March 11, 2005

***BY ELECTRONIC MAIL (rule-comments@sec.gov)***

Jonathan G. Katz, Secretary
Securities and Exchange Commission
450 Fifth Street, NW, Washington, DC 20549-0609

Re: File Number S7-25-99 — Certain Broker-Dealers Deemed Not To Be Investment Advisers (Release No. 34-50980, January 6, 2005)

Dear Mr. Katz:

Northwestern Mutual Investment Services, LLC ("NMIS") submits this comment letter to amplify certain points made in our prior letters, dated September 22, 2004, and February 7, 2005, on the proposed rule.

**I.**

The proposed rule includes a requirement that "[a]dvertisements for, and contracts, agreements, applications and other forms governing, accounts for which the broker or dealer receives special compensation include a prominent statement that the accounts are brokerage accounts and not advisory accounts; that, as a consequence, the customer's rights and firm's duties and obligations to the customer, including the scope of the firm's fiduciary obligations, may differ."

As we noted in our prior comment letter, we understood this portion of the rule to specify the subject matter of the required disclosure, and not the literal disclosure language itself. We now understand that consideration is being given to a specific, literal "one size fits all" disclosure statement, a kind of "Surgeon General's Warning" for all advertisements for, and contracts, agreements, applications and other forms governing fee-based brokerage accounts.

We had previously commented that if a literal disclosure is to be specified in the rule, the language must be very general if it is to be brief, understandable and universally accurate. While we believe the language in the reproposed rule is adequate in terms of describing the subject matter of the required disclosures, it is not really suitable for a standard legend.

For example, if the language in the proposed rule were read literally, we might expect to see all advertisements for, and contracts, agreements, applications and other forms governing fee-based brokerage accounts to include a statement something like the following:

> **The accounts are brokerage accounts and not advisory accounts; that, as a consequence, the customer's rights and firm's duties and obligations to the customer, including the scope of the firm's fiduciary obligations, may differ.**

We assume that a close paraphrase, adapted to the context of the disclosure, would be acceptable. For example, advertising and contracts are both appropriate places for this kind of disclosure, but the context might make the exact language from the rule grammatically awkward. In either case, for example, the legend might be more understandable if it referred to the brand name, if any, for the account. It also might be more understandable if plain English conventions, such as using the pronouns "you" and "your" and "us" and "our" could be used in the appropriate contexts.

Even if our assumptions about the acceptability of plain English and close paraphrases are correct, there remain at least two weaknesses with the language in the proposed rule. First, it might be read to suggest that all advisory "accounts"[1] result in the same duties and obligations to customers, a suggestion that we do not believe to be correct as set forth below.

Second, it seems to assume that all customers have some baseline understanding of an investment adviser's duties and obligations, and can therefore understand the significance of the statement that that a firm's duties and obligations "differ" for a fee-based brokerage account. We think customers who know enough to understand what "fiduciary obligations" are and who otherwise understand the significance of the disclosure language in the proposed rule are the least likely to need the information it contains.

We appreciate both the potential value of uniform disclosure language and also the difficulty of drafting it in a form that is brief, understandable and universally accurate. We offer the following alternative language for "advertisements for, and contracts, agreements, applications and other forms governing" fee-based brokerage accounts:

> **The accounts are brokerage accounts and not advisory accounts. Make sure you understand the services offered and your rights and obligations before opening any account or engaging any adviser.**

A disclosure such as this one, which acknowledges that both fee-based brokerage accounts and advisory accounts cover a range of diverse services, encourages informed choice, which is consistent with the policy underlying the proposed rule, and further inquiry, which is consistent with the portion of subparagraph (iii) that requires a broker-dealer to identify a source for information of this nature. By suggesting that a customer might consider addressing similar inquiries to the broker-dealer offering the fee-based accounts as well as to competing broker-dealers and investment advisers, it would help to maintain a level playing field between the different kinds of firms offering investment advice. It also avoids the risk of stigmatizing fee-based brokerage accounts by suggesting that broker-dealers offering them have something to explain that other firms do not.

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[1] We understand "account" to be used here in a colloquial sense meaning a client or customer relationship, rather than in a technical sense under Article 8 of the Uniform Commercial Code. Advisory clients of an investment adviser do not necessarily have an advisory "account" with the adviser in this technical sense. The actual "account" might be with a different broker-dealer firm or other custodian.

**II.**

As we noted in our prior comment letter, the scope of an adviser's fiduciary and other duties also can vary based on specific statutes or on the common law applicable in particular jurisdictions. It materially depends on the nature and temporal dimension of the adviser's relationship with the advisory client.

