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Carlos M. Morales
Senior Vice President
and Associate General Counsel

Merrill Lynch & Co., Inc.

Office of General Counsel

4 World Financial Center, Fl. 12
New York, New York 10080
212 449 4367
FAX 212 449 5559
cmorales2@exchange.ml.com

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

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

Dear Mr. Katz:

Merrill Lynch & Co., Inc. ("Merrill Lynch"), along with Merrill Lynch, Pierce, Fenner & Smith Incorporated and Merrill Lynch Investment Managers, L.P., commend and appreciate the efforts of the Securities and Exchange Commission (the "Commission") and its Staff to provide guidance to the industry in the form of a proposed interpretation of Section 28(e) of the Securities Exchange Act of 1934, as set forth in SEC Release No. 34-52635 dated October 19, 2005 (the "Release"). We agree that there is a need for clear and updated interpretive guidance, in light of: the importance and value of research provided by broker-dealers to money managers to help them fulfill their fiduciary duties to their clients; the emergence of new technologies; and some press coverage in 2003 and 2004 of potential regulatory concerns in this area.

We appreciate the clear statement in the Release that the Section 28(e) safe harbor applies equally to proprietary and third-party research provided by broker-dealers to money managers. More generally, we recognize the significant work engaged in by the Staff in drafting the Release, along with its concomitant review of the history of Section 28(e) and prior SEC and staff interpretations, its efforts to learn about new technologies and its understanding of the global nature of our industry, by taking into account recent and related actions by the Financial Services Authority in the U.K. We also appreciate the decision of the Commission and its Staff to issue a proposed interpretation, prior to issuing final guidance. The comment process should afford the SEC with the opportunity to meet its particular stated goal of clarifying the scope of "brokerage and research services" in light of evolving technologies and industry practices.

The Release is important to Merrill Lynch in several respects. Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S"), a wholly-owned subsidiary of Merrill Lynch, is a broker-dealer that provides both proprietary and third-party research services to its clients as consistent with the provisions of Section 28(e). In addition, Merrill

Lynch Investment Managers, L.P. ("MLIM"), a subsidiary of Merrill Lynch, is a registered investment adviser whose activities are more directly affected by Section 28(e).

We take this opportunity to comment on selected portions of the Release that in our view require some further clarification from both the perspective of our money manager business, MLIM, and our brokerage and research provider business, MLPF&S. In summary, we believe that while the guidance in the Release as to research services is generally helpful and clear; the guidance in the Release as to brokerage services needs to be further clarified. More specifically, we are most concerned about the level of uncertainty introduced by the discussion in the Release of "commission sharing."

1. Definition of Research

We commend the Commission and its Staff for its updated, clear statement that in determining whether a product or service is eligible as "research" under Section 28(e), the money manager must conclude that the research product or service "reflects a substantive content," that is, the "expression of reasoning or knowledge and relates to the subject matter of section 28(e)(3)(A) and (B)". The Release then provides a number of useful and practical examples of products and services that would be viewed as eligible and ineligible under the expression of reasoning or knowledge standard. Of course, the money manager must also determine that the product or service provides lawful and appropriate assistance in the performance of the money manager's investment decision making responsibilities, and then determine that the amount of commissions paid are reasonable in light of the value of the brokerage and research provided by the broker-dealer. These latter two analytical steps are appropriately reasserted in the Release.

In respect of publicly available services, we believe, as suggested in the Release, that certain financial newsletters and trade journals *should* be eligible as research services if they relate to the subject matter of Section 28(e)(3)(A) and (B). On the other hand, we believe the intention of the Commission and its Staff was appropriately to narrow the scope of the definition of research by developing the "expression of reasoning or knowledge" standard. That standard serves to exclude computer hardware and telephone lines, as stated in the Release, and should also serve to exclude certain publications that are publicly available (whether or not "mass marketed") and that should now be viewed as "overhead" for the money manager and no longer available for purchase with client commission dollars. More specifically, we believe that general circulation newspapers, or other media such as general circulation magazines, delivered in hard copy or on line, and website of similar content, should be excluded from the definition of research under Section 28(e). But, financial newsletters, trade journals and similar publications, although publicly available, should be viewed as eligible "research" so long as they reflect an "expression of reasoning or knowledge "that relates to the subject matter of Section 28(e)(3)(A) and (B). We believe that it is important for the investing public to understand that client commissions are being used for both lawful and appropriate assistance in providing value to the management of their accounts.

