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THE FINANCIAL PLANNING ASSOCIATION

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BY ELECTRONIC MAIL

November 2, 2007

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"®)[1] appreciates the opportunity to comment on the "Interpretive Rule Under the Advisers Act Affecting Broker-Dealers" (the "proposed rule"). The proposed rule would reinstate three interpretive provisions related to rule 202(a)(11)-1, which was vacated by the Court of Appeals for the District of Columbia, in *Financial Planning Association v. SEC* ("*FPA* decision").[2] We appreciate the need to provide clarity to financial services providers and investors regarding application of the Investment Advisers Act of 1940 ("Advisers Act")[3] to broker-dealers providing advisory services to their clients.

FPA has commented extensively on the issues raised by broker-dealers providing investment advice to their clients.[4] We continue to be concerned that investors remain

[1] The Financial Planning Association™ is the largest organization in the United States representing financial planners and affiliated firms, with approximately 28,000 individual members. Not all are investment advisers. Approximately 47 percent are affiliated with SEC-registered investment adviser firms and 25 percent with state securities administrators. Two-thirds of members hold at least one securities license, such as the Series 6, 7 or 24. FPA is incorporated in Washington, D.C., with administrative headquarters in Denver.

[2] 482 F.3d 481 (D.C. Cir. 2007).

[3] 15 U.S.C. 80b.

[4] We refer you to FPA's letters to the SEC dated January 14, 2000, December 7, 2002, June 21, 2004, and September 22, 2004, February 7, 2005, and March 14, 2007, as well as a joint letter submitted with other interested parties on May 6, 2003 (*See* May 6, 2003, letter from Certified Financial Planning Board of Standards, Inc., Consumer Federation of America, FPA, Fund Democracy, Investment Counsel

confused about the obligations of their financial services providers, as do the providers themselves.

In our comments we would like to address specific concerns with two parts of the proposed rule – section 202(a)(11)-1(c) (the "Special Rule") indicating how to distinguish brokerage from advisory accounts, and the discussion of the Securities and Exchange Commission's ("SEC" or "Commission") understanding of the term "solely incidental." We also wish to address the Commission's questions regarding separate contracts or fees for advisory services and the decision not to re-propose the financial planning provisions of the vacated rule. FPA agrees with the Commission's analysis in determining that investment discretion is an advisory activity, and strongly supports adoption of Rule 202(a)(11)-1(2).[5]

I. Special Rule

The Special Rule provides that a registered broker or dealer "is an investment adviser solely with respect to those accounts for which it provides services or receives compensation that subject the broker-dealer to the Advisers Act." As the Commission notes in the Proposing Release, only a few comments were received in the original rule on this provision. In and of itself, this provision would appear to be a reasonable interpretation of the Advisers Act.

Broker-dealers are generally not considered to have a fiduciary relationship with their clients under federal securities laws. In contrast, the Advisers Act holds investment advisers to a fiduciary standard with regard to <u>any</u> investment advice that they provide to their clients. The Special Rule essentially provides that the Advisers Act will not apply to non-advisory accounts merely because the broker-dealer acted as an adviser with respect to other accounts, thereby raising doubts over the applicability of a fiduciary standard to similar advisory activities under broker rules.

In light of the RAND Corporation's study of overlapping services of brokers and advisers, we believe it is premature to adopt this provision. As SEC Chairman William Donaldson noted in announcing plans for a RAND-type study, he asked whether certain broker-dealers that are excepted from the Advisers Act nonetheless should be subject to the fiduciary obligations imposed by the Act on investment advisers.[6] Specifically, we believe that it is appropriate for the SEC to consider whether fiduciary status should extend beyond an advisory account to other aspects of a client relationship maintained by a dual registrant, such as certain brokerage transactions that stem from advisory or financial planning recommendations. We believe investors and financial services professionals alike would benefit from a discussion of this issue before readopting a provision that may be subject to change.

Association of America, and National Association of Personal Financial Advisors to SEC Chairman William Donaldson.

[5] Consistent with our discussion over fiduciary relationships expressed with the 'Special Rule' above, we would ask the Commission to express its view that a broker-dealer taking temporary discretion over a brokerage account would be deemed to be a fiduciary with respect to the discretionary activity.

