

THE ALLIANCE IN SUPPORT OF INDEPENDENT RESEARCH

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Mutual Fund Directors Forum's Call to End "Soft Dollar" Arrangements Ignores Evidence that Research Arrangements Under the Section 28(e) Safe Harbor Benefit Mutual Fund Investors

Washington, D.C., July 29, 2004- The Alliance in Support of Independent Research (www.alliance-research.org) today announced its opposition to the Mutual Fund Directors Forum's suggestion that independent directors of mutual funds should not permit fund advisers to obtain research for mutual funds through portfolio transactions.

Lee A. Pickard, Counsel to the Alliance in Support of Independent Research, Managing Partner of Pickard and Djinis LLP and former Director of the SEC's Division of Market Regulation, said, "Without citing any quantitative or empirical evidence, the Mutual Fund Directors Forum has attacked a practice which has been used by mutual fund advisers for decades to improve the performance of managed funds."

If the MFDF's position were adopted by a fund board, the adviser to the fund would not be able to receive any research, independent or proprietary, from broker-dealers in exchange for fund portfolio transactions. This would not only deprive mutual funds of innovative research products, thus harming their performance, but also would put mutual funds at a distinct disadvantage in competing with other managed investment alternatives, such as hedge funds and separately managed accounts.

The MFDF's position is apparently based on its conclusion that research-commission arrangements "benefit a fund's adviser because it is spared the expense of purchasing or obtaining on its own research provided by the broker-dealer." The fault in this premise is that research obtained through broker-dealers is used by advisers to attempt to improve the investment performance of the managed fund. Research received from broker-dealers is used to supplement, and not as a substitute for, the advisers' own in-house research efforts, and advisers are not required or compelled to expend their own funds for outside research. Accordingly, a fund adopting the MFDF's position would only be depriving its adviser of a valuable tool for improving the fund's own performance. Indeed, studies have shown that the use of research-commission arrangements is positively correlated with account performance. See Stephen M. Horan and D. Bruce Johnsen, *Does Soft Dollar Brokerage Benefit Portfolio Investors: Agency Problem or Solution?*, available on the Alliance's website at (<http://www.alliance-research.org/PDFs/SoftDollarDraft.pdf>).

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The MFDF also suggests that research-commission arrangements are insufficiently transparent to be examined by mutual fund directors, and that directors may have difficulty monitoring for best execution where fund advisers use such arrangements. The Alliance believes these views are belied by the structure of independent research arrangements. As stated previously by the Alliance, and cited in the MFDF report, with respect to independent research arrangements,

virtually all broker-dealers providing third party research services . . . indicate on their customers' statements the dollar value of the research provided to the customer, the aggregate commissions used to pay for the research, and an identification of the research. This method of accountability has made the independent research dissemination process precise and transparent . . .

Accordingly, information regarding securities transaction execution costs is readily available for independent research-commission arrangements, and fund directors have all the necessary tools to monitor the quality of executions received by the fund with respect to such arrangements.

Finally, the Alliance notes that the use of research-commission arrangements by mutual funds is clearly lawful and appropriate provided such arrangements comply with the safe harbor of Section 28(e) of the Securities Exchange Act of 1934, and that such arrangements have been benefiting mutual funds and mutual fund investors for decades. The Alliance urges that mutual fund boards take these facts into consideration when determining whether to act on the MFDF's recommendation.

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Members of the Alliance in Support of Independent Research 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 ("Alliance") include the following broker-dealers:

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

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