THE ALLIANCE IN SUPPORT OF INDEPENDENT RESEARCH

c/o PICKARD AND DJINIS LLP
ATTORNEYS AT LAW
1990 M STREET, N.W.
WASHINGTON, D.C. 20036

TELEPHONE
(202) 223-4418

TELECOPIER
(202) 331-3813

May 16, 2008

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. S7-10-00

Dear Ms. Morris:

The Alliance in Support of Independent Research ("Alliance") (www.alliance-research.org) is pleased to have this opportunity to comment on File No S7-10-00,[1] which reproposes amendments to Part 2 of Form ADV to require investment advisers registered with the U.S. Securities and Exchange Commission ("SEC or "Commission") to deliver to clients a brochure written in plain English about their business practices, conflicts of interest and other background information (the "Brochure"). As a group of broker-dealers furnishing research, brokerage and other support services to advisers and their clients, we focus our comments on the proposed Part 2A, Item 12 disclosure requirements relating to "Brokerage Practices."

The leading members of the Alliance in Support of Independent Research include the following broker-dealers:

BNY ConvergEx Group, LLC
John D. Meserve, Executive Managing Director

Capital Institutional Services, Inc.
Kristi P. Wetherington, President and CEO

Knight Capital Group, Inc.
Timothy J. Conway, Director
Thomas M. Merritt, Esq., Chief Legal Officer
Paul Wagenbach, Esq., Vice President, Assistant General Counsel

[1] SEC Rel. No. IA-2711 (March 3, 2008) [73 Fed. Reg. 13958 (March 14, 2008)] (hereinafter the "Release").

The Interstate Group Division of Morgan Keegan & Co., Inc.
Grady G. Thomas, Jr., President
Jay Thomas, Chief Operating Officer

State Street Global Markets, LLC
Michael X. Richey, Vice President
Jeffrey Grossman, Senior Managing Director
State Street Global Markets Canada Inc.

We believe our members are involved in a significant portion of the arrangements under which fiduciaries such as mutual funds, investment advisers, banks and other money managers are provided with independent research services and products for the benefit of their managed accounts.

Members of the Alliance share a common interest in fostering a favorable regulatory environment in which independent research services and products may be furnished to the money management community, and in preserving the umbrella of protection Section 28(e) of the Securities Exchange Act of 1934 provides to fiduciaries who receive all forms of investment research. A primary goal of the Alliance is to promote the observance of proper standards under the securities laws for disseminating research and achieving best execution of portfolio transactions for managed accounts.

Introduction

Our comment letter focuses principally on the disclosure requirements for advisers related to the selection of broker-dealers and the conflicts arising from the receipt of "soft dollars," *i.e.*, the receipt of benefits such as research in connection with client brokerage. The newly proposed amendments to Part 2 of Form ADV, which require the delivery to clients of a brochure about the adviser's business written in plain English, have much to commend them. However, the proposed provisions addressing the disclosure requirements for soft dollar and

brokerage practices, most of which are similar to what was proposed in 2000, are more likely to confuse and obfuscate than to provide meaningful disclosure to advisory clients regarding these practices. The provisions also appear contrary to the policy guidance regarding client commission arrangements issued by the Commission in July 2006.[2] We ask that instead of the specific, "one size fits all" disclosure provisions proposed in the Release, the Commission consider broader guidelines requiring the disclosure of material conflicts pertaining to an adviser's use of client commissions to obtain research. This would allow clients to get the important information they need to assess whether their best interests are being served, rather than requiring them to sift through boilerplate disclosures that may or may not apply to their particular circumstances. Our specific comments and recommendations are below.

Item 12. Brokerage Practices

Item 12 of Form ADV, Part 2, would oblige advisers to describe the factors they consider in selecting or recommending broker-dealers for client transactions and for determining the reasonableness of their compensation. In this regard, disclosure about three specific areas would be required: research and soft dollars, brokerage for client referrals and directed brokerage arrangements.

Research and Soft Dollar Arrangements[3]

An adviser who receives research or other products and services in addition to trade executions in connection with client securities transactions (*i.e.*, soft-dollar benefits) would have

[2] SEC Rel. No. 34-54165 (July 18, 2006) [71 Fed. Reg. 41978 (July 24, 2006)] ("2006 Release").
[3] We use the term "soft dollars" in this comment letter because that is the phrase used in the Release to discuss client commission arrangements under the Section 28(e) safe harbor. We note, however, that the Commission recognized in the 2006 Release that the phrase "soft dollars" can cause confusion and thus we suggest that in the final release addressing the amendments to Form ADV the Commission use the term "client commission" practices or arrangements to refer to practices under the Section 28(e) safe harbor. See, e.g., 2006 Release at 41978 n.4.

to disclose the practice and discuss the attendant conflicts of interest. It would also have a range of specific disclosure obligations under the new form.[4] The proposed soft dollar disclosures note that although each product and service would not have to be separately identified, the description would have to be specific enough for clients to understand the types of products and services being acquired and to evaluate possible conflicts of interest. Simply disclosing that the adviser obtains various research reports and products will not suffice. More detailed disclosure would be required where the adviser acquires goods and services that do not qualify for the safe harbor under Section 28(e) of the Securities Exchange Act of 1934.

