

November 25, 2005

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-9303

Dear Mr Katz,

Re: File No. S7-09-05) - Commission Guidance Regarding Client Commission Practices under Section 28(e) of the Securities Exchange Act of 1934 (the "Exchange Act")

E*TRADE Financial Corporation ("E*TRADE") appreciates the opportunity to make this submission to the Securities and Exchange Commission (the "Commission") in connection with its proposed interpretation regarding client commission practices under Section 28(e) of the Exchange Act (the "Proposed Interpretation").¹ Please note that E*TRADE is a member of The Alliance in Support of Independent Research (the "Alliance") which is filing a separate comment letter on behalf of its members. In addition to the Alliance letter, E*TRADE has additional comments to provide to the Commission.

E*TRADE previously submitted comments in February 2004 with respect to the Commission's concept release regarding Measures to Improve Disclosure of Mutual Fund Transaction Costs.² As before, our comments are given from the perspective of an independent broker-dealer. In addition to offering both proprietary and non-proprietary mutual funds to retail investors, our institutional brokerage operation transacts securities business for domestic and international money managers globally. Furthermore, our institutional brokerage operation has been a leading provider of soft dollar services to money managers since 1989. Finally, it is also worth noting that E*TRADE does not produce proprietary research or engage in investment banking activities.

E*TRADE strongly believes that the policy considerations behind Section 28(e) remain valid three decades after its enactment: money managers require both investment research and trade execution services in order to serve their clients effectively. "Soft dollar" arrangements, or "client commission" practices as the Commission has referred to them in the Proposed Interpretation, benefit investors by increasing the level of competition in the financial services industry. They enhance the ability of smaller brokers and independent research providers to compete with large, diversified firms. They also enhance the ability of smaller investment

¹ 70 FR 61708 (October 25, 2005).

² See Letter of Jarrett Lilien to Jonathan G. Katz, "Re: File No. S7-29-03 – Request for Comments on Measures to Improve Disclosure of Mutual Fund Transaction Costs," February 20, 2004.

advisers, which depend on third-party research, to compete with larger counterparts. Finally, these arrangements help promote the distribution of independent research.

E*TRADE commends the Commission for recognizing that significant changes to technology and industry practice have necessitated a review of the scope of “brokerage and research services” under Section 28(e). Overall, we support the analysis and conclusions reached by the Commission, although we feel that some additional guidance from the Commission would be extremely helpful with respect to the treatment of trade analytical software, commission sharing agreements and mass market publications.³

In general terms, however, we believe that the Proposed Interpretation will benefit investors by clarifying what are now gray areas for money managers and thereby creating certainty, by reducing the potential for conflicts of interest and, at the same time, encouraging the use of research and technology in managing client accounts.

Attached please find an Appendix that lists E*TRADE’s responses to some of the specific questions posed in the Proposed Interpretation.

Sincerely,

Signed per Ken Hight

Ken Hight
Executive Vice President

³ Please see our comments to questions 3, 5 and 9 respectively in the attached Appendix.

APPENDIX

1. Does the Commission’s interpretation offer sufficient guidance with respect to the types of “advice,” “analyses,” and “reports” that are eligible as “research services” under Section 28(e)?

E*TRADE believes the SEC has provided sufficient guidance with respect to the vast majority of products/services provided to clients.

2. How would investors, money managers, broker-dealers, and others be affected by the Commission’s interpretive guidance that client commissions cannot be used to obtain computer equipment as “research” under Section 28(e)?

E*TRADE believes this that this is a reasonable interpretation and that the industry will adapt accordingly. In our experience, the vast majority of money managers and broker dealers already consider that items which are appropriately classified as computer hardware do not fall under “research” for the purposes of Section 28(e).

3. Does the Commission’s interpretation offer appropriate guidance as to the eligibility of market data and trade analytical software under Section 28(e)?

E*TRADE supports SEC’s approach to market data.

