicts to be disclosed, AIMR replaced recommendations to disclose internalization, preferencing and payment for order flow practices, and the use of principal trades, with a recommendation to disclose to clients the use of an affiliated broker on an agency or principal basis. 4 III. RECORDKEEPING The Guidelines recommend that a firm maintain meaningful and complete trading records to support a firm’s efforts to achieve best execution for clients, disclosures to clients, and broker selection practices. The Guidelines state that the recordkeeping recommendations also may assist a firm in meeting its recordkeeping regulatory requirements and demonstrating to regulators how it seeks to achieve best execution for its clients. With respect to particular recordkeeping requirements, the Guidelines recommend that a firm should document: the process used to select brokers and to oversee broker performance on an aggregate trading basis; the review of the controls in place to prevent or mitigate any adverse effects that conflicts of interest may cause on an aggregate trading basis; the materials prepared for and by the TMOC; and records that support negotiated broker commissions. Ari Burstein Associate Counsel

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