4-507-3

JOSEPH CAPITAL MANAGEMENT, LLC

A FEE ONLY INVESTMENT ADVISORY FIRM

August 18, 2005

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
100 F Street, N.E. 4-327
Washington, D.C. 20549

Re: Request for Extension of Certain Compliance Dates for Rule 202(a)(ll)-1 (S7-25-99) and [File No. 4-507]

Dear Secretary Katz:

I am writing in opposition to the petitions by the Securities Industry Association (SIA)[1] and American Council of Life Insurers (ACLI)[2] to delay compliance with the financial planning and discretionary brokerage portions of the recently adopted rules regarding the broker-dealer exemption from the Investment Advisers Act.[3] In addition to my concern that the Petitioners seek that one of the first

[1] Letter from Ira D. Hammerman, Securities Industry Association, to Jonathan G. Katz, Securities and Exchange Commission, July 28,2005.

[2] Letter from Carl B. Wilkerson, American Council of Life Insurers, to Jonathan G. Katz, Securities and Exchange Commission, July 27,2005.

[3] *See* Certain Broker-Dealers Deemed Nor To Be Investment Advisers, Release Nos. IA 2376; 34-5 1523; File No. S7-25-99 (April 12,2005). The releasing notice states, "[I]nvestors understand financial plans and financial planning to mean something different from brokerage services ... investors ... assumed financial planners held responsibilities relating to the long-term needs of their clients ... our approach would provide broker-dealers the certainty they need to determine when their advisory activities will trigger obligations under the Advisers Act because they can control how they hold themselves out to the public and their customers. Under the rule, a broker-dealer would be subject to the Advisers Act if it portrays itself to the public as a financial planner or as providing financial planning services, whether it uses those particular terms or not. And it must treat as advisory clients all those customers to whom it delivers a financial plan, regardless of what it chooses to call the plan. While we have recognized there are some common elements in a financial plan and a broker-dealer's advice based on its understanding of a customer's needs and objectives, which is incumbent in its suitability analysis, we do no not consider this broker-dealer advice alone as constituting a financial plan. The broker-dealer must also treat as advisory clients those customers to whom it represents that its advice is

acts of the Commission under the new SEC Chairman's leadership is to delay a rule providing essential protections to millions of individual investors, my opposition to the extension is based upon the following specific considerations:

(1) Investor confusion has been caused by fee-based accounts, and providing the requested extension will only exacerbate and extend such confusion;

(2) The Final Rule was extremely liberal in the time constraints it originally imposed, given the continuation of harm to individual investors;

(3) Broker-dealer firms have not demonstrated an adequate compliance effort with the advertising rules which were effective on July 22, 2005, and continue to engage in deceptive advertising as to the scope of their relationships with their customers in advertising for brokerage services (including fee-based accounts), and hence broker-dealer firms should not seek relief given their dismal compliance with already-in-effect provisions of the Final Rule; and

(4) The SEC's emphasis on a renewed culture of compliance within the securities industry would be harmed by the grant of such an extension.

(1) Investor Confusion Has Existed Long Enough. It has been nearly six long years since the SEC first proposed this rule and issued a no-action position in the first release. Moreover, fee-based accounts were first utilized as early as 1995 - a full ten years ago. It is imperative that the confusion caused to individual investors by these fee-based accounts is not extended any further. As recently stated by Commissioner Glassman:

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part of a financial plan even if it uses some other term to describe the plan. Whether a particular document is, under the rule, a financial plan will turn on whether the document or representation bears the characteristics of a financial plan. Whether a communication represents that the services provided are financial planning services will depend on how a reasonable investor would understand the services described in the communication." *Release* at pp. 57-58. The issuing release contemplates that additional steps should be taken by broker-dealer firms address issues of investor confusion and broker-dealer marketing.

> Fee-based, rather than commission-based, brokerage accounts and advertising that raises expectations that the broker is the customer's trusted confidant have increased customer confusion about the duties and obligations they are owed by investment professionals.[4]

It is long past time for the Commission to protect individual investors through implementation and enforcement of the important protections provided in the Final Rule. Further delays, after nearly 10 years of inadequate attention to these issues, should not be tolerated.

(2) The Final Rule Provided A Liberal Deadline For Compliance With Its Provisions, Given The Ongoing Harm Broker-Dealer Activities Had Upon Individual Investors. In undertaking their filings on July 27th and 28th, more than fifteen weeks following the publication of the Final Rule, the petitioners seek an extension on a Final Rule implementation wherein they were already provided with over six months' time to implement the provisions of the Final Rule. The Petitioners seek not just a mere few additional weeks, but rather more than five months' additional time, bringing to nearly one year the total time for implementation of the Final Rule's provisions.

