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Jonathan Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth St. NW
Washington D.C. 20549
By email to rule-comments@sec.gov

File No. S7-25-99: Certain Broker-Dealers Deemed Not To Be Investment
Advisers

To the Commissioners:

On behalf of TD Waterhouse USA, I submit this comment letter on the Commission's rule proposal to permit brokerage firms to offer customers fee-based advisory accounts without registering as investment advisers. TD Waterhouse submitted comments on the previous version of the Commission's proposal, and we are pleased to offer this further perspective on this important investor protection issue.¹

TD Waterhouse commends the Commission for the care and seriousness with which it is addressing the difficult but necessary issue of distinguishing brokerage services from investment advisory services. We concur with the Commission's concern that "customers and potential customers [may not] understand the differences between advisory and brokerage accounts, including the differences in fiduciary duties owed to investors by advisers and brokers."² In response to this concern, the Commission's January 2005 proposal suggests that brokerage firms which are relying on the proposed exception to investment adviser registration should be required to provide enhanced disclosure concerning the differences between brokerage accounts and investment advisory accounts.

We are concerned, however, that the Commission's proposed disclosures may not sufficiently address the differences in regulation between brokers and investment advisers. We have previously provided to the Commission staff TD Waterhouse's recent survey of 1,000 American investors who own stocks, bonds or mutual funds outside of a

¹ See Letter from Timothy P. Pinnington, Vice Chair & Chief Operating Officer, TD Waterhouse, to Jonathan Katz, Secretary, Securities and Exchange Commission, Sept. 22, 2004, available at <http://www.sec.gov/rules/proposed/s72599/tppinnington092204.pdf>. TD Waterhouse Institutional Services is one the nation's leading providers of brokerage and custody services to registered independent investment advisers and their clients. TD Waterhouse Institutional Services is also a division of TD Waterhouse USA (member NYSE/SIPC), one of the nation's largest and fastest growing brokerage firms.

² See Re-Proposing Release, Exch. Act Rel. No. 50980 (Jan. 6, 2005) at p.32.

company-sponsored plan. The survey, a copy of which is attached, clearly indicates the existence of substantial investor confusion concerning the regulatory protections provided to customers of brokers and investment advisers. To summarize some of the key findings:

- 58% of investors incorrectly believe that both stockbrokers and investment advisers have a fiduciary responsibility to act in an investor's best interests in all aspects of the financial relationship.
- 63% of investors incorrectly believe that both stockbrokers and investment advisers are required to disclose all conflicts of interest prior to providing financial advice.
- 84% of investors expect both stockbrokers and investment advisers providing fee-based financial advice to be subject to the same industry regulation.
- 82% of investors were either very concerned or somewhat concerned when they learned that stockbrokers are not required to act in the investor's best interests in all aspects of the financial relationship, or that stockbrokers are not required to disclose all conflicts of interest prior to providing financial advice.
- 86% of investors indicated it would impact their choice of financial professional if they understood the different levels of investor protection from stockbrokers and investment advisers offering the same services.
- 90% of investors expressed support for Congress to enact legislation that creates a clear uniform standard of investor protection for all stockbrokers and investment advisers who provide financial advice to investors.

In short, clear majorities of investors do not understand the current differences between the regulation of investment advisers and that of brokerage firms, and the resulting unequal levels of investor protection for the same or equivalent investment advice services. An overwhelming majority of American investors expect the same level of investor protection whether they deal with an investment adviser or a brokerage firm. Those expectations include that the firm will act solely in the client's best interest in all aspects of the financial relationship, and that the firm will disclose all potential conflicts of interest before providing any financial advice. On these last two issues, the current regulation of investment advisers provides investors more protection than does the current regulation of brokerage firms.

In light of these findings, we are concerned that the Commission's current proposed disclosure may be inadequate to protect investors. The proposed disclosure would inform an investor that an account is a brokerage account, not an investment advisory account, and that the two types of accounts have different rights and obligations, including different fiduciary duties. The proposed disclosure also would give a customer someone with whom to discuss those differences. But American investors do not understand the differences between these types of accounts to begin with. We believe that the Commission's proposed disclosure would not adequately explain those differences - and we doubt any reasonably succinct explanation could fairly explain those differences. More to the point, the clear expectation of American investors is that for investment accounts offering the same or comparable services, there should not be any material differences in investor protection. Investors don't want disclosure that highlights the unequal protections: they want the Commission (or failing that, Congress) to establish a consistent standard of protections for financial advisory services.

