

November 23, 2005

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

*Re: Request for Comment on Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934; File No. S7-09-05*

Dear Mr. Katz:

We are submitting this letter in response to the request of the Securities and Exchange Commission (the “Commission”) for comment on the proposed interpretation with respect to client commission practices under Section 28(e) (“Section 28(e)”) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), contained in Release No. 34-52635 (the “Proposed Interpretation”).

We appreciate the opportunity to comment on the Proposed Interpretation and commend the Commission for the Proposed Interpretation’s comprehensive and thoughtful analysis of Section 28(e) practices. Our firm represents investment advisers, private investment funds, registered investment companies, broker-dealers and depository institutions. The views we express in this letter are our own and do not necessarily reflect those of our clients.

## **I. Eligibility Criteria for Brokerage Services – Temporal Standard**

Under Section 28(e)(3)(C) of the Exchange Act, a person provides “brokerage services” when the person “effects securities transactions and performs functions incidental thereto”. In the Proposed Interpretation, the Commission has proposed using a temporal standard to distinguish between products and services that qualify as “brokerage services” under Section 28(e) and other products and services. Specifically, the Commission has proposed that, for purposes of Section 28(e), brokerage services are those provided during a period beginning when a discretionary manager communicates with a broker-dealer for the purpose of transmitting an order for execution and ending when funds or securities are delivered or credited to the managed account or the account holder’s agent.

We agree with the Commission’s observation in the Proposed Interpretation that effecting transactions is a process. We believe, however, that the temporal standard creates an arbitrary demarcation for determining activities for which products and services qualify as “brokerage services” under Section 28(e). The term “effecting transactions” has long been given an expansive interpretation by the Commission, as for example under Rule 11a2-2(T) adopted under the Exchange Act (the “effect versus execute rule”) and, as used in Section 28(e) to define brokerage services, is amplified by the addition of “functions incidental thereto.” We are concerned that, notwithstanding the broad reach of “effecting transactions,” services and products supporting activities traditionally viewed as part of the process of effecting transactions and performing functions incidental thereto will fall outside the temporal standard.

For example, prior to the time a manager communicates an order to a broker-dealer, the manager determines which market or markets to use, which execution services within particular markets are appropriate in light of the size and character of a transaction, whether to use one or more brokers, which broker or brokers to use, how to time the orders, and how to provide funds to finance and settle transactions. Similarly, following delivery or crediting of funds and securities to the managed account or its agent, a manager reconciles the settlements with the orders, insures that dividends, interest payments or other distributions due to the account with respect to acquired securities have been received, and reviews the manner in which the transaction was effected and the prices received or paid to determine whether the markets, brokers and techniques used resulted in optimal execution, clearance and settlement. We believe that these activities are integral to effecting transactions and that products and services that assist a manager in connection with these activities should be treated as “brokerage services” under Section 28(e)(3)(C).

We can discern no policy reason to exclude, as the temporal standard would, the activities described above from activities for which products and services can be acquired with commissions under Section 28(e). Rather, we believe that the Commission should use a functional approach to determine which activities and related products and services qualify for the protections of Section 28(e). Under a functional approach, the demarcation between “brokerage services” under Section 28(e) and other products and services would be whether the products or services provided lawful and appropriate assistance to the manager for activities involved in effecting transactions for the manager’s accounts, regardless of when the product or service is used in the

transaction process. This approach is the same one managers have followed since 1986 and is no different from the analysis a manager must perform to determine whether a product or service is a “research service” under Section 28(e).

## **II. Eligibility Criteria for Research Services - Mass-Marketed Publications**

The Commission has requested comment on whether the Proposed Interpretation offers sufficient guidance with respect to the types of “advice”, “analyses” and “reports” that are eligible as “research services” under Section 28(e). In particular, the Commission has requested comment on whether further guidance is necessary regarding mass-marketed publications.

We recommend that the Commission provide further guidance regarding the eligibility of mass-marketed publications such as national newspapers and magazines as “research services” under Section 28(e). In particular, we request the Commission to confirm that the extent of a publication’s circulation or availability to a broad public audience is not a determinative factor in assessing the publication’s eligibility under Section 28(e).

If a publication otherwise meets the eligibility criteria for “research services”, the extent of its circulation or public availability should not change the publication’s status. Rather, in determining whether the publication is an eligible “research service” under Section 28(e), the manager must examine whether the publication reflects an expression of reasoning or knowledge, relates to the subject matter of Section 28(e)(3)(A) or (B) and is used by the manager to provide lawful and

appropriate assistance in the performance of the manager's investment decision-making responsibilities.

### **III. Mixed-Use Items - Proxy Voting Services**

The Commission has requested comment with respect to the use of client commissions to pay for proxy voting services. It is our understanding that it is common industry practice to treat proxy voting services as a mixed-use item and to use client commissions to pay for a portion of such services.

We believe that certain proxy voting services reflect the expression of reasoning or knowledge and assist a manager with his investment decision-making responsibilities. To the extent a proxy voting service records and tracks votes cast, we recognize that such functions are not related to the investment decision-making process and thus, would not be eligible as "research services" under Section 28(e).

To the extent, however, that a proxy voting service provides an analysis or recommendation regarding the matter to be voted on, the most effective way to vote or the likely results and consequences of a vote, the service lawfully and appropriately assists a manager in determining both whether and how to vote and whether to retain or dispose of the security involved in the vote and possibly other securities. We believe these functions are as much a part of investment decision-making as other research and should be treated as eligible "research services" under Section 28(e). We recommend, therefore, that the Commission acknowledge the appropriateness of treating a proxy voting service as a mixed-use item and of treating the analytical and advisory portions of proxy voting services as an eligible "research service" under Section 28(e).

#### **IV. Compliance Period**

The Commission has requested comment on whether it should afford time for a manager to implement the Proposed Interpretation. In light of the Proposed Interpretation's impact on a manager's business and operations, the complexity of the products and services involved and the need to modify existing arrangements that frequently have been in effect since 1986, we urge the Commission to adopt a phase-in period of at least 12 months.

In addition, due to the potential expense to broker-dealers and the difficulty and complexity for both investment managers and broker-dealers of recasting a multi-year arrangement entered into in reliance on the Commission's 1986 guidance, we urge the Commission to grandfather for its remaining term any multi-year agreement involving computer hardware and accessories used to deliver research services that was entered into prior to the issuance of the Proposed Interpretation.

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If you have any questions regarding this letter, please contact Anthony C.J. Nuland at 202-737-8833, Patricia A. Poglinco at 212-574-1247 or Robert B. Van Grover at 212-574-1205.

Very Truly yours,  
Seward & Kissel LLP

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