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May 3, 2005

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Ontario Securities Commission  
SECRETARY'S OFFICE

c/o John Stevenson, Secretary  
Ontario Securities Commission  
20 Queen Street West  
Suite 1903, Box 55  
Toronto, Ontario M5H3S8

Re: Concept Paper 23-402 Issued by Ontario Securities Commission

Ladies and/or Gentlemen:

Lynch Jones & Ryan, Inc. ("LJR") is pleased to take this opportunity to respond to certain of the questions contained in the concept paper issued by the Ontario Securities Commission ("OSC") entitled Best Execution and Soft Dollar Arrangements (the "Concept Paper"). As the originator of commission recapture, LJR is anxious that OSC be made aware of how commission recapture works and how commission recapture has benefited pension plans. Since LJR began commission recapture in 1986, we have saved our clients over \$500,000,000 in recaptured commissions. These savings have been achieved without changing how the pension plan's managers handle their trading. Commission recapture has been a potent tool for pension plans in their efforts to reduce costs for their participants.

We have responded below to Questions 18 and 19 from the Concept Paper. Commission recapture and directed brokerage are issues of great importance to us and we are grateful for this opportunity to participate in the regulatory discussion currently taking place in Canada.

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**Question 18: Should directed brokerage or commission recapture arrangements be limited or prohibited?**

Response: No. A commission recapture arrangement may provide substantial benefits to a fund and its shareholders. By way of background, a commission recapture program is required to exclusively benefit the client whose commissions are used

in a commission recapture arrangement. Commission recapture arrangements used to pay a portion of a fund's expenses generally can benefit a fund by lowering its expenses at no additional cost to the fund. In connection with the allocation of a fund's portfolio transactions, the fund's adviser has the fiduciary obligation to obtain best execution – *i.e.*, to execute the transactions in “such a manner that the [fund's] total cost or proceeds in each transaction is the most favorable under the circumstances.”<sup>1</sup> However, the “determining factor is not the lowest possible commission cost but whether the transaction represents the best qualitative execution” for the fund.<sup>2</sup> In the US, each fund's board has a responsibility to obtain assurance that, in participating in a commission recapture program, the fund is receiving best execution of its portfolio trades.<sup>3</sup> In fulfilling their obligations, the board and the adviser should consider the full range and

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<sup>1</sup> Securities Exchange Act Release No. 23170 (April 23, 1986) (“Release 23170”). A broker-dealer's duty to obtain best execution derives from the common law duty of reasonable care to obtain the most favorable terms for its customers. *See Market 2000: An Examination of Current Equity Market Developments*, Division of Market Regulation, United States Securities and Exchange Commission, Study V, “Best Execution,” pp. V-9 – V-15 (Jan. 1994) (“Market 2000 Study”) at V-1; *See also*, Restatement (Second) of Agency, §§ 387, 424 (1958).

<sup>2</sup> Release 23170, *supra*. The Department of Labor (“DOL”), in discussing analogous plan sponsored commission recapture arrangements governed by ERISA, has stated that:

In directing a plan's brokerage transactions, the sponsor has an initial responsibility to determine that the broker-dealer is capable of providing best execution for the plan's brokerage transactions. In addition, the sponsor has an ongoing responsibility to monitor the services provided by the broker-dealer so as to assure that the manager has secured best execution of the plan's brokerage transactions and that the commissions paid are reasonable in relation to the value of the brokerage and other services received by the plan.

ERISA Technical Release No. 86-1 [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,009 (May 22, 1986).

<sup>3</sup> *See, e.g.*, Investment Company Act Release No. 20472 (Aug. 11, 1984) (“Release 20472”) (stating that “a fund's board of directors or trustees, in connection with its review of brokerage allocation policies, should be informed of the fund's brokerage/service arrangements and the effects of the arrangements on fund expenses and commission rates”).

quality of a broker's services, including execution capability, commission rate, financial responsibility, and responsiveness to the adviser.<sup>4</sup> We believe that a fund's board, in exercising its business judgment regarding whether to participate in a commission recapture program, can consider, among other factors, the value of the services which are paid for in deciding whether the fund is obtaining best execution through a commission recapture program. In sum, with the appropriate principles in mind, a commission recapture program can provide significant value to a fund and should therefore not be limited or prohibited.

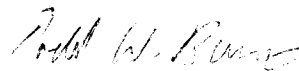
**Question 19: Should disclosure be required for directed brokerage or commission recapture arrangements?**

Response: In the US, disclosure of recapture arrangements extends beyond the disclosure necessary for an adviser to fully inform a fund (or insiders) of the potential for recapturing a portion of brokerage commissions. Registered investment advisers are subject to disclosure duties in regards to brokerage allocation decisions. The level of detail of disclosure, however, will vary among advisers and fund groups. For example, in preparing its fee table, financial highlights table, and related disclosure, each fund participating in a commission recapture program must, to the extent relevant, consider the applicable Form N1-A disclosure requirements in the context of its overall expense arrangements for purposes of adequately disclosing the effects of the recapture program on its expense information. Investment advisers not required to be registered with the SEC also are subject to disclosure obligations under broad antifraud principles, as well as state laws related to investment advisers, and would be required to disclose brokerage allocation decisions due to their materiality. As noted above, an appropriate disclosure requirement should provide a sufficient protective level, consistent with what the OSC appears to be most interested in providing the investing community.

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Should you wish to discuss these matters further, we would be pleased to arrange for a meeting in which to do so. Thank you for allowing LJR to comment on the Concept Paper.

Very truly yours,



Todd W. Burns  
President

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<sup>4</sup> Release 23170, *supra*.