

**SEC STAFF ISSUES NO-ACTION POSITION ON
NEW CLIENT COMMISSION ARRANGEMENTS**

On January 17, 2007, the Office of Chief Counsel of the Division of Market Regulation (“Staff”) of the Securities and Exchange Commission (“SEC”) issued a “no-action” letter¹ clarifying the operation of a new type of client commission arrangement permitted by the SEC’s recent guidance (“Guidance”) concerning Section 28(e) of the Securities Exchange Act of 1934 (“Exchange Act”).²

Under the Guidance, a money manager can agree with a broker-dealer effecting trades for the money manager’s accounts that a portion of the commissions paid by the accounts will be allocated to a “pool” of funds. The manager can thereafter request that the broker-dealer make payments from the pool of funds to service providers for certain research products and services.³ The Staff’s letter addresses the question of whether the recipients of the payments must be registered as broker-dealers pursuant to Exchange Act Section 15(b). The Staff states that it will not recommend that the SEC take enforcement action if the recipients of the payments do not register as broker-dealers.⁴ In taking that position, the Staff noted in particular the following factors:

1. the money manager is responsible for independently determining the value of the research services in accordance with its good faith determination under Section 28(e), although the determination may be based on input from the service provider that provides the research services;
2. the broker-dealer is not involved in determining the value of the research services to the money manager;
3. the service provider receives payment for research services from a pool of commissions that, by agreement between the broker-dealer and the money manager, the broker-dealer has set aside for obtaining research services;⁵

¹ SEC Staff No-Action Letter re: Status of Service Providers in Goldman Sachs & Co.’s Research XPRESS Program (January 17, 2007), available at www.sec.gov/divisions/marketreg/mr-noaction/2007/goldmansachs011707-15a.pdf.

² See Willkie Farr & Gallagher LLP Client Memorandum, “Commission Publishes Interpretive Guidance and Seeks Additional Comments on ‘Soft Dollars’ Safe Harbor” (July 24, 2006), available at www.willkie.com/files/tbl_s29Publications/FileUpload5686/2308/SEC_Publishes_Interpretive_Guidance.pdf.

³ The no-action position is limited to products and services that are considered “research services” under Section 28(e). See Securities Exchange Act Release No. 54165 (July 18, 2006), 71 FR 41978, at Section III.C.

⁴ The no-action position is specifically addressed to the Research XPRESS program operated by Goldman Sachs & Co.

⁵ The letter requesting the relief stated that the payments to the service providers would be “specified dollar amounts.”

4. payment to the service provider is not conditioned, directly or indirectly, on the execution of any particular transaction or transactions in securities that are described or analyzed in the research services; and
5. the service provider provides the research services in return for payment from a pool of commissions, but does not perform other functions that are typically characteristic of broker-dealer activity.

It previously had been clear that broker-dealers could be paid a fee for their research out of a manager's commissions even though the broker-dealers did not perform any broker-dealer functions in connection with the manager's transactions.⁶ The Staff has now made clear that the recipients of payments from the commission-generated pool of funds do not have to be registered as broker-dealers.⁷ The recipients of the payments are compensated for their research services and do not perform broker-dealer functions. In effect, the funds in these payments lose their character as "commissions" if the above factors are present.⁸

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If you have any questions regarding this memorandum, please contact Larry E. Bergmann (202-303-1103, lbergmann@willkie.com), Roger D. Blanc (212-728-8206, rblanc@willkie.com), or the attorney with whom you regularly work.

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⁶ See SEC Staff No-Action Letter re: Gilder, Gagnon & Co. (June 4, 1987).

⁷ The letter does not address the question of whether the research providers may be required to register as investment advisers.

⁸ The Staff's letter refers to the arrangement as a "commission-sharing arrangement." However, the Guidance uses the term "client commission arrangement." The latter term is more appropriate to the situation in the letter, because the no-action position is essentially taking the view that the funds paid to the service providers are not commissions and the service providers perform no broker-dealer functions for the payments.