

February 7, 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”) appreciates the opportunity to comment on Rule 202(a)(11)-1 under the Investment Advisers Act of 1940, as repropoed on January 6, 2005, in Release No. 34-50980 (the “reproposing release”). NMIS was organized in 1968 and is wholly owned by The Northwestern Mutual Life Insurance Company. NMIS offers a full range of securities products and services and is registered with the Securities and Exchange Commission as a broker-dealer and as an investment adviser.

We continue to support this rule proposal for the reasons set forth in our comment letter dated September 22, 2004, on Release No. 34-50213. But we also have profound misgivings about certain of the interpretive positions the Commission is considering.

### **I. Reproposed Rule 202(a)(11)-1**

We agree with the Commission that fee-based brokerage accounts have the potential to provide significant benefits to brokerage customers. We are pleased to offer our brokerage customers a fee-based pricing option, and we believe that in appropriate circumstances this pricing option helps align the interests of our customers with the interests of our representatives.

We also agree with the Commission that brokerage accounts should not be regulated under the Advisers Act based on how these accounts are priced. In fact, it is hard to see how a contrary conclusion would be defensible in light of the Congressional directives codified in Section 202(c) of the Advisers Act and Section 3(f) of the Securities Exchange Act of 1934. These provisions require the Commission to consider efficiency, competition and capital formation in determining whether an action is in the public interest. They should guide the Commission’s consideration of the competitive implications of adopting Rule 202(a)(11)-1.<sup>1</sup>

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<sup>1</sup> Reproposing release at n. 57-58 and accompanying text.

Pricing flexibility generally promotes economic efficiency; exposing an activity that is already comprehensively regulated under the Exchange Act to an additional layer of comprehensive regulation under the Advisers Act based on how it is priced might be expected to have the opposite effect.

The Commission solicited comments on the expanded disclosures called for in paragraph (a)(1)(iii) of the reproposed rule. We believe the expanded disclosure requirement is appropriate and will serve the intended purpose of permitting customers and prospective customers to understand the differences between advisory accounts and brokerage accounts.

We urge the Commission to resist calls to be overly prescriptive in this disclosure requirement. As described in the reproposing release, the differences between a broker-dealer's duties and an adviser's duties depend in large part on the nature of the relationship between the broker-dealer or adviser and the customer, which may vary by firm and by contract. The scope of a fiduciary duty also can vary based on specific statutes or on the common law applicable in particular jurisdictions. We understand this portion of the rule to specify the subject matter of the required disclosure, and not the literal disclosure language itself. It would be helpful if the Commission would confirm this interpretation. If a literal disclosure is to be specified in the reproposed rule, the language must be very general if it is to be brief, understandable and universally accurate.

We also urge the Commission to clarify the last clause of paragraph (a)(1)(iii), which requires that firms "identify an appropriate person at the firm with whom the customer can discuss" the differences. Presumably, the "differences" referred to in this clause are the differences between accounts, not the differences between fiduciary duties. The nature of the services offered with a particular account, and how they might differ from other accounts, are matters we and other reputable firms want our customers to understand.

On the other hand, the differences between the fiduciary and other duties owed by brokers and advisers are matters over which lawyers can disagree, often heatedly and at great length. It would be very expensive to develop, maintain and deliver this kind of information to investors, and we doubt many investors would find it understandable or valuable. It would be helpful if the Commission would clarify this ambiguity in the language of paragraph (a)(1)(iii).

The Commission solicited comment about whether to specify who the appropriate person would be to discuss the differences between an advisory and a brokerage account. The text of the rule does not appear to require that a single person be identified to respond to all inquiries under paragraph (a)(1)(iii), and we think any suggestion to that effect is unrealistic. Some firms might be prepared to have branch office managers provide this kind of information; other firms might deliver it through properly trained personnel in a call center. We urge the Commission to allow for this kind of flexibility in complying with paragraph (a)(1)(iii).

