SIFMA
Securities Industry and
Financial Markets Association

November 2, 2007

VIA ELECTRONIC MAIL

Ms. Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Interpretive Rule Under the Advisers Act Affecting Broker-Dealers
Release No. IA.-2652; File No. S7-22-07

Dear Ms. Morris:

The Securities Industry and Financial Markets Association ("SIFMA")[1] welcomes the opportunity to comment on the above-referenced release (the "Release") issued by the Securities and Exchange Commission (the "Commission" or "SEC") regarding a proposed interpretive rule (the "Proposed Rule") addressing the application of the Investment Advisers Act of 1940, as amended (the "Advisers Act" or the "Act") to certain activities of broker-dealers involving the provision of investment advice.

I. Background and Introduction

Section 202(a)(11)(C) of the Advisers Act provides an exception from the definition of advisers subject to the Act for a broker-dealer "whose performance of [advisory services] is solely incidental to his business as a broker-dealer and who receives no special compensation therefor."[2] This "brokers' exception" recognizes that broker-dealers provide investment advice to customers in the ordinary course of providing brokerage services and that it would be inappropriate to regulate such advice separately under the Advisers Act.[3] In April 2005, the

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[1] SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Market Association, is based in Hong Kong. More information about SIFMA is available on its website at *www.sifma.org*.

[2] 15 U.S.C. §80b-2(a)(11)(C) (2006).

[3] *Opinion of General Counsel Relating To Section 202(a)(11)(C) of the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 2 (Oct. 29, 1940) [11 FR 10996 (Sept. 27, 1946)] ("Clause (C) of Section

Commission adopted Rule 202(a)(11)-1 of the Advisers Act ("Old Rule 202(a)(11)-1"), which exempted broker-dealers offering fee-based brokerage accounts from the Advisers Act and provided guidance on several interpretive questions regarding the application of Advisers Act to activities of broker-dealers including with respect to (i) the provision by broker-dealers of comprehensive financial planning services, (ii) the exercise by broker-dealers of investment discretion, (iii) the determination of adviser status when a customer has both advisory and brokerage accounts with a broker-dealer, and (iv) the use of differing commission schedules by a broker-dealer for full service and discount brokerage. On March 30, 2007, the Court of Appeals for the District of Columbia Circuit (the "D.C. Circuit Court"), ruling for the plaintiffs in *Financial Planning Association v. SEC,* 482 F.3d 481 (D.C. Cir. 2007), vacated Old Rule 202(a)(11)-1 in its entirety. The vacature was entered on October 1, 2007, following the granting of an extension by the D.C. Circuit Court upon a motion submitted by the SEC.[4]

On September 19, 2007, the SEC issued the Proposed Rule to clarify that (i) a broker-dealer provides investment advice that is not "solely incidental to" the conduct of its business as a broker-dealer if it exercises investment discretion (other than on a temporary or limited basis) with respect to an account or charges a separate fee, or separately contracts, for advisory services, (ii) a broker-dealer does not receive "special compensation" solely because it charges different rates for its full-service brokerage services and discount brokerage services, and (iii) a registered broker-dealer is an investment adviser solely with respect to accounts for which it provides services that subject it to the Advisers Act. The Proposed Rule does not reinstate the position set forth in Old Rule 202(a)(11)-1 that provision of comprehensive financial planning services is not "solely incidental to" the conduct of a brokerage business. SIFMA strongly supports the Proposed Rule as well as the effort it reflects by the SEC to clarify the status of certain interpretive positions included in Old Rule 202(a) (11)-1. In particular, SIFMA applauds the Commission's focus on providing legal certainty and giving broker-dealers flexibility to provide customers with a range of services within the framework of a brokerage account. Consistent with the Commission's approach in the Proposed Rule, SIFMA urges the SEC to confirm that the no-action positions it adopted under Old Rule 202(a) (11)-1[5] will apply under the Proposed Rule, subject to the modification we recommend below.

The Proposed Rule recognizes, as we believe it should, that it is in the best interests of consumers to have access to a variety of brokerage services, which are subject to the significant investor protection provided for under applicable laws and self-regulatory organization rules,

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202(a)(11) amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business.").

