Advisory Council on Employee Welfare and Benefit Plans

Report of the Working Group on Soft Dollars/Commission Recapture

November 13, 1997

final

WORKING GROUP ON SOFT DOLLAR AND DIRECTED BROKERAGE

The Soft Dollar and Directed Brokerage Working Group respectfully submits the following report and recommendations to the 1997 ERISA Advisory Council.

I. WORKING GROUP'S PURPOSE AND SCOPE

The 1997 Advisory Council on Employee Welfare and Pension Benefit Plans created a working group to study the need for regulatory changes and/or additional disclosure to pension plan sponsors and fiduciaries on soft dollar and directed brokerage practices. In choosing this topic, council members expressed concern this area lacked sufficient guidance for plan fiduciaries to properly administer their pension plans in compliance with ERISA's fiduciary requirements. In addition, soft dollar and directed brokerage practices had not been comprehensively addressed by Department of Labor staff since the mid-1980s.

The primary objective of this study was to evaluate current soft dollar regulations and industry practices to determine if plan sponsors and other fiduciaries were being provided sufficient disclosure in order to properly protect plan assets. Recommendations resulting from this study were formulated with the guiding principle that pension plan assets belong to plan participants and fiduciary decisions must only be made in the best interest of plan participants. The financial profitability and viability of financial institutions dealing with soft dollars and directed brokerage is the primary concern of the Securities and Exchange Commission and outside the scope of this report. The Securities and Exchange Commission has a separate study underway addressing soft dollar and directed brokerage practices with investment management firms, consultants and brokerage firms.

The first task for the Soft Dollar and Directed Brokerage Working Group was to define the terms "soft dollars" and "directed brokerage". Soft dollars can be defined as "payment for brokerage firm services, other than trade execution, through commissions generated from investment trades". A more detailed explanation is:

> When investment managers buy or sell stock, the price of executing the transaction includes price paid or received for the stock and the brokerage commission. The brokerage commission includes: actual cost of the trading function; principally executing the trade; clearing; settling; custody; and the brokerage firms' profit. The brokerage firm may give up part of their profit to provide credits for investment managers or consultants who use these credits to pay for research and/or other costs associated with the investment process. The commission dollars that a brokerage firm relinquishes in this manner are termed "soft dollars."[1]

To define "directed brokerage" one must first define "commission recapture". "Commission recapture" is a process whereby pension plans receive a rebate resulting from brokerage transactions incurred through the pension plans' investment managers. This rebate represents a portion of commissions (equity trades) or spreads (fixed income trades) charged on these investment transactions."[2] Knowing this definition, we can now define directed brokerage as:

> When plan sponsors direct investment managers to execute a portion of their trades through a selected brokerage firm to the extent the brokerage firm is competitive in price and trade execution. The brokerage firm then rebates a portion of the commissions to the pension plan. The pension plan can be rebated in cash or have the brokerage firm pay certain administrative expenses of ERISA-covered pension plans.[3]

II. WORKING GROUP PROCEEDINGS

In taking testimony on soft dollar and directed brokerage practices, the working group received oral testimony from nineteen (19) witnesses. These witnesses came from four major areas: Pension and Welfare Benefits Administration of the Department of Labor and the Securities and Exchange Commission; corporate pension plan administrators; public pension plan administrators; and financial service providers. Because of substantial interest in the working group topic, oral testimony had to be limited. Consequently, approximately forty (40) individuals were not able to give oral testimony but were encouraged to submit written statements. Five (5) individuals elected to submit written testimony that was added to the record. In addition, twenty-eight (28) written references consisting of periodical articles, newspaper articles, prepared statements, white papers, prior congressional testimony, industry group pamphlets, news releases and written testimony of oral witnesses were added to the record.

The oral testimony, written testimony, and public comments on soft dollars and directed brokerage were received by the working group in a series of five public hearings. During the first public hearing held on April 8, 1997, the working group received testimony from representatives of the two federal agencies primarily responsible for regulating and monitoring soft dollar and directed brokerage practices. Mr. Morton Klevan, Pension and Welfare Benefits Administration, provided the working group an overview of fiduciary standards as they relate to soft dollars and directed brokerage. Mr. Klevan first defined "soft dollars" and how they differ from "hard dollars". He then discussed how soft dollars are used by investment managers to purchase goods and services for their own use while paying for them with funds generated from clients' brokerage commissions.

Mr. Klevan then distinguished "directed brokerage" from soft dollars. He then discussed application of DOL Technical Release 86-1 and its fiduciary obligations for plan sponsors electing to utilize directed brokerage programs. Mr. Klevan closed his testimony discussing the Department of Labor's previous enforcement efforts concerning soft dollars.

The Security and Exchange Commissions' (SEC's) recent sweep of 355 investment managers, consultants and brokers was the subject of testimony from Mr. Gene Gohlke, SEC Inspections Office. The SEC is looking for pervasive, not isolated, practices by firms involved with soft dollars and directed brokerage. The sweep concentrated on third party research providers, which is an area the SEC noted prior abuses. The SEC was also concerned about weak internal controls in many firms for monitoring purchases and sales of research.

Due to input plan fiduciaries have in initiating direct brokerage programs, the SEC was not going to examine directed brokerage as closely as other soft dollar practices. However, the SEC will check to see if directed brokerage guidelines established by plan sponsors are being followed by investment managers and consultants. Mr. Gohlke concluded his testimony stating he would send the working group a copy of the final SEC report as soon as it was available.

Mr. William Quinn, AMR Investment Services, began May 13, 1997 testimony with his recommendation to repeal Section 28(e) of the Securities and Exchange Act of 1934[4] to reduce conflicts of interest between plan participants and investment managers. He stated soft dollars are not used in most parts of the U.S. economy and should not be an allowed practice in money management where trust and integrity of service providers is critical. ERISA[5] provides investment managers sufficient latitude to act responsibly without the safe harbor provided by Section 28(e). Mr. Quinn was followed by Mr. Harold S. Bradley and Robert T. Jackson, American Century Investors, who gave their perspective on soft dollars from the viewpoint of an investment management company. They recommended investment managers be required to disclose to plan sponsors how managers pay for all research purchases. In addition, all research provided to investment advisors should be disclosed on Form ADV filed with the Securities and Exchange Commission.

Mr. William McIntosh, Independent Financial Consultant, recommended elimination of Section 28(e) as part of his June 13, 1997 testimony. He stated it amounts to a $1.2 billion deceptive practice on plan sponsors due to inadequate disclosure. Eliminating Section 28(e) would help improve accounting practices for investment transactions and introduce true competition into the market place for commission rates. Gary Findley, Executive Director and Richard Dahl, Chief Investment Officer, Missouri State Employees' Retirement System, shared examples of soft dollar abuses with the working group. Disclosure is the key to discouraging soft dollar abuses and requires plan sponsors have investment managers and consultants disclose all soft-dollar sources of income at time of hire. Mr. Findley also stated the greatest of portion of soft dollar monies go unreported and are not disclosed to plan sponsors.

Mr. R. Charles Tschampion, GM Investment Management Corporation, wanted to retain Section 28(e), but stated the Securities and Exchange Commission should further clarify the definition of "research" to better determine what can justifiably be purchased. Investment managers and brokers should disclose uses of soft dollars for all clients, so plan sponsors can monitor activity across all client accounts.

The July 16, 1997 testimony began with Mr. Roland Machold, New Jersey Division of Investment, who discussed soft-dollars being used in the internal administration of his public plan investment program. Mr. Machold testified that he does not receive sufficient funding from the New Jersey State Legislature and utilizes soft-dollars to pay for needed administrative expenses. For pension plans utilizing soft-dollars in this manner, he advocated an exacting accounting process with full disclosure, even to the point of third-party auditors reviewing all commission transaction records.

Responding to questions regarding his interpretation of Section 28(e) of the Securities and Exchange Act of 1934, Mr. Machold stated he felt the current interpretation of "research" should be expanded to include travel expenses. He did not want to see the definition of research limited to only those goods that can be purchased with hard-dollars. He preferred the expanded "research" definition to make available for purchase any research service providing assistance in the investment process.

Kenneth L. Kahn, Alpha Management, Inc., shared results of his firm's recent industry survey on directed brokerage. The survey outlined arguments both pro and con in use of directed brokerage by plan sponsors. The survey covered 212 pension plans ranging from sizes from $200 million to $38.5 billion in size. Participants listed reasons for using directed brokerage as (1) lower commission costs; (2) payment of consultant fees; and (3) payment for research. Reasons for not using directed brokerage were (1) utilize passive or indexed assets; (2) leave this function up to money managers; (3) money managers advised against directed brokerage; and (4) concern about not getting "best execution".

Managers are taking advantage of excess commissions and soft-dollars and this amounts to a second, hidden management fee. He also stated small plan sponsors receive an inordinate reward because the majority of research costs are paid by larger pension plans. In response to questions, Mr. Kahn said the current definition of "research" under Section 28(e) should be tightened to better define what goods and services could legitimately be purchased.

Mr. Jan Twardowski, Frank Russell Securities, also directed his testimony to directed brokerage. His firm runs directed brokerage programs he claims save clients an estimated $40 million annually. His clients save from 40% to 70% of commission costs by utilizing directed brokerage. Frank Russell Securities recommends clients limit directed brokerage to approximately 25% of total securities transactions. Mr. Twardowski testified he had no direct evidence of soft dollar or directed brokerage abuses. Without such evidence, the SEC and DOL should not change current regulations. Proof of widespread abuse must be a precondition to any new regulations.

Ms. Tina Byles Poitevien, Fiduciary Investment Solutions, Inc., provided a history of soft-dollars in the investment industry and specific data from surveys on soft-dollars expenditures. According to Ms. Pointevien's testimony, only 25.9% of investment managers were almost always or always satisfied with the quality of execution they received through directed brokerage programs.

