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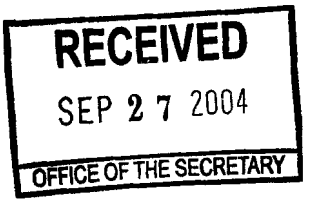

VIA E-MAIL

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

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

Dear Mr. Katz:

Our firm has been asked by an insurance company client engaged in the offer and sale of variable annuity and variable life insurance contracts ("variable contracts") to submit on its behalf this letter of comment on proposed Rule 202(a)(11)-1.[1] The proposed rule would provide broker-dealers with an exemption to provide investment advice to customers with fee-based brokerage accounts without registering as investment advisers under the Investment Advisers Act of 1940 (the "Advisers Act").

Our client has the following concerns. Through the benefit of rulemaking, proposed Rule 202(a)(11)-1 would provide broker-dealers with specific standards for developing and marketing brokerage accounts that involve the provision of investment advice, including asset allocation advice, without a broker-dealer having to register as an investment adviser. At the same time, the Commission's staff (the "Staff") has undertaken to examine asset allocation programs (fee-based and non fee-based) used in connection with variable contracts and decide on a case-by-case basis, without the benefit of rulemaking, whether the insurance company offering the program or another party should be required to register as an investment adviser.

Our client believes that this disparate treatment could produce an unlevel playing field between broker-dealers and insurance companies offering what could be viewed in some cases as similar asset allocation services. Accordingly, our client has asked us to submit this comment letter to urge the Commission to consider the status of variable contract asset allocation programs in a formal rulemaking proceeding similar to the Rule 202(a)(11)-1 proceeding and to defer Commission Staff action on such asset allocation programs until a rule is adopted. Our client believes that such a deliberate rulemaking

[1] *See Certain Broker-Dealers Deemed Not To Be Investment Advisers,* Release No. 34-42099 (November 4, 1999) (proposing Rule 202(a)(11)-1); *Certain Broker-Dealers Deemed Not To Be Investment Advisers,* Release No. 34-50213 (August 18, 2004) (reopening the comment period on proposed Rule 202(a)(11)-1).

approach would be the most appropriate one for determining the status of variable contract asset allocation programs, which in the client's view are as important to investors as fee-based brokerage accounts, serve investors' interests in much the same manner as fee-based brokerage accounts, and raise similar significant policy issues and industry concerns as does proposed Rule 202(a)(11)-1.

The Commission's Consideration of Fee-Based Brokerage Accounts

The Commission proposed Rule 202(a)(11)-1 in 1999 to permit broker-dealers to offer investment advice to customers through fee-based brokerage accounts without registering as investment advisers under the Advisers Act. The Commission noted in the release proposing the rule that it welcomed fee-based accounts as better aligning the interests of broker-dealer customers with those of the brokerage firm and its registered representatives by substituting an asset-based fee for transaction-based compensation as recommended by the Report of the Committee on Compensation Practices (the "Tully Report"). However, because the receipt of asset-based fees could constitute the receipt of "special compensation," fee-based brokerage accounts could require broker-dealers to register as advisers under the Advisers Act. In response, the Commission proposed Rule 202(a)(11)-1.

In proposing Rule 202(a)(11)-1, the Commission opined that while the receipt of special compensation may have been a reliable distinction between brokerage and advisory services in 1940 when Congress adopted the "special compensation" test, the development of fee-based brokerage accounts suggests that this characteristic is no longer a reliable distinction. The Commission stated that it does not believe that Congress intended fee-based brokerage accounts to be subject to the Advisers Act. The Commission therefore concluded that it was appropriate to exercise its authority under Section 202(a)(11)(f) of the Advisers Act to exempt brokerage firms offering fee-based accounts from the Advisers Act under conditions designed to limit the exemption to circumstances where the Commission believes that Congress did not intend to apply the Act.

The Commission Staff's Consideration of Variable Contract Asset Allocation Programs

In late 2003 a number of insurance companies received a letter from the Staff of the Division of Investment Management informing the companies that the Division had commenced an examination of asset allocation programs. The Division's letter informed companies that while its Staff understood all asset allocation programs to provide for the initial allocation of a contract owner's purchase payment among underlying mutual funds in accordance with varying asset allocation models, the Staff was particularly interested in programs that provide for periodic reallocation of contract value to conform to changes in a model that are made by the insurance company or a third party (hereinafter, "dynamic asset allocation programs"). Some of these programs, the Division noted,

provide for automatic reallocation of a contract owner's contract value, while others involve advising the owner in advance of the proposed reallocation and providing the owner with the opportunity to confirm or decline the proposed reallocation.

The Division asked for extensive information about each company's asset allocation programs and related disclosure documents. It also asked each company to provide for each of its dynamic asset allocation programs an analysis of whether the program involves the provision of investment advice to contract owners by the insurance company or any third party responsible for changing the model. Finally, the Division asked each company to provide for each of its dynamic asset allocation programs an analysis as to whether the pool of assets invested according to a particular model constitutes a management investment company; the Division also asked each party to either explain why the program does not involve the provision of discretionary advisory services to clients or provide an analysis of whether the program qualifies for the nonexclusive safe harbor from the definition of investment company under Rule 3a-4 of the Investment Company Act of 1940.

