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Mr. Jonathon G. Katz, Secretary
The Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Subject: Comment on Proposed Soft Dollar Interpretive Guidance (File # S7-09=05)

Dear Secretary Katz:

Thank you for this opportunity to add to my recent comments on the proposed Interpretive Guidance for Section 28(e).

After being passed by Congress in 1975, Section 28(e) significantly increased competition for institutional brokerage and independent research services. Section 28(e) allows investment managers to use the same payment method to purchase independent research from third party brokers that they used historically to buy bundled research from full service brokers.

Because third-party broker dealers, in general, are structured to offer only execution and independently produced research they provide an efficient and economical alternative to using full service brokers. Another benefit of Section 28(e) is that third-party brokerage has increased the transparency of institutional brokerage commissions by separating the costs of research from the costs of execution.

Third-party brokerage facilitates the competitive availability of independent investment research under Section 28(e). This contributes to market efficiency by offering independent (un-conflicted) research as an alternative to "Street Research". This alternative source of investment research can be a safeguard against the sometimes conflicted and biased research offered by full-service brokerage firms ⁽¹⁾.

⁽¹⁾ See testimony, U.S. House of Representative's Banking Committee Hearing "Analyzing The Analyst's" - June 14, 2001 <http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=54>

See testimony, U.S. House of Representative's Banking Committee Hearing "Analyzing The Analyst's II" - July 31, 2001 <http://financialservices.house.gov/hearings.asp?formmode=detail&hearing=55>

See testimony of Dr. Howard Schilit, "The Unintended and Undesirable Consequences of Banning Soft Dollars" given before the U.S. Senate Committee on Banking, Housing and Urban Affairs hearing titled: "Review of Current Investigations and Regulatory Actions Regarding the Mutual Fund Industry: Examining Soft-Dollar Practices" - March 31, 2004 <http://banking.senate.gov/files/schilit.pdf>

See transcript and original video broadcast of a "60 Minutes" interview with New York State Attorney General Eliot Spitzer, titled: "The Sheriff of Wall Street" broadcast date, 10/06/02
http://www.jameshoyer.com/news_cbs_merrill_lynch.html

It's my opinion that the currently proposed Interpretive Guidance very effectively outlines the SEC's concept of the appropriate use of Section 28(e) soft dollars in third-party brokerage arrangements. However, in my opinion, the SEC's currently proposed Interpretive Guidance does not offer sufficient guidance with regard to how interested parties can identify and separate potentially qualifying research in the bundled services environment of full service brokerage firms.

In the 1990's; before, during, and after, "The Sweeps"⁽²⁾ the SEC focused significant effort on auditing, regulating, and enforcing soft dollar procedures on third-party broker / dealers. The SEC has not placed as much regulatory focus on the appropriate use of institutional commissions in the bundled services environment at full service broker / dealers.

The SEC's currently proposed Interpretive Guidance seems, again, to be primarily focused on third-party brokerage and the application of Section 28(e) at third-party brokers providing independently produced research.

This seems peculiar, since most third party brokers offer a limited set of services and have demonstrated their ability and willingness to provide detailed documentation and accounting of their three-party arrangements. In this context it's also important to note, third-party brokerage evolved in direct response to the regulatory requirements of Section 28(e) and in response to the market's demand for unbiased research.

The content of the Inspection Report (released September 22, 1998) was a significant disappointment for third-party brokers and independent research providers because it didn't directly address soft dollar brokerage in the bundled (proprietary) services environment. After the release of the Inspection Report, this apparent lack of regulatory focus on research provided in bundled services arrangements has influenced many third party broker dealers, who experienced the inconvenience and the costs of "The Sweeps", to migrate to a business model incorporating proprietary offerings so they would be treated like a full service broker. Another environmental factor that should be considered, after the release of the Inspection Report many full service brokerage firms set-up soft dollar trading desks to compete with third-party brokers. These soft dollar desks are used to execute and process trades designated to pay for third-party research (or commission recapture). From recent testimony, investigations, and prosecutions it's evident the fungibility of commission dollars in any part of a full service brokerage environment should be a concern to all who are interested in commission oversight.⁽³⁾

(2) See, Office of Compliance Inspections and Examination, U.S. Securities and Exchange Commission, Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds 3 (Sept. 22, 1998) go to > <http://www.sec.gov/news/studies/softdollar.htm>

(3) See text of former SEC Chairman Arthur Levitt's speech to the Securities Industry Association Annual Meeting in Boca Raton, FL in November of 1999. Scroll down to the section "Sticky" brokerage commissions' Link: <http://www.sec.gov/news/speech/speech420.html>

At the time Congress passed Section 28(e) third-party brokerage did not exist. Therefore one must conclude that Section 28(e) was designed to regulate research in the only operating model existent at that time - the bundled services brokerage operating model. Notwithstanding this fact, the full service brokerage industry continues to avoid maintaining the documentation and accounting that allows regulators, fiduciaries, beneficiaries, and account owners to identify the allocation of commissions between: execution related services, research that qualifies for the safe harbor of Section 28(e), non-qualifying services, and quid pro quos. Such accounting is essential for regulatory oversight. And, such accounting is necessary so that fiduciaries and account owners can evaluate the costs and benefits of their asset management and brokerage relationships.

