

**SOFT COMMISSION ARRANGEMENTS FOR COLLECTIVE  
INVESTMENT SCHEMES**

**FINAL REPORT**



**OICJ-IOSCO**

**A Report of the Technical Committee of the International  
Organization of Securities Commissions**

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## **SOFT COMMISSION ARRANGEMENTS FOR COLLECTIVE INVESTMENT SCHEMES: FINAL REPORT**

In November 2006, the IOSCO Technical Committee released a “*Consultation Report on Soft Commissions*.” Submissions were received from fifteen bodies in response to the consultation paper. The submissions raised a number of observations about the report but generally supported its findings. After consideration of these comments, this final report was issued. A feedback statement in which the IOSCO Technical Committee’s considerations regarding the comments are described can be found under Appendix 2 of this report.

### **I - INTRODUCTION**

In its meeting on June 5-8, 2006, the IOSCO Technical Committee approved the mandate proposed by its Standing Committee on Investment Management (SC5) regarding soft commission arrangements for collective investment schemes (CIS). The mandate directs SC5 to examine the regulation (and proposed regulation), among SC5 member jurisdictions, of soft commissions involving CIS and CIS operators and identify any issues of concern to regulators.<sup>1</sup> Accordingly, this paper sets forth an assessment of the key issues identified by SC5 related to soft commission arrangements.<sup>2</sup>

This project is timely. The amount of money involved in soft commission arrangements is quite high (that is, the portion of commissions paid to brokers that are used to “purchase” goods and services through soft commission arrangements), and the

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<sup>1</sup> In most jurisdictions, it appears that there is no material difference in the regulation of soft commission arrangements involving CIS and non-CIS. In this project, we focus only on arrangements involving regulated and registered CIS (i.e., we do not address those collective investment vehicles that are not regulated and registered as CIS in the relevant SC5 member jurisdiction (non-CIS)). In addition, in general, the US responses to this questionnaire do not address vehicles whose operators are registered solely with and regulated solely by the Commodity Futures Trading Commission.

<sup>2</sup> A summary of SC5 member jurisdictions’ responses to a questionnaire relating to soft commission arrangements is attached at Appendix 1.

conflicts of interest for CIS operators is readily evident. Given the importance of soft commissions (including the large amount of money involved), and the conflicts they present, some jurisdictions currently are reviewing the regulation of soft commission arrangements. It is useful for SC5 members to consider, as a group, the key issues discussed below in considering their regulatory approaches to soft commission arrangements.

The mandate also indicates that SC5 may, if necessary, seek to develop general principles concerning soft commission arrangements involving CIS and CIS operators. At this time, the development of general principles regarding soft commission arrangements would not be appropriate because the relevant law in many jurisdictions is changing. SC5 will undertake to monitor those changes over the next two years and will determine whether and how general principles may be developed, especially in the areas of the limitation of the goods and services that can be acquired under soft commission arrangements, and prior and periodic disclosure of soft commission arrangements.

## **II - ASSESSMENT OF KEY ISSUES RELATING TO SOFT COMMISSION ARRANGEMENTS**

**Definition.** The concept of soft commissions is widely recognized in SC5 jurisdictions. In most jurisdictions, however, there is no legal or statutory definition of soft commissions or soft commission arrangements.<sup>3</sup> SC5 members generally agree that a soft commission arrangement is one in which a CIS operator receives a benefit in connection with a CIS's payment of commissions on CIS portfolio securities transactions.<sup>4</sup>

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<sup>3</sup> European Commission Recommendation 2004/384/EC of 27 April 2004 on some contents of the simplified prospectus as provided for in Schedule C of Annex I to Council Directive 85/611/EEC states that, with respect to identifying soft commission arrangements that need to be disclosed in a simplified prospectus: "Member States are recommended to identify as soft commissions any economic benefit, other than clearing and execution services, that an asset manager receives in connection with the fund's payment of commissions on transactions that involve the fund's portfolio securities. Soft commissions are typically obtained from, or through, the executing broker."

<sup>4</sup> This paper does not address brokerage arrangements whereby a CIS (rather than the CIS operator) receives a rebate from the broker-dealer that executes the CIS's

**Benefits (Goods/Services) to CIS Operators from Soft Commission Arrangements.** The agreed upon definition of soft commission arrangements, provided above, focuses on benefits that CIS operators receive. Typically, the benefits take the form of certain goods and/or services (e.g., research reports) that are provided by broker-dealers to CIS operators. CIS pay for all of the services when they pay for the commissions on their portfolio securities transactions, that is, they pay for execution and for the other goods and services.

Some SC5 member jurisdictions specifically limit by law or regulation the benefits that can be obtained with soft commissions (e.g., Canada, Germany, Hong Kong, Ireland, Italy, Luxembourg, Portugal,<sup>5</sup> United Kingdom, United States<sup>6</sup>), while other jurisdictions do not (e.g., Australia, Brazil, Japan, Jersey, Mexico, the Netherlands, Switzerland<sup>7</sup>). Examples of specific limitations:

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portfolio transactions. As SC5 noted in its paper entitled, “Final Report on Elements of International Regulatory Standards on Fees and Expenses of Investment Funds” (November 2004), such a rebate should inure to the benefit of the CIS (e.g., the rebate could be used to offset the fees and expenses of the CIS), and not to the operator or any other party. Nor does this paper address arrangements whereby a CIS or its operator, or any person affiliated with the CIS or its operator, receive a rebate in connection with the investment of the CIS’s assets in another CIS. Those arrangements raise issues that SC5 may examine pursuant to another mandate.

<sup>5</sup> In Portugal, benefits must be disclosed in the CIS rules and approved by the regulator.

<sup>6</sup> In the United States, fiduciary principles require money managers, including CIS operators, to seek best execution for client trades and limit money managers, including CIS operators, from using client assets for their own benefits. The soft commission rule in the United States is a safe harbor to protect money managers in certain circumstances from liability for a breach of fiduciary duty on the basis that the client paid more than the lowest commission rate in order to receive brokerage and research services provided by a broker-dealer.

<sup>7</sup> In Switzerland, retrocessions and other financial advantages in connection with

- Certain seminars/conferences may be permitted benefits in the United States but not in the United Kingdom.
- Market data, such as stock quotes, last sale prices, and trading volumes, may be permitted benefits in the United States but may not be in the United Kingdom.
- Computer hardware is a permitted benefit in Hong Kong and a prohibited benefit in the United Kingdom<sup>8</sup> and United States.
- Valuation software is a permitted benefit in Canada and a prohibited benefit in the United Kingdom.

In those jurisdictions with limits on benefits, benefits that can be purchased with soft commissions generally are those that are used to make investment decisions for a CIS portfolio and include research and order execution services.<sup>9</sup> Research may include: (i) advice as to the value of securities and the advisability of investing in securities; and (ii) analyses or reports concerning securities, portfolio strategy or performance, issuers, industries, economic factors and trends. Some benefits are “mixed-use” items, such as research products and services that also may serve other functions not related to the making of investment decisions. For example, a computer could be used for both research and administrative functions. One regulatory approach to “mixed-use” items allows soft commissions to pay for the research related use of a “mixed-use” item, but requires separate payments by the CIS operator for the non-research related use (e.g., United States).

Each SC5 member jurisdiction must choose its own approach to limiting the

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the investment of assets have to be credited to the CIS.

<sup>8</sup> The United Kingdom does not explicitly prohibit particular benefits, but provides guidance on types of benefits that are likely or not likely to fall within the permitted categories of “execution” and “research”.

<sup>9</sup> Order execution services may include: (i) effecting securities transactions; and (ii) in a majority of SC5 jurisdictions, clearance, settlement or custody. Those services directly benefit a CIS, and do not present the same conflicts of interest for CIS operators as research benefits.

benefits that CIS operators may receive from soft commission arrangements. SC5 members agree that benefits from soft commission arrangements should not include cash payments, or the payment of day-to-day operational expenses of the CIS operators such as: rental of office space, furniture, salaries, travel expenses (hotel, meals, entertainment expenses), or professional licensing.<sup>10</sup>

**Identification of Conflicts of Interest.** Soft commission arrangements present conflicts between the interests of a CIS operator and the CIS and its investors. In particular, the CIS operator receives goods and services from the broker-dealer that the CIS operator does not have to pay for itself. Those benefits could be used to benefit other CIS and non-CIS clients of the operator, not just the CIS whose commissions generated the benefit. This could create an incentive on the part of the CIS operator to generate portfolio securities transactions for a CIS in order to increase soft commission payments. Additionally, when transactions involving soft commissions involve the operator “paying up” (*i.e.*, paying more than the lowest available commission and receiving a benefit) or receiving executions at higher prices, operators using soft commission arrangements face a conflict of interest between their need to obtain the benefit and the CIS’s interest in paying the lowest commission rate available and obtaining best execution of the CIS’s portfolio securities transactions.

