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Ms. Nancy Morris

Secretary

Submitted electronically to: rule-comments@sec.gov

U.S. Securities and Exchange Commission

100 F Street

Washington, DC 20549

Subject: Request for rulemaking relating to brokerage commission disclosure, transparency and the January 17, 2007 SEC Goldman Sachs “No Action” letter.

Dear Ms. Morris:

As you know, in 1975 the U.S. Congress mandated that the securities industry must fully-negotiate brokerage commissions and discontinue its historic practice of enforcing a fixed-price schedule for brokerage commissions. Shortly after the mandated implementation date for fully-negotiated commissions Congress passed an amendment to the Securities Exchange Act of 1934, the amendment is known as Section 28(e). Section 28(e) provides a “safe harbor” for investment advisors to “pay-up” from their fully-negotiated commission rate and receive investment research (only) in exchange for the amount of client commissions “paid-up”.⁽¹⁾

Section 28(e) created a new payment method which gave investment advisors the opportunity to purchase independently produced research with brokerage commissions. Soon several institutional brokerage firms began specializing in providing execution and research *only*. These brokerage firms avoided other lines of business, such as investment banking or mutual fund sales, which might introduce conflicts of interest.

Because in this new brokerage operating model there were three parties to the arrangement (the broker, the advisor, and independent research provider) the brokers became known as institutional third-party brokers.

These brokers built their businesses to comply with Section 28(e); they maintained an accounting of what portion of advisors clients’ commissions paid for execution and what was “paid-up” for independent research. This accounting forms a very clear set of records for brokerage commission disclosure and this level of disclosure allows clients, regulators and other interested parties to examine and test brokerage commission uses for compliance with Section 28(e).

Meanwhile, the full-service brokerage industry has resisted calls for disclosure and transparency in bundled services commission arrangements. And, it’s obvious to many observers that the amounts “paid-up” in bundled full-service brokerage

(1) For a more complete definition of soft dollars please see the SEC “Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisors, and Mutual Funds issued September 22, 1998 Section II Background, part A. Soft Dollars Defined.

<http://www.sec.gov/news/studies/softdollar.htm>

arrangements have not been used *only* to purchase execution and investment research in conformity with the requirements of Section 28(e). Some observers are suspicious that clients' commissions "paid-up" above the fully-negotiated costs of execution (negotiated by fiduciaries) may be the currency that is exchanged for favors such as IPO allocation and consideration for flipping the IPO's before the lock-up period expires. Or, that commissions "paid-up" in undisclosed bundled commission arrangements may be the inducement for other favors that are even less likely to accrue to the direct benefit the owner of the accounts whose commissions are "paying-up" for the benefits the fiduciary advisor is receiving.⁽²⁾

At the SEC open meeting on July 12, 2006, when the vote on the Amended Interpretive Guidance on Client Commission Practices Under Section 28(e) was taken, and the amended Commission Guidance was passed, it was mentioned by several commissioners that a "second wing" of guidance would be opened. It was stated that the second wing of guidance was necessary to explain the requirements for disclosure and transparency in client commission arrangements.⁽³⁾ By September this second-wing of interpretation seemed late in coming, so some commenters filed letters with the SEC mentioning the importance of disclosure in brokerage commission arrangements.⁽⁴⁾

I believe the SEC "No Action" letter issued on January 17, 2006, which describes a new set of conditions allowing brokerage firms to share commissions with third-parties, necessitates parallel ruling on brokerage commission disclosure and transparency.⁽⁵⁾ I am very critical of this "No Action" letter because I don't believe the consequences of creating this new structure and process for independent research payment were considered. The new structure will very likely give a few large full-service broker dealers

(2) See, Remarks of Chairman Arthur Levitt, before the 2000 Annual Meeting of The Securities Industry Association Boca Raton, FL November 9, 2000 - scroll down to the topic heading "Sticky Brokerage Commissions" and "Order Flow and IPO's".

<http://www.sec.gov/news/speech/spch420.htm>

And see:

Statement # 228 of **The Shadow Financial Regulatory Committee** "Disclosure of Soft-Dollar Brokerage by Financial Advisors" submitted February 13, 2006

http://fic.wharton.upenn.edu/fic/Policy%20page/20060213_ShadowStatement228%5B1%5D.pdf

(3) See, webcast of the July 12, 2006 Sunshine Meeting - vote on Commission Guidance Regarding Client Commission Practices Under Section 28(e) of The Securities Exchange Act of 1934

<http://www.connectlive.com/events/secopenmeetings/2006index.htm>

(4) See, request for enhanced disclosure standards from the **American Bar Association** submitted by the Federal Regulation of Securities Law Association - September 14, 2006:

<http://www.sec.gov/comments/s7-13-06/s71306-13.pdf>

See, Public Comment by Bill George on "**Disclosure, transparency and the misreporting of Soft-Dollar Commissions**" (two pages) published on the SEC website, September 21, 2006

<http://www.sec.gov/comments/s7-13-06/s71306-14.pdf>

(5) See, Status of Service Providers in Goldman Sachs Research Xpress^(SM) Program, by Brian A. Bussey Assistant Chief Council of the Securities Exchange Commission. Commonly referred to as the Goldman Research Xpress^(SM) "No Action" letter.

<http://www.sec.gov/divisions/marketreg/mr-noaction/2007/goldmansachs011707-15a.pdf>

a significant competitive advantage. It will provide these brokers with insights into the costs of competitive research, and it will give these executing brokers an early view into what research is effective and what research is not effective. Further, the concentration of order flow and expected reduction of brokerage competition will give a few large brokers insights into advisors' trading strategies and specific securities being traded. This will increase opportunities for trading abuses, such as "front running". Additionally, it seems this "No Action" letter will require a substantially different regulatory regimen. I don't think these consequences were adequately considered before issuing this "No Action" letter.

Most importantly, this "No Action" letter will have the effect of putting independent research providers in an extremely disadvantageous position as regards their ability to compete with proprietary research and the other services provided in bundled undisclosed commission arrangements. Executing brokers will have the opportunity to take their own allocation of commission dollars for proprietary services (which are not identified and not explicitly priced) before whatever is left over goes into the "commission pool". Independent research will be competing for a share of commission dollars against the undisclosed proprietary services offered by executing full-service brokers, and those same executing brokers will control the pool of commission dollars from which third-party research providers might be paid. For the sake of competition and market efficiency independent research producers cannot be dependent on a few large full-service executing brokers to allocate payments for independent research.

Sophisticated transaction cost analysis of large samples of institutional brokerage executions indicate that institutional trades can be executed, on average, at a cost ranging between 1.25 and 1.65 cents per share. Full service brokers typically charge 5 cents per share for their brokerage services without explaining how the 320 to 400 percent "paid-up" above the costs of execution is used. Is the excess commission "paid-up" used to buy proprietary research which qualifies for the safe harbor of Section 28(e)? How does one know? The lack of transparency and disclosure in bundled brokerage arrangements seems intended to inhibit regulators and fiduciaries from discharging their duties. The opacity of bundled brokerage arrangements can camouflage the abuse of fiduciary clients' commissions.

For the above cited reasons, I feel that it's in the best interests of the investing public, the independent research community, the viability of third-party brokerage, and for market efficiency; that the SEC to work rapidly to introduce a mandate for commission unbundling and disclosure. The identification and pricing of the services brokers provide, and for which fiduciaries may "pay-up" with their clients' commissions, will simplify fiduciary and regulatory oversight and reduce opportunities for abuse.

Respectfully Submitted By,

William T. George