

E and O Insurance For Registered Investment Advisors . . .



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Bayard Bigelow, III, MBA, CPA
President and CEO

BY ELECTRONIC FILING AND MESSENGER

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549-0609



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

Dear Secretary Katz:

I am offering comments on the SEC's proposal to allow Broker Dealers access to a status as other than fully disclosed Registered Investment Advisers. I offer these comments from a perspective which I believe is unique in the financial community – I have practiced as a CPA and, for the past 13 years I have managed a professional liability insurance program for Registered Investment Advisers and, at a time in the past, for Broker Dealers. In managing this program, I act as President, CEO and owner of an independent insurance agency. I also hold an MBA in Finance from Columbia University and am well versed in the segments of the financial services professions. The program was established under the sponsorship of the ICFP, the predecessor to the FPA, in 1988. Prior to that, I started up and brought to continuous profitability a professional liability insurance program for CPAs.

Our agency is focused exclusively on underwriting E&O insurance for Registered Investment Advisers, and we have remained active in this market since 1988 as several competitors, many with substantially greater presence in the professional liability insurance markets, have entered our market only to exit within a few years. In short, by virtue of years of experience, we are a repository of knowledge about the liability issues which both Broker Dealers and investment advisers face and are in a unique position to comment upon how each approaches its respective professional responsibilities. Our knowledge is also highly relevant to the issues at hand as it has been put to the test of the marketplace and found not to be lacking in any significant respect. Finally, I have also authored several articles on the financial advisory professions and am frequently consulted or quoted in the business press.

Broker Dealers and Registered Investment Advisers approach a similar market need but from fundamentally different economic and corporate perspectives. The Broker Dealer's primary objectives are to serve as a vehicle for execution of buy and sell orders, maintain an active, robust liquid market for publicly traded securities, to bring securities to market and, to a lesser extent, to provide advice as a service secondary to the purchase and sale of securities. The present regulatory mechanism also allows for Broker Dealers corporately to own separate Registered Investment Advisers, which, as with all other Registered Investment Advisers, must meet the registration and disclosure requirements of the Investment Advisers Act of 1940.

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The congressional intent in establishing the Act was to hold Registered Investment Advisers to a higher duty, that of a fiduciary, to their clients; to require full disclosure by the Registered Investment Adviser of any conflicts of interest in appearance or in fact; and to regulate their market conduct carefully so that the quality of the advice and services rendered to the investing public would be maintained at a high level. We need only look at the pronouncements of the SEC itself to see that this is so. In a public speech delivered on May 1, 2000, Ms. Lori Richards *Director, Office of Compliance Inspections and Examinations* noted:

So many investors need assistance wading through the overwhelming myriad and varied information out there to separate the wheat from the chafe – that they need investment advice from a fiduciary they can trust. While many people have predicted that the growth of the do-it-yourself investor will ebb, I think that your challenge as investment advisers is to present investors with an alternative that they can have confidence in, and can continue to have confidence in. In a very large part, I believe that investors' confidence in investment advisers is founded on good compliance. Your clients' faith in you is based on the fact that you act in their best interests, and in compliance with the law. This trust is critical, and it must be well-founded.

The principles of this statement have greater validity today than they did at the time these remarks were delivered, if for no other reason than the explosive growth of unregulated "alternative investments", hedge funds included. As we have insured both Broker Dealers and Registered Investment Advisers, we are uniquely well qualified to underscore the importance of Ms. Richards' point of view.

Until 1996, our program underwrote both Broker Dealers and Registered Investment Advisers. Beginning in 1993 we began to examine the differences in claims arising from Broker Dealers and those from Registered Investment Advisers. Our predisposition was, because of their heightened legal duty, that Registered Investment Advisers would present claims with both greater frequency and severity than Broker Dealers. To our surprise, just the opposite was the case – claims against Broker Dealers dominated and were, on average, twice as frequent and twice as severe as those made against Registered Investment Advisers. Upon further examination, the differences became even more apparent – while Registered Investment Advisers had the heightened duty of a fiduciary, the evidence unequivocally suggested that they also, at the risk of regulatory censure or sanctions, did a demonstrably more effective job in meeting the needs of the investing public.

As another leading indicator of the effectiveness of the advisors in meeting the needs of the investing public, we also examined the claims files in greater depth. Claims presented by Broker Dealers, which were typically brought against the Registered Representative as well as the Broker Dealer, would contain documentation about the actual trades but little supporting information. A Registered Investment Adviser's file, by contrast, would typically contain documentation of the client's investment objectives and tolerance for risk, an investment policy statement, and continuous files notes as the relationship progressed.

Our strongly held belief, based upon years of underwriting and claims experience with the financial advisory professions, is that the division between Broker Dealers and Registered Investment Advisers is working well and effectively, ensuring that the security markets are efficient and that investment advice is being effectively delivered to investors, particularly to individual investors. In short, based upon credible evidence, there are no clear indications in support of regulatory revisions which ease the burden of regulation on brokers dealers who are much more well equipped to bear the burden than are the many small Registered Investment Advisers; or blur the clear bright line between security sales and investment advice.

Mr. Jonathan G. Katz
January 4, 2005

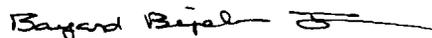
This conclusion is experience and evidence based. Our sense in working with advisers is that the service they provide is highly personalized – the average investor can hardly expect a similar level of high quality investment advice to be delivered by Registered Representatives whose primary objective is driven by sales and commissions.

But the SEC is much better equipped to test these conclusions and to measure differences in the way Broker Dealers (and Registered Representatives) and Registered Investment Advisers protect investors' interests as it is one of the largest repositories of complaint information on investor related complaints. If the shift is warranted by a consistently higher number of claims or consistently greater severity of losses, then the statistics and the economics should be self evident and should speak for themselves.

What the SEC has faced in the opposition to this proposed change is a healthy level of skepticism that the proposed change is warranted, justified, supported by demonstrable and verifiable economics and in the investors' best interest.

The SEC's final ruling has been delayed until well into 2005. This should provide more than enough time for the SEC to test its own hypothesis by using its own data. If the proposed change is supported by the data, then prove the premise. I oppose the proposed change and I believe I represent the voice of the thousands of advisers whom we have insured for years.

Sincerely,



Bayard Bigelow, III, MBA, CPA
President and CEO

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