Soft commission arrangements provide incentives for CIS operators to direct CIS brokerage based on the benefits provided to the operators, rather than focusing on the most favorable execution for the CIS, potentially resulting in higher overall client costs and, consequently, lower performance. The arrangements also may provide incentives to operators to forego opportunities to recapture brokerage costs for the benefit of CIS, and may cause CIS to overtrade their portfolios to fulfill the operators’ soft commission commitments to broker-dealers.<sup>11</sup>

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<sup>10</sup> SC5 members also agree that soft commission arrangements must be consistent with a CIS operator’s duty to act in the best interests of the CIS.

<sup>11</sup> Some industry participants do not believe that soft commission arrangements result in overtrading. See research prepared on behalf of the Investment Management Association, available at [http://www.investmentuk.org/news/research/2004/topic/soft\\_commissions/craresearchcp176.pdf](http://www.investmentuk.org/news/research/2004/topic/soft_commissions/craresearchcp176.pdf).

The use of soft commission arrangements also may disfavor the use of Electronic Communication Networks,<sup>12</sup> and other alternative trading systems, by providing incentives to operators to use systems offering soft commission arrangements, even if the execution quality is not as good.<sup>13</sup> Additionally, soft commission arrangements may contribute to CIS operators paying high commission rates, as operators lack the incentive to negotiate lower commissions and profit from the payment of the higher commission.

We note, however, that soft commission arrangements can provide benefits to CIS investors, provided that those conflicts of interest are adequately addressed by the CIS operators. In some jurisdictions, soft commission arrangements are an accepted and traditional mechanism by which CIS operators obtain valuable investment research. Soft commission arrangements can be used to pay for research that is provided by persons that are independent of the broker-dealer that executes the CIS's portfolio securities transactions. Such research can be of a high quality and of great use to the CIS operator in managing the CIS that generated the soft commissions. In addition, soft commission arrangements may facilitate research into a greater number of companies because such arrangements make it possible for smaller institutions to produce research in niche markets that might otherwise be ignored.<sup>14</sup>

Proponents of soft commission arrangements believe that these arrangements represent 'optimal' levels of research consumption, and that CIS operators underutilize research when forced to pay for it directly. They argue that only those CIS operators that are compensated based on the profitability of their investment strategies (as opposed to

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<sup>12</sup> Electronic Communications Networks, or ECNs, generally are electronic trading systems that automatically match buy and sell orders at specified prices.

<sup>13</sup> Some industry participants do not believe that the use of soft commission arrangements disfavors the use of Electronic Communication Networks ("ECNs") and other alternative trading systems because many ECNs and other alternative trading systems provide soft commission arrangements as part of their execution services.

<sup>14</sup> In this regard, one industry participant noted that soft commission arrangements particularly may benefit smaller managers who may not be able to negotiate lower commission rates from brokers.



their ability to accumulate assets under management) will devote an optimal level of their own assets to research services.

**Regulatory Responses.** Each SC5 member jurisdiction must choose its own approach to regulating soft commission arrangements. All SC5 member jurisdictions agree, however, that CIS operators must manage the conflicts of interest inherent in soft commission arrangements.

None of the SC5 member jurisdictions authorizing soft commission arrangements prohibits CIS operators from receiving any benefits in connection with a CIS's payments of commissions on CIS portfolio transactions. As discussed above, some jurisdictions have laws that specifically regulate soft commission arrangements by, for instance, strictly defining the goods and services that are permitted to make up the benefit that a CIS operator can receive in connection with soft commission arrangements. In those jurisdictions, research and order execution services are permitted benefits while cash payments and benefits consisting of payment of day-to-day operational expenses generally are not. Other jurisdictions do not have laws that specifically regulate soft commission arrangements (e.g., Australia, Brazil, Japan, Jersey, Mexico, the Netherlands). In those jurisdictions that do not have laws specifically regulating soft commission arrangements, there may be other mechanisms in place, such as industry standards, that provide guidance.<sup>15</sup>

In all the SC5 member jurisdictions authorizing soft commission arrangements, these arrangements implicate the fiduciary principles that apply to CIS operators. The fiduciary principles require CIS operators to, as relevant here, seek to obtain best execution for CIS portfolio securities transactions and limit CIS operators' ability to use client assets (e.g., brokerage commissions) for their own benefit.

Among the SC5 member jurisdictions authorizing soft commission arrangements, there are some common conflict management techniques that are used, including:

- All portfolio securities transactions must be subject to best execution requirements (all SC5 member jurisdictions).

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<sup>15</sup> For example, in the case of Australia, see Guidance note 10 at: <http://www.ifsa.com.au/public/content/ViewCategory.aspx?id=71>.

- Soft commission arrangements must be in writing (e.g., Ireland).
- Limitations on the benefits that CIS operators may receive from soft commission arrangements (see above).
- CIS operators that use soft commission arrangements must disclose information about the arrangements to CIS investors and CIS directors (if any) or to the CIS depositary to allow effective monitoring of the use of the CIS’s commissions (e.g., Hong Kong, Italy, Portugal, United Kingdom, United States).<sup>16</sup>
  - Disclosure should be made in the CIS offering document.
  - Disclosure also may be made in periodic reports.
- If the broker-dealer that executes the CIS portfolio securities transactions is an affiliated person of the CIS or the CIS operator, the transactions are subject to heightened scrutiny (e.g., by the board of directors of the CIS in the United States).

Disclosure is a common regulatory technique. In the United Kingdom, CIS operators are encouraged to fulfill their disclosure obligations by following a code adopted by the relevant industry association that requires CIS operators to disclose to the CIS depositary details of how commission payments have been spent and what services have been acquired with the commissions. This requires CIS operators to, in essence, unbundle execution costs from the costs of the goods and services received by the CIS operator.<sup>17</sup> As noted above, many jurisdictions require specific disclosures about soft commissions to be made to the CIS and its investors (including to the board of directors

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<sup>16</sup> European Commission Recommendation 2004/384/EC of 27 April 2004 on some contents of the simplified prospectus as provided for in Schedule C of Annex I to the Council Directive 85/611/EEC states that: “Taking into account current market practice, Member States are therefore invited to require UCITS to consider how far fee-sharing agreements and comparable fee-arrangements are for the exclusive benefit of the UCITS. Member States are recommended to provide for the simplified prospectus to make a reference to the full prospectus for detailed information on that kind of arrangements, which should allow any investor to understand to whom expenses are to be paid and how possible conflicts of interest will be resolved in his/her best interest.”

<sup>17</sup> In the United States, one large fund complex determined to negotiate “unbundled” brokerage fees with several broker-dealers that execute portfolio transactions for the fund complex.

of the CIS in the United States).

**Investors' policies regarding soft commission arrangements.** In some jurisdictions, investors themselves have policies of not using soft commission arrangements (e.g., Japan). Those investors generally are institutional and must rely upon the disclosures from the CIS and the CIS operators that will allow them to choose to invest in CIS.

### **III - CONCLUSION AND WAY FORWARD**

Soft commission arrangements present a challenge to regulators. The arrangements can provide useful benefits to CIS investors, but can be subject to abuses. SC5 will continue to monitor regulatory developments related to soft commission arrangements to determine whether general principles can be developed.

**Appendix 1**  
**Summary of Responses**  
**on Soft Commission Arrangements**

**Question 1 – What is your jurisdiction’s definition of a soft commission arrangement?**

Jurisdiction	Definition
Australia	There is no legal definition of soft commissions. Commercial usage is consistent with proposed definition in footnote 1 (Please note that soft commission arrangements are those in which a broker-dealer’s rebate to the investment manager takes the form of various services and products, but not cash).
Brazil	No formal definition.
France	French law does not provide for a definition of soft commission arrangements as such. However, in practice, these arrangements are understood as referring to any economic benefit (e.g., investment research, financial analysis) received by the investment manager in addition to the execution services provided by a broker in connection with the securities transactions of the portfolios it manages (collective investment schemes, portfolios managed under a mandate).  French regulation nonetheless provides for the specific conditions pursuant to which soft commission arrangements may be used.
Germany	No legal definition (regulation deals only with cash rebates). Code of Conduct of trade association, which is approved by BaFin as a legal regulation defines soft commissions as “money valued advantages (e.g. broker research, financial analysis, market- and price-information systems) received in relation with dealing on financial markets.
Hong Kong	No explicit definition, but the term generally refers to non-cash goods or services received by a fund manager from a broker or dealer for directing transactions in CIS property to the broker or dealer.
Ireland	No formal definition, but regard soft commissions as any economic benefit (other than clearing and execution services), e.g. research services, provided by a broker/dealer to a CIS in connection with the payment of commissions on transactions carried out with that broker/dealer.
Italy	Legally defined as “any agreement, whether oral or written, under which a firm which deals in securities on an advisory basis, or in the exercise of discretion, receives goods or

