November 22, 2004

Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Proposed Rule Change by the New York Stock Exchange, Inc. to Adopt Rule 405A ("Non-Managed Fee-Based Account Programs – Disclosure and Monitoring"), File No. SR-NYSE-2004-13, Release No. 34-50586 (Oct. 25, 2004).

Dear Mr. Katz:

Stephens Inc. ("Stephens") appreciates the opportunity to comment on the proposed rule change by the New York Stock Exchange, Inc. ("NYSE") that would require specific disclosure and monitoring obligations for "Non-Managed Fee-Based Account Programs."[1] Stephens is an NYSE member firm. As we discuss in further detail below, we respectfully believe that the proposed rule change should not be approved because the compliance burdens and costs associated with the rule would substantially undermine the benefits accruing both to firms and to customers from the operation of "Non-Managed Fee-Based Account Programs". These costs and burdens may be so substantial as to effectively force smaller firms (such as our firm and other firms with whom we have discussed this proposal) to provide only commission-based non-advisory accounts to their customers, thus imposing a burden on competition not necessary or appropriate in furtherance of the Securities Exchange Act of 1934 ("Exchange Act"). If, however, the Securities and Exchange Commission ("Commission" or "SEC") were to approve the proposed rule change, we believe that it should be substantially modified from its current form to reduce the compliance burdens and costs associated with the rule.

I. Stephens' Asset-Based Fee Accounts

Stephens, a registered broker-dealer headquartered in Little Rock, Arkansas, is a full-service broker-dealer offering a wide range of brokerage, advisory and investment banking services to clients and customers. Stephens permits retail brokerage customers to elect to pay for Stephens' brokerage services either on an asset-based fee basis or on a traditional commission

[1] This term is defined in the rule to "refer to arrangements in which no investment advisory services are provided by the member or member organization and in which customers are charged a fixed fee and/or a percentage of account value, rather than transaction-based commissions." See proposed NYSE Rule 406A(6).

basis. Under Stephens' non-advisory asset-based fee program, Stephens registered representatives may establish asset-based fee accounts for customers who desire that payment alternative. At the time of establishing an asset-based fee alternative for a customer, whether at account opening or as a change in the payment method for an existing customer, Stephens representatives provide written disclosure to the customer explaining the nature and amount of the fees applicable to the customer's account, and the customer agrees in writing to the specific fees being charged. Stephens does not market its fee-based accounts as advisory accounts – in fact, explicit written disclosure is made to the customer that the account is a brokerage account, and not an advisory account.

II. Discussion

A. The Proposed Rule Change Should Not be Approved

Before it approves a proposed rule change by a national securities exchange such as the NYSE, the Commission must find that the rule is consistent with Section 6(b) of the Exchange Act. Section 6(b)(8) of the Exchange Act requires that the rules of an exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. As outlined below, we believe that the compliance burdens and costs of proposed NYSE Rule 405A would, in the name of investor protection, effectively preclude some full-service brokerage firms, especially smaller firms (including some firms with whom we have discussed this proposal), from establishing programs offering asset-based fee accounts, thus limiting investor choice and imposing a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[2]

To put our comments in perspective, we note that the Commission previously has spoken favorably on asset-based fee brokerage accounts in connection with its pending proposal to exempt brokers offering these types of accounts from registration as investment advisers under the Investment Advisers Act of 1940 ("Advisers Act")[3]. In particular, the Commission explicitly stated that asset-based fee programs:

> benefit customers by better aligning their interests with those of their broker-dealers, and thus are responsive to the best practices suggested in the Report of the Committee on Compensation Practices ("Tully Report"). Under these programs, broker-dealers' and their registered representatives' compensation no longer depends on the number of transactions or the size of mark-ups or mark-downs charged, thus reducing incentives for registered representatives to churn accounts, recommend unsuitable securities, or engage in high-pressure sales tactics. The

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2 We also believe that the National Association of Securities Dealers ("NASD") NTM 03-68 is flawed for the same reasons. In addition, we bring to the Commission's attention that NASD NTM 03-68 appears to be a proposed rule change that has not yet been formally proposed or filed with the Commission under Section 19(b) of the Exchange Act and Rule 19b-4 thereunder.

> Commission welcomes the introduction of these programs, which may reduce substantially conflicts between broker-dealers and their customers.[3]

We strongly agree with the Commission's observations that asset-based fee accounts may operate to reduce the potential conflicts of interest that may arise in commission-based accounts and more closely align the interests of the registered representative and his or her customer. In fact, for these reasons many customers may prefer fee-based accounts to commission-based accounts.

