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NASAA

October 6, 2004

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

Via e-mail to: rule-comments@sec.gov

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

Dear Secretary Katz:

Please accept this comment letter on behalf of the North American Securities Administrators Association ("NASAA")[1] regarding the above-referenced re-release (the "Release").[2] NASAA takes this opportunity to reiterate our comments of January 14, 2000, relating to the previous issuance of the Release.

The proposed rule would exempt certain broker-dealers providing investment advice to clients from registration under the Investment Advisers Act of 1940 ("Advisers Act"), provided such advice is offered on a non-discretionary basis, the advice is solely incidental to the brokerage services provided, and disclosure is made to the clients that their accounts are brokerage accounts.[3] Additionally, the rule provides that a broker-dealer providing discounted brokerage services will not be deemed to have received special compensation if such broker-dealer charges a commission, mark-up, mark-down, or other similar fee for brokerage services that is neither greater than nor less than one provided to other customers.[4] Finally, a broker-dealer will only be an investment adviser for those accounts in which it provides services or receives compensation that subjects it to the Advisers Act.[5]

[1] NASAA is the association of the 65 state, provincial and territorial securities regulatory agencies of the United States, Canada and Mexico. NASAA serves as a forum for state regulators to work with each other in an effort to protect investors at the grassroots level and to promote fair and open capital markets.

[2] Previously released as Release Nos. IA-1845, 34-42099; File No. S7-25-99.

[3] Proposed Rule 202(a)(11)-1(a)(1) through (3).

[4] Proposed Rule 202(a)(11)-1(b).

[5] Proposed Rule 202(a)(11)-1(c).

Wrap Accounts

Subsequent to the 1999 issuance of the Release, NASAA was under the impression that the Commission would continue to require broker-dealers marketing wrap fee programs to register as investment advisers. Recent interpretations, however, appear to exclude or exempt such broker-dealers from investment adviser registration. NASAA categorically opposes any interpretation of the Release that would nullify the current requirement that any broker-dealers sponsoring wrap fee programs register as investment advisers. Therefore, NASAA vigorously opposes any interpretation suggesting that agents of those broker-dealers selling or managing wrap accounts need not register as investment adviser representatives with state securities regulators.

As we stated in our earlier comment letter on this Release, filed January 14, 2000, states register broker-dealers as investment advisers primarily for two reasons. First, solicitors are included in the definition of investment adviser or investment adviser representative in many states. As such, a broker-dealer or agent who solicits advisory services, such as a wrap fee program, must register as either an investment adviser or investment adviser representative. Second, under most state securities laws, any person who determines which recommendation or advice regarding securities should be given falls within the definition of an investment adviser representative.

"Solely Incidental"

The proposed rule would exempt certain broker-dealers providing investment advice where such advice is "solely incidental" to the brokerage services provided. Investment advice impacts investors, regardless of whether the advice is given with or without other brokerage services. NASAA encourages the Commission to define the term "solely incidental." At a minimum, the term should be applied in the context of advice being provided by the broker-dealer to an individual account, as opposed to the overall services of the broker-dealer. NASAA believes that a collaborative effort involving the states and the Commission is necessary to the formulation of a clear standard or particular factors to be used in the determination of "solely incidental."

Discretionary Accounts

NASAA believes that all discretionary accounts of broker-dealers, regardless of compensation arrangements, should be treated as advisory accounts and that any broker-dealer maintaining such accounts should be subject to the requirements of the Advisers Act. By their very nature, discretionary accounts create an investment advisory relationship. It is well settled that investment advisers have a fiduciary duty to their clients. This fiduciary duty should apply to brokers who exercise discretion with clients' funds and in fact provide and act upon their own advice. The Commission should ensure that any broker-dealer or agent exercising discretionary authority with respect to a client's account should is held to this fiduciary standard by requiring registration as an investment adviser or investment adviser representative. Absent registration and application of investment adviser fiduciary standards, investors will not be adequately protected.

Advertising

Section 202(a)(11)-1(a)(3) of the Commission's proposal would require that a broker-dealer's advertisements and contracts for which the broker-dealer receives special compensation "include a prominent statement that the accounts are brokerage accounts." NASAA believes this provision is inadequate to protect investors. Many brokerage firms refer to their brokers as "financial consultants," "financial advisors," and other terms that suggest that the representative is more than a broker. It is not surprising that such terminology has confused many investors into believing that their broker is looking out for their best interests, has disclosed any conflicts of interest and is acting as a fiduciary to the investor.

A broker-dealer should be prohibited from advertising that an account is anything other than a brokerage account, or that advisory services also are available, unless the broker-dealer is appropriately registered under the Investment Advisers Act of 1940. Numerous states already require persons who "hold themselves out" as providing investment advisory services to be registered as investment adviser.[6] By adopting a similar rule, the Commission will create a level playing field and provide consistent treatment of all broker-dealers and investment advisers. Investors will benefit from the distinction in that only those persons who qualify as investment advisers and are willing to subject themselves to a fiduciary standard of care for client accounts will be able to "hold themselves out" as providing such services.

With these changes, the rule will benefit investors by defining the parameters within which broker-dealers fall under the Advisers Act. Additionally, it will create a more uniform approach to defining investment advice. We encourage the Commission to enhance investor protection and to minimize investor and industry confusion by clarifying all issues tied to the incidental practice of advisory services.

Should you have any questions regarding NASAA's position, please feel free to contact Theodore A. Miles, Director of the District of Columbia Securities Bureau and Chair of NASAA's Investment Adviser Section, Tanya Solov, Director of the Illinois Securities Department and Chair of NASAA's Broker-Dealer Section, or Rex Staples, NASAA's General Counsel.

Sincerely,

Franklin L. Widmann

Franklin L. Widmann
NASAA President and
Chief, New Jersey Bureau of Securities

[6] The jurisdictions include: Alabama, Alaska, Arizona, Colorado, District of Columbia, Florida, Idaho, Illinois, Indiana, Iowa, Maryland, Missouri, Nebraska, North Carolina, South Carolina, Utah, Virginia, Washington, and Wisconsin.