SIFMA

Securities Industry and
Financial Markets Association

ASSET MANAGEMENT GROUP

Best Execution Guidelines *for* Fixed-Income Securities

WHITE PAPER

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I. INTRODUCTION

Background

It has long been acknowledged that an asset management firm is a fiduciary subject to a number of duties when acting on behalf of its clients. Among the most important of these duties is the requirement that an asset manager seek "best execution." Best execution is not formally defined in the U.S. federal securities laws and securities industry participants are not uniform in their definition of the term. Industry participants and regulators seem to agree that best execution contemplates an asset manager's executing securities transactions on behalf of a client with the goal of maximizing value for the client under the particular circumstances occurring at the time of a transaction, and generally acknowledge that best execution is not easily quantifiable and encompasses many factors.

Much of the existing guidance regarding an asset manager's duty to seek best execution has been developed in the context of equity securities and the equity markets. Significant differences exist, however, between the equity and fixed-income markets. A far greater number and far more types of instruments, for example, trade on fixed-income markets than on equity markets. The fixed-income markets are characterized by bilateral transactions between parties as principals as opposed to equity markets in which transactions are undertaken on centralized exchanges facilitated by agents. Unlike their equity counterparts, fixed-income markets are fragmented and often subject to limited transparency as a result of the absence of a centralized reporting mechanism for completed transactions.

It is clear that the duty to seek best execution imposed on an asset manager is the same regardless of whether the manager is undertaking equity or fixed-income transactions. The characteristics of the fixed-income markets present a manager with practical difficulties, though, in assessing and documenting fixed-income best execution not faced when undertaking equity transactions. These difficulties in turn result in significant challenges to an asset management firm when developing, and regulators when evaluating, policies and procedures designed to ensure compliance with the duty of best execution of fixed-income security transactions. The lack of existing practical guidance regarding that duty exacerbates the challenges.

Goal of the White Paper

Recognizing the complexities and challenges surrounding best execution in the fixed-income context, the Asset Management Group (the "AMG") of the Securities Industry and Financial Markets Association ("SIFMA") has developed the Best Execution Guidelines for Fixed-Income Securities (the "Guidelines") set out in this White Paper. The Guidelines are intended to fill the current void of practical guidance and represent a synthesis of practices at, and experiences of, a number of SIFMA member firms.

The AMG and SIFMA recognize that asset management firms have diverse business operations. The AMG and SIFMA also acknowledge that some firms may not be able to devote the resources to technology that may enable other firms to access market data relating to fixed-income securities and combine this data with proprietary data to use in their investment processes.

Differences in the operation of firms and the extent of their resources, together with the challenges posed by the structure of fixed-income markets make it difficult, if not impossible, to define a single methodology or standard to define and/or quantify best execution in the fixed-income markets. The Guidelines are thus not intended to mandate, recommend or advocate any single set of procedures or standards of practices for all asset management firms.

The Guidelines instead articulate general principles and provide context and guidance so that individual firms can establish processes and procedures that create a systematic, repeatable, adaptable, and demonstrable approach to seeking best execution on an overall basis. Firms reviewing and considering the Guidelines are encouraged to assess their business practices, potential conflicts, risk management and control environments, and to use the Guidelines in developing best execution policies and procedures that reflect their operations, personnel and resources.

Developing the Guidelines

The Guidelines were developed in four stages. The AMG initially formulated a preliminary set of best execution guidelines on the basis of input from several SIFMA member asset management firms and distributed those preliminary guidelines to SIFMA member firms. Volunteer AMG firms were then enlisted to review the preliminary guidelines and assess their potential effectiveness. SIFMA representatives and outside legal counsel next sought to further assess the potential operation and effectiveness of the preliminary guidelines by interviewing members of portfolio management and/or trading staff and legal and compliance personnel of the volunteer firms. Upon completion of the interviews, SIFMA worked with the AMG steering committee and outside counsel to synthesize the information and formalize the Guidelines.

Beyond the Scope of the White Paper

The AMG concluded that it was of paramount importance to seek to fill the void in best execution guidance in the context of fixed-income securities as soon as reasonably possible. The AMG concluded further that the Guidelines should be published as soon as possible and that certain topics relating to fixed-income best execution guidance be left for later initiatives. In reaching the latter conclusion, the AMG in no way is intending to minimize the significance of these topics. Included among these topics are the following:

Derivatives – A current significant trend among asset managers is the use of various types of derivative instruments. Although volunteer firms uniformly acknowledge this trend and that the Guidelines could have applicability to those instruments, the firms were generally of the view that the topic of best execution in the context of derivatives was more appropriately the subject of future study. For that reason, the topic is addressed below only briefly in this White Paper.

International Guidance – Members of the AMG uniformly recognize that many, if not most, asset management firms today purchase and sell financial instruments on markets outside of the United States. They also are fully aware that guidance regarding the financial markets is regularly made available from financial regulators outside of the United States. Part of the European Commission's Financial Services Action Plan, the Markets in Financial Instruments Directive ("MiFID"), for example, is aimed at establishing comprehensive regulations for investment services and financial markets in the European Union. MiFID has introduced unified European requirements for the best execution of client orders in all MiFID financial instruments. The AMG and SIFMA believe that the principles and guidelines set out in this White Paper are not inconsistent with the framework and requirements developed by MiFID, but concluded that a detailed discussion of MiFID's best execution process-based approach and requirements is beyond the scope of this White Paper.

Plans Subject to the U.S. Employee Retirement Income Security Act of 1974 – Among the clients of many AMG members are employee benefit plans subject to the requirements of the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"). ERISA, among other things, imposes strict obligations on asset managers that meet ERISA's definition of "fiduciary." One such obligation placed on a fiduciary is to obtain the most favorable terms for investment transactions undertaken on behalf of a plan subject to ERISA. Although they determined not to include a detailed analysis of this duty, the AMG members believe that the Guidelines can provide valuable assistance to an asset management firm seeking to fulfill its obligation and the Guidelines, appropriately applied, should satisfy the fiduciary duty standards of ERISA.

Substance of the White Paper

The remainder of this White Paper is divided in to six sections. Sections II and III set out background regarding the duty of best execution generally and the difficulty of applying the duty to fixed-income securities in light of the unique characteristics of the market. Section IV seeks to synthesize existing guidance in light of the complexities of the fixed-income securities and sets out a definition of fixed-income best execution and core elements of a process designed to ensure compliance with the duty. Section V sets out the Guidelines themselves, providing contextual guidance for satisfying the duty of best execution. Section VI presents brief discussions of derivative instruments and achieving best execution, and how the Guidelines can be applied in a manner consistent with international requirements and those imposed under ERISA. Finally, Section VII presents the conclusions of this White Paper.

