



February 7, 2005

Jonathan G. Katz  
Secretary  
U.S. Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, D.C. 20549

Re: File No. S7-25-99  
Release Nos. 34-50980; IA-2340, Certain Broker-Dealers Deemed  
Not To Be Investment Advisers

Dear Mr. Katz:

The Securities Industry Association<sup>1</sup> (“SIA”) appreciates the opportunity to comment on the Commission’s re-proposed Rule 202(a)(11)-1 under the Investment Advisers Act of 1940 (the “Advisers Act”) and other interpretive matters addressed in the Commission’s release entitled *Certain Broker-Dealers Deemed Not To Be Investment Advisers*, Securities Exchange Act Release No. 50980 (Jan. 6, 2005); Advisers Act Release No. 2340 (Jan. 6, 2005) (the “Reproposal”). SIA commented on Rule 202(a)(11)-1 (the “Rule”) as originally proposed in 1999<sup>2</sup> (the “1999 Proposal”), and applauds the Commission’s efforts to issue the Rule in final form by April 15<sup>th</sup> of this

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<sup>1</sup> The Securities Industry Association brings together the shared interests of nearly 600 securities firms to accomplish common goals. SIA’s primary mission is to build and maintain public trust and confidence in the securities markets. At its core: Commitment to Clarity, a commitment to openness and understanding as the guiding principles for all interactions between investors and the firms that serve them. SIA members (including investment banks, broker-dealers, and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry employs 790,600 individuals, and its personnel manage the accounts of nearly 93-million investors directly and indirectly through corporate, thrift, and pension plans. In 2003, the industry generated \$213 billion in domestic revenue and an estimated \$283 billion in global revenues. (More information about SIA is available at: [www.sia.com](http://www.sia.com).)

<sup>2</sup> See *Certain Broker-Dealers Deemed Not To Be Investment Advisers*, Securities Exchange Act Rel. No. 42099; Advisers Act Rel. No. 1845 (Nov. 4, 1999); see Letter to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, from Ira D. Hammerman, General Counsel, Securities Industry Association, Sept. 22, 2004; Letter to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, from Jean Margo Reid, Chair, SIA Investment Adviser Committee, Jan. 13, 2000 and supplemental submissions on Jan. 31, 2002 and Sept. 13, 2002.

year.<sup>3</sup> The Rule would promote customer choice by expanding the availability of fee-based brokerage accounts, which can better align customer interests with broker-dealer incentives.

## **Overview of Comments**

### Broker-Dealers and Financial Planning: A Long History

The Rule, as initially proposed, sought to provide clear guidance on a narrow question, albeit one of great significance for the broker-dealer community and their customers: whether a broker-dealer registered under the Securities Exchange Act of 1934 (the “Exchange Act”) can offer its customers brokerage services on an asset-based fee basis without becoming subject to the Advisers Act. The Commission’s original proposed Rule answered the question in the affirmative, as does the Rule as outlined in the Reproposal. For reasons outlined below, SIA commends the Commission for taking this position, which we believe will strongly promote the interests of brokerage customers by allowing broker-dealers to continue to provide investment advice, guidance and financial planning as part of their services without being subject to the Advisers Act.

Notwithstanding the narrow focus of the Commission’s rulemaking, some participants in the financial services business have sought, for overtly competitive reasons, to turn the Commission’s important initiative into a referendum on the abilities of broker-dealers to provide financial planning services to their customers.<sup>4</sup> In light of the efforts of some commentators on the Commission’s 1999 Proposal to cast doubt on broker-dealers providing financial planning-type services, we believe it is essential at the outset of our comments on the Reproposal to emphasize how integral financial planning, advice and guidance have been over time, and continue to be to this day, to the relationship between broker-dealers and their customers.

The heart of the matter is simply that these types of services have always been not only an incidental, but an essential, component of the customer/broker-dealer relationship.<sup>5</sup> We hope that neither the Rule in final form nor the interpretive guidance the Commission contemplates publishing impinges on the ability of registered broker-dealers to continue to provide these services in a cost-effective manner subject to appropriate, but not duplicative, regulation.

### The Significance of Fee-Based Accounts

Assuming that the final action taken by the Commission on the issue of broker-dealers’ providing financial planning-type services to their customers reflects an

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<sup>3</sup> See *Certain Broker-Dealers Deemed Not To Be Investment Advisers*, Securities Exchange Act Rel. No. 50979 and Advisers Act Rel. No. 2339 (Jan. 6, 2005) (adoption of temporary rule).

<sup>4</sup> See Editorial by Marc E. Lackritz, President of SIA, *American Banker* (Jan. 28, 2005).

<sup>5</sup> See Reproposal at 45.

appropriate balance of customer needs, legitimate regulatory concerns and broker-dealer costs, the Rule will facilitate the continued use and development of fee-based brokerage accounts. The development of those accounts is yet another in a long line of initiatives designed to better serve customers of broker-dealers. Since the time of the adoption of the Exchange Act and the Advisers Act, broker-dealers have worked diligently to improve the services they provide to retail customers while reducing costs and generally enhancing the customer's experience. Today, retail brokerage customers have access to a broad range of account types, fee structures and services, many of which previously had only been affordable for institutional customers. Fee-based accounts, we submit, further these trends while enhancing best practices and avoiding some of the concerns arising from commission-based pricing. Customers have responded very favorably to the opportunity for choice presented by fee-based brokerage accounts; fee-based brokerage accounts represented some \$269 billion of customer assets as of the end of 2004 according to Cerulli Associates.<sup>6</sup>

### Avoiding Duplicative Regulation

Despite the substantially increased benefits to broker-dealer customers in products and services over time, including the increase in account choices, broker-dealers are more tightly regulated than ever before. Broker-dealers have invested heavily in legal and compliance personnel, and in technology, to ensure that they provide their customers with a fair, transparent and efficient investing environment. These enhancements have served customers well by substantially improving the quality of the services broker-dealers provide them. At the same time, broker-dealers have reduced the overall costs of rendering those services, a trend SIA trusts the Commission will not impair by imposing unnecessary duplicative regulation on broker-dealers when they offer fee-based accounts, providing, among other things, investment advice and financial planning-type services. The Commission's initiative, if finalized so as to address the concerns presented below, would not only lead to continued growth of fee-based brokerage accounts, but also would appropriately recognize the significant amount of regulation to which broker-dealers are subject in providing services to their customers.

### Support for the Rule's Central Position

SIA believes strongly that the central position reflected in the Rule is beneficial to broker-dealer customers. Simply stated, that position is that an Exchange Act-registered broker-dealer's offering its customers the alternative of paying a fee rather than a commission for brokerage services should not result in the broker-dealer's becoming subject to the provisions of the Advisers Act.

The Rule, in our view: (1) promotes customer choice by recognizing that fee-based brokerage accounts benefit customers by offering them options as to how to compensate their broker-dealers; (2) is consistent with the intent of Congress in recognizing that broker-dealers provide financial planning advice and guidance, and in seeking to reduce duplicative regulation by adopting the broker-dealer exclusion to the

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<sup>6</sup> Cerulli Associates' reports for the last quarter of 2004 have not yet been published formally.

definition of investment adviser contained in the Advisers Act; and (3) appropriately reflects the substantial amount of regulation to which broker-dealers are subject outside of the Advisers Act. The last of these points was emphasized formally by the Commission in the Reproposal<sup>7</sup> and informally by two senior members of the Commission's staff in a recent letter to the editor of a national newspaper.<sup>8</sup>

As recognized by the Tully Committee,<sup>9</sup> which was formed in the mid-1990s to develop best practices on handling conflicts of interest in brokerage industry compensation practices and in compensating registered representatives, and which was echoed by the Commission in the Reproposal, fee-based brokerage accounts are a significant development in customer choice for payment for financial services and can effectively align customer interests with broker-dealer incentives by "allow[ing] registered representatives to focus on their most important role...providing investment advice to individual customers, not generating transaction revenues."<sup>10</sup> Implicit in this statement is the recognition that a core activity of registered representatives is providing investment advice, guidance and financial planning.

