UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

May 4, 1992

The Honorable John D. Dingell
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Dingell:

I appreciate receiving your follow-up letter of April 14, 1992, regarding wrap fee arrangements and their comparison to mini-accounts. The Commission is aware of the increasing popularity of these arrangements, which has been demonstrated by the large amounts of money flowing from more traditional brokerage accounts into wrap fee accounts.

As I discussed in my letter of April 7, 1992, these arrangements raise issues of best execution and adequate disclosure to investors. For example, when an investment adviser has discretion over a client's account it generally has a duty to obtain the best price and execution for each transaction. Some wrap fee programs require the adviser to use the program's broker-dealer. Where a client directs the adviser to use a particular broker-dealer, the adviser only has a duty to disclose that the client will be foregoing any benefit from savings on execution costs that the adviser could otherwise obtain through, for example, negotiating volume discounts on batched orders. 1/ Other wrap fee accounts permit an adviser to use broker-dealers outside of the program. In these programs, an adviser still has a duty to obtain best execution and should use a broker outside the program if the total of the outside broker's price and commission is less than the program broker's price. Moreover, given the level of fees charged in wrap accounts, an investment adviser or broker-dealer should consider whether a client is better served by paying separately for advisory and brokerage services.

In addition, as in a mini-account program, an investment adviser in a wrap fee arrangement could make similar recommendations for various clients. In the mini-account area, to assure an adequate level of individualization, the Commission

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1/ See Mark Bailey and Co., Investment Advisers Act Rel. No. 1105 (Feb. 24, 1988).

identified as relevant the adviser's provision of continuous advice as to the investment of funds on the basis of the individual needs of each client, the contact between the adviser and client, a client's possession of the indicia of ownership of the funds in its account, a client's authority and opportunity to instruct its adviser to refrain from purchasing certain securities, and the adviser's regular review of a client's financial status and objectives. 2/ Our review of wrap fee programs has shown that these program providers furnish clients with a level of individualization similar to that given to mini-account clients. In fact, many wrap fee providers consider their individualized services a strong selling point. Further, some mini-account providers charge a wrap fee. The Division of Investment Management has required these providers to disclose to potential clients that the wrap fee may be higher than the fee charged by other advisers for the same services.

Wrap fee arrangements differ from other arrangements involving a referral fee, because the adviser and the broker both provide significant services after the account has been established. The adviser decides which securities to purchase for the account and the timing of the purchases. The broker advises the client on which advisers would be appropriate based on the client's expectations, monitors the performance of the chosen advisers, and executes the transactions on behalf of the account. The Divisions of Investment Management and Market Regulation have not encountered any problems with referral fees peculiar to wrap fee accounts.

In addition, if a registered investment adviser pays a referral fee in connection with a wrap fee program, the adviser would be subject to Rule 206(4)-3 under the Advisers Act, the cash solicitation rule. We believe that some investment advisers in wrap fee programs pay referral fees, and to the best of our knowledge these advisers comply with the Rule. In fact, in the mini-account area, the staff has conditioned no-action relief, in part, on a representation that the adviser will comply with the Rule. Rule 206(4)-3 requires a written agreement between the adviser and the solicitor, and requires the solicitor to give the prospective client a copy of the adviser's brochure 3/ and a

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2/ Investment Company Act Rel. No. 11391 (Oct. 10, 1980) (proposing Rule 3a-4).

3/ Rule 204-3 under the Advisers Act requires registered investment advisers to give prospective clients a written disclosure statement describing, among other things, the adviser's services and fees, educational and business background, other business activities, and affiliations with

separate disclosure document describing the solicitation agreement.

Finally, as I stated in my earlier letter, there have been a number of inspections of providers of wrap fee programs. We have not discovered any broker-dealers or investment advisers participating in these programs who were not properly registered with the Commission.

Please be assured that we intend to continue monitoring wrap fee arrangements. I hope this letter addresses your concerns. Please let me know if I can be of any further assistance.

Sincerely,

Richard C. Breeden

Richard C. Breeden
Chairman

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other securities professionals.

U.S. House of Representatives
Committee on Energy and Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515-6115

April 14, 1992

The Honorable Richard C. Breeden
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Breeden:

I appreciate receiving your letter of April 7, 1992 outlining the actions of the Divisions of Investment Management and Market Regulation with respect to various wrap fee programs.

