

# **FSC Guidance Note No. 10.00**



## **Brokerage Arrangements**

**December 2006**

**Main features of this Guidance Note are to:**

- **specify the principles to be adopted in relation to Investment Manager Brokerage arrangements;**
- **provide guidance in the interpretation and application of those principles; and**
- **specify the basis for disclosure of Investment Manager Brokerage Arrangements.**

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## 1. TITLE

- 1.1 This Guidance Note may be cited as FSC Guidance Note No. 10.00 'Brokerage Arrangements'.
- 1.2 FSC has revised Guidance Note No. 10.00 (formerly 'Soft Dollar Dealing') to update guidance and recommended disclosure of brokerage arrangements.

## 2. GUIDANCE NOTE AND COMMENTARY

- 2.1 The guidelines set out in this Guidance Note are shown in bold print. Commentary is shown in normal print immediately after the guideline to which it relates, as an aid to interpretation of the guidelines.

## 3. DATE OF ISSUE

- 3.1 Originally issued 19 July 1999 (previously known as 'Soft Dollar Dealing'); updated October 2006.

## 4. EFFECTIVE DATE

- 4.1 This Guidance Note should be applied in relation to an FSC Member's operations on or after 1 July 2007. Earlier application of this Guidance Note is permitted and encouraged.

## 5. APPLICATION

- 5.1 This Guidance Note should be applied to all investment manager brokerage arrangements.
- 5.2 Where there is a conflict between the requirements of this Guidance Note, applicable legislation, and the Constitution of a Scheme, the requirements of this Guidance Note should, having regard to the purpose of the Guidance Note, be modified appropriately so that, as far as is practicable, the Operator complies with the requirements of this Guidance Note.

## 6. STATEMENT OF PURPOSE

- 6.1 **The purpose of this Guidance Note is to:**
  - **specify the principles to be adopted in relation to Investment Manager Brokerage Arrangements;**
  - **provide guidance in the interpretation and application of those principles; and**
  - **specify the basis for disclosure of Investment Manager Brokerage Arrangements.**

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## 7. APPLICATION OF MATERIALITY

7.1 Failure by an investment manager to adopt or implement this Guidance Note is material if such failure has the potential to adversely affect the confidence of investors, prospective investors, Scheme Operators, Responsible Entities, Superannuation Trustees and other interested parties involved in the Investment and Financial Services Industry.

## 8. DEFINITIONS

8.1 The following terms are specifically defined for the purposes of this Guidance Note:

- ‘Alternative Brokerage Arrangement’ includes arrangements between Investment Managers and Brokers for the provision of any goods or services that are beyond goods and services produced and supplied by the broker and directly linked to trading activity.
- ‘Best Execution’ involves obtaining the most favourable on-going total cost for execution through assessing brokerage, spreads, market impact and speed of transacting with respect to the size and complexity of trades.
- ‘Broker’ refers to an agent who handles the orders of clients to purchase and sell securities, commodities, or other property. The provision of this service attracts brokerage and/or incurs a spread.
- ‘Brokerage’ refers to the fee levied by the broker as their payment for executing purchases or sales of securities as an agent.
- ‘Execution’ refers to services provided by a broker in arranging and settling a transaction or series of transactions initiated by the Investment Manager.
- ‘Investment Manager’ refers to an entity that specialises in the investment of money on behalf of investors. For the avoidance of doubt, in this Guidance Note, Investment Manager also includes any other arrangements involving fiduciaries acting on behalf of investors such as in an IDPS or WRAP arrangement.
- ‘Investment Manager Brokerage Arrangements’ includes execution only, standard full service brokerage practices and any alternative brokerage arrangements.
- ‘Research’ refers to the production of information that is capable of adding value to investment or trading decisions by providing new insights that inform an Investment Manager when making such decisions about investors’ portfolios. By way of illustration, this can include economic analysis, recommendations and forecast data.

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**Research provided by a Broker can either be produced by the Broker (referred to as in-house research) or purchased from a third party (referred to as third party research).**

**8.2 Unless defined in this section, a term used in this Guidance Note has the same meaning as defined in FSC Guidance Note No. 5.00 'Industry Terms and Definitions'.**

### **9. PRINCIPLES**

**9.1 This Guidance Note explores some of the issues Investment Managers should consider before entering into any Brokerage arrangements.**

**9.2 Investment Managers have a fiduciary and statutory duty to act in the best interests of their investors in respect of investment decisions made on their Investors' behalf. Therefore, no client should expect to be disadvantaged by any Alternative Brokerage Arrangement and should be informed with respect to material aspects of such arrangements (see 11).**

**9.3 Investment managers should always seek to obtain best execution, irrespective of any other Brokerage Arrangements they enter into.**

**9.4 Investment Manager Brokerage Arrangements can be divided into two general categories: standard full service brokerage and Alternative Brokerage Arrangements. The treatment of each is considered below.**

#### **9.4.1 Standard full service brokerage**

**Standard full service brokerage covers the provision of broker produced and supplied goods and services that are directly linked with trades and trade advice.**

**The goods or services acquired through such arrangements must be reasonably expected to assist in the provision of investment services, trading activity or making decisions to trade for those clients of the Investment Manager on behalf of whom brokerage is paid.**

**Examples of broker produced and supplied goods and services that are directly linked with trading activity include:**

- Trade execution;**  
**and**
- In-house  
Research.**

**Such arrangements are considered acceptable and should be disclosed as required under 11.1.**

#### **9.4.2 Alternative Brokerage Arrangements**

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Alternative Brokerage Arrangements encompass the following:

- Broker purchased and supplied goods and services that are directly linked with trades and trade advice.