Clearly appreciating the growth in fee-based brokerage accounts, the 1999 Proposal<sup>11</sup> sought to clarify the narrow issue that a broker-dealer's receipt of fee-based compensation was not "special compensation" within the meaning of the Advisers Act's broker-dealer exclusion so as to make the broker-dealer's activities on behalf of that account subject to the provisions of the Advisers Act.<sup>12</sup> The Reproposal emphasizes that the Commission continues "to believe that fee-based brokerage has the potential to provide significant benefits to brokerage customers" and that the Reproposal "therefore reflects [the Commission's] belief that when broker-dealers offer advisory services as part of the traditional package of brokerage services, broker-dealers ought not to be

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<sup>7</sup> The Commission acknowledged in the Reproposal the significant customer-protection benefits broker-dealer regulation provides when it said: "The Exchange Act, Commission rules, and SRO rules provide substantial protection for broker-dealer customers that in many cases are more extensive than those provided by the Advisers Act and the rules thereunder." Reproposal at 21.

<sup>8</sup> See Letter to the Editor by Annette Nazareth and Paul Royce, *The New York Times* (Jan. 12, 2005).

<sup>9</sup> Report of the Committee on Compensation Practices (Apr. 10, 1995).

<sup>10</sup> *Id.*; Reproposal at 8.

<sup>11</sup> *Supra* note 2.

<sup>12</sup> Section 202(a)(11) of the Advisers Act defines an "investment adviser" as "any person who, for compensation, engages in the business of advising others, either directly or indirectly through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities." Paragraph (C) of Section 202(a)(11), commonly referred to as the "broker-dealer exception" or "broker-dealer exclusion," specifically excludes from this definition "any broker or dealer whose performance of [investment advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor..."

subject to the Advisers Act merely because they re-price those services.”<sup>13</sup> SIA emphatically agrees with the Commission’s well-articulated views.

Notwithstanding the benefits for brokerage customers of fee-based accounts, for example, the Commission noted in the Reproposal, some such brokerage accounts may not be suitable for certain types of broker-dealer customers. We reiterate the view expressed in a previous letter we submitted to the Commission,<sup>14</sup> that a fee-based compensation structure can be appropriate for a customer who is not engaged in active trading. Fee-based brokerage services may, for example, provide more certainty and consistency of pricing. Moreover, certain services, such as on-line trading, may only be available in a fee-based program. In our view, any concerns with respect to the suitability of fee-based accounts for customers are best handled as a sales practice issue. The Commission appears to agree with that position in its Reproposal.<sup>15</sup>

### **Comments on Specific Aspects of the Reproposal**

Since publishing the 1999 Proposal for comment, the Commission has heard the views of many commentators and determined to repropose the Rule with modifications and to provide interpretive guidance with respect to the Advisers Act’s broker-dealer exclusion.<sup>16</sup> SIA generally is concerned that certain aspects of the Reproposal, in particular proposed Commission positions relating to the exclusion, do not take into account the best interests of broker-dealer customers or accurately reflect the intent of Congress in adopting the exclusion. SIA believes that the best interests of those customers would be facilitated and the goals of Congress furthered only to the extent that:

- (1) The Commission recognizes in its guidance that some degree of financial planning has been and continues to be integral to broker-dealer services and necessary to carry out a broker-dealer’s suitability obligations, and that a broker-dealer’s “holding out” of its planning services should not cause the broker-dealer to become subject to the Advisers Act.
- (2) An appropriate and practical line is drawn in the Commission’s interpretive guidance as to when financial planning-type services provided as part of a fee-based brokerage account are subject to regulation under the Advisers Act; in our

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<sup>13</sup> Reproposal at 14.

<sup>14</sup> *Supra* note 2.

<sup>15</sup> “...SROs can ensure that the sales practice requirements keep pace with their members’ activities and address any resulting investor protection concerns. For example, recently NASD published a Notice to Members concerning fee-based compensation programs, reminding members that they must have reasonable grounds for believing that a fee-based program is appropriate for a particular customer, taking into account the services provided, the cost, and customer preferences.” See NASD Notice to Members 03-68 (Nov. 2003); Reproposal at 22-3.

<sup>16</sup> See *supra* note 12 for the terms of the broker-dealer exclusion.

view, those services should be regulated under the Advisers Act when a customer pays a separate fee for them.

- (3) Clear, easy-to-understand and effective disclosure regarding the nature of an account a customer chooses to open is provided to that customer.

Specific concerns of SIA regarding the Reproposal and the Commission's proposed interpretive guidance and ways to address those concerns are detailed in our comments below. We have divided our comments into four sections:

- (1) the general topic of financial planning services provided by broker-dealers and our suggested test for when financial planning-type services rendered by a broker-dealer should be subject to the Advisers Act;
- (2) the degree to which broker-dealers are regulated in connection with all services they provide, including investment advice;
- (3) disclosure that broker-dealer customers should be given about the different accounts they may choose to open; and
- (4) miscellaneous other matters raised by the Reproposal.

#### Financial Planning by Broker-Dealers

If adopted as reproposed, the Rule would provide that “[a] broker or dealer registered with the Commission...will not be deemed to be an investment adviser based solely on its receipt of special compensation, provided that any investment advice provided by the broker or dealer with respect to accounts from which it receives special compensation is solely incidental to the brokerage services provided to those accounts.”<sup>17</sup> In the interpretive guidance it would publish in connection with the Rule in final form, the Commission has proposed to take the position that “if a broker-dealer holds itself out as a financial planner or as providing financial planning services it cannot be considered to be giving advice that is solely incidental to brokerage.”<sup>18</sup> Such a broker-dealer would thus become subject to the Advisers Act in providing financial planning services with respect to a customer's account.

We submit that applying a “holding out” standard to determine whether financial planning-type services performed in the context of a brokerage account is subject to the Advisers Act is flawed for at least three reasons: (1) it would be inconsistent with the Advisers Act's broker-dealer exclusion, which recognizes that some degree of financial planning, guidance and advice is an integral part of a broker-dealer's services; (2) it would interfere with a broker-dealer's ability to meet its suitability obligations under

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<sup>17</sup> Reproposal at 100.

<sup>18</sup> Reproposal at 52.

rules of broker-dealer self-regulatory organizations (“SROs”); and (3) it is not supported by an existing Commission staff position, cited in the Reproposal, that the availability of the Advisers Act’s exclusion for lawyers and accountants “turn[s] on whether the lawyer or accountant has held himself out as providing financial planning, pension consulting, or other financial advisory services.”<sup>19</sup>

### Broker-Dealer Exclusion Contemplates Provision of Financial Planning-Type Services

Implicit in the broker-dealer exclusion is a recognition by Congress that a broker-dealer’s regular activities contemplate the broker-dealer’s routinely offering investment advice of the sort that could bring the broker-dealer within the definition of investment adviser. The exclusion speaks in terms of a broker-dealer’s “performance of such services,” with “such” referring to *any* of the services included in the definition that cause a person to be an “investment adviser.” To the extent that financial planning is an investment advisory service within the definition,<sup>20</sup> it is a type of advice that the broker-dealer exclusion covers, so long as the broker-dealer renders the service in a manner that is “solely incidental to”<sup>21</sup> its brokerage services. It is *how* and the context in which the investment advice is rendered and not the *type* of investment advisory service rendered, that determines whether the broker-dealer is covered by the exclusion. As discussed below (see “Financial Planning-Type Services That Are Not Solely Incidental to Brokerage”), we believe that financial planning-type services cross the “solely incidental to” boundary line of the broker-dealer exclusion and become appropriately regulated under the Advisers Act when those services are rendered for a fee separate from the fee paid for the brokerage services provided to a customer. To the extent a broker-dealer provides financial planning-type services other than for a separate fee, those services should be seen as being performed in connection with, and reasonably related to (if not essential to) the brokerage services provided, which may include core elements of financial planning such as assessing a customer’s broad financial situation, evaluating the customer’s investments, savings and tax situation, and analyzing the customer’s long-term needs and goals. In such a situation, a broker-dealer is providing the same brokerage services traditionally rendered by broker-dealers, including elements of a broader service that became known as “financial planning” when it was later rendered by providers that were not otherwise regulated.<sup>22</sup>

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<sup>19</sup> Reproposal at 50, citing Advisers Act Interpretive Rel. No. 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* (Oct. 8, 1987) (“Release 1092”).

