

### AIMR Trade Management (Best Execution) Guidelines

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The Association for Investment Management and Research (AIMR), the nonprofit organization of investment professionals, recently issued its final guidelines for best execution of securities transactions, known as the Trade Management Guidelines (Guidelines).

The Guidelines define best execution in terms of maximizing the value of a client's portfolio in light of the client's stated investment objectives and constraints. Although best execution does not necessarily entail obtaining the lowest possible commission fee, it does entail endeavoring to obtain the most favorable transaction terms reasonably available under the particular facts and circumstances.

As a result of the comments received, the following significant changes were made to the proposed Guidelines:

- Clarification that the Guidelines are recommendations and not standards;
- Recommendation that firms disclose the use of client brokerage to obtain goods and services not constituting research or brokerage services;

- Introduction of a recommendation that addresses client-directed brokerage agreements;
- Postponement of the recommendation to adopt the AIMR Soft Dollar Standards; and
- Limitation of the recommendation to measure the execution quality of trades to securities with readily available comparative data, and clarification that measurement is only but one factor that firms should consider when evaluating best execution.

The Guidelines outline the approach to seeking best execution in terms of three areas: processes, disclosure and recordkeeping.

#### PROCESSES

***Establish a Trade Management Oversight Committee.*** The Committee should meet on a regular basis to evaluate the firm's trade management policies and procedures, and issue recommendations to senior management when appropriate.

***Implement Firmwide Trade Management Policies and Procedures.*** Procedures should be established which (i) assist the firm in identifying

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actual and potential conflicts of interests resulting from trading activities; (ii) require the disclosure of such conflicts to clients; and (iii) assist in a regular quality of service review of selected brokers. As a result of several objections during the comment period, the recommendation in the proposed Guidelines to adopt AIMR Soft Dollar Standards has been postponed until further review and possible revision by the AIMR Standards of Practice Council.

#### ***Establish Policies and Procedures Addressing Client-Directed Brokerage Arrangements.***

Policies and procedures addressing directed brokerage agreements should be established, such as those found in Appendix A of the AIMR Soft Dollar Standards. The AIMR Soft Dollar Standards may be found at <http://www.aimr.org/pdf/softdollars.pdf>.

#### ***Implement a Trade Evaluation Process.***

Processes should be established, using either internal or external resources, to analyze trading costs and execution trends of trades with readily available comparative execution data. The process should be consistently applied and should consider client needs and unique firm circumstances, overall market conditions, and trading venues. Information should be analyzed: (i) from period to period; (ii) against appropriate objectives and benchmarks; and (iii) by broker, trading venues and methods.

***Implement Compliance Procedures to Ensure Employee Adherence.*** The trading policies and procedures should be distributed and taught to all employees, to the extent appropriate.

***Create Broker Selection Guidelines/ Approved Brokers List.*** Brokers should be selected according to various characteristics that may assist the firm in meeting its client trading needs, including:

- *Trade efficiency:* the ability to minimize total trading costs including maintaining adequate

capital, responding during volatile market periods, and minimizing incomplete trades.

- *Level of trading expertise:* ability to obtain liquidity, trade completion, unique trading strategies, quick trade execution, ability to maintain the anonymity of an investment manager, execution and settlement of difficult trades, satisfaction of trading needs, ability to maximize opportunities for price improvement, methods of tracking and correcting trade errors and engaging in after-hours and cross-border trading.
- *Infrastructure:* commitment to technology and a quality trading system;
- *Other characteristics:* suggestions that improve the quality of trade executions, proprietary or third-party research, access to research analysts, broker staff and company insiders.
- *Special transaction services:* step-outs, wrap programs, custody services, directed brokerage and soft dollar arrangements, underwriting syndicate participation and access to IPO shares.

Firms should also consider the broker's financial condition and explore alternative trading options while considering technology developments and market changes that assist the firm in achieving higher quality execution. In the process of developing an approved broker list which takes the foregoing characteristics into consideration, procedures for using a non-approved broker should also be established where the determination has been made that doing so is in the client's best interest.

***Analyze Brokerage Commission Trends and Compare Brokerage Commission Forecasts with Actual Brokerage Commission Paid.*** Firms should make projections on annual trading activity and broker compensation on the approved broker list and periodically compare commission forecasts to actual flows. Variations should be evaluated to

determine whether there are greater opportunities to acquire more trading value or whether revisions to the projections are necessary.

***Establish Controls to Monitor and Evaluate Broker Performance and Execution Quality.***

Firms should review: (i) quarterly broker trading reports; (ii) feedback from firm investment personnel having substantive contact with the broker; and (iii) information gathered through the Trade Evaluation Process.

**DISCLOSURES**

Firms are encouraged to make, on a regular basis, clear, accurate and current disclosures on trade management practices as well as potential and actual conflicts to current and prospective clients. The particular disclosure recommendations that AIMR suggests be made include:

***Disclose Broker Selection Practices.*** The disclosure should describe information considered in the trade management process, including a list of factors used in the broker selection process and how the firm handles trade allocation.

***Disclose Actual and Potential Conflicts of Interest.*** Actual or potential conflicts that warrant disclosure may include:

- Step-outs;
- Trade allocation and aggregation policies;
- Research or other services obtained through soft dollar arrangements;
- Affiliated broker usage on an agency or principal basis;
- Material business relationships with market makers or market centers;
- Directed brokerage arrangements;

- Use of client brokerage to pay for client referrals or other arrangements promoting the firm's business and the distribution of investment company shares that the firm manages; and
- Use of client brokerage to acquire goods or services that do not constitute research or brokerage services.

**RECORD KEEPING**

Firms should maintain accurate and complete trading records which document: (i) the broker selection process; (ii) broker performance on an aggregate basis; (iii) post-trade analysis of execution quality; (iv) conflicts of interest; (v) committee materials; (vi) brokerage commissions; (vii) soft dollar services; and (viii) client agreements.

**CONCLUSION**

The Guidelines are recommendations of practices and procedures to assist a firm in seeking best execution for its clients. Although the Guidelines are not standards, firms are encouraged to adopt as many guidelines as are appropriate to their particular circumstances. If a firm finds it impracticable to adopt a particular recommendation, AIMR suggests that the firm make alternative arrangements that carry the same objective. Compliance with the Guidelines will assist firms in complying with their fiduciary duty to "seek to achieve best execution" when managing their client assets.



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