CAPIS
CAPITAL
INSTITUTIONAL
SERVICES, INC.

October 1, 2008

Ms. Florence Harmon
Acting Secretary
Office of the Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors with Respect to Investment Adviser Portfolio Trading Practices (File No. S7-22-08)

Dear Ms. Harmon:

Capital Institutional Services, Inc. ("CAPIS") appreciates the opportunity to comment on File No. S7-22-08,[1] entitled "Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors with Respect to Investment Adviser Portfolio Trading Practices." With over 30 years experience and as one of the largest remaining independent broker-dealers, CAPIS performs a valuable role by delivering a wide range of services and fostering competition within the industry. Our service offering is broad and includes global agency trading, advanced order execution and independent research distribution for investment advisors and plan sponsors. We are a leading participant in the commission programs under which fiduciaries, such as mutual funds, are provided with research services and products for the benefit of their managed accounts.

In general, CAPIS supports the Commission's intent to improve disclosure, transparency and the flow of information to fund directors in order to assist them in performing their oversight responsibilities. CAPIS has long been a proponent of enhanced disclosure that aids in the review of portfolio trading practices – especially in relation to the concepts of best execution and

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1 SEC Rel. Nos. 34-58264; IC-28345; IA-2763 (July 30, 2008)

1601 Elm Street ■ Suite 3900 ■ Dallas, Texas 75201 ■ 214.720.0055 ■ 800.247.6729 ■ Fax 214.954.0040 ■ www.capis.com
Offices: Dallas and New York ■ Member NYSE, FINRA, SIPC

the use of client commissions to obtain research or brokerage services under 28(e), as well as other programs such as commission recapture and expense reimbursement.

We applaud the Commission for reinforcing the fact that, under 28(e), acquiring research through managed client commissions goes beyond third party research arrangements. It is extremely important to reinforce the fact that "soft dollars" include all mechanisms in which an advisor procures research in exchange for brokerage commissions. Repeated emphasis is vital as there continues to be a lack of understanding in the investment community, by both regulators and practitioners, regarding this point. Ultimately, if an advisor is using managed brokerage commissions to obtain research, whether it be third party research, bundled, proprietary research or through a Commissions Sharing Agreement or Client Commission Arrangement, that advisor is using "soft dollars" and as such, is governed by Section 28(e).

We are also pleased that the Commission's position regarding the Proposed Guidance is not intended to create additional burdens of reporting or oversight for the fund advisors or directors. We agree that this guidance is meant to provide a broad framework and may be used as one of many tools a fund board will utilize in conducting its oversight responsibilities. We support the Commission's idea that there cannot be a one size fits all approach to a board's oversight practices and that this guidance is intended to supplement and not supplant current practices or result in a checklist or fill in the blank format for review.

However, with respect to much of the content included in the Proposed Guidance, we take this opportunity to note some areas of concern. One overarching issue that we feel must be addressed is the underlying negative connotation regarding "soft dollars" that permeates throughout the Proposed Guidance. This is specifically evidenced by the attention paid to the idea of perceived or potential "conflicts of interest." We are especially troubled as some of the "conflicts" cited are born out of incorrect application of Section 28(e). For example, the Proposed Guidance asserts there is a potential for conflict of interest because the advisor receives a benefit when he acquires research under Section 28(e). We note the inaccuracy of this premise. An advisor may only obtain research under the safe harbor if he uses it to benefits his clients. Therefore, it is the fund, and not that advisor, that benefits from research under 28(e).

Additionally, the Proposed Guidance focuses on another potential conflict of interest that, in fact, does not exist. The guidance suggests that the use of client commissions to obtain research could cause an advisor to avoid alternative uses of those commissions, such as commission recapture programs or fund expense reimbursement programs. This statement is inaccurate. Advisors only enter into recapture and expense reduction programs when directed to do so by plan sponsors and fund clients. Because advisors do not enter into these programs voluntarily, there is no conflict of interest as suggested above. In fact, an advisor may actively obtain research with its clients' commissions while also complying with a fund's direction to participate in an expense reimbursement program. The advisor does not have sole discretion and participating in various commission programs is not an all or nothing proposition.