II. BEST EXECUTION AND FIXED-INCOME SECURITIES: EXISTING GUIDANCE

Under a well-settled principle of law, an asset management firm is a fiduciary subject to a number of specific obligations when acting on behalf of its clients.[1] Among these obligations is the duty of a manager "to seek best execution for client trades."[2] The root of the duty is the common law obligation imposed on an agent to act exclusively in its principal's best interests.[3]

Although the duty to seek best execution has long been acknowledged to be a core responsibility of an asset manager, the term is neither included in the U.S. federal securities laws nor uniformly defined by securities industry participants or regulators. In an often cited statement of the duty that appears to have been articulated with equity securities in mind, the U.S. Securities and Exchange Commission ("Commission") in 1986 said that, in seeking best execution, an asset manager must "execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances."[4] The Commission has said that, in seeking this standard, a manager "should consider the full range and quality of a broker's services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness to

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1 *See, e.g., Securities and Exchange Commission v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

2 *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Securities Exchange Act Release No. 54,165 (Jul. 18, 2006).

3 Restatement (Second) of Agency § 387 (1958).

4 *Interpretive Release Concerning the Scope of Section 28(e) of the Securities Exchange Act of 1934 and Related Matters*, Securities Exchange Act Release No. 23,170 at 31-32 (Apr. 23, 1986).

the … manager."[5] The determinative factor, according to the Commission, "is not the lowest possible commission cost but whether the transaction represents the best qualitative execution for the managed account."[6]

Under many definitions of the best execution obligation of more recent vintage, which appear to be accepted by regulators and securities industry participants alike, an asset manager fulfills its duty by executing securities transactions on behalf of a client with the goal of maximizing value for the client under the particular circumstances occurring at the time of the transaction.[7] Defined in this way, the duty is also acknowledged as not easily quantifiable and encompassing many factors such as "the price of the security, commission amount, execution speed, confidentiality, market depth, capital commitment, recent order flow, and knowledge of the other side of the trade."[8] A well-defined process of reviewing and evaluating securities transactions undertaken on behalf of clients is seen by regulators as essential to showing that a manager has met its obligations.[9] Such a review contemplates a firm evaluating "periodically and systematically the quality of execution services received," and amending its procedures over time "as changes occur in the market that give rise to improved execution."[10] The importance of such a process to finding that a manager has fulfilled its obligation is reflected in, among other things, the Commission's position that a manager registered as an investment adviser under the U.S. Investment Advisers Act of 1940 should adopt written policies and procedures designed reasonably to ensure that the adviser satisfies the obligation.[11] A principal and overarching focus of the policies and procedure should be on potential conflicts of interest faced by an asset management firm in executing client transactions.[12]

Regulators, legal commentators and asset managers all appear to agree that the duty to seek best execution applies to client transactions in both equity and fixed-income securities. Yet, as suggested by the discussion above, virtually all existing guidance relating to the duty generally and to how it should be achieved as a practical matter seems to have been developed in the context of equity securities and the equity markets. Existing regulatory and industry guidance on best execution, for example, typically describes practices and assumes that an asset manager has access to information more reflective of what is normally associ-

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5 *Id.*

6 *Id.*

7 *See, e.g.,* Gene A. Gohlke, *What Constitutes Best Execution*, AIMR Conference Proceedings, May 5, 2000.

8 Lori A. Richards, *Valuation, Trading and Disclosure: Three Compliance Imperatives*, Remarks at the Investment Company Institute's 2001 Mutual Fund Conference (Jun. 14, 2001).

9 *Id.*

10 *In re Jamison, Eaton and Wood, Inc.*, Investment Advisers Act Release No. 2,129 (May 15, 2003).

11 Such policies and procedures are implemented by registered investment advisers in meeting a requirement imposed by Rule 206(4)-7 under the U.S. Investment Advisers Act of 1940.

12 *See generally, Jamison, supra* note 10; *In re Mark Bailey & Co.*, Investment Advisers Act Release No. 1,105 (Feb. 24, 1988).

ated with equity security transactions than those involved in fixed-income transactions. Existing guidance also generally seems to assume that best execution can be measured on a trade-by-trade basis, that is, by comparing a particular transaction in a particular security to a meaningful number of other transactions in the same security. Such a measurement can typically be accomplished with respect to equity securities traded on an exchange, but is generally not feasible for fixed-income securities. The degree of contemporaneous market and statistically meaningful[13] data for such measurement typically does not readily exist on an individual issue basis with respect to fixed-income securities.

III. BEST EXECUTION AND FIXED-INCOME SECURITIES: SPECIAL CONSIDERATIONS

As suggested by the discussion above, complicating the development of useful guidance for an asset management firm's duty to achieve best execution in undertaking transactions in fixed-income instruments are the significant differences between fixed-income and equity markets. Fixed-income markets differ from equity markets in at least five fundamental areas, each of which has a bearing on the process an asset management firm employs in seeking best execution: transparency, trading, size and liquidity, pricing, and trading for research.[14] A recognition of these differences is critical to the development of best execution guidelines for fixed-income asset managers because, as one commentator has noted, "[a] centralized exchange, like the [New York Stock Exchange], and the decentralized, dealer-intermediated market through which [fixed-income securities] are traded in the U.S., represent polar extremes in market design."[15]

Transparency

Market transparency refers to the amount of information regarding market conditions and transactions made public on a timely basis. Transparency is often categorized as either pre-trade transparency, which involves the dissemination of quotes (*i.e.,* publicly posted bid-ask spreads) or other indications of trading interest (such as unexecuted orders in a limit-order book), or post-trade transparency, which involves the dissemination of data about completed trades. Markets that disseminate little or no price data are referred to as being "opaque" or "non-transparent."[16]

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13 As described in detail below, considerably more fixed-income securities than equity securities are issued in markets today but generally trade with less frequency and volume. Thus, corresponding trade data for individual issues is less frequent and may involve transactions that have few common characteristics.

14 The market for U.S. treasury securities is largely liquid and transparent and does not suffer many of the limitations of the general fixed-income markets. As a result, this White Paper reflects the challenges of seeking best execution in the fixed-income markets, excluding U.S. treasury securities.

15 Bruno Biais and Richard Green, *The Microstructure of the Bond Market in the 20th Century* at 30-31, Jun. 2005, available at https://littlehurt.gsia.cmu.edu/gsiadoc/WP/2005-E57.pdf.