It must be recognized that the Final Rule presented a fairly easy course for compliance as to its time constraints. Instead of restricting the opening of any new fee-based accounts until such time as the broker-dealer firms adapted their systems and forms, *as would have been proper given the ongoing confusion and harm suffered by individual investors*, the Final Rule permitted investor confusion to continue by permitting new fee-based accounts to be opened notwithstanding non-compliance with the important disclosure provisions of the Final Rule. In essence, the Final Rule approved a period of six months' during which harm could continue to be imposed upon unsuspecting investors by broker-dealer firms. Now, the SIA and ACLI seek to extend such period of investor confusion and harm even further, even though the Commission would have been well within its prerogatives to suspend

[4] Speech by SEC Commissioner: "SEC in Transition: What We've Done and What's Ahead" by Cynthia A. Glassman, Commissioner, U.S. Securities and Exchange Commission, Washington, D.C., June 15, 2005.

entirely the opening of any new fee-based accounts until compliance with the Final Rule was achieved by a firm.

In particular, the SIA seeks "sufficient time for firms to *develop* and disseminate meaningful disclosures about brokerage and advisory relationships." This is despite the fact that the *specific* language of the "meaningful disclosure" is already set forth in the Final Rule itself![5] I cannot fathom why additional time is required to develop a "meaningful disclosure" that is already set in stone, unless the SIA seeks time for its members to ascertain how to weaken the effect of the disclosure through other language. I submit that if the SIA focused its own efforts on assisting its members to implement this standardized disclosure rather than on petitions to extend the time for the implementation of important consumer protections, the SIA would likely serve its members better (as well as the interests of the investing public).

According to the adopting release, a broker-dealer that provides investment advice and delivers a financial plan to a customer or represents to a customer that its advice is provided as part of a financial plan or in connection with financial planning services must register under the Advisers Act and treat that customer as an advisory client.[6] The deadline for compliance with these provisions, contained in Rule 202(a)(11)–1(b)(2) is October 24, 2005. The Petitioners now seek an extension of time for compliance with these provisions. This is despite the fact that, in comments regarding the Proposed Rule, several broker-dealers commented that they make higher level comprehensive financial plans available for an additional fee, treating customers that elect this option as advisory

[5] § 275.202(a)(11)-1(a)(1)(ii) states: "Advertisements for, and contracts, agreements, applications and other forms governing, accounts for which the broker or dealer receives special compensation include a prominent statement that: 'Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits, and our salespersons' compensation, may vary by product and over time.' The prominent statement also must identify an appropriate person at the firm with whom the customer can discuss the differences."

[6] Release, *supra note 3* at p. 83.

clients.[7] Other broker-dealers also commented that many of their registered representatives already possess the CFP® designation[8], and as the Commission knows registration as an investment adviser representative is easily undertaken by those who possess a CFP®, since most states do not require CFP® holders to undertake the Series 65 exam.

Interestingly, the Petitioners have not cited any external factor, such as dealing with the aftermath of some recent terrorist attack on their firms or otherwise, which might compel the issuance of such an extension. The only reasons provided for the extension is the necessity for changes to internal systems and forms to take place in order to comply with the law (and to protect consumers). Given the importance of the protections of this Final Rule for individual investors and its benefits,[9] in removing an ongoing system which continues to cause individual investor confusion and harm, the fact that compliance might involve a bit of hard work for broker-dealer firms should not be a reason for extension of the rule. This is especially true given the continuation of the opening of new fee-based accounts without the important consumer protections provided by the Final Rule. If hard work is required, then a little hard work should be undertaken by the broker-dealer firms, lest investor confusion and harm continue to occur. Given the importance of the issues present, Commission staff spent long nights and many hours during the period from September 2004 to April 2005 analyzing the complex issues present in the Final Rule; we should expect hard work from securities industry participants as well.

(3) Broker-Dealer Firms' Failure To Comply With Advertisement Rules Already In Effect Should Estop Them From Seeking An Extension of The Other Provisions of the Rule. The SIA seeks, on behalf of broker-dealer firms, relief from a reasonable time already provided for implementation of certain of the Final Rules' provisions. The SIA cites its members' good-faith compliance with the

[7] *See, e.g.*, Merrill Lynch Letter, Morgan Stanley Letter, and UBS Letter, cited in the issuing Release, note 209.

