



*International Securities Association For Institutional Trade Communication*

# **US Alternative Commissions Working Group**

## **Communication of Alternative Commission Details – Market Practice**

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### **DISCLAIMER**

This market practice document has been developed by the International Securities Association for Institutional Trade Communication (ISITC) as a statement of professional practices recommended by ISITC. Institutions providing the information recommended in this document will benefit from the efficiencies inherent in a more automated transaction process. Although all institutions are encouraged to act consistently with this document, none are required to do so, and a failure to do so is not, in and of itself, evidence of negligent or inappropriate conduct.



## Document History

Version #	Change Date	Description of Change	Page
1.0	March 14, 2007	Initial document with feedback from 2/26 and 3/6 conference calls	
1.1	April 23, 2007	<ol style="list-style-type: none"> <li>1. Within the scope definition, expanded verbiage under retail directed commission.</li> <li>2. Within the best practice on communicating alternative commission details on allocations, revised the text to focus on the business process rather than the vendor-specific allocation data fields/format.</li> <li>3. Moved vendor-specific allocation data fields/format to the appendix.</li> </ol>	
1.2	May 21, 2007	<ol style="list-style-type: none"> <li>1. Use of new market practice template</li> <li>2. Expansion of scope to include all forms of communicating alternative commission details (i.e. allocation, order, up front agreements)</li> <li>3. Added Definitions</li> <li>4. Added Actors and Roles</li> <li>5. Added Activity Diagrams</li> <li>6. Eliminated alternative commission arrangement templates from the appendix</li> </ol>	5 – 14
1.3	June 1, 2007	<ol style="list-style-type: none"> <li>1. Added Client Commission Arrangement to Definitions section</li> <li>2. Revised Activity diagrams</li> </ol>	6, 11-14
1.4	August 16, 2007	<ol style="list-style-type: none"> <li>1. References to Money Manager and Investment Manager have been revised to Asset Manager</li> <li>2. Under Scope, included a definition of alternative commission arrangement and updated reasons why Retail directed commission and Step ins/outs are out of scope</li> <li>3. Added "Mutual Funds" as additional Actor under Role "Beneficial Owner"</li> <li>4. Revised Introduced Brokerage activity diagram to include scenario where an optional Plan Administrator is a participant in the business process</li> <li>5. Updated Market Practice Rules for Introduced Brokerage (accommodating an optional Plan Administrator) and Commission Sharing Arrangements (FSA footnote)</li> <li>6. Updated vendor specific data elements and formats (in appendix) to accommodate an optional Plan Administrator for Introduced Brokerage</li> </ol>	4-10, 12-15, 18-20



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## 1.0 Background

The ISITC Alternative Commissions working group was formed in September 2005 with the overall objective of improving the efficiencies of various participants in conducting alternative commission business through the introduction of industry standardization and best practices.

The initial focus of the working group was to develop a clear and concise understanding of the alternative commissions business by creating a business primer. The business primer includes the following two artifacts (which are available on the ISITC web site):

- Glossary of terms in alternative commissions
- Alternative commission arrangement template

The glossary of terms provides a common language pertaining to the alternative commissions space. For example, the working group agreed that the following terms represent the distinct types of alternative commission arrangements (including well-known aliases):

- Independent research (aliases: soft dollar)
- Introduced brokerage
  - Optionally crediting a specific broker (reflecting the use of a plan administrator)
- Commission recapture (aliases: directed commission, plan sponsor)
  - Optionally crediting a specific broker (reflecting the use of a plan administrator)
- Commission Sharing Arrangement (CSA)
  - Optionally crediting a specific entity/institution<sup>1</sup>

For each commission arrangement noted above, an alternative commission arrangement template was created providing a flow diagram/description as well as the roles/responsibilities, motivation and considerations for each of the participants. The alternative commission arrangement templates are available on the ISITC web site.

The lack of industry standardization around the communication of alternative commission details was identified as one of the major pain points in conducting and processing this business for both assets managers and Executing Broker/Dealers (B/Ds). In response, the working group conducted a survey whose purpose was to gather intelligence regarding how asset managers and B/Ds currently communicate alternative commission details as well as how these details should be communicated moving forward.

Based on the survey responses, the working group has constructed a “draft” market practice around the communication of alternative commission details. The working group held conference calls to vet the “draft” market practice with a broad audience of working group members, respondents to the survey as well as non-ISITC asset managers and B/Ds who are familiar with the processing of the alternative commission business. Upon reaching a consensus, the working group will publish a final and approved market practice available to the industry.

### 1.1 Scope

#### *1.1.1 Alternative Commission Arrangements*

An alternative commission arrangement can be defined as a mechanism that allows market participants to obtain and pay for any research and/or market data service provided above and beyond pure execution. The alternative commission arrangements that are in scope of the market practice are noted above.

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<sup>1</sup> The SEC recently issued a no action letter to Goldman Sachs, which will allow research providers who are not B/Ds to participate in CSAs. Hence, we will assume that B/Ds as well as non-financial entities/institutions can be denoted to receive commission credit on CSA allocations.

