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November 8, 2005

Re: Securities and Exchange Commission

17 CFR Part 241

[Release No. 34-52635; File No. S7-09-05]

**Commission Guidance Regarding Client Commissions Practices Under  
Section 28(e) of the Securities Exchange Act of 1934 (the "Release")**

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

Dear Mr. Katz:

Charles River Brokerage, LLC is writing in response to [Release No. 34-52635; File No. S7-09-05] **Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934** (the "Release") issued on October 19, 2005 by the Securities and Exchange Commission (SEC). The Release provides further guidance on the complex issue of the proper use of "client commissions" for the payment of "research" and "brokerage" services granted under Section 28(e) of the Securities Exchange Act of 1934<sup>1</sup>.

It appears, based on the text and footnotes<sup>2</sup> of the Release, that the Commission has decided to take a pragmatic approach revolving around 1) a narrowed interpretation of the 1986 Release standard of "lawful and appropriate assistance"<sup>3</sup>; 2) a restatement of Section 28 (e)(3)(A)(B)(C) as it relates to this narrowed interpretation of "lawful and appropriate assistance"<sup>4</sup>; and 3) a list of approved and non-approved items<sup>5</sup>, pertaining to "research", "brokerage", and "mixed-use."

As a result, we are limiting our remarks to topics covered in the release and will not wander off into discussions as to the appropriateness of keeping or not keeping “client commissions”; the unbundling of proprietary research; what is full disclosure and reporting; or the documentation required to fulfill full disclosure and reporting.

It is difficult to disagree with most of the issues covered in the Release. First, for the most part, the Release is a formal restatement of policies, interpretations and enforcements that heretofore have been stated, implied or enforced in other Interpretive Releases, SEC Sweeps and Regulatory actions over the last 20 years concerning the use of “client commissions.” Secondly, the bulk of the Release closely follows industry discussions conducted over the past 18 months as to what should be allowed under the safe harbor and the direction that the Commission might take with this Release. However, the elimination of the order management system (OMS) from the ranks of approved items comes as a complete surprise. It is the Commission’s stance on the OMS that has prompted this response.

We believe the Commission should reevaluate its stance on the OMS for several reasons. First, the Commission states that “lawful and appropriate assistance”, as termed by the 1986 Release, has been broadly applied to services and products “that are only remotely connected to the investment decision making process”<sup>6</sup>. The Commission then lists abuses cited in the 1998 Office of Compliance Inspections and Examinations (OCIE) report, including a statement by the OCIE staff “that money managers have taken an overboard view of the products and services that qualify as “brokerage and research services” under the safe harbor”.<sup>7</sup> The Commission implies that somehow the use of “client commissions” for payment of the OMS under the safe harbor is one of those broadly misinterpreted items that do not fall under the protection of the safe harbor.

After consideration of the Interpretive Releases, SEC Sweep Reports and/or SEC Regulatory Actions issued over the past 20 years relative to Section 28(e) abuses, or the 1998 OCIE Report, please note that neither the regulatory language and/or enforcement states or implies that the use of “client commissions” for OMS payments is in violation of Section 28(e). In other words, there is no precedent for this action. The elimination of the OMS from the ranks of the approved items appears arbitrary.

Second, the Commission states that the application of the “lawful and appropriate assistance” standard to research ...“also applies to brokerage service”<sup>8</sup>. The Commission then points out:

- That brokerage service needs to stay within the boundaries of Section 28(e)(3)(C), which defines brokerage services as
  - “effects securities transactions and performs 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 or person associated with a member or in which such person is a participant.”<sup>9</sup>
- “We believe that Congress intended that “brokerage” services under the safe harbor to relate to the execution of securities transaction”<sup>10</sup>
- “Specifically for the purpose of the safe harbor we believe that brokerage begins when the money manager communicates with the broker-dealer for the purpose of transmitting an order for execution and ends when the funds or securities are delivered or credited to the advised account or the account holder’s agent”<sup>11</sup>

While we are in complete agreement with the above statements, we do not come to the same conclusion as the Commission on the disqualification of the OMS from the safe harbor.

According to the Release the OMS does not qualify for inclusion under 28(e)(3)(C) because it is “not sufficiently related to order execution and fall[s] outside the temporal standard for “brokerage” under the safe harbor”<sup>12</sup> We assume by this statement that the Commission believes 1) that the OMS is somehow divorced from the execution process, 2) that it does not “affect securities transactions”, 3) that it is not involved in the transmittal of the order, and 4) that it has nothing to do with the allocation process once the order is completed. This can not be further from the truth.

