

Structure Matters in Multi-Broker Soft Dollar and Commission Recapture Arrangements

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Why MBAs

- Facilitate best execution
 - Ease sequencing issues with directed orderflow
 - Avoid possible issues with step outs
 - Overcome limited capabilities of MBE sponsor
 - Promote availability of niche executing brokers
 - Foreign brokers
- All within the framework of a soft dollar or commission recapture arrangement



Structure Matters in MBAs

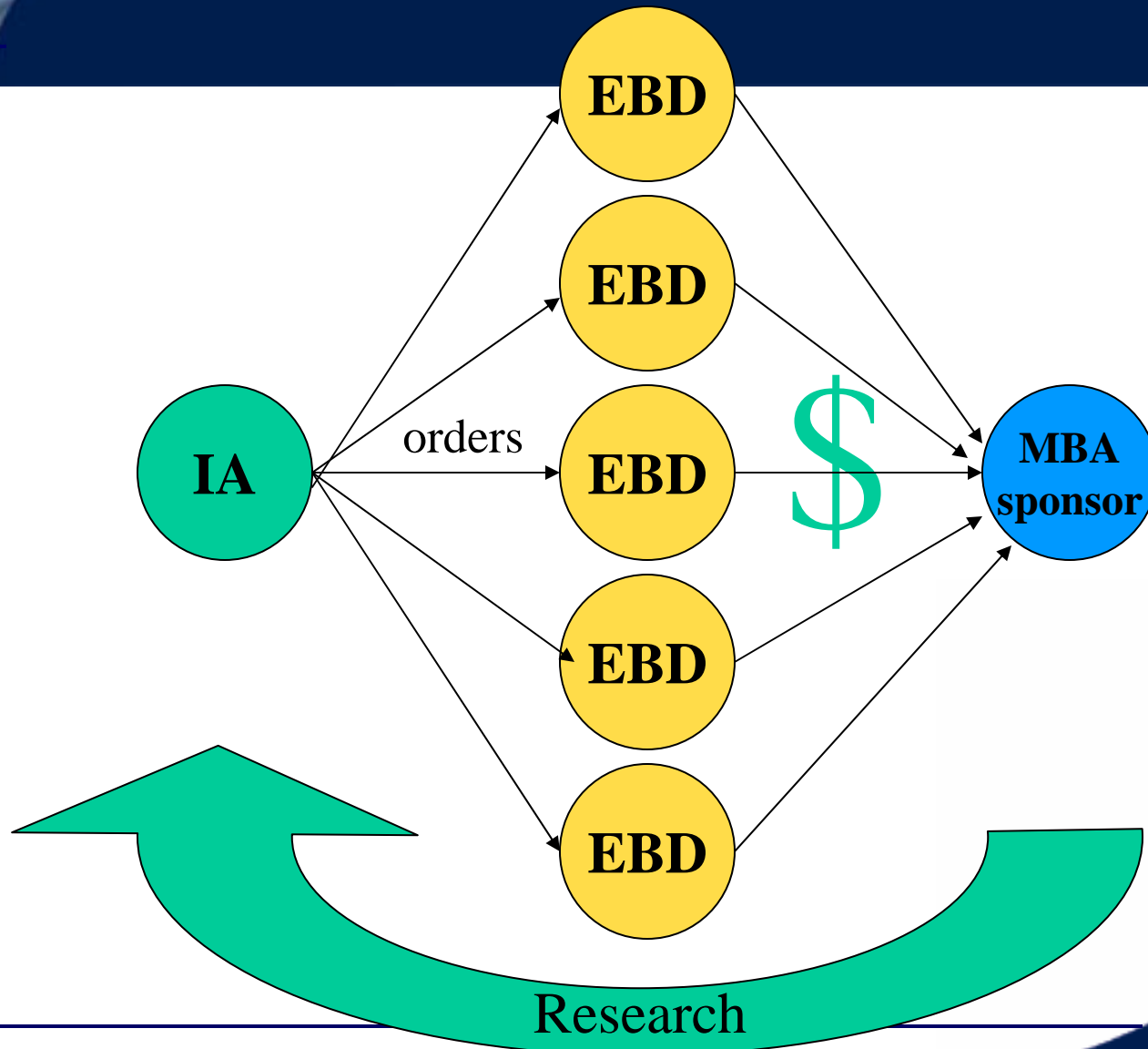
- Form over substance?
- Just like third-party research arrangements
 - Broker isn't viewed as having “provided” third party research unless it is financially responsible to the publisher or reseller for the research
- Where 28(e) needed, MBA sponsor must be viewed as providing “brokerage services”
- MBA sponsor may otherwise have to be viewed as performing a service



MBAs are Proliferating, but . . .

