



Eric D. Roiter
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Boston, MA 02109

December 22, 2005

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934. Release No. 34-52635; File Number S7-09-05.

Dear Mr. Katz:

Fidelity Investments ("Fidelity")¹ appreciates the opportunity to comment on the Commission's proposal to adopt interpretive guidance regarding soft dollar services permitted pursuant to Section 28(e). Fidelity would like to commend the Commission on its proposal and for its decision to seek public comment before issuing its interpretive release.

Our Approach to Research and Brokerage Services. Fidelity has historically relied primarily on research generated by its own staff of investment research analysts. Over the years, we have supplemented our research efforts by acquiring research from the Fidelity funds' executing brokers – research either produced by those executing brokers (so-called proprietary research) or obtained by those brokers on our behalf from third parties (so-called third party research.) In keeping with long-established industry practice, we have acquired this research through the payment of bundled commissions, expenses borne by our funds and other managed accounts. We have done so, and continue to do so, in reliance on the safe harbor of Section 28(e).

Over the last year, we have reduced the use of brokerage commissions to acquire research for the funds and accounts under our investment management. Beginning in 2004, we stopped using commissions to obtain securities market data, notwithstanding the permissibility of using commissions for this purpose under Section 28(e). More

¹ Fidelity Investments, as investment adviser to over 300 mutual funds, is the largest complex of mutual funds in the United States and is also a diversified financial services company that includes several registered investment advisers, registered broker-dealers, including a retail broker-dealer and a clearing firm, registered transfer agents, and a retirement plan services administrator.

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recently, we have begun the process of negotiating agreements with executing brokers under which Fidelity purchases investment research with its own resources (so-called hard dollars), resulting in lower, unbundled commission rates paid by our funds for trade execution services. Two of these agreements have recently been reported in the press.

We Request That the Commission Address an Adviser's Use of its Own Hard Dollars. In general, we support the Commission's proposed interpretive guidance on soft dollars. We urge the Commission, however, to broaden the scope of its adopting release to confirm that a broker-dealer, who also is a registered investment adviser, may sell research to a fund adviser, such as Fidelity, without triggering the restrictions of Section 206(3) of the Advisers Act. That provision prohibits an investment adviser from acting as a principal in a securities transaction with an advisory client without first providing written disclosure to the client and obtaining the client's consent.

The reason that Section 206(3) does not come into play here is quite straightforward: Fidelity, by paying from its own resources, is the advisory "client" of the broker-dealer. In contrast, the Fidelity funds and other accounts managed by Fidelity (collectively "Fidelity funds") are not the advisory clients of the broker-dealer. Accordingly, executing brokers may enter into principal trades with any of the Fidelity funds without triggering Section 206(3).

In our view, the Commission's longstanding positions under the Advisers Act, codified with the adoption of Rule 202(a)(11)-1, confirm our reading of the Act. Rule 202(a)(11)-1(c) provides that "A broker or dealer registered with the Commission under section 15 of the Exchange Act is an investment adviser *solely with respect to those accounts* for which it provides services or receives compensation that subject the broker or dealer to the Advisers Act" (emphasis added). As noted in the January 6, 2005 re-proposing release for Rule 202(a)(11)-1, this has been the Commission's position consistently, at least since 1978. (Release No. 34-50980, text at footnote 5). Since a broker is an adviser only to the accounts for which it provides advisory services or receives advisory compensation, it follows that the broker who sells investment research to Fidelity (and is paid out of Fidelity's own resources) has Fidelity as its advisory client, not the Fidelity funds.

The Commission can readily understand how any contrary reading of Section 206(3) can introduce substantial stumbling blocks for Fidelity, or any fund manager, who wishes to use its own resources to acquire investment research and to move away from the use of fund assets (in the form of brokerage commissions) for this purpose. It is often the case that executing brokers are called upon to commit capital to carry out fund trades. It is impractical, and wholly without any regulatory purpose, to require that an executing broker, who also sells research to Fidelity, on a trade-by-trade basis, send a written disclosure to and obtain consent from the Fidelity fund prior to any principal trade with the fund.