[8] *See, e.g.*, Northwestern Mutual Letter, cited in the issuing Release, note 209.

[9] The issuing Release acknowledges the benefits provided to individual investors, stating "Rule 202(a)(11)-1(b) will benefit these customers by making [financial planning] services subject to the protections of the Advisers Act." Release, *supra note 3* at page 83.

other provisions of the Final Rule. However, many of the SIA's members are not complying with the advertising provisions of the Final Rule which were effective on July 22, 2005.[10]

Commercials continue to exist and be displayed touting the comprehensive financial planning services offered by broker-dealer firms. These ads promise to guide the investor toward the lifetime pursuit of his or her goals,[11] which necessarily implicates comprehensive financial planning services. In response to such advertisements new customers are attracted to the broker-dealer firm, and presumably some customers will open new fee-based accounts in response to such advertisements. Moreover, these advertisements use the generic fictitious name for the company, which might refer either to the wirehouse's broker-dealer corporation, the wirehouse's registered investment adviser firm, or even perhaps to the wirehouse's asset management (i.e., product manufacturing) arm, further causing confusion.

By opening fee-based accounts as a result of such generic advertisements, without the required disclosures of the Final Rule, the broker-dealer firms have failed to demonstrate a commitment to comply with the Final Rule's provisions. It should also be noted that many broker-dealer firms have failed to maintain up-to-date and required fictitious name registrations in some of the states, an important legal requirement which provides investment consumers the ability to discern with whom they may be dealing should they respond to an advertisement which utilizes a fictitious name.

[10] The issuing Release states that "All advertisements for, and contracts, agreements, applications and other forms governing accounts opened after July 22, 2005 in reliance on rule 202(a)(11)-1(a)(1) must include the disclosure required by paragraph (a)(1)(ii)."

[11] In an advertisement on August 17, 2005, on a national cable network, portraying a college graduation event, which implicated financial planning services in the provision of a plan for payment of educational expenses, the ad stated that "when you work with a _____ financial advisor, you get someone unusually devoted to your dreams." The mandated disclosure was not present in this advertisement. Also note the existence of many advertisements which state that the broker-dealer firm is prepared to offer advice to answer a number of "what if" questions, the answering of which questions will necessarily involve financial planning of a comprehensive nature. Again, the mandated disclosures are not present.

Given this non-compliance with already-effective provisions of the Final Rule and the continuation of advertising practices which could only be considered as "business as usual," the SIA should be estopped from, and not be permitted to, seek an extension from the work required by the other important disclosure provisions of the Final Rule.

(4) The SEC's Emphasis on a Renewed Culture of Compliance Within the Securities Industry Would Be Harmed by the Grant of Such an Extension. It is interesting that the ACLI and SIA cite the newness of these requirements, especially as they relate to the "financial planning" provisions of the final rule, when – since 1987 – the SEC had already opined on the applicability of the Investment Advisers Act of 1940 to persons who provide investment advice as a component of other financial services. As stated in well-known IA Release 1092, which specifically addressed the application of the Advisers Act to financial planning activities:

> The staff believes that a person who provides advice, or issues or promulgates reports or analyses, which concern securities, but which do not relate to specific securities, generally is an investment adviser under Section 202(a)(11), assuming the services are performed as part of a business and for compensation. The staff has interpreted the definition of investment adviser to include persons who advise clients concerning the relative advantages and disadvantages of investing in securities in general as compared to other investments. A person who, in the course of developing a financial program for a client, advises a client as to the desirability of investing in, purchasing or selling securities, as opposed to, or in relation to, any nonsecurities investment or financial vehicle would also be "advising" others within the meaning of Section 202(a)(11) ...[12]
>
> In applying the foregoing tests, the staff may consider other financial services activities offered to clients. For example, if a financial planner structures his planning so as to give only generic, non-specific investment advice as a financial planner, but then gives specific securities advice in his capacity as a registered representative of a

[12] [Release No. IA-1092, *Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services*, October 8, 1987, at p.4.

> dealer or as agent of an insurance company, the person would not be able to assert that he was not 'in the business' of giving investment advice ...[13]
>
> It is not necessary that a person who provides investment advisory and other services to a client charge a separate fee for the investment advisory portion of the total services. The compensation element is satisfied if a single fee is charged for a number of different services, including investment advice or the issuing of reports or analyses concerning securities within the meaning of the Advisers Act ...."[14] [Emphasis added.]