The scenario where an asset manager directs commission to a retail financial consultant (also known as “retail directed commission”) is considered out of scope of this version of the market practice given that:

- Use of this type of arrangement is extremely limited
- This type of alternative commission arrangement is not conducive to a market practice as there is no known industry standard identifier available to the asset manager to denote the retail financial consultant at the brokerage firm to receive commission credit

Also, the working group does not consider step ins/outs as alternative commission arrangements (and hence out of scope of the market practice) given that there are no research and/or market data services provided above and beyond pure execution.

### ***1.1.2 Communication Mechanisms***

Based on the survey responses, asset managers use a variety of electronic and non-electronic allocation mechanisms for communicating alternative commission details to B/Ds. The most commonly used mechanisms include:

- Electronic
  - FIX
  - Omgeo OASYS
  - Omgeo OASYS Global
  - Omgeo CTM
- Non-electronic
  - E-mail
  - Fax
  - Spreadsheet
  - Phone

In addition, there are asset managers that communicate alternative commission details using non-allocation methodologies. For example:

- Up front agreements between the asset manager and B/D (e.g. customer trades associated with all FIX orders should be booked CSA)
- Order level (e.g. order is denoted as Soft Dollar at order entry – all customer trades associated with the order should be booked Soft Dollar)

Although the allocation is the predominant methodology used by asset managers to communicate these details to B/Ds, the market practice encompasses all forms of communicating alternative commission details between the asset manager and B/D.

Finally, the market practice includes a proposal for identifying the entity/institution to receive commission credit on the allocation, which was also noted as a major pain point from the results of the survey.

## **1.2 Definitions**

The working group has developed a glossary to ensure a common understanding of the terms and definitions pertaining to the alternative commissions business. A subset of the full glossary is presented below. The full glossary of terms is available on the ISITC web site.

Term	Category	Definition	Alias	Example
Asset Manager	Participant	A registered investment advisor who manages money investments for people, institutions, banks, municipalities, etc.	Investment Manager, Fund Manager, Money Manager	
Beneficial Owner	Participant	Underlying account which pays the commissions and for which the <b>asset manager</b> acts. A person, such as trustee or pension plan sponsor or administrator who does not have investment discretion over the beneficial owner's assets, may represent a beneficial owner.		
Broker Dealer	Participant	An individual or firm who can act either as an agent and take a risk less position as an intermediary between a buyer and seller, or acts as a principal and stands ready to buy and sell for its own account.		
Client Commission Arrangement	Brokerage Service	Umbrella term that encompasses any service above and beyond pure execution.	CCA	
Client Directed Broker	Participant	See <b>Retail Directed Broker</b> .	Retail Directed Broker	
Commission	Commission Arrangement	A fee charged by a <b>broker</b> or <b>agent</b> for his/her service in facilitating a transaction, such as the buying or selling of securities. In the case of securities trading, brokers can be split into two broad categories depending on the commissions they charge. Discount Brokers charge relatively low commissions, but provide no services beyond executing trades. Full service brokers charge higher commissions, but provide research and investment advisory services.		
Commission Recapture	Commission Arrangement	An agreement where a client of an <b>investment advisor</b> mandates an <b>asset manager</b> to direct a portion of the fund's transactions through one or more executing broker dealers. The executing broker dealer then rebates a percentage of the commissions back to the pension fund reducing expenses incurred by the fund. Optionally, a <b>commission recapture agent</b> participates in the arrangement to administer commissions and/or research services.	Directed Brokerage, Directed Commission, Plan Sponsor Arrangement	For example, the pension fund can retain a portion of their commissions to offset the cost of administrative duties or have the broker dealer pay out to research related vendors.

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Commission Recapture Agent	Participant	A <b>broker dealer</b> who administers commissions and/or research services in exchange for a portion of the commission.	Plan Administrator	
Commission Sharing Arrangement	Commission Arrangement	Agreement between an executing <b>broker dealer</b> and one or more research providers for their research / brokerage services. The commission split for execution is negotiated between the <b>asset manager</b> and the executing <b>broker dealer</b> . The executing <b>broker dealer</b> retains the execution element of the gross commission and then pays out the research commission to the pool of research providers as directed by the <b>asset manager</b> . (US Definition)	CSA, CMA (Commission Management Arrangement)	
Directed Broker	Participant	Broker to which a trade will be directed for either execution or clearing services (e.g., <b>Step-Out Broker</b> ) or to which the commission of a trade will be directed (e.g., <b>Broker of Credit, Client Directed Broker</b> , etc.)	Step-out Broker, Broker of Credit, Client Directed Broker, etc. depending on the Commission Arrangement	
Executing Broker	Participant	Broker who executes a trade of securities in the market.	B/D, Broker Dealer	
Hard Dollar	Commission Arrangement	From a broker dealer perspective, it refers to trades executed with a <b>broker dealer</b> without direction to any parties other than the executing broker dealer such that the <b>executing broker</b> retains all of the commissions. From an <b>asset managers'</b> perspective, it refers to direct payment for services rendered.		
Independent Research	Commission Arrangement	A tri-party agreement between an <b>asset manager, broker dealer</b> and <b>research vendor</b> in which the <b>asset manager</b> executes non-principal trades at the broker dealer and the executing broker dealer then pays for the <b>asset manager's</b> research related expenses, where the research related expenses refer to products and services provided to <b>asset manager</b> that are included within the Section 28 (e) safe harbor and for other purposes.	Soft Dollar	

