The difference in the views of these two groups may reflect the differences in the ways the two groups provide research services to advisers and the effect that the Goldman/Morgan Proposal would have on each group. Goldman, Sachs and Morgan Stanley operate as ''full service brokers'' and provide a variety of execution, research and related services to clients. An adviser who executes client securities transactions through these firms typically receives research services developed by the firms (''proprietary'' soft dollar services), much of which is provided without being directly requested by the adviser. The cost of such services generally are bundled in the overall commission charged by the full service broker. In contrast, a ''soft dollar broker'' typically provides advisers with services prepared or produced by parties other than the broker (''third-party'' soft dollar services) in exchange for the allocation of specified amounts of commission dollars.[20] In these types of arrangements, an explicit price denominated in commission dollars, rather than in hard dollars, is typically attached to the research.[21]

The Goldman/Morgan Proposal would affect the two groups of brokers differently. Because proprietary soft dollar services are not offered for a specific price in commission dollars, under the Goldman/Morgan Proposal, disclosure would be required only about the price and value of third-party soft dollar services. Soft dollar brokers argue that if the Commission required more extensive disclosure of third-party soft dollar services than proprietary soft dollar services, advisory clients might be led to believe that advisers derive benefits from soft dollar brokers at the clients' expense that they do not derive from full service brokers, when, in fact, both types of firms confer benefits on advisers.[22] As a result, advisers might be discouraged from using soft dollar brokers.

Representatives of some investment advisers have asserted that current disclosure requirements are adequate.[23] According to these advisers, clients rarely request information about the soft dollar benefits that the adviser receives, and those that are interested currently may obtain the information on request.[24] Other investment advisers, however, argue that the nature of the conflicts involved in soft dollar arrangements warrant more extensive client disclosure than is currently required.[25]

The Commission staff considered issues related to soft dollars in its ''Market 2000'' report on the equity markets released in January 1994.[26] In that report, the staff recommended that quantifiable information about soft dollar services be required to be provided to advisory clients.[27] The report also stated that ''[m]ost importantly * * * any new disclosure requirements should apply equitably. Thus, research and other services obtained either from (full service) firms or (soft dollar) firms should be subject to disclosure.''

II. Discussion

The Commission believes that, in light of the conflicts of interest presented by soft dollar arrangements, additional disclosure about these practices may be warranted. While current disclosure may provide sufficient notice to a client that the adviser has these conflicts, it may not provide the client with sufficient information to permit it to assess the extent to which the adviser obtains soft dollar services or pays up for those services, or the types of services that the adviser obtains through soft dollar arrangements. Enhanced disclosure may provide existing clients with information useful in negotiating limits on the use of their brokerage, and enable prospective clients to make better informed choices of advisers.

The Commission is therefore proposing that certain registered advisers be required to provide clients with annual reports setting forth certain information about their use of client brokerage and the soft dollar services each adviser received during its most recently completed fiscal year.[28] The proposal is intended to provide an advisory client with information that can be used to evaluate the extent to which the client benefits from the adviser's brokerage practices, the extent to which the adviser benefits, and whether the client should attempt to limit the adviser's use of its brokerage. Consistent with the recommendations of the staff in the Market 2000 report, the proposed disclosure requirements would not impose different

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Secretary, Securities and Exchange Commission (Oct. 17, 1994), Commission File No. S7–22–94 (''Alliance Letter''); see also Autranet Letter, *supra* note 11. The Alliance in Support of Independent Research is ''a group of broker-dealers, money managers and research firms sharing a common interest in fostering a favorable regulatory environment in which independent research services and products may be furnished to the money management community.''

[20] In 1980, the Commission stated that research provided through third-party arrangements falls within Section 28(e) of the Exchange Act, even if the money manager participates in selecting the research services provided to it and the research is delivered directly to the money manager by the third party. Securities Exchange Act Rel. No. 17371 (Dec. 12, 1980) (45 FR 83707 (Dec. 19, 1980)). The Section 28(e) safe harbor is not available to third-party soft dollar arrangements unless, among other things, the broker is obligated to the third party to pay for the services. Release 23170, *supra* note 1, at § III; *Kingsley, Jennison, McNulty & Morse, Inc.*, *supra* note 17.

[21] Some full service brokers also will enter into third-party soft dollar arrangements with advisers.

[22] See Alliance Letter, *supra* note 19.

[23] See, e.g., 1993 Hearings, *supra* note 16 (statement of Holly A. Stark, Senior Vice President, Dalton, Greiner, Hartman, Maher & Co.).

[24] Many pension plans require some form of soft dollar reporting from their money managers, primarily in response to a pronouncement of the Department of Labor, the principal federal regulator of employee benefit plans under the Employee Retirement Income Security Act of 1974 (''ERISA''), concerning the ongoing duty of plan fiduciaries to monitor the use of soft dollars by managers. See ERISA Technical Release No. 86–1.

Section 15(c) of the Investment Company Act of 1940 (15 U.S.C. 80a–15(c)) requires the directors of a registered investment company to request and review, and the company's adviser to supply, such information as may reasonably be necessary to evaluate the terms of the advisory contract between the adviser and the investment company. As discussed above, soft dollar arrangements may bear upon the reasonableness of advisory fees. *See* text accompanying note 12 *supra.* Investment company advisers that engage in soft dollar arrangements therefore must provide their boards of directors with information regarding soft dollar arrangements. See Release 23170, *supra* note 1, at § IV.B.3.

Various institutional investors have expressed their views on soft dollar arrangements. *See* 1993 Hearings (statement of Fred G. Weiss, Chairman, Financial Executive Institute's Committee on Investment of Employee Benefit Assets (''CIEBA'')). Mr. Weiss stated that CIEBA, which represents 150 corporate benefit plan sponsors with assets of approximately $600 billion, was unable to develop a clear consensus on whether soft dollar practices were desirable or not. CIEBA did, however, call for more comprehensive reporting of soft dollar arrangements at a firm-wide level to supplement the client-specific information that most of its members currently receive. Other institutional investors believe that current disclosure is adequate. *See* 1993 Hearings (written statement of State Board of Administration of Florida). In addition, the Institutional Investors Committee of the National Association of Securities Dealers, Inc. (''NASD Committee''), which includes representatives of institutional investors, advisers, and brokerage firms, submitted a recommendation to the Commission's staff for additional soft dollar disclosure. The NASD Committee's recommendation was approved by the NASD's Board of Governors. The NASD Committee's recommendation will be placed in the public comment file for the Commission's proposal.

[25] *See* Letter from Louis R. Cohen and Marianne K. Smythe, Wilmer, Cutler & Pickering to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Oct. 17, 1994) (on behalf of Investors Research Corp.) (''Investors Research Letter''), Commission File No. S7–22–94.

[26] *See* U.S. Securities and Exchange Commission, Division of Market Regulation, Market 2000: An Examination of Current Equity Market Developments (Jan. 1994).

[27] *Id.* at V–15.

[28] The proposed amendments would not require that advisers provide each client with information about how that client's transactions were directed. See Section II.F infra.