<sup>20</sup> This view appears to have been adopted some time ago by the staff of the Commission in Release 1092.

<sup>21</sup> See Reproposal at 44, in which the Commission emphasizes the importance of the word “to” in interpreting the limits Congress intended to impose on the broker-dealer exclusion by the phrase “solely incidental to.” We agree with the Commission’s proposed interpretive position that investment advice is solely incidental to brokerage when it is rendered “in connection with and reasonably related to” brokerage services. Reproposal at 43.

<sup>22</sup> Release 1092.

Commentators on the Advisers Act appear to adopt the interpretation of the broker-dealer exclusion as set out above. As two commentators have noted, for example, the exclusion “was included in the Advisers Act because broker-dealers routinely give investment advice as part of their brokerage activities, yet are already subject to extensive regulation under the 1934 Act and possibly state law.”<sup>23</sup> Other observers have said that “[w]hile most broker-dealers initially will come within the definition of an investment adviser, it is clear that Congress did not intend brokerage activities to be regulated under the Advisers Act. Rather, such activities were intended to be regulated under the [Exchange] Act without the additional and often duplicative requirements under the [Advisers] Act.”<sup>24</sup>

The substantial level and broad range of investment advice, planning and guidance broker-dealers have traditionally provided their customers has been acknowledged not only by Congress and commentators, but also by the Commission. The Commission has indicated its view in the Reproposal, for example, that the level of such advice is greater than would generally be thought to be reflected in the words “solely incidental” included in the exclusion.<sup>25</sup> The Commission has also said that the extensive amount of investment advice provided by broker-dealers was well-known at the time the Advisers Act was adopted. As the Commission stated in the Reproposal: “[t]he view that only minor or insignificant advice is excepted by section 202(a)(11)(C) ignores the fact that the advice broker-dealers gave as part of their traditional brokerage services in 1940 was often substantial in amount and important to the customer.”<sup>26</sup> Although the broker-dealer exclusion references investment advisory services, the Commission’s staff has long acknowledged, as suggested above, that those services can include activities considered to be financial planning in nature.<sup>27</sup> Over the years, commentators have, in a similar vein, noted that among the types of advice that broker-dealers have traditionally provided is advice that is of a financial planning nature.<sup>28</sup>

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<sup>23</sup> Reproposal at 17, citing See S. REP. NO. 76-1775; H.R. REP. NO. 76-2639, at 28, 76th Cong. 3d Sess. (“H.R. REP. NO. 76-2639”). See also Thomas P. Lemke & Gerald T. Lins, *Regulation of Investment Advisers* §1:19.

<sup>24</sup> Thomas P. Lemke, *Investment Advisers Act Issues for Broker-Dealers*, Securities and Commodities Regulation at 214 (Dec. 9, 1987) (footnote omitted).

<sup>25</sup> Reproposal at 46.

<sup>26</sup> Reproposal at 45.

<sup>27</sup> See Release 1092, in which the Commission staff stated: “Financial planning typically involves providing a variety of services, principally advisory in nature, to individuals or families regarding the management of their financial resources based upon an analysis of individual client needs. [F]inancial planners or other persons providing financial advisory services, may be investment advisers within the meaning of the Advisers Act, state adviser laws, or both.”

<sup>28</sup> See, e.g., Robert Bendiner, *Current Quotations on Stockbrokers*, The New York Times, May 10, 1953, at SM19, cited in the Reproposal (“[W]hen the Korean War began...[c]ustomers then wanted to know whether to expect confiscatory taxes that would reduce corporate profits, how price controls might effect their securities, and whether some businesses would be squeezed out entirely for lack of materials. ‘You have to talk to them,’ one broker said. ‘Buying and selling is the least part of the service we give them for our

## Interference with Broker-Dealers' Suitability Obligations

That activities that have come to be known as “financial planning” have for decades been integral to broker-dealer services is reflected in the suitability obligations imposed on broker-dealers by SRO rules. These rules provide generally that a broker-dealer must have a reasonable basis for believing that a recommendation made to a customer to buy or sell a particular security is suitable for the customer in light of the customer’s risk tolerance, other securities holdings, financial situation, financial needs and investment objectives.<sup>29</sup> To attempt to ensure that a recommendation to buy or sell a security is suitable, a broker-dealer must, in meeting its obligations under SRO rules, engage in an analysis akin to financial planning in order to provide investment advice on behalf of the customer. SRO rules and communications have emphasized that a broker-dealer’s performing this type of suitability analysis is paramount to the performance of its duties and in the best interests of its customers.<sup>30</sup>

A Commission interpretation that a broker-dealer’s generally holding itself out as a financial planner or as generally providing financial planning services would subject the broker-dealer to the Advisers Act could substantially interfere with a broker-dealer’s

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commissions.”); SEC, Special Study of the Securities Markets (1963) at 330 also referred to in the Reproposal (“Both the volume and the variety of the written investment information and advice originated by broker-dealers, who for the most part furnish it free to their customers as part of their effort to sell securities, are impressive.”); *id.* at 386 (terming investment advice furnished by broker-dealers an “integral part of their business of merchandising securities” even if only “incidental” to that business); *Interpretive Releases Relating to the Securities Exchange Act of 1934 and General Rules and Regulations Thereunder: Future Structure of Securities Markets* (Feb. 2, 1972) (Mar. 14, 1972)] (“In our opinion, the providing of investment research is a fundamental element of the brokerage function for which the bona fide expenditure of the beneficiary’s funds is completely appropriate, whether in the form of high commissions or outright cash payments.”); Tully Report, *supra* note 9, at 3 (“The most important role of the registered representative is, after all, to provide investment counsel to individual clients, not to generate transaction revenues.”). See also Reproposal at 47, footnote 102.

<sup>29</sup> NASD Conduct Rule 2310 provides in pertinent part:

- (a) In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.
- (b) Prior to the execution of a transaction recommended to a non-institutional customer, other than transactions with customers where investments are limited to money market mutual funds, a member shall make reasonable efforts to obtain information concerning: (1) the customer’s financial status; (2) the customer’s tax status; (3) the customer’s investment objectives; and (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

<sup>30</sup> *Id.*; see, e.g., NASD Notice to Members 01-23 (April 2001).

properly performing its suitability obligations. If the Commission adopted the interpretation, a broker-dealer could inadvertently trigger the application of the Advisers Act by simply seeking to follow rules that it must meet. Such a result hardly seems consistent with the Commission's own goals expressed in the Reproposal. As the Commission said in the Reproposal: "[W]e recognize that full-service broker-dealers must consider some aspects of financial planning when determining that their recommendations are suitable. We would not want our interpretation to interfere in any way with a broker's suitability analysis."<sup>31</sup>

#### Holding Out Analysis Not Appropriate for the Broker-Dealer Exclusion

In the Reproposal, the Commission, in essence, asked whether its proposed position that a broker-dealer that holds itself out as engaging in financial planning loses the ability to rely on the broker-dealer exclusion is supported by a long-standing interpretation of the Commission staff with respect to the Advisers Act's exclusion for accountants and lawyers. Under that exclusion, any lawyer or accountant "whose performance of such services is solely incidental to the practice of his profession" falls outside of the Act's definition of an investment adviser.<sup>32</sup> In a 1987 release, *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*, Advisers Act Release No. 1092 (Oct. 8, 1987) ("Release 1092"), the staff articulated its view that:

[T]he [lawyer and accountant] exclusion...is not available...to a lawyer or accountant who holds himself out to the public as providing financial planning, pension consulting, or other financial advisory services. In such a case it would appear that the performance of investment advisory services by the person would not be incidental to his practice as a lawyer or accountant.