Yet another potential conflict suggested by the Proposed Guidance is that an advisor may use fund brokerage to obtain research that benefits another client who has not generated the same level of commissions as the fund. To address this potential conflict, the Commission suggests the advisor should report to the fund director the advisor's use of research on a client specific basis. Section 28(e) statutorily acknowledges that an advisor may consider the value of soft dollar benefits spread across all of his managed accounts. In fact, a term has been coined for this practice called "spreading the benefit."

The practice of "spreading the benefit" has been included in all the reviews of Section 28(e), including a number of proposed and final interpretive releases. Through much scrutiny, it has never been suggested that an advisor should perform a client-by-client transaction analysis. In fact, it has been noted previously that account tracking in this manner is not only undesirable but is also impractical. We dare say it may even be impossible. We bolster this assertion using the following simple example. Research is principally comprised of ideas related to the investment decision-making process. Basically, research is information. Once an advisor learns of such information, it would be unrealistic to expect that advisor to compartmentalize the information and use it for the benefit of his clients based on the pro rata share of each client's brokerage activity at that point in time. Such client-by-client accounting is simply inconsistent with the manner in which research is acquired, absorbed and applied by advisors.

Therefore, the suggestion that a fund director could or should review such transaction activity is a concern on two levels. First, even assuming the managers did attempt to report on this level, without a standard reporting regime, client specific accounting would be based on best guess estimates and vary hugely from advisor to advisor. It is easy to assume there would be an extreme range in the manner in which this information would be procured and reported by different advisors. The information would be difficult for directors to compare and it would not only be unhelpful, but could even be harmful if decisions were based on such incongruent data. Attempting to implement this type of review would be both burdensome to the investment advisor and confusing to the fund boards. The SEC would have to precisely define disclosure requirements for all advisors so that consistent information could be supplied to fund boards in order for this suggested type of review to be conducted in any meaningful or productive manner.

Obviously, the suggested account-by-account review creates a new level of compliance reporting and oversight that does not currently exist under 28(e). And so it clearly goes against the Commission's statement that the Proposed Guidance is not intended to create new or additional reporting burdens. Another example suggested that a board could simply require an advisor to cease the use of soft dollars with fund assets. In order for a Board to properly see that such a request was being adhered to, it is presumable that the Board would be required to create new monitoring processes and procedures and to track them accordingly. Again, this creates an additional standard of review than currently exists.

In relation to our concern that the specific suggestions above would create new levels of compliance and oversight, we note that the Proposed Guidance also includes a recurring theme which could certainly be construed as creating additional responsibilities for fund directors. While the Commission plainly states that the Proposed Guidance is only offered for fund directors "to consider" in conducting their oversight responsibilities, we note that the Commissions often used the term "should." For example, the Proposed Guidance suggests that directors "should" review a specific list of items upon reviewing an advisor's trading practices. This type of directive terminology could easily be construed to create a duty.

These examples demonstrate how the Proposed Guidance could be interpreted to be much more than guidance. As written, the Proposed Guidance could easily be adopted as a set of requirements and as such, fund directors would be forced to take on additional responsibilities and be required to adhere to a new, higher standard of oversight. For these reasons, we recommend that any final guidance address these concerns and make it exceedingly clear that the guidance is truly meant as suggestions that could be in considered to aid fund directors in performing their oversight duties and is not way to be construed to create any additional burdens or responsibilities.

As always, CAPIS greatly appreciates the Commission giving us the opportunity to comment on this issue. Please do not hesitate to contact me if CAPIS can be of any further assistance or should you require any additional information regarding this matter.

Sincerely,

Kelly C. Abernathy

Kelly C. Abernathy
General Counsel
Chief Compliance Officer