16 Hendrik Bessembinder, William Maxwell, and Kumar Venkataraman, *Market Transparency, Liquidity Externalities, and Institutional Trading Costs in Corporate Bonds*, Journal of Financial Economics, Nov. 2006.

Unlike equity securities, fixed-income securities, except for a small number that are listed on an exchange, trade on over-the-counter ("OTC") markets in the United States. The OTC markets, which are characterized by principal and not agency transactions, are decentralized and fragmented, with less pre-trade transparency than an exchange, as dealers generally do not post firm quotes that are widely disseminated, but, instead, individually negotiate bilateral, informal contracts between themselves. These dealers typically maintain inventories in the securities for which they stand ready to buy and sell the particular security on a regular and continuous basis as "market makers."[17]

Post-trade transparency in the OTC markets has historically been relatively limited, although it has improved in the face of initiatives undertaken by Congress, the Commission, buy-side traders, and the NASD (now part of the Financial Industry Regulatory Authority or "FINRA"). Among the most noteworthy of recent initiatives are those taking place in the market for corporate bonds. In 2002, the Commission began requiring the NASD to report all OTC secondary market transactions in a specified set of large, highly rated corporate bonds with an issuance size of $1 billion or greater. Today, the FINRA Trade Reporting and Compliance Engine ("TRACE") records the bond traded, date and time of execution, trade size, trade price, yield, and a buy or sell indication.[18] FINRA members are now required to report virtually all corporate bond transactions to the TRACE system within 15 minutes of the trade. Investors can receive all TRACE data on a real-time basis for a fee or can view the reported data for free with a four-hour delay on the FINRA website.

The advent and expansion of TRACE has greatly improved the amount of information in the market regarding corporate bonds. Nonetheless, the effects of TRACE on the U.S. fixed-income markets generally remains limited because TRACE only provides information on corporate bonds (and other "TRACE eligible" bonds), only provides historic prices (*i.e.*, no active bids or offers) and conveys only limited information on the volume of individual trades.[19]

A fixed-income area outside of the corporate bond market in which enhancements have also been made is the market for municipal securities. The Municipal Securities Rulemaking Board (the "MSRB") provides information on municipal securities similar to that included in TRACE. The MSRB's Real Time Transaction Reporting System resembles TRACE and requires dealers to report all transactions within 15 minutes. The same limitations on transparency that exist with TRACE also limit the usefulness, in the view of some, of the MSRB's reporting system.

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[17] Biais at 11.

[18] For further information see http://www.finra.org/RegulatorySystems/TRACE/index.htm.

[19] Because corporate bonds are often infrequently traded and unevenly held, information available on TRACE may not provide meaningful data for comparison (*i.e.,* price data may be stale or recent data may be from previous trades by the same portfolio manager).

Collection of fixed-income trading data, outside of TRACE and the MSRB system, is typically sparse and disjointed, leaving traders in other markets with few tools at their disposal when seeking best execution. One commentator, while acknowledging the recent efforts to increase transparency, summarized the continued difficulty facing fixed-income traders, saying:

> For all bond traders, however, the best source of information consists of their contacts in the business. Who among other firms' traders has a certain type of bond in inventory? Which of them owes a favor, and to whom? Who quoted a favorable price on a certain bond just this morning? Who is trying to sell off a weak issue? And so on. Information like this is so specialized and often so fleeting that not even a highly automated quotation system like NASDAQ can capture it. This is the kind of information that is gathered during the course of countless phone calls and used at the precise time of its greatest effectiveness.[20]

Although they face the prospects of limited transparency with respect to transactions in individual fixed-income securities, asset managers seeking to engage in transactions in these securities can assess macroeconomic information (*i.e.*, borrowing rate levels, currency values, etc.) involving these securities that is quite transparent regarding the value of similar securities. This later information can be directly relevant, particularly for investment grade fixed-income securities, for a manager seeking to assess best execution for individual transactions and groups of transactions.

Trading

Fixed-income securities are typically issued in the primary market in various auction formats and subsequently traded in secondary markets. Trading in those securities is generally undertaken by dealers trading from their own inventories of securities.

Investing in fixed-income securities in the secondary market is typically accomplished through a series of bilateral negotiations in which a dealer acts as a principal rather than through a centralized trading mechanism (*i.e.*, an organized exchange). Traders interact directly with dealers electronically or over the telephone when purchasing or selling particular fixed-income securities, and the universe of potential trading partners is much smaller in a fixed-income market than in an equity market in which exchanges and electronic platforms bring buyers and sellers together.

Dealers in fixed-income securities make a profit through the "spread," the difference between the issuer's fixed-income security price and the marked-up price offered to buy-

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[20] Robert Zipf, *How the Bond Market Works*, New York Institute of Finance, at 143 (2d ed. 1997).

ers (in the initial offering) or the difference between the quoted bid and ask prices (in secondary market trading). Spreads can differ based on, among other things, the availability of the security and the size of the transaction. Unlike the cost of trading that is incurred in equity security transactions, the cost of trading fixed-income instruments is unstated on a per security basis and is reflected in the marked-up price of those instruments. The latter cost is not designed to compensate the dealer for services provided as a transaction facilitator.

Limited transparency in fixed-income markets enables larger asset management firms to affect spreads far more than they may be able to influence commissions in an equity market, as trading costs in a less transparent market can depend on the firm's sophistication and familiarity with the markets.[21] Several studies published to date have confirmed that bonds often have much larger transaction costs than equity trades as market transparency diminishes.[22] Settlement, custody and other transaction related costs are also typically higher with respect to fixed-income securities than to equity securities.

Each fixed-income transaction involves numerous individual decisions that can, at times, make it difficult, if not impracticable, to find multiple dealer price quotes before a quote is no longer active. An asset manager may need, when operating in volatile markets with limited transparency, to accept the initial prices offered by a dealer without the ability to see or seek out further prices. In addition, a fixed-income security may be traded by a single dealer or only a single dealer may be able to execute a particular size trade, in which case no comparable price quotes exist.

In a case in which the "best price" offered by a dealer to an asset manager is available for a portion of the position that the manager would like to buy or sell, the manager's entering into a transaction for that portion, rather than attempting to negotiate an acceptable price for the entire position, may result in less than optimal overall execution. Moreover, settlement and other transaction-related costs associated with multiple transactions at the best price may lead to the asset manager's clients paying more overall than they would have, for example, had the single purchase been executed at a slightly higher price.