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Introduced Brokerage	Commission Arrangement	<p>A bi-party arrangement between the executing broker and the street research broker/dealer; it is used in the context of an <b>asset manager</b> executing with a trading partner to pay another research broker/dealer for their brokerage services, including proprietary research. The parties agree on a split of commissions generated under the agreement.</p> <p>Notes:</p> <ul style="list-style-type: none"> <li>• When an <b>asset manager</b> uses one broker for execution and post-trade processing and a different broker for independent research, the <b>asset manager</b> should not structure the allocation as a Step-in/out, as the broker providing independent research would then receive 100% of the commission.</li> <li>• Under this scenario, the <b>asset manager</b> should instead structure the allocation as an Introducing Brokerage transaction resulting in an agreed upon split of commissions between the two brokers.</li> </ul>	Introducing Brokerage	<b>Asset Manager</b> 'ABC' trades at Broker Dealer 'All Brokerage' whom in turn pays a percentage of the commissions to Research Broker Dealer 'Sector Analysis Reporting.'
Introducing Broker	Participant	A <b>broker dealer</b> who provides research services to an asset manager in exchange for a share of the commissions with the <b>executing broker dealer</b> .		<b>Asset Manager</b> ABC trades at Broker Dealer All Brokerage who in turn pays a percentage of the commissions to Research Broker Dealer Sector Analysis Reporting.
Plan Administrator	Participant	A <b>broker dealer</b> who administers commissions and/or research services in exchange for a portion of the commission.	Commission Recapture Agent	
Plan Sponsor	Participant	An employer who sets up a pension plan. Used in a commissions context for <b>commission recapture</b> to the pension fund.		See <b>Plan Sponsor Arrangement</b> .
Plan Sponsor Arrangement	Commission Arrangement	An agreement where a pension fund receives a rebate back on commissions to offset the cost of the fund's maintenance or where the executing broker dealer pays the fund expenses.	Rebate Commission, Directed Commission, Directed Brokerage, Commission Recapture	The pension fund of XYZ executes trades through a broker dealer and receives a rebate or percentage of their commissions back, or the executing broker dealer pays the pension fund's vendor expenses.

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Rebate Commission	Commission Arrangement	See <b>Commission Recapture</b> .	Directed Brokerage, Commission Recapture, Plan Sponsor Arrangement	
Research Broker	Participant	A <b>broker dealer</b> with little or no capacity to execute orders or a Research Boutique that provides independent research.		
Research Services	Brokerage Service	Products and services provided by a broker to an investment advisor that are included within the scope of the 28 (e) Safe Harbor act. For purposes of the safe harbor, products or services provided by a broker can include both proprietary and third-party products and services so long as it provides legal and appropriate assistance to the investment advisor in connection with the performance of its investment decision making responsibilities.		
Retail Directed Broker	Participant	A non-institutional retail financial consultant, or registered representative, who has a relationship with an institutional client and provides advice or services such that the institutional client wants to compensate that person by directing some commission dollar to him/her.	Client Directed Broker, Account Directed Broker, Registered Representative, Retail Broker	The State of ABC wishes to direct commissions to a Registered Rep. in the state of ABC for services provided.
Safe harbor / SEC Section 28 (e)	Regulation	The "safe harbor" set forth in Section 28(e) of the Securities Exchange Act of 1934 that provides that an investment advisor is not to be regarded in breach of any duty should accounts over which it exercises investment discretion to pay more than the lowest commission rate available if the investment advisor makes a good faith determination that the value of the brokerage and research services received are commensurate with the rate, and otherwise satisfies the requirements of the safe harbor. <b>Research Brokerage services</b> obtained in relation to commissions paid to a Broker Dealer acting in an "agency" capacity.		