The Commission solicited comments about whether it should act under its authority in Section 206A to exempt broker-dealers from registration under the Advisers Act, so that broker-dealers would not be subject to certain provisions of the Advisers Act with respect to fee-based accounts. While we believe carefully drafted exemptive rules under Section 206A could reduce certain negative consequences of duplicative regulation, an exemption from the registration provisions would be counterproductive. Firms that do not register with the Commission based on a registration exemption could find their fee-based brokerage accounts subject to investment adviser regulation under state law because the preemptive provisions of Section 203A(b)(1)(B) of the Advisers Act would not apply. This result could upset the regulatory balance between the Commission and the States struck by Congress in the National Securities Markets Improvement Act of 1996.<sup>2</sup>

Were the Commission simply to adopt a registration exemption, we would expect most broker-dealer firms to avoid it if possible. Most firms would probably rather register under the Advisers Act, preferring duplicative regulation by the Commission to multiplicative regulation by the Commission and the several States. We agree that action under Section 202(a)(11)(F), rather than Section 206A, is a more sensible approach.

## **II. Proposed Statement of Interpretive Position**

While we support the Rule 202(a)(11)-1 as repropoed, we believe the Commission's proposed interpretive positions have not been sufficiently developed in this rulemaking proceeding. The number of question marks in the reproposing release is indicative of the difficulty and complexity of the proposed interpretive positions. Resolving these questions could have far-reaching consequences for us and our customers as well as for the financial services industry in general.

We think these questions are too important based on the kind of anecdotal evidence generated by notice-and-comment procedures. At the Commission's open meeting on December 22, 2004, we understand Commissioner Goldschmid suggested that the staff undertake a special study of the issues presented by proposed statement of interpretive position. We urge the Commission not to make substantial departures from its existing interpretive positions in this area without the benefit of such a study. At the very least, we urge the Commission not to adopt new interpretive positions in this area without providing for an effective date far enough in the future for us and other industry participants to adapt to them.

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<sup>2</sup> The National Securities Markets Improvement Act of 1996 added Section 15(h) to the Securities Exchange Act of 1934, which prohibited the states from imposing certain regulatory requirements on broker-dealers that are different from, or in addition to, those established under the Exchange Act. The regulatory balance between the Commission and the States was defined in a completely different way for investment advisers and their representatives under Section 203A of the Advisers Act.

We are especially concerned about the proposed interpretive positions on “holding out” and on financial planning services.<sup>3</sup> As noted in the reproposing release, “[b]roker-dealers have traditionally provided investment advice that is substantial in amount, variety and importance to their customers.”<sup>4</sup> Giving investment advice is a core component of the services our broker-dealer representatives offer, as it is for most firms that make personalized recommendations as part of their broker-dealer business. We offer this kind of investment advice to customers with fee-based brokerage accounts, traditional brokerage accounts and to customers whom we serve on an application-way basis, including our variable life and variable annuity customers.

Personalized investment recommendations are subject to NASD’s suitability rule,<sup>5</sup> which incorporates much of the same language the Commission used to describe financial planning in the release reproposing Rule 202(a)(11)-1.<sup>6</sup> We note, too, that NASD’s proposed Conduct Rule 2821, which was recently filed with the Commission, suggests an intention to require an even greater emphasis on financial planning considerations where variable annuities are concerned.<sup>7</sup> The Commission’s recent approval of NASD interpretive material concerning investment analysis tools also reflects a recognition of the public interest in allowing broker-dealers to deliver sophisticated investment advice to their customers.<sup>8</sup>

We and our representatives have invested considerable time and resources to incorporate elements of financial planning into our brokerage business to better serve our customers and to make well-informed recommendations. Our sales training includes financial planning concepts.

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<sup>3</sup> Reproposing release at nn. 106-116 and accompanying text.

<sup>4</sup> *Id.* at n. 39 and accompanying text.

<sup>5</sup> 2310. Recommendations to Customers (Suitability)

(a) In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

(b) Prior to the execution of a transaction recommended to a non-institutional customer, other than transactions with customers where investments are limited to money market mutual funds, a member shall make reasonable efforts to obtain information concerning:

- (1) the customer's financial status;
- (2) the customer's tax status;
- (3) the customer's investment objectives; and
- (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

<sup>6</sup> Reproposing release at n. 111 & accompanying text.

<sup>7</sup> As filed, proposed Conduct Rule 2821 would require a suitability determination that includes, among other things, an assessment of customer’s “existing *insurance* holdings.” SR-2004-183 (filed Dec. 14, 2004).