Size and Liquidity

Considerably more fixed-income securities than equity securities are issued in the market each year, but generally trade with less frequency and less volume than their equity

[21] Bessembinder at 3.

[22] Id. at 4. See also Amy K. Edwards, Lawrence E. Harris, and Michael S. Piwowar, *Corporate Bond Market Transparency and Transaction Costs*, Draft 1.0, Sep. 21, 2004.

[23] Data gathered from *SIFMA Research Reports*, Vol. II, No. 6 (Jun. 27, 2007), available at http://www.sifma.org/research/pdf/RRVol2-6.pdf; and *Average Daily Trading Volume in the U.S. Bond Markets*, SIFMA, available at http://www.sifma.org/research/pdf/Overall_Trading_Volume.pdf.

counterparts. On average, for example, only $20 to $25 billion in municipal bonds and $10 to $15 billion in corporate bonds trade in a given day, compared to the equity markets, in which more than $100 billion in equity securities are traded daily on the NYSE and NASDAQ alone.[23] Smaller investors generally do not purchase directly fixed-income securities, which tend to be traded in much larger blocks than equity securities. Trading in these large blocks can cause a fixed-income market to move quickly, and the large block trades make liquidity a premium.

Fixed-income instruments tend not only to be less liquid than equity securities, as noted above, but they also tend to be held unevenly by market participants. In some cases, only a few dealers will make a market for particular fixed-income securities, limiting the availability and price transparency of the securities. Specific dealers are typically confined to trading in their own inventory or in those fixed-income securities in which they make a market, making trading in desired volumes difficult and time consuming in a volatile market. Regional dealers, for instance, often trade municipal bonds, thus requiring an asset manager to acquire knowledge of, and develop relationships with, dealer firms throughout the country that support a particular issuer or region.

Pricing

Asset managers are generally dependent on dealer quotes, often termed "indicative" quotes, for current pricing information of fixed-income securities. These prices are quoted individually, often only over the telephone by financial service firms that may have relationships with the issuers and/or may desire to be potential counterparties in transactions involving the securities.[24] Prices may also be quoted individually through electronic services such as Bloomberg. In either case, the quoted price may only be relevant for a limited time. Supplementing quotes as an indication of the current prices of fixed-income securities are "evaluations" available from various pricing services. These services typically base their evaluations on, among other things, information provided by issuers of fixed-income securities and financial services firms serving as market makers in the securities. The pricing services can receive compensation from the issuers of the securities for which they provide evaluations.[25]

Dealers use indicative quotes to show interest in buying or selling a particular issue in an effort to solicit bids or offers.[26] Managers looking to buy or sell a fixed-income security may also seek to find a willing counterparty by advertising their bids and offers on services such as TradeWeb or MarketAxess, electronic trading platforms that typically only offer trading for fewer than 20 percent of all corporate bonds.

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24 These relationships can result in conflicts of interests for the firms pricing the securities. See Chester S. Spatt, *The Organization and Performance of Fixed-Income Markets*, Second MTS Conference on Financial Markets, Vienna (Dec. 16, 2004).

25 Receipt of such compensation from issuers can create conflicts of interest for these services when evaluating securities. *Id.*

26 Bessimbinder at 4.

Research and Fixed-Income Securities

The concept of an identifiable arrangement for "soft dollars" provided by a broker-dealer in connection with executing transactions in equity securities as agent on a client's behalf is not generally applicable to fixed-income instruments that are undertaken on a principal and not an agency basis.[27] Research provided by a broker-dealer in connection with a fixed-income transaction executed on an agency basis, however, may generally be paid for using client funds in the same manner as agency transactions involving equity instruments.[28]

Some asset managers also may receive research on fixed-income instruments through the use of soft dollars generated on transactions in equity securities. [29] Other asset managers, instead of compensating dealers for traditional research reports and access to management in connection with fixed-income instruments -- typical uses of equity soft dollars -- may enter into transactions with dealers that present the manager over time with information that can be seen as "research," including what these managers characterized as "good ideas." Entering into a fixed-income transaction solely on the basis of research provided is viewed by many member firms of the AMG as inconsistent with the obligation to achieve best execution.

Dealing with the Challenges of Fixed-Income Securities

Asset managers often seek to deal with the general lack of a central repository of current fixed-income securities trade data by implementing one or more of a number of procedures. Among such procedures that a manager may use with respect to particular securities are: comparing the spread relating to the securities to the spreads of similar, but more liquid instruments, such as U.S. Treasury securities; comparing quotes available from dealers for the securities to those offered for similarly-sized transactions in

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27 In describing the safe harbor covering the use of certain forms of soft dollars set out in Section 28(e) of the Securities Exchange Act of 1934, the SEC has indicated that transactions in fixed-income instruments generally do not qualify: "Managers may not use client funds to obtain brokerage and research services under the safe harbor in connection with fixed income trades that are not executed on an agency basis, principal trades (except for certain riskless principal trades), or other instruments traded net with no explicit commissions." *Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934*, Securities Exchange Act Release No. 54,165 (Jul. 24, 2006), n.27.

28 Thomas P. Lemke & Gerald T. Lins, *Soft Dollars and Other Brokerage Arrangements* § 4:8 at 104 (2007-2008 Ed.) ("[I]n some cases a broker-dealer may execute transactions in fixed income securities (such as government, municipal, and corporate debt instruments as well as mortgage backed securities) or over-the-counter ("OTC") equity securities on an agency basis for a money manager, receiving a normal commission for its services. . . . In connection with these agency transactions, the broker may provide research or other services to the money manager on a soft dollar basis, and the money managers may seek to rely on the Section 28(e) safe harbor."); *See Hoenig & Co*,. SEC No-Action Letter, 1990 SEC No-Act. LEXIS 1212 (Oct. 15, 1990) ("In the Division[of Market Regulation]'s view, transactions do not fall within the safe harbor if the broker-dealer executes the transaction as a principal. . . . Section 28(e) applies to the amount of commission paid to a broker-dealer acting in an agency capacity, and a transaction fee paid to a broker-dealer for effecting a transaction in a principal capacity is not within the safe harbor, irrespective of the label placed on the fee."); *See also Commission Guidance on the Scope of Section 28(e) of the Exchange Act,* Securities Exchange Act Release No. 45,194 (Dec. 27, 2001) (The SEC interpreted Section 28(e) to be available for certain riskless principal transactions in Nasdaq securities, and indicated that the safe harbor could be more widely available to riskless principal transactions in other securities. At the time that the interpretation was published, however, riskless principal transactions in debt securities did not qualify.).

