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BY ELECTRONIC MAIL

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Release No. IA 2652; File No. S7-22-07

Dear Ms. Morris:

The Financial Planning Association ("FPA"®) has asked me to supplement its November 2, 2007 comments to bring to the Commission's attention some recent developments that may affect its consideration of this pending "Interpretive Rule Under the Advisers Act Affecting Broker-Dealers" (the "Proposed Rule"). This letter addresses information that was not available as of November 2, and the FPA would request that the Commission would consider this additional information along with the other comments it has received. As this matter also relates to ongoing work of the Commission apart from the rulemaking, we have copied on this letter both Andrew Donohue (the Commission's Director of the Division of Investment Management) and Elizabeth G. Osterman (the Division's Associate Director of Exemptive Applications and Special Projects).

The issue involves recent information the FPA has received concerning the development of alternative compensation mechanisms for brokerage services. The FPA has received reports that at least two brokerages are examining ways to restructure the compensation system for certain brokerage accounts following the decision of the United States Court of Appeals for the District of Columbia Circuit in *Financial Planning Association v. SEC*, 482 F.3d 481 (D.C. Cir. 2007) (the "*FPA* decision"). Pricing for this new brokerage account reportedly would vary depending upon the trading levels, and be called a "commission." The broker, however, would provide investment advice in connection with the transactions with the commission based upon number of trades. For example, a customer might pay a certain commission rate for zero to 20 trades per month, another commission for 21 to 40 trades, and so on.

The difficulty posed by this example, and other potential repricing of brokerage services, is that such repricing could be used to defeat the purposes of the *FPA* decision by obscuring that the broker is actually receiving special compensation for providing investment advice, or that the investment advice is not "solely incidental" to the brokerage services being provided. On the one hand, it is possible to adopt a system of scaled commissions based upon numbers of trades without providing any investment advice at all; and it is possible that such a system could be developed without providing "special compensation" for investment advice. On the other hand, for a broker that is providing investment advice, the use of the "number of trades" like the percentage of assets under management, or a flat fee for an overall basket of services that includes investment advice (coupled with a lower fee for a basket of services that excludes the investment advice) could well be a surrogate way of obtaining additional compensation for providing investment advice. A brokerage that receives a commission as a percentage of assets under management is profiting by the extent to which it grows the client's account. A brokerage that receives a commission based upon a structure that encourages additional trades in a given month could well be profiting even more directly from the correlation between how much advice the broker is giving and the extent to which the advice is taken to make transactions.

More generally, regardless of the particular system involved, it should not be true that brokers can avoid the fiduciary responsibilities the District of Columbia Circuit discussed under the Investment Advisers Act of 1940 ("Advisers Act") by the mere act of devising an alternative (or less obvious) way of obtaining the same compensation. By repackaging pricing, brokerages can make it difficult for the Commission to enforce the dictates of the *FPA* decision.

In raising this point, the FPA is not saying that what brokerages are doing is necessarily illegal. Brokerages could be drawn to alternate fee mechanisms for other reasons, and having brokers offer different means of pricing, taken by itself, is a good thing. But the SEC must be in a position to prevent brokerages from evading the Court's decision by placing old wine into new bottles. Otherwise, there will remain two classes of standards applying to investment advice and consumers will remain confused about what to expect from their advisers.

The FPA is concerned that the Proposed Rule does not sufficiently arm the Commission to perform this function. Although the FPA agrees with the Commission that investment advice cannot be said to be "solely incidental to the conduct of [a broker's or dealer's] business as a broker or dealer" when the broker or dealer "[c]harges a separate fee, or separately contracts for advisory services," or "[e]xercises investment discretion," 17 C.F.R. §275.202(a)(11)-(1)(a)(1), (a)(2), neither of these two provisions would seem to assist the SEC in evaluating whether a new pricing mechanism reflects an attempt to recover for investment advice that is not solely incidental to the provision of brokerage services.

The only provision of the Proposed Rule that would directly address special compensation, proposed § 275.202(a)(11)-1(b), also provides no assistance on this point. To the contrary, it states that a registered broker or dealer "does *not* receive special compensation within the meaning of section 202(a)(11)(C) of the Advisers act solely because the broker or dealer 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." In context, this provision is understandable.

It is possible for a broker to charge one client a higher or lower fee than another for "similar brokerage" services, without necessarily charging the fee for providing investment advice. And as the Release points out, at 13, different prices could at least in theory be the result of "lower expenses and less overhead."

However, the fact that different pricing structures for different customers *might* not *necessarily* involve special compensation for providing investment advice, does not mean that those structures *do not, in fact*, involve special compensation for providing investment advice. Indeed, there is an especial reason to be concerned when new pricing structures, never before perceived to be appropriate or advantageous, are developed in the advent of the Court's decision, with no change in the services involved.

