THE ALLIANCE IN SUPPORT OF INDEPENDENT RESEARCH

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November 23, 2005

Mr. Jonathan G. Katz
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-9303

Re: File No. S7-09-05

Dear Mr. Katz:

The Alliance in Support of Independent Research ("Alliance") is pleased to have this opportunity to comment on File No. S7-09-05, the Securities and Exchange Commission's proposed interpretive release with respect to client commission practices under Section 28(e) of the Securities Exchange Act of 1934 (the "Interpretive Release").

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 broker-dealers:

Capital Institutional Services, Inc.
Don C. Potts, Chief Executive Officer and
Kristi Wetherington, President

E*TRADE Capital Markets
Ken Hight, Executive Vice President

The Interstate Group,
A Division of Morgan Keegan & Company, Inc.
Grady G. Thomas, Jr., President

Knight Equity Markets L.P.
Joanne Mascellino, President, Donaldson & Co. Division

Second Street Securities
Gerard M. Visci, President

Westminster Research Associates, Inc.,
A BNY Securities Group Co.
John D. Meserve, President

We believe our members are involved in a significant portion of the arrangements 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.

Overview

The Alliance applauds the Commission's efforts to provide additional clarity and guidance to participants in Section 28(e) arrangements. In the past there has been confusion among some industry participants regarding the applicability of Section 28(e) and the Commission's regulatory stance towards third-party research arrangement. In this regard, some incorrectly believed that Section 28(e) did not apply to proprietary research arrangements, while others were under the impression that third-party research arrangements were subject to enhanced scrutiny by the SEC and its staff. The Alliance thanks the Commission for clarifying once again that Section 28(e) applies equally to client commission arrangements involving full service broker-dealers providing proprietary brokerage and research services to money managers, as well as to third-party research arrangements where independent research services and products are provided to money managers by broker-dealers. The Alliance also thanks the Commission for recognizing the benefits that third-

party research arrangements can provide to money managers and their managed accounts. Finally, the Alliance commends the Commission for its use of the term "client commission" practices or arrangements throughout the Interpretive Release, rather than "soft dollars," as the latter term has led to confusion and misimpressions of what is a legitimate and valuable financial service.

A. Comments on the Framework for Analyzing Client Commission Arrangements

The Alliance supports the Interpretive Release's three step test for determining whether a product or service falls within the Section 28(e) safe harbor. The Alliance also agrees in substance with the Commission's proposed eligibility criteria for "research services." The Alliance does believe, however, that some clarification is necessary with respect to the Interpretive Release's discussion of the proposed criteria for "brokerage services." The Alliance also submits that the Interpretive Release's discussion of certain products and services is inconsistent with the statutory language of Section 28(e) and, in some instances, the eligibility criteria discussed in the release.

1. Eligibility Criteria for "Research Services" and "Brokerage Services"

The Alliance generally supports the criteria set forth in the Interpretive Release for determining whether a product or service constitutes a "research service" under Section 28(e), which appears to be a refinement of, and not a material change to, the Commission's 1986 release concerning Section 28(e).[1] The Alliance also agrees with many of the Commission's statements regarding the types of products or services that, if put to proper use, may fall within the Section 28(e) safe harbor, including: research reports; financial newsletters and trade journals; quantitative analytical software; portfolio analytic software; certain seminars and conferences; market data; company financial data; certain consultant's services; communication of certain execution-related

information between institutions, broker-dealers and custodians, including connectivity services and dedicated lines; order routing software, algorithmic trading software and trade analytic software. The Alliance further substantially agrees with the Interpretive Release's description of products and services with inherently tangible or physical attributes which are not eligible as "brokerage and research" under the safe harbor, such as office equipment, furniture and business supplies, rent, utilities, telephones, etc. We do note, however, that while examples of such products being purchased by money managers with client commissions are often cited by critics of Section 28(e) as grounds to narrow the scope of the Section 28(e) safe harbor, we do not believe that the practice of paying for such items through Section 28(e) arrangements has ever been widespread or prevalent.

While the Alliance is supportive of the Commission's decision to provide guidance with respect to the eligibility criteria for "brokerage," under Section 28(e), we are concerned that the discussion in the Interpretive Release is silent regarding the treatment of custody services under the Section 28(e) safe harbor. The statutory language of Section 28(e) specifically references custody functions as coming within the safe harbor.[2] We are concerned that as presently worded, the Interpretive Release may leave the impression that custody functions are excluded from the definition of "brokerage services," a result that would be inconsistent with the statutory language. Accordingly, we ask that the final release clarify that custody functions fall within the eligibility criteria for "brokerage" under the Section 28(e) safe harbor.

B. Comments on Specific Products or Services

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[1] SEC Rel. No. 34-23170 (April 23, 1986).

[2] " . . . a person provides brokerage . . . services insofar as he . . . effects securities transactions and performs functions incidental thereto (such as clearance, settlement, and custody) . . .. Securities Exchange Act of 1934, Section 28(e)(3)(C).

1. Order Management Systems

The Commission suggests in the Interpretive Release that order management systems ("OMS") used by money managers to manage their orders and related hardware 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 set forth in the Interpretive Release.[3]

We submit, however, that 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:

- The connectivity features of OMS are important execution tools for investment managers.
- The integration of market data and indications of interest by brokers with orders, executions, fills, and partial fills serves the brokerage 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.
- Real time quantitative analysis and portfolio modeling are important services of OMS.
- Intra-day portfolio evaluations assist in the investment decision-making process.
- Brokerage, custodian and DTC trade upload/interfaces of OMS assist in effectuating trade executions, settlements and clearance.