Given the existence of IA-1092, and indeed the Investment Advisers Act of 1940 itself, the ACLI is patently incorrect when it asserts that the Final Rule results in the *initial* imposition of the Advisers Act to activities which it describes as follows in its Petition:

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[13] *Id.* at p.5. Of interest to this observer is whether the business model of the firm formerly known as American Express Financial Advisors, the practices of which were the subject to a recent state enforcement action relating to breach of fiduciary duty. This observer believes that such business model fails to meet the requirements of the Advisers Act and IA-1092. It does not make sense, to this observer, that an investment advisory firm can provide a financial plan under an investment adviser platform and then "switch hats" and sell commission-based and proprietary products under a broker-dealer account. Presumably multiple switches in hats would occur, as the registered representative would have to refer back to, and further explain, the financial plan as it was being implemented, as well as provide updates to the financial plan were needed. This all appears, in the opinion of this observer, to be a violation of the fiduciary duties owed by the investment adviser and its representatives and a violation of the dictates of IA-1092. Once the investment adviser "hat" and the important fiduciary duties are assumed toward the customer by a financial advisor, that financial advisor should not be permitted to escape such fiduciary duties by the mere act of "removing the hat" in cavalier fashion. Once the relationship of trust and confidence is in place, especially in connection with the provision of comprehensive planning services, the fiduciary duty and other requirements of the Advisers Act should continue throughout the course of the relationship with the customer. To do otherwise would be violative of Section 215(a) of the Advisers' Act, a breach of fiduciary duty (by the financial advisor suggesting that the customer move to an account or relationship which has lesser protections for the customer), and a cause of significant confusion and potential harm to customers.

[14] *Id.* at pp.5-6.

> As a technological extension of the life insurer's emphasis on fact-finding and needs-based recommendations, the company provides qualified agents access to proprietary planning software that generates custom tailored reports based on information customers provide about their financial background and objectives.
>
> The company's planning software can address a variety of topics, including: survivor income; disability protection; long term care planning; retirement planning; education planning; estate planning; major purchase funding; and, asset allocation. Several of these topics focus on traditional insurance planning issues supported by fact-finding and customer needs. This insurance company has historically made the reports available to customers without charge or obligation.[15]

Since when did these planning activities not fall under the mandates of the Investment Advisers Act of 1940? Merely because no fee was charged for the financial plan itself does not mean that the service is not an investment advisory service (since other compensation may be received when the product is sold). IA-1092 clearly points this out. Once financial planning is undertaken, whether it be in connection with the sale of any security (including life insurance products which possess characteristics of a security) or otherwise, the customer has the reasonable expectation that he or she is dealing with a trusted adviser. The customer is entitled to deal with a *fiduciary* under the Advisers Act. Simply because life insurance industry participants failed to adhere to the requirements of the Advisers Act in the past does not merit the requested relief. Moreover, this requested relief is really in the form of a wholly new temporary exemption from the provisions of the Advisers Act, as it does not deal with fee-based brokerage accounts. Insurance companies should, instead, immediately suspend providing such comprehensive financial planning services to customers and potential customers until such time as they are prepared to fully comply with the Advisers Act.

The SIA and the ACLI seek relief from provisions of the law, with regard to financial planning services, as if the Final Rule was some great surprise. However, as stated in the Release of the Final Rule:

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[15] ACLI Letter, *supra note 2.*

> We do not believe that financial planning, as it is understood today, necessarily follows as a consequence of rendering brokerage services. Instead, it is a relatively new service that many brokers provide in a manner essentially independent of their brokerage services.[16]

The petitions of the SIA and ACLI point out an even graver problem in the compliance arena. There is a tendency in the broker-dealer industry and insurance industry to regard as permitted anything which is not specifically prohibited. As Professor Frankel pointed out in a recent article, when commenting on the rule-making history of the SEC:

> [In the 1980's and 1990's] the tendency was to seek specificity of rules. Gray areas would be inefficient and create uncertainty ... To be sure, they should not cross the line to a prohibited behavior, but anything that is not prohibited should be permitted. This approach led to the style of specific regulation. Details were increased and activities that involve discretion were addressed by regulation more specifically. Whatever was not addressed, however, would be permitted, or in the case of doubt, there was a good argument that the behavior should be permitted ...
>
> Paradoxically the approach of specificity has blurred the fundamental and very simple principle; the principle on which all fiduciary rules are based: The money which the managers manage is **other people's money**. All benefits from controlling and managing the money do not belongs to the managers, except the amounts that are specifically allocated to the managers by a specific clear agreement. If there is no such agreement, there is no benefit to the managers. Specificity of interpretation shifted attention from the reason of the rules to the words of the rules, and from the words of the rules to the world outside the words—a vast expanse of opportunities for the advisers and fiduciaries to benefit from their managerial power.[17] [**Emphasis in original.** Emphasis added.]

