

VIA ELECTRONIC MAIL

September 22, 2004

Jonathan G. Katz, Secretary
U.S. Securities & Exchange Commission
450 Fifth Street, NW
Washington, DC 20549-0609

RE: Release Nos. 34-42009; IA-1845; File No. S7-25-99; Certain Broker-Dealers
Deemed Not To Be Investment Advisers

Dear Mr. Katz:

The Financial Services Institute¹ (“FSI” or “the Institute”) appreciates this opportunity to comment on the SEC’s proposed rulemaking that would address certain changes in the application of Section 202(a) (11) of the Investment Advisers Act of 1940 (the “Advisers Act”) to broker-dealers that offer certain full-service and execution-only broker-dealer programs to their customers and charge an asset-based fee in lieu of traditional commissions, markups, or mark-downs (the “Proposed Rule”). The Proposed Rule is based on the Commission’s initial conclusion that “these programs benefit customers by aligning their interests with those of their broker-dealers”. We support this goal, and the Commission’s preliminary conclusion that these programs are consistent with the best practices recommended in the Report of the Committee on Compensation Practices (the “Tully Report”).

The Institute is an association that represents the interests of a diverse cross-section of broker-dealers and investment advisers, most of whom are registered as both. Our members generally evaluate the client’s overall personal and financial needs and objectives, risk tolerance and financial situation before making recommendations of specific products and services. If it is suitable for the client, our members may offer investment advisory services for an asset-based fee, recommend securities products that may or may not have a commission or a combination of products and services. The suitability of a particular product or service does not turn on the form of compensation, but on whether the service or product is the best choice for the client given the client’s stated needs, objectives and risk tolerance.

The form of compensation should be, and for our members is, irrelevant when assessing suitability. For this reason we are concerned that merely calling a non-discretionary fee-based account a brokerage account simply because the broker-dealer does not collect traditional brokerage commissions would not in and of itself place the client on the same footing with the broker-dealer. It will also likely confuse investors by leading them to

¹ The Financial Services Institute, Voice of the Independent Contractor Broker-Dealer, was formed on January 1, 2004. Our members are broker-dealers and registered investment adviser firms that serve representatives who are independent contractors. The Institute has 95 member firms, with more than 120,000 registered representatives and over \$7.8 billion in Total Revenues.

believe that a “fee-based program” is suitable simply because the “traditional conflicts of interest” associated with traditional commission-based accounts appear to not exist, based on the conclusions reached by the Tully Commission. Just as people with different diseases cannot be required to take the same medication, it would be irresponsible to require a single fee structure for all customers.

The proposed rule would do nothing to address the fact that broker-dealers would continue to encourage customers to purchase individual securities and products rather than offer their clients true needs-based advice and those products that are intended to achieve the investor’s overall personal needs and objectives. It therefore is only the way investors pay for the trading that would change -- the nature of the trading and the accounts would not. .

We are concerned that, if the rule is adopted as proposed, investors will be confused and lead to believe that because they now pay asset-based fees rather than commissions they necessarily are receiving more personalized, ethical, suitable advice. The resulting confusion, we would suggest, highlights the traditional fundamental differences between broker-dealers and investment advisers. As a result there are fundamental differences in the laws and rules that govern broker-dealers and investment advisers. We urge the Commission to consider these differences carefully before taking steps to change the basic regulatory framework that ensures these differences.

We commend the Commission for its thoughtful, carefully crafted attempt to reduce or eliminate the conflicts of interest that historically have lead to churning of accounts, recommending unsuitable securities, or engaging in high-pressure sales tactics. The elimination of this type of unethical behavior will benefit both investors and the securities industry as a whole. We also agree, given the proliferation of these “fee-based programs”, that a rule is necessary to clarify for the investing public exactly what they should and should not expect from the representatives who services asset-based accounts. However, we are concerned that the Proposed Rule would not offer sufficient guidance for the industry and the investing public as to what they can reasonably expect when it comes to how these programs should be regulated and the application of a traditional suitability analysis. In this area, the Commission would be well-advised to do no harm, as investors would likely be confused if the Commission were to allow broker-dealers to advertise a trading account as something that it is not solely because the broker-dealer is paid an asset-based fee as opposed to a commission.

Accordingly, we respectfully request the Commission to strongly consider the following issues before adopting any rule in this area:

1. Would permitting transaction-oriented broker-dealers to advertise traditional brokerage trading accounts as “fee-based programs” achieve the best practices suggested in the Tully Report and championed by former Commission Chairman Arthur Levitt?

We believe it would not. The Commission should ensure that broker-dealers should only be permitted to allow “fee-based programs” without having the programs be deemed advisory activities if the programs truly take into consideration the investor’s overall personal and financial needs, goals and objectives. “Fee-based programs” that actually meet this test will by their very nature entail advice that is

much more than “solely incidental,” and therefore will be advisory activities. We urge the Commission to clarify the “solely incidental” test to clarify that it includes advice given in the traditional brokerage context such as advising a client with respect to one specific security or a specific trading strategy, even if it does not encompass an overall investment plan that may also include estate, insurance, and tax issues.

2. Will the further blurring of business and regulatory distinctions between broker-dealers and investment advisers better protect the investing public?

We do not believe this will be the case. We appreciate the fact that the Commission understands the various distinctions between the broker-dealer and investment adviser regulatory framework. We also acknowledge that other commenters have articulated these distinctions, and we therefore, we will not revisit each of them here. However, we urge the Commission to consider carefully in adopting the Proposed Rule whether blurring these distinctions will ultimately confuse investors. As we discussed above, we believe that anyone who provides investment advice tailored to an investor’s overall personal and financial needs and objectives and risk tolerance should register as an investment adviser. Alternatively, someone who offers advice only with respect to one security or trading strategy may be providing investment advice that is incidental to their primary business as a broker-dealer and should not be permitted to hold themselves out as providing services traditionally provided by investment advisers merely because they charge an asset-based fee.

3. Are the disclosure requirements initially proposed by the Commission adequate?

We think not, and suggest that the Commission revisit the proposed advertising requirements. We urge the Commission in adopting the Proposed Rule to ensure that broker-dealers who offer “fee-based programs” provide meaningful, plain English disclosures concerning the specific nature of the advice that will be offered, including a thorough discussion of the difference between true investment advice and advice that is “solely incidental” to the broker-dealer’s brokerage business. That should include a disclosure that the “fee-based program” is not subject to the Advisers Act. We also suggest that the disclosure include a side-by-side comparison of the execution charges for the account as a commission-based account and the fees that will be charged in the fee-based account, both in light of the number of trades that will be permitted under the “fee-based program.” This is the only way investors will be able to make an informed decision about which account is best suited to their needs and objectives. Finally, we urge the Commission to require broker-dealers to include in the disclosure a discussion of the fact that investors who participate in a “fee-based program” will be offered other specified products and services and that these products and services will entail additional charges.

Again, thank you for the opportunity to comment on the Proposed Rule. Should you have any questions, please contact us at 770 933-6846.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Dale E. Brown', written in a cursive style.

Dale E. Brown, CAE
Executive Director & CEO

pc: Honorable William H. Donaldson
Honorable Cynthia A. Glassman
Honorable Harvey J. Goldschmid
Honorable Paul S. Atkins
Honorable Roel C. Campos
Paul F. Roye
Robert Plaze
Robert L. Tuleya
Nancy Morris