

The image features a logo for 'fi360' centered on a background of wavy, horizontal lines in shades of orange and yellow. The 'fi' is in a black serif font, '360' is in a larger orange serif font, and a registered trademark symbol (®) is to its upper right. Below '360' are the words 'global' and 'fiduciary insights' in a smaller, italicized, light-colored serif font.

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global
fiduciary insights

A Fiduciary Approach to Conflicts of Interest and Risk Governance

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Adviser Payments and Conflicts of Interest

presented by

Cipperman *Compliance* services LLC

Outsourcing. Consulting. Tools.

Agenda

- Best Execution
- Soft Dollars
- Solicitation and Revenue Sharing
- Pay-to-Play

Best Execution

- Fiduciary Responsibility
- Recent Cases
- Policies and Procedures
- Testing
- Clearing Brokers

Fiduciary Responsibility

- An investment adviser has a fiduciary responsibility to ensure client gets best execution of securities trades.
 - Not just price
 - May consider other factors
 - Full disclosure

Recent Cases

- *In re Schmeidler*
- *In re Goelzer*
- *In re Tilden Loucks*

Policies and Procedures

- How to select brokers
- Best execution committee
- Execution factors
- Conflicts
- Trade aggregation and allocation
- Trade Errors
- Cross-Trading and Principal Trading
- Disclosure

Execution Factors

- Price improvement
- Speed
- Commission (price)
- Order size
- Willingness (inventory)
- Access to markets
- Reliability
- Financial stability
- Service
- Value of research provided
- Technology
- Anonymity
- Financial responsibility

Conflicts

- Soft dollars
- Distribution of products
- Preferential access to IPOs and investment opportunities
- Directed brokerage & use of step outs
- Trade sequencing (who goes 1st)
- Non-cash comp rules

Trade Aggregation and Allocation

- Fairness
- Cost sharing
- Proprietary accounts
- Large accounts

Best Execution Reviews

- Some effort to compare commission rates against what's available
- Probably can't rely on clearing broker
- Some form of 3rd party verification
- Peer universe comparison (like performance)
- Benchmarks
- Bring in consultant (mutual funds)
- May consider multiple factors (not just rate)

Benchmarks

- VWAP (Volume Weighted Average Price)
- Average value of price improvement per trade
- Total value of price improvement
- Average basis points price improvement
- Percentage of trades at best price
- Percentage of trades within spread
- Percentage of trades outside of spread
- Average basis points from trade high
- Average basis points from trade low
- Average basis points from mid-price high
- Average basis points from mid-price low

Only one clearing broker recommended

- Ask client for specific instructions
- Make sure client signs agreement directly
- Periodically inform
- ADV disclosure re business practices

Algos and Dark Pools

- Transparency
- Lower rates
- No soft dollars

Soft Dollars

Definition:

commissions used by an adviser to receive products or services from the broker above and beyond mere execution

Potential Problems

- Breach of fiduciary duty
- Failure to disclose/fraud
- ADV
- Breach of contract
- ERISA

Section 28(e) (safe harbor)

No person using the ... means ... of interstate commerce, in the exercise of investment discretion with respect to an account shall be deemed to have acted unlawfully or to have breached a fiduciary duty under State or Federal law ... solely by reason of his having caused the account to pay a ... broker, or dealer an amount of commission for effecting a securities transaction in excess of the amount of commission another ... broker, or dealer would have charged for effecting that transaction, if such person determined in good faith that such amount of commission was reasonable in relation to the value of the brokerage and research services provided by such ...broker, or dealer, viewed in terms of either that particular transaction or his overall responsibilities with respect to the accounts as to which he exercises investment discretion.

Elements

- Investment discretion
- Eligible research and brokerage
- Required broker functions
- Problem of mixed use products

Soft Dollar Issues

- Recent enforcement actions
 - *In re J.S. Oliver Capital Management*
 - *SEC v. Hovan*
- Focus of boards of funds and institutional clients
- ADV disclosure

Solicitation Payments and Revenue Sharing

- Rule 206(4)-3
- Disclosures
- Record-keeping
- State Registration
- Back-door revenue sharing

Pay-to-Play

- Rule 206(4)-5
- Cases
- OCIE Risk Alert
- State lobbying laws

Rule 206(4)-5 prohibitions

- Provide investment advisory services for compensation to a government entity within two years after a contribution to an official of the government entity is made by the investment adviser or any covered associate of the investment adviser (including a person who becomes a covered associate within two years after the contribution is made)
- Make a payment to solicit a government plan to a solicitor that is not registered as an investment adviser or broker-dealer
- Coordinate a political contribution if the adviser manages plan or is seeking advisory business

Rule 206(4)-5 Definitions

- Contribution
- Covered Associate
- Government Entity
- Official
- De Minimus

OCIE Risk Alert

- Training
- E-mail surveillance
- Review potential employees and promotions
- Requiring pre-clearance

Cases

- *In re Goldman Sachs*
- Rattner and Quadrangle

Lessons

- Disclose
- Don't be “too clever by half”
- Tread carefully into soft dollars
- Watch dual registrants
- Testing
- Investment advice and politics don't mix

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Additional Announcements



- Join us as we celebrate our 10th annual INSIGHTS Conference in Nashville, TN. Visit our website to learn more. (www.fi360.com/conference). The deadline to submit your speaker proposal is October 11.
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