



MANAGED FUNDS ASSOCIATION

VIA ELECTRONIC MAIL AND FEDERAL EXPRESS

November 23, 2005

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

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

Dear Mr. Katz:

Managed Funds Association (“MFA”) appreciates the opportunity to make this submission to the Securities and Exchange Commission (the “Commission”) in connection with its proposed interpretation (the “Proposed Interpretation”) regarding client commission practices under Section 28(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).¹

MFA is the only U.S.-based global membership organization dedicated to representing the interests of asset managers in the alternative investment industry, including hedge funds, funds of funds and managed futures funds. MFA’s over 1,000 members include professionals from the majority of the world’s 50 largest hedge funds who manage a significant portion of the estimated over \$1 trillion invested in these investment vehicles.

As representative of the hedge fund industry, MFA supports the Commission in its undertaking to provide further guidance on money managers’ use of client assets to pay for research and brokerage services under Section 28(e) of the Exchange Act (the “Safe Harbor”). MFA has focused on the issue of soft dollar practices for our industry in the recently published *MFA’s 2005 Sound Practices for Hedge Fund Managers* (“*MFA’s 2005 Sound Practices*”), which we enclose for the Commission’s review and make reference to herein. *MFA’s 2005 Sound Practices* includes a comprehensive set of recommendations on “transactional practices”² which cover documentation management, the selection of clearing and executing brokers, as well as soft dollar arrangements. We believe our recommendations with respect to third-party arrangements, mixed-use allocations and documentation retention are consistent with the Proposed Interpretation.³

MFA believes the Proposed Interpretation appropriately revisits and clarifies the meaning of the phrase “brokerage and research services” as previously set forth in the Commission’s 1986 Release.⁴ The

¹ 70 FR 61708 (October 25, 2005).

² See Section VI, *MFA’s 2005 Sound Practices*.

³ Section 6.8, *MFA’s 2005 Sound Practices*.

⁴ 51 FR 16004 (Apr. 30, 1986).

Proposed Interpretation correctly reflects the changes in technology and in client commission practices that have taken place over the last 19 years and provides useful guidance to both the hedge fund industry and the investors who rely on the Safe Harbor.

MFA endorses the Commission's effort to provide market participants direction as to the proper framework for analyzing whether a particular service falls within the definition of "brokerage and research services." We concur with the Commission's determination that "research services" are to be restricted to "advice, analyses, and reports" within the meaning of Section 28(e)(3). We believe the Commission is correct in its assertion that "products or services that do not reflect the expression of reasoning or knowledge, including products with inherently tangible or physical attributes (such as telephone lines or office furniture), are not eligible as research under the safe harbor."⁵ While we overwhelmingly agree with the Commission's interpretation of the Safe Harbor, in at least one respect, however, we believe the Proposed Interpretation is too narrow and is contrary to the interests of investors, as more fully described below.

Post-Trade Analytics

The Commission asserts that "products and services such as trade analytics, surveillance systems, or compliance mechanisms, do not qualify as 'brokerage' in the safe harbor because they are not integral to the execution of orders by the broker-dealers, *i.e.*, they fall outside the temporal standard described above."⁶ However, MFA believes that products and services such as post-trade execution quality analysis are directly relevant to the ability of an investment manager to obtain the "best execution" of its orders. Such tools are used by investment managers to determine the execution quality of trading by various broker-dealers and whether a particular broker-dealer provides better executions in a particular space. Investment managers may use these tools to determine where to route future order flow in connection with a particular trade. As a result, these procedures directly benefit investors, are integral to the execution of orders by broker-dealers and also reflect substantive content related to trade execution.

We believe that these tools should constitute "research" under Section 28(e)(3)(B), because they are "analyses and reports concerning... the performance of accounts." The Commission does not analyze whether these tools are research in the Proposed Interpretation. Furthermore, Section 28(e)(3)(C) of the Safe Harbor includes services that are "required in connection therewith the rules of the Commission or a self-regulatory organization." We assert that analytical tools that help an investment manager comply with SEC rules should fit within this part of the Safe Harbor as well. While a broker is not required to provide these services, these tools do address required compliance functions.

It is our understanding that post-trade execution quality analysis is generally interpreted as within the Safe Harbor under the prior guidance. We are concerned that the proposed narrowing of the scope of brokerage services to exclude post-trade execution quality analysis could act to deprive investors of the benefits of this valuable analysis by discouraging investment managers from conducting the same degree of post-trade execution analysis that is currently performed. In order to ensure that investors continue to receive these benefits,⁷ we respectfully suggest that the Commission revise the proposed temporal standard to include the analysis of execution quality, even if done after the completion of the clearance and settlement process. We believe that post-trade execution analysis is a valuable tool that is designed to help the investor, their use should be encouraged by the SEC and the SEC should expressly include them within the Safe Harbor.

⁵ 70 FR at 61707.

⁶ 70 FR at 61708.

⁷ MFA devotes a portion of *MFA's 2005 Sound Practices* to a discussion of the importance of best execution practices (See Section VI).

MFA's 2005 Sound Practices

MFA would like to take this opportunity to stress the importance of disclosure in sound soft dollar practices. In *MFA's 2005 Sound Practices* we specifically recommend that a hedge fund manager fully disclose that it may engage in soft dollar arrangements and should clearly disclose its policies with respect to such arrangements. For those managers who rely on the Safe Harbor, *MFA's 2005 Sound Practices* suggests that the hedge fund manager should evaluate with its advisers how to:

1. Make a good faith determination that the amount of commission is reasonable in relation to the value of the brokerage and research services provided by the broker-dealer, in light of the terms of the particular transaction or the hedge fund manager's overall responsibilities with respect to its discretionary accounts;
2. Disclose the hedge fund manager's policies and procedures relating to such soft dollar arrangements; and
3. Determine whether the brokerage and research services are covered within the Safe Harbor.⁸

Conclusion

MFA again applauds the Commission on the Proposed Interpretation and hopes that the Commission will further consider the inclusion of post-trade analytics in the Safe Harbor for the reasons discussed above.

We appreciate this opportunity to share our views with the Commission and we would be happy to discuss any questions the Commission or its staff may have with respect to this letter. MFA would like to continue to serve as a resource for the Commission as it considers issues which impact the hedge fund industry. Please feel free to reach me at 202.367.1140.

Respectfully submitted,

/s/ John G. Gain

John G. Gain
President

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

Enclosure

⁸ Section 6.10, *MFA's 2005 Sound Practices*.