	services in return for business put through or in the way of another person whether on a pre-paid, continuous or retrospective basis.”
Japan	No legal definition.
Jersey	No legal definition.
Luxembourg	No specific legal definition under Luxembourg law. Instead, refer to EU definition.
Mexico	No legal definition.
Netherlands	There is no explicit definition, but a CIS/management company is obliged to report on: “Agreements or goods or services to be delivered to the management company, the depositary, the CIS or separate entities related to these entities, in exchange of the execution of orders for the CIS or the management company.”
Ontario	OSC defines as generally being the practice by dealers of using commissions on brokerage transactions to pay for goods or services other than order execution or services directly related to order execution.
Portugal	CNVM Regulations define as: “non-pecuniary gains, namely, services that are freely provided to the CIS management company, or to a related party . . . , or to the board of the management company or its employees, when such services arise from a commercial relationship established by the management company on behalf of the CIS.
Quebec	No legal definition, but regulate the following under Policy Statement Q-20: “Use by dealers of brokerage commissions as payment for goods or services other than order execution services (“soft dollar” deals).
Spain	No legal definition; not regulated under Spain’s legislation.
Switzerland	There is no legal definition of soft commissions. However according to the Collective Investment Schemes Act (CISA) which entered into force on 1 January 2007 retrocessions and other financial advantages (“soft commissions”) in connection with the investment of assets have to be credited to the CIS.
UK	No longer a legal definition as of 1/2006. The regulatory regime defines the circumstances in which an investment manager may receive goods and services from another person in addition to execution of its customer orders.
US	No legal definition. Generally defined as those arrangements under which an operator sends client brokerage transactions to a broker, and, in exchange, obtains research and brokerage products or services in addition to execution services from or through the broker. In the context of CIS, generally defined as those arrangements in which a CIS operator obtains the benefit of research and brokerage services in connection with a CIS’s payments of commissions on CIS securities portfolio transactions.

*Does your jurisdiction distinguish between different types of soft commission arrangements?*

Jurisdiction	Definition
Australia	No. There is no legal distinction between types of soft commission arrangements.
Brazil	No. There is no legal distinction between types of soft commission arrangements.
France	Prior to the new regulation of January 2008, there was no legal distinction between the different types of soft commission arrangements.  Under the new regulation effective as of January 2008, a distinction will be made between unbundled soft commission arrangements which will be authorized and bundled ones which shall be prohibited.
Germany	No. There is no legal distinction between types of soft commission arrangements.
Hong Kong	No. There is no legal distinction between types of soft commission arrangements.
Ireland	No. There is no legal distinction between types of soft commission arrangements.
Italy	No. There is no legal distinction between types of soft commission arrangements.
Japan	No. There is no legal distinction between types of soft commission arrangements.
Jersey	No. There is no legal distinction between types of soft commission arrangements.
Luxembourg	No. There is no legal distinction between types of soft commission arrangements.
Mexico	No. There is no legal distinction between types of soft commission arrangements.
Netherlands	No.
Ontario	No. There is no legal distinction between types of soft commission arrangements.
Portugal	No. There is no legal distinction between types of soft commission arrangements.
Quebec	No. There is no legal distinction between types of soft commission arrangements.
Spain	NA
Switzerland	No. There is no legal distinction between different types of soft commission arrangements.
UK	No. Not since 1/2006.
US	No. There is no legal distinction between types of soft commission arrangements.

***Question 2 – Are soft commission arrangements permitted in your jurisdiction?***

Of the jurisdictions that answered, almost all permit soft commission arrangements so long as they follow either specific regulation of such arrangements, or, if there is no specific regulation, so long as the arrangements generally follow fiduciary principles and conflicts are disclosed.

Jurisdiction	No	Yes
Australia		X
Brazil		X
France		X <sup>18</sup>
Germany		X
Hong Kong		X
Ireland		X
Italy		X
Japan		X <sup>19</sup>
Jersey		X
Luxembourg		X
Mexico		X
Netherlands		X
Ontario		X
Portugal		X
Quebec		X
Spain		X <sup>20</sup>

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<sup>18</sup> Subject to specific conditions.

<sup>19</sup> In Japan, although there is no regulation of soft commission arrangements, it is common practice that securities companies provide institutional investors with their internal research materials free of charge.

<sup>20</sup> In Spain, CIS regulation states that: expenses charged to a CIS can not be an additional cost for services associated to the management company or depositary functions, which are already paid by the respective fees (management and depositary fees). Under this rule, some of the services included under the definition

Switzer-land		X
UK		X
US		X

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of soft commissions (research and analysis, for instance) should not be charged to the CIS (directly, as a specific fee or indirectly, through higher transactions cost), since these activities are associated to the management company function, and so forth paid by the management fee. If there were other products or services provided to the investment funds (which could also be considered as soft commissions) essential for the normal activity of the fund, not associated with the management company or depositary functions, then this expense could be charged to the CIS, if they are included in the prospectus of the fund, and the products or services are in behalf of the CIS. Nevertheless, as a consequence of the public release of the interpretation to this rule, the industry is preparing a document where soft commissions issues will be analysed, CNMV will assess this document.



**Question 3 – In general, how are soft commission arrangements regulated in your jurisdiction. For example:**

**a. What benefits can be purchased with soft commissions?**

Jurisdiction	Definition
Australia	No specific regulation.
Brazil	No specific regulation, but fund manager may receive non-pecuniary benefits so long as this doesn't cause losses for investors. The most commonly purchased benefits resembling the soft commission arrangements are stock research and data feeder services (such as Reuters and Bloomberg), i.e. services aimed at supporting the investment fund's management.
France	<p>- Prior to the new regulation of January 2008, French regulation did not provide per se for a list of the benefits that could be purchased with soft commissions. Nevertheless, French regulation did specify the conditions to be complied with by soft commission arrangements. Specifically, under such conditions, soft commission arrangements (i) were not to contravene the best-execution obligation and the obligation to ensure competition among intermediaries, (ii) had to directly benefit to the clients (in the case of mandates) or unitholders (in the case of CIS), (iii) could not be paid in cash nor remunerate goods or services corresponding to the essential resources and means that the investment management company was required to have under French law, such as administrative or accounting management, staff compensation or offices, (iv) had to be in writing and the corresponding agreement had to be disclosed to the persons who were responsible for internal control and compliance within the investment management company, and (v) their value had to be assessed by the investment management company and specified in the company's annual financial statements.</p> <p>- Under the new regulation effective as of January 2008, the services that can be purchased with soft commissions have to comply with two strict conditions: (i) they have to be directly linked to the order execution services; and (ii) they may not remunerate either services for which the investment management company receives a management fee commission, or services and goods that correspond to the means that the investment management company is legally required to have for the purpose of carrying out its activity.</p> <p>French regulation provides for a non-exhaustive list of non-permitted services, i.e., services that can in no event be purchased with soft commissions. This list is not exhaustive and</p>

	includes among others the portfolio valuation services, travel costs, the provision of publicly available information, custody services.
Germany	Generally services that are used to make investment decisions regarding a CIS portfolio and are in the best interest of investors. Can include broker research; financial analysis, market- and price-information systems.
Hong Kong	Goods and services which are of demonstrable benefits to the CIS investors. These may include research and advisory services; economic and political analysis, portfolio analysis, including valuation and performance measurement, market analysis; data and quotation services; computer hardware and software incidental to the above goods and services; clearing and custodian services; and investment-related publications. Does not include travel, accommodations, entertainment, general administrative goods or services, general office equipment or premises, membership fees, employee salaries or direct money payments.
Ireland	Only benefits permitted are those which will assist in the provision of investment services. With regard to the regulation of investment management firms, the Code of Conduct provides: “Goods or services supplied under a soft commission agreement must reasonably be expected to: (a) assist in the provision of investment services to the firm’s clients by means of: (i) specific advice on dealing in, or on the value of, any investment instrument; or (ii) research or analysis relevant to paragraph (i) above (or about investment generally and matters relevant thereto; or (iii) use of computer or other information facilities to the extent that they are used to support investment decision-taking, advice, research or analysis; or (b) provide custodian services relating to investment instruments of, or managed for, clients; or (c) provide services relating to valuation of portfolios or the measurement of the performance of portfolios; or (d) provide market-price services.
Italy	Article 49 of CONSOB Resolution 11522/1998 provides that soft commission arrangements are allowed if they benefit exclusively the fund while hard commission arrangements (under which the broker splits the transaction fees paid by the CIS with the management company) are prohibited. Also, Article 54(4) of this Resolution provides that CIS operators shall require transactions to be carried out in the best possible conditions (with regard to time, size and nature of transactions) and monitor that such conditions are effectively achieved. Best execution must be obtained independent of the existence of soft commission arrangements.
Japan	No specific regulation.
Jersey	No specific regulation.