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We request that the Commission explicitly endorse in its adopting release our view of Section 206(3) so as to reassure the brokerage community and investment advisers alike that hard dollar research payments will not disadvantage their clients or their own operations.

Soft Dollar Guidance. In addition to our request for interpretive guidance on the use of hard dollars to purchase research, we have the following comments on the Commission's soft dollar interpretive release.

- **Brokerage Services Are Covered by Section 28(e).** We agree with and commend the Commission for its reaffirmation that Section 28(e) provides a safe harbor to an investment manager with regard to the acquisition of brokerage services as well as research services, so long as the investment manager makes the good faith determination called for under the provision. Since its enactment in 1975, Section 28(e) has generated significant attention and discussion with regard to the safe harbor it extends for investment research. It is helpful that the Commission, in its current guidance, affirms that the Section 28(e) safe harbor protects investment advisers with respect to the payment of commissions for brokerage services as well.
- **Defining Services Incidental to Brokerage.** While we commend the Commission for seeking to clarify which kinds of services are incidental to effecting a securities transaction, the temporal standard that the Commission proposes to establish in its release – that brokerage service begins with communication to the broker – may well lead to problems of interpretation and, in our view, is probably unduly narrow.
 - Under Section 28(e), a broker provides brokerage services “insofar as he...effects securities transactions and performs functions incidental thereto....” While post-trade services are plainly included by example in the statute, the statute does not necessarily limit itself to post-trade brokerage services. Anything “incidental” to trade execution is statutorily defined as a brokerage service. Therefore we question whether elimination of all pre-trade services as “incidental” to brokerage is in keeping with the statute.
 - The Commission's temporal standard seems inconsistent with guidance in the proposing release itself, which would permit the use of commissions to pay for lines of communications as a form of permitted brokerage service, even though communications lines, of necessity, are installed prior to any trade-specific communication taking place.
 - With this in mind, we would encourage the Commission to develop a functional standard that turns on whether a service provided by a broker has a

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direct causal nexus to the placement, execution, clearance or settlement of a securities trade.

- *Reaffirming Third Party Research.* We applaud the Commission's affirmation that the 28(e) safe harbor applies to third party research. Third party research promotes healthy competition in the brokerage industry and encourages improvement in overall investment research quality. We also commend the Commission for recognizing that research includes computer-driven analytical programs and applications. We encourage the Commission to continue to include computer analytics within the definition of permitted soft dollar research.
- *Disclosure of Soft Dollar Expenses.* We believe that the Commission can and should take steps to improve disclosure of soft dollar expenses by advisers to their clients, whether registered investment company clients or institutional accounts. We note that the Financial Services Authority in the United Kingdom has encouraged this approach in its own rulemaking and we renew our suggestion, made in our comment letter of March 2, 2004, that the SEC adopt rules calling upon advisers to disclose the value of research services provided to the adviser on a bundled basis, based on assistance provided by brokers.² We believe that enhanced disclosure will address many of the concerns raised by the purchase of investment research with soft dollars.

² Given that a disclosure regime concerning soft-dollar research services will be in effect in the UK from January 2006, we believe that it would be timely for the SEC to encourage similar developments in the US. In this regard, since many brokers and advisers operate in both markets, we encourage the SEC to develop rule proposals for disclosure that take into account developments going into effect in the UK.

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We would like to thank the Commission for considering our comments. Please contact either the undersigned or Stuart Fross at 617-392-2698 should you have any questions concerning this letter.

Sincerely yours,

A handwritten signature in black ink that reads "Eric D. Roiter". The signature is written in a cursive style with a large, stylized "E" and "R".

Eric D. Roiter

cc: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
The Honorable Cynthia A. Glassman
The Honorable Annette L. Nazareth

Catherine McGuire, Chief Counsel
Division of Market Regulation

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