We submit that Release 1092 itself answers the questions posed by the Commission in the Reproposal. In the text of Release 1092 immediately following the language quoted above, the staff goes on to say that: "Similarly, the exclusion for brokers or dealers contained in Section 202(a)(11)(C) [of the Advisers Act] would not be available to a broker or dealer, or associated person of a broker or dealer, acting within the scope of the business of the broker or dealer, if the person receives any special compensation for providing investment advisory services." In short, the staff said that how a lawyer or accountant holds out his or her services is an appropriate standard to determine whether the lawyer or accountant providing investment advice should be excluded from regulation under the Advisers Act. The standard to be used in assessing whether a broker-dealer should be subject to the Advisers Act, according to Release

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<sup>31</sup> Reproposal at 51-2.

<sup>32</sup> Section 202(a)(11)(B) of the Advisers Act.

1092, is the nature of the compensation received by a broker-dealer in providing investment advisory services.

In our view, the legislative intent underlying the broker-dealer and the lawyer and accountant exclusions leads to the conclusion in Release 1092 that the holding out concept should not be applied to the broker-dealer exclusion. As described above, in adopting the broker-dealer exclusion, Congress recognized that broker-dealers regularly provided a significant amount of advisory services, including financial planning, to their customers. To our knowledge, Congress expressed no similar view regarding lawyers and accountants. Applying a holding out test, a relatively low-level threshold, to determine when the lawyer and accountant exclusion is not available seems logical and appropriate, as those professionals may not typically be providing substantial and ongoing amounts of investment advice and financial planning services in the normal course of their professions. Applying the test, however, to broker-dealers runs counter to the recognition reflected in the broker-dealer exclusion that broker-dealers regularly provide their customers with investment advice and financial planning-type services.

That broker-dealers operate subject to a comprehensive regulatory scheme in providing investment advice or financial planning services is further support for the conclusion that a mere holding out standard should not determine the availability of the broker-dealer exclusion. Such a low-level threshold would not seem warranted in light of that regulatory scheme, but would be appropriate, as acknowledged in Release 1092, in assessing the availability of an exclusion from the Advisers Act for professionals such as lawyers and accountants, and even independent financial planners, who unlike broker-dealers, would not be subject to comprehensive financial regulation absent the application of the Advisers Act.

#### Financial Planning-Type Services That Are Not Solely Incidental To Brokerage

Although we believe that a broker-dealer's merely holding itself out as providing financial planning services should not result in the broker-dealer's losing the benefits of the broker-dealer exclusion, we agree with the suggestion in the Reproposal that, under some circumstances, the rendering of those services should be deemed as not solely incidental to the brokerage business for purposes of the exclusion. Many, if not most, SIA members have adopted a policy of treating financial planning-type services for which the customer pays a fee separate from that paid for brokerage services as not solely incidental to their businesses within the meaning of the broker-dealer exclusion. The charging of a separate fee generally reflects the recognition by our members that such services may be provided totally independent of brokerage services, and therefore cannot be considered incidental to brokerage services.

In our view, the payment of a separate fee should be the test included in the Rule as adopted in final form to specify when financial planning-type services are not solely incidental for purposes of the broker-dealer exclusion. As noted above, this indicator has been, and continues to be, used by many broker-dealers in determining the availability of the exclusion. Perhaps more important, the payment of a separate fee is a bright line,

providing broker-dealers with the ability to determine with substantial certainty the regulatory scheme to which they are subject in providing financial planning-type services. Assessing whether a broker-dealer must meet investment adviser or broker-dealer rules by reference to an inherently subjective standard, such as the comprehensiveness of the services being rendered would, on the other hand, provide no such certainty, and is more likely to create chaos than clarity.

We believe it imperative that, if the Rule in final form uses the test of a separate fee in specifying when the Advisers Act applies to a particular broker-dealer/customer relationship, the Commission set out clearly in the Rule when the Act ceases to apply to the relationship. In particular, the Rule should, in our view, make clear that the Advisers Act applies to the formulation of a financial plan for a customer, but ceases to apply with respect to the implementation of the terms of the plan or with respect to, the broker-dealer's ongoing relationship with the customer.

#### Use of Terms "Financial Consultants" and "Financial Advisors"

We strongly believe that the question asked by the Commission in the Reproposal regarding whether a broker-dealer's calling its registered representatives "financial consultants," "financial advisors" or the like should result in the broker-dealer's not being able to rely on the Advisers Act's broker-dealer exclusion, should be answered with an emphatic "No." Such titles are quite descriptive of the services provided by typical broker-dealer representatives -- those representatives, as part of their ongoing business, consult with or advise customers as to their finances. In addition, those titles appear not to be widely used throughout the financial services business to refer to other securities industry professionals.

The Reproposal cites no factual support for the notion that customers of broker-dealers have been or are confused by terms such as financial consultants or financial advisors, which have been used throughout the securities industry for close to two decades. We submit that, to the extent such confusion does exist, it can and should be appropriately addressed by disclosure describing the various services provided by a registered representative and his or her qualifications to provide the services.

Although we believe that the use of the terms "financial consultant" and "financial advisor" should not cause a broker-dealer to lose its ability to rely on the broker-dealer exclusion, we agree with the Commission that use of certain terms could lead to that result. In our view, terms such as "portfolio manager," "asset manager," "money manager," "investment counselor" and "investment adviser" are not consistent with a broker-dealer's providing investment advice solely incidental to the conduct of its brokerage business, as those terms seem clearly associated with professional asset management activities that are intended to be regulated under the Advisers Act. We recommend that the Commission seriously consider precluding a broker-dealer from relying on the exclusion to the extent it refers to its representatives by any of these titles.

## Broker-Dealer Customers Are Well-Protected by Existing Regulation, Which Should Not Be Duplicated

Customers who maintain fee-based brokerage accounts and receive investment advice, including advice of a financial planning nature, as a part of the services provided to those accounts are well-protected by SRO and Commission broker-dealer regulations. The Commission clearly and articulately acknowledged in the Reproposal the comprehensiveness of these regulations and expressly noted no need for new requirements duplicating these regulations, as discussed below. In taking this stance, the Commission was following the lead of Congress when it adopted the Advisers Act's broker-dealer exclusion. As the Commission points out in the Reproposal: “[T]he broker-dealer exception in the [Advisers] Act was designed not to except broker-dealers whose advice to customers is minor and insignificant, but rather to avoid additional and duplicative regulation of broker-dealers, which were regulated under provisions of the Exchange Act that had been enacted six years earlier.”<sup>33</sup> Adding another layer of regulation on broker-dealers was clearly not one of Congress' goals in formulating an exclusion for broker-dealers under the Advisers Act.

Customers who maintain brokerage accounts and receive some degree of investment advice in connection with those accounts are not harmed by a “regulatory gap” that some may assert regulation under the Advisers Act would fill. No such regulatory gap exists. As the Commission acknowledged in the Reproposal: “[B]roker-dealers are subject to extensive oversight by the Commission and one or more self-regulatory organizations under the Exchange Act. The Exchange Act, Commission rules, and SRO rules provide substantial protections for broker-dealer customers that in many cases are more extensive than those provided by the Advisers Act and the rules thereunder.”<sup>34</sup> The accounts for these customers are already highly and fully regulated; subjecting the accounts willy-nilly to the Advisers Act would be akin to providing a cure to a disease that does not exist.