Directed brokerage programs worked best on easy trades involving large capitalization stocks, that are exchange listed and traded in quiet markets. Ms. Poitevien quoted a 1995 Plexus position paper that found directed brokerage clients receive less than best execution, because investment managers put directed brokerage trades last when making difficult trades. In response to questions from working group members, Ms. Poitevien recommended the Securities and Exchange Commission adopt a specific list of acceptable research purchases. Everything on that list must be directly related to the investment function.

The working group had heard from two (2) prior witnesses recommending eliminating Section 28(e) for pension plans and that same recommendation from Mr. Bryce Barnes, Quantel Associates, covered no new ground. However, Mr. Barnes made a unique recommendation in advocating adding questions to Form 5500 to insure plan sponsors are complying with ERISA Technical Release 86-1, which he felt was now largely ignored. His second recommended change to Form 5500 was to revise instructions for Schedule C requiring plan sponsors list all fees greater than $5,000 paid to investment managers with soft dollars.

Mr. Herbert C. Skinner, Jr., Investment Performance Services, stated that much of the confusion over commission recapture programs was because plan sponsors did not understand the trading process. Commission costs are just one component of overall trading costs and could be the smallest. The best way to minimize execution and opportunity costs were to allow investment managers the flexibility to (a) minimize market timing and impact costs; (b) get best execution; and (c) utilize brokerage firms who can provide liquidity. Mr. Skinner stated plan sponsors could best fulfill their responsibilities by placing their recapture brokerage firms in competition with the rest of industry to provide best execution on each trade. Plan sponsors who utilize directed brokerage are relieving their investment managers from some or all their fiduciary responsibility for best execution and assuming that responsibility themselves.

Representing the Securities Industry Association (SIA), Mr. Howard J. Schwartz updated the working group on progress by the SIA panel looking into best practices in use of soft-dollars. Best practices are needed because individuals have alleged soft-dollar arrangements are deceptive, present conflicts of interest, constitute hidden profits and result in something less than best execution. Mr. Schwartz stated the best practices would cover disclosure, procedures for brokerage dealers and fiduciaries to monitor, effects of market forces, and would probably not recommend elimination of Section 28(e) which would potentially cause both practical and theoretical problems.

Jack M. Marco, Marco Consulting Group, began the September 17, 1997 meeting by stating there were three (3) parts to directed brokerage -- the "good", the "bad" and the "ugly". The "good" was directed brokerage could result in significant savings to the pension plan. The savings could be used to offset plan administrative expenses and, if done correctly, would not interfere with investment managers' execution of trades. The "bad" was when plan sponsors over-directed trades by utilizing a single brokerage firm for more than 25% to 30% of overall trades. Another bad feature of directed brokerage programs is, if not structured properly, they could interfere with managers' execution of trades. Mr. Marco also testified he knew of directed brokerage programs

where clients never received promised rebates or paid five to six times higher than the actual cost of services provided.

The "ugly" of directed brokerage programs is many arrangements are done orally with very little written evidence. Therefore, it becomes very difficult for plan sponsors to properly monitor the entirety of soft-dollars arrangements affecting their plan assets.

Mr. Marco recommended plan sponsors insist on "no other compensation" clauses in their contracts with consultants. These clauses would prohibit consultants from accepting any compensation unless specifically covered by the contractual agreement. Another Marco recommendation was third-party audits be utilized to review all trades made by investment managers for the plan sponsor's account. Without independent third-party confirmation of trading practices, plan sponsors could not determine if consultants are complying with contractual agreements.

Mr. Samuel W. "Skip" Halpern, Independent Fiduciary Services, organized his testimony around specific questions plan sponsors can ask in selecting investment managers, monitoring investment managers' performance, and monitoring brokerage. Questions plan sponsors should ask when utilizing consultants to select investment managers are: (a) Is any manager candidate favored or disfavored because of their level of trading with an affiliated broker-dealer of the consultant? (b) How much in commissions has each candidate paid their consultants' broker-dealer in the recent past? (c) How much in spread securities has each candidate traded with the consultant's broker dealer?

The questions for plan sponsors to ask when monitoring investment managers' performance are: (a) What portion of total equity trades is each investment manager conducting through consultant's broker dealer on this account and others? (b) What percentage of total fixed income trading is conducted through consultant's broker dealer on this account and others? (c) In both cases, how much of this trading involves soft dollars and specifically what does each manager receive in return?; (d) How much in total compensation (both hard and soft dollars) does the consultant and its broker dealer receive from this account?

Lastly, questions plan sponsors should ask when monitoring brokerage practices are: (a) What subjects have plan sponsors specifically hired the consultant to address? (b) Do plan sponsors pay the consultant through directed brokerage or participate in a commission recapture program? (c) Does anyone with sufficient expertise and independence monitor brokerage activities on behalf of the pension plan?

Some final recommendations Mr. Halpern left with the working group are plan sponsors should require written soft-dollar disclosures from consultants. In addition, plan sponsors should request brokers and consultants supply them with written copies of their projected soft dollar and directed brokerage budgets annually.

Oral testimony for the working group concluded with remarks from Mr. Barry P. Barbash and

Mr. Steven M. Wallman, Securities and Exchange Commission, who provided a report on progress to date on SEC's recent "sweep" of 355 investment managers, brokers and consultants. The report was being compiled and had not yet been approved by the Commissioners for release to the public. Mr. Barbash stated he would make a copy available to the working group upon release by the Commissioners.

III. FINDINGS AND RECOMMENDATIONS

Soft dollar and directed brokerage practices involve responsibilities for plan sponsors, administrators, and other fiduciaries created by ERISA's fiduciary duties under Section 404[6] and prohibited transaction provisions under Section 406.[7] ERISA Section 404 states a fiduciary's overriding responsibility is to "discharge his duties with respect to a plan solely in the interest of the plan participants and beneficiaries and for the exclusive purpose of ... defraying reasonable expenses of administering the plan."[8] This duty to act for the exclusive purpose of providing benefits and defraying expenses is known as the "exclusive purpose rule". The exclusive purpose rule also charges fiduciaries with responsibility for keeping administrative expenses at reasonable levels maintaining accurate record keeping, and monitoring service providers. Fiduciaries must administer affairs of the plan in the best interests of plan participants and beneficiaries alone and exclude from consideration interests of third parties. Fiduciaries must also avoid transactions involving self-dealing conflicts of interest or use of plan assets to benefit parties-in-interest.[9]

These legal responsibilities are the basis which require plan fiduciaries to closely monitor plan expenses. Soft dollar and directed brokerage programs are funded through use of commission dollars. Soft dollars and commission rebates generated by investment managers through trading activities are plan assets, and both plan sponsors and investment managers have fiduciary responsibilities regarding their prudent management and oversight as they do with other plan assets.

After reviewing the testimony, the working group developed specific recommendations which fall into two main categories. The first category are recommendations involving a change to current regulations or statutes. The second group are recommendations for plan sponsors and other fiduciaries to follow in their relationships with investment managers, consultants, and brokerage firms. The recommendations involving regulatory or statutory changes can be further divided into two (2) subgroups. The first subgroup contains recommendations within the purview of the Department of Labor. The second subgroup involves recommendations the Department of Labor can make to the Securities and Exchange Commission. Each of the following recommendations stand independently and are not cumulative.

Recommendations Involving Regulatory or Statutory Change

DEPARTMENT OF LABOR RECOMMENDATIONS:

A. Modify Form 5500 requiring plan sponsors to list all fees greater than $5,000 paid with directed brokerage.

B. Add a question to Form 5500 requiring plan sponsors to certify they are complying with requirements of ERISA Technical Release 86-1 in using directed brokerage programs.

DEPARTMENT OF LABOR RECOMMENDATIONS TO SECURITIES AND EXCHANGE COMMISSION:

A. Securities and Exchange Commission should tighten Section 28(e) definition of "research" to better determine what can justifiably be purchased with soft dollars.

B. Securities and Exchange Commission should prepare a specific list of which brokerage and research services are acceptable purchases with soft dollars.

C. Investment Managers should be required to provide to each client full disclosure of all trades for that client involving soft dollars and the benefits investment managers receive from those soft dollars. In addition, investment managers should be required to provide a description of their policies involving soft dollars.

D. External research provided to investment managers must be disclosed in summary form on Form ADV filed with the Securities and Exchange Commission.

The recommendations listed above are those in which there was agreement by a majority of working group members. There were two additional recommendations, not supported by a majority, in which the minority working group members requested their opinion be included along with the majority opinion.

E. The working group minority recommended repealing Section 28(e) for employee benefit plans only, thereby eliminating the safe harbor for research purchases.

Majority Opinion

Soft dollars, used prudently, can provide investment managers with much needed information allowing them to perform better for clients. Plan sponsors should make decisions on how best to use pension plan assets, including commissions, by balancing factors such as best execution, need for research, and all costs, including brokerage commissions.[10] Under this argument, the ability of brokerage firms to provide research services in return for commissions encourages more and better research. Both the SEC and Congress have acknowledged the positive effects of research on investment decision making. In a 1972 study addressing brokerage and other practices published prior to the enactment of Section 28(e), the SEC noted "it is essential that the viability of the process by which research is produced and disseminated not be impaired."[11] Approximately 90% of investment managers in the United States obtain research through soft dollars.[12]

Consequently, removal of the Section 28(e) safe harbor could have widespread negative effects throughout the investment management industry.

Trade groups representing the soft dollar industry had claimed competition for order flow from the soft dollar industry has exerted downward pressure on commission rates and has reduced the costs of execution and research. According to a March, 1997 report by the Alliance in Support of Independent Research, "the competition for institutional order flow by research brokers and other broker dealers have brought down the cost of trading from a high of 82 cents per share in 1975 to an average of 6 ½ cents today."[13]

Minority Opinion

Eliminating Section 28(e) for employee benefit plans would not preclude use of soft dollars, but only require all soft dollar purchases be solely in the best interest of plan participants and structured to avoid prohibited transactions. Investment managers would need to get plan sponsors prior approval and then fully disclose all research related purchases. This could be done by investment managers submitting a soft dollar budget to plan sponsors for approval each year and then later submitting a report of actual expenditures. Who can argue against giving plan sponsors this information which is key to fulfilling their fiduciary responsibilities under ERISA. In addition, elimination of Section 28(e) would not prohibit use of directed brokerage or commission recapture programs.