Another point that warrants consideration, on page 35 of the SEC's proposed Interpretive Guidance it states that "trade analytics" does not qualify as execution or research under the SEC's Temporal Standard. My interpretation of "trade analytics" includes the kind of trade analysis that is provided by many investment consulting firms like: Abel / Noser, Elkins / McSherry, and Plexus Group (or even some less sophisticated Volume Weighted Average Price [VWAP] trade analytics). Such trade analysis is very useful for determining "best execution" and trading quality & consistency. By deduction, it's also useful for analyzing the costs and the components of brokerage commissions.

Trade analytics also reveals performance loss from poor execution and it reveals excess commission charges. Therefore, I believe trade analytics are a useful and necessary tool for fiduciaries, beneficiaries, and account owners. Trade analytics are research that should be given the safe harbor of Section 28(e).

In direct response to your request for comments on specific issues discussed in the proposed Interpretive Guidance:

- (1) Does the commission's interpretation offer sufficient guidance with respect to the types of "advice" "analysis" and "reports" that are eligible as research services that are eligible under Section 28(e)? **Answer:** Yes, with the exception of trading cost analytics, as noted above.
- (2) How would investors, money managers, broker-dealers, and others be affected by the Commissions interpretive guidance that client commissions cannot be used to obtain computer equipment as "research" under Section 28(e)? **Answer:** I believe most (fiduciary) asset managers do not presently use soft dollars to buy computer hardware or hardware peripherals so this guidance will have little economic or operational impact.
- (3) Does the Commission's interpretation offer appropriate guidance as to the eligibility of market data and trade analytical software under Section 28(e)? **Answer:** As I mentioned above, I believe "trade analytics" is a valuable tool used for measuring best execution and for assessing performance loss from poor quality execution and excessive brokerage costs. Therefore I believe trade analysis is research, and should qualify for the safe harbor of Section 28(e).
- (4)
 - (a) Does the Commission's interpretation offer appropriate guidance as to the eligibility of "brokerage" services, functions and products under section 28(e). **Answer:** As noted above, I believe, where Section 28(e) is concerned, the preoccupation of the Commission for the last fifteen years, or so, has been with third-party brokerage. I believe the

investigations and prosecutions of full service broker dealers conducted since the year 2000 have revealed a pattern of commission abuses at full service brokerage firms that necessitate Interpretive Guidance focused specifically on the abuses that have been discovered. I believe that a constructive first step in the process would be to require pricing of proprietary research services and accounting for the soft dollar allocation of client commissions which is paid as reimbursement for proprietary services. This would allow testing for these services' qualification under section 28(e) and allow identification of 28(e) services - as distinguished from other valuable brokerage services (and quid pro quos).

(b) How would this (currently proposed) guidance affect existing arrangements or practices? **Answer:** I believe the currently proposed guidance provides some optimism about the availability of the Section 28(e) safe harbor for the provision of unbiased research for the future. However, I believe third-party brokerage and independent research cannot enjoy equal competitive footing with full service brokerage until proprietary research is accounted for and priced.

(c) Are there types of research that should be excluded from the safe harbor, even though they might appear to satisfy the temporal standard? **Answer:** As noted above, in my opinion the safe harbor of 28(e) should extend to transaction cost analysis.

(5) Does the Commission's interpretation offer sufficient guidance about third party research and commission sharing arrangements? **Answer:** In my opinion, it does.

