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COMMITTEE ON SMALL BUSINESS
(on leave of absence, 110th Congress)

Congress of the United States
House of Representatives

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July 13, 2007

The Honorable Christopher Cox
Chairman
Securities Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Dear Chairman Cox:

We are writing to share our concern about the impact of a recent opinion (*FPA v. SEC*) by a panel of the D.C. Circuit Court. We believe this decision will have the effect of limiting investors' choice in the pricing, execution and products and services. As you know, the Court vacated the Commission's rule 202(a)(11)-1 under the Investment Advisers Act of 1940 (the "Advisers Act"). The rule had the practical effect of allowing financial services firms the ability to offer a fee-based pricing alternative to commission-based brokerage accounts to their clients without triggering certain requirements and restrictions of the Advisers Act.

The Commission's actions for more than a decade have evidenced its support for the fee-based brokerage pricing alterative. Beginning with the "Tully Report," which was commissioned by then SEC Chairman Arthur Levitt in 1994, the Commission urged broker-dealers to adopt fee-based compensation arrangements as a best practice. The Commission has also supported fee-based brokerage by first issuing a no-action letter almost a decade ago and, later, the now-vacated rule 202(a)(11)-1. Firms have reasonably relied on the Commission's support of the fee-based pricing alternative in offering fee-based brokerage services, and more than 1 million clients have chosen to utilize these fee-based brokerage services for many years, for good reason:

1) Fee-based brokerage provides consumer choice in how to compensate their financial services provider for brokerage services;

2) Fee-based brokerage aligns interests of brokerage firms with their clients, by reducing incentives for account churning and allowing compensation to rise with positive account performance;

3) Fee-based pricing offers clients a better basis to determine brokerage transaction costs in advance than do commissions, which vary based on the size and number of transactions; and

4) Fee-based brokerage offers consumers access to the full range of brokerage services, including those involving principal trades with the sponsoring firm or access to public offerings – services not available to investment advisory clients.

Additionally, we are concerned that the Court's ruling may have the consequence of restricting consumer choice. In order to comply with the ruling, financial services firms and their clients will either (1) need to transition back to the old trade-by-trade commission-based compensation model, contrary to industry best practices and SEC recommendations or (2) transition to a fee-based advisory account, which will severely limit consumer choice and access to the wide range of investment options available in a brokerage account.

Specifically, the Advisers Act imposes a restriction on principal trading that commonly occurs in today's fee-based brokerage accounts. Section 206(3) of the Advisers Act prohibits an investment adviser from effecting transactions for clients while acting as principal for its own account or the account of an affiliate without disclosing the adviser's role in the transaction to the client in writing. The Commission has interpreted Section 206(3) to require the client's written consent before completion of each transaction. In 1940, this restriction was a needed protection due to lack of transparency in the market and difficulty in determining execution quality. Today, it is a practical impossibility and unnecessary burden on clients who want their integrated financial services firms to meet all of their financial needs.

Changes in the markets, regulation and technology call into question the necessity of this restriction. Instead, in many cases it has become a burden that limits consumer choice of product, price and execution options. The markets for most securities are more transparent, deeper and more liquid than ever before. Investment advisers and broker-dealers have best execution obligations they can fulfill by accessing electronic quotations from multiple venues almost instantaneously. With respect to equity securities, firms review the quality of execution offered by various market centers by comparing execution information that is available on the websites of every market center. SROs and the Commission regularly examine order routing practices to make sure that regulated advisers and broker-dealers are routing and executing orders properly. In short, the abuses that Section 206(3) was intended to address have been corrected by improvements in the market, regulation and technology over the last 70 years.

As the foregoing clearly illustrates, principal trading relief for non-discretionary advisory accounts is critical in order to minimize the impact on clients which will result from the Court's decision. We urge you and the Commission to examine all options to provide relief in advance of the October 1st stay. One such option could be recognizing that modern market and regulatory protections would allow financial services firms through non-discretionary fee-based investment advisory accounts to preserve a client's ability to engage in principal trades with the financial adviser by obtaining a client's one-time prospective written consent before engaging in any such transactions.

While we believe that granting principal trading relief will ease many of the adverse consequences of the Court's recent order, we also look forward to learning about the Commission's other plans, if any, to provide relief to financial services providers and the investing public from the effects of the Court's order.

Sincerely,

Dennis Moore
Member of Congress

David Scott
Member of Congress

William Lacy Clay
Member of Congress

Melissa Bean
Member of Congress

Lincoln Davis
Member of Congress

Joe Donnelly
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