Use of soft dollars for research purchases essentially results in a management fee above and beyond the "handsome" fee already negotiated by managers.[14] Soft dollars allows investment managers to use clients' trading activity to pay for their research. Research services should be purchased by investment managers for cash if they are deemed necessary.[15] Soft dollar commission fees are really hidden fees, which are not permitted in any other business.[16]

Section 28(e) should be repealed for employee benefit plans to reduce conflicts of interests between beneficiaries and fiduciary managers and allow investment managers to focus on best execution and lower overall commission costs. The safe harbor provisions of Section 28(e) are too broad to protect ERISA plans and they remove accountability for soft dollar relationships. ERISA already provides investment managers with sufficient latitude to act in the best interest of plan participants and beneficiaries in trading without the safe harbors provided by Section 28(e).[17] The need for Section 28(e) has passed. It may have been created for good reasons and in a sea of good intentions. But, its day is over.[18]

F. The working group minority recommended eliminating use of soft dollars for employee benefit plans. Brokerage firms would be required to unbundle their services and investment managers must pay separately for execution and research with hard dollars.

Majority Opinion

Commission recapture programs and soft dollar arrangements have complimented each other and fostered competition in brokerage industry. Competition provided by these innovative programs has ultimately benefitted the pension plan participants by increasing the amounts of commission dollars credited back to pension plans. Commission recapture programs have provided pension plans the choice plan sponsors want by unbundling services and allowing plan sponsors to determine if commissions are being used optimally for their particular plan. When done correctly, directed brokerage does not interfere with managers' trade flow and can generate significant income back to the pension plan.[19]

The U.S. Department of Labor has already established guidelines for plan sponsors electing to use directed brokerage arrangements. As long as directed brokerage programs stay within the guidelines established by DOL Technical Release 86-1[20], they should be allowed to continue. DOL Technical Release 86-1 permits the purchase of goods and services, other than research, as long as: purchases are made on behalf of the pension plan; total compensation paid to the broker is reasonable; best execution of trades is obtained; and plan sponsors monitor brokers for best execution.[21]

Directed brokerage does not undermine best execution because today directed brokerage trades are handled exactly like non-directed trades. In the past, when a manager was faced with a mixture of directed and non-directed trades, the manager would often send the non-directed trades, together as a block, and then send the directed ones individually. The first block of non-directed trades would normally get a better price than later individual directed trades, causing less than best execution for the directed trades.[22] Managers have now developed "step-out" trades, where managers ask non-directed brokers to transfer (step-out) a certain percentage of transactions to directed brokers. Thus, directed transactions get the same execution as non-directed transactions, in addition, to plan sponsors getting their directed rebate.[23]

If a plan sponsor does not direct, then their plan may be subsidizing every other pension plan's research.[24] Although directed brokerage signifies work for plan sponsors, the money saved on commissions is well worth it. As fiduciaries, plan sponsors should be monitoring their investment managers and brokers anyway. Besides, managing directed brokerage programs is no longer difficult in light of the evolution of investment technology.[25]

Likewise, a properly structured commission recapture program can assist investment managers, reduce plan costs, and help plan sponsors fulfill their fiduciary responsibilities. The key is to give investment managers a number of highly-respected firms with which to trade, no specific directions in trading, and give them the ability to do executions and transactions as they see fit, and still save money for the pension plan.[26]

Minority Opinion

Use of soft dollars effectively results in an additional fee above and beyond the agreed to fee by both parties. Use of soft dollars allows investment managers to use a client's trading activity to

pay for their research. Research services should only be purchased by the investment manager for cash, if they are deemed necessary.[27]

Use of soft dollars is analogous to an airline asking passengers to use their own credit cards to buy fuel for the flight from one destination to another after they have already paid for their ticket. Obviously, passengers would not approve of this arrangement, and neither should investment managers be allowed to benefit from undisclosed soft dollar arrangements.[28] Many investment managers receive excessive amounts of research, which they readily admit much of which is not needed. Purchasing unneeded research keeps the overall commission cost structure higher than it would otherwise be.[29] According to a 1991 Greenwich Associates Report, portfolio managers only read approximately 30% of research reports they receive. Investment managers at the largest funds, read only about half that amount.[30] Evidence again of plan assets being wasted.

Eliminating soft dollars should not appreciably impact market liquidity. Larger brokerage firms generally are willing to act as principals in making markets at higher commission costs to provide liquidity for investors, and the small percentage of trades requiring it. Trades requiring liquidity assistance comprise probably less than 20% of all trades; however, widespread use of soft dollars tends to drive up costs on the other 80% of trades where liquidity is not a factor.[31]

Directed brokerage undermines a managers' ability to get best execution. By directing to a particular broker, plan sponsors influence investment managers' ability to obtain best execution; thus, any savings plan sponsors may experience in commission dollars are really a greater loss on the execution side.[32] According to a 1991 survey conducted by Rodney L. White, Center for Financial Research, only 25.9% of investment managers were almost always or always satisfied with the quality of execution for directed brokerage.[33]

DOL Technical Release 86-1 places a substantial burden on plan sponsors for monitoring reasonable brokerage compensation and best execution of trades for directed brokerage programs. Technical Release 86-1 clearly says if a plan sponsor steps in to pick up responsibility for a portion of the trading function (by entering a directed brokerage program) the plan sponsor has an obligation to monitor for reasonable brokerage fees and achievement of best execution.[34] Plan sponsors do not know the right questions to ask investment managers and brokerage firms to get information they need to meet fiduciary obligations of Technical Release 86-1.

In many cases, plan sponsors are individuals who do carpentry work, do plumbing work and make and sell widgets.[35] Clearly, these individuals are not capable of making informed investment decisions and monitoring sophisticated investment mangers and brokerage firms having much greater financial expertise than they do. In one-sided situations such as this, the entire advantage is in the corner of investment managers and brokerage firms. These one-sided conflicts can best be avoided by simply eliminating the source of conflict which is soft dollar use in employee benefit plans.

Recommendations Involving Plan Sponsor Guidance

ERISA places substantial responsibilities on plan sponsors and other fiduciaries charged with overseeing administration and investments of pension plans. Responsible plan fiduciaries either do not understand their role and responsibilities or do not have sufficient experience or an appropriate source of information concerning legal requirements and industry practices to deal with soft dollar and directed brokerage programs. Therefore, the working group concluded that educational information would be very useful for all plan sponsors and other fiduciaries and would particularly benefit fiduciaries of small and medium-size pension plans. While additional educational materials will not change behavior of those acting in their own best interest or choosing to disregard their fiduciary obligations, it could still discourage activities by educating responsible fiduciaries to recognize improper conduct.

The working group makes the following recommendations in an effort to further educate plan sponsors and fiduciaries. These are individual recommendations and are not collective.

A. Plan sponsors should avoid soft dollar conflicts of interests by hiring only consultants with no financial arrangements with brokerage firms.

B. Soft dollar income disclosure to plan sponsors by investment managers and consultants should be audited by independent accountants as long as cost beneficial.

C. Plan sponsors should obtain copies of brokers' and investment managers' projected directed brokerage budgets and, if applicable, soft dollar budgets.

D. Soft dollar brokerage monitoring should be done only by parties with sufficient expertise and independence, with no vested interests to protect.

E. All contracts with investment managers and consultants should require written disclosure of potential conflicts of interest.

F. Contracts with consultants should require disclosure of all compensation they receive from investment managers either through the sale of services or through directed brokerage arrangements.

G. Investment managers' contracts should require disclosure to plan sponsors of how managers pay for research and how the pension plan benefitted from that research.

H. Plan sponsors should have consultants and investment managers acknowledge their fiduciary status in writing.

I. Plan Sponsors should obtain written confirmation of oral representations made by consultants and investment managers regarding brokerage arrangements.

J. Plan Sponsors should create specific guidelines for responsible soft dollar and directed brokerage programs.

Endnote References for Sections I, II and III

1. *The Morals of the Marketplace - Soft Dollars and 12;b.1 Fees*, Fiduciary Standards Issue (1994).

2. *News Update*, Lynch, Jones & Ryan, Inc., Feb. 1997, at 5.

3. Donaldson and Company.

4. 15 U.S.C. § 28(e)(1).

5. 29 U.S.C. §§ 1001-1461.

6. 29 U.S.C. § 1104.

7. 29 U.S.C. § 1106.

8. 29 U.S.C. § 1104 (a)(1)(A).

9. *Whitfield v. Tomasso*, 682 F. Supp. 1287, 1302-3 (E.D.N.Y. 1988).

10. Jan Twardowski, President of Frank Russell Securities, Official Transcript (July 16, 1997), at 61.

11. Statement on the Future of the Securities Markets, 37 Fed. Reg. 5286, 5290 (Feb. 4, 1972).

12. Tina Byles Poitevien, President and Chief Executive Officer of FIS Funds Management, Inc., Official Transcript (July 17, 1997) at 79.

13. *Id.* at 80.

14. William Quinn, President of AMR Investment Services, Official Transcript (May 13, 1997), at 8.

15. *Id.*

16. *Id.* at 12-13.

17. *Id.*

18. William A. McIntosh, Independent Financial Consultant, Official Transcript (June 13, 1997) at 62.

19. Howard J. Schwartz, Chief Executive Officer of Lynch, Jones & Ryan, Inc., Official Transcript (April 8, 1997) at 31-38.

20. Tech. Rel. 86-1, Pension and Welfare Benefits Admin., U.S. Dept. of Labor, May 22, 1986.

21. *Id.*

22. Kenneth L. Kahn, President and Chief Operating Officer of Alpha Management, Inc., Official Transcript (July 17, 1997) at 37-38.

23. *Id.* at 40-45.

24. *Id.* at 45-47.

25. *Id.* at 47-49.

26. Herbert C. Skinner, Jr., President and Principal of Investment Performance Services, Official Transcript (July 16,1997) at 115-131.

