



November 21, 2005

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

RE: File No. S7-09-05

Dear Mr. Katz,

I am writing on behalf of Mellon Financial Corporation, Pittsburgh, Pennsylvania ("Mellon") and its registered investment adviser affiliates with regard to the Commission's Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934 (the "Act") [Release No. 34-52635; File No. S7-09-05] (the "Release").

Headquartered in Pittsburgh, Mellon provides institutional asset management, mutual funds, private wealth management, asset servicing, payment solutions, investor services and treasury services to institutions, corporations and high net worth individuals throughout the world. Mellon has 16 wholly owned subsidiaries that are registered with the Commission as investment advisers ("RIAs") and an ownership interest in one other RIA.¹

Mellon appreciates the efforts of the Commission to clarify and provide guidance on the complex issue of the proper use of client commissions for the payment of "research" and "brokerage" under Section 28(e) of the Act. Although we generally agree with the proposals contained within the Release, we offer some suggested modifications and requests for clarification for your consideration.

Order Management Systems ("OMS") and Trade Analytics

According to the Release, in order to qualify as an eligible brokerage product or service under the Section 28(e) safe harbor, a person must "...effect securities transactions and perform functions incidental thereto (such as clearance, settlement and custody) or required in connection therewith by rules of the Commission or a self-regulatory organization of which such person is a member...." In addition, an investment adviser must show that the eligible product or service provides lawful and appropriate assistance in carrying out the investment adviser's responsibilities. The Commission proposes a temporal standard for evaluating whether a

¹ The following RIAs are wholly-owned subsidiaries of Mellon Financial Corporation: Boston Safe Advisors, Inc.; The Boston Company Asset Management, LLC; The Dreyfus Corporation; Dreyfus Service Corporation; EACM Advisors LLC; Founders Asset Management LLC; Franklin Portfolio Associates, LLC; Laurel Capital Advisors, LLP; MBSC, LLC; Mellon Capital Management Corporation; Mellon Equity Associates, LLP; Mellon HBV Alternative Strategies LLC; Mellon Hedge Advisors, LLC; Newton Capital Management Limited; Pareto Investment Management Limited and Standish Mellon Asset Management Company LLC. Mellon Financial Corporation has an ownership interest in the following RIA: Hamon U.S. Investment Advisors Ltd.

brokerage product or service is eligible under the safe harbor, specifically identifying eligible brokerage as that brokerage service which "...begins when the money manager communicates with the broker-dealer for the purpose of transmitting an order for execution and ending when the funds or securities are delivered or credited to the advised account or the account holder's agent..." Based on this standard, the Release states that the OMS that investment advisers use to manage orders are "not sufficiently related to order execution and fall outside the temporal standard for "brokerage" under the safe harbor.... " The Commission further lists formerly acceptable products and services that become ineligible when the standard is applied including, but not limited to, post trade analytics, OMS hardware including telephones and computer terminals, and surveillance systems.

We are most concerned with the Commission's stance that an OMS does not qualify as eligible brokerage or research services under the safe harbor, and urge the Commission to reconsider its exclusion of the OMS in its final interpretation. Contrary to what its name implies, the OMS operates as both an order execution system as well as an order management system, is an integral part of the execution process, and fits squarely within the temporal standard. The OMS is integral to the execution of orders and electronic trading in that, for example, integrated indications of interest ("IOIs") provided by an OMS enable a trader to make determinations as to the most appropriate destination or venue to execute orders. It may also enable efficient handling and execution of customer trades. Several of Mellon's RIAs utilize order management systems that include portfolio management tools, including modeling tools, and order generators. The OMS provides efficient connectivity from the portfolio manager to the trading desk and from the trading desk to the broker, which are directly related to order execution and analogous to the connectivity services and trading software that the Commission considers eligible brokerage. Some OMS employ market data as well as customized data such as alpha, pre-trade cost estimates and execution options, which may be considered eligible trade research. The OMS also enables post-trade analytics which allow portfolio managers and traders to evaluate execution quality, which can in turn lead to greater efficiencies in the investment decision-making process. Finally, the technologically advanced OMS has enabled a more efficient trading and portfolio management process by reducing the error ratio formerly associated with manual systems, which in turn has benefited clients. With the market becoming more highly electronic and automated every year, the OMS has become the central technological component to efficient execution and will continue to be even more so in the future as new methods of information dissemination and related software are developed. Given that the OMS is used to transmit orders to brokers for execution, and to track executions and allocations, all functions that the Commission has indicated are acceptable brokerage services, it is unclear why the Release concludes that an OMS does not constitute eligible brokerage if not eligible research as well.