In an effort to show in broad relief the full extent of current broker-dealer regulation and how that regulation compares with that imposed under the Advisers Act and its rules, we have prepared the chart attached as Exhibit A to this letter. The chart only serves to confirm the Commission's observation in the Reproposal<sup>35</sup> that broker-dealers are already well-regulated and, in fact, may be better regulated than registered investment advisers and financial planners.

Some commentators, the Commission notes in the Reproposal, have asserted that applying the Advisers Act to fee-based brokerage accounts would cause broker-dealer representatives providing services to those accounts to be deemed “fiduciaries” having

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<sup>33</sup> Reproposal at 16.

<sup>34</sup> Reproposal at 21.

<sup>35</sup> *Id.*

specific duties and obligations toward their customers.<sup>36</sup> Implicit in these assertions would appear to be the view that being subject to fiduciary standards is somehow better than being subject to broker-dealer rules. Such a view neglects to take into account the Commission's observation in the Reproposal that: "[B]roker-dealers often play roles substantially different from investment advisers and in such roles they should not be held to standards to which advisers are held...."<sup>37</sup>

Those who believe that the obligations of a broker-dealer representative toward his or her customers compare unfavorably to those of a registered investment adviser toward its customers not only fail to appreciate the different roles played by the two types of professionals, but also neglect the substantial overlap in the responsibilities of those professionals. The Commission's staff has indicated, for example, that the core duty of a registered investment adviser is "an affirmative duty of utmost good faith, and full and fair disclosure of material facts."<sup>38</sup> The Commission has also said that "the adviser's duty to disclose material facts is particularly pertinent whenever the advice is in a situation involving a conflict, or potential conflict with a client."<sup>39</sup>

The Commission has acknowledged that broker-dealers, in fact, and "[c]ontrary to the perception of many commenters...are under obligations to disclose conflicts of interest. Those obligations derive from many sources, including agency law, the shingle theory, antifraud provisions of the securities laws and the rules and regulations of the Commission and the SROs."<sup>40</sup> In short, customers of broker-dealers, as a practical matter, are afforded a level of protection from conflicts of interest similar to that received by customers of registered investment advisers. This protection is supplemented by suitability and "know your customer" rules implemented by various SROs.<sup>41</sup>

### Enhanced Disclosure Requirements

We strongly support the intent of the proposed Rule's disclosure requirements to lessen any perceived investor confusion about the nature of fee-based brokerage accounts. We commented favorably on the disclosure requirements of the Rule in our January 13, 2000 letter to the Commission<sup>42</sup> relating to the 1999 Proposal and we

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<sup>36</sup> *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963) is often cited by the Commission and its staff for the proposition that "[a]n investment adviser is a fiduciary who owes his clients an affirmative duty of utmost good faith and full and fair disclosure of material facts." See e.g., Release 1092.

<sup>37</sup> Reproposal at 22-3

<sup>38</sup> Release 1092.

<sup>39</sup> *Id.*

<sup>40</sup> Reproposal at 21.

<sup>41</sup> See NASD Conduct Rule 2310, *supra* note 29; See New York Stock Exchange Rule 405.

<sup>42</sup> See Letter to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, from Jean Margo Reid, Chair, SIA Investment Adviser Committee, Jan. 13, 2000.

reiterate our support now for clear and useful disclosure regarding the nature of an account a broker-dealer customer chooses to open.

We agree with the Commission that a broker-dealer customer should receive disclosure that is designed to inform the customer of the nature and scope of the services it is being offered. We believe, however, that the emphasis in the Reproposal's disclosure requirement on the possible differences between the duties of a broker-dealer and those of an investment adviser overstates those differences and is not practically helpful to customers. Those duties are largely determined by reference to the customer's agreement with his or her broker-dealer, and the scope of fiduciary duty, if any, is dependent on the facts and circumstances of the particular client relationship. We believe that investors would be better served by disclosure that tells them that the nature and scope of the services they receive can differ from brokerage to investment advisory accounts, and that they can seek to better understand the nature and scope of the services they are obtaining by reviewing the agreement for their account (before opening the account if they deem it necessary) and/or raising any questions about those services with their representative at the broker-dealer.<sup>43</sup> As the Commission suggested in the Reproposal, moreover, whether a representative acts as a fiduciary with respect to an account under applicable laws is necessarily a complex fact-based question that requires substantial legal analysis and should not be determined solely on the basis of whether the account is a fee-based brokerage account or an advisory account "but upon the role [the representative for the account] [is] playing."<sup>44</sup>

One disclosure enhancement the Commission could consider relates to the proposed requirement that a statement be placed on all agreements, contracts, applications and other forms governing the operation of a fee-based brokerage account that the scope of "the firm's fiduciary obligations may differ" with respect to different types of accounts. While SIA agrees that as a legal matter, differences exist between fiduciary obligations of advisers and broker-dealers, we believe that, from an investor protection standpoint, that is one of the less material differences, given that the suitability/know your customer obligations of broker-dealers are subject to significantly greater regulatory and self-regulatory oversight. As the chart attached as Exhibit A

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<sup>43</sup> We suggest the following changes to the text of proposed Rule 202(a)(11)-1(a)(iii) of the Advisers Act to implement the disclosure standard discussed above:

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 the accounts are brokerage accounts and not advisory accounts; that, as a consequence, the ~~customer's rights and~~ firm's duties and obligations to the customer, including ~~the scope of the firm's~~ any fiduciary obligations, may differ; and that the customer should review the account agreement to understand the nature and scope of the firm's services and obligations and discuss any questions with a representative of ~~must identify an appropriate person at the firm with whom the customer can discuss the differences.~~

<sup>44</sup> Reproposal at 23.

clearly demonstrates, there are many distinctions that can be drawn between the regulatory oversight of advisers and broker-dealers. Furthermore, as previously noted, the Reproposal, prior Commission pronouncements and the observations of numerous commentators, all reflect that the current regulatory scheme provides equal, and perhaps even better protection to broker-dealer customers. Therefore, we strongly believe that enhanced disclosure would better serve investors if it is focused on a clear and meaningful description of the services being provided, rather than on regulatory and legal distinctions. In that regard, we would pose the following question: If it is appropriate to require broker-dealers to disclose that the firm’s “fiduciary duties may differ,” is it any less appropriate to require independent financial planners and other non-registered broker-dealers providing similar services to disclose that differences exist with respect to mandatory continuing education requirements, fidelity bonding or that their activities are not subject to SRO oversight? We think this question amply demonstrates the complexity and shortcomings of disclosure with respect to legal and regulatory matters, and why it is far more helpful to investors for the Commission to focus on more specific disclosure indicating: (1) the type of account being opened by the customer; (2) that brokerage accounts and investment advisory accounts may differ in terms of their scope and nature; and (3) that each account is governed by regulations that may differ, among other things, as to the extent of regulatory oversight and fiduciary obligations.

We recommend that, regardless of the disclosure requirement contained in the Rule as adopted, the Commission make clear in instructions to the Rule or otherwise that the requirement is not intended to prescribe the exact language that must be used, or to preclude a broker-dealer from adding to, or varying, the disclosure it uses in any advertisement, agreement, or other document in satisfying the requirement. The Commission’s taking this action will enable broker-dealers to tailor disclosure to fit the context in which it is used and, in the process, enhance the quality and readability of the disclosure for broker-dealer customers.

We also recommend that the Commission, in answer to one of its questions in the Reproposal, not require a particular person be designated to receive such inquiries. In our members’ collective experience, such a requirement would be difficult to implement and would not further customers’ understanding of the nature and scope of their account.

