November 24, 2005

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

Dear Mr Katz,

Subject: Comments on proposed interpretive guidance on client commission practises under 28(e). File Number S7-09-05

We appreciate the opportunity to comment on the interpretive release with respect to client commission practices under Section 28(e) of the Securities Exchange Act of 1934, published by the Securities and Exchange Commission ("SEC").

A. European Association of Independent Research Providers ("EuroIRP")

As a brief introduction, EuroIRP is the European trade association for independent research firms, which was formed in 2005 with the following goals:

1. To enhance the awareness and reputation of independent research
2. To work with regulators and investors to promote the awareness and acceptance of payment structures
3. To improve the regulatory and fiscal environment in which independent research firms operate

Our primary focus in terms of regulation is Europe, and our inaugural meeting was attended by Charlie McCreevy, European Commissioner responsible for Internal Market and Services, Christina Sinclair, Head of Institutional Business Policy, Financial Services Authority ("FSA") and Jean de Demandolx Dedons, Board Member, Autorité des marchés financiers ("AMF"). On issues of US regulation we intend to work closely with Investorside Research Association. Whilst Investorside seeks to make a broader submission, our intention here is to comment primarily on question 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 are concerned that the SEC's approach is contradictory to the FSA's in important respects.

B. General observations

Firstly we would applaud the SEC for clarifying that Section 28(e) will apply to both independent, third-party research and to research from full-service broker-dealers.

We are also encouraged by the sentiment acknowledged in the document on the importance of a consistent global approach to regulation. However, as our specific observations below highlight, in reality the guidance, applied literally, would result in significant differences in US and UK regulation. In contrast to the measures taken by the FSA, it would also not secure a level playing field for proprietary and independent research. We recognize that the SEC is operating under different constraints than the FSA, with the limitations imposed by the 1934 Act and subsequent revisions. Indeed, as a European association, we do not claim to fully understand the specific limitations imposed by US statute. However, we urge the SEC to recognize the changes in market structure in this area, and, where possible under the constraints imposed by the Act, consider more substantial revisions.

C. Specific observations

Our main concerns are focused on Section G: Third-Party Research and Commission-Sharing Arrangements (CSAs). Despite the stated intention in Section E to take into account the FSA's work on "execution" and "research", and the statement that *"the proposed interpretative guidance is generally consistent with the FSA's rules"*, there are in fact material differences.

The FSA's final rules published in PS05/9 state that the rules will *"promote competition between those who produce investment research by removing the regulatory distinction between research services provided by brokers along with execution (i.e., bundled services) and research services provided by third parties (i.e. softed services)".*

Whilst the SEC interpretive guidance makes a step in the right direction by removing the discrimination between third-party and full-service research for "soft" (or "client commission") practices, the proposed continued minimum activities requirements for Commission Sharing Arrangements represents a missed opportunity to improve both the quality and price of both execution and research that investment managers procure for their clients, and goes against both the regulatory intentions of the FSA, as well as the direction of market practice in the UK, thus heightening the cost of regulatory compliance for investment managers active in both countries.

The intent of the FSA's regulatory efforts in this area has been to separate purchasing decisions for execution and research, encouraging investment managers *"to seek, and brokers to provide, clear payment and pricing mechanisms that enable individual services to be purchased separately"*[1]. The FSA described CSAs as having *"the potential to form part of the market-led solution to deliver greater transparency and accountability in the use of dealing commissions and potentially better payment and pricing mechanisms"*[2].

The anticipated benefits of CSAs under FSA regulation are as follows:

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[1] See p.17, FSA CP05/5 "Bundled brokerage and soft commission arrangements: proposed rules"
[2] See p.15, FSA CP05/5

- **Investment managers are better able to seek best execution**. Existing soft dollar arrangements typically result in managers nominating one or two brokers through whom to pay bills for non-execution services. Each individual bill must be paid in full by trading with the broker who has the legal obligation to pay for the non-execution service, and usually result in in-advance volume commitments to the brokers concerned. This means that traders lack discretion in some instances, contravening best execution. CSAs have significant advantages. CSAs allow clients to deal with the broker of choice at the point of execution. They empower the trading desks to focus on best execution, whilst still enabling the fund managers to pay for research services from diverse providers, thereby meeting the objective of separating the purchasing decisions for execution and research.

- **Increased competition in the provision of execution services.** As a result of the discrete pricing of execution (without the bundling in of non-execution services such as research), and removal of guaranteed business levels associated with soft-dollar arrangements, there will be heightened price and service competition in execution than in the current bundled environment.

