

**MEMO# 19364**

November 14, 2005

## **DRAFT ICI COMMENT LETTER ON PROPOSED SEC SOFT DOLLARS GUIDANCE -- NOVEMBER 17TH CONFERENCE CALL**

©2005 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [19364] November 14, 2005 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 40-05 EQUITY MARKETS ADVISORY COMMITTEE No. 39-05 INVESTMENT ADVISERS COMMITTEE No. 13-05 SEC RULES COMMITTEE No. 63-05 SMALL FUNDS COMMITTEE No. 31-05 RE: DRAFT ICI COMMENT LETTER ON PROPOSED SEC SOFT DOLLARS GUIDANCE -- NOVEMBER 17TH CONFERENCE CALL As previously indicated, the Securities and Exchange Commission recently published for comment an interpretive release concerning client commission practices under Section 28(e) of the Securities Exchange Act of 1934.<sup>1</sup> The Institute has prepared the attached draft comment letter, which is briefly summarized below. Comments are due to the SEC no later than November 25th. The Institute will hold a conference call on Thursday, November 17th, at 2:30 p.m. Eastern time, to discuss the draft letter. The dial-in number is 1-800-369-1192 and the pass code is 51966. Please send an email to Abby Bair at [abair@ici.org](mailto:abair@ici.org) to let us know if you plan to participate on the call. If you cannot participate on the call, please provide any comments on the draft letter to the undersigned at 202/326-5822 or [frances@ici.org](mailto:frances@ici.org) before the time of the call. The draft letter expresses support for the Commission's proposed interpretive guidance and applauds the Commission for soliciting public comment before issuing final guidance. It discusses the benefits that "client commission arrangements" can and do provide, and describes how tightening the Section 28(e) safe harbor will benefit investors. The draft letter then comments on the following specific issues.

**Level Playing Field for All Investment Advisers** The draft letter recommends that the Commission take steps to level the playing field by prohibiting the use of client commissions outside the safe harbor for all investment advisers, regardless of the type of client account involved. It indicates that the current regulatory

<sup>1</sup> See Memorandum to Closed-End Investment Company Committee No. 38-05, Equity Markets Advisory Committee No. 38-05, Investment Advisers Committee No. 11-05, SEC Rules Committee No. 57-05 and Small Funds Committee No. 30-05 [19274], dated October 21, 2005.

<sup>2</sup> disparity creates a strong financial incentive for broker-dealers to favor hedge fund and other advisers who, unlike advisers to investment companies and to ERISA accounts, are permitted to use client commissions to make payments outside the safe harbor. The letter notes that tightening the safe harbor will exacerbate this situation, to the detriment of mutual fund shareholders and retirement plan participants. It recommends that the Commission adopt a rule under

the Investment Advisers Act of 1940 that will prohibit an investment adviser from using client commissions to pay for any products or services that fall outside the safe harbor.

**Eligible Brokerage and Research Services** The draft letter generally supports the proposed guidance concerning the eligibility criteria for “research services” and “brokerage” under Section 28(e). It recommends modifications to:

- clarify that publications available to the general public (i.e., mass-marketed publications that are widely circulated to the general public and intended for a broad, public audience) are not within the scope of the safe harbor;
- clarify that a money manager will be permitted to make a reasonable allocation of client commissions to pay for components of an order management service that meet the criteria for eligible brokerage or research services; and
- permit money managers to treat proxy voting services as a mixed-use item in appropriate circumstances.

**Commission-Sharing Arrangements** The draft letter makes reference to the discussion in the Commission’s release of the responsibilities of introducing brokers in the context of commission-sharing arrangements. The letter recommends that the Commission clarify that the guidance does not place any affirmative obligations on money managers to ensure that introducing brokers comply with any criteria specified in the guidance or applicable law. It notes that a money manager typically will have no way of knowing, for example, whether an introducing broker is making and/or maintaining required records relating to customer trades.

**Implementation of the Guidance** The draft letter recommends that the Commission clarify that any final guidance will apply on a prospective basis, and provide an appropriate implementation period. The letter suggests that the Commission designate an effective date following the adoption of final guidance (e.g., 30 days after adoption), after which any new (or renewed) client commission arrangements would have to comply with the guidance. It recommends that the Commission provide a reasonable period of time (e.g., six months) for investment advisers to unwind or modify, as necessary, client commission arrangements existing as of the effective date. It further recommends allowing investment advisers to use credits earned under existing 3 arrangements for a period not to exceed six months following the end of the implementation period. The letter also recommends that the Commission permit investment companies to make any necessary changes to their registration statements at the time of the next regularly scheduled amendment after changes to policies and procedures are adopted.

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Attachment (in .pdf format)