Step-in / Step-out	Commission Arrangement	A type of transaction whereby an <b>asset manager</b> executes an order with one broker (i.e., <b>Step-out Broker</b> ) and performs post-trade processing (clearing and settlement) with a different broker (i.e., <b>Step-in Broker</b> ) for a portion or all of the trade, and a portion or all of the accounts. The broker(s) performing the post-trade processing (i.e., where the subs A/Cs are custodied) will receive the commission. If a full step-in then the <b>Step-in Broker</b> will receive the full commission. If a partial step-in then the <b>executing broker dealer</b> and <b>Step-in Broker</b> will split the commission based on where the sub A/Cs are custodied. Whether a partial or full step-in, the whole trade is executed at the same price for all accounts, including those accounts the execution broker steps out on. <b>Asset managers</b> use step-outs as a means to meet institutional and plan mandates for directions (i.e., soft, recapture, plan recapture) and enables the investment advisor to trade one block order as opposed to splitting or stripping orders into directed and non-directed processes.(Note: A Step-out arrangement should not be confused with, or used for, Introduced Brokerage. See Introduced Brokerage.)		
Street Research Broker	Participant	Registered Broker who provides only research and has no trading desk.	Research Broker, Boutique Broker	Any Research House with or without a trading desk.

### 1.3 Actors and Roles

The roles involved in the alternative commission business processes are as follows:

1. Asset Manager – The party who manages the assets and executes orders on behalf of the Beneficial Owner.
2. Executing Party – The party who executes orders and allocates customer trades as directed by the Asset Manager.
3. Beneficial Owner – The party whose assets are being traded by the Asset Manager.
4. Research Provider – The party who provides research and/or market data services to the Asset Manager.
5. Plan Administrator – The party who administers commissions and/or services for the plan’s benefit.

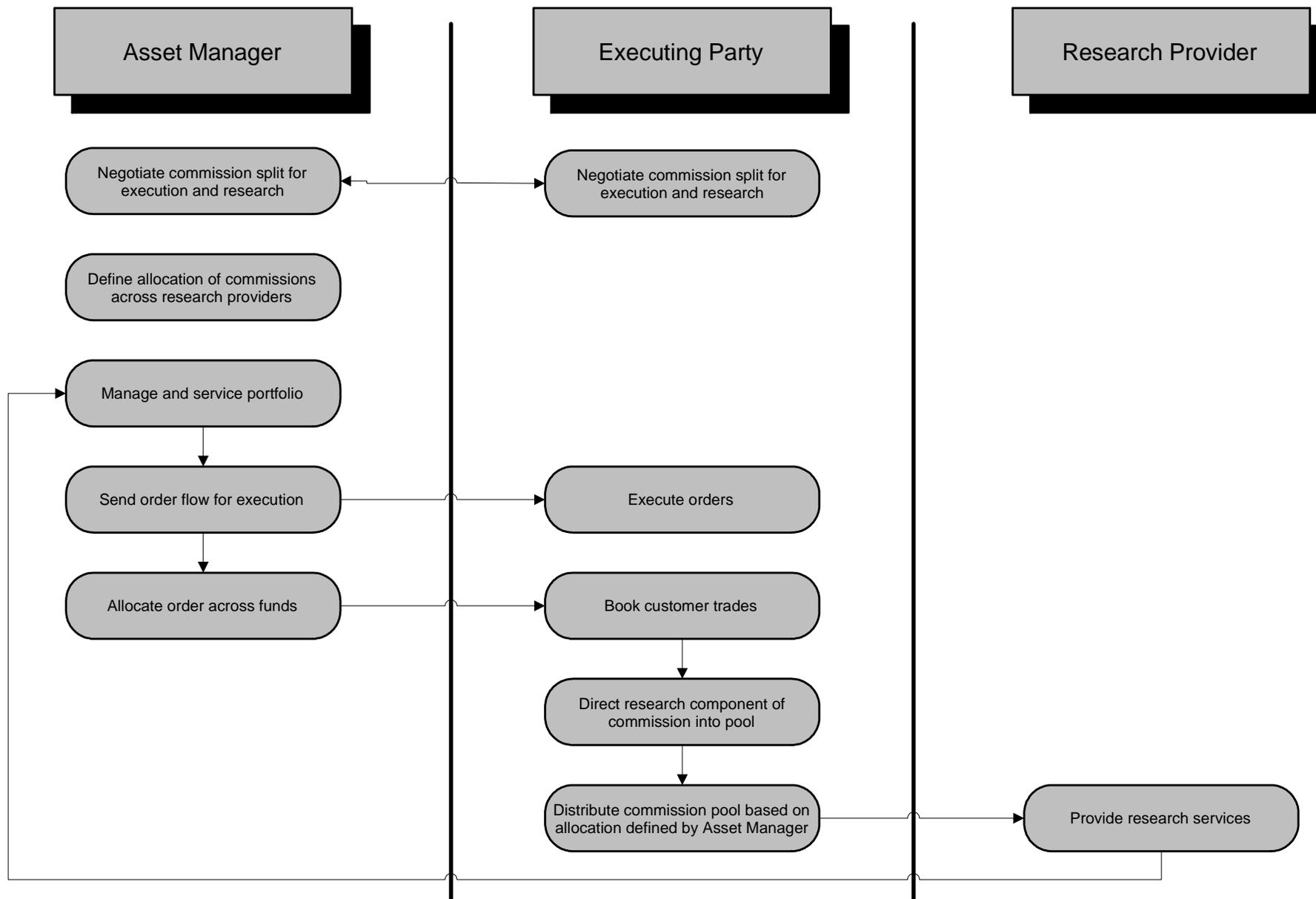
The actors that would typically play these roles are as follows:

