September 22, 2004

By Electronic Filing and Messenger

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

Re: *Release Nos. 34-50213; IA-2278; File No. S7-25-99; Certain Broker-Dealers Deemed Not To Be Investment Advisers*

Dear Mr. Katz:

The Personal Financial Planning Executive Committee ("PFP Executive Committee" or the "Committee") of the American Institute of Certified Public Accountants ("AICPA") respectfully submits the following comments on the Securities and Exchange Commission's ("the Commission") proposed rule regarding Certain Broker-Dealers Deemed Not to be Investment Advisers ("the Rule").

The American Institute of Certified Public Accountants is the largest national, professional organization of CPAs, with more than 340,000 members in business and industry, public practice, government, and education. It sets ethical standards for the profession and U.S. private auditing standards. It also develops and grades the Uniform CPA Examination. Among its members are registered investment advisors, personal financial planners and CPAs serving broker-dealers. The PFP Executive Committee of the AICPA determines technical policies regarding personal financial planning and serves as the official representative on those matters. The Committee supports nearly 80,000 CPAs who provide personal financial planning services as part of their financial planning or tax practices.

Overview and Recommendations

The PFP Executive Committee commends the Commission's efforts to provide guidance to broker-dealers regarding the application of the Investment Advisers Act of 1940 ("the Advisers Act") to their current business practices. However, we do not believe the proposed rule, as it is currently written, adequately protects the interests of investors. Further, the Committee believes the rule will lead to greater investor confusion regarding the differences between an advisory service and a brokerage service.

A primary distinction between an advisory service and a brokerage service exists in the level of responsibility that must be afforded to the investor. By law, an investment adviser owes a primary duty of loyalty to the client's best interest, foregoing personal gain when necessary to protect the interests of the client. The responsibilities of a broker-dealer, however, do not rise to the same fiducial level of responsibility to investors. Broker-dealer representatives are held to a standard of suitability and knowledge of the client, but duty of loyalty is to their broker-dealer under the agency relationship. As fiduciary responsibility is paramount to the objectivity and integrity of investment advice, the Commission must maintain a clear division between investment advisory services and brokerage services.

Although the intent of the Commission's rule is to minimize the burden of dual registration and regulation for certain broker-dealers, the risks to investors are substantial. Broker-dealers are not bound to the same fiduciary standards as investment advisors. Accordingly, when broker dealers advertise their services, there is significant risk they may simply use the investment advice to sell their brokerage services. The Commission states that "[it has] observed that some broker-dealers offering these new accounts have heavily marketed them based on the advisory services provided rather than the execution services, which raises troubling questions as to whether the advisory services are not incidental to the brokerage services."

Following the recent market downturns, corporate scandals and the shift in the burden of retirement savings from employers to employees, objective and prudent investment advice is crucial to investor protection. Even with the proposed disclosures, the PFP Executive Committee does not believe investors will fully understand the differences between an advisory and a brokerage account.

To insure investor interests are adequately protected, the PFP Executive Committee proposes the following substantive changes to the proposed rule:

1. As broker-dealers shift their business strategy from "full-service" commission programs to fee-based programs, the "solely incidental" exception from the Advisers Act should be more clearly defined so broker-dealers can reasonably determine when registration with the Commission is required.
2. All discretionary accounts should be treated as advisory accounts, regardless of the form of compensation received.
3. Factors other than discretionary authority should be considered when determining whether a broker-dealer is an investment adviser and should register with the Commission.
4. Broker-dealers who would rely on the rule should not be permitted to hold themselves out to the public in marketing and advertising materials as providing investment advisory services.
5. The required disclosures to investors should be written in such a way that an average investor would easily understand the differences between a brokerage account and an advisory account.

If the Commission is unable to make the recommended modifications to the proposed rule, the PFP Executive Committee respectfully requests that the Commission withdrawal the rule in its entirety.

Proposed Rule - Section 202(a)(11)

The Advisers Act regulates the activities of certain "investment advisers.[1]" Specifically excepted from the definition of an investment adviser, is "any broker or dealer whose performance of such [investment advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore.[2]"

The Commission's staff interpreted the investment adviser definition in an Investment Advisers Act Release No. IA 1092, October 8, 1987, to mean, generally, that "if the activities of any person providing integrated advisory services satisfy the elements of the definition, the person would be an investment adviser... unless entitled to rely on one of the exclusions [including the broker-dealer's exception] from the definition of investment adviser." The Commission noted that a facts and circumstances approach is to be used to determine who is required to register under these rules.

Under the proposed rule, a broker-dealer providing investment advice to customers, regardless of the form of its compensation, would be excluded from the definition of investment adviser as long as: (1) the advice is provided on a non-discretionary basis; (ii) the advice is solely incidental to the brokerage services; and (iii) the broker-dealer discloses to its customers that their accounts are brokerage accounts. The rule also would keep a broker-dealer providing advice to customers from being subject to the Advisers Act solely because it also offers execution-only brokerage services at reduced commission rates. Finally, the proposed rule would clarify that broker-dealers that are subject to the Advisers Act are subject to the Act only with respect to advisory clients.

According to the Commission, "[t]he new [broker-dealer] programs essentially re-price traditional full service brokerage programs but do not fundamentally change their nature. Subjecting broker-dealers that offer these programs to the Advisers Act would impose unnecessary regulatory burdens on the provision of brokerage services contrary to the intent of Congress when it passed the Advisers Act." The Commission further states "[u]nder the fee-based programs…a broker-dealer's or registered representative's compensation no longer depends on the number of transactions or the size of mark-ups or mark-downs charged…"

The Commission states that Proposed Rule 202(a)(11)-1 would "keep a full service broker-dealer from being subject to the Act solely because it also offers execution-only brokerage services." The Commission also indicates "a broker-dealer would not be considered to have received special compensation solely because the broker-dealer charges a commission,

[1] 15 U.S.C. 80b-2(1)(11)
[2] 15 U.S.C. 80b-2(1)(11)

mark-up, mark-down or similar fee for brokerage services that is greater than or less than one it charges another customer."

