



MORGAN STANLEY INSTITUTIONAL EQUITY

# U.S. Head Trader Forum

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## Regulation & its Effects on Our Business

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C O U N S E L O R S   A T   L A W

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# Regulation & its Effects on Our Business

- **Regulatory Trends and the Focus on Conflicts**
- **Key Areas of Focus**
- **What's Next**
- **Staying Ahead of the Game**



# Regulatory Trends and the Focus on Conflicts

- **Our New World: Regulation by Enforcement**
  - Enforcers getting out ahead of regulators
  - Aggressive investigative techniques
  - “They Don’t Get It” Mentality
  - Piling on



# Regulatory Trends and the Focus on Conflicts

- **Unrelenting Focus on Conflicts**

- **SEC Enforcement Director Steve Cutler:**

- “Just because a certain way of doing things is second nature to you, and appears to be standard operating procedure on the Street, doesn't mean it's the correct way of doing things.”


- **SEC Market Regulation Director Annette Nazareth**

- “There is no safety in numbers. You cannot hide under the shade of ‘standard industry practice.’ Firms that ignore conflicts of interest do so at their peril.”



# Key Areas of Focus

- **Conflict Issues**
  - Reciprocal Brokerage
  - Soft Dollars, including US and UK reform proposals
  - Directed brokerage
- **Current Best Execution Issues**
- **Market Structure Issues**



# Reciprocal Brokerage

- SEC and Congressional focus
- Line of past enforcement cases
- Issues for Advisers
  - Fiduciary obligations
  - Best execution & interpositioning concerns
  - Rule 12b-1 issues
  - Board Monitoring
  - Disclosure
- Structure matters



# Soft Dollar Reforms and Issues

- UK CP-176 proposal
  - Exclude market pricing & information services
  - Require managers to rebate cost of bundled services
- H.R. 2420
  - Fund disclosure of arrangements
  - Board oversight
- SEC initiatives
  - Q&A release - reining in practices



# Directed brokerage

- Cross-subsidization issues
- Sequencing issues
- Due diligence issues
- Disclosure issues



# Current Best Execution Issues

- Best execution process
- Trading Costs
- Information Leakage
- Cross Trade Issues
  - Inadvertent crosses
  - Continuing focus on proper valuation
  - DOL developments



# Market Structure Issues

- **Senate & Hill Hearings from Last Week**

- ITS “Trade Through” Rule
- Role of Specialists
- Market Fragmentation
- Questions about the SRO Model
  - NYSE
  - Chicago Stock Exchange



# What's Next

- **SEC initiatives**

- Year-end release on reciprocal brokerage
- Soft dollar Q&A
- Email retention for advisers
- Market structure adjustments
  - Short sale rule amendments
  - Further trade through rule exemptions
  - NASDAQ exchange registration?
- Enforcement cases

- DOL cross trade PTCE
- Congress - Mutual fund legislation
- NY AG???



# Staying Ahead of the Game

- Take a fresh look at your practices
  - Be proactive in identifying & addressing conflicts
  - Most big trader-related insurance claims have involved:
    - Choosing brokers based on a personal relationship
    - Kickback schemes
    - Undisclosed or improper use of client brokerage to reward client referrals or fund sales
    - Lack of checks - portfolio manager acting as trader too
- Involve your legal & compliance staffs
  - Make sure they understand what you're doing