Role	Asset Manager	Executing Party	Beneficial Owner	Research Provider	Plan Administrator
Actor	Asset Manager	Executing Broker/Dealer	Pension Fund, Plan Sponsor, Mutual Fund	Research Broker/Dealer, Research Boutique	Recapture Agent

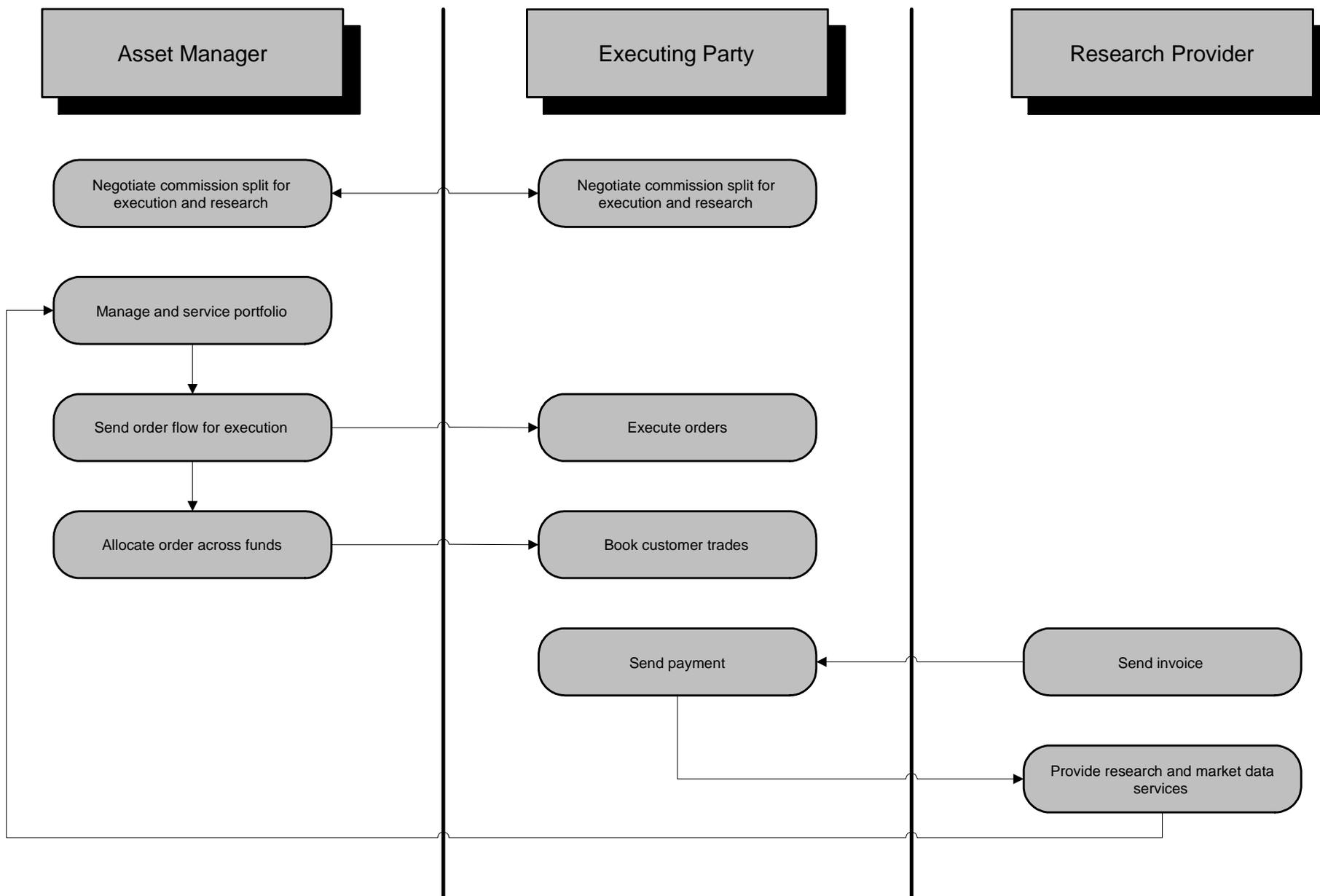
## 1.4 Activity Diagrams

This section shows the main activities that yield an observable result to one or more actors and that allow the business process described to achieve its business objective