NYSE Rule 405A, however, imposes substantial, unnecessary burdens on firms attempting to establish programs or already offering fee-based accounts such that many firms effectively would be forced to stop offering these accounts to customers, even those customers for which this type of account is most appropriate. Proposed Rule 405A(1) would require members to provide to each customer, prior to the opening of an account in a Non-Managed Fee-Based Account Program and annually thereafter, a disclosure document describing the types of Programs with sufficient information for the customer to make a reasonably informed determination as to whether a particular Program is appropriate for them, including, at a minimum: a description of the services provided, eligible assets, fees charged including projected customer costs, any condition or restrictions imposed, and a summary of the Program advantages and disadvantages. Many of these disclosures are reasonable, indeed most are already provided to customers.

However, projecting costs for asset-based fee accounts as drafted in the proposed rules entails anticipating future account activity. In this regard, it appears that the rule might contemplate more than just merely stating the percentage used to determine the annual fee. Moreover, effective disclosure generally requires context, and the requirement to project customer costs therefore could be potentially open-ended. For example, if a firm elected to address the requirements of the rule by attempting to disclose comparative cost data, the rule could, in addition to imposing the burdens of projecting costs for asset based-fee accounts, impose on firms the burden of also projecting costs in different types of accounts to provide

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3 We strongly support this SEC rule proposal, and urge the Commission to adopt it. See Exchange Act Release No. 50213 (Aug. 18, 2004), 69 FR 51620 (Aug. 20, 2004) (republishing for comment Exchange Act Release No. 42099 (Nov. 4, 1999), 64 FR 61226 (Nov. 10, 1999)). As noted above, Stephens does not market asset-based fee accounts as advisory accounts and provides specific disclosure that these accounts are brokerage accounts. In addition to being inconsistent with the statutory exemption for broker-dealers in Section 202(a)(11)(C) of the Advisers Act, registration of broker-dealers that offer fee-based brokerage accounts as investment advisers would add additional costs without providing any additional investor protection benefits. Commenters objecting to this proposal generally are registered investment advisers who are not aware of the extensive oversight to which broker-dealers are subject as members of self-regulatory organizations ("SROs"). To the contrary, investment advisers registered under the Advisers Act are not required to be members of SROs, and, in fact, no SROs for investment advisers providing securities advice exists.

context. This is not only unduly burdensome, but could be viewed as implying a recommendation for future account activity based on pure guesswork as to how future events might affect the future performance of the customer's account and therefore could create both compliance problems and potential liability problems.

While we do provide our customers with disclosure of many of the subjects listed in the proposed NYSE Rule at account opening, projecting expected account activity and then revisiting the account relationship each year in order to project future account activity is a difficult proposition, and suggests an ability to forecast markets and related account activity that is now prohibited. In the discussion of this requirement in the NYSE's rule filing, no guidance is provided on how a firm would go about projecting customer costs. In this regard, it should be noted that, in connection with the Commission's new confirmation proposal for mutual fund transactions, the Commission estimated that the costs associated with the point of sale disclosure requirement, which includes a requirement for broker-dealers to estimate first-year Rule 12b-1 fees, would be approximately \$83,333 per broker-dealer for start-up costs and approximately \$180,556 per broker-dealer for annual ongoing compliance costs.[4]

In contrast, the Commission made clear that additional regulatory burdens were not contemplated with respect to asset-based fee accounts in the cost-benefit section of its proposal to exempt brokers offering these accounts from registration as investment advisers. As the Commission stated:

> While the benefits of the proposed rule are substantial (although difficult to quantify), the incremental costs associated with the rule are small. Broker-dealers taking advantage of the rule will need to maintain certain records establishing their eligibility for the rule (*e.g.*, contracts or agreements governing the accounts and advertisements related to the accounts), but rules under the Exchange Act already require the maintenance of those records. Thus, the only incremental cost associated with the rule is the cost of adding a statement to those documents that the accounts are brokerage accounts. As discussed in the Paperwork Reduction Act analysis above, we believe this cost is insignificant.[5]

While not explicitly stated, the Commission at that time did not anticipate that the additional supervisory or compliance burdens, and the associated costs, contemplated by this rule would or should be imposed on firms that offered asset-based fee accounts.

While we recognize that the Commission's proposed point-of-sale disclosure requirement is substantially different from proposed NYSE Rule 405A(1), we believe that the Commission's cost-benefit discussion in the point-of-sale disclosure proposal gives a sense of some of the types of analysis that would be required to evaluate the potential costs that broker-dealers are likely to

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4 See Exchange Act Release No. 49148 (Jan. 29, 2004), 69 FR 6438 (Feb. 10, 2004).

