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February 4, 2005

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

Re: File No. S7-25-99

Dear Mr. Katz:

The Public Investors Arbitration Bar Association ("PIABA") opposes the SEC's proposal to except from the Investment Advisers Act of 1940 broker-dealers which give investment advice.

We understand the SEC proposal will except from the Advisers Act broker-dealers which market fee-based accounts and give investment advice to customers, provided the advice is incidental to the firm's brokerage services, the account is nondiscretionary, and the broker-dealer makes certain mandatory disclosures. The exception for the most part will apply to large broker-dealers which are converting their business to fee-based accounts.

A fundamental premise of the proposed exception is that major brokerage firms are rendering advisory services incidental to the traditional brokerage business of buying and selling securities. We believe the SEC's proposal ignores the fact that while historically the business of retail broker-dealers focused on executing the purchase and sale of securities, in recent years firms have shifted their emphasis to marketing products which bear little relationship to these traditional brokerage services. Major brokerage firms are now providing credit cards, check writing, home mortgages, retirement planning, pension planning, tax planning, estate planning, life insurance, and other nonbrokerage services.

Having developed what in essence is a broad-based financial planning business, these firms actually have sought to set themselves apart from the limited, traditional stockbroker-customer relationship.

For example, sales personnel at the following firms are given these designations:

> Merrill Lynch: "Financial Consultant"
> Morgan Stanley: "Financial Advisor"
> Raymond James: "Financial Advisor"
> American Express: "Financial Advisor"
> UBS PaineWebber: "Financial Advisor"
> Oppenheimer Funds: "Financial Advisor"
> Smith Barney: "Financial Consultant"

In addition to designating their sales personnel as financial advisors and financial consultants, the major firms engage in broad solicitation of customers for financial planning services. Merrill Lynch's Client Handbook advises customers:

> In today's complex world, continued financial planning is an essential part of achieving financial security. Planning-based financial management helps you make the most of your resources by identifying and implementing

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> appropriate strategies for reaching your financial goals. With the expertise of a financial advisor who is backed by the resources of an experienced full-service organization, you will have access to all the tools you need to effectively put your plan into action. . . . Your Financial Consultant will recommend an asset-allocation strategy suitable for your current circumstances and risk tolerance that can help you achieve your financial goals . . . your Financial Consultant will help you select appropriate investments and track your portfolio's results.

The first page of Merrill Lynch's current Web site for individual investors confirms that its business is no longer simply that of buying and selling securities, stating:

> **We See Your Financial Life in Total℠**
>
> How do you see your financial life? Your investments are here. Your retirement there. Your mortgage over here. Seen separately and managed separately, your financial life can only take you so far. Now there's a way to go beyond those limits.
>
> Total Merrill℠ is the power of all that is possible from a relationship with Merrill Lynch – a relationship that provides you with a lifetime of personalized solutions based on your total financial picture.

This statement is followed by the below listing of Merrill Lynch Product Centers, each of which has a separate section on the Web site:

Advice and Planning	Retirement
Beyond Banking	Credit and Lending
Estate Planning Services	Investments
Business Financial Services	Tracking Progress

And Merrill Lynch is not unique. Other major firms market similar nontraditional products and planning services. Any suggestion that the major firms are providing investment advice incidental to traditional brokerage services ignores the true nature of their business.

With brokerage commissions reduced and market returns declining, this change in the character of the business of major brokerage firms may be expected to continue and even accelerate. As pointed out in the Associated Press article, *Brokerages Keep Busy Competing for Clients*, Michael J. Martinez (January 23, 2005):

> With modest returns expected from stocks in 2005, brokerage houses, many of which are now part of larger diversified financial corporations, will be intensifying their efforts to get their clients not only to trade stocks, but also to sign up for financial advice, tax help, estate planning and retail banking.

Major brokerage firms bear little resemblance to the stock brokerages exempted from the Investment Advisers Act of 1940 by Congress, and as the nature of their business has changed, so too has the investment advice they provide to the public. Investment advice rendered by these firms is more akin to general financial planning, in large measure promoting nonbrokerage products rather than incidental to "brokerage" activities. Because of the changed character of these firms, subjecting them to the Advisers Act does not offend the original congressional intent underlying the exception approved by Congress back in 1940.

It is also important to recognize that the fee-based services at issue here are not marketed as an isolated package but rather are sold by the major brokerage firms as part of their total services program. Fee-based accounts have been integrated into the entire array of asset-gathering products marketed by these firms. It is therefore unrealistic to structure an exception triggered by the mere existence of a fee-based account.

PIABA believes that tailoring an exception to allow these major financial institutions to render what are essentially investment advisory/financial planning services and avoid compliance with the Advisers Act is fundamentally inconsistent with the purposes of the Act and represents a failure of investor protection. Any exception for these firms should only relate to areas where the Advisers Act regulation is duplicated under the Securities Acts. The Advisers Act fiduciary duty and disclosure rules in particular should apply to these firms.