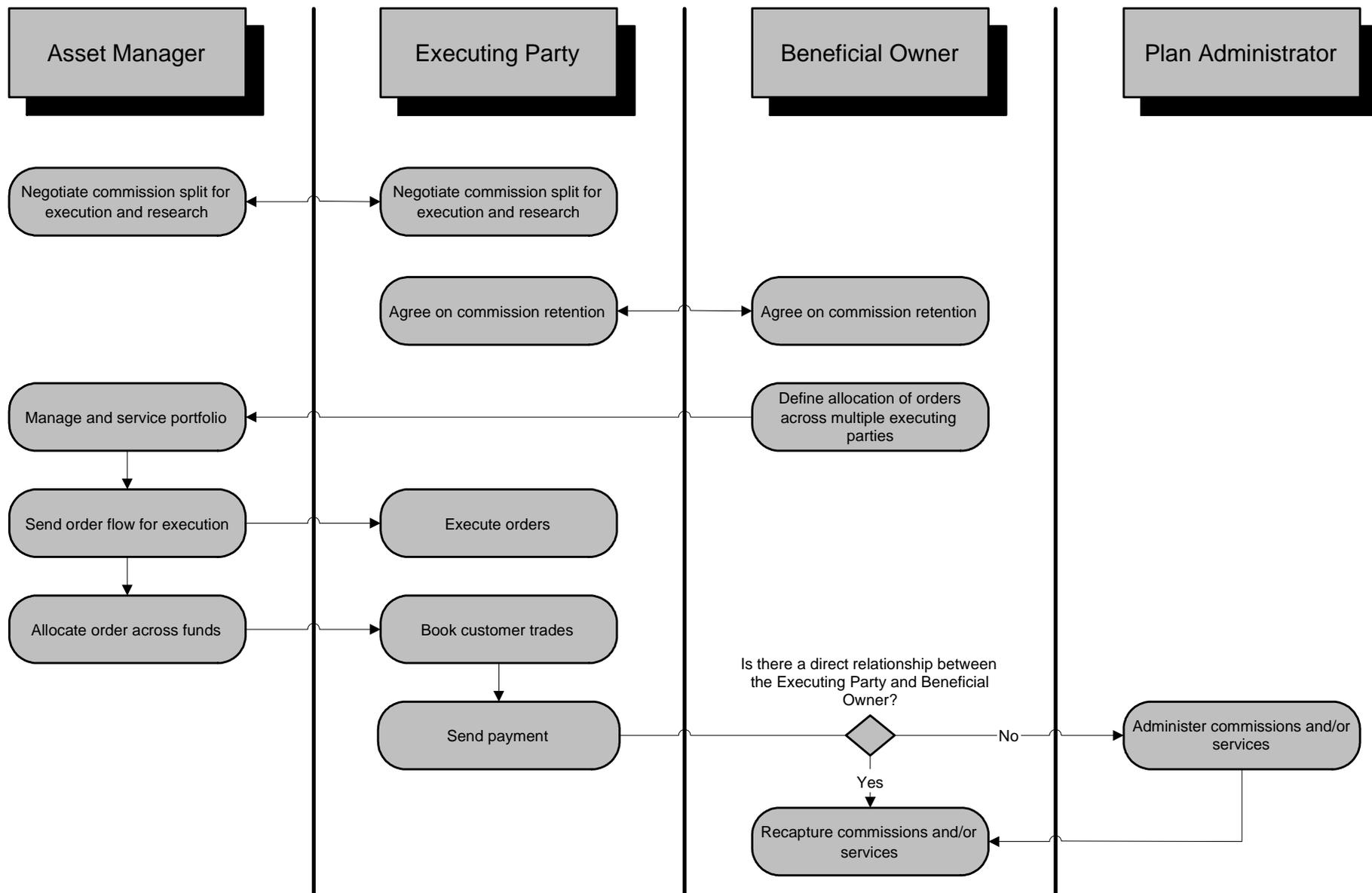
### Activity Diagram - Commission Sharing Arrangement (CSA)