It is easy to find discussions of an adviser's fiduciary duty that start and end with SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180 (1963). But this case, as important as it is, is neither the beginning nor the end of the story. Capital Gains was a fraud case under Section 206 of the Investment Advisers Act of 1940, and the Adviser's Act is fundamentally an anti-fraud statute. While Congress understood investment advisers to be fiduciaries when the Advisers Act was enacted in 1940, this was not some innovation under the Advisers Act. Rather it amounted to a recognition of the fiduciary obligations that arose under the common law then prevailing.[2]

In addition to fiduciary obligations, of course, specific rules and regulations were imposed on investment advisers under the Advisers Act because they were understood to be fiduciaries. These rules and regulations arise under federal law, at least insofar as federal covered advisers are concerned. But after the National Securities Market Improvements Act of 1996, many advisers are prohibited from registering with the Commission under Section 203A of the Advisers Act. Rather they are required to register with the several states and are subject to state laws regulating their conduct. NSMIA adds an additional level of complexity to any discussion about how "the customer's rights and firm's duties and obligations to the customer, including the scope of the firm's fiduciary obligations, may differ."[3]

As if the law were not complex enough, an adviser's fiduciary and other obligations also depend on the application of the law to specific facts. It is not the case that all advisers have the same fiduciary and other obligations, that an adviser owes the same obligations to all customers for all purposes, or that fiduciary duties last forever. An adviser's fiduciary and other obligations arise out of written agreements, disclosures and other representations. The scope of these obligations ultimately depends on the services the adviser promises to deliver.[4]

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[2] See In re Spear & Staff, Incorporated, Investment Advisers Act Release No. 188, [1964-66 Transfer Binder] Fed. Sec. L. Rep. ¶ 77,216 at 82,304 n. 10 (March 25, 1965). It is nevertheless true that federal law controls the fiduciary standards applicable under Section 206 of the Advisers Act. Transamerica Mortgage Advisors, Inc. v. Lewis, 444 U.S. 11, 17-18 (1979).

[3] See Friedman, The Impact of NSMIA on State Regulation of Broker-Dealers and Investment Advisers, 53 Bus. Law 511, 515-17, 549-51 (1998).

[4] The Commission made this point clearly in one of its leading opinions about the fiduciary duties of investment advisers. In re Arleen W. Hughes, 27 S.E.C. 629, 637 (1948) ("Our determination that registrant is a fiduciary with respect to her customers and is obligated to make the indicated disclosures does not stem merely from the fact that she renders investment advice, a common practice of over-the-counter firms generally. Our conclusion rest on the fact that registrant has created a relationship of trust and confidence with her clients by holding herself out as performing confidential advisory services for a fee, and has represented that she would act solely in the best interest of her clients and that she would make only such recommendations as would serve their interests."), aff'd, 174 F.2d 969 (D.C. Cir. 1949).

The definition of "investment adviser" includes a wide range of businesses. An adviser who offers only financial planning, for example, takes on different duties and obligations to the customer than does an adviser offering discretionary investment management. Diversified financial services business, including firms dually registered as broker-dealers and advisers, may have numerous advisory and non-advisory accounts or other relationships with the same customer, each with different fiduciary or other obligations. Moreover, advisory relationships also have a temporal dimension. That is, they may have a limited duration.

The initial decision in a recent administrative proceeding exemplifies many of these complexities. In IFG Network Securities, Inc., et al., Admin. Proc. No. 3-11179 (Feb. 10, 2005), the administrative law judge found that a respondent's fiduciary duty did not extend to certain recommendations to purchase class B mutual fund shares in part because the advisory relationship terminated with the delivery of a customer's financial plan. The respondent implemented the plan, and recommended the purchase of B shares, in his capacity as an associated person of a broker-dealer, not as an adviser.[5] The factual basis for this finding depended in large part on the services offered under the respondent's advisory contract and the efficacy of the respondent's disclosures.[6] The administrative law judge distinguished the facts in IFG from those in another case where a dual registrant did not differentiate between its advisory and broker-dealer services.[7]

We recognize that reliance on an administrative law judge's unreviewed initial decision may be misplaced. The point here is simply that there are limits to what a standard legend can say about fiduciary duties given that an evidentiary hearing might be needed to determine what these duties might mean.

These complexities make it very difficult to devise a standard legend. We realize the staff might feel the language we have suggested above does not go far enough. But we question whether, given these complexities, it is realistic to expect a standard legend to convey much detailed information, as opposed to suggesting the need to read and understand agreements and disclosures and to make other inquiries as appropriate. We continue to believe a disclosure requirement specifying the subject matter to be disclosed in general terms will be more effective.

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Thank you for the opportunity to comment. If you have any questions, please call me at (414) 665-5034.

Very truly yours,

Mark A. Kaprelian
Secretary

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[5] Initial decision at 40-41.
[6] Initial decision at 30, n. 76 and accompanying text.
[7] In re Marc N. Geman, 54 S.E.C. 1226, 1240-42 (2001).