



ICSA

INTERNATIONAL COUNCIL of SECURITIES ASSOCIATIONS

March 15, 2007

Ms. Pamela Vulpes
IOSCO General Secretariat
C/ Oquendo 12
28006 Madrid
Spain

Re: Comment on IOSCO's Consultation Report on Soft Commission Arrangements¹

Dear Ms. Vulpes:

We are writing on behalf of the members of the International Council of Securities Associations ("ICSA") which is composed of the trade associations and self-regulatory associations active in the world's major securities markets.² We would like to thank the members of Standing Committee 5 ("SC5") for the work that they have done to produce the *Consultation Report on Soft Commissions* ("the *Report*") that was released in November of last year. We welcome the opportunity to comment on the Report.

First, we agree that the Report is timely, and believe that is so, not only because of the importance of the underlying subject matter, but also because it has the potential to positively contribute to greater cross-border regulatory consistency at a time when numerous jurisdictions have either recently adopted, or are considering, adopting rules or other forms of guidance, with respect to soft commission arrangements. These efforts include, among other things:

- U.K. Financial Services Authority ("FSA") adoption of final rules on Bundled Brokerage and Soft Commission Arrangements.³

1 For purposes of this comment letter the terms soft commission arrangements, soft dollar arrangements and client commission arrangements may be used interchangeably.

2 The members of the International Council of Securities Associations (ICSA) represent and/or regulate the overwhelming majority of the world's equity and fixed income markets. ICSA's objectives are: (1) to encourage the sound growth of the international securities markets by promoting harmonization in the procedures and regulation of those markets; and (2) to promote mutual understanding and the exchange of information among ICSA members. A list of ICSA members is attached to this document.

3 FSA Policy Statement 05/9 (July 2005). The final rules became fully effective on June 30, 2006.

- U.S. Securities and Exchange Commission (“SEC”) issuance of Guidance Regarding Client Commission Practices under Section 28(e) of the US Securities Exchange Act of 1934.⁴
- French “Autorité des Marchés Financiers (“AMF”) adoption of a new regime of Commission Sharing Agreements in the beginning of 2007 to be implemented shortly.
- Canadian Securities Administrators (“CSA”) issuance of Proposed National Instrument 23-102 and Request for Comment on Use of Client Brokerage Commissions as Payment For Order Execution Services or Research (“Soft Dollar” Arrangements”).⁵
- The provisions relating to inducements and best execution in the European Union’s Markets in Financial Instruments Directive and its implementing measures.⁶

These regulatory changes together with other initiatives – such as use of disclosure protocols in the UK developed by the relevant trade associations consistent with the FSA’s focus on the transparency of the arrangements in order to ensure that investors have sufficient information to make well-informed investment decisions;⁷ the use by French brokers and asset managers, of a “Framework for Broker Compensation by Investment Managers;⁸ and greater use of commission sharing arrangements in the UK, US, France and elsewhere – appear to be having an effect on business models and processes in a large number of jurisdictions which, we suggest, should be allowed to run its course.

In the light of these ongoing regulatory and business changes, ICSA strongly supports the SC5’s decision to monitor developments over the next two years before considering whether to develop general principles or other recommendations for soft commissions. We would encourage IOSCO to consult again on any further work it plans to do arising from its review of soft commission arrangements.

4 SEC Release No. 34-54165 (July 18, 2006). The guidance became fully effective on January 24, 2007. The SEC has indicated that it also intends to address the transparency of client commission arrangements.

5 Canadian securities regulators are currently reviewing comments received during the 90 day comment period which expired on October 19, 2006.

6 European Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive covers these topics. CESR has announced its intention to carry out further work on soft commission and unbundling.

7 FSA Handbook (7.18.2 G) The purpose of this section is to ensure that an investment manager’s arrangements in relation to dealing commissions are transparent and demonstrate accountability to customers where commissions are spent in acquiring services in addition to execution, and consequently that customers are treated fairly.