[4] On May 17, 2007, the Commission applied to the D.C. Circuit Court for a 120 day extension to entry of the order. The request was granted on June 25, 2007. *Fin. Planning Ass'n v. SEC,* No. 04-1242, 2007 U.S. App. LEXIS 15169 (D.C. Cir. June 25, 2007).

[5] *Arthur W. Hahn,* SEC No-action Letter, September 29, 2005, *available at http://www.sec.gov/divisions/investment/noaction/ubs092095.htm;* and *Morgan, Lewis & Bockius LLP,* SEC No-action Letter, November 17, 2005, *available at* *http://www.sec.gov/divisions/investment/noaction/morganlewis111705.htm*

including lower cost alternatives. We believe that enhancing customer choice while providing investor protections and allowing for a more economical cost structure is clearly in the best interest of the investing public. In addition, the Proposed Rule allows for greater customer convenience by confirming that a customer may subscribe to differently-regulated services from the same service provider who is dually registered. To the extent that the existence of an advisory relationship were to result automatically in investment adviser rules applying also to any co-existing brokerage relationship, firms might be unwilling to offer both services due to the additional expense and burdens of complying with overlapping regulatory schemes. This could have the unfortunate result of forcing customers to select two different firms and, thereby, potentially increasing their own costs and administrative burden. Finally, the SEC's decision not to reinstate its prior position with respect to comprehensive financial planning is sensible, given the SEC's ongoing study of broker-dealer and investment adviser regulation and related issues. In sum, we believe that the Proposed Rule has taken an important step towards enhancing customer choice and reducing customer confusion by adopting an understandable and workable framework around when a broker is subject to the Advisers Act and when it is not and providing the flexibility to broker-dealers to discount their services or to offer both advisory and brokerage services to the same customer.

II. Separate Contract or Fee for Advisory Services & Discretionary Investment Advice

SIFMA also strongly supports the clarification contained in the Proposed Rule that a broker-dealer, which separately contracts for, or separately charges a fee for, *investment advisory services*, should be subject to regulation under the Advisers Act. We believe that this interpretation correctly focuses on customer expectations by looking to the contract signed by the customer or the service for which the customer is being charged to define the regulatory status of the relationship between the customer and his or her financial services provider. The interpretation also recognizes that, for example, the administrative fees charged to customers by broker-dealers in connection with brokerage (and which are unrelated to the provision of investment advisory services), such as charges for wire transfers, ACAT fees and charges for production of additional copies of the periodic statements, would not constitute "special compensation" or subject the broker-dealer to the ambit of the Advisers Act.

III. Discretionary Investment Advice

SIFMA supports the SEC's efforts to develop clearer guidance regarding when a broker-dealer's advisory activities will be deemed to be "solely incidental to" its brokerage business. In order to avoid customer confusion and ensure that broker-dealers are able to provide services in an operationally robust and clearly defined manner, we agree that it is important for the SEC to articulate its position with respect to the exercise of investment discretion. We believe that the SEC should provide continuity and legal certainty in this area. Accordingly, SIFMA supports adoption of the guidance provided in respect to the exercise of discretion, including the exclusions for exercise of temporary or limited discretion.