2. "Mixed-Use" Approach

We believe that as technologies evolve, the concept of "mixed use" will become more and more important. As a result, we are pleased that the Commission continues to believe that the "mixed use" approach is appropriate. Under this approach, a money manager is required to make a reasonable allocation of the cost of the product according to both the character of the products/services (distinguishing between eligible and ineligible products/services, in whole and in part) and, in the case of eligible products, its actual use. This process isolates those aspects of the product or service that cannot be obtained with client commission dollars. For example, if 80% of a product or service is eligible research or brokerage, then 20% of the cost should be paid by the money manager and not with client commissions and that should be documented. We believe, however, it would be helpful for the Commission to provide suggestions on other ways in which investment managers may properly and practically apply and document this process.

One of the reasons why we believe the mixed-use approach will be important going forward is the evolution of a new class of products that will combine order management, execution management and trade cost analyses. While we agree that order management per se would not be eligible research or brokerage services, other components may very well be. For example, one component of a holistic system may be applied as a means of implementing a trading strategy, and consequently a feature of brokerage (such as order routing and algorithmic trading). We would expect that vendors will and should bill the money manager directly for the order management component, but that the other components may be provided by a broker-dealer under Section 28(e). Accordingly, the categorical statement in the Release that order management systems do not constitute brokerage, should be followed by a recognition that the order management systems may be a component of a holistic system that also provides eligible brokerage services. We discuss our views on trade analytics below.

3. Definition of Brokerage

While we believe that much of the Release discussing the scope of the research definition serves to clarify the Section 28(e) safe harbor, we believe that the discussion of the scope of "brokerage" has served to create a good deal of uncertainty, particularly in respect of the proposed, new temporal standard and the discussion of "commission-sharing". We also believe that the provision of trade analytics should be considered eligible brokerage services under Section 28(e) as an important function incidental to effecting securities transactions.

The Temporal Standard: The Release sets forth a new "temporal" standard for the scope of the definition of brokerage. More specifically, the Release states that "brokerage begins when the money manager communicates with the broker-dealer for the purpose of transmitting an order for execution and ends when funds or securities are delivered or credited to the advised account or the account holder's agent." We do not see any particular value in this temporal standard. In addition, we believe the temporal standard is too limiting and it may create unintended consequences. The definition of brokerage in Section 28(e) and any additional Commission guidance in the final interpretive release should be sufficient without introducing the temporal standard.

We see the following specific issues: First, brokerage should also include providing indications of interest, market color, pre-trade analytics (based on post-trade data), and advice on when and how to place an order, all of which typically happen prior to transmitting an order, even when that occurs in a different communication prior to the order placement. Second, Section 28(e) defines brokerage to include functions incidental to effecting securities transactions, such as clearance, settlement and custody. Custody services would occur outside of the Commission's temporal standard, namely after settlement and delivery. It should be noted that custody services tend to be an important consideration for smaller money managers.

Third, and perhaps most importantly, the provision of brokerage in compliance with Section 28(e) is very intertwined with the rationale for directing brokerage to a particular broker-dealer for best execution considerations. Best execution has historically involved an analysis of price, but also an analysis of other aspects of a broker-dealer's execution capabilities, such as ability to execute large orders and the availability of technological aids in executing and processing trades. These non-price factors become evident over time and it is past experience with a broker-dealer that affords a money manger the appropriate level of confidence in the overall execution quality and services offered by a broker-dealer, and that past experience becomes the basis for placing a new order with that broker-dealer. Indeed, a money manager must make a good faith determination that the commissions paid are reasonable in relation to the brokerage and research services received pursuant to Section 28(e). As clearly stated in the text of Section 28(e) and articulated in the Release, the money manager may make this determination *either* in terms of the particular transaction or the money manager's overall responsibility for discretionary accounts. Footnote 109 of the Release further highlights previous guidance that a money manager should consider the full range and quality of a broker-dealer's services, including financial responsibility and responsiveness to the money manager. The Release confirms this prior guidance. In doing so, we believe it is clear that a temporal standard is too limiting.

Related to the above discussion, we believe that trade analytics are a function of brokerage. As noted above, certain order management systems soon to be available will combine order management with execution capabilities and trade cost analysis. Money managers generally believe that these services are important in fulfilling their fiduciary duties to their clients and in making a good faith determination as to the level of commissions paid in relation to the value of the research and brokerage services received. In addition, broker-dealers have begun to offer trade analytics of its executions to clients. These services are considered to be useful for clients and part of the overall execution offering. More specifically, trade analytics, which can be more generally referred to as execution cost analysis and transaction consulting, may involve: post-trade analytics based on end of day data; post-trade analytics based on a larger sample of data over a longer period such as a month; and the provision of market micro-structure statistics, such as average daily trading volume, intra-day volatility, average spread, average trade, bid of offer sizes, on a global per market basis, that can assist in future execution decisions. It would be troublesome if money manager clients were to refuse to accept trade analytics from broker-dealers, because the Commission asserts in its final release that they are not an eligible service under Section 28(e). In such a case, only hedge fund managers and certain others, which obtain informed consent from their clients that their

commissions will be used outside of the scope of Section 28(e), will be provided with these important, evolving set of services.