Mellon is aware that oftentimes compliance mechanisms are components of many trade order management systems and by themselves would not be eligible brokerage services under the safe harbor. For example, two of our RIAs utilize Charles River and MacGregor Predator order management systems which both contain compliance components. In such instances, Mellon acknowledges that these non-eligible components should receive mixed-use treatment and RIAs should treat them accordingly. However, this does not mean that the entire order management system should be considered ineligible for the reasons already stated. Furthermore, in such instances where a mixed-use allocation is applied, we believe that the Commission should provide additional guidance and outline a procedure for unbundling products and services so as to ensure that investment managers are following an approved and not arbitrary or subjective unbundling process. (*see* further discussion regarding unbundling set forth below).

The Interpretive Release also states that trade analytics services and software are ineligible brokerage services for the same reasons that OMS are, namely because such products are "not integral to the execution of orders by the broker-dealers ...[and] fall outside the temporal

standard....” The guidance classifies such services or products as overhead and at best elaborates in footnote 98 that to the extent money managers use trade analytics both for research and to assist in fulfilling contractual client obligations, the trade analytical software is a mixed-use product.

Mellon believes that post-trade analytics should fall within the temporal standard for brokerage or be classified as eligible research since these services are integral to the execution of orders. As with the OMS, post-trade analytics enable a trader to make determinations as to where to place trades and also serve a research function for further execution options. For example, Mellon’s RIAs utilize post-trade measurement and transaction cost analysis software such as that distributed by Plexus, Abel Noser and ITG to assist with execution quality, portfolio rebalancing and trade practice analyses, which essentially serve a research function by virtue of the way the software is utilized. The insights and recommendations that are regularly obtained from post-trade analytics are in turn implemented in future trades within the temporal standard, and as a result should reasonably qualify as pre-trade analytics and eligible brokerage. Moreover, because the OMS provides real-time stamping for order receipts, placements and executions, RIAs are equipped with precise data for post-trade analytics calculations. At least one of our RIAs has used the software as a research tool to analyze patterns of investment behavior that could have inhibited their investment process and potentially jeopardized performance, thereby helping improve their performance going forward. As a result, it is unclear why the Release views pretrade analytics as eligible while post-trade analytics are considered ineligible. Mellon respectfully requests that the Commission provide further guidance on whether trade analytics and analytical software are ineligible or mixed-use products as it is unclear to us whether or not certain software utilized by our RIAs are ineligible or deserve mixed-use analysis and, in the latter instance, what should be the mixed-use analysis procedure.

Computer Hardware

The Release states that computer hardware, including peripherals and delivery mechanisms associated with computer hardware such as cables and telecommunications lines, even if it may assist in the delivery of research, is not eligible under the safe harbor because it does not reflect substantive content related to making decisions about investing. The Commission should provide additional guidance as to whether hardware for information products, workstations and trading information systems such as those associated with, for example, a Bloomberg terminal, would be ineligible. Alternatively, we would appreciate clarification as to whether such services would be considered mixed-use, where the service is eligible but the hardware is ineligible.