Luxembourg	Only those services directly linked to activities the investment manager provides to the fund. Apart from execution services, this generally covers research activities.
Mexico	No specific regulation.
Netherlands	No specific regulation.
Ontario	Soft commissions can only be used to pay for goods and services that are “order execution services” and “investment decision-making services.” “Order execution services” are: (i) order execution, and (ii) services directly related to order execution such as clearance, settlement and custody, whether the services are provided by a dealer directly or by a third party. “Investment decision-making services are: (i) advice as to the value of securities and the advisability of effecting transactions in securities; (ii) analyses and reports concerning securities, portfolio strategy or performance, issuers, industries, or economic or political factors and trends; and (iii) data bases or software to the extent that they are designed mainly to support the services referred to in (i) and (ii) whether the services are provided by a dealer directly or by a third party.
Portugal	Only if benefit the unit-holders by: (i) allowing free access to research or statistical information produced by the broker or other related entities; or (ii) allowing free access to electronic tools used in an efficient management of the UCITS, such as Bloomberg, Reuters, or electronic negotiation platforms.
Quebec	No specific list in regulation. Not permitted: (i) dealer may not use any portion of the commissions earned on brokerage transactions executed on behalf of a manager as payment for goods or services provided to the manager other than order execution services or investment decision-making services. Alternatively, the manager may not direct brokerage transactions to a dealer as payment for goods or services provided to the manager other than other execution services or investment decision-making services. Order execution services are order execution and services directly related to order execution such as clearance, settlement and custody, whether the services are provided by a dealer directly or by a third party. Investment decision-making services are: (i) advice to the value of securities and the advisability of effecting transactions in securities; (ii) analyses and reports concerning securities, portfolio, strategy or performance, issuers industries or economic or political factors and trends; (iii) data bases or software to the extent they are designed mainly to support the services referred to in (i) and (ii). Also, dealer may not buy/sell securities from/to manager if price adjusted to compensate dealer for goods or services other than order execution services or investment decision-making services. Finally, a manager may not pay a dealer for distribution of shares of the fund by directing

	brokerage transactions to that dealer or, at the request of the dealer, to a third party, unless the Autorite des Marche Financiers du Quebec determines that rates are not higher than normal for such transactions.
Spain	No specific regulation.
Switzerland	No specific regulation necessary because art. 21 para. 2 CISA states that soft commissions in connection with the investment of assets have to be credited to the CIS. This new legal disposition has adopted the Swiss Funds Association's code of conduct which requires that arrangements must accrue directly or indirectly to the fund, that fund management companies draft a clear written policy regarding the use of soft commissions, and that the fund management companies adopt appropriate procedures with portfolio managers and monitor compliance with such procedures. The code of conduct is going to be amended due to CISA.
UK	Execution and research services, provided they will reasonably assist the investment manager in providing services to its customers. Research is material capable of adding value by providing new insights that inform fund managers when making investment or trading decisions about their clients' portfolios. Such material should: (i) represent original thought (i.e., the critical and careful consideration and assessment of new and existing facts - and does not merely repeat or repackage what has been presented before); (ii) have intellectual rigor and not merely state what is commonplace or self-evident; and (iii) involve analysis or manipulation of data to reach meaningful conclusions. Execution is services provided by a broker that: (i) are demonstrably linked to the arranging and conclusion of a specific transaction (or series of related transactions; and (ii) arise between the point at which the fund manager makes an investment decision and the point at which the transaction is concluded. The following services are not regarded as research or execution: (i) services related to valuation or performance measurement of portfolios; (ii) computer hardware; (iii) dedicated telephone lines; (iv) seminar fees; (v) subscriptions for publications; (vi) travel, accommodation or entertainment costs; (vii) office administrative computer software, for example, word processing or accounting programmes; (viii) membership fees to professional associations; (ix) purchase or rental of standard office equipment or ancillary facilities; (x) employees' salaries; (xi) direct money payments; (xii) publicly available information; and (xiii) custody services other than those incidental to the execution of trades.
US	Brokerage and research services are the benefits that can be purchased by a CIS operator in a soft commission arrangement. A person provides brokerage and research services insofar as he: (A) furnishes advice, either directly or through publications or writings, as to the

	<p>value of securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities; (B) furnishes analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy, and the performance of accounts; or (C) effects securities transactions and performs functions incidental thereto (such as clearance, settlement, and custody) or required in connection therewith by rules of the SEC or a self-regulatory organization of which such person is a member or person associated with a member or in which such person is a participant. In addition, the CIS operator must make a good faith determination that the amount of client commissions paid is reasonable in light of the value of the services provided by the broker-dealer. The following are not eligible as research: office space, furniture, clerical assistance, salaries, airfare, hotels and meals, professional exam review courses, membership and licensing fees, utilities, electronic proxy voting services used to vote proxies, marketing, copier costs, office supplies, fax machines, couriers and backup generators, legal expenses, design of websites, mass-marketed publications and computer hardware. In addition, some services may have both research and non-research benefits (mixed use). When acquiring mixed use benefits, advisers must make a reasonable allocation and pay for only research and brokerage expenses using soft commissions. For example, software systems that provide administrative and recordkeeping functions in addition to research are mixed use benefits. The costs of attending a research seminar also are mixed use; the fees for the seminar may be paid for with soft commissions while the travel costs, hotel, meal and entertainment expenses may not.</p>
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***b. How do you regulate the conflict of interest presented by soft commission arrangements?***

Jurisdiction	Definition
Australia	<p>CIS operators must have adequate arrangements for management of conflicts of interest. Generally, a CIS operator must control conflicts so that the quality of its financial services is not significantly compromised. If conflicts cannot be adequately managed through controls and disclosure, the conflict must be avoided. CIS operators also are subject to additional requirements including an obligation to act in the best interests of the CIS members and, if there is a conflict, to give priority to members' interests.</p>
Brazil	<p>Investment fund managers must act in the best interest of investors. Must disclose all conflicts of interest to clients. Self-regulating initiatives by trade group set forth obligations to (i) avoid practices that may jeopardize the fiduciary duties maintained with investing clients; and (ii) be prudent when performing actions, as though dealing with their own assets. In addition, liability may result from any default or misconduct, which also may result in disciplinary procedures and penalties.</p>
France	<p>- Prior to the new regulation of January 2008, soft commission arrangements had to comply with specific conditions for the purposes of avoiding and limiting conflicts of interests. In particular, pursuant to such regulatory conditions, soft commissions arrangements (i) were not to prevent compliance with the best-execution obligation and the obligation to ensure competition among intermediaries, (ii) had to directly benefit to the clients (in the case of mandates) or unit holders (in the case of CIS), (iii) could not be paid in cash nor remunerate goods or services corresponding to the essential resources and means that the investment management company was required to have under French law, such as administrative or accounting management, staff compensation, or offices, (iv) had to be in writing and the corresponding agreement had to be disclosed to the persons who were responsible for internal control and compliance within the investment management company, (v) their value had to be assessed by the investment management company and specified in the company's annual financial statements. Furthermore, if the total value of the soft commissions received by the investment management company on its portfolio management activity, exceeded 1% of its annual revenue, the said company had to describe in its annual report the conditions under which soft commissions arrangements were used. In particular, such report had to provide detailed information about the nature of the soft commissions, the agreements governing them, the way they were valued, and the measures taken to address conflicts of interests (and specifically, the measures taken to prevent or</p>

	<p>deal with conflicts of interest in the selection of intermediaries).</p> <p>- Under the new regulation effective in January 2008, soft commission arrangements will further be subject to specific conditions. In particular, they will be required to (i) be unbundled and disclosed as such, (ii) be of direct interest to the clients and (iii) directly linked to the order execution services, (iv) be valued on a regular basis, (v) be provided for in a written agreement, (vi) not to remunerate either services for which the investment management company receives a management fee commission, or services and goods that correspond to the means that the investment management company is legally required to have for the purpose of carrying out its activity, and (vi) not to impair the investment management company's duty to act in the best interests of the clients.</p>
Germany	Manager must document in writing that transactions are in the best interest of investors.
Hong Kong	<p>Require that all transactions carried out by or on behalf of a CIS be at arm's length. Neither the manager nor any of its connected persons may retain cash or other rebates from a broker/dealer in consideration of directing transactions in CIS property to the broker/dealer except that soft dollars may be retained if: (a) the goods or services are of demonstrable benefit to the holders; (b) the transaction execution is consistent with best execution standards and brokerage rates are not in excess of customary institutional full-service brokerage rates; (c) adequate prior disclosure is made in CIS offering documents; and (d) periodic disclosure is made in the CIS annual report.</p>
Ireland	<p>Soft commission arrangements are only acceptable where the broker or counterparty to the arrangement has agreed to provide best execution. In addition, a firm may not enter into a soft commission agreement unless such agreement is in writing. A firm that deals for a client through any other party pursuant to a soft commission agreement may not so deal and may not advise a client to so deal unless: (i) the benefits will assist the firm's clients; (ii) the other party has agreed to deal to the best advantage of the client; (iii) the firm is satisfied on reasonable grounds that the terms of business and methods by which the relevant dealing services will be supplied do not involve any risk of comparative price disadvantage to the client and that, in any case where the other party acts as principal, the price at which the transaction is carried out is at least as favorable to the client as the price that might reasonably be expected to be available in the absence of a soft commission arrangement; and (iv) prior written disclosure of the agreement is made to the client.</p>
Italy	<p>Overarching principles of Resolution 11522/1988 provide that CIS operators must: (i) prevent funds from being overcharged or excluded from benefits; (ii) inform investors of income and benefits accruing from collective management service other than management commissions and fees; and (iii) ensure fair treatment of CIS managed when carrying out</p>