"Commission Sharing": Of most concern to us is the discussion in the Release of "commission sharing" that tends to obfuscate rather than to clarify the relevant issues. For years, Merrill Lynch has supported the notion that the only proper means of permitting multiple broker-dealers to participate in the same commission revenue stream is through a bona fide introducing/clearing arrangement. The introduction of the term "commission sharing" in the context of a discussion of introducing broker/clearing arrangements may be misleading unless there are particular examples beyond the introducing/clearing relationship that the Commission believes would qualify under Section 28(e). If the Commission means to include introducing/clearing relationships exclusively, it should say so rather than creating an area for possible misunderstanding, particularly when others (e.g., U.K market participants) are using the "commission sharing" terminology in a different manner. If, however, the Commission means to communicate that there are, in fact, other avenues available to distribute commissions to multiple parties, we would welcome more clear and concrete explanation of the ways in which this may be properly accomplished.

More specifically, when the Commission states that the qualification of an agreement under SRO rules does not assure that Section 28(e)'s standards have been met, it leaves both the broker-dealer and the investment management community in a state of uncertainty. Without a more definitive standard, investment managers have no means of determining whether a particular clearing relationship is one that qualifies under the safe harbor. Most of the relevant conduct of the broker is unobserved by the investment manager. Accordingly, if there are specific concerns beyond well-understood introducing/clearing arrangements approved by the SROs and appropriate under prior Commission guidance, then those concerns should be specifically articulated. While the four points identified by the Commission with respect to such arrangements may be updated as described here, we agree with three of the four points: (i) the introducing broker's financial responsibility, (ii) the introducing broker's availability (if not actual participation) to monitor and respond to customer comments concerning the trading process (although in instances in which a customer chooses to discuss an issue with the clearing broker with which an order was placed, such a choice should not prevent the clearing relationship from being regarded as valid under Section 28(e)) and (iii) generally monitoring trades and settlements. With respect to the standard of making and maintaining books and records, the Release suggests that an allocation of that function to the clearing broker might be improper; we believe that such an allocation may be properly permitted pursuant to the terms of clearing agreement and an introducing broker should not be required to create unnecessary duplicate records to satisfy the standards under Section 28(e).

4. <u>Services in a Distribution</u>

Given the apparent goal of the Commission to provide guidance in as comprehensive manner as practicable, we believe there should be a brief acknowledgement in the final release that under NASD rules and longstanding practices, "bona fide research" as consistent with Section 28(e) constitute services in a distribution for which selling concessions may be paid in a fixed priced offering.

5. Transition Period

We respectfully request the Commission to consider current contractual arrangements in establishing an effective date for its final interpretive release. A number of originators of research services require that users of their services execute multi-year agreements, some of which have hardware and other features imbedded within them that would not qualify under the proposed interpretation under Section 28(e). To permit broker-dealers providing certain third-party products and services to extract themselves from current commitments, or for money managers to establish a process for applying mixed-use allocations for such products and services, the Commission should consider a establishing a phase-in period. More specifically, the Commission may wish to grandfather contractual arrangements that were entered into prior to the issuance of the final release for a period up to one year to permit this transition to occur as smoothly as possible.

Merrill Lynch appreciates the opportunity to comment on the proposed interpretive guidance. If you have any questions or would like to discuss our comments further, please contact Peggy C. Willenbucher at 212-449-4378 or the undersigned.

Very truly yours,

cc: Christopher Cox, Chairman
Cynthia A. Glassman, Commissioner
Paul S. Atkins, Commissioner
Roel C. Campos, Commissioner
Annette L. Nazareth, Commissioner
Robert D. Colby, Acting Division Director, Division of Market Regulation
Meyer Eisenberg, Acting Division Director, Division of Investment Management
Larry A. Bergmann, Associate Director, Division of Market Regulation
Jo Anne Swindler, Assistant Director, Division of Market Regulation
Patrick M. Joyce, Special Counsel, Division of Market Regulation
Stanley C. Macel, IV, Special Counsel, Division of Market Regulation
Marlon Quintanilla Paz, Special Counsel, Division of Market Regulation

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