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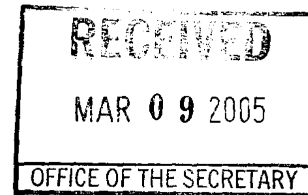

March 9, 2005

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

File No. S7-25-99

Dear Mr. Katz:

We appreciate this opportunity to comment on the U.S. Security and Exchange Commission's (SEC or Commission) proposal to exempt certain fee-based brokerage accounts from regulation under the Investment Advisers Act (IAA).[1] These comments reflect our views regarding the SEC's December, 2004, Concept Release that reopened the comment period on the Commission's original 1999 proposal. Our principal concern with the more recent release, as with the original proposal, is that the Commission continues to rely on a "solely incidental to" standard – a standard that has never been defined and therefore cannot be enforced -- to draw a distinction between brokers and advisers. In effect, this distinction artificially restricts the scope of investor protections intended by the IAA.

We support a number of improvements proposed in the SEC's re-release as useful, but not sufficient, to secure necessary investor protection reform. Most useful are the new requirements that:

- all discretionary accounts are to be defined as advisory accounts, and
- disclosures to investors are to be improved, by:
  - placing additional restrictions on brokers' ability to hold themselves out to the public as advisers without being regulated as advisers,
  - identifying selected aspects of financial planning as a field of expertise that is to be recognized as an advisory service, and by
  - connecting fee-based brokerage accounts with a legend to appear on advertisements and account documents that (1) states that the account is a brokerage account and not an advisory account and that there are differences between these accounts, including with respect to the scope of the firm's fiduciary obligations, and (2) identifies a person at the firm with whom the customer can discuss these differences.

[1] See: "Certain Broker-Dealers Deemed Not To Be Investment Advisers"; Release Nos. 34-50980; IA-2340; File S7-25-99.

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However, we believe development of a functional definition of the "solely incidental" standard is essential to providing the kind of differentiation that must be drawn between brokers and advisers -- if investor protections intended by Congress in the IAA are to be realized in a technologically innovative and dynamic investment marketplace.[2]

We believe that it is simply misleading for a broker-dealer to market its advisory services when in fact such services are only an insignificant part of its business. Under these circumstances, the broker is able to claim an unwarranted exclusion from protections provided to investors under the IAA.[3] We are also concerned that enhancements advanced by the re-proposal are made tentative and tenuous – if not ephemeral -- by the continuing absence of an appropriate SEC advisory standard for what advice can be offered by a broker-dealer that is considered "solely incidental". In effect, the proposed rule would eliminate receipt of special compensation for advice as a bright-line test for screening requests for the exclusion while failing to provide any substantive clarification of what does and does not qualify as "solely incidental". Implementation of the proposed rule would further blur and weaken the investor protections afforded by the IAA.

Clearly, the construction of a definition for a "solely incidental" standard is challenging. For example, it will not always be apparent how significant advisory services must be before they no longer can be characterized as solely incidental to the brokerage services provided. Conceptually, we agree with the Commission that in order for services to be considered "solely incidental" they must involve at least some provision of advisory services to investors. However, the Commission's characterization of "solely incidental" advisory services in the re-proposal with terms such as "in connection with" and "reasonably related to" the brokerage business expands the scope and level of advisory services that would be considered incidental. For example, it is hard to imagine how financial planning -- that by definition is selling advice that may relate to investments, but also may encompass other financial issues -- could not be considered to be "in connection with" or "reasonably related to" a broker's business.

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[2] We find compelling the findings from a legislative history of the broker-dealer exception from the Investment Advisers Act, prepared by Barbara Roper of the Consumers Federation of America (CFA), and submitted to the SEC, February 7, 2005. She concludes that "[u]nfortunately, rather than clarifying the standard, the Commission has in essence interpreted it out of existence. In its place, it has proposed an "in connection with and reasonably related to" standard that would allow brokers virtually unlimited freedom to offer advisory services outside the protection of the Advisers Act." [p. 2].

[3] See our letter to William H. Donaldson, Chairman, SEC, November 17, 2003, regarding the originally proposed rule (Rule 202(a)(11)-1; File No. S7-25-99.

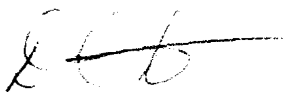
To address these issues, we believe that the definition of "solely incidental" should be discriminating, complemented with illustrations of where various types of advisory services would no longer be considered incidental. The definition should be embedded in the rule.

In the end, to effectively provide for some continuity and investor protection in the marketplace, the meaning of "solely incidental" must be clear to even the lay investor, and represent more than a balancing of interests among service providers. The standard must give preeminence to protecting the interests of the investing public. We agree with other commentators from the investor protection community that in developing these requirements, the SEC should determine which services are most appropriately regulated under a standard that includes a fiduciary duty to the client and an obligation to disclose conflicts of interest, and which can safely be regulated under a less stringent standard of sales conduct.

Conclusion

We generally support the additional disclosure requirements outlined in the re-proposal, released in December, 2004. However, these additional disclosures will have only a limited substantive effect on improving the understanding by investors of the implications of their service choices and the protections offered by understanding their rights. Clarifying the rule in this area will provide significant guidance – to the brokerage industry, the investment advisory profession, state and federal regulators, and investors – concerning the circumstances and activities that will subject brokerage accounts to the laws and regulations governing investment advisors. We urge the Commission not to forego this opportunity to introduce a meaningful functional differentiation between brokers and advisers.

Sincerely,



David Certner
Director
Federal Affairs