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[3] We note there is no regulatory definition of order management system, nor are the features of order management systems provided by various vendors or developed internally necessarily similar or uniform.

- Profit and loss monitoring tools based upon real-time intra-day market data assist in the investment decision-making process.

As one can observe, these features, commonly part of an OMS, provide brokerage and research support from a number of perspectives. Accordingly, while we have no issue with the Commission's determination to exclude hardware attendant to an OMS from the scope of the Section 28(e) safe harbor, as the Interpretive Release seems to suggest, we ask the Commission to reconcile its position on the eligibility of the above-referenced features of OMS with the statutory language of Section 28(e) and relevant interpretations. Specifically, we request the Commission to modify its statement regarding OMS to clarify that features of an OMS, 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 "brokerage" prong of the Section 28(e) safe harbor.

2. Trade Analytics

The Interpretive Release notes that trade analytics may have a research component that is eligible for treatment as research under the Section 28(e) safe harbor. We support this view, and note that trade analytics typically include information and data that fall within the specific statutory language of Section 28(e). For example, trade analytics provide information regarding the performance of accounts.[4] Trade analytics also provide information and advice regarding the availability of purchasers or sellers of securities.[5] Accordingly, we support the Commission's

[4] Section 28(e)(3)(B).

[5] Section 28(e)(3)(A).

determination to include trade analytics as a product that is eligible for treatment as research under the Section 28(e) safe harbor.

3. Proxy Services

The Alliance requests that the Commission clarify that proxy services contain facets which are eligible for treatment as research under the Section 28(e) safe harbor. Proxy information and advisory services, including newsletters and proxy analyses and recommendations, provide analysis and data regarding many issues with a direct relationship to the value of, or the advisability of investing in, securities, including: executive compensation and incentives; executive and employee stock option plans; board structure and practices; proposed mergers and acquisitions; requests for capital authorization; contested proxy solicitations; shareholder proposals, and social and environmental policies and responsibilities. Such information, when used by a manger as part of his or her investment decision-making responsibilities, clearly falls within the Section 28(e) safe harbor. On the other hand, the portion of proxy services associated with assisting managers with the administrative functions of voting ballots, maintaining vote records, and delivering client reports, which deal with the mechanics of casting proxy votes, as opposed to the formulation of investment-related decisions, would appear to be outside the Section 28(e) safe harbor.

C. Client Commission Arrangements Outside the Section 28(e) Safe Harbor

The Interpretive Release states that conduct not protected by Section 28(e) "may constitute a breach of fiduciary duty as well as a violation of the federal securities laws . . ." We ask that the Commission clarify that the Interpretive Release does not change well-established law which

holds that with proper disclosure and/or consent, and absent a specific statutory prohibition,[6] arrangements pursuant to which a money manager (including a federally-registered investment adviser) or account receive goods and services outside the Section 28(e) safe harbor can be structured consistent with the federal securities laws and relevant fiduciary principles.

Existing state fiduciary laws typically require an investment adviser who wishes to obtain a product or service for its own use and to pay for it with client portfolio commissions to fully disclose the arrangement to, and receive the consent of, its client(s). In reliance on such laws many investment advisers, particularly advisers to hedge funds, have entered into contractual arrangements with their clients which allow the adviser to use portfolio commissions to pay for products and services outside the Section 28(e) safe harbor. Such arrangements represent an informed decision by the parties to allocate the costs of their relationship in a particular way, and should not be disturbed. An adviser who fails to fully disclose the parameters of such an arrangement, or who violates some other fiduciary principle, would be subject to possible liability under general fiduciary law and under the anti-fraud provisions of the Investment Advisers Act of 1940. Given the fact that adequate investor protections exist, we see no reason to interfere with informed arrangements reached by private parties with respect to the use of their commissions. We also see no grounds upon which to interpret the Investment Advisers Act of 1940 to prohibit registered investment advisers and their clients from entering into arrangements outside the Section 28(e) safe harbor, provided such arrangements are properly disclosed to, and consented to by, clients. We note that this issue is of particular importance at this time, given the fact that many previously unregistered hedge fund

[6] We note that, as discussed in the Interpretive Release, managers of registered investment companies and pension funds subject to ERISA may violate the Investment Company Act and ERISA, respectively, unless their client commission

managers will be required to register with the Commission in response to the Commission's recent amendment of Investment Advisers Act Rule 203(b)(3)-1.

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We hope these comments assist the Commission and its Staff in finalizing an interpretation which will provide guidance to industry members regarding client commission arrangements. Members of the Alliance would welcome the opportunity to further communicate with members of the Commission or the Commission 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.
William D. Edick, Esq.
Pickard and Djinis LLP
Counsel to The Alliance
In Support Of Independent Research

cc: Hon. Christopher Cox
Hon. Paul S. Atkins
Hon. Roel C. Campos
Hon. Cynthia A. Glassman
Hon. Annette L. Nazareth

Mr. Robert L.D. Colby, Acting Director
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arrangements fall within the Section 28(e) safe harbor.