However, we would urge the Commission to provide further clarity regarding the eligibility of trade analytical software. The Proposed Interpretation does not give sufficient guidance as to the situations where such software can qualify as either “research” or “brokerage” under Section 28(e). Such software is used by money managers in a variety of ways, including analysis of trade performance of a portfolio in order to make investment decisions and to select brokers. In such circumstances, we would submit that it would be appropriate to classify such software as either research or brokerage depending on the specific use made by the money manager. We accept that there are uses for such software which are best described as administrative in nature and therefore a cost to be borne by the money manager. However, provided the money manager makes a good faith determination with respect to his usage of trade analytical software and otherwise meets the requirements of the “research” or “brokerage” tests under Section 28(e), we do not see why such software cannot be treated as a mixed use product. We would therefore appreciate further guidance from the Commission on this point.

4. Does the Commission’s interpretation offer sufficient guidance as to the eligibility of “brokerage” services functions, and products under Section 28(e)? How would this guidance affect existing arrangements or practices? Is the Commission’s temporal standard sufficiently clear? Are there types of services that should be excluded from the safe harbor, even though they might appear to satisfy the temporal standard. If so, explain why those services should be excluded – for example, is the service unrelated to the execution of transactions?

We broadly support the Commission’s interpretation of “brokerage”, subject to our comments regarding trade analytical software above.

5. Does the Commission's interpretation offer sufficient guidance about third-party research and commission-sharing arrangements?

E*TRADE supports the Commission's approach on third-party research.

However, we are concerned that the minimum requirements set out by the Commission to satisfy eligible commission sharing arrangements will severely limit the use of commission sharing agreements solely to traditional introducing broker relationships. We accept that it is appropriate for the broker providing research to a money manager to take some active part in effecting a transaction for the money manager. In our experience, however, some money managers have been using one broker to receive research and another broker to execute trades. In such cases, the broker providing research may be involved in receipt and transmission of orders to the executing broker, monitoring and post trade reporting to the client and dealing with trading/settlements issues. He therefore plays a direct role in effecting trades. Therefore, in this instance, it is not necessarily the case that the broker providing the research will have assumed financial responsibility to the executing/clearing broker for trade failures. We would therefore be grateful for specific guidance as to whether commission sharing arrangements other than the traditional introducing broker arrangements may be eligible under section 28(e).

6. How does the Commission's interpretive guidance differ from the approaches that other regulators, SROs, market participants, trade organizations, and investor advocacy groups have adopted or recommended with respect to client commission practices?

We do not have any specific comments on this question.

7. Are there types of products or services 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?

We do not have any specific comments on this question.

8. Should the Commission provide additional guidance on the allocation and documentation of mixed-use items?

Subject to our comments regarding trade analytical software, we are generally satisfied with the Commission's guidance with respect to mixed-use items.

9. Concerns have been expressed by some industry participants and others that mass-marketed publications (publications that are widely circulated to the general public and intended for a broad, public audience) are part of a firm's overhead and should not be paid for with client commissions. To what extent are these being paid for with client commissions? 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?

We would appreciate greater clarity regarding the specific types of publications which should be excluded under Section 28(e). For instance, are trade publications such as The Economist acceptable, which are widely used by the industry even though they are available to the public at large? Certain other publications have complementary analytical tools available for subscription which can cost several thousand dollars per month but which nevertheless include the basic mass-marketed publication as part of the subscription price. However, given the cost, we would not consider such products as available to the mass market. Further guidance from the Commission on this point would be extremely helpful.

10. Should the Commission afford firms time to implement the interpretation? In commenting, please provide specific examples of any potential implementation issues.

E*TRADE believes that the Commission should afford firms a reasonable period of time to review their current procedures and ensure that they are in compliance with the Proposed Interpretation. As the Commission has noted, the Financial Services Authority in the United Kingdom has provided for a significant transitional period for UK firms to implement the changes it has made regarding client commission practices. Whilst we do not consider that the costs of compliance will be significant, firms should be given adequate time to review and implement changes, including making required technology changes to firm's systems which administer client commission practices, and to train staff. We suggest that a period of not less than six months would be reasonable in this regard.