Discussion

As noted in the Release, the use of client securities transactions to obtain research can result in conflicts of interest between the adviser and its clients. The identification of the conflicts and the extent to which they might be material will vary among advisers, depending on the status of the adviser, the type of clients served, the method of payment for the research and the adviser's use of the research. It has been a longstanding industry practice and a regulatory requirement that an adviser disclose its soft dollar activities and discuss the attendant conflicts of interest. We believe that the current level of disclosure required of advisers has been sufficiently protective of investor interests.

Unfortunately, the disclosure of soft dollar practices being proposed in Item 12 of Form ADV goes beyond obligating the adviser to concisely disclose its soft dollar arrangements and any attendant conflicts. As noted below, many of the specific disclosures that the Release would require are excessively detailed, not suited to the business of many advisers, and may end up misleading clients. We also note that the specificity proposed by the Release would lead to

[4] We are pleased that the SEC made clear in the Release that these disclosure obligations apply with equal force to proprietary research services (*i.e.*, research produced by the broker-dealer that provides it) and third-party research services (*i.e.*, research produced by a party other than the providing broker-dealer).

boilerplate disclosure defeating one of the Release's main purposes of promoting the use of plain English in disclosure documents.

Specific Disclosures Being Called For By Item 12

(i) Item 12 would require the adviser to explain in its Brochure that when it uses client brokerage commissions (or markups or markdowns) to obtain research or other products or services, that it receives a benefit because it does not have to produce or pay for the research, products or services.

Comment:

Such a statement is neither universally true nor accurate. Client accounts benefit from research provided under Section 28(e) as the safe harbor requires that research be used in the investment decision making process. Also, it is usually not the case that the research would be produced by the adviser if not obtained for soft dollars because in many instances the adviser does not have the capacity to produce the research or to pay for the research itself.

(ii) The adviser obtaining research for commissions would have to disclose that it may have an incentive to select or recommend a broker-dealer based on its interest in receiving the research or other products or services, rather than on its clients' interest in receiving best execution.

Comment:

The negative implications of this suggested disclosure are apparent, and the statement is inaccurate. First, the SEC has repeatedly stated that the value of research and brokerage services is an important part of a best execution analysis[5] *and thus it is logically inconsistent to suggest that an adviser must decide between research and best execution. Second, there is no evidence that advisers compromise or disregard execution quality in submitting portfolio transactions to broker-dealers who provide research. Indeed it is our members' experience that execution quality is a primary consideration of fiduciaries in the broker selection process. Third, we note that because of the flexibility*

[5] See SEC Rel. No. 34-2323170 (Apr. 23, 1986) at 32 ("A money manager should consider the full range and quality of a broker's services in placing brokerage including, among other things, the value of research provided as well as execution capability, commission rate, financial responsibility, and responsiveness to the money manager.")

provided by the 2006 Release an adviser may now select a broker solely on its execution capabilities and still receive the research it desires from another broker-dealer or non-broker-dealer research preparer. Thus, the conflicts of interest identified by the Release may not be relevant to the operations of a particular adviser.

(iii) Item 12 would require an investment adviser which causes clients to pay commissions (or markups or markdowns) higher than those charged by other broker-dealers in return for soft dollar benefits (known as paying-up) to disclose this fact.

Comment:

Some advisers are able to make this determination and disclosure. However, many advisers are not in a position to know with any certainty in any given transaction or series of transactions whether they are paying higher commissions than those charged by other broker-dealers for comparable services. The transaction process has many variables in addition to price (e.g., level of service, timing, size) all of which can justify the commission charged for a particular transaction.

(iv) An adviser would be required to disclose in the brochure whether soft dollar benefits service all of its clients' accounts or only those that paid for the benefits. The adviser would also have to disclose whether it seeks to allocate soft dollar benefits to client account proportionately to the soft dollar credits the accounts generate.

