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Via E-mail



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Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
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Washington, DC 20549

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Re: Proposed 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)

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Dear Mr. Katz,

Boston
Hartford
London
Los Angeles
New York
Orange County
San Francisco
Silicon Valley
Tokyo
Walnut Creek
Washington

On behalf of Frank Russell Securities Inc. ("Russell"), we appreciate the opportunity to comment on the Securities and Exchange Commission's ("Commission") proposed interpretive guidance ("Interpretive Release") regarding the soft dollar "safe harbor" of section 28(e) of the Securities Exchange Act of 1934, as amended ("Exchange Act"). We are requesting that the Commission clarify in any adopting release that the interpretive guidance does not pertain to commission-recapture arrangements.¹

Exchange Act section 28(e) generally provides that a person who exercises investment discretion with respect to an account shall not be deemed to have acted unlawfully or to have breached a fiduciary duty under federal or state law solely by reason of such person having caused the account to pay more than the lowest available commission if such person determines in good faith that the amount of the commission is reasonable in relation to the value of the brokerage and research services received.² The Interpretive Release confirms earlier guidance by the Commission that, in reliance on Exchange Act section 28(e), client commissions may be used to pay for third-party research or brokerage services provided by the broker-dealer charging the commission.

¹ Commission recapture is an arrangement whereby a client (e.g., a pension plan or mutual fund) directs a money manager or other person with trading authority to execute a portion of the client's trading activities with a particular broker-dealer. In return, the broker-dealer agrees to rebate some portion of the commission to the client.

² Section 28(e) of the Securities Exchange Act of 1934.

The Interpretive Release addresses two issues relevant to our request: (i) the scope of research and brokerage services obtainable in reliance on the section 28(e) safe harbor and (ii) the role or activities of the broker-dealer that provides the research or brokerage services. Sections III.C. and III.D. of the Interpretive Release propose to narrow the definition of research and brokerage services. Section III.G.2. of the Interpretive Release interprets section 28(e) to be available only where the broker-dealer providing the research or brokerage services and charging the commission is involved in effecting the trade by performing certain minimum activities in connection with the transaction (the principle effect of which is to ensure that if the broker-dealer providing the research or brokerage service is an introducing broker, the clearing agreement must allocate to the introducing broker certain minimum responsibilities).

Russell is a leading sponsor of commission-recapture programs, pursuant to which Russell enters into arrangements with various broker-dealers that agree to rebate to Russell a portion of commissions paid by clients of Russell's commission-recapture program. Russell in turn rebates a portion of those rebated commissions to the client. The portion of the commission rebated by the broker-dealer to Russell and the portion of the rebate paid by Russell to the client varies based on the amount of commissions paid and other factors considered by the parties when negotiating the agreements. Commission-recapture programs serve a variety of purposes, but in significant part they enable clients to negotiate better net commission rates by enhancing the client's bargaining position through participation in the program. Russell does not typically act as introducing broker in connection with its commission-recapture arrangements and does not, therefore, have many of the responsibilities identified by the Commission as necessary to be deemed to be effecting a transaction for purposes of Exchange Act section 28(e).

Although commission-recapture arrangements are in some ways similar to soft-dollar arrangements -- in that rebated commissions are sometimes used to purchase research or brokerage services -- commission-recapture programs do not generally raise the same concerns as soft-dollar arrangements.³ Under a typical soft-dollar arrangement, the benefit accrues directly to the investment adviser, and only indirectly to the client. Investment advisers may have an incentive to use the benefit for clients other than the clients whose transactions generated the soft dollars or select a broker-dealer on the basis of the research or brokerage services provided rather than best execution. Section 28(e) addresses these conflicts by providing a "safe harbor" for investment advisers by defining the appropriate uses for commission dollars (*i.e.*, research and brokerage services).

³ Investment Company Act Release No. 21221, at 3 (July 21, 1995). *See also* Inspection Report on the Soft Dollar Practices of Broker-Dealers, Investment Advisers and Mutual Funds, Office of Compliance, Inspections and Examinations, U.S. Securities and Exchange Commission (September 22, 1998).

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Commission-recapture arrangements do not pose the same potential for conflicts of interest because the rebated commissions directly benefit, and are the property of, the client, not the adviser. Thereafter, the use of the rebated commissions is subject to the same limitations as the client's cash is generally and the use of those rebated commissions is as transparent as any other cash expense of the client. Most importantly, commission-recapture programs are dissimilar from soft dollars in that they are outside the scope of the safe harbor: recaptured commissions are hard dollars, not services or credits for services.

Russell has been approached by clients and potential clients that have expressed concern regarding the applicability of the Interpretive Release to commission-recapture arrangements, particularly the applicability of the Commission's proposed interpretation regarding commission-sharing arrangements. We appreciate that Exchange Act section 28(e) is a safe harbor and cannot, by its terms, be violated. We further appreciate that commission-recapture arrangements are outside the scope of the section 28(e) safe harbor; however, because commission-recapture (or directed brokerage) is so frequently discussed together with soft dollars, we believe there has been some confusion as to the relevance of this guidance to commission-recapture arrangements.

We respectfully urge the Commission to note specifically in any re-proposing or adopting release that the limitations proposed with respect to the research and brokerage services obtainable in reliance on Exchange Act section 28(e) and the Commission's statements regarding commission-sharing arrangements in the Interpretive Release address only those arrangements seeking protection under the section 28(e) safe harbor and are, therefore, not applicable to commission-recapture arrangements. We thank you for the opportunity to provide comments on this Interpretive Release. If you have any questions, please contact me at 202.778.3185 or Aileen Foley at 202.778.6106.

Sincerely yours,



Julian Rainero

cc: The Hon. Christopher Cox, Chairman
The Hon. Cynthia Glassman, Commissioner
The Hon. Paul Atkins, Commissioner
The Hon. Roel Campos, Commissioner
The Hon. Annette Nazareth, Commissioner

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