

THE ALLIANCE IN SUPPORT OF INDEPENDENT RESEARCH

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Mr. Christopher Preston
Institutional Business Policy
Financial Services Authority
25 The North Colonnade
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London E14 5HS

Re: Comments on Consultation Paper 06/18 – Financial Services Authority Quarterly Consultation (No. 10) Proposed Amendment to Conduct of Business Sourcebook (Use of Dealing Commission)

Dear Mr. Preston:

The Alliance in Support of Independent Research is pleased to have this opportunity to comment on a proposed amendment to the Conduct of Business Sourcebook (Use of Dealing Commission) found in Consultation Paper 06/18 of the Financial Services Authority (“FSA”). The proposed amendment would narrow the scope of permissible services relating to the execution of trades or the provision of research (“non-permitted services”), specifically excluding under COB 7.18 connectivity services and order and execution management systems (“OMS”) from being obtained with account commissions.

For the reasons set forth below, we urge the FSA to modify its proposed amendment regarding OMS and connectivity services to clarify that features of OMS and connectivity services, to the extent they provide assistance in the investment decision-making process, or provide assistance with respect to the formulation, modification or institution of orders, could satisfy either the “research” or the “execution” prong of COB 7.18.

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The Alliance In Support Of Independent Research

Members of the Alliance share a common interest in fostering a favorable regulatory environment in which research services and products may be furnished to the money management community, and in preserving the umbrella of protection Section 28(e) of the Securities Exchange Act of 1934 provides to fiduciaries who receive all forms of investment research.

The leading members of the Alliance in Support of Independent Research include the following U.S. broker-dealers:

Capital Institutional Services, Inc.
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E*TRADE Brokerage Services Inc.
Jennifer A. Connors, Head of Global Brokerage Compliance

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Westminster Research Associates Inc.,
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Our members are involved in a significant portion of the arrangements in the United States under which fiduciaries such as mutual funds, investment advisers, banks and other money managers are provided with independent research services and products for the benefit of their managed accounts.

Comment

In July of 2005, the FSA issued comprehensive guidance to limit investment managers' use of dealing commission to the purchase of "execution" and "research" services. (CP05/9) Although in COB 7.18G the FSA set forth certain examples of goods and services which the FSA does not regard as "execution" or "research," the overriding policy articulated in CP05/9 was that investment managers are to make their own judgments regarding the application of the definitions of "execution" and "research" services found in COB 7.18.4E(1) and 7.18.5E(1), respectively, to particular services used by the manager.

We do not take issue with the FSA's earlier determination to exclude computer hardware, dedicated telephone lines and administrative computer software from being obtained with client commissions. To the extent an OMS has elements which encompass these non-permissible features, we would agree that account commissions should not be a vehicle for their procurement in the absence of explicit client consent. However, given the support OMS and connectivity services render to the investment decision process, we believe it would be inappropriate to categorically state that no portion of OMS and connectivity services may be obtained for commissions.

We also note that both the FSA and the U.S. Securities and Exchange Commission ("SEC") have indicated a desire to achieve as much consistency as possible between the U.S. and U.K. regulatory regimes addressing the use of client commissions. Following the FSA's July 2005 release, and a July 2006 interpretation published by the SEC, with a few small exceptions this regulatory harmony has been achieved. The proposed amendment to COB 7.18 would represent a divergence between the U.S. and U.K. approach to client commission arrangements, subjecting firms engaged in cross border transactions to conflicting standards.

Accordingly, we urge the FSA to modify its proposed amendment regarding OMS and connectivity services to clarify that features of OMS and connectivity services, to the extent they provide assistance in the investment decision-making process, or provide assistance with respect to the formulation, modification or institution of orders, could satisfy either the “research” or the “execution” prong of COB 7.18.

Connectivity Services and Order Management Systems Provide Valuable Execution and Research Services

We believe that in the U.K., as in the U.S., connectivity services and OMS play an important role in the investment decision process of asset managers.

A review of the functionality of the typical features of OMS reveals that they assist in significant ways in facilitating executions and settlements of transactions and, in addition, facilitate the investment decision-making process. We highlight the following features of OMS as supportive of the investment decision-making or the execution/settlement process:¹

- The connectivity features of OMS, which provide access to multiple sources of liquidity and pricing, are important execution tools for investment managers.
- The integration of market data and indications of interest by brokers and dealers with orders, executions, fills, and partial fills serves the execution process.
- The application of market data to updating securities positions, risk ratios, and arbitrage ratios provide investment assistance to the investment manager.
- Cash monitoring enables the most efficient use of account assets and the efficient deployment of cash to the securities transaction process.