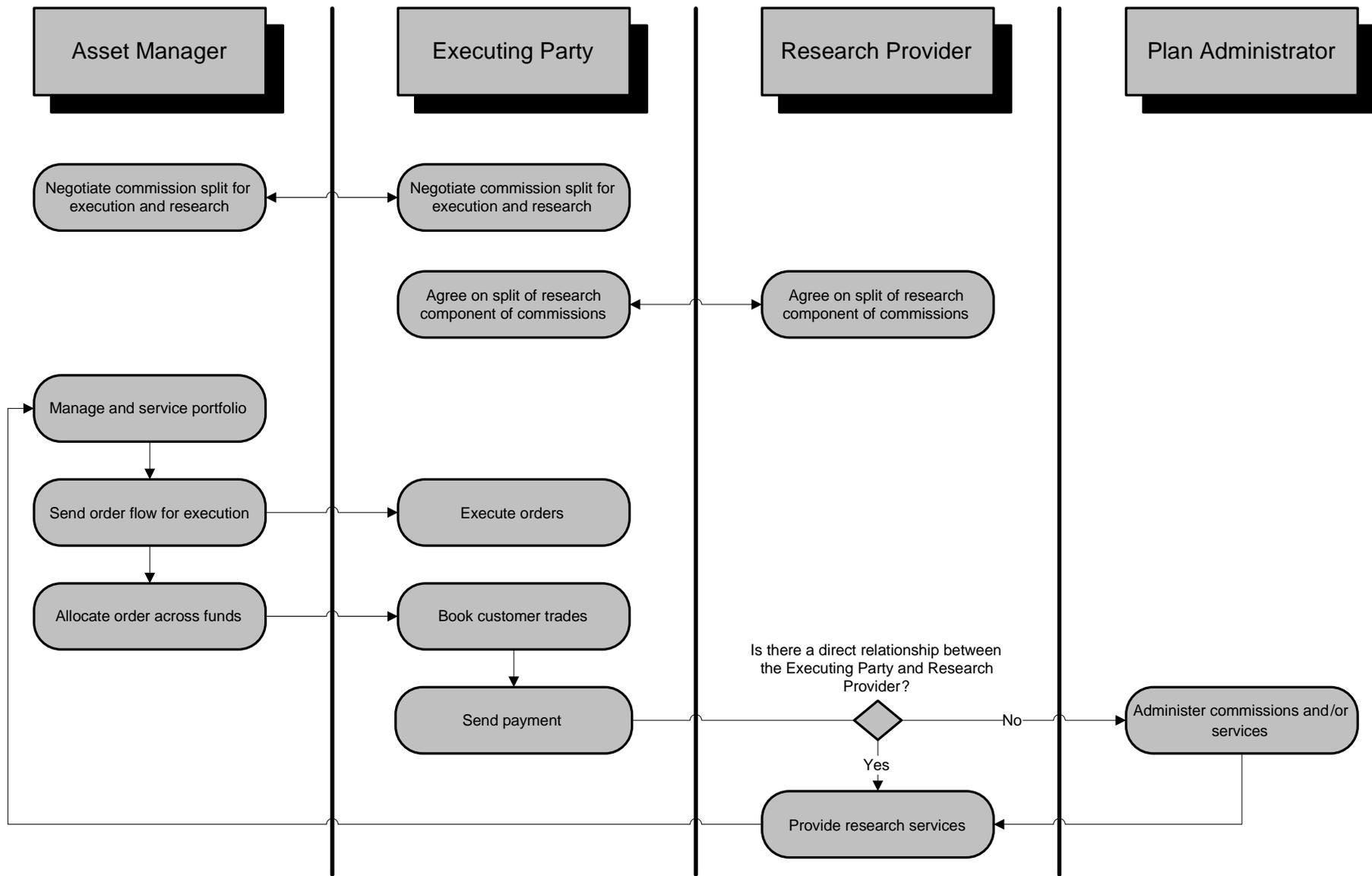
### Activity Diagram - Independent Research



### Activity Diagram - Commission Recapture



### Activity Diagram - Introduced Brokerage



## 1.5 Sequence Diagrams

This section should describe the high-level communication requirements that the business process requires. It shows the typical exchanges of communication in the context of a transaction. Note that for the same business process, there may be more than two actors/roles involved having different communication requirements.

As noted earlier, the communication of alternative commission details is typically performed via the trade allocation and occasionally at time of order entry or via an up front agreement between the Asset Manager and Executing Party. There is minimal back and forth communication (i.e. messaging) between parties for these business processes. As a result, it was decided to bypass this section in the market practice document as it provided little additional value.

## **2.0 Business Definition**

### **2.1 Business Data Requirements**

This section will describe the business information required for the business processes to occur.

#### **2.1.1 Entity/Institution to Receive Commission Credit**

The objective here is to enable the Asset Manager to communicate the entity/institution to receive commission credit (e.g. Research Provider) in an unambiguous manner using an industry-recognized identifier. The Executing Party will then be able to uniquely identify the entity/institution to receive commission credit in an automated fashion.

Our assumption is that the entity/institution to receive commission credit falls into one of the following categories:

- Financial or non-financial entity/institution
- Within the financial community, B/D or non-B/D
- US or non-US entity/institution

The working group members recommend that the Asset Manager use the Bank Identification Code (BIC) maintained by SWIFT to identify the entity/institution receiving commission credit given the following characteristics of the BIC:

- The BIC is a unique identifier that identifies precisely the entity or institution, financial or otherwise.
- The BIC is meant for universal usage and not just on the SWIFT network.
- Both B/Ds and non-B/Ds can be assigned a BIC.
- Both US and non-US entities are eligible to be assigned a BIC<sup>2</sup>.
- Both financial and non-financial entities are eligible to be assigned a BIC<sup>3</sup>.
- SWIFT provides several low-cost options for market participants (i.e. Asset Managers, Executing Parties, OMS vendors and utilities) to download the master list of BIC codes to their internal database

#### **2.1.2 Communicating Alternative Commission Details**

It is required that the Asset Manager denotes the type of alternative commission arrangement:

- Independent research (aliases: soft dollar)
- Introduced brokerage
- Commission recapture (aliases: directed commission, plan sponsor)
- Commission Sharing Arrangement (CSA)

In addition, based on the specific alternative commission arrangement being communicated, the Asset Manager may need to provide the entity/institution to receive commission credit. These requirements will be presented in the next section (i.e. market practice rules).