[6] *See* Statement of SEC Chairman, Open Meeting of April 6, 2005.

II. "Solely Incidental" Discussion

In the release for the proposed rule ("2007 Proposing Release"), the SEC discusses section 202(a)(11)(C) of the Adviser's Act, which provides an exception for broker-dealers whose advisory services are "solely incidental to his business and who receives no special compensation therefor." The discussion provides background and context for section 202(a)(11)-1(a) of the proposed rule, which specifies circumstances in which a broker or dealer is providing advice that is *not* solely incidental to its business.

With the exception of the provisions in the proposed rule, however, it is not clear to us what the Commission's present view is of the "solely incidental" language of the Advisers Act, in light of the *FPA* decision. Specifically, the 2007 Proposing Release refers back to the 2005 Proposing Release for the rule that was vacated. It discusses the SEC's understanding of "solely incidental," as stated in the 2005 Proposing Release. What is not clear is whether the Commission is merely providing historical background for the proposed rule, or whether it is stating that its current understanding of "solely incidental" is consistent with the previous view. If it is the latter, we must restate our strong objection to the SEC's overly expansive interpretation of the term, which is clearly in conflict with the plain language and the intent of the Advisers Act.

Referring to the 2005 Proposing Release, the SEC states its understanding of "solely incidental to" as meaning "the advisory services rendered to an account are in connection with and reasonably related to the brokerage services provided to that account." Although the *FPA* decision did not address this particular term directly, the court applied traditional tools of statutory construction to the broker-dealer exclusion under Section 202(a)(11)(c) of the Advisers Act in determining that Congress had addressed the precise issue at hand and that the "plain meaning" of the law should be paramount.[7]

The Commission's expansive interpretation under that rule would allow a limited or tenuous relationship between the advisory services and the brokerage services that satisfies the solely incidental test. As noted in FPA's legal arguments to the court, the rule

> does not consider a broker-dealer's investment advice to be more than "solely incidental…even when that advice is substantial;" even if "providing investment advice" is the "most important role" of the broker-dealers it is exempting from the statute; or, if in practice, "brokerage is incidental to the advisory services."

The SEC's previous interpretation stands in stark contrast to the plain language which suggests that the exclusion would apply if the advice were given *only* as an *incidental consequence* of providing the brokerage services. This issue was discussed in FPA's February 7, 2005, letter to the Commission, which stated in part:

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[7] *See FPA v. SEC* decision, March 30, 2007, at 13, "[t]he plain meaning of legislation should be conclusive, except in the 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters" [citing *United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 242 (1989), quoting *Griffin v. Oceanic Contractors, Inc.,* 458 US. 564, 571 (1982).

> We would point to the more common and frequent usage of the term "solely incidental" in the Advisers Act, its legislative history, in industry, and staff commentary over the ensuing decades. The SEC should not grasp at straws in honing in on an isolated use of the term "incident." "Incidental" is defined in modern dictionaries as "occurring or likely to occur as an unpredictable or minor accompaniment"[8] and "occurring by chance or in isolation."[9] "Solely" is defined as "alone" or "singly."[10] The legislative history of the Advisers Act also contains references to "merely incidental" advice by brokers. "Merely" appears to have been used interchangeably with "solely," and suggests a very similar result: "nothing else or more; only."[11] In combination, the plain-English meaning of the term "solely or merely incidental" strongly suggests that investment advice was to be dispensed only in isolated or limited circumstances – not as a regular part of brokerage where the customer paid for advice in connection with a stock purchase or sale.

The plain statutory language suggests a limited reading of the exception that is inconsistent with the expansive interpretation of the 2005 Proposing Release. If the Commission is *not* suggesting that this is its current interpretation, we respectfully suggest it make a clear statement to that effect.

III. Separate Contract or Fee for Advisory Services

Section 202(a)(11)-1(a)(1) of the proposed rule provides that a broker or dealer is not providing advice that is "solely incidental" to the conduct of its business as a broker or dealer if it is charging a separate fee for advisory services or separately contracts for advisory services. The SEC proposes this section of the rule as a codification of previous interpretations. FPA generally supports this provision. We think it is an appropriate interpretation of "solely incidental" and consistent with the plain meaning and intent of the Advisers Act, i.e., brokers or dealers are excluded from the definition *only* if their advice is incidental to their business.

