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Via Electronic Filing

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: File No. S7-25-99, Proposed Rule 202(a)(11)-1
Certain Broker-Dealers Deemed Not To Be Investment Advisers

Dear Mr. Katz:

Charles Schwab & Co., Inc. ("Schwab") appreciates this opportunity to comment again on proposed Rule 202(a)(11)-1, answer questions the Commission posed when it reopened the comment period, and recommend several changes to the rule that will help assure investor protection and a level playing field among firms that provide advice. We believe that independent advisors have raised some important considerations that can be addressed through this rulemaking. Specifically, we are in agreement with independent advisors about the need to tighten disclosure, and we want to make sure that industry rules require that all investment professionals do the right thing for the investor.

Although particular issues can be addressed in a rulemaking, Schwab believes that the current debate over this rule highlights a lack of clarity in the industry and, more importantly, with the investing public, about the respective roles and obligations of investment advisors and brokers. The time may be ripe for a comprehensive review of the separate statutory schemes for investment advisors and broker-dealers in light of how professional roles have changed over the years. This may lead to recommendations to Congress for fundamental reforms in how investment advisors and broker-dealers are regulated. In the very least the Commission should clarify when investment advice is "solely incidental to brokerage." A functional approach is consistent with the Commission's statement in the proposing release that "the nature of the services provided, rather than the form the broker-dealer's compensation takes," should be the primary determinant of regulatory status. Under a functional approach, holding yourself out as offering a discrete financial planning service for a fee, or providing any type of discretionary portfolio management no matter the form of compensation, should fall under the Investment Advisers Act.

Schwab is proud to be the industry leader in serving the needs of independent investment advisors and in referring our clients who want and need discretionary advice or customized financial planning to independent advisors. We understand the tremendous value and expertise that investment advisors provide to investors with those needs.

Investors have a range of needs and want choices in how they receive and pay for investment services, including advice. Many do not need ongoing advisory relationships, and do not want to pay for occasional advice through the full commission brokerage model. Proposed Rule 202(a)(11)-1 has enabled Schwab to fill a gap for these investors who otherwise would not have ready access to advice on their terms from a professional. Schwab believes that individual investors deserve a choice in their relationships with investment professionals, whether with a broker and/or an investment advisor, and a choice in how to pay for those services.

In reopening the comment period, the Commission has asked whether the "current fee-based programs more closely align the interests of investors with those of brokerage firms and their registered representatives." Generally speaking, asset-based fees, as well as flat fees for investment advice, can eliminate potential conflicts of interest between brokers and their clients arising from the traditional brokerage model of paying registered representatives based on trading commissions. This was a key conclusion of the Committee on Compensation Practices ("Tully Commission"). Just as important for investors, fee-based programs can bring greater transparency to brokerage service pricing by unbundling the fee for advice from the commissions for trade executions.

Over the last four years, for a comparatively modest fee and without raising our trading commissions, Schwab brokers have been able to offer non-discretionary advice to clients relating to their securities purchase and sale decisions. In giving advice, our brokers rely to a great extent on the internal research Schwab produces as a broker-dealer. As the Commission stated in 1999, traditional brokerage programs have always included a component of advice, but fee-based programs make the fee transparent instead of hidden within a higher commission schedule. This is the case at Schwab, where if a client wants advice, it is available for a defined fee separate from trading commissions or as part of a fee-based service. If a client wants only execution services, he or she pays for them through transaction commissions (when applicable). Clients are able to understand what they are paying for, and only have to pay for what they get. In this regard, the proposed rule facilitates investor protection.

The Commission also asked whether there would be an impact on broker-dealers if it elects not to adopt a final rule. As we have informed the Commission's staff on a number of occasions, Schwab has relied on the proposed rule and the staff's related "no action" position to offer investors expanded choice about how to pay for brokerage services. We have told the clients enrolled in our non-discretionary advice services that we are not acting as an investment advisor, consistent with the 1999 proposing release. A Commission decision not to adopt a final rule would disrupt our ongoing relationships

with these clients, who would be faced with a confusing change in how we serve them, process their orders, and give them advice. If the Commission changes its position, we would continue to serve the needs of these clients but would have to go through a costly transition period and incur new ongoing compliance costs, all with respect to the advice we provide now incidental to our brokerage services. The additional Adviser Act requirements – layered on top of the extensive broker-dealer investor protection rules we already comply with including new appropriateness guidelines from our SROs governing fee-based accounts – would add substantial additional expense, putting upward pressure on the fees that we currently set to maximize investor access and affordability.

The third question the Commission asked is whether it should require broker-dealers to register as investment advisors if they use terms like "investment advice" in advertising, or "is a prominent disclosure that an account is a brokerage account sufficient to alert an investor to the nature of the account?" Although we are not aware of investor complaints or confusion arising from broker-dealers following the requirements of the proposed rule, we agree with many of the comments from independent advisors and others that the disclosure should be more robust to eliminate that possibility. Clear and prominent disclosure is the key, rather than prohibiting plain-English accurate descriptions of a brokerage service as including "investment advice." To this end, we recommend that the Commission adopt a more exacting disclosure requirement:

> (a) The firm is acting as a broker-dealer and not as an investment advisor, (b) the non-discretionary investment advice provided is part of a brokerage service, and (c) the account is a brokerage account and not an investment advisory account governed by the Investment Advisors Act of 1940.

In addition to enhancing the disclosure, there are other clarifications we ask the Commission to make in the final rulemaking to assure that brokerage advice services are treated equally and that the rule does not advantage a particular business model or type of fee. The proposing release only discussed in detail two factual situations where a broker-dealer would not be deemed an investment adviser under the rule. The first situation is a broker who charges an asset-based fee on a non-discretionary account for services that include advice. The second situation is a "full service" broker who offers an alternative, reduced commission schedule for execution-only brokerage. The adopting release should confirm that any form of compensation arrangement is covered under the rule, provided that the advice is non-discretionary and solely incidental to brokerage. Consistent with the unbundling and transparency rationale in the proposing release, this includes a flat fee for advice where related trade executions are separately priced.

Because dual registrant firms like Schwab act as both broker-dealer and investment advisor depending on the activity, it is important for the Commission to acknowledge that a dual registrant can have both a brokerage and an investment advisory relationship with the same client. For example, when a registered representative refers a client to an investment advisor (such as with a managed account or wrap fee program), he

or she is acting in an advisory capacity and must provide the disclosure brochure and meet other requirements under the Advisers Act. That same client may have enrolled in other services from the broker-dealer for which he or she is receiving incidental advice under the proposed rule. Finally, to avoid confusion the final rule should reflect the fact that broker-dealers provide advice to clients (or customers), not to "accounts."

We appreciate this opportunity to comment on the proposed rule and to suggest ways to strengthen it to promote the interests of investors and to assure a level playing field. I would be happy to address any questions that you may have.

Very truly yours,

Christopher P. Gilkerson

Cc: Chairman William H. Donaldson
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