	transactions that involve conflicts, such as soft commission arrangements.
Japan	No specific regulation. In general, regulation prohibits soliciting business from any customer with a promise to provide any special benefit to the customer, in connection with the sale or purchase of, or any other form of transaction. In addition, there is a fiduciary duty to beneficial owners of investment companies and trustee may not trade in a way that damages the beneficial owners. Must meet best execution. May consider quality of research in preparing list of brokers with whom an investment trust management company may do business.
Jersey	Requires arm length transactions between conflicted parties. Best precaution principles will apply. Also, would expect proper disclosure of conflicts of interest.
Luxembourg	Investment managers must determine how to manage conflicts in light of the legal/contractual obligation that they have to act in their customer's (i.e. fund's) best interest.
Mexico	By law CIS operators must safeguard in any time the interest of fund's shareholders, for which they must provide all relevant information sufficient and necessary for decision-making. Also, CIS operators must observe each fund's code of conduct, and such document is centered on preventing and solving conflicts of interest between the operator and fund's shareholders.
Netherlands	CIS and CIS manager must act in best interest of investor
Ontario	General obligation of the manager to act in the best interests of the CIS and its beneficiaries. Also, requirement in Ontario Securities Commission Rule 31-505 Conditions of Registration for registered dealers or advisers to deal fairly, honestly and in good faith with their clients.
Portugal	Through disclosure (see below).
Quebec	Manager of a portfolio or fund must act in best interests of the beneficiaries of the portfolio or fund, and accordingly, commissions must be used as payment for goods or services that are for the benefit of the beneficiaries and not for the benefit of the manager.
Spain	Conflicts are regulated under general principle of best execution and the related parties transactions regime. Information must be disclosed to investors about procedures in place to avoid conflicts of interest and to ensure that related party transactions are being carried at market prices or better. Any soft commissions would have to be disclosed in the prospectus and be on behalf of the CIS.
Switzerland	See above. In addition, according to the code of conduct which has been recognized by the Swiss Federal Banking Commission as a minimal standard, the fund management company



	<p>must base its decision on objective criteria and act in the best interest of investors in selecting counterparties. It shall direct orders only to carefully selected counterparties that, seen overall, offer the best execution in terms of price, time and quality. As a consequence every fund management's auditor has to comment on the compliance with the SFA's code of conduct in their annual audit report.</p>
UK	<p>Generally, the fund manager must not accept softened goods and services that impair, or are likely to impair, compliance with its duty to act in the best interests of its customers. Specifically, it must ensure best execution and manage conflicts of interest. Trade association guidelines assist fund managers in determining what amount of dealing commission they are paying for execution and what for research in that brokers will provide fund managers information about the "execution" component of commission paid. Fund managers will be accountable to clients on the amounts of commission spent on execution and research services as this will be separately visible.</p>
US	<p>See response to 3(a). In addition, in the context of CIS, the CIS board, especially the independent directors, monitor the conflicts created by the operator's direction of the CIS's brokerage. Directors are required to assess the CIS operator's use of soft commissions when evaluating the amount of the operator's compensation, and the CIS operator is required to keep the directors informed about such arrangements.</p>

*c. What disclosures do you require in connection with soft commission arrangements?*

Jurisdiction	Definition
Australia	In addition to controlling and avoiding conflicts, a CIS operator must disclose benefits and relationships in a Financial Services Guide before providing financial services to retail clients. Disclosure also may be required as part of the obligation to have in place adequate arrangements to manage conflicts of interest. Disclosure about conflicts should: (a) be timely, prominent, specific and meaningful to the client; (b) occur before or when the financial service is provided, but in any case at a time that allows the client a reasonable time to assess its effect; and (c) refer to the specific service to which the conflict relates.
Brazil	Investment funds must disclose all expenses in the prospectus and in the funds' by-laws. In addition, the investment funds' financial statements must be disclosed annually to investors as well as monthly disclosure of a profile comprising the basic information about the fund including general data and a description of the portfolio.
France	<p>- Prior to the new regulation of January 2008, French law did require that the use of soft commissions be disclosed in three different ways: (i) in the CIS prospectus which had to provide details as to the use of such commissions, (ii) in the CIS annual financial statements and in the portfolio's annual report (in the case of a mandate), and (iii) in the investment management company's annual financial statements and, where applicable, in the investment management company's annual report (if the total value of the soft commissions received by the investment management company on its portfolio management activity, exceeded 1% of its annual revenue, the said company had to describe in its annual report the conditions under which soft commissions arrangements were used. In particular, such report had to provide detailed information about the nature of the soft commissions, the agreements governing them, the way they were valued, and the measures taken to address conflicts of interests (and specifically, the measures taken to prevent or deal with conflicts of interest in the selection of intermediaries).</p> <p>- Under the new regulation effective as of January 2008, the investment management company is also subject to disclosure obligations toward its clients. In particular, the investment management company has to report on the conditions pursuant to which it has used brokerage services including support services (e.g. research services) for the last fiscal year when the amount of the brokerage commissions used has been over 500,000 euros for the last fiscal year. Such report has to be posted onto the investment management company's website or if absent, it shall be included in the annual financial report relating to the relevant collective investment schemes and mandates.</p>

Germany	CIS prospectus must disclose the intention of the management company to make use of soft commission arrangements.
Hong Kong	Prior disclosure in the CIS offering document of a summary of the terms under which soft commissions are received. Periodic disclosure in annual report of a statement describing the manager's soft dollar practices, including a description of the soft commissions received. A "nil" statement is required if no soft commission arrangements exist during the period.
Ireland	Prospectus must provide information in relation to permitted soft commission arrangements. Annual and semi-annual accounts also require a description of the soft commission arrangements affecting the CIS during the reporting time period. A firm must provide to any client to whom it is relevant details of any changes in its policy in relation to soft commissions promptly after implementation of any such changes.
Italy	CIS operators are required to disclose soft commission arrangements to CONSOB and to investors through the prospectus (must disclose types of entities with which CIS operator concluded agreements for the recognition of benefits as well as describing contents of those agreements).
Japan	No specific regulation.
Jersey	Disclosure in the prospectus.
Luxembourg	No specific regulation, but administratively, CSSF requires soft commission arrangements to be properly disclosed in the fund's prospectus and periodic reports. Generally, wording of disclosure is: "The investment management agreement between the fund and the investment manager provides the right for the investment manager to effect transactions with or through the agency of a third person with whom the investment manager has a soft commission agreement. The services to be rendered by such a third party must be in direct relation to the activities of the investment manager and must be in the interest of the fund. The soft commissions shall not be payable to physical persons and the soft commissions and related party transactions shall be disclosed in the periodic reports of the fund. CIS auditors must describe arrangements in their reports to CSSF. Moreover, investment manager provides reports to the fund including a summary of brokers used, commissions and soft commissions, types of services received through agreements, an indication to what extent services used and whether any affiliated brokers involved, total amount of brokerage directed by fund, a confirmation that no financial obligation resulted for fund, confirmation that ongoing compliance procedures relating to best execution satisfactory, and a confirmation that brokerage rates are not in excess of customary institutional full-service

	brokerage rates.
Mexico	Funds must have a manual of conduct which is applicable to its board members and to all of its service providers. This manual must contain policies and procedures to be followed regarding the transactions that any insider could perform regarding fund's shares and also to avoid conflicts of interest. Also the "relevance principle" (applicable to the preparation of the prospectus), establishes that funds must disclose any relevant information, including all qualitative and quantitative information, necessary to know its true financial, administrative, judicial and economic situation, and all of its activities and risks, whose disclosure or omission affects the evaluation, estimation of the price of its shares and investment decision-making that, according to analysis practices a common investor should effectuate. It should also disclose any relevant information related to its operator or, if applicable, its financial group, if such information affects or is related to the fund.
Netherlands	Prospectus, simplified prospectus and periodic reports must contain disclosure on the existence of arrangements, parties involved, and the value of the delivered goods.
Ontario	A CIS is required to disclose in its prospectus or annual information form the names of the persons or companies who have provided "investment decision-making services" to the manager since the date of the last prospectus or annual information form of the CIS, together with a summary of the nature of those services, where the remuneration for those services was paid through commissions on brokerage transactions executed on behalf of the CIS. In addition, the notes to a CIS's financial statements must include to the extent ascertainable, separate disclosure of the soft dollar portion of total brokerage transaction costs, where the soft dollar portion is the amount paid or payable for goods and services other than order execution.
Portugal	Prospectus and must disclose a list of soft commissions which may be assigned and the person or entity to whom they are destined; and the nature of the entities from which the profit may be received and the conditions which must be met for soft commission arrangements to be acceptable. Only those that have a positive impact in the service provided to the unit holders are allowed.
Quebec	Must disclose in prospectus or annual information form the names of the persons that have provided any investment decision-making services to the manager since the last prospectus or annual information form, together with a summary of the nature of those services, where the remuneration for those services was paid through commissions on brokerage transactions executed on behalf of the mutual fund, along with an estimate of the aggregate amount of any commissions on brokerage transactions that were directed to dealers since the date of the last prospectus or annual form.