In connection with adoption of the Proposed Rule, we request that the SEC re-confirm the no-action positions taken in two letters adopted under Old Rule 202(a) (11)-1.[6] The first of these no-action positions relates to the exercise of investment discretion by a broker-dealer in connection with cash management services provided to "institutional investors," as defined in NASD Rule 3110(c)(4). The letter provides that exercise of discretion under those circumstances would appropriately be characterized as "temporary or limited" discretion within the meaning of Old Rule 202(a)(11)-1 and thus, incidental to brokerage and within the brokers' exception to the Advisers Act. After operating under this No-Action Letter for two years, SIFMA members have found the guidance to be useful in allowing firms to deliver customized cash management services to a portion of their sophisticated customer base. Given the utility of the guidance, however, we believe that a broader group of sophisticated investors would benefit from having access to, and the choice to use, customized, cash management services offered pursuant to the no-action relief. In our experience, high net worth customers who have less than $50 million in assets but possess significant assets and considerable investment sophistication would benefit from having access to the customized cash management services provided through discretionary brokerage programs offered pursuant to the Staff's no-action guidance. These customers, who qualify as "qualified purchasers," as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940, as amended (the "'40 Act"), have the necessary sophistication to understand the services provided and to hire expert advisers and family offices to assist them in selecting and evaluating the services. As the Commission recognized in the context of investments in private funds, "qualified purchasers" are financially sophisticated, able to appreciate risks associated with less regulated investments and can evaluate on their own behalf the level of management fees charged, conflicts of interest, investment risk, leverage and liquidity.[7] In our view, if qualified purchasers are sufficiently sophisticated to invest in private funds (as provided in Section 3(c)(7) of the '40 Act), they should be deemed to be sufficiently sophisticated to evaluate and invest through the customized, discretionary cash management services provided by broker-dealers on a brokerage basis pursuant to the SEC's no-action guidance. In addition, given the continual development of new types of products, SIFMA believes that the specific limitations set forth in the No-Action Letter unnecessarily constrain the ability of firms to carry out cash management services pursuant to the No-Action Letter. We believe that it is in the best interest of customers for firms to have the flexibility to utilize any bona fide cash management instrument or security as part of a customized cash management strategy rather than to limit the available instruments. Accordingly, we request that the SEC re-confirm the position set forth in its prior No-action Letter with respect to the exercise of discretion in connection with cash management services but to modify the position to (i) add as eligible customers "qualified purchasers" as defined in Section 2(a)(51)(A) of the '40 Act and (ii) expand the conditions in the letter to include any *bona fide* cash management instrument as eligible for inclusion under the relief.

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[6] *Op. Cite.*

[7] S. REP. NO. 104-293, at 10 (1996). *See also* H.R. REP. NO. 104-622, at 18 (1996) ("The legislation also provides a new exception…to permit investment pools that sell their securities only to 'qualified purchasers' who *are deemed to be sophisticated investors…"* (*emphasis added))*

In November 2005, the SEC also confirmed that a broker-dealer would not be deemed to have exercised investment discretion for purposes of Old Rule 202(a)(11)-1 to the extent that its associated persons exercise discretion and the discretionary authority stems from a personal or family relationship. As the Staff recognized, grants of authority by a spouse, child, family friend or similar personal relationship result from the individual's personal associations and not from his or her employment – even though the accounts are maintained with the broker-dealer. Firms have operated in reliance on this position without any issue, and we are not aware that this reliance has led to any customer complaints or confusion. Accordingly, we respectfully request that the Staff reinstate this position in connection with adoption of the Proposed Rule.

IV. Commission Differentials

SIFMA strongly supports the Commission's proposal to re-instate the interpretive position included in Old Rule 202(a)(11)-1 that a broker-dealer will not be considered to have received "special compensation" for purposes of Section 202(a)(11)(C) of the Advisers Act (and therefore will not be subject to the Advisers Act) *solely* because the broker-dealer charges a commission, mark-up, mark-down or similar fee for brokerage services that is greater or less than one it charges another customer. We agree with the rationale articulated in the Release that pricing differences are based on a variety of factors and it is "too hypothetical," in the case of commission differentials between full service and discount brokerage, to attribute the higher commission levels to the presence (or absence) of investment advice. We also agree with the statement cited by the Staff in the Release, based on a Comment Letter received in 2005 on the original rule proposal, that the availability of discount brokerage and lower cost brokerage alternatives advantage customers and are in the best interest or the investing public.[8] In our view, the guidance benefits consumers by encouraging firms to offer a greater variety of accounts and services as well as to provide consumers with discounted prices. A rule, such as this one, which provides customers with greater choice and the possibility of lower cost alternatives, is, in our view, clearly in the best interest of the investing public.