Timeframe for Implementation of Guidance

The Commission has specifically requested comment from RIAs with regard to how much time firms would need to implement the interpretation. In Mellon’s case, each of our RIAs would need to review their soft dollar arrangements and modify those arrangements if necessary, implement new policies and procedures in light of any final guidance and educate employees on new policies and procedures. In addition, given that each of our RIAs specifically budget for their soft dollar usage during each firm’s fiscal year, which runs from January 1 through December 31 for all of our RIAs, we believe that any adoption of the interpretation should allow for a one year implementation period from the date the final interpretive release is published at a minimum. In addition, should any vendor agreements specifically provide for longer time periods, for example Bloomberg typically has a two-year term in their contracts, firms should be allowed additional time periods as their contracts require. Imposing a generous rather than a strict timeframe for compliance should facilitate minimal disruption to firms, allow a seamless implementation and

prevent RIAs from being out of compliance with the final release if the terms of their current agreements have not yet expired. Finally, we suggest that the final release clarify that such new guidance operate on a prospective basis following the effective date, and that it does not impose any liability retroactively for practices that were conducted in good faith reliance on prior SEC interpretive guidance and generally accepted industry practice.

Commission-Sharing Arrangements

The Commission sets forth specific elements that are required for a commission-sharing arrangement to be eligible under the safe harbor. Specifically, the Release states that any commission-sharing arrangement must be part of a "...normal and legitimate correspondent relationship in which each broker-dealer is engaged in securities activities of a more extensive nature than merely the receipt of commissions paid to it by other broker-dealers for research services provided to money managers (i.e., – "effecting securities transactions" requirement)." The guidance then sets forth four duties that a broker must perform at a minimum in order to meet the "effecting securities transactions" requirement. Finally, the Release requires that a broker-dealer effecting the trade must be legally obligated "...to pay for the service ultimately provided to a money manager (i.e., "provided by" requirement)."

The Commission should provide additional guidance as to how RIAs can ensure that the brokers with whom they deal are actually adhering to these standards. This may be best illustrated by way of the following hypothetical example: An RIA has a relationship with Introducing Broker A who provides the RIA with a research product or service. Broker A does not have a trading desk to enable it to execute trades, so Broker A asks clearing Broker B to execute and clear their trades. It would be extremely helpful if the Commission could provide guidance in the final release as to how the RIA could adequately determine whether Broker A and Broker B are adhering to these standards.

Proxy Voting

The Interpretive Release does not specifically identify electronic proxy voting services as an eligible research product or service under the safe harbor, and the Commission has specifically requested comments on whether or not client commissions are commonly used to pay for these services. Mellon's RIAs utilize one entity as their proxy voting agent and proxy services include both a research services component as well as an operational or voting agent component, with each RIA receiving a separate invoice for the research portion of its bill. The two components receive mixed-use treatment with the research service invoice paid for with soft commissions and the proxy voting service paid in hard dollars by the RIA. Research services include, among others, analyses and alerts containing voting recommendations with respect to publicly traded companies, assessments of the impact of proxy proposals on shareholder value for issues such as executive and director compensation and contested solicitations, and shareholder value transfer models. This research assists in deciding how to vote proxies, which represents a significant part of investment management responsibilities to clients. Mellon believes that these services fall within the definition of eligible research products and services under the safe harbor and urges the Commission to clarify that the research portion of proxy services be treated similarly.

Unbundling Guidance

The Commission has specifically requested comment on whether additional guidance on the allocation and documentation of mixed-use items would be beneficial. Mellon strongly believes

that additional guidance would be helpful. The Interpretive Release states that in order to avail themselves of the safe harbor, investment managers must make a "...good faith determination that the commissions paid are reasonable in relation to the value of the brokerage and research services received." The burden of proof in demonstrating this determination is on the investment manager. Currently, RIAs have no uniform process for determining the actual cost of research and other services that are provided by a broker and bundled for one fee. A definitive procedure for calculating mixed-use and unbundling would greatly assist investment managers and remove any doubt that the determination that a given RIA is making is arbitrary or subjective.

We hope that our comments will be helpful to you and appreciate the opportunity to share our views. We will gladly make ourselves available should you have specific questions regarding any of the content of this letter. Accordingly, please feel free to contact me or Kevin F. Mawe (at 617-722-7167) or Laurie Knapp (at 617-722-7722).

Very truly yours,

/s/

Michael E. Bleier
General Counsel

Cc: Kevin F. Mawe
Laurie C. Knapp