Spain	Information must be disclosed to investors about procedures in place to avoid conflicts of interest.
Switzerland	Prospectus, simplified prospectus and periodic reports must contain disclosure on the existence of arrangements and the parties involved. Further the prospectus must inform on the fact that soft commissions have to be credited to the CIS.
UK	Initial and ongoing disclosures must be given to fund manager's customers about the use of commission for research and execution goods and services, whether obtained from the executing broker or a third party. For a CIS, the fund itself is the customer so the depository receives the disclosure on behalf of fund investors. Initial disclosure must include a description of the firm's policy on dealing commissions. The firm must explain the expenditure of all amounts. Disclosure also must be made annually about the goods and services purchased using dealing commissions. This disclosure must include details of the services acquired and must be divided into those considered execution and those considered research. In addition, the industry has developed a code of conduct to encourage enhanced disclosure.
US	CIS operators must disclose information about soft commission arrangements in their registration form including: if the value of research, and services given to the operator or related person is a factor in selecting broker-dealers; the research and services to be received; whether clients may pay commissions higher than those obtainable from other brokers in return for those services; whether research is used to service all of the operator's accounts or just those accounts paying for it; and any procedures the operator used during the last fiscal year to direct client transactions to a particular broker in return for research services received. Similarly, a CIS must disclose in its statement of additional information whether its operator considers the receipt of research services in selecting brokerage and, if so, the nature of the research services that are provided. If applicable, the CIS must also explain that the research services may be used by the operator in connection with the CIS.

**Question 4 – Can you quantify in any way the level of risk presented by soft commission arrangements in your jurisdiction? For example:**

**a. can you quantify the amount of money used by managers to purchase soft commission benefits during the last three years (e.g., total amount of commissions paid by managers and total amount/percent used to purchase soft commission benefits?)**

Jurisdiction	No	Yes
Australia	X	
Brazil	X	
France	X	
Germany	X	
Hong Kong	X	
Ireland	X	
Italy	X	
Japan	X	
Jersey	X	
Luxembourg	X	
Mexico	X	
Netherlands	X	
Ontario	X	
Portugal	X	
Quebec	X	
Spain	X	
Switzerland	X	
UK		Estimates vary as to the amounts involved. According to OXERA, total commissions paid to UK brokers in 2000 were around £2.3 billion, with around £660-980 million used to “purchase” goods and services through soft commission or bundled brokerage arrangements. According to Deloitte, total commissions paid to UK brokers in 2002/2003 were around £2.9-3.5 billion, and around £758-905 million was used to “purchase” goods and services through soft commission or bundled brokerage

		arrangements.
US		According to research from Greenwich Associates, equity soft commissions in the US fell from \$970 million in 2005 to \$725 million in 2006.

*b. can you quantify the number, or probability, of soft commission abuses occurring in your jurisdiction during the last three years?*

Jurisdiction	No	Yes
Australia		Not aware of any abuses
Brazil	X	
France		Not aware of any abuses.
Germany	X	
Hong Kong	X	
Ireland		Not aware of any abuses
Italy	X	
Japan	X	
Jersey	X	
Luxembourg		Not aware of any abuses
Mexico		Not aware of any abuses
Netherlands	X	
Ontario	X	
Portugal	X	
Quebec	X	
Spain	X	
Switzerland		Not aware of any abuses.
UK	X	
US	X	



*c. can you quantify the impact of soft commission abuses in your jurisdiction during the last three years?*

Jurisdiction	No	Yes
Australia		Not aware of any abuses
Brazil	X	
France		Not aware of any abuses.
Germany	X	
Hong Kong	X	
Ireland	X	
Italy	X	
Japan	X	
Jersey	X	
Luxembourg		Not aware of any abuses.
Mexico		Not aware of any abuses.
Netherlands	X	
Ontario	X	
Portugal	X	
Quebec	X	
Spain	X	
Switzerland		Not aware of any abuses.
UK		Research carried out for the FSA by OXERA suggests that the over-consumption of bundled and softed services (and associated expenses borne by investors) was at least £50-72 million per year.
US	X	

*d. how often have you instituted enforcement actions (or taken other, less formal, remedial actions) involving improper soft commission arrangements during the last three years?*

Jurisdiction	NA	None	Some
Australia			Not aware of any abuses
Brazil	X		
France		X	
Germany		X	
Hong Kong		X	
Ireland		X	
Italy	X		
Japan			
Jersey		X	
Luxembourg		X	
Mexico		X	
Netherlands		X	
Ontario		X	
Portugal		X	
Quebec		X <sup>21</sup>	
Spain		X	No action specifically involving soft commissions, but there have been enforcement actions related to conflicts of interest involving transaction costs between related parties such as management companies and brokers.
Switzerland		X	
UK		X	
US			Two enforcement actions involving, among other things, failure to disclose a soft commission arrangement and misrepresenting soft commission practices to clients. <sup>22</sup>

<sup>21</sup> No data was computed, but there is no recall of such enforcement actions.

<sup>22</sup> See Fundamental Portfolio Advisers, Investment Advisers Act Release No. 2146 (July 15, 2003),

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available at <http://www.sec.gov/litigation/opinions/33-8251.htm> and Schultze Asset Management LLC and George Schultze, Investment Advisers Act Release No. 2633 (August 15, 2007), available at <http://www.sec.gov/litigation/admin/2007/ia-2633.pdf>.

*e. how many complaints about soft commission arrangements have you received during the last three years?*

Jurisdiction	NA	None	Some
Australia			Not aware of any specific complaints
Brazil		X	Brazilian fund industry extremely concentrated. Only 12 fund managers manage 82% of total assets under management.
France	X		
Germany		X	
Hong Kong		X	
Ireland		X	
Italy	X		
Japan	X		
Jersey		X	
Luxembourg		X	
Mexico		X	
Netherlands		X	
Ontario	X		
Portugal		X	
Quebec		X	
Spain		X	
Switzerland		X	
UK			Over the last four years, the FSA has consulted widely on reform of the existing rules and practices. Comments received from a variety of market participants, trade associations and pension fund trustees indicate some dissatisfaction with soft commission and other bundled brokerage arrangements.
US	X		

***Question 5 – Does the regulatory regime in your jurisdiction distinguish between soft commission arrangements involving CIS and those involving non-CIS)?***

Jurisdiction	No	Yes
Australia		All entities licensed by ASIC are subject to the obligation to have in place adequate arrangements to manage conflicts of interest. CIS operators are subject to additional requirements including an obligation to act in the best interests of the CIS members and, if there is a conflict, to give priority to members' interests.
Brazil	X	
France	X	
Germany		Yes in that self-regulation by trade association relates only to CIS. There is no code applicable to soft commission arrangements when the management company is conducting individual portfolio management.
Hong Kong	X	
Ireland	X	
Italy		Disclosure of soft commission arrangements is required only for arrangements involving CIS. There is no disclosure requirement for management on a client-by-client basis of investment portfolios.
Japan	X	
Jersey	X	
Luxembourg	X	
Mexico	X	
Netherlands		Only CIS are regulated
Ontario		<p>Yes, with regard to disclosure only. Where the soft dollar transaction does not involve a CIS, a portfolio manager must, where requested, either by the OSC or a beneficiary of the portfolio, disclose the names of the persons or companies who have provided any investment decision-making services to the portfolio manager during the most recently completed financial year of the portfolio, together with a summary of the nature of those services, where the remuneration for those services was paid through commissions on brokerage transactions executed on behalf of the manager.</p> <p>Where the soft dollar transaction involves a CIS, the CIS is required to disclose in its</p>

		prospectus or annual information form the names of the persons or companies who have provided “investment decision-making services” to the manager since the date of the last prospectus or annual information form of the CIS, together with a summary of the nature of those services, where the remuneration for those services was paid through commissions on brokerage transactions executed on behalf of the CIS. In addition, the notes to a CIS’s financial statements must include to the extent ascertainable, separate disclosure of the soft dollar portion of total brokerage transaction costs, where the soft dollar portion is the amount paid or payable for goods and services other than order execution.
Portugal		Only CIS are regulated.
Quebec		Yes, with regard to disclosure.
Spain	NA	
Switzerland		Yes, art. 21 para. 2 CISA and the SFA’s code of conduct only apply to CIS.
UK	X	
US		Yes. Soft commission arrangements involving CIS and non-CIS are both regulated. However, the regulation for CIS is more restrictive. In particular, CIS operators are prohibited from using soft commissions to pay for products and services other than brokerage and research services, as described in response to 3(a) above. Non-CIS investment managers may, under certain circumstances (e.g., full disclosure), use soft commissions to pay for products and services other than brokerage and research services. In general, the US responses to this questionnaire do not address vehicles whose operators are registered solely with and regulated solely by the Commodity Futures Trading Commission.