- **Increased competition in the provision of research services.** As a result of the discrete pricing of research and the identical disclosure and record keeping requirements for research from brokers and independent, third-party providers, investment managers will be better able to judge whether value-for-money is being achieved when purchasing research using client commissions than is currently possible in a bundled environment.

The reality of market practice in the UK is that CSAs have been embraced, and it is our impression that all major investment managers operating in the UK will have CSAs in place in Q1 2006. The advantage of CSAs as they are being implemented in the UK, is that most investment managers are establishing 6-10 CSAs with different brokerage firms, something that is supportive of the principle of best execution, and is strongly supported by trading desks.

The interpretive guidance creates or sustains the following negative consequences:

1. By introducing the four minimum activities for the introducing broker-dealers on p.46, the SEC is limiting the investment managers' ability to use this mechanism to pay for third-party research. Research firms provide assistance in the performance of investment decision making, and their ability to do this is unrelated to the execution function. However, in order to be paid by managers who do not use soft dollar arrangements, research firms often set up trading desks, without the infrastructure or skilled personal that might reasonably be expected to be necessary to achieve best execution. US managers either use what they perceive to be sub-standard execution services or resort to step-outs and other such arrangements in order to pay for research, recognizing the damage done to their clients' performance but arguing that these arrangements represent a necessary evil. To eliminate this behavior, CSAs should be a mechanism available for fund managers to pay for investment research, and they should be available for use paying research firms with or without execution capabilities.

2. The effect of the guidance in its current form will be non-standardisation and confusion in payment mechanisms between the US and UK. "Soft" no longer exists in the UK as a regulatory

definition, and CSAs will become the primary alternative payment mechanism for third-party research, as well as in many instances full-service brokerage research (whereby a large global brokerage with strong execution capabilities is being used by investment managers to pay a smaller, specialist brokerage firms with strong research, but weaker execution capabilities). Yet in the US, CSAs will be severely limited in their scope, and investment managers will have to maintain "soft" agreements to pay for much third-party research. Any investment manager operating in the two jurisdictions (i.e. many of the major firms) will have to operate separate payment mechanisms, rather than adopting consistent global payment mechanisms using CSAs. The maintenance of separate payment mechanisms, with different legal structures, and the new disclosure requirements adopted in the UK will result in an increased cost of regulatory compliance.

3. Lastly, the impact of the current guidance will be to perpetuate an un-level playing field for independent, third-party research, and full-service brokerage research. Third-party research firms are precisely those firms that need CSAs most, because, for good reason, they do not have execution functions. Research firms without execution functions are unlikely to meet minimum activities requirement, and will thereby be at a disadvantage, since they will find it more difficult to sell their services to managers who do not use soft-dollar arrangements, and they cannot charge customers a variable price that reflects the value of the research provided by sharing commissions when a manager acts upon a research recommendation. Meeting the minimum activities requirement would imply changes to both the cost base and capital adequacy requirements for third-party research firms. Doing this would negatively impact these businesses, without having any positive effect on their ability to enhance clients' investment decision making.

Purchasing decisions for execution and research, should, as the FSA states, be separate. With both the regulatory and market changes taking place in the UK, and potentially Europe, the SEC should use this opportunity to encourage use of CSAs, which achieve this objective, and not insist that research providers are involved in "effecting" the transaction. The SEC is right to want to limit abuses of 28(e), but this goal has been achieved by refining the allowable services definition. The FSA's approach to disclosure and transparency also achieves this goal.

Our questions to the SEC would be firstly what is the intention of the strictures around CSAs? Does the guidance in this area represent new revisions, or are these existing strictures dictated by the original Act? Indeed, more generally, we would appreciate more clarity as to what represents new revisions, and what represents re-statements of past releases. If the SEC cannot move its position on CSAs, we would appreciate clarification on the expected compliance burden for independents to meet the minimum activities requirements and be paid through CSAs?

D. Conclusions

Investment research assists performance in investment decision making, and meets the allowable services definition. The SEC should re-consider its position on CSAs and the minimum activities. CSAs provide a valuable combination of high quality investment research and best execution, by separating purchasing decisions. The SEC's approach to CSAs will have negative unintended

consequences, yet is not necessary to curb abuses of the safe harbor, which is achieved by restricting allowable services.

We would welcome the opportunity to further share our experience of CSA in the UK market with the SEC.

Yours sincerely,

John Kay, Chairman
Hans Plugge, Director