



Permitted Soft Dollar Practices

This memorandum is a guideline and contains information regarding eligible and ineligible uses of soft dollars within the safe harbor found under [Section 28\(e\)](#) of the Securities Exchange Act of 1934. This memo is structured in three parts: (i) discusses, generally, the eligibility of research services; (ii) discusses, generally, the eligibility of brokerage activities; and (iii) discusses, generally, mixed-use items.

Research Services

For purposes of the safe harbor, a person provides . . . research services insofar as he-

- (A) furnishes advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing, or selling securities, and the availability of securities or purchasers or sellers of securities;
- (B) furnishes analyses and reports concerning issuers, industries, securities, economic factors and trends, portfolio strategy, and the performance of accounts; . . .

Traditional research reports analyzing the performance of a particular company or stock clearly are eligible under Section 28(e). Meetings with corporate executives to obtain oral reports on the performance of a company are eligible because reasoning or knowledge will be imparted at the meeting (i.e., reports) about the subject matter of Section 28(e) (i.e., concerning issuers). Seminars or conferences may also be eligible under the safe harbor if they truly relate to research, that is, they provide substantive content relating to the subject matter in the statute, such as issuers, industries, and securities. However, travel expenses to attend such a seminar are not within the 28(e) safe harbor).

Software that provides analyses of securities portfolios is eligible under the safe harbor because it reflects the expression of reasoning or knowledge relating to subject matter that is included in Section 28(e)(3)(A) and (B). Corporate governance research (including corporate governance analytics) and corporate governance rating services could be eligible if they reflect the expression of reasoning or knowledge relating to the subject matter of the statute (for example, if they provide reports and analyses about issuers, which can have a bearing on the companies' performance outlook). All advice, research or reports must fall within the categories listed in the statute. For example, a consultant's advice is allowed if it relates to a portfolio strategy but not if it relates to a managers internal operations.

Mass-marketed publications are not included within 28(e). Mass-marketed publications are those publications that are intended for and marketed to a broad, public audience. Indicia of these mass-marketed publications include, among other things, that they are circulated to a wide audience, intended for and marketed to the public, rather than intended to serve the specialized interests of a small readership, and have low cost.

However, certain other publications may qualify as "research" under the guidance above. Indicia of publications that are not mass-marketed and could be eligible research under the safe harbor include, among other things, that they are marketed to a narrow audience, directed to readers with specialized interests in particular industries, products, or issuers, and have high cost. For example, financial newsletters and other financial and economic publications that are not targeted to a wide, public audience may be eligible research under the safe harbor.

Products or services that do not reflect the expression of reasoning or knowledge, including products with inherently tangible or physical attributes (such as telephone lines or office furniture), are not eligible as research under the safe harbor. Similarly, office equipment, office furniture and business supplies, salaries (including research staff), rent, accounting fees and software, website design, e-mail software, internet service, legal expenses, personnel management, marketing, utilities, membership dues (including initial and maintenance fees paid on behalf of the money manager or any of its employees to any organization or representative or lobbying group or firm), professional licensing fees, and software to assist with administrative functions such as managing back-office functions, operating systems, word processing, and equipment maintenance and repair services are examples of other overhead items that do not meet the statutory criteria for research set forth in this release and are not eligible under the safe harbor. Computer hardware and peripherals are also outside of the "research services" safe harbor.

Market research that may be eligible under Section 28(e) can include pre-trade and post-trade analytics, software, and other products that depend on market information to generate market research, including research on optimal execution venues and trading strategies. In addition, advice from broker-dealers on order execution, including advice on execution strategies, market color, and the availability of buyers and sellers (and software that provides these types of market research) may be eligible "research" under the safe harbor.



With respect to data services such as those that provide market data or economic data such services could fall within the scope of the safe harbor as eligible "reports" provided that they satisfy the subject matter criteria and provide lawful and appropriate assistance in the investment decision-making process. Company financial data and economic data (such as unemployment and inflation rates or gross domestic product figures) are eligible as research under Section 28(e).

Research provided by brokers who are not involved in "effecting" a transaction is permitted within the safe harbor so long as such researching broker is providing information for the benefit of the advisees. Likewise, third-party research is within the 28(e) safe harbor.

Brokerage Services

Under Section 28(e)(3)(C) of the Act, a person provides "brokerage . . . services" insofar as he or she:

effects securities transactions and performs functions incidental thereto (such as clearance, settlement, and custody) or required in connection therewith by rules of the Commission or a self-regulatory organization of which such person is a member or in which such person is a participant.