Comment:

Disclosing that soft dollars may not benefit all accounts is current practice and is useful to advisory clients. However, few if any advisers allocate or are capable of allocating soft dollar benefits proportionately. The safe harbor of Section 28(e) includes a statutory recognition that research cannot be allocated in proportion to the soft dollar credits utilized to obtain the research. Requiring an adviser to state whether it allocates soft dollar benefits to clients proportionately is unrealistic and contrary to the premise of Section 28(e). Obliging advisers to state whether they allocate soft-dollar benefits in proportion to credits from specific client accounts suggests that credits can be allocated in this manner and implies that the adviser who does not allocate credits proportionately is acting improperly. Merely stating that soft dollars may not benefit all client accounts should suffice.

(v) The adviser will be required to explain in the Brochure the procedures it used during its last fiscal year to direct client transactions to a particular broker-dealer in return for soft dollar benefits the adviser received.

Comment:

It is not clear that a client would benefit from reading about an adviser's procedures for executing transactions and obtaining research. Advisers face several actual and potential conflicts of interest, many of which are more acute than the use of commissions to obtain research. We see no reason to single out soft dollar arrangements when there is no requirement for advisers to disclose the procedures they use to address other potential conflicts. We also note that the Release repeatedly admonishes advisers that the Brochure be in plain English and concise and direct. The requirement to disclose the procedures used by advisers in this highly technical area would appear to undercut such an objective.

Directed Brokerage by Clients of Adviser

Where a client of an adviser directs brokerage on his or her account to a particular broker-dealer, the adviser would be required to describe the practice in its Brochure and explain that it may not be able to achieve best execution of the client's transactions. The Brochure would also inform the reader that a client directing brokerage may cost the client more money. The SEC gives the example that in a directed brokerage account, the client may pay higher brokerage commissions because the adviser may not be able to aggregate orders to reduce transaction costs, or the client may receive less favorable prices. However, in a note the SEC makes an exception to this disclosure requirement where the adviser only permits clients to direct brokerage "subject to best execution." If so, the investment adviser need not respond to this directed brokerage disclosure requirement.

Comment:

It is highly questionable whether a directed brokerage arrangement costs clients more money. Directed brokerage arrangements are typically made by a client with the objective of reducing costs. Thus, a client may direct his transactions to a broker rebating back a portion of the charges or to a broker who the client believes delivers

> *good executions. Moreover, virtually all directed brokerage arrangements are predicated on the portfolio transactions being subject to best execution. Where the client makes a determination that it is in its best interest to direct brokerage, it would not appear necessary for an adviser to have to make disclosure in the Brochure about such a directed brokerage arrangement.*

Summary and Recommendation

The current Form ADV disclosure provisions for soft dollars require advisers to disclose material conflicts of interest resulting from the use of client commissions for research. Advisers following these general guidelines have been able to fashion disclosures which give their clients information upon which the clients can make informed decisions about the advisers' use of commissions. Where there have been disclosure deficiencies, they have largely occurred because of underlying abuses and not from any deficiencies in the SEC's existing Form ADV disclosure guidelines.

It is our view that many of the specific disclosure requirements proposed in the Release, such as requiring an adviser to say that it may have an incentive to select a broker-dealer based upon research instead of best execution, do not reflect current industry practices and would confuse, rather than enlighten, advisory clients. Further, the proposed disclosure requirements ignore an adviser's ability to separate the execution and research functions which has occurred as a result of the SEC's 2006 Release.

Rather than creating a rigid mandate of specific disclosures which may not apply to a particular adviser's operations, we recommend that the Commission require advisers to determine and disclose in the Brochure, under broad guidelines, the material conflicts of interest pertaining to the use of client commissions to obtain research. Thus, the disclosure requirements under Item 12 would ask the adviser to: (i) describe the material aspects of its use of client commissions to obtain brokerage and research; (ii) identify any material conflicts of interest

arising from such activities; and (iii) concisely address them in the Brochure in a manner which would permit the account to assess whether its best interest is being served. Within these broad guidelines an adviser electing to use client commissions for research would fashion its own disclosures predicted on the status of the adviser, the type of clients being served and the adviser's method of obtaining and using the research services.

* * * * *

We hope these comments assist the Commission and its staff in considering measures to improve the disclosure of the practice of client commission arrangements. Members of the Alliance would welcome the opportunity to further communicate with members of the Commission or the Commission staff regarding our comments.

Please call Lee A. Pickard or William D. Edick at 202-223-4418 if you have any questions.

Sincerely,

The Alliance in Support of Independent Research

by: Lee A. Pickard
William D. Edick
Pickard and Djinis LLP
Counsel to the Alliance in Support of Independent Research

cc: The Honorable Christopher Cox
The Honorable Paul S. Atkins
The Honorable Kathleen L. Casey
Andrew J. Donohue, Director, Division of Investment Mangement
David W. Blass, Assistant Director, Division of Investment Management