We would like to cite several recent Charles River Development press releases as examples of our point:

- Charles River Development today announced that testing has begun on a new interface with The Yield Book(R) fixed income analytical system that synchronizes The Yield Book’s analytics with current holdings to **increase the accuracy and efficiency by which a fund manager can execute fixed income investment strategies. The firms’ new XML API interface links the analytics engine of The Yield Book with the Charles River Investment Management System (Charles River IMS) to synchronize analytics and portfolio holdings on both systems at all times, even as executions occur intraday.**<sup>13</sup>
- Charles River Development, a leading provider of financial software and consulting services to the global investment management community,

today announced that it has expanded Charles River Investment Management System (Charles River IMS) **connectivity offerings with eight embedded prime broker interfaces**. As a result, hedge fund clients can leverage multiple prime broker relationships through one integrated platform, automatically and electronically **transferring trade details to a variety of disparate prime broker systems**. The recently added prime broker interfaces include Bear Stearns, Banc of America Securities, CSFB, Deutsche Bank, Goldman Sachs, Lehman Brothers, Morgan Stanley, and UBS.<sup>14</sup>

- Charles River Development, a market leading provider of global investment management software and services, today announced that it has expanded Charles River Investment Management System (Charles River IMS) connectivity offerings with 10 new embedded interfaces to equity algorithmic trading brokers, bringing the total number to 14. The recently added algorithmic broker interfaces include CIBC World Markets, Direct Trading Institutional Inc., Goldman Sachs, Instinet Global Algorithmic Trading, Investment Technology Group, Inc., Lehman Brothers Inc., Merrill Lynch, Sanford C. Bernstein & Co., LLC, Susquehanna Financial Group, LLLP, and UBS Investment Bank. **As a result, Charles River has centralized traders' execution tools onto one platform, providing them with hands-on control and direction over trade execution strategies.**

Charles River IMS is a comprehensive software suite for portfolio management (Charles River Manager), order management and electronic trading (Charles River Trader), and real-time compliance monitoring (Charles River Compliance). Portfolio managers and traders utilizing Charles River IMS can run a potential trade through pre-trade compliance in Charles River Compliance, **apply a particular algorithmic strategy directly from the Charles River Trader blotter, set specific trade parameters, and electronically route the order via FIX to the selected broker venues**. Fills then flow back into Charles River IMS. **The process is automatic and seamless with no double entry or switching**<sup>15</sup>

We have highlighted text that clearly delineates a direct correlation between the modern OMS and “lawful and appropriate assistance” as termed by the 1986 Release and narrowed by the Commission. In addition, according to these examples, it is clear that the OMS provides trade functionality at the formation of the trade, at the transmittal of the trade to execution venues, and at the allocation point of the trade upon its completion. All of this functionality falls well within the parameter of Section 28(e)(3)(C) by supporting trade execution. An argument can also be made that it supports best execution.

It should be pointed out that although the examples cited are unique to Charles River's OMS the core functionality found in Charles River's OMS is germane to most systems. The degrees of separation between the various OMS providers are the technology platform used; how the information is processed; the speed at which the information is processed; the ability to add functionality in a timely manner; and the adaptability of the OMS to the workflow of any particular user.

The items cited above are only a few of the countless examples that illustrate why the modern OMS fits the Commission's narrowed 1986 Standard and Section 28(e)(3)(C) today - But what about the future? As the financial services industry moves toward the goals of straight through processing (STP) and trade settlement on a T+1 or T+0 basis, it becomes apparent that the OMS is a critical part of the investment manager's front and back office, providing portfolio management, access to liquidity, best execution, trade allocation, a reduction in trading costs, and support for STP. All this functionality falls, no matter how narrow the definition, well within the parameters of "lawful and appropriate assistance."

In summary, we applaud the efforts of the Commission to provide the industry with clear guidelines on the uses of the Section 28(e) safe harbor. We are in agreement with the bulk of the Commission's Interpretive Release. However, we strongly disagree with the Commission's elimination of the OMS as part of the approved uses of "client commissions". We request, based on the arguments presented herein, that the Commission reevaluate its position on this matter.

Finally, it has been said that "a picture is worth a thousand words." Therefore, we cordially invite you and the members of the Commission's Task Force on Soft Dollars to participate in a demonstration of the Charles River Order Management System, one of the industry's leading order management systems. Such a demonstration will dispel any doubt, and answer any questions, as to the qualifications of the OMS under Section 28(e). If this sounds to you and the Commission like a worthwhile exercise, please contact us as to an appropriate time and date.

Sincerely yours,



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**Addendum to Comments**  
**Request for Comments on Specific Issues**

**1) Does the Commission’s interpretation offer sufficient guidance with respect to the types of “advice”, “analyses” and “reports” that are eligible as “research services” under Section 28(e)?**

**Response:** Yes. As stated in our comments, it is difficult to disagree with most of the issues covered in the Release. First, for the most part, the Release is a formal restatement of policies, interpretations and enforcements that heretofore have been stated, implied or enforced in other Interpretive Releases, SEC Sweeps and Regulatory actions taken over the last 20 years concerning the use of “client commissions.” Secondly, the bulk of the Release closely follows industry discussions conducted over the past 18 months as to what should be allowed under the safe harbor and the direction that the Commission might take with this Release.

**2) How would investors, money managers, broker-dealers, and others be affected by the Commission’s interpretive guidance that client commissions cannot be used to obtain computer equipment as “research” under Section 28(e)?**

**Response:** There would be minimal impact. It has long been accepted that computer equipment is not covered under the safe harbor.

