

**MEMO# 19398**

November 22, 2005

## **REVISED DRAFT ICI COMMENT LETTER ON PROPOSED SEC SOFT DOLLARS GUIDANCE**

©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. [19398] November 22, 2005 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 41-05 EQUITY MARKETS ADVISORY COMMITTEE No. 40-05 INVESTMENT ADVISERS COMMITTEE No. 15-05 SEC RULES COMMITTEE No. 64-05 SMALL FUNDS COMMITTEE No. 33-05 RE: REVISED DRAFT ICI COMMENT LETTER ON PROPOSED SEC SOFT DOLLARS GUIDANCE The Institute recently sent you a draft comment letter on the SEC's interpretive release concerning "client commission practices" under Section 28(e) of the Securities Exchange Act of 1934.\* We held a conference call with members on November 17th to discuss the draft letter. Based on the conference call and other comments, we have revised the draft letter in certain respects. A copy of the revised letter is attached and it is briefly summarized below. Comments on the guidance must be filed with the SEC no later than November 25th. If you have any comments on the attached draft letter, please contact me at 202/326-5822 or frances@ici.org by 12:00 p.m. on Wednesday, November 23rd. The revised draft letter notes that the use of soft dollars raises complex policy and practical issues that have been the subject of widespread debate and divergent opinions for many years. It makes reference not only to the potential benefits of soft dollars to investors, but also to the conflict of interest concerns that have led many in the mutual fund business, including independent fund directors, to recommend that soft dollar practices be curtailed. The letter observes that, based on the proposed interpretation, it appears that the Commission has concluded that the Section 28(e) safe harbor and related guidance remain an acceptable way to preserve the benefits of "client commission arrangements" for investors while subjecting these arrangements to appropriate safeguards. It expresses support for the proposed guidance, subject to the following comments on specific issues. • The Commission should take steps to level the playing field by prohibiting the use of client commissions outside the safe harbor by all investment advisers, regardless of the \* See Memorandum to Closed-End Investment Company No. 40-50, Equity Markets Advisory Committee No. 39-05, Investment Advisers Committee No. 13-05, SEC Rules Committee No. 63-05 and Small Funds Committee No. 31-05 [19364], dated November 14, 2005. 2 type of client account involved. This change will ensure that all advisers treat investors equitably in connection with the adviser's use of brokerage, and that broker-dealers do not have an incentive to favor hedge fund and other advisers who are permitted to use client commissions outside the safe harbor. • The Commission should modify the proposed guidance to: o Exclude from the safe harbor

publications that are marketed to the general public. o Permit the use of client commissions to pay for order management systems under a mixed use analysis. (In a change from the earlier draft, the letter recommends that the Commission revise the proposed temporal standard for eligible brokerage. The letter recommends that the temporal standard begin when a money manager makes an investment or trading decision, rather than when the manager communicates with a broker-dealer for the purpose of making a trade. It states that this change would recognize that certain functions performed by a money manager before transmitting an order are part of, or incidental to, the execution process for purposes of Section 28(e).) o Clarify that money managers may treat proxy voting services as mixed use items in appropriate circumstances. • The Commission should clarify that the proposed guidance concerning commission-sharing arrangements does not place any affirmative obligations on money managers with respect to the responsibilities of introducing brokers under the guidance and applicable law, and should ensure that any responsibilities placed on brokers are appropriate and workable. • The Commission should make clear that any final guidance applies on a prospective basis, and should provide an appropriate transition period for money managers to conform their practices to the new requirements. (In a change from the earlier draft, the letter recommends that the Commission provide a one-year, rather than a six-month, transition period for money managers to unwind existing client commission arrangements and use credits earned under existing arrangements.) Frances M. Stadler Deputy Senior Counsel Attachment (in .pdf format)

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