



SEC Proposes Brokerage Practice Guidance for Fund Boards

The SEC has issued a release proposing guidance about how mutual fund boards can discharge their responsibility to oversee the fund portfolio trading practices followed by the funds' investment advisers. The proposals, which have been widely expected for some time, are included in Release No. 34-58264 (July 30, 2008), which is available [here](#).

The SEC has invited interested parties to comment on the proposed guidance on or before October 1, 2008.

The release acknowledges that a fund's adviser is primarily responsible for making the difficult judgments required in determining the extent to which a fund is obtaining best execution of fund portfolio transactions and what services and products can be acquired in reliance on the safe harbor of Section 28(e) of the Securities Exchange Act. The release also acknowledges that a fund board's responsibility in these matters is primarily to exercise oversight.

Nevertheless, the release sets forth certain difficult determinations that the SEC proposes fund boards must or should make in exercising their oversight function. (We itemize some of these determinations in the bullet points that appear further below.) In this respect, however, the release pushes fund boards to assume a degree of responsibility for fund portfolio trading practices that may go beyond mere oversight and that fund boards may not be well equipped to fully discharge.

The release provides only limited guidance to assist fund boards in discharging any such responsibilities. The release does itemize numerous types of information that boards should or may obtain to assist them in making the determinations that the release expects of them. It is foreseeable, however, that in many cases such information will only be the starting point for what will remain a difficult and uncertain analysis.

Set forth below are some of the statements in the release that contemplate that fund boards will make various determinations:

- "It is imperative that the fund's directors both understand and scrutinize the payment of [portfolio trading] transaction costs by the fund and determine that payment of transaction costs is in the best interest of the fund and the fund's shareholders."
- "The fund's board, in providing its consent [to any conflicts of interest in connection with the adviser's trading practices], should...satisfy itself that the adviser is fulfilling its fiduciary obligations and is acting in the best interest of the fund."
- "[F]und directors should determine whether the adviser's trading practices are conducted in the best interests of the fund and the fund's shareholders."
- "[A]lthough a fund adviser may satisfy the requirements...under the section 28(e) safe harbor, a fund's directors still should evaluate the adviser's use of fund brokerage commissions to purchase research and services to determine whether the adviser is acting in the best interest of the fund."

Other language in the release at least implies (but does not so specifically state) that the board will make certain determinations. For example, with respect to a fund adviser's obligation, when relying on Section 28 (e), to determine in good faith that the amount of commissions paid is reasonable in light of certain products and services provided by the broker-dealer, the release states: "An adviser should demonstrate to the board that it has met this burden.... We also request examples of effective practices fund boards employ when evaluating whether an adviser has made the good faith determination required under Section 28(e)." The implication seems to be that a board in each case should make a judgment about whether the adviser has made the necessary good faith determination.

Similarly, the release states:

In directing the adviser, the board also should consider such matters as: (i) whether it is appropriate for the adviser to refrain from purchasing research services in connection with certain types of trades, depending on market conditions; (ii) whether it is appropriate for the adviser to use fund brokerage commissions to receive brokerage and research services on some or all trades; (iii) whether fund brokerage commissions should be used only in connection with a commission recapture or expense reimbursement program; and (iv) whether some combination of these alternatives may be in the best interest of the fund.

Again, the release states: "Fund directors should...consider whether the adviser properly accounts for use of fund brokerage commissions to purchase research that primarily or solely benefits another client of the adviser."

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