## **Other Comments**

### Discretionary Accounts

If adopted as reproposed, the Rule would specify that a broker-dealer providing discretionary investment advice with respect to a brokerage account would be unable to rely on the broker-dealer exclusion. “Discretionary investment advice” in this context would be defined by reference to Section 3(a)(35) of the Exchange Act.<sup>45</sup> We are

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<sup>45</sup> Under that section, a person exercises “investment discretion” with respect to an account if:

directly or indirectly, such person (A) is authorized to determine what securities or other property shall be purchased or sold by or for the account, (B) makes decisions as to what securities or other

concerned that this definition is too broad for the purpose for which it is being used and would not reflect the different forms of discretionary authority that broker-dealer customers regularly grant to their broker-dealers, ranging from discretion limited by customer instructions to trade certain securities at specific prices during particular time periods, to full discretion to execute any and all transactions on behalf of the customer. Discretionary authority of this sort, we understand from our members, is commonly subjected to significant internal review by a broker-dealer before and after the trades are made. Moreover, such authority must be exercised in accordance with various regulations to which broker-dealers are subject.

The wide variety of discretionary arrangements into which broker-dealers enter with customers reflect the expressed needs of those customers. A customer who expects to be on vacation, for example, may provide his or her broker-dealer with discretion limited as to a particular time period, as to the specific type of security and/or as to the price at which the security could be bought or sold. A customer who is an “insider” of a public company and who desires to trade his or her company’s stock under a plan in accordance with Rule 10b5-1 under the Exchange Act<sup>46</sup> may afford his or her brokerage firm discretion. A customer may provide his or her broker-dealer with discretion with respect to cash held in the customer’s account. In such case, the customer may provide the broker-dealer with a list of the types of investments that may be purchased with the cash, characterized, for example, by liquidity, concentration and credit rating. A typical customer in such an account, however, does not provide the broker-dealer any authority to sell any such investments.

We submit that use of discretionary authority in connection with the sorts of accounts noted above would appear not to raise regulatory concerns that would necessitate application of the Advisers Act. Nevertheless, we agree with the Commission’s observation in the Reproposal that certain accounts over which a broker-dealer representative has broad discretionary authority should be subject to the Advisers Act.<sup>47</sup> We recommend that the Commission, while continuing to provide investors with the benefits and choices afforded by limited discretionary accounts, modify the Rule so as to provide that broker-dealers’ having discretion limited by written customer instructions as to: (1) time periods of a temporary nature; (2) one or more specific securities or types of securities; or (3) prices at which they can be purchased and, in some cases, sales can be made, are not exercising discretionary investment advice.

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property shall be purchased or sold by or for the account even through some other person may have responsibility for such investment decisions, or (C) otherwise exercises such influence with respect to the purchase and sale of securities or other property by or for the account as the Commission, by rule, determines, in the public interest or for the protection of investors, should be subject to the operation of the provisions of this title and the rules and regulations thereunder.

<sup>46</sup> That Rule discusses the use of a “written plan” for trading securities that would involve insiders trading on the basis of material nonpublic information but for the plan, commonly known as a “Rule 10b5-1 plan.” See Rule 10b5-1 under the Exchange Act.

<sup>47</sup> Reproposal at 36.

## Costs of Converting Discretionary Accounts

The Rule, if adopted as repropounded, would effectively cause conversion of all discretionary brokerage accounts now subject only to broker-dealer regulation to be converted into accounts subject to that regulation and the Advisers Act. Such a conversion would likely work to the disadvantage of customers, who, as a result, could face increased costs or who could lose their chosen forms of brokerage accounts to the extent their broker-dealer determined not to continue to provide those forms of accounts rather than effect such conversion.

Conversion from brokerage accounts to Advisers Act-regulated accounts would result in increased recordkeeping responsibilities, which costs likely would be passed through to customers. These advisory accounts, for example, unlike brokerage accounts, would be subject to Rule 204-2 of the Advisers Act, which requires that detailed records need to be kept for each recommendation relating to securities in the account and the basis for the recommendation. Newly created advisory accounts would need to be furnished, together with other account-opening documents, Part II of the Form ADV or comparable disclosure determined by the broker-dealer describing the services being offered to the customer.

Conversion of a customer's discretionary brokerage account into an account covered by the Advisers Act could, in addition to imposing new costs on the customer, impair the customer's ability to engage in principal transactions with his or her broker-dealer. Principal transactions with such an account are subject to Section 206(3) of the Advisers Act, which requires that the customer having the account consent to each such transaction, a time-consuming process that may lessen the likelihood of a broker-dealer engaging in such a principal transaction.

The Commission's staff has acknowledged that being able to execute principal trades without getting customer consent may be advantageous to the customer, noting that: "We are concerned that unless we clarify these issues, advisers will unnecessarily avoid engaging in principal and agency transactions that may serve their customers' best interests."<sup>48</sup> Principal transactions may be in the best interests of such a customer at times, as they may allow the customer's transaction to achieve best execution or be completed in a more timely manner than otherwise. We submit that imposing unnecessarily burdensome regulation on principal transactions would be contrary to the interest of broker-dealer customers, a view the Commission appears to share. We understand from our members that principal transactions with discretionary brokerage accounts including highly transparent fixed income securities or fixed income securities not widely available in the market are common in the broker-dealer industry. A customer holding such accounts has determined that a discretionary brokerage account that may execute principal trades without his or her consent before each trade is in his or her best

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<sup>48</sup> See *Interpretation of Section 206(3) of the Investment Advisers Act of 1940*, Advisers Act Rel. No. 1732 (July 17, 1998).

interest; placing these accounts under the principal trading prohibitions of the Advisers Act would eliminate such a customer's flexibility in choosing an investment option.

### Advertising of Broker-Dealer Services

Some commentators to the Rule as proposed have cited certain broker-dealer advertisements, some of which are more than five years old, as suggesting that broker-dealers were not providing investment advisory and financial planning-type services in a manner incidental to their brokerage businesses.<sup>49</sup> We understand from our members that some of the advertisements described programs operated by broker-dealers in accordance with the provisions of the Advisers Act. In addition, some of the advertisements were designed to set out a full package of services provided by a broker-dealer to prospective customers and were not intended to highlight any particular services or services. Such a presentation would seem quite consistent with a broker-dealer's reliance on the broker-dealer exclusion.

### Regulatory Approach

The Reproposal asks whether the Commission, in regulating fee-based brokerage accounts, should adopt an approach different from that reflected in the Reproposal. The Reproposal asks in particular whether the Commission should, in the alternative, adopt the position that in offering such accounts, a broker-dealer should be deemed an investment adviser within the meaning of the Advisers Act. Under the alternative approach, the Commission would then use its authority in Section 206A of the Advisers Act to exempt broker-dealers from specified provisions of the Advisers Act, such as the Act's registration requirements. We seriously question the regulatory premises upon which the alternative approach seems to be based. The approach appears to reflect the view that fee-based accounts cannot be offered in a way that is solely incidental to the conduct of a broker-dealer's business. The approach also appears to reflect a concern that broker-dealers may not be able, for compliance purposes, to distinguish accounts subject to broker-dealer rules and those subject to the Advisers Act. We have no reason to doubt that fee-based accounts can be offered in a way consistent with the broker-dealer exclusion and we are aware of no regulatory enforcement history that suggests that broker-dealers compliance personnel are unable to differentiate brokerage from advisory accounts.

The Commission's seeking to exempt certain broker-dealers from some or all of the provisions of the Advisers Act would seem to raise countless practical problems. A determination would initially need to be made regarding from which provisions broker-dealers would be exempt. Such a determination almost certainly would require the Commission's consulting other regulators and would likely engender a whole variety of views among securities industry participants. Reconciling the various positions likely

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<sup>49</sup> Letter to Jonathan G. Katz, Secretary, U.S. Securities and Exchange Commission, from Barbara L.N. Roper, Director of Investor Protection, CFA, Jan. 13, 2000.

would be difficult and time consuming, leading to prolonged uncertainty and confusion in the brokerage industry in the interim.

