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September 22, 2004

Re: **File No. S7-25-99**

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

Dear Mr. Katz:

We appreciate the opportunity to comment on proposed rule 202(a)(11)-1 (the "Proposed Rule) under the Investment Advisers Act of 1940 (the "Advisers Act"), which the Commission originally proposed on November 4, 1999 (the comment period was reopened on August 18, 2004).

The substance of this letter was submitted to the Staff on January 14, 2000, but in light of the length of time since it was originally sent I felt it was appropriate to resubmit the comments.

We commend the Commission's efforts to recognize technological and other changes affecting the securities markets and the impact these changes are having on the delivery of financial services to clients. Thus, we generally support the Commission's Proposed Rule to permit broker-dealers to offer different fee arrangements to their customers without triggering application of the Advisers Act. However, we request that the Commission consider the following issues prior to final adoption of the Proposed Rule.

A. Significance of Discretionary Authority

1. Discretion and Transaction-Based Fees

Under the Proposed Rule, a registered broker-dealer will not be deemed an investment adviser based on the broker-dealer's receipt of special compensation provided, among other conditions, that the adviser "does not exercise investment discretion...over the accounts from which it receives special compensation." The

proposing release, however, requests comment as to whether all discretionary accounts of broker-dealers should be treated as advisory accounts, presumably including accounts from which the adviser receives traditional transaction-based fees and no “special compensation.”

We strongly believe that discretionary brokerage accounts which are charged traditional transaction-based fees should not be treated as advisory accounts. As noted in the proposing release, the Commission considered this issue approximately twenty years ago in Advisers Act Release No. 626 (Apr. 27, 1978). In that release, the Commission considered whether it should change its long-held position and begin viewing discretionary brokerage accounts as advisory accounts subject to the Advisers Act. Shortly thereafter, the Commission concluded in Advisers Act Release No. 640 (Oct. 5, 1978) that it would continue to take the position that broker-dealers “who exercise discretionary authority over a limited number of their customers’ accounts, but do not receive special compensation for such services,” would not need to treat those accounts as advisory accounts.

We believe that the Commission’s longstanding position with regard to discretionary brokerage accounts is fundamentally sound and that the reasons supporting the Commission’s position twenty years ago remain valid. First, we believe that a change in the Commission’s position may amount to an impermissible limitation on the scope of the exclusion provided by Section 202(a)(11). The language of the section does not indicate that only broker-dealers without discretion are eligible for the exemption. Second, we believe that the practical impact of this change would be significant. Broker-dealers are already subject to an alternative regulatory scheme under the Securities Exchange Act of 1934 (the “Exchange Act”) and related self regulatory organizations. Application of the Advisers Act to broker-dealers who offer discretionary, commission-based brokerage accounts would result in an additional and somewhat redundant set of regulations leading to substantial expenses. Finally, we are not aware of any significant abuses that have occurred over the past twenty years which might prompt the Commission to change its position. Because we believe that the Commission’s longstanding position is implicit in the exemption provided by Section 202(a)(11), we do not suggest any alterations to the text of the Proposed Rule on this point.

2. Discretionary and Non-Advisory Fixed or Asset-Based Fees

We further believe that the same conclusion should be reached if a broker-dealer with discretionary authority over client accounts charges a traditional transaction-based fee, along with an additional fixed or asset-based fee, provided that the additional fee is charged for services other than investment advice. We note that brokerage firms often charge a fixed or asset-based fee for services such as custody, account maintenance and on-line access to a broker-dealer’s internet site that provide securities trading, stock quotes, proprietary or third-party research, proprietary market information and financial news supplied by third parties. As these additional fees are not received for advisory services, we believe the fees should not be considered special compensation for purposes of determining whether a broker-dealer with discretion over client accounts should be deemed an investment adviser. We agree with the staff’s view that registration as an investment adviser should depend on whether the broker-dealer has discretion and is compensated for investment advice. Therefore, we recommend changing the Proposed Rule as indicated in Appendix A (in clause (b)) to clarify that compensation for advisory

services does not include fixed or asset-based fees charged for brokerage, custody or other non-advisory services.

B. Required Statements in Advertisements and Contracts

Under the Proposed Rule, all advertisements for accounts and all agreements and contracts governing the operation of accounts are required to contain a prominent statement that the accounts are brokerage accounts. We believe that the inclusion of the statement is not necessary and in some situations inappropriate. For instance, a broker-dealer may make available on its website certain market or research information that may be accessed by both its discretionary and non-discretionary clients, as well as non-clients. To comply with the Proposed Rule, a broker-dealer may need to include a prominent statement on the website that the website is a brokerage account. Under these circumstances, a requirement to place a prominent statement on the website that it is a brokerage account may be inappropriate or even confusing to readers. Accordingly, we believe that this requirement should be removed from the Proposed Rule. In the alternative, we suggest that a more practical and flexible approach would be for the Proposed Rule to require a statement *that an account is not an advisory account and is not subject to regulation under the Advisers Act*. Under this alternative approach, we would amend the Proposed Rule as indicated in Appendix A (in clause (a)(3)).

