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Group

Solutions from The Bank of New York

1633 Broadway, New York, NY 10019

November 25, 2005

Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-9303

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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)

Dear Mr. Katz,

The Bank of New York, through BNY Securities Group and its broker-dealer affiliates,¹ is pleased to submit this letter in response to the U.S. Securities and Exchange Commission's request for comment on its proposed interpretive guidance on client commission practices (the "Proposed Guidance").

We support the Commission's effort to update its existing guidance with respect to Section 28(e) of the Securities Exchange Act of 1934, as amended ("Section 28(e)") and commend the Commission for its thoughtful and reasoned analysis. We are particularly pleased the Commission so clearly stated the fundamental principle that Section 28(e) makes no distinction between proprietary products and independent products, whether bundled or unbundled. Like the Commission, we think it is time to retire the phrase "soft dollars," which

¹ The Bank of New York is the oldest bank in the United States. It was founded in 1784 by Alexander Hamilton and was the first corporate stock to be traded on the New York Stock Exchange in 1792. The Bank of New York, through a number of entities in the BNY Securities Group sector, is committed to providing institutional clients, such as investment advisers, institutional investors and broker-dealers, a broad range of agency brokerage, clearing and financial outsourcing services. Critical components of the Group's offerings include trade execution, commission management and independent research. BNY Securities Group combines best execution brokerage with an opportunity for institutional customers to select from the highest performing sources of independent research in an environment where all costs are completely transparent, and has grown to be one of the largest aggregators of independent research in the world.

has caused so much confusion and brought undue scrutiny on legitimate client commission arrangements. Money managers now have certainty that the ultimate source of the product or service is irrelevant to the Section 28(e) analysis and their determination whether it provides lawful and appropriate assistance in the performance of their investment decision-making responsibilities.²

Our comments below track the order of the Proposed Guidance and are enumerated accordingly.

Comments on the Proposed Guidance

1. *Section III. Commission's Interpretive Guidance - Introductory Paragraph*

During the past two years, individual commissioners and staff members have made numerous comments in support of independent research. BNY Securities Group is gratified but not surprised that the Proposed Guidance evidences the Commission's continued support of independent research. We understand, however, that some money managers believe they must limit the amount of independent research they obtain with client commissions whereas there is no such restriction on the amount of proprietary research they receive on a bundled basis from full-service brokers. Some money managers believe this restriction is derived from a Commission rule or guideline. This practice seems to run counter to the Commission's view that proprietary products and independent products should be treated equally under Section 28(e) and it would be helpful if the Commission made it clear that such arbitrary cap or percentage limits are not only unnecessary but inconsistent with Section 28(e).

2. *Section III.B. Framework for Analyzing the Scope of the "Brokerage and Research Services" under Section 28(e)*

BNY Securities Group believes that the Commission's guidance with respect to the three-step analysis that a money manager should conduct when determining whether a product or service falls within the safe harbor of Section 28(e) will be very useful to money managers. Importantly, the three-step approach recognizes that a money manager must retain the discretion ultimately to determine whether a particular product provides lawful and appropriate assistance.

² Since Section 28(e) is a safe harbor, the Proposed Guidance should in no way impact a money manager's practices with respect to using client commissions to obtain products and services outside of the safe harbor, provided that it makes clear disclosure, obtains consent and complies with any other applicable federal or state rules or regulations.

In the past, money managers have struggled to develop efficient procedures and controls to help them conduct their Section 28(e) analyses. The Commission's three-step approach will provide money managers with a framework that they can adapt to their particular businesses and client commission practices. A money manager can use client commissions to obtain a product or service eligible under the safe harbor only if the manager uses that product or service for investment purposes and determines that the cost is reasonable. The latter two prongs of the Commission's test will depend on the specific facts and circumstances presented by a money manager's investment process, investment strategy and client relationships. The Commission's guidance strikes the proper balance between restricting the use of client commissions for limited purposes and allowing money managers a degree of flexibility to obtain products and services that truly help them in the investment process, ultimately benefiting investors.

3. *Section III.C. Eligibility Criteria for "Research Services" under Section 28(e)(3); Lawful and Appropriate Assistance*

The Proposed Guidance offers several important guideposts, describing categories of products and services that would be within and without the definition of "research" under Section 28(e). This is exactly the type of clear, practical guidance that practitioners find most useful. Importantly, however, the Commission did not simply adopt a laundry-list approach to the definition of research. We believe establishing an extensive list of specific products and services would inhibit innovation in the market for research and would be inconsistent with the Commission's three-step approach, discussed above.

As the market for research changes, Section 28(e) must be flexible enough to accommodate new forms of research. Market data is a perfect example. While some might consider market data to be a commodity, money managers now rely on market data feeds to achieve best execution of orders and to optimize quantitative investment strategies. The Commission correctly recognizes the importance of these data to the execution and investment process. No doubt new services and new uses for existing services will emerge in the coming years. We believe Section 28(e) and the Commission's three-step approach will remain flexible enough to allow such services and practices to flourish.