- Some are questionable structurally
 - This could result in exposure to advisers and brokers involved
- Differences may seem subtle, but all parties need to understand these subtleties
- SEC and Congressional focus

Soft Dollar MBAs

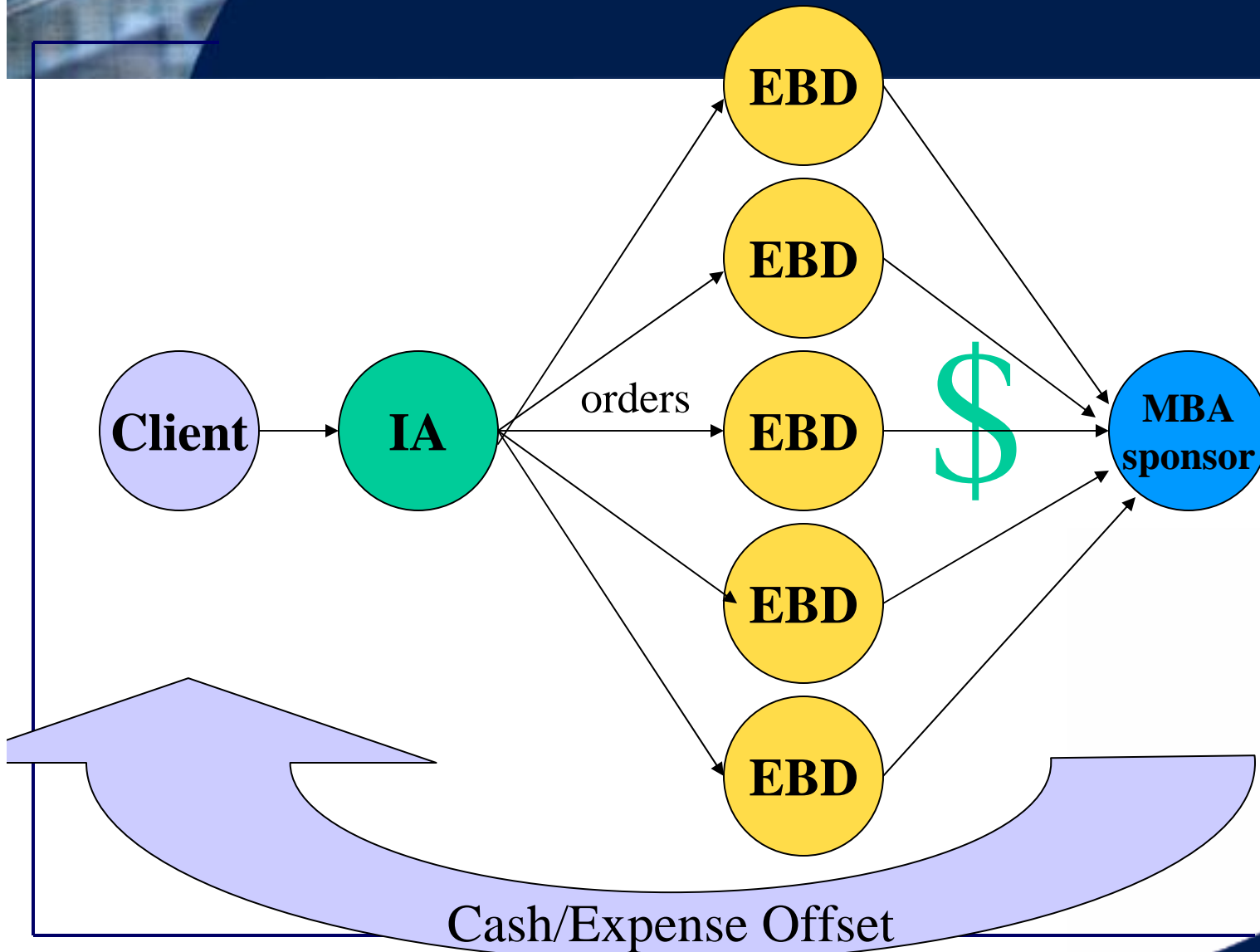




Soft Dollar MBAs

- Section 28(e) safe harbor is essential to participating advisers
- MBA sponsor must provide research *and* brokerage services
 - Mere receipt of commissions or finders fees isn't enough
- But involvement of MBA sponsor may be limited
 - to that of an introducing firm in a “normal and legitimate correspondent relationship”
 - where adviser bypasses MBA sponsor and places trades with clearing firm
- Components
 - Fully disclosed clearing arrangement
 - MBA must at least
 - Bear financial responsibility for trades until payment received by clearing firm
 - Maintain client communications
 - Monitor and respond to client comments on the trading process
 - Maintain client records
 - Monitor trades and settlements

Commission Recapture MBAs



Commission Recapture MBAs

- Section 28(e) is not applicable (or needed)
- MBA sponsor need not provide brokerage services or execute trades
 - Except where it needs to provide a service in order to receive part of the recaptured commissions
 - ERISA or 1940 Act clients for which MBA sponsor or affiliates is fiduciary or adviser
 - Otherwise, 100% pass through
 - Structuring as introducing/clearing arrangement helps overcome this issue
 - Advisers Act 206(3) and Rule 206(3)-2
 - ERISA PTCE 86-128
- Rebates are not limited to equities or to agency/eligible RP trades
- Other issues
 - 10b-10 disclosure issues with MBAs
 - Limits on rebates
 - Fixed price offerings
 - 12b-1 fees

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