27. Quinn, at 8.

28. *Id.* at 9.

29. *Id.* at 11.

30. Poitevien, at 80.

31. Quinn, at 11.

32. Kahn, at 40.

33. Poitevien, at 81.

34. Bryce C. Barnes, President of Quantel Associates, Official Transcript (July 16, 1997) at 100-101.

35. *Id.*

IV. SUMMARY OF ORAL TESTIMONY

The following constitutes a brief summary of oral testimony given by witnesses who testified before the Working Group on Soft Dollars and Director Brokerage.

April 8, 1997 Meeting

MORTON KLEVAN
Senior Policy Advisor
Pension & Welfare Benefits Administration-DOL

Mr. Klevan defined "soft dollars" as "when you use other people's money to buy something for yourself. Hard dollars is when you take it out of your own pocket. This situation arises when investment managers purchase goods and services for their use, but pay for them with client's brokerage commissions. These purchases would normally be prohibited transactions for ERISA plans if not for Section 28(e) of the Securities and Exchange Act of 1934. This safe harbor allows investment managers to pay higher commission rates if they receive research services in addition to trade execution. Safe harbor protection is available for investment managers only and does not apply to plan sponsors.

Mr. Klevan then distinguished "directed brokerage" from soft dollars. Directed brokerage is when plan sponsors recapture on behalf of the plan a portion of brokerage commission dollars to pay for custodian fees, accounting fees, performance measurement and other administrative costs. Plan fiduciaries must assure investment managers obtain best execution on directed brokerage trades and commission rates are reasonable considering difficulty of the trades. However, Section 28(e) does not require research services be used solely for the benefit of the client whose brokerage commissions are paying for those services.

Mr. Klevan made two suggestions for fiduciaries to avoid conflict of interest difficulties with their consultants. His first suggestion was that fiduciaries only hire consultants who have no soft dollar arrangements with brokerage firms. His second suggestion was for plan sponsors to then have consultants acknowledge their fiduciary status in writing. Lastly, Mr. Klevan discussed Department of Labor's enforcement efforts in the area of soft dollars. There has been only one 1989 enforcement case filed on record. Currently, no other cases are being prosecuted and soft dollars is not a current area of emphasis for enforcement.

GENE GOHLKE
Associate Director-Inspections Office
Security and Exchange Commission-Inspections Office

Mr. Gene Gohlke provided a progress report on the Securities and Exchange Commission's (SEC's) most recent "sweep" of approximately 350 investment management firms, consultants, and brokers. The inspection sweep included both ERISA and non-ERISA plans and is looking for pervasive, not isolated, practices in soft-dollar usage. The SEC initiated this study for several reasons. The first reason was the increasing number of soft-dollar enforcement cases being filed by the SEC. Second, was the significant publicity this subject received in recent press articles and, lastly, because the last SEC comprehensive evaluation was over ten (10) years ago and the SEC wants to investigate compliance with its current rules.

To date, SEC staff has completed all field work and interviews with the 350 plus participants. Field work notes are now being compiled into a first draft report. The sweep concentrated on third-party research providers rather than firms providing proprietary research. Mr. Gohlke noted most prior abuses were arrangements involving third-party research. He also believed the current sweep would result in enforcement cases being filed. Preliminary results indicate a need for additional disclosure

to plan sponsors. SEC staff found substantial discrepancies between amounts of research purchased and disclosure of information regarding those purchases to plan sponsors.

Section 28(e) of the Securities and Exchange Act of 1934 provides a safe-harbor for investment managers and consultants to purchase research services with soft-dollars. This safe-harbor keeps the purchase of research-related items from being prohibited by the SEC. In his testimony, Mr. Gohlke defined "research" to include such things as Bloomberg terminals, periodical subscriptions, performance measurement evaluations, computer software, PC's, conference fees, but not all travel expenses. He stated some travel by research analysts may fit under the Section 28(e) exception. Mr. Gohlke felt it would be a problem for ERISA plan trustees to attend conferences and seminars where their expenses were paid by soft-dollars from that plan. This practice could be a prohibited self-dealing transaction for ERISA plan trustees.

Another area of SEC concern were the weak internal controls in place in many investment advisory firms and broker dealers. Research purchases and sales were not being tracked and accounted for properly. Staff in charge of research purchases and sales were operating with minimal oversight. SEC staff was also concerned by possible bogus research shops being set up to split research fees.

The SEC sweep was not going to look as closely at directed brokerage practices. The reduced scrutiny is because plan fiduciaries have directed transactions to particular brokerage firms who will share some portion of commission dollars with the plan. However, the SEC will check to see if directed brokerage guidelines established by plan sponsors are being carried out by investment managers. SEC staff was going to closely examine the amount of disclosure provided to plan sponsors, because some practices were felt to require informed consent prior to being carried out. Hedge funds were especially bad about soft dollar expenditures not related to research.

May 13, 1997 Meeting

WILLIAM F. QUINN
President
AMR Investment Services

Mr. Quinn began his testimony with a description of AMR Investment Services ("AMR") and its corporate policy with respect to soft dollar trading. In connection with its pension plans, AMR oversees both external and internal managers. AMR instructs its equity managers that soft dollar trading should not be used in its portfolios either to obtain research or pay for any plan or mutual fund expenses. AMR believes the best way to achieve best execution on all trades is to eliminate any potential conflicts of interest that would be introduced by soft dollar practices.

Mr. Quinn explains what he perceives as the problems with soft dollar trading and AMR's method of compensating for the inefficiencies created by these practices. Soft dollar trading allows external managers to use trading activities to pay for their research -- research that should be paid by the manager with hard dollars if necessary – which is not fair to AMR. These practices cause cost inefficiencies either because AMR may receive less favorable execution or because AMR pays for bundled trading and research that may not benefit it or other clients. AMR thus encourages

its managers to utilize automated trading systems or discount brokers. (About 20% of the dollar volume of trades are executed on a discounted basis.) In addition, AMR monitors its managers' trading practices to determine whether they have received any research services. From this process, AMR determined that for over 70% of the fully-priced trades, managers received research services, but at the best price and at the lowest cost, i.e., "essentially for free." Mr. Quinn believes, however, that because managers tend to receive excessive research, the overall commission cost structure is higher than it would otherwise be. AMR has also witnessed some questionable practices by managers, but Mr. Quinn has never seen a manager abuse his or her fiduciary status in connection with soft dollar trading.

In conclusion, Mr. Quinn recommends that Section 28(e) be repealed to reduce conflicts of interest between fiduciaries and managers, to focus managers on best execution and lower overall commission costs incurred by investors. Mr. Quinn believes the safe harbor provision of 28(e) is too broad to protect ERISA plans, removes accountability for soft dollar relationships and is not necessary in light of ERISA's ability to provide investment managers with sufficient latitude to act in the best interest of beneficiaries. In the event that Section 28(e) is not repealed, Mr. Quinn recommends that (a) brokerage firms unbundle their services and have managers pay execution and research separately with hard dollars or (b) managers fully disclose soft dollar trades and the benefits received therefrom.

In response to questions from the panel, Mr. Quinn had these comments:

-- First, that there is a division among industry pension groups as to benefits associated with soft dollar trading depending on whether the plan primarily uses outside investment advisors or internal management.

-- Second, he sees no advantage to paying for research through commissions because it only serves to obfuscate the costs to pension plans. Mr. Quinn goes on to describe a method by which soft dollar trades could be reported in the event that Section 28(e) was not repealed.

-- Third, Mr. Quinn suggests investment advisors could provide greater disclosure in their form ADV about their brokerage allocation practices, and in particular, describe commissions amounts generated by brokers and the amount research received from brokerage firms.

-- Fourth, the definition of "research" is subjective and rather than establish guidelines as to what should be disclosed, require managers disclose the cost of trading and question the costs that appear to be associated with research.

-- Fifth, 401(k) plans are probably more subject to abusive soft dollar practices because they invest in mutual funds which have not, until recently, been scrutinized by the SEC.

-- Sixth, Mr. Quinn states assessing the value of research is very difficult and the practical answer to soft dollar trading is full disclosure.

HAROLD S. BRADLEY AND ROBERT T. JACKSON
Director of Equity Trading and Chief Financial Officer
American Century Investment Management

Messrs. Bradley and Jackson presented an asset management company view that soft dollars are not currently being accounted for. They provided background on the evolution of soft dollar practices, which according to a Greenwich Associates report approaches $1.3 billion in value.

They stated that buy side traders are in a conflict whether to serve the interests of investor-shareholders or the management company shareholders, an example would be when traders could forego best price to pay bills without the sponsors' knowledge. Using a conversion ratio of 1.6, at least $375 million of profits have accrued to investment management companies that are not adequately disclosing soft dollar usage.

They suggested full disclosure of third-party services paid with soft dollars in equivalent hard dollar amounts can be accomplished by asking traders how they pay their bills and requiring investment advisors to disclose all research purchases on form ADV filed with the Securities and Exchange Commission.

June 13, 1997 Meeting

WILLIAM A. MCINTOSH
Independent Financial Consultant

Mr. McIntosh testified that using soft dollars was a deceptive practice and results in a second and undisclosed management fee for investment managers. Commission rates of 6 cents per share, originally intended to provide competition, has now become a charade. Any commission expense over one and a half to two cents per share is pure profit for brokerage firms. This excessive profit leads to conflicts of interest that in Mr. McIntosh's opinion are no different than "money laundering". Rather than working diligently for best execution, many investment managers are under extreme pressure to avoid best execution and actually inflate commission rates to make more soft-dollars available. Four parties should benefit from each soft dollar transaction. However, Mr. McIntosh believes only three parties are currently benefitting. Brokers get commissions, money management firms get free research and research services sell more product. The fourth party are plan sponsors who receive nothing, but pay the entire transaction cost.