We also provide the following additional comments:

1. No Investor Harm

The SEC has taken the position that the proposed exception will cause no harm to investors and that investors dealing with brokerage firms are effectively protected by securities rules and regulations applicable to those firms, including the NASD suitability rule and the federal securities laws. The SEC fails to acknowledge that the suitability rule and the liability provisions of the federal securities laws apply only to purchases and sales of securities. The application of these principles to brokerage firms for advisory or other nonbrokerage services is questionable. It is important for investor protection that the fiduciary duty obligations contained in the Advisers Act apply to these firms. It is also important to investors that they receive the additional disclosures mandated by the Advisers Act, which are not required under the federal securities laws. PIABA believes the loss of these protections is investor harm. In short, broker-dealers providing investment advice and financial planning must be subject to the same legal standards as are applicable to other investment advisers.

A recent survey conducted by Opinion Research Corporation of Princeton, New Jersey, found that 91 percent of investors believe the same investor protection rules should apply to both stockbrokers and financial planners who offer the same kind of investment advisory services, and that 65 percent of respondents indicated they would be less likely to use a stockbroker providing investment advice if the individual was subject to weaker investor protection rules than a financial planner providing the same services. PIABA believes this common-sense reaction is instructive.

2. Use of Disclosures to Demonstrate Differences Between Types of Accounts

The SEC has acknowledged that customers are confused as to the nature of their accounts, the account characteristics, and whether in fact they have investment advisory or traditional brokerage accounts. Therefore, as part of the proposed rule, disclosure is required concerning the nature of the accounts and the difference in the legal protections available to different accounts.

PIABA believes that mandatory disclosures, warnings, and explanations are of little practical value in establishing investor protection in this area. This is particularly true in view of the complexity of the concepts at issue. It is unrealistic to expect that the average investor will be able to understand and evaluate a meaningful analysis of a brokerage firm's duties under the federal securities laws in contrast to an investment adviser's duties under the Advisers Act. Further, suggesting that investor confusion can be addressed by designating a person at the brokerage firm to explain the terminology ignores the implications of the obvious conflict of interest.

Boilerplate disclosures for advisory accounts cannot be deemed a substitute for imposing the statutory duties otherwise applicable under the Advisers Act.

3. The Bright-Line Test

The SEC seeks a bright-line test to determine when broker-dealers are acting as financial planners as opposed to providing advisory services which are incidental to the traditional brokerage business. It would seem apparent that when broker-dealers call their stockbrokers "financial advisers" and "financial consultants" and offer financial planning, products, and services, extending well beyond purchasing and selling securities, they are acting as investment advisers and not broker-dealers. Using contorted definitions and vague disclosures as a substitute for a common-sense, straightforward determination that these broker-dealers are subject to the Advisers Act is a disservice to investors. PIABA believes the difficulty in establishing a bright-line test reflects the artificial nature of the underlying analysis. Investment advisory services provided by the brokerage industry simply are not incidental to their traditional brokerage business.

4. Do Investors Benefit from Allowing Broker-Dealers an Exception Under the Investment Advisers Act Because It Encourages Broker-Dealers to Shift Clients from Traditional Brokerage Accounts to Fee-Based Accounts

PIABA is concerned that the broad-based shift of investors from traditional brokerage accounts to fee-based accounts may not be a benefit to a large number of investors. Many investors may actually incur even greater fees in a fee-based account than in a traditional brokerage account. This would be true for buy-and-hold investors who engage in limited trading with modest commission charges. Similarly, a transfer to a fee-based account may be detrimental where investors hold mutual funds with built-in commissions and little turnover, or money-market funds which do not generate significant commissions. This is not a hypothetical issue. Because of improper transfers to fee-based accounts, the NASD has issued *Notice to Members 03-68* to alert broker-dealers to this improper activity.

In addition, PIABA is concerned that a fee-based account will result in broker inattention to customers' changing investment needs.

Thus, while the SEC suggests the shift to fee-based accounts would better align investor and broker-dealer interests, the potential change may in fact establish a new conflict of interest which may mean new exposure for investors. Worse yet, there may be no remedy under the federal securities laws or suitability rule for a wrongful account shift since there may be no purchase or sale of securities.

5. Favoring the Industry

The presentation and tone of the SEC's proposal strongly suggest that while the SEC may be willing to make further modifications, the Commission is determined to adopt a permanent exception from the Advisers Act for qualifying broker-dealers. This predetermination is also supported by the SEC's original 1999 proposal which included the "temporary" exception encouraging the industry's shift to fee-based accounts with no investor-protection provisions, and which, although temporary, remains in place.

PIABA is concerned that the brokerage industry's structural shift in reliance on the temporary exception, which *ipso facto* created a compliance burden for the industry, may affect the SEC's determination as to whether a permanent exception should be adopted.

PIABA believes that it is inappropriate for the SEC to be concerned about this so-called burden on the industry in making the best decision in the interests of investors.

With declining commissions, the brokerage industry's shift to a fee-based advisory system obviously was motivated by financial considerations. Presumably, the industry determined that the economic benefits of changing the structure of their business more than offset the potential burdens of ultimately being required to comply with the Advisers Act. By making a business decision to rely on a temporary exception, they accepted the risk that it would not be made permanent, together with any related burdens.

An additional consideration with respect to supporting the interests of the brokerage industry is the culpable role of the major firms in recent investment scandals. The prime example, of course, is the analyst fiasco. There may be no event in our lifetime that will cause greater investor losses and more severe market disruption. In this context, where the issue is investor protection, regulators should be less concerned about protecting the profits of the brokerage industry and more concerned about protecting the public.

Very truly yours,

PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

Laurence S. Schultz
Federal Legislation Committee Chairman

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