29 *Cf. Department of Labor,* SEC No-action Letter, 1990 SEC No-Act. LEXIS 1397 (Jul. 25, 1990).

similar instruments from other dealers; and developing and utilizing model valuations for the securities. Use of procedures of this sort can enhance the judgments of the securities made by the manager's own personnel and consideration of the factors involved in assessing best execution cited above.

IV. BEST EXECUTION AND FIXED-INCOME SECURITIES: SYNTHESIS

The members of the AMG uniformly agree that best execution in the context of fixed-income securities is appropriately defined as an asset manager's duty to determine and evaluate the circumstances under which the overall value of investment decisions for its clients with respect to those securities will be maximized. The members of the AMG believe that, in light of the special characteristics of the fixed-income markets, best execution be evaluated not on a transaction-by-transaction basis, but on an overall basis over an extended period of time.

The key to an asset manager's meeting its fixed-income best execution obligation is -- as it is with respect to equity securities -- the development of a process and policies reflecting a number of core elements. In the AMG's judgment, those elements include:

- Identifying the key components of favorable and efficient fixed-income executions;
- Identifying significant factors and information to be considered in selecting fixed-income trading counterparties;
- Determining and documenting trade execution policies and procedures;
- Developing a defined system of controls and risk management regarding fixed-income executions;
- Providing regular supervision and rigorous review of the fixed-income best execution process; and
- Testing and monitoring compliance with policies and procedures.

V. THE GUIDELINES

The Guidelines drawn from the practices and experience of a number of AMG member firms that appear below represent a composite set of principles. The Guidelines are designed to further the goal of achieving fixed-income best execution as defined in Section IV of this White Paper and incorporate the core elements of a best execution process and policies as set out in that Section. The Guidelines are principle-based and intended to be adapted by an individual asset management firm in light of its own circumstances in seeking to achieve overall best execution in fixed-income markets. No AMG member firms, however, currently have adopted the Guidelines in the exact manner set out below and the AMG and SIFMA believe that every asset management firm should, in evaluating the Guidelines, assess its own business practices, potential conflicts, and control environment if or when incorporating the Guidelines into its policy and procedures.

Set out below are eight Guidelines for fixed-income asset management firms to consider when developing or evaluating their policies and processes for seeking best execution.

Guideline 1 – Policy and Procedures: An asset management firm should develop a best execution policy and procedures tailored to its operations and the types of fixed-income securities in which it trades.

In developing fixed-income best execution policy and procedures, an asset management firm, on the basis of its own circumstances and the specific types of instruments in which it invests principally on behalf of clients, should establish a process for seeking best execution, contemplating well-defined policies and procedures, systems, and oversight that support seeking best execution. Firms should consider the types of instruments, the entire life cycle of a transaction from portfolio management to the execution of the transaction by the traders, and post-trade review and documentation.

To the extent a firm has multiple departments, such as the portfolio management, trading, legal, compliance, and operations departments, these departments should collaborate in the drafting and implementation of the best execution policy and procedures. Because seeking best execution involves an overall trading process, the process used by an asset management firm should not be static, but should evolve over time as the firm, its trading strategies, its clients and the markets change. Any policy and procedures adopted need to be broad enough to cover all types of securities and trades in which the firm may engage.

Asset management firms should tailor procedures to their own circumstances. Nevertheless, certain elements would seem appropriate for each firm to consider in establishing best execution procedures. Those elements include:

- The factors that the firm's portfolio managers and/or traders generally will consider (or may be precluded from considering) when determining with what counterparty and when to execute transactions;
- The establishment and maintenance of an approved counterparty list, and the monitoring of its use;
- The potential uses by the firm of pricing services or programs (proprietary and non-proprietary) and other data available to the firm to assess market information and assist portfolio management and/or trading with best execution;

- The delineation of responsibilities of personnel involved in best execution, including, to the extent applicable, the head of the firm's trading, the firm's compliance and legal departments, portfolio managers, traders and analysts, and any best execution review committee established by the firm to oversee the process; and

- The controls and risk management procedures regarding trading activities that can relate to best execution, including conflicts of interest potentially affecting not only the asset management firm, but also dealers, counterparties, pricing services and other parties providing services to the firm.

Once an asset management firm has established and implemented a best execution policy and procedures, the overall process, including the policy and procedures, should be periodically reviewed with portfolio management, trading, compliance and legal personnel to ensure efficiency and address any areas that may need review and enhancement.

Guideline 2 – Establishment of a Best Execution Committee or Similar Structure: A best execution committee, or similar structure, may help in establishing and evaluating periodically the process an asset management firm will follow, and set the appropriate "tone from the top."

A committee or similar structure can promote a unified approach to best execution from the firm's leadership to follow. The committee could be composed of individuals involved with the trading process, such as portfolio management, trading, legal, compliance, and operations/systems personnel, and hold regularly scheduled meetings to discuss and review the effectiveness of the asset management firm's policy and procedures. The size and nature of the committee should reflect the characteristics of the particular asset management firm; a committee in a larger asset management firm may, for example, tend to be more formal than the structure used by a smaller firm. A firm should keep reasonably detailed records of these meetings and implement actions taken at the meetings. The firm's disclosures should be modified over time as necessary to inform clients and regulators of significant changes made at such meetings.

Discussions with AMG volunteer firms suggest that the primary functions of best execution committees or oversight bodies are:

- to ensure that personnel involved with the trading process acknowledge and understand the importance of seeking best execution;

- to undertake regular and rigorous reviews of the firm's best execution policy and procedures and the effectiveness of steps taken to implement, monitor and enhance best execution performance;

- to ensure that the firm is using reasonable diligence to identify the best markets for the securities transactions it undertakes on behalf of clients, in light of the limitations that may be inherent in certain markets; and

- to report the results of the committee's ongoing oversight and review to the firm's senior management and other parties determined by the firm to be appropriate (which parties might include by way of example, trustees of employee benefit plans, clients subject to ERISA or boards of directors or trustees of investment companies registered under the U.S. Investment Company Act of 1940).

Legal and compliance personnel, the volunteer firms believe, should support the best execution committee in its review of the policy and procedures, and keep the committee informed of changes in regulation and practice in the industry.

Guideline 3 – Review of Quantitative and Qualitative Information: An asset management firm should evaluate and determine, in light of its access to reliable market data for the types of fixed-income securities in which it will primarily invest on behalf of clients, the extent to which its best execution policy should include pre-trade evaluation of data and execution decisions, and/or post-trade analysis of transactions.