Mr. McIntosh said the only answer is to eliminate Section 28(e) of the Securities and Exchange Act of 1934. Current operations under 28(e) amount to a $1.2 billion deceptive practice because of inadequate disclosure. The original reasons for establishing Section 28(e) are no longer applicable. Section 28(e) was first established to protect small research firms and give them the same quality execution as larger firms. Technological improvements in market transactions now give small firms the ability to get quality execution like large firms. In addition, Mr. McIntosh felt there would be no reduction in quality of research available and managers would quickly pay for research with hard dollars if they needed it.

Eliminating Section 28(e) would help improve accounting practices for brokerage firms and investment managers tracking and accounting for investment transactions. Another benefit would be eliminating supplementary budgets for pension plan administrators who use soft-dollars to pay for operating expenses. Using soft dollars to pay for plan expenses amounts to a secondary off-budget source of financing which is not always properly accounted for. The last benefit of eliminating Section 28(e) was that true competition for commission rates would be introduced to the marketplace and rates would drop accordingly. Mr. McIntosh believed SEC Commissioners were receptive to eliminating Section 28(e), but would act only if pushed by public attention to this issue.

GARY FINDLAY AND RICHARD DAHL
Executive Director and Chief Investment Officer
Missouri State Employees Retirement System

Messrs. Findlay and Dahl provided the perspective of public plan administrators and fiduciaries of a large public pension system. They spoke about their experience with soft dollars and directed brokerage, citing examples where investment consultants were to be paid only modest hard-dollar retainer fees and eventually received ten to twenty times that amount in soft dollar fees. The soft dollar fees were received either from investment managers the consultant hires in exchange for a share of investment management fees or from an affiliated broker to whom the investment manager directs an inordinate amount of trades credited to the consultant's account. They also confirmed that most monies involved in soft dollar and directed brokerage transactions go unreported.

They then described Missouri PERS mechanisms for discouraging abuse in soft dollar practices. The system is funded solely through trust fund assets and has an experienced in-house investment staff that meets with prospective investment managers and advises the Board on investment issues. The system also places caps on average brokerage commissions.

They cited as their principal concern the plan sponsor's responsibility, when hiring a consultant, to request information in writing on the consultant's relationships with outside service providers. They emphasized that disclosure is key, which can be accomplished by plan sponsors asking lots of questions and requiring written answers from consultants and investment advisors.

(A sample questionnaire may be found in the article, "In Pursuit of Objectivity in Investment Counseling," Plan Sponsor Magazine, November 1996, pp 66-77.)

R. CHARLES TSCHAMPION,
Managing Director of Investment Strategy and Asset Allocation
General Motors Investment Management Corporation

Mr. Tschampion began his testimony with a description of General Motors Investment Management Corporation ("GM") and its policy with respect to soft dollar trading. GM manages

$65 billion of defined benefit pension funds using both external and internal managers. GM expects its managers to generate reasonable commission costs and monitor their commission practices. GM engages in commission recaptures with primarily one firm, the Frank Russell Company and informs its managers that although they are not required to direct their commission business through Russell Securities, they are encouraged to do so.

Mr. Tschampion spent the bulk of his testimony addressing difficulties in defining what constitutes "research" with respect to soft dollar practices and his recommendations to the working group. There is, for example, "market trading research" in which the broker helps a customer determine what to sell and when. The next level of research consists of useful information generated by a brokerage firm pertaining to the market which can assist a manager in making industry or stock selections. There is also "access research" (an even "softer" form of research) in which the firms pays a third party expert to give his or her views on the market which may only be pertinent to the asset allocation practices of the fund. At each level it becomes increasingly difficult to assess whether the customer should pay for the research provided. Ultimately, Mr. Tschampion believes the test is whether the research aids in the investment decision process for the investment manager's or the client's account.

Because of inherent difficulties in determining which research a customer should pay for, Mr. Tschampion recommends managers simply disclose the services they are acquiring for their commission dollars. In addition, managers should maintain records that disclose both on an individual client basis and on a firm basis services obtained for the commission dollars received. In this way, plan sponsors could determine whether there has been an inappropriate use of commission dollars by investment managers.

The bulk of the questions raised by the panel focuses on GM's commission recapture program. Mr. Tschampion describes the program as recapturing 50 to 70 percent of the commission generated to pay primarily for consulting fees or, in the case of an overage, to pay for other plan expenses noting that any expenses paid for under such a program must be legitimate.

Mr. Tschampion recommended the working group consider further defining "research" under Section 28(e), but concludes that it may ultimately prove very difficult and the working group may be better off simply defining the safe harbor parameters of Section 28(e). Mr. Tschampion believes that it would be very difficult to provide guidelines as to what constitutes "reasonable research" and defers to the guidance provided in the AIMR and CIEBA letters. Finally, Mr. Tschampion recommends that Section 28(e) not be repealed stating that so long as the research is legitimate and enhances the investment decision-making process, systems should not be created to restrict and impair research services.

July 16, 1997 Meeting

ROLAND M. MACHOLD,
Director
New Jersey Division of Investment

Mr. Machold begins his statement with a discussion of the seven pension funds managed by his Division and the Division's position with respect to soft dollar trading. Mr. Machold notes that all pension funds are managed internally together with numerous State funds and that the costs associated with managing such funds are "minuscule" -- slightly less than one basis point. The Division strongly supports use of commission dollars to purchase research and other services for the benefit of pension fund members. The Division also supports full disclosure of all commissions, a clear definition of eligible services and close monitoring and accounting for all commissions. Mr. Machold notes that as all funds are managed internally, there is no conflict of interest between plan sponsors and any managers (internal or third party managers), there is no need to engage in commission recapture programs and there is no need to worry about misappropriation by fund managers.

Mr. Machold spent the bulk of his testimony discussing use of commission proceeds in his funds. Nearly 40% is used to pay for "research services" which include general publications, economic services, performance measurement, corporate research, consultants, subscription services, various information data banks, and certain research packages which may include expenses for travel and room and board. None of the services provide personal advantages to the personnel of the Division or support the general overhead of the Division.

In conclusion, Mr. Machold made the following recommendations: First, the current scope of Section 28(e) as it applies to investment managers and not to plan sponsors remain the same in any amended versions of Section 28(e). Second, a broad definition of research that can be purchased with commission dollars be adopted. As Mr. Machold points out, since research expenses are not paid for by the New Jersey legislature, a broad definition is critical in light of the Division's limited resources, including travel and hotel expenses. The Division would not like to limit the definition either (a) to services which are not customarily available and offered to the public on a commercial basis or (b) to expenses delineated as research versus non-research (as this line is too imprecise). Third, he recommended that the broadest disclosure requirements and any independent reviews are implemented noting the Division reviews and evaluates research and execution capabilities of every broker semi-annually and discloses every transaction and every commission monthly. In sum, Mr. Machold states commission dollars are essential to managing the funds the Division supervises and the Division would oppose any radical changes in the standards and interpretations that are currently expressed in Section 28(e).

KENNETH KAHN
President and Chief Operating Officer
Alpha Management, Inc.

Mr. Kahn testified eighty percent of plan sponsors are either satisfied or very satisfied with their directed brokerage programs. His survey results listed arguments against directed brokerage. First, directed brokerage undermines managers performance by preventing "best execution". Secondly, sequencing of directed trades is a problem. Some directed brokerage firms have poor execution.

Third, managers need commission dollars to purchase research. Proprietary and soft dollar research is necessary to enhance management performance. Fourth, commissions pay for the broker's willingness to commit capital. Lastly, the management of directed trading is an unnecessary burden for the plan sponsor. The savings realized is not worth the time or the commitment required to manage a directed brokerage program.

The arguments for directed brokerage from the survey are as follows. First, "best execution" is no longer the problem. Directed trades are handled exactly the same as non-directed trades. Directed brokers have become major trading firms. There have been created vast global correspondent networks and step-outs. The issue for plan fiduciaries whether the plan derives additional benefits in investment services from their commission dollars.

Second, the issue has become that plans have legitimate needs. Commissions impact the bottom line. Growth of assets and turnover of portfolios have created excess commissions. Eighty percent of a plan's returns are attributable to strategic decisions of the plan. Specific stock selection accounts for only 20 percent of returns. Many plans do not have adequate funding to support internal research requirements.

Third, managers are taking advantage of excess commissions. Purchases of soft dollar services by managers amounts to a second, hidden management fee. Plans who don't direct brokerage may subsidize the plans that do direct. The commission savings are well worth the small effort. Plan fiduciaries are required to have a process for managing investment expenses.
Mr. Kahn supports modification of Section 28(e) to better define "research." Mr. Kahn supports the use of soft dollars because he believes plan sponsors want an unbundling of research and execution because unbundling lowers plan sponsor cost.

JAN TWARDOWSKI
President
Frank Russell Securities

Frank Russell Securities has been in the directed brokerage business since 1969. By combining the buying power of its clients' $700 billion dollars in assets, Frank Russell Securities is able to negotiate favorable directed brokerage pricing with major brokerage firms around the world. Frank Russell clients are able to achieve discounts of 40 to 70 percent from the fully-negotiated commissions clients normally pay. The savings total about $40 million dollars a year. These savings come in the form of rebates from Frank Russell Securities to the client.

In total dollars, directed brokerage dollars are mostly used to pay various Russell fees. Cash refunds to the client is the second most frequent use. Frank Russell Securities also pays third-party invoices for clients primarily in investment analysis, data services, custody fees and consulting services. Payments are made only after a fund fiduciary gives express instructions and states that the expenses are bonafide fund expenses.

Mr. Twardowski reads ERISA as requiring securities firms to provide quarterly statements to clients showing for each transaction a complete breakout of who gets what portion of commissions, how much executing brokers keep, how much clients get back and how much Frank Russell retains. In other words, full disclosure of gross margins.

Frank Russell Securities believes "best execution" remains of paramount importance. Mr. Twardowski believes it is far more important than saving a few cents per share on commissions. Investment managers always retain the best execution responsibility. Frank Russell Securities recommends a maximum of 25% direction by its clients. Frank Russell finds larger percentages can sometimes constrain the broker's ability to achieve best execution.