In its discussion, the Commission posits the question whether a broker-dealer could separately contract for advisory services, yet remain excepted from the Advisers Act if it does not receive "special compensation." As discussed at length in our February 7, 2005 letter, congressional intent and the plain language of the Advisers Act require that in order for a broker-dealer to be excepted from the Act, it must satisfy **both** elements of the exception. The activity must be solely incidental to the broker or dealer's conduct of its business **and** the broker-dealer may not receive special compensation for the advice. If either test is not met, the exception fails.

As the SEC suggests in its discussion, "a separate contract specifically providing for the provision of investment advisory services reflect[s] a recognition that the advisory services are provided independent of brokerage services and, therefore, cannot be

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[8] American Heritage® Dictionary, Fourth Edition, 2000.

[9] Merriam-Webster Dictionary of Law, 1996.

[10] American Heritage Dictionary, Fourth Edition, 2000.

[11] *Id.*

considered solely incidental to the brokerage services." In fact, we would go further – if a contract, *de facto*, provides for advisory services, the services should not be considered solely incidental to the brokerage services. The Commission's use of the qualifier "specifically" could lead some to interpret the rule as allowing advisory services to be provided so long as it is not specifically or explicitly described in the contract.

In the same vein, we ask whether in drafting the rule the Commission considered whether the reference to a "separate" contract is too limiting. We suggest that whether the advisory services are "solely incidental" should not depend on whether the services are contracted for separately, or as part of a broader contract with the broker-dealer. Any contract providing for advisory services should create a presumption that the services are not solely incidental to brokerage or other services, insofar as "solely incidental" would imply that the services would not need to be spelled out in a contract.[12]

IV. Financial Planning

When rule 202(a)(11)-1 was adopted in 2005, it included a provision that generally held that financial planning services offered by a broker-dealer were not solely incidental. To address some interpretive issues raised in connection with the rule, the SEC provided a staff interpretive letter.[13] That letter is now terminated.

Rather than re-propose the financial planning part of the rule and the related interpretations, the Commission has committed to considering issues related to financial planning following review of the RAND Corporation study commissioned by the SEC comparing the levels of protection afforded to customers of broker-dealers and investment advisers under federal law.

FPA supports this undertaking and looks forward to the results of the study and the opportunity to address any SEC recommendations arising out of the findings. We wish to express our understanding that in choosing not to re-propose the financial planning restrictions of the vacated rule, the SEC is not implying that financial planning services are generally solely incidental to brokerage services or that broker-dealers can generally hold themselves out as financial planners without being subject to registration under the Advisers Act.

V. Conclusion

FPA supports paragraph (a)(1) of the proposed rule, with clarifications as noted. We also support codification of previous SEC interpretation regarding separate contracts and fees for advisory services in (a)(2), but suggest a somewhat broader rule may be

[12] We would go farther in expressing our concern that the provision of free advisory services should be deemed an oral contract and not solely incidental advice. We note the practice of at least one wirehouse of providing free financial plans to its brokerage customers. We believe that the SEC should view such activities as not solely incidental advice and the indirect receipt of special compensation, notwithstanding the absence of a written agreement or advisory contract. In this instance, there is a clear expectation by the firm that it would offset the cost of the financial plan by receipt of compensation in implementing some or all of the financial planning recommendations.

[13] Securities Industry Association, SEC Staff Letter (Dec. 16, 2005).

warranted to fully capture advisory services that are not solely incidental to the brokerage activity of a dual registrant. We oppose adoption of paragraph (c) given the importance and the complexity of the fiduciary and other issues surrounding dual registrants that should await further review by the Commission following completion of the RAND study. Finally, as suggested above, we respectfully request that the Commission clarify its intent in citing the 2005 Proposing Release with regard to its understanding of "solely incidental."

Thank you for the opportunity to comment. If you require additional information or clarification, please don't hesitate to contact me at 202-449-6343.

Very truly yours,

Daniel J. Barry
Director of Government Relations