**Question 6 – In your jurisdiction, how are soft commissions reflected in the financial statements of a CIS (for instance, are they included in the cost basis of the relevant securities)?**

Jurisdiction	Not Reflected	Reflected
Australia		Depends on the accounting standards applicable to the CIS operator.
Brazil		All expenses must be reflected in financial statements.
France		<ul style="list-style-type: none"> <li>- Prior to the new regulation of January 2008, details on the use of soft commissions were required to be provided in the CIS annual financial statements.</li> <li>- Under the new regulation effective as of January 2008, the investment management company will in particular be under an obligation to report to its clients on the conditions pursuant to which it has used brokerage services including support services (e.g., research services) for the last fiscal year when the amount of the brokerage commissions used has been over 500,000 euros for the last fiscal year. Such report shall be posted on the investment management company’s website or if absent, it shall be included in the annual financial report relating to the relevant collective investment schemes and mandates.</li> </ul>
Germany	X <sup>23</sup>	
Hong Kong	X <sup>24</sup>	
Ireland		Periodic reports issued by CIS must include detail in relation to the soft commission arrangements in place during the reporting period. (However they are not required to be included in the cost basis of the relevant securities).
Italy		Benefits received under soft commission arrangements, by macro category, and

<sup>23</sup> Soft commissions are not included in the cost basis of the relevant securities and are not reflected in semi-annual reports. Auditors will review how the management company has dealt with soft commission arrangements.

<sup>24</sup> Soft commissions are not reflected in CIS financial statements, but the annual report must describe the soft dollar practices, including a description of the goods and services received by the manager. There is no requirement to quantify the value of soft commissions received.

		the corresponding monetary value must be described in the CIS annual report.
Japan	X	
Jersey	X	
Luxembourg		In principle, soft commissions are included in the cost basis of the relevant securities.
Mexico	X	
Netherlands		Reflected separately, or, if included in the cost basis, they must be disclosed in the Notes (quantitative and qualitative)
Ontario		A recent change to Canadian accounting rules requires that portfolio transaction costs (for financial assets classified as held for trading) be recognized immediately in net income. This means that CIS portfolio transaction costs, a portion of which may consist of soft dollars, must be recognized as an expense. This expense is to be reflected in the CIS's trading expense ratio required to be disclosed in accordance with the continuous disclosure rule applicable to CIS in Canada. This same continuous disclosure rule also requires CIS to set out in the notes to their financial statements the soft dollar portion of total brokerage transaction costs, to the extent this amount is ascertainable.
Portugal	X	
Quebec		New regulation in force since June 1, 2005 requires notes to financial statements to include separate disclosure of soft dollar portion of the total commissions paid if the amount is ascertainable.
Spain	NA	
Switzerland		Soft commissions are included in the cost basis of the relevant securities. Further, periodic reports must contain disclosure on the existence of arrangements.
UK	X <sup>25</sup>	
US		Under generally accepted accounting principals, most portfolio transaction costs, including the use of soft commissions, are either included as part of the cost basis of securities purchased or subtracted from the net proceeds of securities sold and ultimately are reflected as changes in the realized and unrealized gain or loss on portfolio securities in the fund's financial statements.

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<sup>25</sup> Reflected in the cost basis for securities acquired by CIS.



**Question 7 – Please identify the primary issue(s) presented, in your jurisdiction, by soft commissions.**

Jurisdiction	Primary issue(s)
Australia	The two main issues are: How are conflicts on interest that arise from soft commissions dealt with by the CIS operator; and Is disclosure about soft commissions adequate?
Brazil	Since soft commissions not yet specifically regulated, the main issue would be the development of such regulation.
France	Prior to the new regulation of January 2008, the main issue that had been identified was the lack of transparency of the services remunerated by soft commissions. French regulation was amended in this regard in particular for the purposes of enhancing the transparency on brokerage fees.
Germany	No significant supervisory problems yet identified. The reporting period 2006 will be the first audit reporting period BaFin will receive descriptions of soft commission arrangements.
Hong Kong	Has not encountered any significant issues or problems.
Ireland	The primary issues are: Lack of transparency - investors in the CIS may not have sufficient information of the arrangements or knowledge of the benefits being provided; and The extent to which these commissions are in the best interest of unitholders.
Italy	Conflict of interest issues. Also, difficult to assess whether investor interests are being fairly served by CIS operators. CONSOB thinking about limiting benefits that can be purchased by defining a list of permitted goods and services.
Japan	
Jersey	No issues identified.
Luxembourg	CSSF has not encountered specific problems but realizes problems may occur if the relationship between the investment manager and broker obstructs proper control and if potential conflicts of interest are not properly managed. It also may be difficult to distinguish between permitted ( <i>i.e.</i> , services directly linked to activities investment manager provides to the fund) and non-permitted services.
Mexico	No supervisory problems yet identified. However, there are many rules to avoid

	conflicts of interest or, if not avoidable, to disclose them.
Nether-lands	AFM has advised the Ministry of Finance to change the legislation to require that the “profits” of soft commissions be transferred to the CIS.
Ontario	<p>The primary issues are:</p> <ul style="list-style-type: none"> <li>• Conflicts of interest <ul style="list-style-type: none"> <li>o Soft dollar arrangements create potential conflicts of interest because of the incentives that such arrangements may create for advisers to place their interests ahead of their clients, including the incentive to direct trades to dealers for goods and services that benefit the advisers and not their clients;</li> <li>o These potential conflicts of interest may obscure the advisers’ best execution obligations, as dealers may be selected for the soft dollar arrangements rather than for the quality of trade execution;</li> </ul> </li> <li>• Need for updated regulation <ul style="list-style-type: none"> <li>o Current soft dollar policy (OSC Policy 1.9) does not provide clear guidance as to what soft dollars use is or is not acceptable. Existing provisions are too broad and subject to too much interpretation. Furthermore, as the policy is not a rule, it lacks enforceability. The OSC is currently working on a new soft dollars rule that is intended to clarify the scope of allowed services and set out detailed disclosure requirements to provide increased transparency. In the case of CISs, the proposed rule suggests that the CIS’s Independent Review Committee (required under Canadian CIS fund governance rule) review the detailed disclosure;</li> </ul> </li> <li>• Disclosure <ul style="list-style-type: none"> <li>o Additional disclosure needed to increase accountability and transparency;</li> <li>o Existing disclosure requirements currently being revisited through new soft dollars rule proposal.</li> </ul> </li> </ul>
Portugal	Conflicts of interest and information disclosure to the market and unit holders.
Quebec	Need for updated regulation regarding soft commissions.
Spain	NA
Switzer-land	Has not encountered any significant issues or problems.
UK	FSA’s view that a market failure exists. There is an incentive for fund managers to direct business to brokers to obtain additional services, rather than the most favorable trade execution terms for their customers and this is an unacceptable market distortion.

	<p>Anticipate that new rules will provide firms with an incentive to manage the costs of execution and research services, by making their decisions more transparent and exposing them to competitive pressure. FSA also has proscribed firms from purchasing goods and services other than execution and research because do not believe transparency alone is a sufficient incentive to change practices.</p>
<p>US</p>	<p>Disclosure/transparency to CIS investors and CIS board (<u>e.g.</u>, are costs opaque). How much do investors need to know; how much can investors rely on CIS board's oversight; and should investors be provided additional information on request?</p> <p>Best execution (<u>e.g.</u>, don't want CIS operators to disfavor use of ECNs and other alternative trading systems because have incentive to use systems offering soft commission arrangements even if execution is not as good).</p> <p>Scope of benefits covered.</p>

**Appendix 2**  
**Feedback Statement on Public Comments**  
**Received by the Technical Committee on the**  
***“Consultation Report on Soft Commissions”***

**Introduction**

1. The IOSCO Technical Committee publicly released in November 2006 a consultation report on Soft Commissions. The deadline for comments was March 15, 2007.
2. This statement summarizes the main issues raised in the comments received and explains how they are addressed in the final report.

**Responses (General)**

3. Fifteen organizations provided comments on this consultation paper. SC5 met in Amsterdam on May 23-24, 2007 to consider them.
4. Broadly speaking, the majority of comments received expressed support for IOSCO’s work. Comments stated that the report clearly and correctly recognizes the conflicts inherent in soft commission arrangements.
5. Many organizations supported IOSCO’s determination not to take action now, and none explicitly called for the development of best practices now. The undertaking by SC5 to continue to monitor soft commission arrangements over the next two years and determine whether to do further work in the area is consistent with the majority view expressed by comments received. As part of this monitoring, SC5 intends to look more specifically at whether it can develop a common list of goods and services that may be purchased using soft commissions, and a common approach to initial and periodic disclosure relating to soft commission arrangements.
6. Three organizations generally disfavored approaches that require unbundling. One organization generally supported an approach that requires unbundling. SC5 is not addressing unbundling at this time.
7. Two organizations suggested including an analysis of commission sharing

arrangements. SC5 understands this comment to relate specifically to arrangements contemplated by the UK's Financial Services Authority.<sup>26</sup> SC5 did not make any changes in response to this comment because it believes that it would be premature to include an analysis of commission sharing arrangements at this time. Future work on soft commission arrangements, as described above, may provide an opportunity for SC5 to address such arrangements.