Mr. Twardowski does not believe there has been abuse of soft dollars in directed brokerage. He could not remember receiving a request that would skirt the edge of the regulations by the DOL or SEC, much less violate them. No investment manager has asked them to pay a service fee that is not clearly within the 28(e) safe harbor. No fund has requested Frank Russell Securities pay for something that is not clearly a legitimate expense of a pension fund.

Based upon Frank Russell's experience, they are of the opinion that commission abuses by managers or funds are not at all wide spread in the pension investment industry. If abuses exist, there appear to be ample and specific remedies under the securities laws and in ERISA for both the SEC and the Department of Labor to correct any abuses as they occur.

Mr. Twardowski doesn't believe pension plans are hurt by Section 28(e). Mr. Twardowski recommends that Section 28(e) be "developed" further through industry rather than regulatory solutions. He believes AIMR will come up with industry input standards that are more specific than Section 28(e) while providing for more disclosure.

TINA BYLES POITEVIEN
President
Fiduciary Investment Solutions, Inc.

Ms. Poitevien testified there are two separate unrelated practices under the soft dollar umbrella. The first is soft dollar transactions that are, when properly structured, covered under Section 28(e) for research purposes. The second is soft dollar transactions not covered under Section 28(e) that involve commissions on orders that plan sponsors direct to a particular brokerage house, i.e. directed brokerage. These dollars are used to obtain research and other products for client's use.

Ninety percent of all money managers in the United States obtain research through the use of soft dollars. Approximately $600 million of brokerage commissions spent annually by money managers are converted into soft dollars. Most studies show a preponderance of soft dollars being expended on market and stock research, security quotations systems and databases.

Statistics state 52% of institutional investors have soft dollar arrangements with brokerage firms or money managers. Within this group, 41.2% of commissions generated through such directed

brokerage arrangements were rebated to pension plans. In addition, the most prevalent use of soft dollars by plan sponsors and trustees was defraying costs of consulting, actuarial and custodian costs. Notably consistent with the institutional investment study, 44.4% of respondents said their plan sponsor clients use directed brokerage for commission recapture.

The controversy surrounding soft dollars basically involves the following:

(1) what constitutes appropriate research service;
(2) what level of disclosure should be provided to consumers of investment management services and products purchased through soft dollars; and
(3) impact of soft dollar transactions particularly in combination with directed brokerage on the ability of investment managers to obtain best price execution.

Any clarification of the definition of legitimate soft dollar expenses should consider the following: (1) what research services are directly related to the investment process; (2) what products or services should be treated as a firm wide overhead expense; and (3) is there a threshold above which the diminishing returns negate legitimate research expenditures. For example, according to a 1991 Greenwich Associates Report, many portfolio managers read only 30 percent of research reports they receive. Managers of the largest funds read only about half of that amount.

Trade groups representing the soft dollar industry claim competition for soft dollars has exerted downward pressure on commission rates and has reduced the cost of execution. Directed brokerage arrangements have particularly been criticized for compromising execution quality. Most studies have found directed brokerage or soft dollar arrangements work best when management strategies consist of "easy trades" such as large capitalization stocks that are exchanged listed and traded in quiet markets.

Tina Poitevien recommends keeping Section 28(e), but requiring increased disclosure and definition of what constitutes research. She suggests use of a definitive list of the types of expenditures representing qualifying research.

HERBERT C. SKINNER, Jr.
President
Investment Performance Services

Mr. Skinner's testimony was limited only to the subject of Commission Recapture Programs (CRP) for pension plans, and not "soft dollars" used by investment managers. He recited under ERISA, trustees are charged with prudent fiduciary responsibility to control plan costs. He noted Commission Recapture Programs allow pension plans to recapture a significant percentage of commissions when executing trades by the plan's investment managers.

If properly structured, with no direction and no minimum dollar amount or specific percentage of business designated, investment managers are not inhibited from achieving "best execution" in the trading process. In fact, execution costs (getting the best price) is much more important than commission charges and can have three times the impact. He emphasized it is critically important that

plan sponsors be offered the largest and best Wall Street brokerage firms included in a Commission Recapture Program.

Mr. Skinner testified the largest brokerage firms offering best institutional execution will not unbundle costs directly to plan sponsors. If they reduce their commission charges below 5-6¢ per share for one manager they would have to reduce for all. Brokerage firms will sell to a firm like his and others, who are NASD members, execution services only at a substantially reduced cost allowing them the ability to rebate to their clients. The main reason they have these relationships is to increase order flow through their trading desks and generate additional commission revenue they otherwise would not receive.

Mr. Skinner pointed out that the worst thing that can happen in a Commission Recapture Program is the plan sponsors receive no "recaptured" rebate. On the other hand, if investment managers can use brokers offered, then plan sponsors can receive a substantial check and reduce expenses up to 50%. This, he emphasized, can be achieved without altering the way investment managers handle their orders and does not inhibit them in any way from receiving "best execution".

BRYCES BARNES
President
Quantel Associates, Inc.

Mr. Barnes stated rather emphatically that SEC Rule 28(e) should be eliminated for pension plans. His argument was the current tangle of exemptions has spawned fixed rate commissions (at close to $.06/share) and an industry of rebaters who function solely to get around these fixed rates. He stated pension funds should be allowed to achieve economies of scale directly by negotiating commissions.

Mr. Barnes articulated that the Pension Welfare Benefit Administration Technical Release 86-1 clearly defines obligations for plan sponsor that become involved in the trading function. He offered the opinion that these obligations are largely ignored by plan sponsors. Therefore, he recommended the Department of Labor add questions to Form 5500 for the plan sponsor to disclose compliance with Technical Release 86-1.

In his final observation, he noted that Schedule C of Form 5500 - Instructions states - "Item 2 of Part I must be completed to report all persons receiving, directly or indirectly, $5,000 or more in compensation for all services rendered to the plan during the plan year". To deal with this he recommended a clarification to the instructions that would require disclosure of service provider fees paid through soft dollars and/or directed brokerage.

HOWARD J. SCHWARTZ
Chairman and Chief Investment Officer
Lynch, Jones and Ryan, Inc.

Mr. Schwartz began his testimony by stating his firm, Lynch, Jones and Ryan, Inc. is probably most responsible for the development of the commission recapture concept. He explained commission

recapture results from plan sponsors directing their investment managers to execute a percentage of equity and fixed income trades through designated brokerage firms. Brokers will then rebate a percentage of income resulting from trades directly back to plan sponsors. Plan sponsors may receive rebates in cash or brokerage firms may pay for plan administrative expenses.

As more brokerage firms entered the commission recapture market increased competition resulted. This competition has resulted in two (2) benefits for plan sponsors. The first benefit is increasing amounts of total commissions are being credited back to plan sponsors. Secondly, competition has resulted in increased plan sponsor education of the potential benefits offered by commission recapture. Approximately 15% of pension plans nationwide are now utilizing commission recapture programs.

Mr. Schwartz then discussed the history of Section 28(e) of the Securities and Exchange Act of 1934 and reasons why it was implemented. Mr. Schwartz believes Congress passed Section 28(e) to allow for payment of research which is a valuable service offered to investment managers and the benefits are passed on to pension clients.

Mr. Schwartz concluded his testimony by outlining plan sponsors' fiduciary responsibility in determining if plan commissions are used to benefit plan participants. Plan sponsors should periodically review how commissions are being used; what portions are allocated for recapture, if any; what portions are used for research; and what portions are needed in trade execution. Plan sponsors should keep in mind that the goal of the fiduciary is to obtain the best return on investments for plan participants while maintaining appropriate risk levels. Trading practices should first seek to obtain best execution and brokerage services are only a small part of the overall investment process.

September 17, 1997

JACK M. MARCO
President
Marco Consulting Group

Mr. Marco testified the good side of directed brokerage is that it provides significant savings to plans and can be used to offset other plan expenses. Done correctly directed brokerage does not interfere with investment managers' execution. The only question is whether investment managers receive the full benefit, in the form of services, of the brokerage directed or if the plan receives any benefit. Plan's should get the benefit of directed brokerage because it represents plan assets. If directed brokerage is done correctly with full disclosure, it can be very beneficial for pension plans.

The bad aspects of directed brokerage include "over directing", where a plan instructs its investment managers to place a very high percentage of trades with a certain broker, and direction programs utilizing discount brokers. Both these practices adversely affect investment managers normal trading patterns. Investment managers have told Mr. Marco a directed brokerage

arrangement should mainly use large institutional brokers for trading. This type of direction does not affect the managers' trading patterns and execution.

From the standpoint of the plan, commission dollars are plan assets but the investment manager may view commissions as perks that they can distribute. There are a lot of brokerage firms from which managers may choose and who they choose to deal with is a perk they can distribute. If used properly, these perks provide managers with research that benefit plans. If used improperly, perks provide investment managers with personal benefit and access to new business.

Another problem is inadequate reporting of what commissions are purchasing. For example, a consultant may offer a service for "free" or a brokerage firm may offer custodial services if the plan uses the brokerage firm for trades. These arrangements often do not spell out how much must be traded through the brokerage firm or how much the commissions are worth. In his experience, such arrangements with no set fee result in total commissions significantly greater than the consultant would get if he established a fixed fee.

Finder's fees are also an ugly problem. In this scenario, a broker/consultant conducts an investment manager search for a plan. However, the consultant only recommends investment managers who if selected will direct a certain percentage of the plan's brokerage to this broker/consultant afterwards.

The easiest, simplest, and currently untraceable way of paying a consultant is through commissions. Many consultants have a brokerage arm or a brokerage clearing arrangement. The investment managers simply trade through the consultant's brokerage arm for the credit of the consultant. Mr. Marco stated he could make more money by accepting such trades than he is making for services he provides to clients. He recommends consultants not accept trades by investment managers unless directed on behalf of one of the consultant's clients and pursuant to a written commission recapture arrangement.

Mr. Marco recommended plan sponsors require consultants to disclosure annually all income they receive directly or indirectly from investment managers. Consultant contracts should state they receives no compensation from any one dealing with the plan and they will report any future compensation from any one dealing with the plan. He acknowledged such disclosure could be a problem for large broker consultants in which the brokerage arm does business with many investment managers but that disclosure could be provided with respect to the consulting division. He feels disclosure is the only way to stop the conflicts of interest.

