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September 7, 2006

Via Electronic Mail (rule-comments@sec.gov)

U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Attention: Nancy M. Morris, Secretary

Re: File No. S7-13-06 — Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, SEC Release No. 34-54165 (July 18, 2006)

Ladies and gentlemen:

We appreciate the opportunity to respond to the Commission's request for comment in the above-captioned release (the "Interpretive Release") regarding the availability of safe harbor provided by Section 28(e) of the Securities Exchange Act of 1934 to the client commission arrangements.

We commend the Commission for clarifying for money managers and broker-dealers the scope of the Section 28(e) safe harbor. The Interpretive Release addresses and resolves several issues that in recent years have been sources of uncertainty for market participants. Most importantly, we agree with the Commission's decision in the Interpretive Release to revise its original proposal that would have required the introducing broker in a "normal and legitimate" correspondent relationship to be at risk to the clearing broker for its customer's failure to pay. We believe the Commission's decision to incorporate into its interpretation the variety of Section 28(e) arrangements the industry has developed is consistent with the congressional intent of Section 28(e) and will benefit investors by allowing money managers appropriate flexibility in seeking best execution.

We respectfully recommend, nonetheless, that the Commission clarify one important issue. In its original proposal issued in October 2005, the Commission identified four minimum criteria an introducing broker must satisfy to be "effecting" transactions within the meaning of Section 28(e). In its discussion of the statutory term "effecting", the Interpretive Release now says:

> [W]e believe that the statutory term 'effecting' requires that, in order for the money manager to use the safe harbor, a broker-dealer that is "effecting" the trade must perform at least one of four minimum functions and take steps to see that the other functions have been reasonably allocated to one or another of the broker-dealers in the

arrangement in a manner that is fully consistent with their obligations under SRO and Commission rules.[1]

We believe the Commission should clarify that an introducing/clearing agreement consistent with New York Stock Exchange Rule 382 or NASD Rule 3230 is not necessary for a client commission arrangement to come within the Section 28(e) safe harbor. Under the Interpretive Release, a broker-dealer can meet the statute's "effecting" requirement by performing one or more of the seven functions enumerated in the Interpretive Release. The remainder must be allocated to the other broker-dealer, but we believe effective allocation does not necessarily require an introducing/clearing agreement consistent with New York Stock Exchange Rule 382 or NASD Rule 3230. Performing only monitoring functions and responding to customer inquiries, for example, would not involve a function that would require allocation under the SRO rules, but would nevertheless suffice under the Commission's seven-factor test for application of the safe harbor. Particularly since the Commission now looks at the functions performed rather than whether there is a "normal and legitimate" correspondent relationship, we think the presence or absence of an introducing/clearing agreement complying with the NYSE or NASD rule should not be relevant.

We believe one additional issue warrants Commission clarification. The Interpretive Release states that software that provides analysis of securities portfolios qualifies under the safe harbor as research because it reflects the expression of reasoning or knowledge relating to subject matter that is included in Section 28(e)(3)(A) and (B).[2] At a different point, however, the Interpretive Release states that software functionality used for recordkeeping or administrative purposes, such as managing portfolios, and quantitative analytical software used to test "what if" scenarios related to adjusting portfolios, asset allocation, or for portfolio modeling do not qualify as "brokerage" under the safe harbor because they are not integral to the execution of orders by the broker-dealers, i.e., they fall outside the temporal standard.[3] That point, while consistent with the Commission's discussion of its temporal standard, could create confusion. It would be helpful if the Commission clarified that portfolio-modeling software in any event qualifies for the safe harbor if it assists the asset manager in making investment decisions.

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We appreciate the time the Commission has devoted to this subject. We believe the Commission has devised a positive framework that offers greater certainty and flexibility to money managers consistent and promotes the public interest. If the Commission or any

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1 Interpretive Release in text after n.174 [citation omitted].

2 *Id.* in text accompanying n.92.

3 *Id.* in text preceding n.124.

members of the staff would like to discuss these issues with us, we would be pleased to make ourselves available for that purpose.

Respectfully submitted,

Kim Bang by R.D.B.

cc: The Hon. Christopher Cox, Chairman
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The Hon. Roel C. Campos, Commissioner
The Hon. Annette L. Nazareth, Commissioner
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