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<sup>2</sup> In the event that the entity/institution does not have a SWIFT BIC code, SWIFT does allow the entity/institution to establish a BIC code, which is free of charge to the entity/institution, though cannot be used for routing purposes within the SWIFT network.

<sup>3</sup> Non-financial or corporate entities are eligible to receive a Business Entity Identifier (BEI) from SWIFT, which is structured and behaves exactly as a BIC.

## **2.2 Market Practice Rules**

This section describes the agreed market practices for the business processes presented in this document.

### Commission Sharing Arrangement<sup>4</sup>

- In the case where the Asset Manager wants to credit a specific Research Provider (in this case, any entity/institution), the Asset Manager should communicate the Research Provider to receive commission credit using the BIC as recommended above

### Introduced Brokerage

- The Asset Manager should communicate the Research Provider (in this case, a broker/dealer) to receive commission credit using the BIC as recommended above
- In the case where a Plan Administrator participates in the business process, the Asset Manager should communicate the broker/dealer acting as Plan Administrator using the BIC as recommended above

### Commission Recapture

- In the case where a Plan Administrator participates in the business process, the Asset Manager should communicate the broker/dealer acting as Plan Administrator using the BIC as recommended above
- When there is a direct relationship between the Executing Party and Beneficial Owner, it is recommended that the Asset Manager communicate the Executing Party using the BIC as recommended above
- If the Asset Manager does not communicate any entity/institution for this business process, it should be assumed that there is a direct relationship between the Executing Party and Beneficial Owner (no Plan Administrator)

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<sup>4</sup> The FSA allows an optional Plan Administrator to participate in the CSA business process. That is, the Asset Manager executes orders with various broker dealers and directs their commissions to the Plan Administrator. The Asset Manager then directs the Plan Administrator to credit Research Providers based on a specified allocation.

### 3.0 Appendix A – Communicating Alternative Commission Details on Allocations – Vendor Specific Data Elements and Formats

Allocation Method	Commission Arrangement	Best Practice	Mandatory / Optional
Omgeo OASYS	Independent Research	<ul style="list-style-type: none"> <li>Set “Soft Dollar” flag to “S” (sub-allocation level)</li> </ul>	Mandatory
	Introduced Brokerage	<ul style="list-style-type: none"> <li>Populate “BOC” field with the BIC representing the Introducing B/D</li> </ul>	Mandatory
		<ul style="list-style-type: none"> <li>Populate Sub-allocation “Comments” field with BIC representing the Plan Administrator</li> </ul>	Optional (populate only if a Plan Administrator is a participant)
	Commission Recapture	<ul style="list-style-type: none"> <li>Populate Sub-allocation “Comments” field with “COMMISSION RECAPTURE”</li> </ul>	Mandatory
		<ul style="list-style-type: none"> <li>Populate “BOC” field with the BIC representing the B/D acting as Plan Administrator</li> </ul>	Optional though recommended <sup>5</sup>
	Commission Sharing Arrangement	<ul style="list-style-type: none"> <li>Populate Sub-allocation “Comments” field with “COMMISSION SHARING ARRANGEMENT”</li> </ul>	Mandatory
<ul style="list-style-type: none"> <li>Populate “BOC” field with the BIC/BEI representing the entity/institution</li> </ul>		Optional (populate only if there is a need to credit a specific entity/institution)	

<sup>5</sup> The working group recommends that the Asset Manager populate the BOC field with the BIC representing the Executing Party when there is a direct relationship between the Executing Party and Beneficial Owner. If the Asset Manager does not populate the BOC field then assume there is a direct relationship between the Executing Party and Beneficial Owner.

Allocation Method	Commission Arrangement	Best Practice	Mandatory / Optional
FIX	Independent Research	Set "Process Code" field to "1" (Soft)	Mandatory
	Introduced Brokerage	Populate "BOC" field with the BIC representing the Introducing B/D	Mandatory
		Populate "AllocText" field with BIC representing the Plan Administrator	Optional (populate only if a Plan Administrator is a participant)
	Commission Recapture	Set "Process Code" field to "6" (Directed)	Mandatory
		Populate "BOC" field with the BIC representing the B/D acting as Plan Administrator	Optional though recommended <sup>6</sup>
	Commission Sharing Arrangement	Populate "AllocText" field with "COMMISSION SHARING ARRANGEMENT"	Mandatory
Populate "BOC" field with the BIC/BEI representing the entity/institution		Optional (populate only if there is a need to credit a specific entity/institution)	

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<sup>6</sup> The working group recommends that the Asset Manager populate the BOC field with the BIC representing the Executing Party when there is a direct relationship between the Executing Party and Plan Administrator. If the Asset Manager does not populate the BOC field then assume there is a direct relationship between the Executing Party and Plan Administrator.