Mr. Marco also recommended plan sponsors require the pension plan auditor or consultant's independent auditor verify all commissions to the consultant have been properly paid in accordance with client directed brokerage arrangements and that no income has been received from other sources.

Mr. Marco recommended any communication concerning the level of investment managers direction should come from plan sponsors and not from consultants. Also, evidence of a high

level of direction through only particular brokerage firms when the investment manager has full discretion should be the basis for questions by plan sponsors on how they make decisions concerning brokerage firms.

SAMUEL W. "SKIP" HALPERN
President
Independent Fiduciary Services, Inc.

Mr. Halpern discussed problem areas, from his personal experience when consultants are compensated with directed brokerage. First, do investment managers provide the pension plan with quality securities execution if they engage in trading practices to influence investment consultants? Second, what is the value and objectivity of consultants advice concerning both investment managers and their evaluation? Third, are fees (direct and indirect) to both investment managers and the investment consultant reasonable? Finally, are procedures of the plan sponsor adequate to monitor and protect the fund from potential conflicts?

Mr. Halpern noted when a consultant also provides brokerage service--either because the consultant is a subsidiary of a broker-dealer or the consultant affiliates with broker-dealers to offer commission recapture arrangements--it can create problems. If the consultant is an ERISA fiduciary with respect to investment advice, the prohibited transaction rules of ERISA apply. Many abuses that arise are forms of self-dealing and are violations of ERISA's prohibited transaction rules. Even if the consultant is not a fiduciary, problems can still result in liability for plan sponsors and for investment managers. The issue is whether investment managers are using plan assets--commission dollars--in the plan's best interest or their own.

Mr. Halpern stated plan sponsors must focus on what specific functions the consultant is to perform and be alert to possible conflicts with respect to those specific functions. When a consultant advises plan sponsors in selection of investment managers, plan sponsors should require disclosure by both investment managers and consultants. The critical information plan sponsors should seek is whether any investment manager candidates are favored or disfavored by consultants based on their level of trading with broker-dealer affiliates of consultants. Plan sponsors should attempt to determine how much in commissions investment managers have paid to consultant's broker-dealer affiliate in recent years and for what. This question should also be asked with regard to commissions as well as principal trades and bond trades. Plan sponsors should also ask how much trading investment manager candidates will do in the future with consultant's broker-dealer affiliate on this account and all other accounts. Mr. Halpern noted his written testimony materials provided a list of specific disclosure items that plan sponsors should include in request for proposals (RFPs) for consulting services.

When consultants are retained to monitor investment managers' performance, plan sponsors should ask consultants to disclose how much in commission business, fixed income trading or principal trading each of the plan's investment managers is doing through consultant's broker-dealer affiliate not only on the fund's account but on other accounts. Plan sponsors should also ask how much trading involves soft dollars and what does each manager receive in return.

Plan sponsors should ask each investment manager for their current directed brokerage or soft dollar budget. This lists parties to whom investment managers expect to direct commissions during the year and services they anticipate in return. In one case, an investment manager's budget included many entries for well-known investment consulting firms who have broker-dealer affiliates. In each case, the service listed in return for commissions was "performance measurement analysis". The obvious questions for plan sponsors is how much performance measurement analysis does one investment manager need and what is the real motivation for paying these commissions to different consulting firms in the same year and for the same service?

Finally, if consultants are retained to monitor brokerage, plan sponsors should insure consultants have sufficient expertise and independence to perform this function. Either someone independent of consultants, or consultants themselves if they do not have a broker-dealer affiliation, should monitor the conversion ratio in commission recapture or directed brokerage programs, total level of brokerage consultants get, and whether trades through consultants stop after a hard dollar equivalent fee has been reached.

Mr. Halpern made two (2) specific recommendations: First, he stated plan sponsors should separate the consulting function from the brokerage function. Someone without a financial stake in the outcome should monitor different functions. Second, he believes written disclosure both in response to an RFP and on an ongoing basis should be required from both consultants and investment managers listing total amounts of brokerage applicable investment managers do with consultant's broker-dealer affiliate for all accounts.

BARRY BARBASH
Director-Division of Investment Management
Securities and Exchange Commission

Mr. Barbash indicated the Securities and Exchange Commission (SEC) has been very concerned about soft dollar practices since the addition of Section 28(e) to the Securities Exchange Act of 1934. The Commission's concerns stem from the opportunity soft dollar practices provide for a conflict of interest between investment managers and their clients; their potential for causing managers to breach their fiduciary duty to seek best price and execution; and from incentives they provide for a manager to "churn" or over-trade an account in order to generate soft dollar credits. From a broader perspective, the Commission is also concerned soft dollars could lead to market inefficiencies in pricing of both brokerage and advisory services.

Mr. Barbash testified the Commission historically has dealt with the issue of soft dollars by three ways: (1) issuing interpretive guidance as to the meaning and operation of Section 28(e), i.e., what services constitute "research" within the safe harbor; (2) proposing disclosure initiatives; and (3) bringing enforcement actions. He described the enforcement actions as involving either investment managers engaging in illegal activities depriving clients of soft dollar benefits or as nondisclosure cases where investment managers used soft dollars for services other than research.

Mr. Barbash then described some of the Commission's more recent initiatives which tended to focus on disclosure. He described the Commission's 1995 adoption of amendments sought to reflect services received by funds under directed brokerage arrangements. In 1995, the Commission also proposed a rule requiring investment advisers to disclose products and services received from primary brokers and aggregate commission information for each broker. The Commission received many negative comments on the proposal from many sources, including plan sponsors, who thought they could get better information by simply asking their investment managers for information.

Response to the proposed rule contributed to the Commission's decision to conduct a sweep examination because the Commission wanted a full picture of soft dollar practices. Mr. Barbash also clarified at this point that he was speaking for himself, and not on behalf of the Commission. Mr. Barbash next described the Commission's 1997 sweep examination of soft dollar practices, which involved 75 brokers and 280 advisers. He indicated the Commission's report was not yet complete and he could only make preliminary observations on their findings. The Commission found many institutional investors, including registered investment managers, registered investment companies, pension funds, and trust companies, are engaged in soft dollar practices. The Commission also found most soft dollar arrangements are oral, not written, and that a third of the brokers examined provided "non-research, non-execution services". Such services included rent for the manager travel, salaries of personnel, postage, parking, furniture, and, in one case, college tuition. He indicated that such soft dollar payments are not prohibited so long as there is full disclosure and consent by plan sponsors.

The Commission further found brokers viewed soft dollar compliance as investment manager's responsibility, not their own. He indicated Commission staff were surprised at this because they believed that prior statements of the Commission placed some, albeit different, responsibilities on brokers. Mr. Barbash also stated the Commission found a great deal of variability in the quality of disclosure by managers, ranging from 'simple boilerplate" to "well-stated policies". Finally, the Commission found there was considerable confusion about what constituted "research" in terms of applicability of Section 28(e) safe harbor.

Mr. Barbash then offered his views on where the Commission would be focusing in the future. He expected a disclosure initiative aimed at investment managers to be forthcoming as part of revamping Form ADV. He also expected more enforcement actions to be brought as a result of the sweep. Finally, Mr. Barbash noted many trade associations are also focusing on the soft dollar area.

In response to a question about proposed changes to Form ADV, Mr. Barbash indicated they would try to reformulate the questions to receive more specific and clear information. Mr. Barbash indicated the Commission's report on soft dollars would probably be finished sometime in the Fall and may become public. In response to another question, Mr. Barbash indicated in theory, directed brokerage is arranged by plan sponsors so plan sponsors can get benefits resulting from execution. This differs from situations where the benefit goes to the investment managers which involves a conflict of interest and thus disclosure and consent.

STEVEN H. WALLMAN
Commissioner
Securities and Exchange Commission

Mr. Wallman began his testimony by stating he was offering his own personal views on soft dollar practices and not expressing views of the Commission. He explained his approach to the issue focuses less on current legal distinctions and more on where the law should go, why soft dollar practices exist, whether they are inherently "bad", and whether they can be eliminated by changing the underlying economic reasons for their existence. He began this discussion by stating some soft dollar usages, such as funding vacations or college tuition without client consent, are simply inappropriate and constitute "fraud". He indicated such breaches of fiduciary duty, including the duty of best execution are problems regardless whether soft or hard dollars are used to pay for them. He doesn't see the problem as being caused by soft dollars themselves, they are just the currency that is often used.

This led Mr. Wallman to whether there was any reason to distinguish between hard and soft dollars when used to make appropriate expenditures and why soft dollars were being used. He indicated different people use soft dollars for different reasons. He stated the fee table disclosure required of mutual funds led to use of soft dollars to gain competitive advantages because transaction costs are not included in the table. Reducing the amount of reported fees could be accomplished by actually reducing expenses or by directing brokerage to brokers giving soft dollar credits. Since those who do not use soft dollars look like they are charging higher advisory fees to retail investors, usage of soft dollars become pervasive.

Mr. Wallman then testified he believes some public pension funds can face budget problems. When extra expenses arise, public pension funds must either seek additional appropriations, a difficult task, or use soft dollars as an alternative source of revenue. He indicated soft dollars provide an off-balance sheet method of augmenting operating budgets. Turning to investment advisors, he indicated soft dollars allow managers to bid for contracts stating lower expenses and fees than they could demonstrate if paying for everything in hard dollars. While a sophisticated plan sponsor or consultant would understand the effect of soft dollars, Mr. Wallman indicated it could be difficult to explain the differential in rates to oversight committees.

Having explored why different parties used soft dollars, Wallman then discussed possible solutions. He thought eliminating or severely restricting soft dollar usage would not work because current users could simply look to integrated full service providers which utilize "internalized" soft dollars. He also stated eliminating or severely restricting soft dollars could lead to joint ventures and affiliations providing similar bundled services for a flat commission rate. Thus, he did not believe a "regulatory, command and control type of solution" would work. He also thought requiring disclosure of an implied "fair value" of services whether provided by integrated full service brokers or soft dollar arrangements was difficult because of valuation problems. Finally, he did not believe narrowing or clarifying Section 28(e) would get to the root of the problem.