As a result, TD Waterhouse returns to the suggestion made in our September 2004 comment letter. Without repeating all the details set forth there, we urge the SEC to combine the best investor protection practices of both investment adviser and brokerage firm regulation. Brokerage firms that promise their customers ongoing investment advice for a fee should be subject to a new kind of regulation that combines the best investor-protection features of both registered investment advisers and registered broker-dealers. These fee-based advice brokerages should give their customers full disclosure of all potential conflicts of interest and how they manage those potential conflicts - just as investment advisers are currently required to provide an annual Form ADV to customers and potential customers. Moreover, these fee-based advice brokerages should accept that they owe fiduciary duties to the investors to whom they offer investment advice, just as do investment advisers. As explained in our prior comment letter, these brokerages would not be subject to some current regulations that currently govern investment advisers; for example, the prohibition on principal trading would be replaced with a rigorous (and we believe more effective) best execution standard. Further, these fee-based advice brokerages should continue to be subject to all current brokerage firm regulations, such as state registration and examinations, SRO registration and examinations, SRO sales practice rules, and rules requiring adequate net capital, customer reserve accounts and fidelity bonding.

We believe our proposal combines the best of both investment adviser and brokerage firm regulation. It would apply the brokerage industry standard of frequent examinations by multiple levels of regulators, and the strict brokerage regulation of financial solvency and sales practices. However, it would add stricter disclosure and fiduciary duty standards of investment adviser regulation. Investors could receive the benefits of fee-based advice without losing any of the protections given to customers of brokerage firms or investment advisers. We suggest that our alternative may protect investors better than the Commission's proposed disclosure-based alternative.

TD Waterhouse applauds several changes the Commission has made in its January 2005 release from its original 1999 fee-based advice exemption. The Commission, explicitly citing TD Waterhouse's September 2004 comment letter, now proposes to mandate that all fully discretionary asset management be performed in accounts subject to full investment advisory registration.³ We agree that fully discretionary asset management - whether paid for by a fee, or paid for by commissions - requires the full protection of the strict fiduciary and disclosure standards contained in the Investment Advisers Act.

TD Waterhouse also supports the Commission's recognition in the January 2005 release that financial planning - advice on issues such as taxes, estate planning, insurance, loans and other banking services - should be provided only in accounts subject to full investment advisory registration. These services are unconnected from any securities transaction. To treat such services as "solely incidental to brokerage" would stretch the Investment Advisers Act beyond what its plain language can support. More importantly, as we stated in our September 2004 comment letter, investors deserve assurance that these financial planning services are performed subject to strict and clear fiduciary duties. In our view, both of these changes to the Commission's 1999 proposal are improvements, and will provide investors with a greater level of protection in areas where they are particularly vulnerable.

TD Waterhouse USA believes the Commission's January 2005 proposal is a significant step forward from its 1999 and August 2004 proposals on fee-based advice.

³ See *id.* at p.34 n.71.

However, we urge the Commission to go even further, and ensure that the regulation of fee-based securities advice is consistent, whether that advice is provided by a brokerage firm or by an investment adviser. Disclosure alone is not an effective means to address the differences between the regulation of investment advisers and brokerage firms. American investors want the same high level of investor protection from every firm they pay for investment advice, no matter how that firm is registered with the SEC. We appreciate the opportunity to provide additional input on this important issue, and we would be pleased to discuss these comments further or provide the Commission or its staff with any other assistance on this matter.

Sincerely,

A handwritten signature in black ink, appearing to read 'TP Pinnington', with a large, sweeping flourish at the end.

Timothy P. Pinnington
President & Chief Executive Officer
TD Waterhouse USA

Attachment: TD Waterhouse 2004 U.S. Investor Perception Study

INTRODUCTION

The businesses of brokerage firms and investment advisors have converged with respect to providing investment advice to individual investors. The services of brokers and investment advisors have become almost indistinguishable to investors, but the Securities and Exchange Commission's regulatory scheme does not reflect this fact. Currently there is a debate over the "Merrill Lynch Rule," which provides a regulatory exemption for stockbrokers to offer fee-based financial advice without providing the same investor protections as the Investment Advisors Act of 1940. As a result, stockbrokers and investment advisors are both offering fee-based financial advisory services, but are subject to different regulations and therefore provide unequal levels of investor protection.

OBJECTIVES OF THE STUDY

The TD Waterhouse 2004 Investor Perception Study examined investor awareness, expectation, concern and impact around the unequal levels of investor protection provided by stockbrokers and investment advisors offering fee-based financial advice. In particular, the study sought to gauge:

- The relevance of unequal levels of investor protection around fee-based financial advice
- Whether investors understand that different levels of investor protection exist for the same services
- Whether investors are concerned about different levels of investor protection for the same services
- If increased awareness of unequal protections would impact an investor's choice of a financial professional

KEY FINDINGS INCLUDE:

AWARENESS:

- *There is confusion and low awareness regarding the unequal levels of investor protection provided by investment advisors and stockbrokers:*
 - *58% of investors incorrectly believe that both stockbrokers and investment advisors have a fiduciary responsibility to act in an investor's best interest in all aspects of the financial relationship*
 - *Only 25% of investors indicated they were aware that investment advisors already have a fiduciary responsibility to act in an investor's best interest in all aspects of the financial relationship*
 - *44% of investors were not aware that stockbrokers do not have a fiduciary responsibility to act in the investor's best interest in all aspects of the financial relationship*
 - *63% of investors incorrectly believe that both stockbrokers and investment advisors are required to disclose all conflicts of interest prior to providing financial advice*
 - *Only 17% of investors indicated they were aware that investment advisors are already required to disclose all conflicts of interest prior to providing financial advice*
 - *51% are not very aware or not aware at all that stockbrokers are not required to disclose all conflicts of interest prior to providing financial advice*