V. Dual Registrants

SIFMA supports the interpretive guidance included in the Proposed Rule that provides for determination of adviser status, based on the services provided, the contractual relationship between the customer and the broker-dealer and the compensation charged for each account. Broker-dealers provide a broad variety of products and services to their customers that are and should be regulated differently. Given the care with which Congress and the Commission have

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[8] *Interpretive Rules Under the Investment Advisers Act Affecting Broker-Dealers*, 72 Fed Reg. 55,126 at 55,129 (Sept. 27, 2007) (to be codified at 17 C.F.R. pt. 275) (*citing* Comment Letter of Merrill, Lynch, Pierce, Fenner & Smith (Feb 7, 2005), at p. 7 ("[electronic brokerage programs offer] lower expenses and less overhead, [and it is] entirely appropriate, and necessarily competitive, for firms to have reduced their fees for such services, and this reduction is obviously in customers' best interests.")).

developed regulation that is designed to address particular risks, it would ignore the regulatory intent and benefit of customization to hold broker-dealers to the highest or lowest common denominator of regulation based on differing relationships with customers.[9] The Advisers Act was designed to protect particular relationships between a customer and its investment adviser and not to supplant the Securities Exchange Act of 1934 or other existing regulation.[10]

By clarifying that advisory status depends upon each account or service selected by the customer, the Proposed Rule helps to ensure that customer expectations are met. In addition, the Proposed Rule provides for legal certainty. The interpretation also confirms the current and long-standing practice in which customers choose to enter into different relationships with their financial services firm depending upon the customer's own service and account elections, needs and circumstances. In our experience, this will reduce the possibility of customer confusion and lead to cost-effective pricing, treating each separate account relationship in the manner provided under the regulation applicable to that account type or service rather than super-imposing a broader overlay that may be difficult to understand and expensive to support from an infrastructure perspective. We commend the SEC for recognizing these concerns and support adoption of the guidance in the Proposed Rule.

VI. Financial Planning

Finally, we support the Commission's decision not to address financial planning at this time. We agree with the Commission's conclusions that they should consider whether or not to address this issue at a later date in light of the findings of the Rand Study.

VII. Conclusion

We appreciate your giving us the opportunity to comment on the Proposed Rule. We believe that the Proposed Rule appropriately focuses on providing legal certainty in the aftermath of the vacature of Old Rule 202(a)(11)-1. If adopted in the form proposed together with the clarification that prior no-action positions relating to Old Rule 202(a) (11)-1 remain effective, the guidance should, in our view, reduce the risk of customer confusion while allowing broker-

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[9] *See Report of the Special Study of Securities Markets of the Securities Exchange Commission*, H.R. Doc. No. 95, 88 Cong., 1st Sess. (1963), ch. VII, at 738 ("In the interests of the public, the regulatory agencies and the securities industry, further and continuing attention should be given to possibilities to coordinating efforts and allocating responsibilities . . . Among such possibilities would be . . . coordination of efforts in defining standards of conduct in areas of common concern.").

[10] *Certain Broker-Dealers Deemed Not to Be Investment Advisors*, SEC Rel. No. 34-51523, at 22-26 (Apr. 12, 2005), *available at* http://www.sec.gov/rules/final/34-51523.pdf ("First, as drafted in 1940, the Advisers Act avoided additional and largely duplicative regulation of broker-dealers, which were regulated under provisions of the Exchange Act that had been enacted six years earlier. Second, the broker-dealer exception in the Advisers Act was understood to distinguish between broker-dealers who provided advice to customers only as part of the package of traditional brokerage services for which customers paid fixed commissions – who were not covered by the Advisers Act – and broker-dealers who also provided advisory services (typically through special advisory departments) for which customers separately contracted and paid a fee – who were covered by the Act.") (citations omitted).

dealers to focus on providing customers with a broad selection of products and services, in a cost-effective manner and knowing with certainty how those products and services will be regulated. Should you have any questions about our views, please feel free to contact the undersigned at 202-434-8440 or Mike Udoff at 212-618-0509.

Sincerely yours,

Ira D. Hammerman
Senior Managing Director
and General Counsel

cc: The Hon. Christopher. Cox, Chairman
The Hon. Paul S. Atkins, Commissioner
The Hon. Annette L. Nazareth, Commissioner
The Hon. Kathleen L. Casey, Commissioner
Andrew J. Donahue, Director, Division of Investment Management
Robert E. Plaze, Division of Investment Management
Erik R. Sirri, Director, Division of Market Regulation
Robert Colby, Division of Market Regulation