<sup>8</sup> Order Granting Approval of Proposed Rule Change and Amendment No. 1 Thereto, and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 2 and 3 to Adopt New Interpretive Material to NASD Rule 2210(d)(2)(N) to Allow NASD Member Firms to Use Certain Investment Analysis Tools, Exchange Act Release No. 50463 (Sept. 28, 2004).

Many of our representatives are members of the Financial Planning Association, or have earned the Certified Financial Planner<sup>TM</sup> certificate or the Chartered Financial Consultant designation. In appropriate cases, our representatives prepare their recommendations using sophisticated computer software, and they may present their recommendations in the context of their customer's overall financial plan.

The financial advice we provide in this fashion is fairly characterized as financial planning, yet it is also quite literally incidental to our business as a broker-dealer. Not every customer needs or wants a written financial plan, and we do not create one for everybody. We do not contract with our customers to deliver a written financial plan and we do not charge separately for the planning services we provide. If our representatives do not make a sale, they are not compensated for their efforts at all. Broker-dealers historically have met a significant part of the public's demand for financial advice in just this way.

In the reproposing release, the Commission asked whether to limit its interpretation of financial planning that is not solely incidental to circumstances where customers separately contract for financial planning services or where a separate fee is charged. In our view, these are the only sensible criteria for drawing the line between planning services that are incidental to brokerage and those that are not. A contractual promise to deliver a written financial plan at an agreed upon price, regardless of whether a sale is made, is not "solely incidental" within the meaning of Section 202(a)(11)(C) and with the Commission's long-standing interpretations of this language.<sup>9</sup> Conversely, the delivery of some or even all of the same elements of that plan by a broker-dealer at no extra charge to determine an individual's objectives, goals, time horizon and risk tolerance and to formulate personalized investment recommendations based on these factors is "solely incidental." We think it would be impractical and ultimately misguided to try to draw a bright line between a broker-dealer's suitability analysis and an adviser's financial planning services on any other basis.

More importantly, the accurate usage of generic terms such as "investment advice" and "financial planning" by broker-dealers as such should not be prohibited. If a broker-dealer can engage in activities fairly described by these terms, there is no good reason to prohibit them from using these terms in their public communications, including advertising, so long as the usage is otherwise consistent with the Exchange Act and the applicable rules and regulations thereunder. Such a prohibition would likely result in the development of new vocabulary that would be more likely to confuse investors about the services they are getting than it would be to inform them.

Likewise, while we understand the superficial appeal of prohibiting broker-dealer representatives from using titles such as "financial advisor" or "financial consultant," prohibiting them from using hard-earned credentials, such as Certified Financial Planner<sup>TM</sup> and Chartered Financial Consultant, would not be in the public interest. Our research indicates that most

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<sup>9</sup> Although we do not offer financial planning services for a separate fee, some of our broker-dealer representatives may offer such a service through affiliated or unaffiliated registered investment advisers.

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investors evaluate titles and designations with a high degree of skepticism. Prohibiting professionals from using legitimate designations would deprive the public of a means to evaluate their qualifications.

Our efforts to deliver high quality financial advice have been informed by the Commission's existing guidance on the "solely incidental" element of Rule 202(a)(11)(C), including the Commission's Financial Planning Release<sup>10</sup> and related no-action letters.<sup>11</sup> We think the public interest would be ill-served by new interpretive positions that would increase the cost or reduce the supply of financial advice that broker-dealers provide. We also think the public interest would be ill-served by discouraging broker-dealers from using financial planning techniques in recommending securities, or truthfully representing the quality of their services or the qualifications of their personnel.

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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<sup>10</sup> Securities and Exchange Commission, Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants and Other Persons who Provide Investment Advisory Services as a Component of Other Services, Investment Advisers Act Release No. 1092 (Oct. 8, 1987).

<sup>11</sup> See Princor Financial Services Corporation (pub. avail. January 30, 1991) (available on Westlaw 1991 WL 176654); Nathan & Lewis Securities, Inc. (pub. avail. Apr. 4, 1988) [(CCH Fed.Sec.L.Reptr. '87-'88 Tr.Br. ¶ 78, 681)]. Elmer D. Robinson (pub. avail. January 6, 1986) (CCH Fed.Sec.L.Reptr. '85-'86 Tr.Br. ¶ 78,188).