The Proposed Rule, however, provides no assistance in determining whether, in fact, pricing mechanisms are being used to evade the District of Columbia Circuit's decision. Although the Commission's September 24, 2007 Release (the "Release") (at 12-13) alludes to there being "other factors," that might show that a given situation involves "special compensation," it does not identify any of those factors. Accordingly, the FPA is concerned that brokerages will be led to conclude that, so long as they recast their pricing to be something different from "fee based," they can lead investors to believe that they are being retained to provide investment advice, and charge more for it, without assuming the fiduciary obligations required by the *FPA* decision. That result would be contrary to both the words and the spirit of the Court's ruling.

The potential advent of new pricing mechanisms also makes especially problematic some of the other comments in the Release. On page 12 of the Release, the Commission acknowledges its "longstanding view that, with respect to brokerage commissions or other transaction-based compensation, broker-dealers receive 'special compensation' where there is a clearly definable charge for investment advice." But the Release then it goes on to say that:

> if a firm negotiates different fees with its customers for similar transactions, the Commission would *not* conclude that the customer being charged the higher fee is paying 'special compensation' for investment advice based solely on differences in charges, because whether the pricing difference is based on the presence or absence of investment advice is 'too hypothetical.'

And, in footnote, the Release states:

> In addition, in the 2005 rulemaking, we stated that the interpretive position [redefining "special compensation" so as to exclude two-tiered pricing] was necessary to supersede past staff interpretations that would lead to a full-service broker-dealer being subject to the Advisers Act "with respect to accounts for it provides advice incidental to its brokerage services merely because it offers

> electronic trading or other forms of discount brokerage." 2005 Proposing Release at n.88 and accompanying text. Having revised those past staff interpretations, we conclude that they do not necessarily lead to the conclusion that a broker-dealer's full service accounts are advisory accounts subject to the Advisers Act merely because the broker-dealer also offers some form of discount brokerage.

Release at 12 n.21.

Having stated (in 2005) that it was necessary to adopt a change in the rule to "supersede" past staff interpretations (and so informed the Court in its brief), the Commission cannot mean to say that it now believes the change was not necessary at all. In the *FPA* decision, the District of Columbia Circuit had concluded that the earlier rule "flout[ed] six decades of consistent SEC understanding of its authority under subsection (F)," 482 F.3d at 490, and referred to the SEC's historic positions concerning subsection (C) and two-tiered pricing. According to the Court:

> Very shortly after enactment of the IAA, the SEC advised that any charges directly related to the giving of investment advice would be special compensation. On October 28, 1940, the SEC General Counsel issued an opinion stating:
>
> > Clause (C) of section 202(a)(11) amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business. On the other hand, that portion of clause (C) which refers to "special compensation" amounts to an equally clear recognition that a broker or dealer who is specially compensated for the rendition of advice should be considered an investment adviser and not be excluded from the purview of the Act merely because he is also engaged in effecting market transactions in securities.
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> 11 Fed. Reg. 10,996 (Sept. 27, 1946) (reprinting SEC General Counsel opinion letter of October 28, 1940). Thus, any charges "directly related to the giving of advice" would be special compensation. *Id.*
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> This contemporary interpretation was reflected as well when the SEC addressed two-tiered pricing arrangements (including a discounted fee arrangement) in 1978:
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> > [I]f a broker-dealer has in effect, either formally or informally, two general schedules of fees available to a customer, the lower without investment advice and the higher with investment advice[,] and the difference is primarily attributable to this factor ... the [SEC] would regard the extra charge as "special compensation" for investment advice.

> 43 Fed.Reg. 19,224, 19,226 (May 4, 1978). The SEC made clear at the time that "[t]his would be the case even in a situation, currently nonexistent, in which a current 'full service' firm implements a 'discount' or 'execution-only' service." *Id.; see also Townsend & Assocs., Inc.,* SEC No-Action Letter, 1994 SEC No-Act. LEXIS 739 (Sept. 21, 1994); *Am. Capital Fin. Servs., Inc.,* SEC No-Action Letter, 1985 SEC No-Act. LEXIS 2209 (Apr. 29, 1985).

FPA, 482 F.3d at 490 n.7.