(6) How does the commission's Interpretive Guidance differ from the approaches other regulators, SRO's, market participants, trade organizations, and investor advocacy groups have adopted or recommended with respect to client commission practices? **Answer:** In my opinion the investigations and prosecutions conducted by the New York State Attorney General have been a watershed event for highlighting brokerage commission abuses. However it seems that the penalties were not appropriate. I believe management and supervisory personnel at brokerage firms should have been prosecuted and punished. Punishing a few staff analysts or traders will not change the "culture". The monetary penalties hurt the equity holders of brokerage firm stocks, and ultimately the penalties will be paid out of profits generated from operating revenue, the perps are only inconvenienced. And, I believe the Global Research Settlement accomplishes nothing. There is no such thing as free research - once again, the costs of this agreement will come out of operating revenue. Widely distributed ostensibly "free" research provides no information or knowledge advantage in relatively "efficient" markets. Under the Global Research Settlement management and supervisory personnel at brokerage firms don't feel the appropriate level of punishment for their wrong-doing. It seems the **SRO's** have largely failed to protect the interests of retail and institutional investors. The pronouncements and suggestions of the trade industry groups serve the interests of full service brokers, large active mutual funds and pension investment managers.

I believe investor advocacy groups, like Fund Democracy and The Investor Protection Division of The Consumer Federation of America, have done a good job of identifying the potential for abuse from undisclosed commission arrangements, but I think they have failed to appreciate the differences (in commission transparency) between third-party brokerage and the bundled commission arrangements of full service brokers.

(7) Are there types of products or services and their components that are commonly paid for with client commissions for which additional guidance would be useful? If so, please provide facts about these products and services and their components, and how they are used. For example, are client commissions commonly used to pay for proxy voting services? **Answer:** I believe Interpretive Guidance on commission uses will be necessary soon for hedge fund managers and hedge fund advisors. I believe the allocation of proxy issue analysis and proxy voting is understood by most in the industry.

(8) Should the Commission provide additional guidance on the allocation and documentation of mixed use items? **Answer:** I don't believe additional guidance in this area is necessary.

(9) Concerns have been expressed by some industry participants and others that mass-marketed publications (publications that are broadly marketed and intended for a broad, public audience) are part of a firm's overhead and should not be paid for with client commissions:

(a) To what extent are these types of publications being paid for with client commissions? **Answer:** It's my impression that, in most cases, such publications are no longer being purchased with soft dollars in most instances.

(b) Are the purposes and uses of these types of publications distinguishable from those of traditional research products? Should the commission provide further guidance in this area? **Answer:** In my opinion, most forms of broadly circulated print media provide little significant value to industry professionals. Some broadly circulated electronic media (Wall Street Journal Online, Investors Business Daily Online, and TheStreet.com) might provide "advice" "data" and / or "analysis" that contributes to investment decision making, but for the most part the information is redundant and stale (and sometimes biased) when compared to institutional information sources / systems. And the editorial and "news reporting" policies at broadly distributed research services that are supported significantly by "Street" advertising revenue are almost totally useless for investment decision making.

(10) Should the Commission afford firms time to implement the interpretation? In commenting, please provide specific examples of any specific implementation issues? **Answer:** If, after considering comments, the SEC decides to implement requirements for constructive commission disclosure of the bundled service arrangements of full service brokers, I believe a six month implementation period would be appropriate. The change is significant, but the warning signs have been there for several years (see footnote 2, on page 2).

In closing I will say, it appears that some fiduciaries and some account owners are beginning to address the need for more careful oversight of the use of brokerage commissions. Recent investigations and prosecutions by plan sponsors⁽⁴⁾, on behalf of their beneficiaries, demonstrate that with clear guidelines enforcement can be achieved by knowledgeable fiduciaries using litigation and other market forces. And I believe the SEC's requirement for Independent Directors for mutual funds will greatly benefit market influences that will protect the brokerage commission dollars of mutual fund investors. However, I believe that the SEC can assist the process by providing very clear interpretive guidance on the subject of how to identify and account for proprietary research which qualifies for the safe harbor of Section 28(e), when such research is provided by brokerage firms in the bundled services environment. Also, it seems the SRO's should place more emphasis on fiduciary responsibility in their training and testing regimens. Apparently, such emphasis would be particularly useful for NASD "Series 55" candidates and registrants⁽⁵⁾.

Thank you again for the opportunity to express my comments on the proposed Interpretive Guidance for client commission practices under Section 28(e) of the Securities Exchange Act of 1934.⁽⁶⁾

⁽⁴⁾ See, web page of "The Benchmark Companies'" Library of Articles. These articles include news reports and comments on several investigations and prosecutions of brokerage commission abuse. > <http://www.benchmarkalert.com/library/> <

⁽⁵⁾ See, Wall Street Journal article: "SEC Examines Rebates Paid To Large Funds" by Susan Pulliam and Gregory Zuckerman, Published January 6, 2001; Page C1

⁽⁶⁾ For a more extensive listing of the resources that have influenced the opinions expressed in this comment please visit: <http://www.home.earthlink.net/~wtgeo/index.htm>

Sincerely,

Bill George