

**Investment Committee Memorandum**  
Board of Regents, State of Iowa

**Subject:** Investment Policy Manual Modifications (Soft Dollars)

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**Recommended Action:**

Recommend the Board consider, as a first reading, the changes to the Board's investment policies regarding soft dollars as outlined in this memorandum.

**Executive Summary:**

With increased disclosure and scrutiny of soft dollar practices, the following policy revision is recommended in order to clarify the Board's position on soft dollars. The Securities Exchange Commission (SEC) has defined the term "soft dollars" to mean products and services, other than execution of transactions, that a fund manager receives from a broker in exchange for the external portfolio manager's direction of transactions to the broker. "Products and services" is generally defined as research services that assist fund managers in the performance of their investment decision making.

Current Board policy seeks to achieve a balance between reduction of commission costs and "best price." The proposed policy change acknowledges that best execution may occur through block transactions with volume discounts that generate soft dollars. The policy revision reemphasizes best execution and price, and if applicable, the monitoring of external portfolio manager soft dollar policies and practices by the Board's investment advisor.

**Background:**

**Soft Dollars** Soft dollar arrangements are those in which an adviser may pay a commission rate in excess of the lowest available rate in recognition of "brokerage and research" services provided by the broker. Such arrangements are legally permitted if the conditions of Section 28(e) of the Exchange Act, as interpreted by the SEC, are met.

Permissible brokerage and research products and services include anything that provides lawful and appropriate assistance to the portfolio managers in the performance of their investment decision-making function.

**Mixed Use Research Products and Services** If a research product or service has both research and non-research uses (for example, in the case of computer hardware), an allocation must be made between the research and non-research functions, with the portion allocable to research being paid with commission dollars, and the non-research portion being paid by the advisor and measured in terms of the time spent on each use.

Services "Provided" by Broker	In all cases, any brokerage or research product or service that the advisor obtains for soft dollars must be "provided" by a broker-dealer. To satisfy this standard in the case of services purchased from third party vendors (as opposed to produced by the broker itself), the broker must assume a direct obligation to purchase the product or service from the vendor without regard to the amount or timing of any commissions received by the broker from the advisor or its clients.
Reasonable Commissions.	The commissions paid must be reasonable in relation to the value of the brokerage or research products or services provided.
Permissible Transactions	Section 28(e) expressly provides a safe harbor for "commissions" in excess of the lowest available. The Section 28(e) safe harbor does not encompass transactions in securities executed by a broker-dealer on a principal basis (including risk less principal transactions).
Contract Language	Soft dollars became an issue during recent contract negotiations with two new fund managers. One fund manager proposed adding the following contract language:

In connection with the selection of brokers and dealers and the placing of orders, the Advisor shall obtain the most favorable execution and price available under the circumstances then and there existing; provided, that in determining what is in the best interest of the Account, Advisor will not only consider the available prices and rates of brokerage commission, but other relevant factors including, without limitation, execution capabilities, the value of ongoing relationships Advisor may have with such brokers, dealers, floor brokers and research and other services, as defined in §28(e)(3) of the Securities Exchange Act of 1934, as provided by such brokers, dealers or floor brokers which are expected to enhance Advisor's general portfolio management capabilities. In addition, Advisor may receive equipment, subscriptions and reimbursement for professional memberships from brokers or dealers, and may purchase research and other services directly from vendors, obtaining reimbursement from brokers or dealers, all on a soft dollar basis. Advisor will determine in good faith that the amount of such commission is reasonable in relation to the value of the brokerage, research and other services provided by such broker, viewed in terms of either that particular transaction or Advisor's overall responsibilities to all of its clients. The research and other services so provided may relate to a specific transaction placed with such broker, but for the most part the research services will consist of a wide variety of information useful to the Account, Advisor and other clients. Advisor's ability to obtain such research and other services is an integral factor in the establishment of its fees hereunder.

Proposed Policy  
Changes

The Universities are recommending the following changes for section 7.03.H of the Board of Regents Investment Policy to include a soft dollar policy.

H. Execution of Transactions

Execution of transactions will seek to achieve a balance between reduction of commission costs and "best price."

The institutions shall not do business with any brokerage firm that mandates binding arbitration as the only recourse for settlement of a disputed claim.

External portfolio managers and the institutions and the brokers with whom they execute transactions shall exercise their best efforts in minimizing transaction costs and market impact while achieving executions at competitive prices.

The external portfolio managers may, within policies and guidelines determined by the Investment Committee and the institutions and approved by the Board, have full discretion to buy, sell, invest, and reinvest in investment assets on behalf of the institutions. With respect to the Board's investment accounts, the external portfolio managers use of soft dollar trades to acquire products or services to be used in the administration of the fund, are permissible only if the trade provides best execution and price. External portfolio managers shall report soft dollar policies and practices to the Board's investment advisor. If soft dollar trades occur within the Board's investment accounts, the Board's investment advisor will monitor the external portfolio manager soft dollar policies and practices to ensure an appropriate relationship to the management of the Board's investment account. Any issues relative to soft dollar policies and practices shall be a part of the Board's investment advisor's annual comprehensive evaluation of the performance of the Board's external portfolio manager.

The institutions shall regularly solicit competitive bids from two or more brokers before executing transactions, and shall require that the brokers provide confirmations of trades to the treasurers except in the following circumstances:

- a. The security is a new offering of direct obligations of the U.S. government or agencies of the U.S. government.
- b. The security is maturing within one year from the purchase date.
- c. It is deemed in the best interest of the institution and is approved in writing by the Treasurer or Vice President for Finance, i.e. where timing or placement is a concern and additional solicitation would likely have a detrimental effect or loss of opportunity.