A key element in a fixed-income best execution process is the use by an asset management firm of quantitative and qualitative information in evaluating particular transactions. Volunteer firms were not uniform in their use of pre- and post-trade information. The Guidelines contemplate an asset management firm's evaluating to some degree both pre-trade and post-trade information and are not intended to suggest that either choice should be made to the exclusion of the other.

It is likely that the types of fixed-income securities primarily traded by an asset management firm, and resources available to the firm to gather and evaluate market data that may not be readily available, will serve as the principal bases for the firm's decision to emphasize the process that occurs before transactions are executed, or to rely more heavily on post-trade analyses of actual transactions. An asset management firm trading primarily in municipal securities reported with the MSRB or regularly-traded corporate bonds, for example, may need less emphasis on pre-trade procedures in view of relatively more liquidity and transparency of such securities, and seek instead to monitor transactions on an overall post-trade basis. A firm that is primarily involved in fixed-income securities that can lack liquidity and/or transparency (*e.g.*, high-yield or emerging market securities) may instead place greater emphasis on pre-trade procedures in recognition of the characteristics of those types of securities; the firm in such a case will likely have equally imperfect market information both before and after the transaction. Firms that trade across several fixed-income markets should consider procedures that can be applied to each particular market based on its characteristics.

Guideline 4 – Counterparty Selection: An asset management firm should identify specific quantitative and qualitative criteria for selecting counterparties, and such counterparties should be evaluated periodically against these criteria.

Volunteer firms emphasizing pre-trade evaluation generally place a premium on the criteria used in selecting a counterparty for a particular transaction. In some instances, such as with a thinly traded security, only one counterparty may make a market in that security, essentially dictating the best execution decision for the trader. In other cases, however, traders may need to consider other factors.

Portfolio managers and traders at the volunteer firms identified a wide variety of factors used in evaluating counterparties with which to execute transactions. Nonetheless, many common factors were cited by most of the volunteer firms, including:

- Price;
- Likelihood of execution;
- Likelihood of execution within a desired time frame;
- Market conditions;
- Ability of a counterparty to execute in desired volume;
- Ability of a counterparty to act on a confidential basis;
- Ability of a counterparty to act with minimum market effect;
- Creditworthiness of a counterparty in relation to risk created by the transaction;
- Willingness and ability of a counterparty to make a market in particular securities;
- Operational coordination by a counterparty with the asset management firm and custodians of the firm's clients, including ability to communicate, to settle trades reliably and to quickly and effectively resolve differences;
- Counterparty's reputation for ethical and trustworthy behavior;
- Client preferences/guidance (*i.e.*, minority-owned, regional-based, ERISA, registered investment company, etc.) for permissible counterparties;[30]
- Use of automation by a counterparty;
- Willingness of a counterparty to commit capital to a particular transaction;

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30 Volunteer firms acknowledged that such preferences should only be sought when consistent with the overall duty of best execution.

- The market knowledge of a counterparty; and
- Ability of a counterparty to execute difficult transactions in unique and/or complex securities.

Many of the volunteer firms noted that specific factors should be considered not only individually but in combination with others over time when selecting counterparties.

In the judgment of the AMG, every asset management firm, regardless of the principal investment strategy or strategies it follows, is well-advised to maintain a master list of counterparties and allow trading only with those counterparties whose names appear on the list. An automated system that prevents trades with non-approved counterparties can be helpful when feasible. Volunteer firms suggested that an asset management firm should, at a minimum, implement a process for allowing counterparties to be added to the approved list (*i.e.*, reviewing counterparty credit ratings) and removing them when they no longer meet the firm's established standards.

Guideline 5 – Utilizing Technology: An asset management firm should consider and incorporate available technological resources when developing a best execution process.

AMG member firms agree uniformly that strict and thorough trading policies and procedures combined with compliance safeguards incorporating technological advances can decrease the need for post-trade review and increase the likelihood of best execution. The amount of capital devoted to technology for best execution monitoring and compliance varies considerably among AMG member firms. Firms that had devoted considerable resources to proprietary systems that enabled them to gather data about the marketplace and the availability and pricing of otherwise non-transparent securities generally were more comfortable relying on their pre-trade processes for making best execution determinations, and determined it to be less necessary to undertake significant post-trade monitoring and analyses. Other firms, in contrast, focused resources on post-trade monitoring, and developed processes that reflected that decision. In the AMG's view, both means are appropriate when creating best execution systems. Volunteer firms were unanimous in concluding that some amount of capital should be devoted to technology for the best execution process.

Guideline 6 – Dealing with Conflicts of Interest: Regardless of whether an asset management firm's emphasis is pre- or post-trade, the firm's policy and procedures and internal monitoring systems need to address potential conflicts of interest that could impair the firm's ability to obtain best execution.

Conflicts of interest in the trading process can have a direct effect on best execution.[31] Unlimited personal trading by firm employees in securities being traded by the firm, for example,

[31] *See supra* note 12.

can move a market, particularly in less liquid securities, potentially impairing the ability of the firm to obtain best price, or even to obtain the securities at all. Regulators have made clear that business practices within firms that may affect the trade execution process should be identified and procedures should be reasonably designed to ensure that those business practices will not interfere with an asset manager's duty to seek best execution. AMG members uniformly agree that the following areas, among others, raise the potential for conflicts of interest that may affect the fixed-income best execution process:

- compensation and promotion incentives that may reward portfolio managers and/or traders based on the number of transactions and volume;
- proprietary trading and personal trading;
- payments for research;
- product sales consideration for trade flow;
- broker-dealer affiliations;
- gifts and entertainment; and
- portfolio managers' and traders' relationships with counterparties.

Volunteer firms generally did not allow compensation and promotion incentives that reward traders based on the volume or size of trades because, in the firm's judgment, those incentives inherently have the potential to create conflicts of interest. Some firms deal with the potential conflicts raised by gifts and entertainment by maintaining a public master list of all entertainment expenses and gifts received by portfolio management and trading personnel and for each client. Public disclosure of this type can be used as a way to allow employees to monitor each other's relationships with clients and counterparties and can deter problematic behavior.

Proprietary and personal trading is typically addressed in the compliance manual and code of ethics of a volunteer firm. Firms generally have a separate policy and procedures for employees to follow for proprietary trading to address potential conflicts of interest that could arise. These procedures typically include pre-clearance by legal or compliance personnel of any personal trades against lists of restricted securities. Firms that have broker-dealer affiliates generally either prohibit trading with those affiliates or implement strict procedures to minimize the occurrence and appearance of conflicts. In attempting to address possible conflicts of interest that may arise when close family members of their personnel are employed by counterparties they use for transactions, many of the volunteer firms require employees to notify the firm's legal and/or compliance departments of such relationships. Volunteer firms agreed that close business and personal relationships with individual counterparties may create the appearance of a conflict and therefore should be monitored carefully.