EXPECTATION:

- *Although awareness is low, investors have high expectations regarding protections offered by providers of fee-based financial advice.*
 - *69% expect all financial professionals that offer fee-based financial advice to provide the same level of investor protection*
 - *83% expect all financial professionals that offer fee-based financial advice to act in the investor's best interests in all aspects of the financial relationship*
 - *84% expect all financial professionals that offer fee-based financial advice to have the same conflict of interest disclosure requirements*
 - *78% expect a stockbroker to disclose all conflicts of interest to an investor in a financial relationship either before providing financial advice or before and regularly thereafter*
 - *84% expect both stockbrokers and investment advisors providing fee-based financial advice to be subject to the same industry regulation*

CONCERN:

- *Furthermore, investors are very concerned when they learn that there are unequal levels of protection provided by stockbrokers and investment advisors.*
 - *81% were either very concerned or somewhat concerned that both stockbrokers and investment advisors provide fee-based financial advice yet offer unequal levels of investor protection*
 - *83% were either very concerned or somewhat concerned that all financial professionals offering fee-based financial advice are not subject to the same industry regulation*
 - *82% were either very concerned or somewhat concerned that stockbrokers are not required to act in the investor's best interest in all aspects of the financial relationship*
 - *82% were either very concerned or somewhat concerned that stockbrokers are not required to disclose all conflicts of interest prior to providing financial advice*

IMPACT:

- *If American investors had a higher degree of awareness of the unequal levels of protection provided by stockbrokers vs. investment advisors, it would impact their choice of financial professional.*
 - *86% indicated it would impact their choice of financial professional if they understood the different levels of investor protection from stockbrokers and investment advisors offering the same services*
 - *81% were either very likely or somewhat likely to seek services from an investment advisor if they knew investment advisors were required to act in the investor's best interest in all aspects of the financial relationship*
 - *81% were either very likely or somewhat likely to seek financial advice from an investment advisor if they knew investment advisors were required to disclose all conflicts of interest prior to providing financial advice*
 - *88% indicated they would not seek financial advice from a stockbroker if they knew stockbrokers were not required to act in the investor's best interest in all aspects of the financial relationship*
 - *87% indicated they would not seek financial advice from a stockbroker if they knew stockbrokers were not required to disclose all conflicts of interest prior to providing financial advice*

IMPACT (CONTINUED):

- *In addition, as investors became more informed of the unequal protections throughout the course of the survey their levels of expectation increased significantly. These findings represent the last sequence of questions in the survey.*
 - *92% expected that all financial professionals who offer fee-based financial advice should provide the same levels of investor protection*
 - *94% expected that all financial professionals who offer fee-based financial advice should be required to adhere to the same industry regulation*
 - *95% expected that financial professionals who offer fee-based financial advice should have a fiduciary responsibility to act in the investor's best interest in all aspects of the financial relationship*
 - *95% expected that all financial professionals who offer fee-based financial advice should be required to disclose all conflicts of interest prior to providing financial advice*

- *In the end, a significant majority of the American investing public expressed support for Congress to enact legislation that creates a clear, uniform standard of investor protection for all stockbrokers and investment advisors who provide fee-based financial advice.*
 - *90% of the American investing public expressed support for Congress to enact legislation that creates a clear uniform standard of investor protection for all stockbrokers and investment advisors who provide financial advice to investors*
 - *87% indicated that Congress should enact legislation that requires stockbrokers to have a fiduciary obligation to act in the investor's best interest in all aspects of the financial relationship*
 - *90% indicated that Congress should enact legislation that requires stockbrokers to disclose all conflicts of interest prior to providing financial advice*
 - *88% believe legislation that creates a uniform standard of investor protection applicable for both stockbrokers and investment advisors would boost investor confidence*

CONCLUSION

American investors have a low level of awareness about the regulations governing stockbrokers and investment advisors. The survey results indicate investors are unaware of, and confused about the unequal protections offered by those who provide fee-based financial advice. However, investors have very high expectations regarding the protections that should be provided by stockbrokers and investment advisors offering fee-based financial advice. Consequently, investors expressed a very high level of concern regarding the disparities in protection based on existing regulations. The survey clearly indicated that if investors had a higher degree of awareness, this knowledge would impact their choice of a financial professional.

METHODOLOGY

TD Waterhouse USA commissioned research firm Penn, Schoen & Berland Associates, Inc. to conduct interviews with 1,000 American investors who own stocks, bonds, or mutual funds outside of a company-sponsored plan. The survey has a margin of error of $\pm 3\%$. Interviews were conducted online from October 18 - 22, 2004.