4. *Section III.D. Eligibility Criteria for "Brokerage" under Section 28(e)(3); Lawful and Appropriate Assistance*

BNY Securities Group welcomes the Commission's first significant guidance with respect to the meaning of "brokerage services" under Section 28(e). The adoption of a definitive standard is helpful. We believe, however, that restricting the temporal standard to the time when an order is transmitted,

although clear, does not reflect the realities of the marketplace and a money manager's duty of best execution.

When establishing a brokerage relationship, a money manager considers a series of complex factors, such as the broker's creditworthiness, knowledge about market activity (e.g., the trading characteristics of a particular sector or securities within a sector), willingness to commit capital, and overall service levels. Many of these factors fall outside the temporal standard articulated in the Proposed Guidance, but they are critical to a money manager's decision regarding where to execute a trade. We believe the definition of brokerage for the purposes of Section 28(e) should include all of the factors a money manager may consider in fulfilling its duty of best execution.

The Commission's statement regarding order management systems ("OMSs") is confusing, and it illustrates the problems inherent in (i) tying the eligibility of a brokerage product to a point in time and (ii) pigeon-holing a product or service into either a brokerage or research bucket. Money managers consider the relationships that brokers have with OMSs as one of the factors they evaluate, not only when establishing their brokerage relationships, but when choosing an OMS, because they want to ensure that the OMS they employ enables them to send order flow to their preferred brokers. Consequently, we think it is appropriate for an OMS in its entirety to be considered eligible under Section 28(e).

Furthermore, we think it is a mistake to require money managers to categorize an OMS as either a research product or a brokerage product. Many OMSs contain sophisticated functionality that, if analyzed on a stand-alone basis, would clearly constitute research or brokerage. The fact that a money manager accesses such functionality through its OMS should not prove fatal to his or her good faith determination that the OMS product properly falls under Section 28(e). At a minimum, money managers should be able to analyze order management systems as "mixed use products." We strongly encourage the Commission to reconsider its position on OMSs as it finalizes its guidance.

5. *Section III.G.2. Third-Party Research and Commission-Sharing Arrangements – "Effecting" Transactions*

We also welcome the Commission's guidance with respect to commission-sharing arrangements and believe that it will help eliminate any inconsistent and potentially problematic industry practices that might exist in this area. In connection with the requirement that a broker-dealer providing a Section 28(e) eligible product or service must be involved in "effecting" the trade, we ask the Commission to clarify a point that we believe is implicit in the Proposed Guidance: that a broker-dealer who satisfies the necessary elements of a commission-sharing arrangement (as articulated in the Proposed Guidance) is

considered to have "effected" a trade for purposes of Section 28(e), even if it is not involved in the execution, clearance and settlement of the trade.

There is, however, a potential unintended consequence. Some money managers appear to be concerned that they may now have a heightened responsibility to investigate whether their brokerage partners have established commission-sharing arrangements that satisfy the four elements in the Proposed Guidance. BNY Securities Group believes that this is not necessary. The brokers engaging in these arrangements have independent obligations to act in conformity with Section 28(e), including the Commission's guidance, in cases where their money manager clients seek the protection of the safe harbor. Money managers should be entitled to rely on representations from the brokers who share their commissions that they are following the Commission's guidance, once finalized.

6. *Section IV. Request for Comments*

BNY Securities Group is pleased to provide the Commission with input on the following topics:

- *Proxy Voting Services* – Our understanding is that some fund managers pay for proxy voting services with client commissions. Most proxy voting service products provide two types of assistance to fund managers. They enable them to physically place votes, but they also provide valuable analyses and information on the issues to be voted upon which help fund managers determine which way to vote. The first type of functionality may be considered administrative in nature and thus outside of Section 28(e), but the second type should be considered research within the meaning of Section 28(e). Consequently, we believe that fund managers should be able to characterize proxy voting services as mixed-use products and it would be helpful if the Commission gave more guidance on that point.
- *Implementation* – Both broker-dealers and money managers will have to examine their current practices to ensure that they comply with the principles set forth in the Proposed Guidance and the final guidance once available. Additionally, money managers typically evaluate their Section 28(e) product and service needs at the end of each calendar year and work with broker-dealers to enter into arrangements in order to meet those needs, some of which may be long term in nature. BNY Securities Group suggests that, when issued, the final guidance be prospective and that the Commission provide a lengthy implementation timeframe of at least six months to one year. This will enable both broker-dealers and money managers to conduct a comprehensive review of their client commission practices and bring them in line with the final guidance in an orderly fashion.

We thank the Commission for the opportunity to provide comments on the Proposed Guidance and would be happy to meet in person to discuss any of these issues with you at your convenience.

Very truly yours,

/s/ Joseph M. Velli

Joseph M. Velli
Senior Executive Vice President
The Bank of New York Company, Inc.

Cc: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Cynthia A. Glassman, Commissioner
The Honorable Annette L. Nazareth, Commissioner
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