A number of volunteer firms stressed that information flows with respect to fixed-income securities may only be available from certain counterparties, which in turn often result in long-standing relationships of trust and confidence. Such a relationship is often of importance in seeking a counterparty willing to extend credit to the manager, or expend the resources to locate a large quantity of less liquid securities for the manager without alerting the market. Such a relationship can, however, also lead to the potential for conflicts of interest that volunteer firms believe should be addressed by procedures that are designed to monitor the potential for these conflicts, without impairing otherwise appropriate and important interactions.

Guideline 7 – Transaction Reports: Transaction reports, particularly when viewed on an aggregate basis and over time, can provide a valuable tool when gauging and evaluating the success of an asset management firm's best execution efforts.

Volunteer firms stressed that the unique characteristics in the fixed-income markets limit the utility of monitoring transactions on a trade-by-trade basis, as comparable data simply does not exist for a large number of these transactions. Reviewing trading activity over extended periods under these circumstances, the firms asserted, becomes a critical tool in achieving an effective best execution process.

Periodic reviews of fixed-income transactions are undertaken by AMG members on an asset class basis and/or by portfolio manager or trader, depending on the data being reviewed. AMG members review and evaluate aggregate trading data during different periods (*i.e.*, daily, weekly, monthly, and/or quarterly) to identify trends and anomalies in trade data. Evaluations by member firms are made, for example, of transaction data for trading concentrations, order and transaction counts, holdings and dealer profiles.

Supervisory personnel of AMG members typically follow up on any trading patterns that suggest unusual activity (*e.g.*, same day trades, next day trades or similar spreads) or unusual concentrations of trades with particular dealers. The AMG believes that, although market data may often be an imperfect tool for evaluating best price, asset management firms should make reasonable efforts to (1) gather transaction data that is available and (2) review patterns and outliers or atypical trading patterns revealed in that data with portfolio employees and their supervisors to trigger questions, evaluate patterns and undertake more detailed review when appropriate. As part of a post-trade best execution review process, asset management firms should, in the AMG's view, consider documenting the rationale underlying a particular transaction in fixed-income securities or the rationale underlying multiple transactions in fixed-income instruments undertaken in meeting similar objectives, policies or strategies.[32]

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32 Documentation could be accomplished, for example, with a "trade book" or "notebook" (manual or online).

Volunteer firms identified a number of specific periodic reports that they believe can facilitate achieving best execution:

> ***Portfolio Manager Transaction Review Report*** – Such a report is intended to confirm that transactions were executed on behalf of clients' portfolio in accordance with those clients' specified guidelines.
>
> ***Gift and Entertainment Report*** — This report identifies any gifts received in excess of a specified amount, entertainment in excess of a specified amount per person or entertainment by a person involved in the trading process. Volunteer firms asserted that, if such a report is used by a firm, the firm's compliance personnel should follow up with the person and his or her supervisor if these limits are exceeded without prior authorization. The volunteer firms also noted that a report outlining the gift and entertainment activity of portfolio management and trading staff may be completed on a less frequent basis. Such a report could be reviewed for frequent, unusual or excessive items over previously specified limits.
>
> ***Dealer Summary Report*** — Such a report allows review by a portfolio manager or other person of dealer transactions over a specified period. According to volunteer firms, transactions should be reviewed for the presence of services atypical of the dealer and for the dealers providing excessive gifts. This report may reveal unusual activity regarding trades or spreads.

Guideline 8 – Use of Market Data to Evaluate Best Execution: When readily available, post-trade market data can help to ensure an effective best execution process. Post-trade information may, however, have limitations, particularly with respect to fixed-income securities traded in less transparent markets, and asset management firms should evaluate carefully the usefulness of such data when developing their best execution process.

Volunteer firms uniformly were of the view that readily available post-trade fixed-income market data can be very useful, but were quick to emphasize that current dissemination of fixed-income market transaction data may have limited usefulness. Firms noted that contemporaneous market data may simply not be available and that, as a result, market data may only be one component of their post-trade evaluation process.

The volunteer firms ascribed varying degrees of value to current market data. Some firms pointed out that trade data from pricing services generally represents end-of-day pricing, and thus generally may not be an accurate reflection of prices throughout the day, particularly in a volatile market or a thinly traded security. The most relevant price evidence, according to the volunteer firms, is that of the specific transacted security, and potentially in related or benchmark securities, at the relevant time, in the relevant volume and known to the transacting portfolio employee. The firms noted that, as any of those identified variables change, the relevance of the price data declines, as will the significance and importance of the price data. The firms maintained that data and information derived from trading screens, news services, counterparties and other transactions undertaken by portfolio managers and/or traders in a firm prior to the execution of a particular transaction represent indicators regarding the factor of price in best execution. Third-party best execution evaluators, in the view of some firms, have not yet developed sufficiently reliable programs for the fixed-income industry to be used as a compliance tool to evaluate a firm's receipt of best execution. The AMG believes that, at a minimum, an asset management firm must make its own judgment regarding which data is of sufficient relevance to trigger further review.

VI. CONSIDERATIONS BEYOND THE SCOPE OF THIS WHITE PAPER

The AMG concluded that detailed consideration of three topics relating to best execution of fixed-income securities -- the standards and procedures to be applied to transactions in derivative instruments, guidance articulated by regulators outside of the United States regarding fixed-income best execution, and the standard and procedures to be applied to transactions involving clients that are plans subject to ERISA -- is beyond the scope of this White Paper and best left to future initiatives. The AMG's conclusion is a practical one of time and resource constraints and not intended to reflect the view that the topics are insignificant. Indeed, in light of the importance of the subjects, the AMG determined to include the brief summaries below:

Derivatives

AMG members were consistent in their views that derivative instruments are of increasing importance to their businesses and that seeking best execution in connection with those instruments raises significant challenges. In general, the challenges parallel those presented by fixed-income securities described above. As can be the case with fixed-income securities, for instance, information about individual transactions involving derivatives is generally not centrally available, and certain derivatives can lack liquidity, at least from time to time. Many derivatives trade on the OTC market and derivative transactions are typically individually negotiated.

