Public Investors Arbitration Bar Association

November 19, 2004

VIA FEDEX

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

Re: Proposed NYSE Rule Change
File No. SR-NYSE-2004-13
Rule 405(A) ("Non-Managed Fee-Based
Account Programs - Disclosure and Monitoring)

Gentlemen:

I write on behalf of the Public Investors Arbitration Bar Association ("PIABA") to comment on the proposed change to Rule 405(A). While on its face the rule may appear to be positive to investors, we believe the rule fails to address the larger problems customers face with fee based accounts.

PIABA is concerned that the proposed rule fails to more fully address the obligations of member firms under Rule 405, and that some member firms will argue in arbitration proceedings that the rule limits their responsibilities to the matters specific to the rule proposal. The proposed rule fails:

1. to ensure the suitability of any outside investment advisors recommended to a customer;
2. to ensure that transactions within the NFBA directed by an investment advisor recommended by the member firm are suitable for the customer; and
3. to make appropriate "exceptions."

While Rule 405 is referenced in passing in the NYSE's discussion of the "purpose" of the Proposed Rule (see page 3 of the rule filing), it is not referenced in the rule itself.

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A) The proposed rule fails to address the suitability obligations of member firms when recommending outside investment advisors to customers.

Many of the NFBA programs being offered to customers today are coupled with a menu of outside investment advisors recommended to the customer and with whom the customer typically enters into a separate agreement (as contemplated by the proposed rule). For example, Merrill Lynch pursues this practice through its Consults program. PIABA members have found that firm recommendations of these outside investment advisors are themselves often unsuitable; *i.e.*, the background and trading style of the recommended advisor is inconsistent with the customer's investment objectives and background. This area is ripe for abuse for at least two reasons. First, the member firms and the outside investment advisors often have contractual agreements whereby a greater portion of the percentage fee goes to the member firm, as the member firm increases the volume of referrals to the outside investment advisor. Second, the member firms receive higher percentage fees (typically 1-2%) when they place the customer's money with an investment advisor trading in equities, than one holding fixed income securities (typically below 1%), such as bonds.

In summary, the member firm has strong incentives to direct to investment advisors handling equity accounts, and to direct a high volume of business to specific portfolio managers.

PIABA is concerned that the proposed rule's silence regarding suitability obligations when recommending outside advisors will be construed as absolving member firms/associated persons of those obligations, so long as the member firms and associated persons satisfy their obligations under the proposed rule, to ensure that the NFBA program itself is "appropriate for each customer taking into account the services provided, anticipated costs, and customer objectives." The Proposed Rule should expressly obligate member firms and associated persons to ensure the suitability of any outside investment advisor who is recommended to - or whose identity is brought to the attention of - the customer by the member firm/associated person.

B) The proposed rule fails to address the obligations of member firms to monitor the suitability of the activity within the NFBA.

An NFBA hallmark has been a tendency by member firms/associated persons to eschew all responsibility for the activity within the NFBA, both during the existence of the account and in

defense of claims involving those accounts. There seems to be a prevailing belief among member firms and associated persons that their responsibilities under Rule 405 end once an NFBA is opened.

NYSE Rule 405 requires that member firms "[u]se due diligence to learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization" and to "[s]upervise diligently all accounts handled by registered representatives of the organization." Yet, the text of the Proposed Rule appears to limit the obligations of member firms to monitoring the accounts solely for the purpose of "identifying levels of customer account activity that may be inconsistent with the Program costs incurred by the customer."

Limiting the supervision and monitoring the NFBAs in this matter disregards the reality of the relationship between customers, the member firm and the outside investment advisors who have been recommended to the customer by the member firm offering the NFBA. In reality, customers have little to no contact with the outside investment advisor, even when signing the separate agreement with the outside advisor. Typically, all questions, concerns and other discussions regarding the account are the subject of communication between the customer and the member's "registered representative handling the account," exactly as envisioned by the supervisory provisions of Rule 405.

Again, the reality is that customers **believe** they are getting some monitoring service from the member firm/associated person when they pay the percentage fees. Further, it has been the experience of PIABA members that when the member firm recommends an outside investment advisor, **the greatest portion of the percentage fee goes to the member firm, not to the outside investment advisor.** Certainly, given that the member firm is being regularly compensated, the duty to monitor the activities of the outside investment advisor for suitability of trading seems entirely reasonable.

PIABA urges that the Proposed Rule be clarified and/or revised to comport with the requirements of Rule 405 and the reality of the relationship between customers and member firms in the context of NFBAs by specifically incorporating the suitability and supervisory obligations of Rule 405 when the outside investment advisor was recommend to - or otherwise brought to the attention of - the customer by the member firm or one of its associated persons.

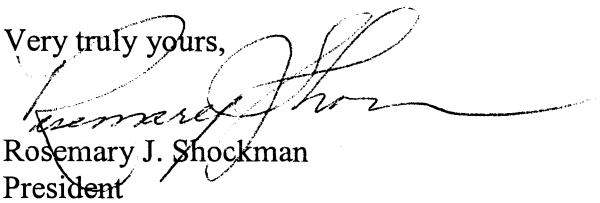
C) PIABA is concerned about the exceptions to the Proposed Rule.

The Proposed Rule would except pension plans with investment advisors. Many of the pension plans covered by the exception would be the plans of medical clinics and professional practices. Often, doctors in a medical plan are the trustees of the plan. Our members have seen repeated instances in which the doctors selected a broker-dealer, allowed the broker-dealer to select an investment advisor, and relied on the broker-dealer/associated person with respect to the suitability of the recommendation of the investment advisor, and with respect to the monitoring of the activity of the investment advisor. Many of these doctor trustees are not sophisticated investors. Such entities should not be excepted.

Further, the Proposed Rule would except trusts with outside investment advisors. Trusts have become extremely common "mom and pop" estate planning devices in our country. The majority of assets of many of our members' retired clients are held in family trusts. The trustees of such trusts are typically the husband and wife who set up the trust, and many are very financially unsophisticated. Again, when a broker-dealer/associated person recommends an investment advisor, the member firm should have suitability obligations with respect to the recommendation of the investment advisor, and with respect to monitoring of the trading by the investment advisor.

We urge that a more expansive rule be developed to cover what PIABA perceives as the broader problems set forth above.

Very truly yours,



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