5 See supra note 3.

incur in attempting to project customer costs for asset-based fee accounts at account opening and also possibly providing the costs associated with other types of accounts for comparison. Furthermore, unlike the point-of-sale disclosure requirement in the Commission's proposal, proposed Rule 405A(1) requires firms to project customer costs each year for as long the asset-based fee account is open. Thus, it is likely that compliance with the proposed NYSE rule would be even more costly than the Commission's estimates for the point-of-sale disclosure requirement for mutual funds.

Proposed NYSE Rule 405A(3) and (4) also contain requirements that make it unduly burdensome to offer asset-based fee accounts. Proposed NYSE Rule 405A(3) requires members to establish and maintain systems and procedures adequate to monitor, on an ongoing basis, transactional activity by customers in Non-Managed Fee-Based Account Programs. These systems and procedures must include specific transactional parameters or criteria for identifying levels of customer account activity that may be inconsistent with the Program costs incurred by the customer. Proposed NYSE Rule 405A(4) requires members to maintain written procedures for contacting and following-up with customers identified pursuant to proposed NYSE Rule 405A(3), at a minimum, every 12 months or more frequently if circumstances warrant it. At a minimum, such contact must include notification that the level of account activity for a specified time-frame may be inconsistent with the Program costs incurred by the customer.

With regard to the requirements in 403A(3), we understand that firms, including Stephens, currently do not have the systems in place to monitor the type of transactional activity contemplated by the proposed rule. The NYSE proposal would require firms to create costly new systems for these types of accounts that, in effect, require the creation of exception reports for transactional activity that may reflect transactions different from those anticipated, whether from inactivity or otherwise. In addition, the annual time-frame specified in the proposed rule is substantially shorter than the review period under Exchange Act Rule 17a-3(a)(17). This SEC rule requires, among other things, a broker-dealer to furnish to a customer every thirty-six months an account record that includes an account's investment objectives if the broker-dealer is or was required to make a suitability determination with respect to the account during this time period. While the SEC's rule requires a more general analysis of the types of securities in a customer's account every three years, the NYSE's rule requires a more complicated transaction-by-transaction analysis each and every year. At the very least, if any such disclosure rule is to be adopted, the time periods involved for review should be more akin to the three-year requirement of Exchange Act Rule 17a-3(a)(17).

Perhaps most problematic, the requirements in proposed NYSE Rule 405A(3) and (4) solely focus on "levels of customer account activity that may be inconsistent with the Program costs incurred by the customer." These requirements place firms in an untenable position by creating a presumption that certain customers should have been in different types of accounts or should be switched to other types of accounts depending upon account activity during an annual period. This is the proverbial "slippery slope." Absent meaningful analysis of market trends and how that relates to customer activity to support these requirements, an annual evaluation -- apparently an arbitrary selection -- may have the unintended consequence of creating market activity not in the customer's interest.

In particular, if a firm determines at the annual evaluation that the transactional activity in an asset-based fee account was not as anticipated, the rule could create a presumption that the customer either should have been in a lower cost account or did not receive recommendations consistent with the account type in place. This presumption potentially could be extended to create an analogous presumption for commission-based accounts in which the amount of commissions were such that the customer could have had lower costs in an asset-based fee account. Unfortunately, there could then arise claims that the broker is required to refund the amount of fees it actually earned from the account that exceed the amount of fees it would have received if the customer had the other type of account. In effect, this could impose an essentially strict liability standard, based on hindsight, for failing to see into the future accurately. These are not purely speculative possibilities, either. Stephens has been required to respond to NYSE regulatory inspection requests for Stephens to identify asset-based fee accounts that, in hindsight, would have had lower costs if they had been commission-based accounts and to identify commission-based accounts that, in hindsight, would have had lower costs if they had been asset-based fee accounts. The proposed rule, therefore, could improvidently incentivize brokers to execute sufficient trades in such accounts to meet the activity level requirements, whether or not such trading activity is in the best interest of the customer.

Moreover, as a practical matter, it would be very difficult to make effective contact with all customers annually to determine if they wish to switch back-and-forth between asset-based and commission-based accounts based on a hindsight evaluation that they could have paid less in fees during a prior period. It would appear inconsistent with a customer's wishes, interfering with the contractual arrangement between the broker and its customers, for a firm to make the selection for the customer. We wonder how a firm would go about effecting the switch, and whether any liability would attach to the firm for initially placing a customer in an asset-based fee account based on a hindsight evaluation or later not switching the customer to a commission-based account. Similarly, making the individual customer evaluations on an annual basis would require a tremendous use of personnel resources unavailable to most firms, including Stephens.