In the AMG's judgment, the Guidelines can provide some assistance to asset management firms seeking to establish best execution processes and procedures covering derivative instruments. The consensus among the volunteer firms is, however, that seeking best execution in the derivatives context requires further detailed study of, among other things, the nature and types of instruments and the manner in which they trade.

International Guidance

AMG members uniformly see their business worlds as global in scope and potentially subject to regulations and guidance adopted by financial regulators in a host of different jurisdictions. One recent initiative of a non-U.S. regulation of consequence are the unified European requirements for the best execution of client orders introduced by MiFID. The MiFID best execution initiative is a process-based approach that requires a firm to create and operate effective execution arrangements for obtaining the best possible results, including an execution policy to monitor the effectiveness of those arrangements and to provide information to clients. The MiFID approach provides flexibility in terms of an asset management firm's ability to apply the requirements in a way that is appropriate to its business model and client requirements.

The AMG notes that applying the MiFID requirements in a fixed-income context can present practical difficulties for an asset management firm; the requirements have been developed around equity securities and the equity markets and do not address asset classes and markets with attributes different from those of equities, such as fixed-income securities and the fixed-income markets. The AMG believes that principles and the Guidelines discussed above are not inconsistent with the framework and requirements for best execution developed by MiFID.

ERISA Plans

Virtually all AMG members have clients that are plans subject to ERISA. ERISA, among other things, imposes strict obligations on asset managers that meet ERISA's definition of "fiduciary" and prohibits certain transactions involving plans subject to ERISA and certain persons termed "interested persons" with respect to the plans. The U.S. Department of Labor ("DOL"), which has interpretive and enforcement authority over the fiduciary responsibility provisions of ERISA, has interpreted the provisions as imposing a duty on a fiduciary with respect to a plan subject to ERISA to obtain the most favorable terms for investment transactions undertaken on behalf of the plan, which duty the DOL refers to as the duty of "best execution." Although they determined not to include a detailed analysis of ERISA's requirements relating to best execution, the AMG members believe that the Guidelines can provide valuable assistance to an asset management firm seeking to meet these requirements and the Guidelines, appropriately applied, should satisfy the fiduciary duty standards of ERISA. The Guidelines do not, however, provide guidance as to the potential applicability of the prohibited transaction provisions of ERISA to an asset manager's best execution policies and procedures; applicability of those prohibitions depend largely on the particular operations and relationships of an asset management firm.

VII. CONCLUSION

The AMG acknowledges that existing guidance for seeking best execution has been developed around trading in equity securities and generally assumes that best execution can be measured on a transaction-by-transaction basis, largely due to the transparency, liquidity and other characteristics of the equity markets that permit a higher degree of measurement at such a level. In the fixed-income markets, the accurate measurement of best execution in this manner, however, generally is not feasible because of the unique characteristics of each fixed-income market. The volunteer firms uniformly made clear in their interviews that the fixed-income markets present different challenges than the equity markets when seeking best execution. Because of these challenges, the members of the AMG uniformly agree that best execution in the context of fixed-income securities is appropriately defined as an asset manager's duty to determine and evaluate the circumstances under which the overall value of investment decisions for its clients with respect to those securities will be maximized. The Guidelines are intended to adapt the principles of best execution to the fixed-income markets, and to fill the current void of practical guidance and represent a synthesis of practices at, and experiences of, a number of SIFMA member firms. Some best execution policies and procedures should be universally applied; the best execution process implemented by an individual firm should by necessity be specifically tailored to reflect the unique characteristics of that firm and the markets in which it trades.

Acknowledgements

At a New York City lunch and learn event in August, 2005, John R. Gidman, Executive Vice President of Loomis Sayles & Company, L.P., raised the possibility of the preparation of industry guidelines relating to best execution standards that would apply to fixed-income securities transactions entered into by asset management firms. That suggestion led to several exploratory conference calls organized by what was then The Bond Market Association ("TBMA") which were followed by a series of more in-depth meetings conducted by TBMA's Market Practices and Standards Committee. This Committee was chaired by Richard M. Weil, Chief Operating Officer and Managing Director of PIMCO. When SIFMA's Asset Management Group (the "AMG") was subsequently established, the Steering Committee of the AMG requested Mr. Weil and Sara Lou Sherman, Senior Vice President and Counsel of Wellington Management Company, to lead the process within the AMG of developing a fixed-income best execution White Paper that would recommend pragmatic guidelines designed to be helpful to individual AMG member firms in connection with their own policies and procedures.

Throughout the first half of 2007, AMG senior staff and outside counsel, Willkie Farr & Gallagher LLP, conducted member visits with eight asset management firms to ascertain the various approaches that could be utilized by any registered investment adviser seeking to meet its responsibilities to achieve best execution in the normal course of its fixed-income securities business. Needless to say, these visits revealed diverse business models as well as differing, yet equally effective, ways to satisfy best execution responsibilities. Indeed, this diversity along with the input of members concerning the differences existent between equity securities trading and the bond markets have been referenced in this White Paper. The main benefit of these visits was a better understanding of the nuances of the securities markets and, in turn, this understanding, when shared with the members of the AMG Steering Committee in the second half of 2007, enabled the AMG to agree upon the suggested guidelines that are set forth in the White Paper.

The AMG believes that, as is typically the case with recommendations for new procedures, unforeseen issues will likely arise relative to its work on best execution as changes occur in the marketplace. Also, in the current technology environment in the investment industry, utilities, vendors and other administrators are likely to introduce products that could have an effect on any given section of this White Paper. Accordingly, SIFMA / AMG would welcome any suggestions or questions that members or other market participants might have regarding the recommendations expressed herein. Finally, the AMG notes that it shared a substantially final draft of its fixed-income best execution guidelines with members of the staff of the Securities and Exchange Commission and sought to respond to comments the staff made with respect to the draft prior to posting the White Paper on SIFMA's Web site in January, 2008. The AMG very much appreciates the willingness of the staff to provide its comments. Readers should understand,

however, that the AMG did not seek the staff's endorsement of its recommendations in the White Paper and that neither the SEC nor the staff provided any such endorsement.

The Asset Management Group of the Securities Industry and Financial Markets Association reports to the Board of Directors of the Association. David L. Murphy, CFA, President, Strategic Advisers, Inc., Fidelity Investments, serves as 2008 Chair of the Steering Committee of the Asset Management Group. Joseph W. Sack, Managing Director of the Association, serves as principal staff advisor to the Asset Management Group. Questions or comments regarding this White Paper may be directed to Mr. Sack at jsack@sifma.org or 212-313-1165.

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