However, industry experts (See "Mutual Fund Distribution: The 1980-82 Revolution And A Decade of Evolution" by Allan S. Mostoff, 1992 Mutual Funds And Investment Management Conference Materials, at I-38) advise that wrap fee arrangements raise at least the following regulatory concerns:

whether the brokerage component of the wrap fee is appropriate for the particular type of account and customer;

whether the total fee is in line with the aggregate of fees otherwise payable for individual component services;

whether the wrap fee involves a disguised referral fee or "kickback" arrangement;

whether recommendations made to participants in wrap fee programs are individualized or, instead, raise "mini-account" questions;

what standards should be applicable to selection of executing brokers and determining best execution;

whether various service providers are properly qualified and registered to provide that service; and

whether the disclosure to clients is adequate.

I would appreciate assurances that the Commission is aware of and focusing on these issues in the studies, examinations, inspections, and possible form revisions discussed in your letter. Any "kickback" arrangements are of particular concern because they raise the specter of a revival of illegal "give-ups" that flourished under fixed commission rates. See Report of Special Study of the Securities Markets of The Securities and Exchange Commission Part 2, House Document No. 95, Pt. 2 (July 17, 1963).

Thank you for your cooperation and attention to this matter.

Sincerely,

JOHN D. DINGELL
CHAIRMAN

cc: The Honorable Edward J. Markey
The Honorable Norman F. Lent
The Honorable Matthew J. Rinaldo

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

THE CHAIRMAN

April 7, 1992

The Honorable John D. Dingell
Chairman
Committee on Energy and Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Dingell:

This letter is in response to your letter of February 19, 1992 concerning "wrap fee" accounts at U.S. securities firms. You expressed particular interest in the amount and structure of fees under these programs and the issues raised under the federal securities laws.

Wrap fee programs often combine money management, brokerage, custody, and other administrative services for a single fee based on a percentage of assets under management. Wrap fee accounts typically involve the provision of financial services by investment advisers and broker-dealers with differing roles and responsibilities. Fees for wrap accounts investing in equity securities can be 2 to 3 percent of assets, depending on the size of the account.

The management and brokerage services provided as part of a wrap fee program may be beneficial for some investors, but not for others. In view of the relatively high level of fees, these programs may not be suitable for advisory clients who are not active traders. For some clients, paying separately for brokerage and advisory services may be more suitable than a wrap fee.

In addition to suitability, wrap fee programs raise the issue of best execution. An adviser's ability to choose a broker-dealer varies among wrap fee programs, and, therefore, the extent of its duty of best execution also varies. However, when an investment adviser has discretion over a client's account it generally has a duty to obtain the best price and execution for each transaction. 1/

1/ See, e.g., Rule 206(3)-2(c) under the Investment Advisers Act; Soft Dollar Arrangements, Securities Exchange Act Rel. No. 23170 (Apr. 23, 1986).

The Divisions of Investment Management and Market Regulation have been studying the structure of various wrap fee programs and examining how investment advisers and broker-dealers comply with their responsibilities under the federal securities laws when they participate in these programs. In addition, inspections of wrap fee providers have been conducted that focus on both investment advisers and broker-dealers.

The Division of Investment Management is also considering the desirability of revisions to the investment adviser registration form, Form ADV, in part because of the growing number of advisers participating in wrap fee programs. Any such revisions would require brokers (who must also register as advisers) and advisers to disclose more fully their wrap fee arrangements to clients and prospective clients. 2/

I hope this letter addresses your concerns. Please let me know if I can be of any further assistance.

Sincerely,

Richard C. Breeden

Richard C. Breeden
Chairman

2/ Form ADV already requires applicants to describe their fee schedule in detail, and the Advisers Act requires advisers to provide that information to clients and prospective clients.

U.S. House of Representatives
Committee on Energy and Commerce
Room 2125, Rayburn House Office Building
Washington, DC 20515

February 19, 1992

The Honorable Richard C. Breeden
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Dear Chairman Breeden:

Pursuant to Rules X and XI of the Rules of the U.S. House of Representatives and our continuing oversight of securities and exchanges, the Committee is examining the growth of wrap-fee accounts at U.S. securities firms as underscored by a recent study prepared by Samuel Thayer of Harbridge House Inc. and Jeff Coburn of the Secura Group.

Concerns have been raised about, among other things, the amount and structure of the fees associated with these products. Please advise us what issues these arrangements raise under the federal securities laws and what the Commission is doing in response to these developments. We would appreciate receiving your response by the close of business on Friday, March 27, 1992.

Thank you for your cooperation and attention to this request.

Sincerely,

JOHN D. DINGELL
CHAIRMAN

cc: The Honorable Edward J. Markey
The Honorable Norman F. Lent
The Honorable Matthew J. Rinaldo