By solely focusing on costs, proposed Rule 405A(3) and (4) do not take into account other important factors that affect the determination as to whether an asset-based fee account is in the best interest of a particular customer, despite the discussion in the proposal that other factors can be considered. The "lowest cost is best" approach embraced by the proposed rule also undervalues the attention given by a broker to his customer and the advice of the broker when his considered conclusion is to advise that no trading activity should be executed in the customer's account during a given time period. For example, in recent years during volatile or down markets, astute brokers often recommended to customers that it was best, economically speaking, to avoid purchases or to hold the securities they owned, and neither buy new securities that may have been overvalued, nor sell securities at unjustifiably depressed prices. When the general economy improves and the market's direction changes, however, a customer may be more likely to engage in more securities transactions. Other personal factors also may lead a customer to decide, in the middle of a particular year, to engage (or stop engaging) in securities transactions. Yet none of this is taken into account in the NYSE's proposed rule language.

Viewed in its entirety, this proposal is indicative of a troubling trend in which the individual customer's judgment as to the type of relationship the customer wants to have with a *broker is being replaced by regulatory fiat that the lowest costs are always the best option.*[6] This position, however, is inconsistent with analogous industry practices in which the Commission has recognized that all the facts surrounding a transaction need to be considered to determine whether the transaction was appropriate for the customer. For example, in the best execution area, the Commission has repeatedly stressed that "the duty of best execution requires a broker to seek the most favorable terms reasonably available under the circumstances for a customer's transaction," and that "execution price and speed are not the sole relevant factors in obtaining best execution of investor orders."[7] This concept, however, is missing in proposed NYSE Rule 405A.

B. If the Proposed Rule is Not Rejected, The NYSE Should Amend the Proposed Rule Change before Approval

We believe that if the proposed rule is not rejected, it should be amended before the Commission considers approving it to address the problems outlined above. In particular, we believe that the following changes should be made:

- Proposed NYSE Rule 405A(1) should be amended to remove the requirement to project customer costs.

- Proposed NYSE Rule 405A(3) and (4) should be combined into one paragraph and amended to require a member to maintain policies and procedures to periodically review, on an exception basis, customer accounts in a Non-Managed Fee-Based Account Program that have been identified as potential exceptions to determine whether the Program continues to be appropriate for the owners of such accounts, taking into account the services provided, historic account activity and customer preferences and objectives.

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6 See, e.g., NASD NTM 03-68. In this Notice to Members, the NASD seems to have embraced this position by asserting that a recent decision upheld by the Commission means that suitability includes a cost component. See In the Matter of the Application of Wendell Belden, Exchange Act Release No. 47859 (May 14, 2003). A more proper reading of this decision is that it is limited to the facts of the case – facts in which a broker placed large dollar purchases of Class B shares and admitted that he did so for the commissions.

7 See, e.g., Exchange Act Release No. 43590 (Nov. 17, 2000), 65 FR 75414 (Dec. 1, 2000). The Commission further noted that, "other factors may be relevant, such as (1) the size of the order, (2) the trading characteristics of the security involved, (3) the availability of accurate information affecting choices as to the most favorable market center for execution and the availability of technological aids to process such information, and (4) the cost and difficulty associated with achieving an execution in a particular market center." Similarly, a customer may choose to open a fee-based account for reasons of convenience to the customer, because the customer prefers to pay a single fee each quarter, or because the customer expects to make numerous trades in the future and reasonably believes that this type of account will, over the long run, be the most economically advantageous to the customer.

The periodic review should occur at least every thirty-six months. These policies and procedures should include a documented determination noting whether the member has concluded to contact the owner of an account identified as a potential exception through a letter or telephone call and the results of the contacts that are made.

We believe that these amendments would substantially reduce the compliance burdens and costs associated with proposed NYSE Rule 405A.

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We appreciate the opportunity to provide our views on proposed NYSE Rule 405A. We strongly believe that if approved in its current form, the rule will substantially increase the costs and burdens of making the asset-based fee pricing alternative available to customers and could force many firms to forego establishing or to consider dropping asset-based fee accounts. This result would be contrary to the Tully Report's "Best Practices" recommendations and the Commission's stated view that fee-based programs benefit customers by better aligning their interests with those of their broker-dealers. More fundamentally, we object to regulatory prescription of broker-dealer pricing policies, the elimination of competition in the securities marketplace among full service firms, and limiting investor choice by substituting a "cheapest is always best" standard for customer judgment. We therefore believe that, if any form of Rule 405A is to be adopted, the proposed rule should be substantially amended before the Commission considers approving it, to reduce the compliance burdens and costs associated with the rule. If you have any questions regarding anything in this letter, please do not hesitate to contact our firm's General Counsel, David Knight, directly at (501) 377-2573.

Sincerely,

Curt Bradbury
Chief Operating Officer

Cc: Annette Nazareth
Robert Colby
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