8 AFEI-AFG Charter of Good Practice: “Framework for Broker Compensation by Investment Manager”, published in July 2006.

ICSA particularly wishes to thank SC5 for the very helpful compilation in the Appendix to the Report which sets forth the soft commission arrangement regulatory regimen in the various SC5 jurisdictions. We believe that the compilation will provide invaluable guidance to financial services organizations who engage in cross-border soft commission arrangement activities, and also be of considerable assistance to regulatory authorities in coordinating their oversight activities.

In terms of specific comments, ICSA appreciates SC5's efforts to provide an overview of both the benefits and conflicts associated with soft commission arrangements. However, when finalizing the report we suggest that some further clarification and elaboration be provided in order to create a better context for evaluating the benefits which such arrangements provide to investors. In that regard, the Report should more clearly articulate that the benchmark for determining the appropriateness of the research and brokerage services received is whether such services enhance the investment decision making process or order execution quality for the benefit of investors.

In addition, ICSA is concerned that the Report's discussion of conflicts will lead readers to conclude wrongly that best execution should be equated with lowest commission cost. In fact, the predicate for regulations such as Section 28(e) of the US Securities Exchange Act of 1934, is that investment managers should have a "safe harbor" when paying more than the lowest commission where the benefits obtained equal or exceed the additional commission cost. Furthermore, studies have shown⁹ that implicit execution costs, such as, market impact and opportunity costs (none of which are discussed in the Report) greatly exceed explicit commission costs. These implicit costs can be significantly ameliorated through the brokerage services, including clearance and execution, received in connection with soft commission arrangements. Among other things, such services can help assure prompt execution, execution and settlement of difficult trades, execution of unique trading strategies, maximization of liquidity to facilitate large trades, and enhanced opportunities for price improvement.¹⁰ Therefore, because of the substantial benefits that these brokerage services provide to investors, it is important that they be given due weight by SC5.

We also note an apparent discrepancy in the text between footnote 5 of the Report, which records the EU Commission's recommendation that soft commissions should not include paying for the economic benefits of clearing and execution services and the text in the 'definition' which appears to include these services. A similar problem arises on page 8 in the discussion of the situation with regard to 'research and order execution services'. Since we believe it to be world-wide current practice, not disputed in any jurisdiction, to include clearing and execution as within the scope of services which can be paid for by commission, we suggest that the discrepancy be resolved accordingly.

9 See, for example, SEC Concept Release on Portfolio Transaction Costs. Release No. 33-8349 (December 18, 2003).

10 For a more complete discussion of these, and other factors impacting the broker selection and best execution processes, see CFA Institute Trade Management Guidelines, November 8, 2002, p.7-8.

We hope that our comments have been helpful and will give the members of SC5 additional context and direction for determining what course of action may be appropriate going forward for their work on soft commission arrangements.

Representatives from the ICSA Task Force on Soft Commissions would be pleased to meet with the SC5 to discuss any of the matters set forth in this letter further, or to assist in any other way that will be helpful for its consideration of this issue.

Sincerely,

A handwritten signature in black ink, appearing to read "Joe Oliver". The signature is stylized with a large, sweeping initial "J" and "O".

Joe Oliver, President and CEO
Investment Dealers Association (IDA)
and Chairman, ICSA Advisory Committee

A handwritten signature in black ink, appearing to read "Marilyn Skiles". The signature is written in a cursive, flowing style.

Marilyn Skiles
Secretary General
ICSA

The following associations are members of ICSA:

Association of Capital Market Intermediary Institutions of Turkey (TSPAKB)

Australian Financial Markets Association (AFMA)

Bond Exchange of South Africa (BESA)

French Association of Investment Firms (AFEI)

International Capital Market Association (ICMA)

Investment Dealers Association of Canada (IDA)

Italian Association of Financial Intermediaries (Assosim)

Japan Securities Dealers Association (JSDA)

Korea Securities Dealers Association (KSDA)

London Investment Banking Association (LIBA)

NASD

Securities and Financial Markets Association (SIFMA)

Swedish Securities Dealers Association (SSDA)

Taiwan Securities Association (TSA)