¹ We note there is no regulatory definition of order and execution management systems, nor are the features of these systems, provided by various vendors or developed internally, necessarily similar or uniform. We attempt to identify features common to many of such systems.

- Real time quantitative analysis of accounts and portfolio modeling are important services of OMS.
- Intra-day portfolio evaluations assist in the investment decision-making process.
- Brokerage, custodian and trade upload interfaces of OMS assist the manager in effectuating trade executions, settlements and clearance.
- Profit and loss monitoring tools based upon real-time intra-day market data assist the manager in the investment decision-making process.

From a trade execution perspective, many of the OMS features and related connectivity services described above directly support portfolio executions beginning at the point at which the asset manager has made his investment or trade decision (*e.g.*, by giving instant access to liquidity, and meaningful price data related to the market) and thus squarely fall within the temporal test outlined in COB 7.18.4E. Moreover, the OMS features performing brokerage, custodial and trade upload interfaces are linked to arranging and concluding specific investment transactions (COB 7.18.4E and COB 7.18.8G(m)).

Turning to the research component of OMS, the integration of real-time market data and cash and securities positions into the investment decision process constitutes analysis of data necessary to reach meaningful conclusions and adds value to the investment decision process (COB 7.18.5E).

Our understanding of COB 7.18 on the Use of Dealing Commission is that certain features of OMS and related connectivity services represent execution and research services, which, in significant measure, are permissible services obtainable with client commissions. An asset manager would have reasonable grounds to be satisfied that the OMS and connectivity services described above would reasonably assist the manager in servicing its accounts as called for by COB 7.18.3R(3). Furthermore, obtaining such services for commissions would not impair the duty of the manager to act in the best interest of his accounts where the services are dedicated to enhancing the

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execution and investment decision process on behalf of the manager's accounts. We therefore urge the FSA to allow asset managers to analyze OMS and connectivity services based upon the specific features provided by such services, rather than to impose a blanket ban on the use of client commissions to obtain any services offered through OMS.

**The FSA and the SEC Should Seek to Coordinate
Their Treatment of OMS and Connectivity Services**

As part of a comprehensive interpretive release on client commission arrangements (SEC Rel. No. 34-54165 (July 18, 2006)) the SEC determined that certain features of OMS may be obtained through client commission arrangements under the Section 28(e) safe harbor. In this regard, the SEC specified that services including: connectivity among the money manager, broker-dealer and custodians including dedicated voice or data lines between the broker-dealer and the money manager's OMS, and message services used to transmit orders to broker-dealers for execution; order routing and algorithmic trading software; software used to transmit orders to direct marketing access systems; clearance and settlement services; post-trade matching; electronic communication of allocation and settlement instructions; and, electronic confirmations and affirmations all may constitute permissible brokerage services under Section 28(e), depending upon their use by the manager.

Further, the SEC viewed several features of OMS as eligible research services for commissions. These latter features included pre-trade analysis and other products that depend on market information to generate market research.

We understand that both the SEC and the FSA, where appropriate, seek common regulatory objectives and guidelines for financial institutions operating in the global markets. To that end, we

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urge compatibility of the positions of the FSA and the SEC regarding acceptable services for commissions. Our understanding is that compatibility of views involving the use of commissions for OMS and connectivity services was essentially accomplished in the FSA's July 2005 policy statement on soft commissions and the SEC's interpretive release of July 2006. We urge the FSA to reconsider its proposed amendment given the importance of maintaining compatibility between FSA and SEC guidelines.

* * * * *

We hope these comments assist the FSA and its staff in finalizing its proposed amendment which will provide guidance to industry members regarding the permitted status of OMS and connectivity services. Members of the Alliance would welcome the opportunity to further communicate with members of the FSA's staff regarding our comments. Please call Lee A. Pickard or William D. Edick at 202-223-4418 if you have any questions.

Sincerely,

The Alliance In Support Of Independent Research

By: Lee A. Pickard, Esq.
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Counsel to The Alliance
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