



Securities Industry Association

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February 14, 2002

The Honorable Harvey L. Pitt
Chairman
U.S. Securities and Exchange Commission
450 Fifth Street N.W.
Washington, D.C. 20549

Re: Proposed Rule 202(a)(11)-1
(File No. S7-25-99)

Dear Chairman Pitt:

The Securities Industry Association ("SIA")¹ would like to take this opportunity to reiterate its strong support for the above-referenced proposal as well as to respond to certain recent comments submitted by the Consumer Federation of America ("CFA") and other organizations representing certain independent investment advisers and financial planners.

As noted in our comment letter of January 13, 2000 and as events have demonstrated since then, fee-based brokerage arrangements have grown dramatically in the securities industry in the last few years. They offer new choices to clients so that they can select both the services that they need and the manner in which they pay for those services. These arrangements provide a variety of benefits to clients including, for example, a more predictable cost structure that can help clients plan for their goals. Perhaps none of these benefits, however, are more important than the fact that these fee-based accounts can help clients feel that their interests are more closely aligned with those of their registered representatives and their respective firms.

We view these developments very positively. The acceptance of these services in the marketplace demonstrates that they addressed, and continue to address, a clear and definitive need on the part of investors. Moreover, they are directly in line with the

¹ The Securities Industry Association brings together the shared interests of nearly 700 securities firms to accommodate common goals. SIA member firms (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 manages the accounts of nearly 80 million investors directly and indirectly through corporate thrift and pension plans, and generates \$358 billion of revenue. Security firms employ approximately 760,000 individuals in the U.S. (More information about SIA is available on its home page: <http://www.sia.com>)

recommendations and goals of the Tully Commission and are structured to avoid some of the conflicts raised by industry critics. These arrangements, when encompassing the offerings of full-service brokerage firms, provide clients with an opportunity for a broad and meaningful way to address their investment needs. These arrangements have therefore been recognized by SIA's Board of Directors and are included in our best practices guidelines.²

We believe that the SEC recognized the potential benefits of these arrangements when it formulated its rule proposal in 1999. Fee-based compensation structures for brokerage accounts had, in fact, developed in a climate of some regulatory uncertainty due to the vagueness in the definition of the term "special compensation" contained in the Investment Advisers Act of 1940 ("Advisers Act"). The Commission, to its credit, recognized that this uncertainty needed clarification and that the form of compensation paid by clients, by itself, should not be the sole, deciding factor in determining the regulatory status of a particular type of service or program offered by a broker dealer or dual registrant. Thus, the Commission issued the instant proposal, with its included disclosures and safeguards.

We agree, of course, that the rule should require clear and direct disclosure so that investors understand the nature and extent of the services that they receive. There should be no confusion as to whether a particular arrangement constitutes a brokerage or an investment advisory service. SIA, in its comment letter on the proposal,³ suggested ways to improve this disclosure. In fact, clients typically receive substantial disclosures and descriptions of these arrangements including sales materials, contracts, periodic communications and meetings with their registered representatives. We therefore strongly disagree with the suggestion that investors do not have the ability to understand what they are enrolling in, that these arrangements are somehow inherently too confusing or that broker-dealers are seeking to use the proposed rule to offer investment advisory services without compliance with the Advisers Act.

The vast majority of SIA members are dually registered as broker dealers and investment advisers and/or have investment advisory affiliates. They have traditionally offered a broad variety of both brokerage and investment advisory services. Fee-based brokerage accounts provide new –and many would say, desirable – choices for investors. We are not aware of any evidence that suggests that firms have improperly categorized any of these services for regulatory purposes, nor do we know of investor complaints in this regard. We believe just the opposite is true. Products and services subject to applicable statutory guidelines, regardless of the form of compensation paid by clients, will continue to be offered by our members in compliance with the terms of those statutes. Thus, for example, notwithstanding the instant proposal issued in 1999 regarding fee-based compensation (which contains an on-going "no-action" position), firms continue to treat wrap fee portfolio management programs as being subject to the Advisers Act.

² See SIA Best Practices "A Guide For The Securities Industry," November 1996.

³ Letter to Jonathan G. Katz dated January 13, 2000

More fundamentally, the suggestion of the CFA and others that investor protection will somehow be eroded by the proposed rule, is simply not accurate. Broker dealers are subject to a broad panoply of rules and regulations under the provisions of the Securities Exchange Act of 1934, as well as pursuant to extensive – and multiple - self-regulatory organization (“SRO”) requirements governing broker-dealer activities. For example, the Exchange Act requires disclosure under Rule 10b-10 of extensive information regarding various matters (including the nature, manner and costs of transactions) and Rule 15c3-3 contains extensive customer protection provisions. SRO rules, such as those administered by the New York Stock Exchange and NASD, address, among other things, know your customer duties, suitability, net capital and fidelity bonding requirements. We note that independent investment advisers and financial planners are not subject to a comparable self-regulatory regimen. Further, and in particular, these firms are simply not subject to the frequency and intensity of regulatory inspections from federal and state regulators and SROs that broker dealers are, notwithstanding the discretionary control of client assets that advisers usually have.⁴

Fee-based brokerage arrangements have been offered to the public for several years and constitute a distinct and growing portion of the securities industry. SIA believes that the adoption of the proposed rule, along with appropriate changes to improve disclosure and clarify the status of certain discretionary accounts, will help finalize the regulatory foundation of these services. Such adoption will help firms continue to provide services, which many investors have embraced. We believe that the availability of these choices is beneficial to the investing public and in line with best practices that should be encouraged. Therefore, we urge you to support the early adoption of a final rule.

We thank you for the opportunity to address these issues and to supplement our earlier submission. If you have any questions, please do not hesitate to contact me at (202) 296-9410.

Sincerely,

Stuart J. Kaswell
Senior Vice President
and General Counsel

cc: Annette Nazareth, Esq.
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⁴ While the frequency of investment adviser examinations has increased since the implementation of NSMIA, it does not approach the frequency of regulatory examinations of broker-dealers.