Fee-Based Brokerage Accounts Should Be Treated Consistently With Variable Contract Asset Allocation Programs

Our client has significant concerns that if the Commission adopts proposed Rule 202(a)(11)-1 and thereby provides broker-dealers the certainty of an exemptive rule with which to develop and market brokerage accounts that involve the provision of investment advice without the broker-dealer having to register as an investment adviser, while at the same time the Commission's Staff continues to consider on a case-by-case basis, without the benefit of standards developed in a formal rulemaking process, whether individual insurance companies may offer variable contract asset allocation programs without registering as investment advisers, an unlevel playing field will have been created. Judging by the number of comment letters the Commission has received (and continues to receive) on proposed Rule 202(a)(11)-1, as well as other recent developments, the rule is being viewed as potentially having a very significant impact on broker-dealer firms and their competitors.[2] The rule would appear also to involve significant public policy issues.[3]

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[2] According to the release announcing the reopening of the comment period for proposed Rule 202(a)(11)-1, the Commission received a substantial number of comment letters on the rule. The Financial Planning Association (the "FPA") has actively opposed the rule since its inception and recently petitioned the United States Court of Appeals for the District of Columbia Circuit for review of the Commission's proposal of the rule. *See Financial Planning Association v. Securities and Exchange Commission*, Petition for Review (July 20, 2004) (available on the FPA's website at www.fpanet.org).

[3] As noted, the Commission indicated in the initial proposing release for Rule 202(a)(11)-1 that it welcomed fee-based brokerage accounts as better aligning the interests of broker-

The Commission is to be commended for reopening the comment period on proposed Rule 202(a)(11)-1. The reopening reflects the critically important nature and complexity of the investment adviser status questions involved. The complexity of similar investment adviser status questions led the Commission to launch a study of "wrap-fee programs," followed by a protracted rule-making proceeding that culminated in the adoption of Rule 3a-4. Like wrap-fee programs, variable contract asset allocation programs have many permutations that warrant a careful regulatory assessment. Variable contract asset allocation programs present the following types of issues:

- Whether the programs, which are often provided to contract owners without a separate fee, should nonetheless be deemed to involve the provision of advisory services "for compensation," given the current lack of clear guidance as to whether and when compensation should be equated with "any direct or indirect economic benefit";

- Whether the provision of asset allocation services to contract owners by insurers may rise to the level of constituting part of the insurer's "regular business," again given a lack of clear guidance as to this standard;

- Whether the provision of asset allocation programs constitutes the rendering of the type of "investment advice" Congress intended to capture in the definition of "investment adviser"; and

- Whether if some programs do in fact cause insurers to be deemed "investment advisers" under the definition in Section 202(a)(11) of the Advisers Act, the Commission should exercise its exemptive authority provided by Congress in Section 202(a)(11)(f) to exempt insurers from having to register as advisers under the Act, and under what conditions and other regulatory safeguards. In this regard, we note that proposed Rule 202(a)(11)-1 recognizes that in certain circumstances investment advice that is provided incidentally in a fee-based brokerage account should not trigger Advisers Act registration. Our client believes that similarly, a party offering asset allocation advice incidentally to a variable contract could likewise be exempted from registration in appropriate circumstances.

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dealer customers with those of the brokerage firm and its registered representatives by substituting an asset-based fee for transaction-based compensation as recommended by the Tully Report.

Conclusion

On behalf of our client, we urge the Commission as it considers whether to adopt Rule 202(a)(11)-1 to institute a similar rulemaking proceeding to consider the status of variable contract asset allocation programs under the Advisers Act. Our client believes that this would constitute an appropriate regulatory action given that variable contract asset allocation programs raise similar public policy and regulatory interpretive questions as those involved in the Commission's proposal of Rule 202(a)(11)-1. Moreover, until the Commission and variable contract issuers have had the benefit of going through such a deliberative process, we urge the Commission to defer consideration of variable contract asset allocation programs by its Staff.

We would be pleased to meet with members of the Commission and/or its Staff to assist the Commission in undertaking such a rulemaking proceeding. We would also be pleased to provide additional written analysis of the complex and varied regulatory issues that may be involved in analyzing the status of variable contract asset allocation programs under the Advisers Act, as well as the appropriate conditions for exempting from the Act, in whole or in part, those asset allocation programs that may appropriately be viewed as triggering the application of the definition of "investment adviser" under Section 202(a)(11).

If you have any questions or comments, please do not hesitate to call the undersigned at 202.383.0590 or Steve Roth at 202.383.0158.

Respectfully submitted,

W. Thomas Conner

cc: Paul F. Roye, Division of Investment Management
Susan Nash, Division of Investment Management
William J. Kotapish, Division of Investment Management
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