Section 28(e)(3)(C) describes the brokerage products and services that are eligible under the safe harbor. In addition to activities required to effect securities transactions, Section 28(e)(3)(C) provides that functions "incidental thereto" are also eligible for the safe harbor. Clearance, settlement, and custody services in connection with trades effected by the broker are explicitly identified as eligible incidental brokerage services.

Other incidental services include: post-trade matching of trade information; other exchanges of messages among broker-dealers, custodians, and institutions related to the trade; electronic communication of allocation instructions between institutions and broker-dealers; routing settlement instructions to custodian banks and broker-dealers' clearing agents; and short-term custody related to effecting particular transactions in relation to clearance and settlement of the trade.

According to the SEC, services related to execution of securities transactions begin when an order is transmitted to a broker-dealer and end at the conclusion of clearance and settlement of the transaction. Unlike brokerage, research services include services provided before the communication of an order.

Under this temporal standard, communications services related to the execution, clearing, and settlement of securities transactions and other functions incidental to effecting securities transactions, i.e., connectivity service between the money manager and the broker-dealer and other relevant parties such as custodians (including dedicated lines between the broker-dealer and the money manager's order management system; lines between the broker-dealer and order management systems operated by a third-party vendor; dedicated lines providing direct dial-up service between the money manager and the trading desk at the broker-dealer; and message services used to transmit orders to broker-dealers for execution) are eligible under Section 28(e)(3)(C). In addition, trading software used to route orders to market centers, software that provides algorithmic trading strategies, and software used to transmit orders to direct market access ("DMA") systems are within the temporal standard and thus are eligible "brokerage" under the safe harbor.

On the other hand, hardware, such as telephones or computer terminals, including those used in connection with OMS and trading software, are not eligible for the safe harbor as "brokerage" because they are not sufficiently related to order execution and fall outside the temporal standard for "brokerage" under the safe harbor. In addition, software functionality used for recordkeeping or administrative purposes, such as managing portfolios, and quantitative analytical software used to test "what if" scenarios related to adjusting portfolios, asset allocation, or for portfolio modeling (whether or not provided through OMS) do not qualify as "brokerage" under the safe harbor because they are not integral to the execution of orders by the broker-dealers, i.e., they fall outside the temporal standard described above.

Further, managers may not use client commissions under the safe harbor to meet their compliance responsibilities, such as: (i) performing compliance tests that analyze information over time in order to identify unusual patterns, including for example, an analysis of the quality of brokerage executions (for the purpose of evaluating the manager's fulfillment of its duty of best execution), an analysis of the portfolio turnover rate (to determine whether portfolio managers are overtrading securities), or an analysis of the comparative performance of similarly managed accounts (to detect favoritism, misallocation of investment opportunities, or other breaches of fiduciary responsibilities); (ii) creating trade parameters for compliance with regulatory requirements, prospectus disclosure, or investment objectives; or (iii) stress-testing a portfolio under a variety of market conditions or to monitor style drift. Additionally, trade financing, such as stock lending fees, and capital introduction and margin services are not within the safe harbor because these services are not sufficiently related to order execution.

Moreover, error correction trades or related services in connection with errors made by money managers are not related to the initial trade for a client within the meaning of Section 28(e)(3)(C) because they are separate transactions to correct the manager's error, not to benefit the advised account, and thus error correction functions are not eligible "brokerage services" under the safe harbor.



Short-term custody related to effecting particular transactions and clearance and settlement of those trades fits squarely within the statute because it is tied to processing the trade between the time the order is placed and settlement of the trade. In contrast, long-term custody is provided post-settlement and relates to long-term maintenance of securities positions, and therefore does not fit within the safe harbor.

"Mixed-use" Items

The mixed-use approach requires a money manager to make a reasonable allocation of the cost of the product according to its use. For example, an allocable portion of the cost of portfolio performance evaluation services or reports may be eligible as research, but money managers must use their own funds to pay for the allocable portion of such services or reports that is used for marketing purposes.

Where a product has a mixed use, a money manager should make a reasonable allocation of the cost of the product according to its use, and the money manager must keep adequate books and records concerning allocations so as to be able to make the required good faith determination.

Proxy services may be treated as mixed-use items, as appropriate. Proxy service providers offer a range of products, some of which may satisfy the standards for eligible "research" under the safe harbor. For example, reports and analyses on issuers, securities, and the advisability of investing in securities that are transmitted through a proxy service may be within Section 28(e). In contrast, products or services offered by a proxy service provider that handle the mechanical aspects of voting, such as casting, counting, recording, and reporting votes, are administrative overhead expenses of the manager and are not eligible under Section 28(e).



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