Subjecting broker-dealers offering any type of fee-based accounts to the Advisers Act would not only present practical problems for the Commission, it would also cause broker-dealers to incur additional costs that would likely be substantial. If a broker-dealer were deemed an investment adviser with respect to fee-based brokerage accounts, the individual representatives of the broker-dealer providing services to the accounts would appear to fall within the category of individuals subject to state registration requirements contemplated in Section 203A of the Advisers Act and described in Rule 203A-3 under the Act. In the experience of SIA, the costs of such registration can be exceedingly high, especially for smaller broker-dealers. Some of our members estimate that such costs could begin at more than \$1,000 per representative for initial registration without taking into account ongoing maintenance fees.

In addition, counsel with whom SIA has consulted believe that the Commission likely would be held not to have authority under Section 206A of the Advisers Act or any other provision of the Act to waive the imposition of, or exempt broker-dealers from, adviser representative registration. Faced with such registration of their personnel, broker-dealers would likely pass on some or all of those costs to their customers or restrict their offering of fee-based accounts, results that clearly would not be in the interests of broker-dealers' customers.

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SIA appreciates the opportunity to have provided you with these comments on the proposed Rule and the Reproposal. If we can be of any further assistance to you and your colleagues in this matter, please contact me at (202) 216-2045 or Michael Udoff, Associate General Counsel of SIA, at (212) 618-0509.

Very truly yours,

Ira D. Hammerman  
Senior Vice President and General Counsel

Enclosure

cc: The Honorable William H. Donaldson  
The Honorable Paul S. Atkins  
The Honorable Roel C. Campos  
The Honorable Cynthia A. Glassman

The Honorable Harvey J. Goldschmid  
Paul F. Roye, Esq.  
Annette L. Nazareth, Esq.  
Giovanni Presioso, Esq.  
Robert E. Plaze, Esq.

**EXHIBIT A**

**REGULATORY OVERSIGHT OF BROKER-DEALERS AND INVESTMENT ADVISERS**

<b>CATEGORY</b>	<b>BROKER-DEALERS: PROTECTION OFFERED</b>	<b>INVESTMENT ADVISERS: PROTECTION OFFERED</b>
<b>REGULATORY PHILOSOPHY</b>	<p>Both SEC and self-regulatory organization (SRO) rules impose anti-fraud and suitability obligations on broker-dealers that are specific and detailed. For example, the NASD requires that a broker-dealer recommending a securities purchase to a customer satisfy two separate suitability obligations:</p> <ul style="list-style-type: none"> <li>• Reasonable Basis Suitability - the broker-dealer must believe that the recommended security is suitable for any investor. To satisfy this obligation, broker-dealers must conduct due diligence any security that they recommend to potential investors; and</li> <li>• Customer-Specific Suitability. the broker-dealer must believe that its recommendation to invest in the security is suitable for that particular investor. To reach this determination, a broker-dealer must, in accordance with NASD Rule 2310, examine the investor’s financial status, tax status and investment objectives, as well as any other pertinent information.</li> </ul> <p>In addition, NYSE’s “Know Your Customer Rule” requires members to use due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by the member, and every person holding a power of attorney over any account.</p> <p>Other obligations include the business</p>	<p>The SEC says of the Advisers Act, “instead of prescribing a set of detailed rules, the Act contains a few basic requirements.” The Advisers Act is deliberately unspecific so as to regulate as many diverse kinds of investment advisers as possible; by necessity, however, this results in less guidance and oversight of regulated investment advisers than more specific and detailed regulations.</p>

CATEGORY	BROKER-DEALERS: PROTECTION OFFERED	INVESTMENT ADVISERS: PROTECTION OFFERED
	conduct rules specified in NASD Conduct Rule 2000 <i>et seq.</i> and the broker-dealer responsibilities listed in NASD Conduct Rule 3000 <i>et seq.</i>	
<b>SUPERVISION OF REGISTERED REPRESENTATIVES</b>	NASD Conduct Rule 3010(a)(5) requires that registered securities representatives be supervised by a principal of the broker-dealer who is also registered with the NASD. Both representatives and principals must pass examinations administered by the NASD in order to work for a broker-dealer, thus ensuring that customers are served by knowledgeable employees.	Screening for investment advisers and employees is only for past disciplinary history, not industry knowledge. Past experience is disclosed in Form ADV.
<b>CONTINUING EDUCATION REQUIREMENTS</b>	<p>NASD Conduct Rule 1120 sets forth the continuing education requirements for registered persons.</p> <ul style="list-style-type: none"> <li>• <b>Firm Element</b> - requires each member firm to annually develop and implement a written plan for training its registered persons based on an assessment of its own specific training needs.</li> <li>• <b>Regulatory Element</b> - a computer-based education program administered by NASD to help ensure that registered persons are kept up-to-date on regulatory, compliance, and sales practice matters in the industry.</li> </ul> <p>Each registered person is required to complete the Regulatory Element initially within 120 days after the person's second registration anniversary date and, thereafter, within 120 days after every third registration anniversary date.</p>	While certain trade associations may have education and qualification requirements for member investment advisers, the Advisers Act does not impose continuing education requirements on investment advisers.
<b>REQUIRED CUSTOMER DISCLOSURES</b>	<p>Rule 10b-10 requires broker-dealers to disclose specific information to their customers about securities transactions at or before the completion of every securities transaction, including conflict of interest disclosures:</p> <ol style="list-style-type: none"> <li>a. the identity of the security</li> <li>b. the number of shares purchased or sold;</li> <li>c. the price at which the transaction was effected;</li> <li>d. whether the broker-dealer is acting as</li> </ol>	<p>Section 206(3) requires an investment adviser that wishes to engage in a principal transaction with a customer to:</p> <ol style="list-style-type: none"> <li>a. disclose in writing to a customer, before the completion of a transaction, that it is acting as principal for its own account; and</li> </ol>

CATEGORY	BROKER-DEALERS: PROTECTION OFFERED	INVESTMENT ADVISERS: PROTECTION OFFERED
	<p>agent for the customer, as agent for some other person, as agent for both such customer and some other person, or as principal for its own account;</p> <p>e. if the broker-dealer acts as the customer's agent, the amount of the remuneration it receives from the customer;</p> <p>f. for agency transactions in which the broker-dealer also participates in the distribution of the securities, it must disclose the source and amount of remuneration that it receives from third parties; and</p> <p>g. if the broker or dealer acts as principal, whether it is a market maker in the security.</p> <p>NASD Rule 2230 also requires that a confirmation disclose, among other things:</p> <ul style="list-style-type: none"> <li>• the capacity in which the member is acting; and</li> <li>• the source and amount of any commission or other remuneration received or to be received by such member in connection with the transaction.</li> </ul> <p>NASD Rule 2340 requires general members to send, at least quarterly, an account statement describing any securities positions, money balances, or account activity to each customer whose account had a security position, money balance, or account activity during the period since the last such statement was sent to the customer.</p>	<p>b. obtain client consent to the transaction.</p> <p>Rule 206(3)-2 permits an adviser to act as broker for both its advisory client and the party on the other side of the brokerage transaction ("agency cross transaction") without obtaining the client's prior consent to each transaction, provided that the adviser obtains a prior consent for these types of transactions from the client, and complies with other, enumerated conditions.</p> <p>Rule 204-3 requires registered investment advisers to deliver Part II of Form ADV or a brochure containing equivalent information at the beginning of an advisory relationship. In addition, advisers must offer to provide a Part II or brochure at least annually thereafter.</p> <p>Rule 206(4)-4 requires every SEC-registered investment adviser to disclose promptly to clients legal or disciplinary events that are material to an evaluation of the adviser's integrity or ability to meet its commitments to clients.</p>
<p><b>INVESTOR EDUCATION AND PROTECTION</b></p>	<p>NASD Conduct Rule 2280 requires members to provide each year in writing the following information to customers:</p> <p>a. NASD Regulation Public Disclosure Program Hotline Number;</p> <p>b. NASD Regulation Web Site Address;</p>	<p>While certain trade associations may undertake investor education initiatives, the Advisers Act does not require investment advisers to attempt to educate investors.</p>