8. Two organizations suggested that the project not be limited to soft commission arrangements involving CIS. SC5 did not make any changes to address this comment because SC5's focus is on CIS. If, however, SC5 does develop best practices for CIS soft commission arrangements in the future, SC5, in consultation with SC3, could consider whether to do additional work on soft commission arrangements outside of the CIS context.

9. Two organizations suggested that soft commissions do not really raise a great risk for overtrading. In response, SC5 inserted a footnote stating that: "Some industry participants do not believe that soft commission arrangements result in overtrading. See research prepared on behalf of the Investment Management Association, available at [http://www.investmentuk.org/news/research/2004/topic/soft\\_commissions/craresearchcp176.pdf](http://www.investmentuk.org/news/research/2004/topic/soft_commissions/craresearchcp176.pdf)."

10. Two organizations suggested that the French response in the Appendix be amended to include information relating to the change in regulation effective January 1, 2008. Appropriate changes have been made.

11. One organization suggested that the report more clearly articulate that the benchmark for determining appropriateness is whether services enhance investment decision making or order execution quality for the benefit of investors. In response, SC5 inserted the following statement: "SC5 members also agree that soft commission arrangements must be consistent with a CIS operator's duty to act in the best interests of the CIS."

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<sup>26</sup> The FSA defined a commission sharing arrangement as follows: "In a CSA, the executing broker agrees that part of the dealing commission it earns will be redirected to one or more third parties, nominated by the fund manager, as payment for research services that they have provided to the manager." See Bundled Brokerage and Soft Commission Arrangements, Policy Statement 04/23 (Nov. 2004) at n.8.

12. One organization suggested that all types of soft commissions be prohibited. SC5 did not make any changes in response to this comment. The report notes that this is one possible regulatory response, but no member jurisdiction currently follows this approach.

13. One organization noted that footnote 5 of the consultation report cites to a European Commission recommendation that states that soft commissions should not include clearing and execution services, while the definition in the consultation report appears to include these services. SC5 believes that the commenter misunderstood the European Commission recommendation. In response, SC5 is clarifying that the European Commission recommendation is in the context of what description of soft commission arrangements needs to be disclosed in a simplified prospectus (clearing and execution services are integral to the arrangement and thus need not be described).

14. One organization suggested that soft commission arrangements do not disfavor the use of Electronic Communication Networks. In response, SC5 inserted a footnote stating that: “Some industry participants do not believe that the use of soft commission arrangements disfavors the use of Electronic Communication Networks (“ECNs”) and other alternative trading systems because many ECNs and other alternative trading systems provide soft commission arrangements as part of their execution services.”

15. One organization argued that soft commission arrangements particularly may help smaller managers who are not able to negotiate down the broker firms’ headline brokerage rates to generate savings for investors. In response, SC5 inserted a footnote stating that: “In this regard, one industry participant noted that soft commission arrangements particularly may benefit smaller managers who may not be able to negotiate lower commission rates from brokers.”

**Responses (specific)**

16. The following chart describes the issues raised by each organization.

Zentraler Kreditausschuss (central association of the German banking industry)	Agree that conflicts of interest have to be managed carefully and support high degree of transparency. Share IOSCO’s view that no action necessary at the
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	moment.
AFEI (French Association of Investment Firms)	<p>Endorses ICSA’s response but wants to add specific comments re: France. New French regulation prohibits soft commissions, but will permit some shared commissions – therefore should change French responses.</p> <p>AFEI published Charter of Good Practice on commission sharing arrangements in 2006. Generally support initiative. Supports greater harmonization if done in consultation with industry. Suggests IOSCO work with CESR to ensure level playing field for MiFID jurisdictions.</p>
AFG (French Asset Management Association)	<p>Strongly supports future establishment of IOSCO international standards for regulating soft commissions (and more broadly the composition of transaction fees paid by CIS) because standards would enhance comparison between products or services in different countries, better transparency, harmonization of cross-border transaction processes. New French regulation prohibits soft commissions, but will permit some shared commissions – therefore should change French responses. Shared commissions, in which commissions paid to brokers split between execution and investment/trading decision support services, permits better assessment of services and better transparency. Should be considered by IOSCO. Regarding conflicts, may be difficult to attribute the benefit from services covered to only the persons who supported the relevant services.</p>
AIMA (Forum for Hedge Funds, Managed Futures and Managed Currencies)	<p>Conflicts can be managed by disclosing to the fund’s governing body and to investors (both in offering document and subsequent periodic disclosure). Hedge fund investors are sophisticated and don’t need as much protection. Hedge fund managers usually ally interest with investors (invest own money in fund). Softing has</p>

	<p>benefits. Report does not take into account impact that best execution rules under MiFID have on ability of hedge fund manager to enter into arrangements in EU countries and that makes SC5 work premature. Need harmonization or there will be regulatory arbitrage. Prefer approach that sets out with clarity what goods and services can be purchased and what appropriate disclosure must be made. Prefer UK approach.</p>
ALFI (Luxembourg's fund industry association)	<p>Should harmonize work on soft commissions with CESR. Should also address segregated pension accounts because fiduciary obligations the same. Best solution is disclosure. IOSCO should review later after national legislation done and reconsider whether to issue general principles. At that time, IOSCO needs to determine if approach really reduces costs for investors or imposes regulatory burdens that lead to higher costs for investors.</p>
BdB (Association of German Banks)	<p>Conflicts of interest have to be managed carefully and support high degree of transparency. Share IOSCO's view that no action should be taken at the moment.</p>
ICI (national association of US investment company industry)	<p>Agree that IOSCO should monitor changes in relevant law before attempting to develop broad general principles. With regard to fiduciary principles and oversight, agree that these help ensure fund managers make appropriate use of soft commissions. Supported U.S. regulation to limit the types of services to those that could reasonably be expected to enhance the quality of brokerage and investment services. Should apply to all investment managers, not just fund managers. Support appropriate disclosure but do not support approaches that require fund managers to unbundle execution costs without also requiring brokers to provide unbundled information to managers.</p>
European Banking Federation	<p>Agree that conflicts of interest have to be managed carefully but believe soft commission benefits have</p>



	<p>limited practical relevance. Agree no action should be taken at the moment. If consider developing general principles, should compare the actual influence that soft commissions have on the operators and weigh the expected positive effects against cost and burden of regulation. Support disclosure rather than regulation, but there may be difficulties in specifying intangible influences.</p>
<p>Investment Management Association (represents UK-based investment management industry)</p>	<p>IOSCO should not limit the report to softing arrangements involving CIS and CIS operators because management of segregated portfolios the same. UK pension fund disclosure code requires disclosure to investors on how investment managers make choices between trading counterparties and trading venues, information on how the resulting commission spend is built up, and what services are met out of commission spend. Broadly agree with analysis but do not think there is an incentive to overtrade to get soft commission payments. Research shows no evidence of over-trading. IOSCO should consider how Commission Sharing Arrangements can be promoted. Bundled services are sold that way because value of information provided to portfolio manager varies and becomes less as the information is shared with other people. Information is very important for liquidity and the more liquid the market, the lower the spreads will be. Do not support unbundling (leads to decline in research).</p>
<p>INVERCO (Spanish Association of CIS and Pension Funds)</p>	<p>Agree generally with analysis. Soft commissions may be a source of conflicts, but represent valuable tool. INVERCO is involved in working group that is establishing standards of good practice. Should identify conflicts, limit to either execution (defined by objective, temporal and qualitative standards) or research (relevant, elaborate, timely, original). Should have a list of prohibited services. Broker and management</p>

	company should review to determine what is execution and research; done only if total commission paid exceeds 1 million euro and if plan to enter commission sharing arrangement. Should disclose to investors and regulator through prospectus and annual report.
LIM Advisors (member of AIMA)	All types of soft dollars should be banned.
ROBECO (Dutch asset manager)	Generally agrees with the conflicts identified. Should analyze commission sharing agreements. Believes that execution services are so tightly connected to research that complete unbundling is not desirable.
BVI (German fund and asset management industry association)	Agree that not ready for international standards. Agree with overall assessment of key issues.
ICSA (International Council of Securities Associations - represents and/or regulates most of the world's equity and fixed income markets)	Agree that SC5 should monitor developments over next two years before considering whether to develop general principles. Report should more clearly articulate that the benchmark for determining appropriateness is whether services enhance investment decision making or order execution quality <u>for the benefit of investors</u> . Best execution does not necessarily mean lowest commission cost – there are benefits of soft commissions. Footnote 5 indicates that the EU Commission recommends that soft commissions should not include clearing and execution but rest of report indicates it should.
Alliance in Support of Independent Research (U.S. group promoting regulation that supports independent research)	US and UK regulatory action resulted in guidelines that properly address any conflicts created by soft commissions. Believe that soft commission arrangements do not result in overtrading and believe that soft commissions do not disfavor the use of ECNs because many ECNs provide soft commission arrangements as part of execution services.