PFP Executive Committee of the AICPA - Comments and Recommendations

In its request for comments, the Commission asks "[whether] current fee-based programs more closely align the interests of investors with those of brokerage firms and their registered representatives than do traditional commission-based services?" The Committee recognizes that investors are increasingly demanding more options for receiving and paying for investment services. With the emergence of low-cost, online trading and a growing investor resistance to high commissions, broker-dealers have pursued new service models to offset diminishing revenues from their transactional-based services.

Although the adoption of fee-based programs by broker-dealers is in direct response to the growing investor demand, the Committee cautions the Commission in adopting rules that would further blur the distinctions between brokerage and investment advisory services. The proposed rule has generated much disagreement and debate amongst investment advisors and broker-dealers. As such, the Committee is concerned that even with the required disclosures and restrictions on the applicability of the proposed rule, most investors would not fully understand the differences between an investment advisory account and a brokerage account which provides "solely incidental" investment advice.

The "incidental to brokerage services" exception.

The Commission frequently refers to "incidental" and "solely incidental" in the proposed rule but does not define such terms. The Commission should provide further definitional guidance or examples, such as it has provided with wrap fee programs, for which the investment adviser services are not considered incidental to the brokerage services. Such additional factors which may cause a broker dealer to be outside the exception include whether:

- The investor entrusts substantial control over financial affairs to the broker-dealer,
- There is more than customary reliance on the broker-dealer's advice,
- A substantial disparity exists in the relative knowledge of the broker-dealer and the investor, or
- The frequency or volume of ongoing advice provided by the broker-dealer is substantial

All discretionary accounts should be treated as advisory accounts regardless of the form of compensation received.

The Commission states in the proposed rule "the new [fee-based] programs essentially re-price traditional full service brokerage programs but do not fundamentally change their nature." However, the Commission considers "[d]iscretionary accounts that are charged an

asset-based fee would be considered advisory accounts" whereas "discretionary accounts from which a broker-dealer does not receive special compensation, e.g., accounts that pay commissions, would still be treated as brokerage accounts not subject to the [Adviser] Act." If the fee-based broker-dealer programs are merely a re-pricing of full-service commissioned programs, then the method of compensation should not be considered a factor in determining whether a discretionary account is an advisory account. As the risk for potential abuse of investors within a discretionary account is high, the PFP Executive Committee believes the Commission should treat all discretionary accounts, regardless of the form of compensation, as advisory accounts.

Factors other than discretionary authority should also be considered when determining when a broker-dealer is also serving as an investment adviser.

The Commission has only applied a standard of "discretionary control" when determining whether a broker-dealer is an investment adviser. In developing the proposed rule, the Commission has further adopted a standard of substance over form to assess whether a broker-dealer has attained investment adviser status. According to the Commission, investment advisor status would be determined based on the nature of the services performed for a client rather than on the form of the broker-dealer's compensation.

In applying this substance over form standard to the services of a broker-dealer, situations may arise in which a broker-dealer does not have discretionary authority over a client's assets but nonetheless holds significant power or control over the client's account. Such a situation may arise where a client places unusual or special reliance on the investment advice of the broker-dealer and the broker-dealer is aware of such reliance. A broker-dealer may also have provided "solely incidental" advice over the course of many years as a result of which the broker-dealer has become a trusted advisor. In such situations, the broker-dealer may be deemed an investment adviser, even though discretionary authority is not present. In assessing the substance of the broker-dealer's services, the Commission should consider all factors which may elevate a broker-dealer's services to those of an investment advisor.

Broker-Dealers who Rely on the Proposed Rule Should Not be Permitted to Hold Themselves out to the Public as Providing Investment Advisory Services in Marketing and Advertising Materials

As stated previously, the Commission has observed "that some broker-dealers offering these new [fee-based] accounts have heavily marketed them based on the advisory services provided rather than the execution services." If the investment services are truly incidental to the broker-dealer's brokerage services, then the marketing and advertising should also reflect the incidental nature of those services. Broker-dealers who hold themselves out to the general public in advertisements and marketing as providing investment advisory services should be required to register as investment advisors.

The Broker-Dealer Discloses to Its Customers that Their Accounts are Brokerage Accounts

The proposed rule would require that all advertisements for the accounts and all agreements and contracts governing the operation of the accounts contain a prominent statement that the accounts are brokerage accounts and not advisory accounts. In comment letters submitted to the Commission, a few representatives of broker-dealers requested a change in the disclosure requirements from "prominent" display to a lesser-defined standard to "clearly disclose." The Committee believes that modifying the rule to affect a lesser standard to "clearly disclose" would permit broker-dealers to publish their required disclosures in the "fine print" rather than prominently on the face of the documents.

The PFP Executive Committee believes that disclosures should be provided to investors to not only clearly disclose, but prominently disclose which services the investor will and will not be receiving from the broker-dealer. Further, the disclosures should be written in such a way that an average investor would easily understand.

Conclusion

The PFP Executive Committee of the AICPA supports the efforts of the Commission to clarify the application of the Advisers Act as it relates to broker-dealers and their representatives. As investor reliance on independent and objective investment advice is critical in today's economy, it is imperative that the Commission protect the interests of investors by maintaining a clear and distinct separation between investment advisory and brokerage services. If the Commission is unable to develop clear disclosure requirements and maintain a clear delineation of advisory and brokerage services, the Committee respectfully requests that the Commission withdraw the rule.

Sincerely,

Joel H. Framson

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