CATEGORY	BROKER-DEALERS: PROTECTION OFFERED	INVESTMENT ADVISERS: PROTECTION OFFERED
	<p>and</p> <p>c. A statement as to the availability to the customer of an investor brochure that includes information describing the Public Disclosure Program.</p> <p>This investor education program ensures that customers are encouraged to inform themselves about their brokerage firm and the regulations governing its behavior.</p>	
<p><b>ANNUAL COMPLIANCE MEETING</b></p>	<p>NASD Conduct Rule 3010(a)(7) requires each registered representative to attend a firm compliance meeting no less frequently than annually.</p>	<p>No comparable requirement.</p>
<p><b>PROTECTION OF CUSTOMER FUNDS AND SECURITIES</b></p>	<p>The Securities Investor Protection Corporation (“SIPC”) offers protection for customer funds and securities in the event that a registered broker-dealer goes bankrupt.</p> <p>Rule 15c3-3 governs a broker-dealer’s acceptance, custody and use of a customer’s securities. Rule 15c3-3 is intended to ensure that a broker-dealer in possession of customers’ funds either deployed those funds “in safe areas of the broker-dealer’s business related to servicing its customers” or, if not deployed in such areas, deposited the funds in a reserve bank account to prevent commingling of customer and firm funds. Rule 15c3-3 seeks to inhibit a broker-dealer’s use of customer assets in its business by prohibiting the use of those assets except for designated purposes. The Rule also aims to protect customers involved in a broker-dealer liquidation. If a broker-dealer holding customer property fails, Rule 15c3-3 seeks to ensure that the firm has sufficient reserves and possesses sufficient securities so that customers promptly receive their property and there is no need to use the SIPC fund.</p> <p>NASD Conduct Rule 3020 requires members to maintain fidelity bonds to insure against certain losses and the</p>	<p>Rule 206(4)-4 under the Advisers Act requires every SEC-registered investment adviser that has custody or discretionary authority over client funds or securities, or that requires prepayment six months or more in advance of more than \$500 of advisory fees, to disclose promptly to clients and prospective clients (collectively, "clients") any financial conditions of the adviser that are reasonably likely to impair the ability of the adviser to meet contractual commitments to clients. The rule also requires advisers (regardless of whether the adviser has custody or requires prepayment of fees) to disclose promptly to clients legal or disciplinary events that are material to an evaluation of the adviser's integrity or ability to meet its commitments to clients.</p> <p>There is no organization similar to the SIPC protecting customers of registered</p>

CATEGORY	BROKER-DEALERS: PROTECTION OFFERED	INVESTMENT ADVISERS: PROTECTION OFFERED
	<p data-bbox="391 275 911 485">potential effect of such losses on firm capital. The Rule applies to all members with employees who are required to join SIPC and who are not covered by the fidelity bond requirements of a national securities exchange.</p> <p data-bbox="391 600 954 705">New York Stock Exchange Rule 319 imposes similar requirements upon members of the New York Stock Exchange.</p>	<p data-bbox="985 275 1370 411">investment advisers and there is no net capital requirement or bonding requirement under the Advisers Act.</p> <p data-bbox="985 457 1382 989">Section 412 of ERISA requires that an investment adviser fiduciary of an employee benefit plan and every person who handles funds or other property of such a plan to be covered by a fidelity bond that meets the requirements of section 412 of ERISA and the Department of Labor's implementing regulations, unless the fiduciary is a corporation that is permitted to exercise trust powers or to conduct an insurance business.</p>

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<p align="center"><b>STATUTORY DISQUALIFICATION</b></p>	<p>a. Under § 3(a)(39) of the Securities Exchange Act of 1934 (“Exchange Act”), broker-dealers and employees who have committed serious misconduct, such as securities or commodities-related misconduct, crimes described in Section 15(b)(4) of the Exchange Act, which involve fraud, or misappropriation of funds, or any felony conviction, are statutorily barred from the securities business.</p> <p>b. Under Article III, Section 3(b) of NASD's By-Laws, a “statutorily disqualified” employee cannot become or remain associated with an NASD member unless the disqualified person's member firm applies for relief from the statutory disqualification under Article III, Section 3(d) of the By-Laws.</p> <p>c. NASD Conduct Rule 3010 requires each member to establish, maintain, and enforce written procedures to supervise the activities of its registered representatives and associated persons. A member who seeks to employ a statutorily disqualified person must implement a special supervisory plan.</p>	<p>Under § 203(c)(2) and 203(e) of the Investment Advisers Act of 1940, the Commission cannot register an investment adviser if the investment adviser or an associated person has been convicted of a felony or had a disciplinary record subjecting them to disqualification.</p> <p>The SEC may suspend or terminate the registration of any investment adviser if the investment adviser or an associated person has been convicted of a felony or had a disciplinary record subjecting them to disqualification.</p>
<p align="center"><b>PUBLIC AVAILABILITY OF DISCIPLINARY INFORMATION ABOUT REPRESENTATIVES</b></p>	<p>NASD collects, compiles, organizes, indexes, digitally converts and maintains regulatory information from registered persons, member firms, government agencies and other sources and maintains information in the proprietary Central Registration Depository (“CRD®”) database. NASD publicly releases information regarding registered securities representatives, including disciplinary information on the NASD’s website through the BrokerCheck system, allowing customers to easily access up-to-date information. Information collected by the NASD is compiled and monitored by the NASD, which adds an extra level of protection for customers against fraudulent</p>	<p>The Advisers Act requires investment advisers to disclose their disciplinary history and investment experience in a Form ADV. The SEC makes the completed Form ADV publicly available through its website.</p>

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<b>OVERSIGHT OF BROKER-DEALERS AND REGISTERED REPRESENTATIVES</b>	<p>disclosures.</p> <p>Broker-dealers are subject to the oversight of the NASD (and/or the New York Stock Exchange) in addition to the SEC (principally under the Exchange Act), which offers several benefits, including:</p> <ul style="list-style-type: none"> <li>a. The opportunity for the NASD to marshal resources unavailable to the SEC, including greater access to industry expertise;</li> <li>b. The NASD is subject to fewer personnel, contracting and procedural requirements than the SEC;</li> <li>c. Standards of ethical behavior established by the NASD that are higher than those set by the SEC (<i>e.g.</i>, NASD and other SRO members are required to observe high standards of commercial honor and just and equitable principles of trade in the conduct of their business).</li> <li>d. The opportunity for industry leaders to participate in the regulatory process through the NASD and thus acquire a greater sense of their stake in the process; and</li> <li>e. A staff of 2200 at the NASD dedicated to monitoring brokerage firms only.</li> </ul>	<p>For SEC-registered investment advisers, there is currently only SEC oversight (principally under the Investment Advisers Act).</p>
<b>COMPLIANCE POLICIES AND PROCEDURES</b>	<p>NASD Conduct Rule 3010(b) requires broker-dealers to establish and maintain written procedures that are reasonably designed to achieve compliance with applicable securities laws and regulations, and the applicable rules of the NASD.</p>	<p>New Rule 206(4)-7, with which investment advisers must comply by October 5, 2004, mandates that investment advisers (1) adopt and implement policies and procedures reasonably designed to prevent violation of the Advisers Act, (2) annually review those policies and procedures, and (3) appoint a chief compliance officer to oversee the policies and procedures. However, the Rule does not require the policies and procedures to be</p>

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		reasonably designed to prevent violations of other federal securities laws.
<b>EXAMINATION OVERSIGHT</b>	Both the NASD and SEC inspect broker-dealers on an annual basis. In addition, other SROs will inspect their member broker-dealers.	Only the SEC staff will inspect investment advisers. The inspection cycle averages five years.