

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

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Mr. Paul Craig  
Wholesale and Prudential Policy Division  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS  
Great Britain

*Re: Comments on Consultation Paper 05/5 – Financial  
Services Authority “Bundled Brokerage and  
Soft Commission Arrangements”*

Dear Mr. Craig:

The Alliance in Support of Independent Research is pleased to have this opportunity to comment on proposed rules issued by the Financial Services Authority under Consultation Paper 05/5 relating to bundled brokerage and soft commission arrangements. Our comments focus on the portion of the proposed rules which would limit investment m

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Exchange Act of 1934 provides to fiduciaries who receive all forms of investment research here in the United States. 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. The leading members of the Alliance include the following broker-dealers:

Capital Institutional Services, Inc. (CAPIS)  
Don C. Potts, Chief Executive Officer  
Kristi P. Wetherington, President

E\*Trade Securities LLC  
Susan Holgate, VP of Institutional Brokerage

The Interstate Group  
A Division of Morgan Keegan & Company, Inc.  
Grady G. Thomas, Jr., President

Knight Equity Markets L.P.  
James P. Smyth, Managing Director  
Joanne Mascellino, President, Donaldson & Company

Second Street Securities  
Gerard M. Visci, President

Westminster Research Associates Inc.  
A BNY Securities Group Co.  
John D. Meserve, President

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

### ***The Alliance's Comments***

The Alliance agrees with the Financial Services Authority ("FSA")'s decision to address issues related to bundled brokerage and soft commission arrangements primarily through an industry-led solution based on an enhanced disclosure regime. The Alliance supports measures which would provide institutional investors with information necessary to evaluate the efficacy of research-commission arrangements entered into by an account's adviser.

In the United States, competitive pressures and business practices have led broker-dealers who provide independent research services to fiduciaries to produce and deliver customer statements indicating the cash value of the research provided to the customer and the aggregate commissions used to pay for the research. This type of accountability has made the research dissemination process more efficient and has benefited the fiduciary and its accounts by bringing them accurate cost and benefit information.

The Alliance also supports the efforts of the FSA, and similar efforts in the United States by the Securities and Exchange Commission, to clarify the permissible uses by an investment manager of his clients' commissions to obtain execution and research services. The Alliance believes, however, that the FSA's proposed rules as they relate to the provision of research services are in need of clarification.

The FSA's rules as a general proposition would permit an investment manager to obtain goods and services relating to the provision of research if the research: (i) provides "new insights" about the customers' portfolios; (ii) "represents original thought . . . in the assessment of new and existing facts;" (iii) "has intellectual rigor"; and (iv) "involves analysis or manipulation of 'data.'"

While each of the above elements for qualified research represents laudable objectives, they unfortunately, either as individual items or in the aggregate, do not offer any form of precision in their application. Rather, they leave the investment manager, his regulators and others attempting to review the use of commissions with both uncertainty and enormous latitude as to what might qualify as research. The end result of these proposed requirements is likely to be unanswerable questions, and, before a vigorous regulator, few items of research would remain unchallenged.

The U.S. securities industry has experienced problems in the past that arise from a standard for research that is uncertain and vague. In 1976, the SEC sought to define further research under Section 28(e) of the Securities Exchange Act of 1934. At that time, the SEC set forth a general standard as to what would not qualify for research under Section 28(e), to wit, "products and services which are readily and customarily available and offered to the general public on a commercial basis." The SEC's 1976 standard proved unworkable. In 1986, the SEC found that the 1976 standard was difficult to apply and unduly restrictive

and that uncertainty about the standard may have impeded investment managers' from obtaining goods and services they believe were important to the making of investment decisions. The 1976 standard was withdrawn by the SEC.

The same uncertainties that arose from the SEC's 1976 standard are prevalent in the FSA's proposed requirements for what is permissible research. There may be many different opinions as to whether or not a particular service has "intellectual rigor" or "original thought" attendant to it. It does not seem prudent to allow an investment manager to be second guessed as to whether a particular piece of information is helpful to him in seeking profitable investments for managed accounts.

In 1986, the SEC set forth a new controlling principle to be used in determining whether a service is research that has been easy to understand and apply. Products that provide lawful and appropriate assistance to a manager in his investment decision making responsibilities constitute research, while products that are overhead or provide only administrative services do not.<sup>1</sup> In support of this standard, the SEC did two things: it identified certain items as clearly outside of Section 28(e)'s definition of research (e.g., such as office space, furniture, clerical assistance) and it introduced a mixed-use concept which requires an investment manager seeking to obtain a service or product for commissions which has elements which assist in the investment decision

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<sup>1</sup> See SEC Release No. 34-23170.

process, but also provides administrative support to the investment manager, to make a reasonable allocation of the cost of the service or product according to its use. Only the portion of the service of use in the investment decision-making process may be paid for with client commissions. Overall, these measures employed by the SEC since 1986 for determining the eligibility of a service or product for research have worked well. There are few participants (e.g., broker-dealers, money managers) which do not have a clear idea of what is today permissible research under Section 28(e).