**3) Does the Commission interpretation offer appropriate guidance as to the eligibility of market data and trade analytical software under Section 28(e)?**

**Response:** No. The Commission has decided to eliminate market data and trade analytical software under Section 28(e). This is out of sync with the Financial Services Authority (FSA) stance on this subject. The FSA has stated that client commissions could be used for trade analytics as long as it could be determined and documented that such usage was for the purpose of quantifying the results and performance on any trade. In other words: how did I do and what can I do to improve. However, they did ban the use of client commissions if the trade analytics were used in a marketing and/or sales capacity. The FSA recognizes that trade analytic could be a valuable tool in assessing best execution.

**4) Does the Commission’s interpretation offer sufficient guidance as to the eligibility of “brokerage” services, functions and products under Section 28(e)?**

**Response:** No – please see response comments

**4a) How would this guidance affect existing arrangements or practices?**

**Response:** There is potentially a large impact on existing arrangements. There is no precedent for the elimination of the order management system (OMS) (see comments) under the safe harbor. Many firms have existing arrangements for using client commissions for their OMS. The elimination of the OMS could, considering the financial cost of such systems for the smaller firms, force various firms to seek alternative methods of execution, presenting a possible reversal of the strides made in cost effective trade execution (see comments).

**4b) Is the Commission's temporal standard sufficiently clear?**

**Response:** Yes it is clear. However, the Commission's interpretative use of the standard as it relates to the OMS in our opinion is flawed. – Please see comments

**4c) Are the types of services that should be excluded from the safe harbor, even though they might appear to satisfy the temporal standard? If so, explain why those services should be excluded – for example, is the service unrelated to execution of transactions?**

**Response:** No comment

**5) Does the Commission's interpretation offer sufficient guidance about third party research and sharing of commissions?**

**Response:** Yes

**6) How does the Commission's interpretive guidance differ from the approaches that other regulators, SROs, market participants, trade organizations, and investor advocacy groups have adopted or recommended with respect to client commission practices?**

**Response:** The Commission's use of "lawful and appropriate assistance" by definition requires that the Commission take a more transactional approach to the use of client commission under the safe harbor. On the other hand, the FSA has at the root of their guidance "that originality is an essential component of research..." which revolves around the FSA's belief "that research should provide new insights".

The Commission's position is more functionally oriented; whereas the FSA is more intellectually oriented. In addition it appears the FSA has decided to give the user of "client commissions" wider latitude in their use. However, both the FSA and the Commission have decided to provide an itemized list of approved and non-approved items.

**7) Are there types of products or services that are commonly paid for with client commissions for which additional guidance would be useful? If so, please provide facts about these products and services and their components, and how they are used. For example, are client commissions commonly used to pay for proxy voting services?**

**Response;** No comment

**8) Should the Commission provide additional guidance on the allocation and documentation of mixed-use items?**

**Response:** No. For the most part the Release sufficiently explains mixed-use.

**9) Concerns have been expressed by some industry participants and others that mass-marketed publications (publications that are widely circulated to the general public and intended for a broad, public audience) are part of a firm's overhead and should not be paid for with client commissions. To what extent are these types of publications currently being paid for with client commissions? Are the purposes and uses of these types of publications distinguishable from those of traditional research products? Should the Commission provide further guidance in this area?**

**Response:** There should be two components for determining if mass-market publications qualify under the safe harbor. First, do these types of publication provide "new insights"? Two, can it be documented that these publications provide "lawful and appropriate assistance"? If the answer is yes to both of these questions, then, regardless of their origin, they should be allowed as "research". These two questions would align, on a limited basis, mass-market publications with the more traditional research products.

**10) Should the Commission afford firms time to implement the interpretation? In commenting, please provide specific examples of any potential implementation issues.**

**Response** Yes there should be an implementation period. As an example, see response to question 4a. It will take time for many firms to evaluate the financial impact of the elimination of the OMS and to determine a proper course of action.

1. SECURITIES AND EXCHANGE COMMISSION  
17 CFR Part 241  
[Release No. 34-52635; File No. S7-09-05]  
Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the  
Securities Exchange Act of 1934
- 2 id Footnote 7 15 U.S. C. 78bb(e). The commission also is considering whether at a later time to  
propose requirements for the disclosure of client commission arrangements page 4
- 3 Id page 21
- 4 Id Sections C, D &E pages 27, 32, 36
- 5 Id
- 6 Id page 21
- 7 Id page 23
- 8 Id page 26
- 9 Id page 32
- 10 Id page 33
- 11 Id page 34
- 12 Id page 35
- 13 Charles River Press release 10/25/2005: Charles River Integrating Yield Book Analytics  
to Synchronize Fixed Income Holdings and Analytics
- 14 Charles River Press release 10/03/2005: Eight Leading Prime Brokers Connect to Charles River IMS
- 15 Charles River Press release 06/20/2005 Fourteen Leading Algorithmic Brokers Connect to Charles  
River IMS