

MEMO# 22903

September 23, 2008

Draft Institute Letter on SEC Proposed Soft Dollar Guidance; Conference Call September 25

[22903]

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TO: CHIEF COMPLIANCE OFFICER COMMITTEE No. 13-08
CLOSED-END INVESTMENT COMPANY COMMITTEE No. 32-08
COMPLIANCE ADVISORY COMMITTEE No. 15-08
EQUITY MARKETS ADVISORY COMMITTEE No. 46-08
FIXED-INCOME ADVISORY COMMITTEE No. 27-08
INTERNATIONAL COMMITTEE No. 24-08
SEC RULES COMMITTEE No. 67-08 RE: DRAFT INSTITUTE LETTER ON SEC PROPOSED
SOFT DOLLAR GUIDANCE; CONFERENCE CALL SEPTEMBER 25

As we previously informed you, the Securities and Exchange Commission has proposed guidance for boards of directors of registered investment companies to assist them in fulfilling their fiduciary responsibilities with respect to overseeing the trading of portfolio securities. [\[1\]](#) The proposed guidance focuses on the role of the board in overseeing the best execution obligations of the investment adviser in connection with soft dollar arrangements. The Commission requested general and specific comments on the Proposed Guidance. The Commission also solicited comments on whether to propose new disclosure requirements for investment advisers to fund shareholders and other investment advisory clients addressing the use of client commission arrangements. The Institute's draft letter is attached and summarized below.

Comments on the proposed guidance are due by October 1, 2008. We will hold a conference call on Thursday, September 25 at 3:00 EDT to discuss the draft letter. The dial-in number is 888/324-8112 and the pass code is 35585. If you plan to participate on the

call, please r.s.v.p. to Maureen Maher at mmaher@ici.org or 202/326-5823. If you are unable to participate on the call, you may provide your comments to Mara Shreck at mshreck@ici.org or 202/326-5923, or to Ari Burstein at aburstein@ici.org or 202/371-5408.

The draft letter supports the underlying goal of the Commission's proposal but states that the Institute has two concerns with respect to the Proposed Guidance. First, as currently drafted, certain aspects of the Proposed Guidance could be interpreted to impose additional responsibilities on fund boards, some of which go beyond their traditional oversight role. Second, certain language in the Proposed Guidance, and the overall tone of the Guidance itself, may create an impression that certain portfolio trading practices, particularly soft dollar practices, are per se unsuitable for funds and that fund boards therefore should prohibit such practices.

I. The Proposed Guidance May be Interpreted to Impose Additional Responsibilities on Fund Boards of Directors

The draft letter states that while we support assisting fund directors in approaching and fulfilling their responsibilities of overseeing and monitoring a fund adviser, the overall tone of the Proposed Guidance and the "laundry list" of issues that a fund board is recommended to examine suggest a level of involvement that goes beyond the ordinary oversight role of fund boards. In addition, the directives in the Proposed Guidance appear to prescribe, rather than suggest for consideration, a specific list of tasks for directors and are more consistent with board micro-management than with traditional oversight.

Similarly, the draft letter states that the Proposed Guidance overstates directors' responsibilities with respect to evaluating the use of fund brokerage commissions and soft dollars. Read literally, the Proposed Guidance could be interpreted to require a board to consider the adviser's justification for each individual use of client commissions and to direct an adviser in its use of commissions in certain instances.

The draft letter also expresses concern with the overall "checklist" approach of the Proposed Guidance. The Proposed Guidance includes several lists of items that directors "should request" from advisers and requests comment on the information boards "should receive" with respect to soft dollar usage. The draft letter states that these checklists, and the accompanying prescriptive language, stray from the Commission's intention to provide directors with information "to consider" in performing their duties.

For these reasons, the draft letter recommends that any final guidance reiterate throughout the Commission's intention to provide guidance for fund directors to consider in performing their responsibilities and clarify that ultimately a fund board's role is to oversee the adviser's responsibilities. The draft letter also recommends that the Commission clarify that the Proposed Guidance's lists are only suggested lists of data, information, factors, or discussion items for fund boards to consider in light of the specific circumstances of the

funds they oversee and not mandatory “checklists.”

II. The Language and Overall Tone of the Proposed Guidance May Imply the Prohibition of Certain Portfolio Trading Practices

The draft letter states that, combined with some of the prescriptive language used in the Proposed Guidance, the overall tone of the Guidance may create an impression that certain portfolio trading practices, particularly soft dollar practices, are unsuitable for funds and may influence directors to alter their approach to oversight in this area.

The draft letter notes that Congress has implicitly recognized the benefits of soft dollars in its adoption of Section 28(e) and the Commission has issued several releases affirming and interpreting the use of this safe harbor. The draft letter states that the Proposed Guidance has the potential to change this longstanding tone dramatically and does not present a balanced discussion of the uses of soft dollars in conjunction with providing a list of conflicts raised by soft dollar practices. The draft letter therefore recommends that the Commission present a more balanced discussion of these issues in its final guidance.

The draft letter also recommends that the Commission clarify certain of the conflicts listed in the Proposed Guidance. In particular, the draft letter states that the use of a fund’s brokerage commissions to obtain research that benefits an adviser’s other clients does not necessarily present a conflict of interest, particularly if the research also benefits the fund. The draft letter notes that Section 28(e) permits an adviser to consider the value of soft dollar benefits to all accounts for which it exercises investment discretion, and not just the fund whose trades generated the commissions. Thus, purchasing research and brokerage services with fund brokerage commissions that may benefit another advisory client are in no way inappropriate. The draft letter recommends that the final guidance make clear that a fund board may use its discretion to determine whether the fund is benefiting from the soft dollar services acquired by the adviser.

III. Disclosure to Other Advisory Clients and Fund Investors

The Commission requests comment on whether it should propose additional disclosure to fund investors of the information it is suggesting that fund boards should consider. The draft letter states that while the Institute supports disclosure of useful and relevant information to fund investors, we do not believe that additional disclosure to fund investors is warranted at this time.

Ari Burstein
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endnotes

[\[1\]](#) See Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors with Respect to Investment Adviser Portfolio Trading Practices, SEC Release Nos. 34-58624, IC-28345 (July 30, 2008), 73 Fed. Reg. 45646 (Aug. 6, 2008) (“Proposed Guidance”).

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