Also, in the question and answer session, Mr. Wallman did answer one question. The summary was, "In response to a question as to whether the commission would consider disclosure in the financial statements by the reporting of embedded transaction fees, Mr. Wallman indicated that reporting of transaction fees is a very complex issue because of the different commission rates and services available, because strategies involving the market impact of large transactions can lead to higher transaction costs, yet lower overall cots since over the counter mark-ups are not considered transaction fees. He indicated that regulating in one area, transaction fees, would just route the behavior elsewhere.

V. WRITTEN MATERIALS PLACED OF RECORD

(Disclaimer: *Official transcripts/executive summaries of the W.G. are available for a fee from the DOL-contracted official court reporter, Bayley Court Reporting, for the April through October, 1997 meetings. Bayley's telephone number is 202-234-7787 and the exact dates of the meetings must be requested. Contact is Mike Shuman. As of the November meeting, the DOL's official court reporting contract changed and that contractor is Executive Court Reporting at 301-565-0064.

Any item ** (double starred) in the index is available for the private source, e.g. association, company, etc., as it is proprietorial in nature. It is not in the purview of the DOL to distribute private organizations' sales and marketing materials.

The final report of the Working Group will be available via hard copy from the Public Disclosure Office of the Pension and Welfare Benefits Administration at 202-219-8771, or via the Department of Labor's Internet Address: http://dol.gov/dol/pwba around the first week of December, 1997. Questions regarding the Council charter, membership, nominations process, study issues and other related matters may be addressed to Sharon Morrissey, Executive Secretary, at 202-219-8921 or 202-219-8753 or via fax at 202-219-5362.)

Index for Soft Dollar and Directed Brokerage Working Group

April 8, 1997 Meeting

a) Agenda
b) *Official Transcript
c) *Executive Summary of Transcript
d) Pre-package from Chairman Wood on Soft Dollar definitions
e) Technical Release 86-1, issued by the PWBA on May 22, 1986
f) Written Remarks of Presentation Made to Working Group by Howard J. Schwartz, President and Chief Executive Officer of Lynch, Jones & Ryan, Inc., who also later provided the **company's Independent Research Sourcebook, Global Edition 1996-1997 and a proposal from the company's Plan Sponsor Services to save money for XYZ Corporation, 1997.

May 13, 1997 Meeting

a) Agenda

b) *Official Transcript

c) *Executive Summary of Transcript

d) "The Provisions of Investment Services by Broker-Dealers: A Guide to Soft Dollar Practices", a white paper provided by Pickard and Dijinis, written by Lee A. Pickard, Senior Partner of this Washington D.C. law firm. (This paper was developed by the Alliance in Support of Independent Research, a group of broker-dealers and other financial institutions with a common interest in fostering a favorable regulatory environment in which research services and products may be furnished to the money management community and in preserving the umbrella of protection that Section 28(e) of the Securities Exchange Act of 1934 provides to fiduciaries receiving research services.)

e) Several news stories including:

1) "Some Regulatory Rain on the Managers' Parade?" New York Times, dated May 11, 1997.
2) "Soft dollar probe: An SEC offensive targets broker-dealers, investment advisors and mutual funds" , Plan Sponsor Magazine, dated April 1997.
3) "Take a Hard Look at Soft Dollar Deals; SEC Scrutinizing Rebates Stock Account Managers Get for Steering Business to Brokers" by Brett D. Fromson, The Washington Post, December 10, 1996.
4) "Soft-dollars Exam Given by SEC: Mutual Fund Advisers are Targeted" by Vineeta Anand, Pensions & Investments, December 9, 1996.
5) "Soft dollars, Hard Sell", Institutional Investor, December 1996.
6) "SEC to Review Brokerages' Payments to Investment Advisers" by Brett D. Fromson, The Washington Post, November 5, 1996.
7) "Changes in Trading Give Investors Edge" by Barry B. Burr, Pensions & Investments, September 30, 1996.

f) Testimony of William F. Quinn, President of AMR Investment Services.

g) Copy of the outline of testimony from witnesses Harold S. Bradley and Robert T. Jackson of American Century Investment Management, Kansas City, Mo., plus:

1) Paper from the 1994 Mutual Funds and Investment Management Conference on Soft Dollars and Other Portfolio Issues, pages 3-11.
2) List of vendors whose services or products can be purchased with soft dollars.
3) Congressional testimony before Subcommittee on Telecommunications and Finance Committee on Energy and Commerce, U.S. House of Representatives, Paul G. Haaga, Jr., Senior Vice President of Capital Research and Management Company, Los Angeles, California, July 13, 1993.
4) Transcript of oral testimony in July before the same Committee by Anson Beard, Managing Director of Morgan Stanley Group, Inc., concerning soft dollar commission practices in securities markets.

June 13, 1997 Meeting:

a) Agenda
b) *Official Transcript
c) *Executive Summary of Transcript
d) Outline of Planned Testimony by R. Charles Tschampion, CFA, managing Director of General Motors Investment Management Corp. (GMIMCo) plus Soft Dollar Schematic and:
   1) Association for Investment Management and Research (AIMR) Letter of May 19, 1995 to Jonathan G. Katz of the SEC on the disclosure by investment advisers regarding soft dollar practices.
   2) Financial Executives Institute's Committee on Investment of Employee Benefit Assets letter, also to Mr. Katz, dated May 15, 1995 on soft dollar practices disclosure.
e) Outline of Teleconference Testimony of Gary Findlay, Executive Director of the Missouri State Employees Retirement System (MOSERS) on Pursuing Objectivity in Investment Consulting, accompanied by a Plan Sponsor Magazine article, November 1996, by Findlay and Steven Yoakum, Executive Director of the Public School Retirement System of Missouri.
f) Outline of Planned Testimony of William A. McIntosh, Financial Consultant, June 13, 1997.
g) Wall Street Journal article, "SEC Brings Action Targeting Abuses of Soft Dollars", May 30, 1997.
h) Written testimony of Roger D. Blanc, Wilkie Farr & Gallagher on Soft Dollar Practices of Brokers, Investment Managers and Hedge Funds.

July 16, 1997 Meeting:

a) Agenda
b) *Official Transcript
c) *Executive Summary of Transcript
d) Prepared Remarks of Roland Machold, Director of the Division of Investments, New Jersey Division of Investments, Newark, NJ.
e) "Directed Brokerage - The Arguments for and Against" and "Two perspectives on Plan-Sponsored Directed Brokerage" presented by Kenneth Kahn, President and Chief Operating Engineer, Alpha Management, Inc.
f) Testimony Outline from Jan Twardowski, President of Frank Russell Securities, Tacoma, WA.
g) Testimony of Tina Poitevien, President and Chief Executive Officer, FIS Funds Management, Inc.
h) Outline from Bryce Barnes, President, Quantel Associates, Inc.
i) A Presentation by Herbert C. Skinner, Jr., President and Principal, Investment Performance Services.
j) Outline of presentation of Howard J. Schwartz, President, Lynch, Jones & Ryan and a **copy of the Securities Industry Association's pamphlet on "Best Practices:A Guide

for the Securities Industry." Also included is a news release issued by SIA on Schwartz's appointment to the panel chairmanship.

k) Pensions & Investments article: "Ennis, Knupp Cuts Soft Dollars", June 23, 1997.

l) Letter from William A. McIntosh, Independent Consultant and June witness, as a follow-up to his appearance.

September 17, 1997 Meeting:

a) Agenda

b) *Official Transcript

c) *Executive Summary of Transcript

d) Testimony Summaries from Working Group Chairman to elicit group members to prepare summaries in advance of drafting final report.

e) Testimony of Jack M. Marco, President, Marco Consulting Group.

f) Testimony of Samuel W. "Skip" Halpern, Independent Fiduciary Services, Inc.

g) Written testimony of Christopher Tobe, CFA, President of the Louisville, Ky., Society of Financial Analysts.

h) Written testimony of Karen L. Barr, General Counsel, Investment Counsel, Association of America, Inc.

i) "Pros, Cons on Directed Brokerage" news story on Kenneth L. Kahn, July witness, from September 15, 1997 Pensions and Investments.

October 8, 1997 Meeting:

a) Agenda

b) *Official Transcript

c) *Executive Summary of Transcript

d) Overview of Witnesses" Recommendations for W.G. to decide which ones it would include in its final report

e) "A Soft $$ Program Without Performance Remorse", Wayne Wagner, Plexus Group.

November 13, 1997 Meeting

a) Agenda

b) *Official Transcript

c) *Executive Summary of Transcript

d) Final Report of the Working Group for 1997 (Not available until it has officially gone forward to the Secretary of Labor. Anticipate its release the first part of December in hard copy and on the Internet)

e) Letter from the Association of Investment Management and Research, dated November 7, 1997, requesting a delay of the W.G.'s report until it had issued its report on the subject.

VI. 1997 SOFT DOLLAR AND DIRECTED BROKERAGE WORKING GROUP MEMBERS

James O. Wood, Chairman (11/95-98)
Louisiana State Employees' Retirement System

J. Kenneth Blackwell, Vice Chairman (11/96-99)
Treasurer, State of Ohio

Michael R. Fanning (11/96-99)
Central Pension Fund International
Union of Operating Engineers and Participating Employees

Carl S. Feen (11/94-97)
CIGNA Financial Advisors

Thomas J. Healey (11/94-97)
Goldman, Sachs & Company

The late Vivian Lee Hobbs (11/95-98)
Arnold and Partner

Marilee P. Lau (11/95-98)
KPMG Peat Marwick, LLP

Dr. Thomas J. Mackell, Jr. (11/96-99)
Simms Capital Management, Inc.

Joyce A. Mader (11/94-97)
O'Donoghue & O'Donoghue

Zenaida M. Samaniego (11/94-97)
Equitable Life Assurance
Society of the United States