

client's brokerage was directed ("client-specific information"). Client-specific information could assist a client in comparing the use of its brokerage with that of the adviser's other clients.<sup>53</sup> The benefits of a requirement to disclose client-specific information, however, may be outweighed by the time and cost to advisers of preparing separate reports for every client. This cost would likely be passed on to advisory clients. Furthermore, advisory clients currently receive or have access to confirmations of their transactions that disclose the identities of the brokers used and the amounts of commissions charged.<sup>54</sup> Comment is requested whether client-specific information should be required in the annual report and, if so, what information should be required.<sup>55</sup>

### G. Delivery and Filing

Reports on Form ADV-B would be prepared on an annual basis and would report on brokerage directed during the adviser's most recently completed fiscal year.<sup>56</sup> The report would be required to be filed with the Commission and delivered to clients no later than sixty days after the end of the fiscal year, and delivered to prospective clients no later than the time that an advisory contract is entered into.<sup>57</sup>

<sup>53</sup> To the extent differences between the manner in which an adviser uses a particular client's brokerage and the brokerage of the adviser's other clients is caused by client-directed brokerage, the requirement of the proposal to disclose the percentage of client-directed brokerage might render client-specific information unnecessary. See Section II.D *supra*.

<sup>54</sup> See rule 10b-10 under the 1934 Act [17 CFR 240.10b-10] (requiring broker-dealers to send immediate confirmations of transactions to their customers). The confirmations, or quarterly statements containing all of the information required in the confirmations, must be sent to the holder of the account, rather than any fiduciary managing the account. See Securities Exchange Act Rel. No. 34962 (Nov. 10, 1994) [59 FR 59612 (Nov. 17, 1994)] at §II.A.2.

<sup>55</sup> As noted above, an adviser to an investment company is required to provide information about its soft dollar arrangements to the company's board of directors. See note 24 *supra*. The information provided by the adviser generally should include specific information about the adviser's use of the investment company's brokerage. The proposed annual report would supplement this fund-specific information.

<sup>56</sup> Paragraph (a) of proposed rule 204-4; General Instructions 1 and 5 to proposed Form ADV-B. The table in the annual report would be required to disclose commissions paid during the adviser's most recently completed fiscal year even if soft dollar services paid for with those commissions had been or will be received during another fiscal year. Conversely, disclosure of soft dollar services received during a fiscal year would be required even if commissions were or will be directed to pay for those services during another fiscal year. General Instruction 5 to proposed Form ADV-B.

<sup>57</sup> Paragraphs (a) and (b) of proposed rule 204-4; General Instructions 3 and 4 to proposed Form ADV-B. Rule 204-3 under the Advisers Act, which generally requires advisers to furnish a disclosure

Because the report would provide information about brokerage over which the adviser has discretion, the report would be required to be delivered only to those clients over whose accounts the adviser has or will have brokerage discretion. An adviser would be considered to have brokerage discretion over an account if it (1) had the authority to determine, without obtaining specific client consent, the brokers to be used or the commissions paid in connection with any transactions for the account, or (2) significantly influenced the selection of brokers by a client and received soft dollar services from a broker chosen by the client.<sup>58</sup> An adviser would not be required to provide the report to a client that, without the adviser's influence, directed that a single broker execute its transactions, or prior to each transaction approved the broker to be used for the transaction.<sup>59</sup> Comment is requested whether this definition of brokerage discretion is appropriate, and whether the report should be required to be delivered to clients over whose accounts the adviser does not have brokerage discretion.

The Commission is proposing that the report be prepared on an *annual* basis. More frequent reporting would be more costly and may not be necessary for clients to monitor an adviser's brokerage direction practices. Furthermore, an annual report may provide a more representative sample of an adviser's brokerage practices. Comment is requested whether the report should be

brochure to prospective clients no later than 48 hours prior to the time that the advisory contract is entered into, permits the brochure to be delivered at the time that the contract is entered into if the contract can be terminated without penalty within five business days. Paragraph (b)(1) of rule 204-3 [17 CFR 275.204-3(b)(1)]. Proposed rule 204-4 would not similarly differentiate between providing the annual report before or at the time that the contract is entered into. Generally, however, the determination of when a contract is entered into would be the same for the purposes of both rules.

<sup>58</sup> Paragraph (c)(1) of proposed rule 204-4; General Instruction 2 to proposed Form ADV-B. An adviser would not be deemed to have brokerage discretion over an account if substantially all of the client's transactions were directed to a broker that was compensated for executing the transactions based upon a percentage of the assets managed by the adviser, such as in a "wrap fee" program, even if the adviser could in certain circumstances direct the client's transactions to other brokers.

<sup>59</sup> An adviser would be required to deliver the annual report to a client if the adviser had discretion over any of the client's brokerage, even if some or most of the client's brokerage was directed by the client. Delivery of the annual report also would be required if the adviser had the authority to select brokers for particular transactions from a list previously approved by the client.

required to be prepared more frequently than annually, such as quarterly.<sup>60</sup>

### H. Goldman/Morgan Proposal

The Goldman/Morgan Proposal differs from the Commission's proposal in a number of respects. The Goldman/Morgan Proposal would, among other things, require quarterly rather than annual reporting, require disclosure of the commission price and value of specific third-party soft dollar services, and require disclosure of certain client-specific information. The Commission has requested comment on these elements of the Goldman/Morgan Proposal separately in this Release. The Commission also requests comment whether the Goldman/Morgan Proposal generally would be preferable to the Commission's proposal.

### III. Disclosure By Brokers Providing Soft Dollar Services

The amendments being proposed in this Release would require disclosure by *advisers* that receive soft dollar services from brokers. In a letter to the staff, Autranet, Inc. ("Autranet"), a broker providing third-party soft dollar services to advisers, proposed an entirely different approach that would impose certain recordkeeping and disclosure requirements on *brokers* providing third-party soft dollar services to ensure that the services were provided within the safe harbor of Section 28(e) of the Exchange Act.<sup>61</sup> Under the Autranet

<sup>60</sup> The Morgan/Goldman Proposal would have required quarterly reporting.

<sup>61</sup> Autranet also has proposed that the Commission prohibit understandings that commit an adviser to a predetermined amount of commissions in exchange for soft dollar services. The Commission requests comment on the feasibility of this proposal. In particular, the Commission requests comment whether prohibiting a stated commission ratio in exchange for soft dollar services will deter the negotiation of commission rates and cause advisers that are less sophisticated or influential to pay higher commissions.

In addition, Autranet proposed that the Commission ensure that an independent research originator make its services available to a number of brokers and not enter into exclusive agreements. For instance, under "bump up" or bonus arrangements a vendor will assign a cash value to its product and offer it to the public at large for a lower price than charged to a broker providing the product pursuant to a soft dollar arrangement. In other arrangements, a vendor will tie the availability of its product to a single affiliated or unaffiliated broker, thus causing all trades to go through that broker in exchange for the service. Autranet believes that by eliminating commission commitments and exclusivity arrangements, a client can be better assured that the adviser obtained the best execution of the client's order. The Commission requests comment on the feasibility of a prohibition on exclusivity and bonus arrangements and whether such a proposal would accomplish the objective of assuring best execution. The Commission also has forwarded these proposals to the NASD for its consideration under its authority to promulgate just and equitable principles of trade.