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[16] Release, *supra note 3* at p.56.

[17] Washington University School of Law Professor Tamar Frankel, *The Scope and Jurisprudence of the Investment Management Regulation*, Presented at ILEP Conference April 9-10, 2005, at pp.8-9.

The SIA's and ACLI's request is but a perpetuation of a poor attitude toward compliance which led to stock analyst conflicts of interest and a whole host of other Wall Street scandals. This poor attitude is one in which reliance occurs upon the absence of specific prohibitions in the law, despite the clear application of broad legal principles (even when clarified by an earlier interpretative release) to the activity. This new request of the SIA and ACLI for delay is a *direct affront* to the new culture of compliance sought to be instilled by the SEC. As explained by Lori Richards, Director of the SEC Office of Compliance Inspections and Examinations, in a recent speech:

> [M]any of us at the Commission have called upon firms to adopt what we call a 'Culture of Compliance' in their core business model, a culture that emphasizes doing what's right, even in the absence of regulatory guidance or a clear prohibition. Clearly, regulators from around the world have been giving similar thought to this issue – the IOSCO paper recognizes that while different jurisdictions may have different approaches and policies to help ensure compliance with their securities laws, regulators share a common belief that the compliance function plays an essential role preventing possible misconduct and in promoting ethical behavior, which can in turn lead to fair and orderly markets and investor confidence in those markets.[18]

The SIA even goes so far as to state that an extension of time before the application of these important investor protection disclosure requirements would "be consistent with the need for a study" of other important issues raised by the Final Rule. Since when is the proposed study (and, presumably, actions resulting therefrom, which could take years) tied in any way to implementation of the Final Rule? Should the entire Final Rule be put on another indefinite hold – for another six years? Public policy supports investor protection, not a continuation of gross delay in the protection of individual investors.

Extending the deadline for implementation of the Final Rule is *an attack against* the new culture of compliance which broker-dealer firms should be instead be pressing hard to instill within their firms. The SEC already provided a great deal of latitude to broker-dealer firms under the Final Rule –

[18] Lori Richards, Speech at National Regulatory Services' Twentieth Annual Spring Compliance / Risk Management Conference, Scottsdale, AZ, April 20, 2005.

permitting six months' to pass by and thousands and thousands more fee-based accounts to be opened – without the full protections of the Final Rule's disclosure requirements. If broker-dealer firms desire to continue to offer fee-based accounts to new customers, their compliance efforts must be directed at adherence to the law, not its continued avoidance.

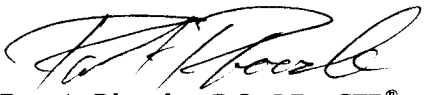
In Conclusion. SEC Chairman was entirely correct when he stated, in his initial statement to SEC Staff on August 4, 2005:

> **And that's what we are all about here -- ensuring that those who exercise power and control over Other People's Money respect the trust that has been placed in them ... and treat investors right.**

The Securities Industry Association and the American Council of Life Insurers would seek to have Commission, as one of its first acts under Chairman Cox's leadership, significantly delay implementation of important disclosure provisions of a rule which is designed to provide essential protections to millions of individual investors. In addition to the significant implications and public policy considerations set forth in this comment letter, there are many additional reasons for the Commission to not accede to the demands of the SIA and ACLI.[19] I urge the Commission to deny these Petitions and to insist upon prompt and full compliance with the Final Rule.

Thank you for the opportunity to submit these comments.

Respectfully submitted,



Ron A. Rhoades, B.S., J.D., CFP®
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[19] The author supports the Comment Letters of the Investment Adviser Association (August 4, 2005) and of the Consumer Federation of America, Fund Democracy, Consumer Action, and Consumers Union (August 11, 2005), which contain other compelling arguments for denial of the SIA and ACLI's Petitions.

cc: The Honorable Christopher Cox, Chairman
The Honorable Paul S. Atkins, Commissioner
The Honorable Roel C. Campos, Commissioner
The Honorable Cynthia A. Glassman, Commissioner
The Honorable Annette Nazareth, Commissioner
Giovanni Prezioso, General Counsel
Meyer Eisenberg, Acting Director, Division of Investment Management
Robert L. D. Colby, Deputy Director, Division of Market Regulation
Mr. Robert E. Plaze, Associate Director, Division of Investment Management