There is nothing in this passage that suggests that the link between two-tiered pricing and special compensation was "too hypothetical" to implicate the Advisers Act. To the contrary, the words "too hypothetical" in the September 24, 2007 Release appear to come from a passage in the 1978 Release upon which the *FPA* Court relied, in which the Commission staff *distinguished* the type of pricing that appeared to be "too hypothetical" *from* the type of *two-tiered* pricing that *would* implicate the Advisers Act. The full passage reads:

> If a firm negotiates different fees with its clients for similar transactions, the Division would not regard the differences in charges 'special compensation' for investment advice since whether they were or were not based on the presence or absence of investment advice appears too hypothetical.
>
> Nor would the Division regard as 'special compensation' general differentials which exist because a firm provided, on the one hand, an unrestricted execution service and, on the other hand, a restricted execution service such as one in which customers must have the necessary cash in their accounts at the time a purchase order is placed and must accept execution at the next day's opening price.
>
> ***However, if*** a broker-dealer has in effect, either formally ***or informally***, two general schedules of fees available to a customer, the lower without investment advice and the higher with investment advice and the difference is primarily attributable to this factor or if a broker-dealer should separately bill a particular customer with a specific charge for investment advice, the Division would regard the extra charge as 'special compensation' for investment advice. This is the position that was taken by the General Counsel in 1940 and it is the position that the Division believes would be taken by a court today. This would be the case even in a situation, currently nonexistent, ***in which a current 'full-service' firm implements a 'discount' or 'execution-only' service.*** If the differential in general rate structure offered to a particular client could be said to be primarily attributable to the rendering of investment advice the Division would deem at least part of the differential to be 'special compensation' for investment advice.

43 Fed. Reg. 19224, 19226 (May 4, 1978) (emphasis added).

In 1999, when the Commission originally proposed the Broker-Dealer Rule that the Court ultimately struck down, the Commission had no problem determining that the difference in pricing between execution-only services and "full-service" was primarily attributable to the rendering of investment advice. It said that the use of two-tiered pricing:

> make[s] visible that which has always been apparent – a portion of commissions charged by full service broker-dealers compensated the broker-dealer for advisory services.

Certain Broker-Dealers Deemed Not To Be Investment Advisers, 64 Fed. Reg. 61,226, 61,228 (Nov. 10, 1999). The "special compensation" was not "hypothetical" at all.

Accordingly, the FPA must assume that the Commission is merely taking the position that it is possible to have different prices for different customers without providing "special compensation" for investment advice. And the FPA takes some comfort in the Commission's representation that its view is supposed to be "consistent with the staff position announced" in the 1978 Release. Release at 12 n.23. If, however, if the Commission were really intending to declare either that (1) brokers can, without implicating the Advisers Act, use a system in which "formally or informally," there are "two general schedules of fees available to a customer, the lower without investment advice and the higher with investment advice and the difference is primarily attributable to this factor"; or that (2) the type of two-tiered pricing involved in "execution-only" versus "investment advice" that "make visible" the fact that "a portion of commissions charged by full service broker-dealers compensated the broker-dealer for advisory services," now does *not* implicate the Advisers Act, it would be breaking with both it own prior staff analysis and the ruling of the District of Columbia Circuit.

To avoid that implication, the interpretive rule needs to explain what the Commission means to accomplish. The Proposed Rule does not provide any example of a pricing structure that *would* implicate the "special compensation" language in the Advisers Act, or any guidance from which a broker or customer could determine what implicates this provision. The Release does not even suggest anything a brokerage could do to trigger an *inquiry* that it *might be* receiving "special compensation" for investment advice. To the contrary, the Release states that the Commission will not "look outside the fee structure of a given firm to determine whether special compensation exists," Release at 13 – even, if, in fact, those fee structures make it "apparent" that brokerages *are* receiving special compensation for advice.

The Commission previously concluded that a regulation was essential to exempt broker-dealers who otherwise would be subject to the Advisers Act under the "special compensation" provision. It cannot be that the Commission is currently unaware of any situation in which the special compensation language would actually apply. The failure to have any language explaining what those situations are or might be can only be expected to breed new confusion as brokers move to new compensation schemes some of which may have nothing to do with investment advice, but others could be intended for no other purpose than to avoid the Court's ruling.

In making these comments, the FPA is not saying that brokers are always subject to the Advisers Act. It is possible for brokers to provide advice on specific trades that is solely incidental to their work as brokers. It is possible to structure fees that do not afford brokers special compensation for providing that advice. But it is not true that all advice brokers give is solely incidental to their work as brokers or that none of it is the subject of special compensation. And the FPA is concerned that the proposed rule fails sufficiently to explain when, in accordance with the Court's decision, brokers are subject to the Advisers Act.

We hope that these comments are helpful. The FPA looks forward to working with the Commission to formulate this guidance in a way that honors the Commission's prior views, the Court's opinion, the terms of the Advisers Act, and the interests of all concerned.

Sincerely,

ROSS, DIXON & BELL, LLP

By ______________________
Merril Hirsh

cc: Andrew Donohue
Elizabeth G. Osterman
Duane Thompson, Financial Planning Association