The goods or services acquired through such arrangements must be reasonably expected to assist in the provision of investment services, trading activity or making decisions to trade for those clients of the Investment Manager on behalf of whom brokerage is paid.

Examples of broker purchased and supplied goods and services that are directly linked with trading activity include:

- Third Party Research;
- Software that assists in pre-trade analysis.

Agreements between Investment Managers and Brokers that involve the allocation of brokerage towards the purchase of items listed above from other providers are an example of an Alternative Brokerage Arrangement.

Such arrangements are considered generally acceptable and should be disclosed as required under 11.1 and 11.2.

- Broker produced and supplied goods and services that are not directly linked with trades and trade advice.

The goods and services acquired through such arrangements are unlikely to assist an Investment Manager in the provision of investment services, trading activity or making decisions to trade.

Examples of goods and services that are not directly linked with trading activity include:

- Services relating to the valuation or performance measurement of portfolios.

Such arrangements are generally not acceptable and should be disclosed to investors under 11.1 and 11.2.

Broker purchased and supplied goods and services that are not directly linked with trades and trade advice.

The goods and services acquired through such arrangements are unlikely to assist an Investment Manager in the provision of investment services, trading activity or making decisions to trade.

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**Examples of goods and services that are not directly linked with trading activity include:**

- **market data available from data service providers; and**
- **subscriptions for publications;**
- **office administrative computer software;**
- **computer hardware;**
- **the purchase or rental of any other items of office equipment;**
- **office rental;**
- **staff remuneration;**
- **travel, accommodation, and entertainment costs;**
- **costs associated with attending conferences and seminars;**
- **membership fees to professional associations;**
- **services relating to the valuation or performance measurement of portfolios; and**
- **custody services.**

**Such arrangements are generally not acceptable and should be disclosed to investors under 11.1 and 11.2.**

- **Directed brokerage and commission recapture arrangements.**

**Directed brokerage encompasses arrangements whereby an investor directs that trades for its account be executed through a specific broker. In return, the investor is often provided with a rebate of commission or additional goods and services either from that broker or a third party.**

**Similarly, commission recapture programs provide for a rebate of commission or additional goods and services without a specific direction to trade through a particular broker.**

**Investment Managers should only enter into such arrangements after having regard to the principles established under this Guidance Note and any other relevant guidance issued by FSC.**

**The acceptability of such arrangements depends on the facts and circumstances of each case.**

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However, as such arrangements are considered Alternative Brokerage Arrangements under this Guidance Note, they should be disclosed to investors under 11.1 and 11.2.

- **Prime brokerage arrangements.**

Such arrangements provide investment managers with the ability to borrow securities for long-short strategies. Trade execution, custody and securities borrowing arrangements are often interlinked and all reflected in a brokerage fee.

Such arrangements are considered generally acceptable and should be disclosed to investors under 11.1 and 11.2.

**9.4 In respect of all Investment Manager Brokerage Arrangements, Brokerage derived from one group of Investors should only result in the provision of Research and other goods and services for the benefit of that group of Investors.**

### **10. TRADE MANAGEMENT POLICIES**

**10.1 The Investment Manager should establish trade management policies in relation to all its Brokerage arrangements. The policies should set out:**

- **what Alternative Brokerage Arrangements the Investment Manager has in place, including the goods or services that may be accepted as part of those arrangements;**
- **the Investment Manager's strategy for obtaining Best Execution and ensuring that any Brokerage arrangements do not interfere with this imperative;**
- **the policy of the Investment Manager in relation to managing potential conflicts involving any Alternative Brokerage Arrangements; and**
- **the Investment Manager's approach to disclosure consistent with 11 below.**



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### **11. DISCLOSURE**

**11.1 Details of the Investment Manager's Trade Management Policies (refer to paragraph 10.1) should be published on the Investment Manager's website.**

**11.2 Annual disclosure should also be made to Investors on request and should include:**

- information on all the Investment Manager's Alternative Brokerage Arrangements, explaining how these impact all affected Investors or class of investors;**
- in addition, information should also be provided on the costs and, where applicable, the expected benefits of such arrangements. Records to support the information should be maintained by the Investment Manager; and**
- a statement indicating whether the Investment Manager has complied with this Guidance Note and if not, why not.**

**11.3 Where a significant change in the Investment Manager's Brokerage Arrangements has occurred during the year, this should be disclosed to investors in the same way the Investment Manager notifies Investors of other significant changes to investment practices.**