Rather than going down a path which experience shows leads to unworkable guidelines and uncertainties, we would strongly suggest that the FSA consider a standard similar to that adopted by the SEC in 1986 coupled with examples of goods and services which do not qualify and, in addition, requiring investment managers to undertake a mixed-use allocation when confronted with a service which has both research and administrative components. We note that under any standard, it is the responsibility of the money manager to determine whether it is permissible to pay for a good or service through client commissions.

#### ***Eligibility of Specific Goods and Services***

A number of examples of goods and services are cited by the FSA as not constituting permissible research under the FSA's proposed guidelines. Clearly, most of the items cited, such as travel, entertainment and office administrative software, should not be obtained by an investment manager with client

commissions, without explicit and informed consent of the client. The list of permissible research services, as finally devised by the FSA, will prove helpful to the financial community and lend more certainty to the proper use of client commissions. Nevertheless, a few examples identified by the FSA in Consultation Paper 05/5 require additional comment.

***Price Feeds or Historical Price Data (“Raw Data”)***

The FSA asks for comment on whether raw data feeds (e.g., price feeds, historical price data) should be a permissible item as an execution service. Otherwise, the FSA proposes to exclude raw data as a permissible research service unless the data has been analyzed or manipulated.

A data feed relating to securities transactional activity (e.g., last sale information, quotations) is an essential component of the execution process and of investment decisions to buy or sell securities. The real-time dissemination of this data to investment managers is equally important to the investment process and to the execution of securities transactions.<sup>2</sup> The rapid delivery of market information is as likely to precipitate investment decisions as any other type of research service. Further, analysis or manipulation of this data does not change

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<sup>2</sup> We note that market participants are willing to pay a premium to receive real-time market data, even though delayed information is often available for free. This illustrates that although market data may have some administrative uses, fiduciaries consider it an important element of the investment decision making process, because the administrative uses of such data could be easily satisfied by using delayed information.

the essential character of the underlying information or its value to the investment manager. In many cases, the distinction between raw data and manipulated or analyzed data is not discernible. Real-time price feeds benefit clients in the investment decision process as much as other types of research that the FSA finds permissible.

In addition, if raw data is to be isolated from other portions of trade/electronic research services with respect to commission eligibility, there is likely to be created a large class of services which in the United States are called mixed-use products or services, in most cases the raw data component being a minor element of the overall research. Many money managers may well eschew real-time information systems rather than having to address the mixed-use determination necessitated by an exclusion of raw data. Allowing a money manager to make a determination as to whether raw data is helpful in the investment-decision making or execution process would avoid this result and the resulting efficiencies will benefit the market and investors.

In summary, given the critical importance of real-time market information to the investment decision and trading process, we recommend that the FSA's guidelines not discourage investment managers from using client commissions to obtain real-time market information for either trading purposes or to make investment decisions for accounts.

### ***Subscriptions for Publications***

Many investment research firms offer their investment research both for commissions and on a cash subscription basis in publication form. In addition, highly specialized publications offer valuable insights in regard to company products and other developments relating to the economic performance of issuer companies. We recommend that the FSA guidelines on permissible research allow for the investment manager to be able to determine that a particular publication may be acquired for commissions where the publication is not of a mass publication nature.

### ***Publicly Available Information***

One item referenced in the proposed FSA guidelines as not meeting the requirements of research is “publicly available information.” As noted hereinabove, the 1976 standard of the SEC incorporated a standard similar to that of publicly available information (i.e., the SEC referenced a standard centering around that which is “offered to the general public” on a commercial basis). The SEC subsequently determined this standard to be difficult to apply and unduly restrictive. The SEC also noted that the uncertainty about the standard may have impeded investment managers from obtaining research services. We believe a similar adverse result would occur in the U.K. should this exclusionary standard be adopted. Virtually all research is premised on and

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incorporates public information.<sup>3</sup> Applying such an exclusionary standard to a determination as to whether a product or service is research will provide little guidance (and give rise to uncertainty) as to what are the parameters of permissible research.

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We hope these comments are helpful to the FSA in formulating guidelines regarding permission execution and research services for soft commissions. We would be pleased to answer any questions you may have on this matter.

Sincerely,

The Alliance in Support of Independent Research

By:

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Lee A. Pickard  
William D. Edick  
Counsel for The Alliance  
Pickard and Djinis LLP  
Attorneys at Law  
1990 M Street, NW, #660  
Washington, D.C. 20036  
Telephone: 202-223-4418

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<sup>3</sup> In the United States, to the extent information acted upon by an investor is non-public and material, legal issues arise as to the permissibility of acting on such information in the purchase or sale of securities.