

**Bill George**  
**Blue Sky Research Services**  
**Encino, CA**

April 7, 2008

Nancy Morris, Secretary  
U. S. Securities and Exchange Commission  
100 F Street NW  
Washington, DC 20549-1090

**Subject:** File Number S7-10-00, Release No. 2711- Proposed Amendments to Form ADV

Dear Ms. Morris and SEC:

Beginning at "Item 12. Brokerage Practices." on page 32 of the proposed amendments to the Form ADV there are several questions about investment advisors' soft dollar practices. Form ADV seems an appropriate vehicle for institutional advisors to make public disclosures about the ways they use clients' brokerage commissions, however history has demonstrated advisors' extreme unwillingness to acknowledge their use of soft dollars.

At an SEC "Sunshine Meeting" held on July 12, 2006, the **Commission Guidance Regarding Client Commission Practices Under Section 28(e) of The Securities Exchange Act of 1934** was unanimously approved by the SEC commissioners. In this "Sunshine Meeting" several commissioners and other SEC staff members publicly emphasized the priority and importance of a planned "second wing of guidance on disclosure and transparency in client brokerage commission arrangements".<sup>1</sup> This second wing was never initiated. I believe such Commission Guidance is a necessary first step to make the proposed Form ADV disclosures fair and informative.

The definition of soft dollars is: brokerage commissions paid-up in excess of the fully-negotiated costs of execution.<sup>2</sup> For years, many institutional advisors have denied using soft dollars in spite of the fact that these same advisors pay significantly higher brokerage commissions than would be necessary to purchase fully-negotiated execution only brokerage. In spite of the clarity of the long standing definition of soft dollars some industry professionals would like to manufacture a definitional differentiation between fully-disclosed soft dollars used to purchase independent third-party research, as differentiated from undisclosed soft dollars used to purchase unidentified bundled proprietary services from full-service brokers.<sup>3</sup>

Reliable estimates put the current level of institutional advisors' total soft dollars in the range of 10 to 12 billion dollars per year.<sup>4</sup> Yet less than ten percent of these soft dollar expenditures are identified and disclosed. Many investment professionals have commented that the magnitude of this unaccounted drain on institutional clients' investable assets has serious negative impact on the long-term compounding of investors' portfolio returns.<sup>5</sup>

---

<sup>1</sup> See, SEC webcast archives **Wednesday, July 12, 2006** at <http://www.sec.gov/news/openmeetings.shtml>

<sup>2</sup> See, SEC OCIE September 22, 1998 **Inspection Report** - Section II. A. Soft Dollars Defined, at > <http://www.sec.gov/news/studies/softdolr.htm>

<sup>3</sup> See, **Request For Rulemaking** from ICI President, Matthew Fink - dated December 16, 2003 to SEC at > <http://www.sec.gov/rules/petitions/petn4-492.htm> and see, article titled, **A Scandalous Non-Scandal in Mutual Funds**, Wednesday December 17, 2003 at > [http://www.poorandstupid.com/2003\\_12\\_14\\_chronArchive.asp#107170017138618353](http://www.poorandstupid.com/2003_12_14_chronArchive.asp#107170017138618353)

<sup>4</sup> See, Pensions & Investments article titled, **Time For Soft Dollar Transparency** by Kristi Wetherington - October 30, 2006 and see comment by Harold Bradley Sr. Vice President of American Century Investments, at > <http://www.investopedia.com/ask/answers/04/011404.asp>

<sup>5</sup> See, speech to: A.A. Sommer Lectureship, Fordham University, New York, NY - November 3, 2000 by SEC Chairman, Arthur Levitt, **Costs Paid With Other People's Money** (scroll to "'Sticky' Brokerage commissions") at > <http://www.sec.gov/news/speech/spch419.htm>

Early in this decade several States' Attorney Generals, the SEC, and the NASD conducted investigations of institutional advisors and full-service brokerage firms. These investigations resulted in numerous prosecutions, penalties, fines and settlements. It's obvious that many of the conflicts of interest and frauds discovered in these investigations were motivated by advisors' exchange of institutional clients' brokerage commissions for undisclosed unidentified services and favors provided by full-service brokers. Most of the full-service brokerage favors discovered in these investigations did not accrue direct benefit to the institutional clients whose brokerage commissions were used to buy the favors.<sup>6</sup>

Furthermore, as I pointed out in a **Request for Rulemaking** I filed with the SEC on February 7, 2006,<sup>7</sup> the structure of the recently created Client Commission Arrangements (CCA's) significantly increases the potential for abuse of institutional clients' undisclosed brokerage commissions. Full-service brokers provide execution services, proprietary research, and other proprietary brokerage services - like investment banking - in "bundles" of undisclosed services. When such brokers control the commission allocation process it invites the temptation to use institutional clients' brokerage commissions for self-serving and conflicted goals. In the majority of new CSA's the executing broker doesn't identify commissions paid-up (above the fully-negotiated costs of execution) and they don't identify, or price, the proprietary brokerage services they provide. Putting these full-service brokers at the center of the CSA threatens the availability of commissions "left over" in the CSA's commission pool and available to purchase fully-disclosed research from independent research providers who are competing with the full-service executing brokers' proprietary services.

In closing, I will point out that institutional investment advisors and full-service brokers have always argued that the identification of, and accounting for, their brokerage services is impossible or uneconomical. They will point to the intangible nature of some of the services brokers provide, and they will mention the difficulty of assigning values to intangible services. These arguments will seem less compelling if listeners consider that institutional advisors generally maintain internal commission accounting records which are used to allocate commissions to research providers. Also, institutional advisors generally maintain internal commission accounting records used for brokerage order allocation and for negotiating with brokers on issues relating to service levels expected in exchange for the advisor's order flow (commissions). It seems reasonable that institutional trustees, mutual fund directors, plan sponsors, other fiduciaries, and *even* account owners might request these internal commission accounting records so they can discover how brokerage commissions are being used. And, until equal transparency and disclosure are mandated and enforced, it seems reasonable that regulators might make use of advisors' internal commission accounting records to better understand advisors' uses of soft dollars in bundled undisclosed brokerage arrangements.

Thank you,

Bill George

---

<sup>6</sup> See, **Global Analyst Research Settlement** at > <http://www.sec.gov/news/speech/factsheet.htm> and > [http://en.wikipedia.org/wiki/Global\\_settlement](http://en.wikipedia.org/wiki/Global_settlement) and, see **Blood on The Street** by Charles Gasparino at > <http://www.amazon.com/Blood-Street-Sensational-Generation-Investors/dp/0743250230>

<sup>7</sup> See, **Request For Rulemaking on disclosure and transparency in Client Commission Arrangements** submitted by William T. George (scroll down to File No. 4-531 February 10, 2007) at > <http://www.sec.gov/rules/petitions.shtml>