In addition, the Proposed Rule may present practical difficulties. If the requirement to make a prominent statement remains in the final rule, broker-dealers relying on the rule presumably would need to amend all of their existing account documents to add the necessary language. This process would be time consuming and expensive. We propose instead that, if the requirement for a prominent statement remains in the rule, the staff require the statement only for accounts entered into after the effective date of the rule. We would amend the Proposed Rule as indicated in Appendix A (in clause (a)(3)).

C. Wrap Fee Sponsors

According to the rule release, a broker-dealer sponsor of a wrap fee program would be required to continue to treat wrap fee accounts as advisory accounts subject to the Advisers Act. Thus, a broker-dealer who sponsors a wrap fee program would be required to register as an investment adviser, even if the broker-dealer does not exercise discretion over the selection of underlying portfolio managers or a client's portfolio securities. We believe that this result is incongruous in that a broker-dealer would not be required to register as an adviser if it helped a client choose securities, but would be required to register if it helped a client choose a portfolio manager. We believe that the test for registration in the case of wrap fee sponsor should be the same as for other broker-dealers and turn on whether or not the broker-dealer has discretion and charges an asset-based fee. If the broker-dealer simply recommends portfolio managers, but the client make the decision, the broker-dealer should not be required to register as an investment adviser. Accordingly, as indicated in Appendix A (in clause (d)), we believe that broker-dealers who sponsor wrap fee program should be viewed as providing advice solely incidental to brokerage services, provided the broker-dealer does not have discretion over client accounts with respect to the selection of portfolio managers or portfolio securities.

D. General Comment: References to “Special Compensation”

Clause (a) of the Proposed Rule states that a broker-dealer will not be deemed an investment adviser “based solely on its receipt of special compensation.” Parts of the quoted phrase are then repeated in clauses (1), (2) and (3), as well as clause (b). We believe that the use of this phrase is both confusing and redundant. No broker-dealer is considered an investment adviser solely because it is receiving special compensation. In order to be deemed an investment adviser, a broker-dealer must also be providing advice with respect to securities or otherwise performing a function that causes it to be considered an adviser. The use of the word solely creates an implication that a broker-dealer can comply with the proposed rule (i.e., no discretion, solely incidental advice and a prominent statement) and still not fall within the rule because of some extraneous factor that causes it to be deemed an investment adviser. We do not believe that this was the Staff’s intention and therefore suggest that the phrase “based solely on its receipt of special compensation” be eliminated in clause (a) along with references to the phrase in clauses (1)(2)(3) and (b).

We appreciate the opportunity to comment on the proposed rule. Please feel free to contact me at (212) 450-4684 if the staff would like discuss any of these points in greater detail.

Very truly yours,

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APPENDIX A

§ 275.202(a)(11)-1 Certain broker-dealers deemed not to be investment advisers.

A broker or dealer registered with the Commission under Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) (the “Exchange Act”):

(a) Will not be deemed to be an investment adviser ~~based solely on its receipt of special compensation~~ *with respect to an account*, provided that:

(1) The broker or dealer does not exercise investment discretion, as that term is defined in Section 3(a)(35) of the Exchange Act (15 U.S.C. 78c(a)(35)), over the accounts ~~from which it receives special compensation~~;

(2) Any investment advice provided by the broker or dealer with respect to the accounts ~~from which it receives special compensation~~ is solely incidental to the brokerage services provided to those accounts; and

(3) Advertisements for, and contracts or agreements governing, the accounts, *if opened after xx date*, ~~for which the broker or dealer receives special compensation~~ include a *prominent statement that the account is not an advisory account and is not subject to regulation under the Advisers Act*;

(b) Will not be deemed to have received ~~special~~ compensation *for advisory services* solely because the broker or dealer (A) charges a commission, mark-up, mark-down or similar fee for brokerage services that is greater than or less than one it charges another customer or (B) *receives a flat or asset-based fee for brokerage, custody or other non-advisory services*; ~~and~~

(c) Is an investment adviser solely with respect to those accounts for which it provides services or receives compensation that subject the broker or dealer to the Act; *and*

(d) *Will not be deemed to be an investment adviser with respect to an account provided that the broker-dealer is acting as a sponsor to a wrap fee program and is not exercising investment discretion over the selection of portfolio managers or portfolio securities on behalf of the account.*