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Jonathan G. Katz
Secretary
U.S. Securities & Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549

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

Dear Mr. Katz:

Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's ("Commission" or "SEC") proposal to adopt Rule 202(a)(11)-1 (the "Proposed Rule") under the Investment Advisers Act of 1940 (the "Advisers Act"). For the reasons stated below, Merrill Lynch strongly supports adoption of the Proposed Rule.

Merrill Lynch believes that the Proposed Rule benefits the investing public by allowing firms to offer clients a full array of choices in fee arrangements. Clients selecting fee-based pricing are protected both by the safeguards of the Proposed Rule as well as by a comprehensive broker-dealer regulatory structure. Finally, the Proposed Rule is consistent with legislative intent and prior Commission guidance.

The Commission Should Encourage Broker-Dealers to Offer Pricing Alternatives

Merrill Lynch believes that investors benefit from having a greater choice in their brokerage compensation arrangements. The Commission's proposal encourages this choice by fostering innovation in the offering and pricing of investment services to meet changing investor preferences.

We believe that this type of innovation is a positive development for the investing public and the securities industry. Clients can now select the services that they need and

[1] Merrill Lynch is registered with the Commission as both a broker-dealer and an investment adviser.

the manner in which they pay for those services. Brokerage firms have the flexibility to design and implement account offerings with creative pricing arrangements. Clients can benefit from more predictable transaction costs as well as fee arrangements with which they feel comfortable.

A climate of regulatory uncertainty inhibits such innovation to the detriment of clients and the securities industry. The Proposed Rule provides the necessary regulatory framework.

Clients Benefit from Fee-Based Brokerage

Fee-based brokerage was developed in part to meet clients' needs and preferences and in part to respond to the best practices suggested in the Report of the Committee on Compensation Practices (commonly know as the Tully Report), which Report was requested by the SEC. These pricing arrangements have grown dramatically in the last few years, demonstrating that they address a clear need for certain investors. The development of these programs has been viewed in a positive light because, as recommended by the Tully Report, many clients believe these arrangements can help them align their interests with those of their broker-dealers.[2] Fee-based brokerage should also help reduce certain types of sales practice abuses such as churning and the recommendation of unsuitable securities.

Clients benefit from a wide choice of pricing alternatives. At Merrill Lynch, clients now have several pricing options to select for different services, depending on their investment needs and preferences, including:

- Our online, execution-only service with reduced commission rates.
- Traditional full service brokerage accounts serviced by registered representatives with commissions paid on a per-trade basis and separate fees for each account and related service.
- Full-service, fee-based non-discretionary brokerage accounts serviced by registered representatives where the fee covers various services, including trading commissions, account fees, and related service fees (such as Visa cards and ATM fees).
- Fee-based investment advisory services that provide clients with money management on a discretionary or non-discretionary basis.

Of course, clients need to understand their choices. We therefore agree with the Proposed Rule's requirements that clients should receive clear disclosure in advertisements, sales literature and client agreements about the costs, nature and extent of services that they will receive. Firms must clearly communicate available offerings to clients, as well as provide appropriate training and supervision of registered representatives. With these additional protections, Merrill Lynch strongly believes that the Proposed Rule serves the best interests of investors.

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[2] In its proposing release the Commission states that it "welcomes the introduction of these programs, which may reduce substantially conflicts between broker-dealers and their customers."

Brokerage Clients are Well Protected by Extensive Regulation

No demonstrable reason or regulatory imperative exists for the imposition of Advisers Act requirements on fee-based brokerage services. Brokerage services, whether fee-based or commission-based, are subject to a comprehensive broker-dealer regulatory framework. As the Securities Industry Association points out in its comment letters, regulatory oversight of broker-dealers is wide-ranging and at least comparable to regulatory oversight of investment advisers. Broker-dealers have an obligation to deal fairly with their clients and are subject to a well-developed suitability duty when making securities recommendations. Clients of broker-dealers are also protected by various client protection rules such as the SEC's net capital and reserve requirements, possession and control requirements, and the segregation of client securities from proprietary securities.

Moreover, broker-dealers are subject to regulation by at least one self-regulatory organization (SRO). Many firms, such as Merrill Lynch, are members of multiple SROs and are examined by several SROs every year. The states also regulate broker-dealers, and firms are subject to examination in each state in which they conduct business.

The Proposed Rule properly permits innovation in the offering and pricing of brokerage services to meet investors' needs without unnecessarily increasing the regulatory burden. There is simply no need to add another layer of regulation by invoking the Advisers Act.

Broker-Dealers Have Always Provided Investment Advice to Clients

The Proposed Rule is in accord with Congressional intent and takes the appropriate approach in not applying the Advisers Act to advice provided by a broker-dealer in the ordinary course of its business.

As the Commission correctly recognized in its proposing release, the services offered in fee-based arrangements are fundamentally the same as those available in traditional full service brokerage relationships. Properly viewed, these new brokerage arrangements are simply pricing alternatives. Clients receive a package of brokerage services: trade execution, asset custody, recordkeeping and our traditional full service advice and guidance. The manner in which a brokerage firm is compensated should not be determinative as to whether an account is brokerage or advisory in nature. The nature of the services provided, rather than the form of compensation, should determine the applicability of the Advisers Act.

At the time Congress adopted the Advisers Act in 1940, broker-dealers routinely provided investment advice to clients that was incidental to their brokerage services. They continue to do so today. The Advisers Act explicitly recognizes that fact and specifically excludes broker-dealers from the Advisers Act in those circumstances. Having required broker-dealers to register with the SEC only six years earlier in 1934, Congress clearly did not intend to subject brokerage firms to duplicative, unnecessary regulation. We agree with the Commission's statement that Congress could not have intended that fee-based pricing for brokerage services be subject to regulation under both the Securities Exchange Act of 1934 and the Advisers Act.

Specific Requests for Comments

In the current release, the Commission seeks comment on a number of subjects, including the impact of non-adoption of the Proposed Rule. We have addressed many of these in our comments above. We do note that brokerage pricing alternatives have become pervasive since the issuance of the proposing release in 1999. Indeed, the popularity of fee-based pricing has grown dramatically among our clients. In developing fee-based pricing, broker-dealers have relied on the Commission's guidance and the "no-action" position embedded in the proposing release. We think it would cause enormous confusion and dislocation for both clients and brokerage firms if the Commission withdrew the Proposed Rule.

The Commission has also asked whether brokers should be precluded from using certain terms like "investment advice" and "financial planning" in connection with advertising these services. We think that such an approach is simplistic, impractical and a disservice to investors. It also misperceives the important role that full service brokerage firms have in guiding their clients with their investment decisions. As mentioned previously, it is well recognized that broker-dealers can and should provide advice to clients in connection with their brokerage transactions. This is the core of full service brokerage. Clients want and need investment advice in these difficult economic times. Such advice needs to be available for clients in order to help them make informed investment decisions.

We also note that many brokerage firms are dually registered as investment advisers and should be permitted to reference their broad array of brokerage and investment advisory services in a single advertisement. We think that prominent disclosure of the type indicated in the Proposed Rule should be sufficient to alert clients to the nature of the services being provided.

Conclusion

Merrill Lynch strongly urges the Commission to adopt the Proposed Rule. We think the reasons offered in support in 1999 are even more compelling today. We look forward to final adoption.

If you have any questions or need additional information, please contact the undersigned.

Very truly yours,

Paul S. Gottlieb, by J.T.

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