

February 7, 2005

By Electronic Filing

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

*Re: Release Nos. 34-50980; IA-2340; File No. S7-25-99; Certain Broker-Dealers  
Deemed Not To Be Investment Advisers*

Dear Mr. Katz:

The Personal Financial Planning Executive Committee (“PFP Executive Committee” or the “Committee”) of the American Institute of Certified Public Accountants (“AICPA”) respectfully submits the following comments on the Securities and Exchange Commission's ("the Commission") re-proposed rule regarding Certain Broker-Dealers Deemed Not to be Investment Advisers (“the Rule”).

The American Institute of Certified Public Accountants is the largest national, professional organization of CPAs, with more than 340,000 members in business and industry, public practice, government, and education. Among its members are registered investment advisors, personal financial planners, and CPAs employed by broker-dealers. The PFP Executive Committee of the AICPA determines technical policies regarding personal financial planning and serves as the official representative on those matters. The Committee supports nearly 80,000 CPAs who provide personal financial planning services as part of their financial planning, investment advisory or tax practices.

**Overview and Recommendations**

The PFP Executive Committee of the AICPA appreciates the opportunity to submit comments on the re-proposed Rule. The Committee recognizes there have been substantial issues raised by investment advisers, financial planners, broker-dealers, and others regarding the Rule. However, we believe the most significant party whose interests are superior to all others in this debate is the investor. Ultimately, the Commission owes a duty to protect the interests of investors. The AICPA believes the Rule could have unintended, negative consequences for investors.

The PFP Executive Committee does not recommend the Commission develop a series of illustrations, attempting to define limits on incidental advice for fee-based accounts. Rather, we believe all fee-based accounts should be managed as advisory accounts. This

approach truly creates a bright-line test and eliminates the need to establish subjective guidelines on what constitutes incidental advice. The Committee does not believe the re-proposed Rule could be drafted in a way to protect the average investor.

The difference between an investment advisor's fiduciary duty and a broker's duty of suitability standard is substantial. Over sixty years ago when the Securities Exchange Act of 1934 and the Investment Advisors Act of 1940 were adopted by Congress, broker's offering fee-based services was not contemplated. Congress should review the applicability of the two Securities Acts in light of changing business practices. Additionally, with the ever increasing complexity of the investment markets, advice has become more important to the overall client relationship. This emphasizes the need for Congress to redefine the protections necessary for differing levels of advice. Therefore, until Congress addresses these issues, the Committee strongly recommends the Commission withdraw the re-proposed Rule in its entirety in the interest of investor safety.

### **Discussion of the Re-Proposed Rule**

The Committee understands the Commission's interest in developing a Rule permitting, and consequently encouraging, broker-dealers to adopt alternative fee-structures for their clients. We recognize the Commission's intention to respond to the Tully report and to encourage broker-dealers to adopt business models less dependent on securities transactions, without subjecting them to the additional burden of dual regulation. Accordingly, we agree there is value to investors in making transactions a lesser focus in brokerage accounts. However, we do not believe, after reviewing the re-proposed Rule and the comments submitted by others, the Rule could be written in a way to achieve the intended results, while enhancing investor protections.

While we understand the Commission's efforts to accommodate the broker-dealers in offering fee-based service models, we believe the primary goal should be to mandate that these broker-dealers are fiduciaries when they give investment advice to clients. This can only be done by requiring broker-dealers who offer fee-based accounts to comply with the Advisers Act. We believe the Rule as it is proposed will result in further investor confusion regarding the nature of advisory and brokerage services that cannot be corrected through disclosures or bright line tests.

Upon reviewing the re-proposed rule, the PFP Executive Committee has identified the following issues, leading to our conclusion the Rule should be withdrawn in its entirety:

#### **Solely Incidental to Brokerage Services**

The Committee believes the "solely incidental to" brokerage services test cannot be reasonably defined in the re-proposed Rule. The Committee generally agrees with the Commission's interpretation of Congressional intent in drafting the Advisers Act was to allow broker-dealers to provide a minimal level of investment advice, as long as such advice was incidental and related to the primary business of brokerage services. The

Securities Exchange Act of 1934 (“Exchange Act”) further defines the business of brokers as “effecting transactions in securities for the account of others”<sup>1</sup> while the business of a “dealer” is defined as “buying and selling securities for such person’s own account through a broker or otherwise”<sup>2</sup>. When the Exchange Act became law brokerage services were primarily transactional in nature, although there were certain elements of advice in those services. However, the Committee believes Congress recognized the quantity and standard of the advice was secondary to the primary transactional relationship. Congress further acknowledged the secondary nature of investment advice by creating the exemption for professionals (including, for example, accountants and attorneys) where the principal relationship with the client was other services.

Within the commission-only brokerage model, the compensation and incidental advice could be traced directly to brokerage transactions. Any investment advice unrelated to the brokerage service was typically billed under a separate advisory agreement. In this arrangement, a client could generally distinguish the brokerage and advisory services by the billing process. As fee-based accounts emerged over the past decade, the direct relationship between compensation and brokerage transactions was lost. When a fee is charged rather than a commission, it is no longer clear when investment advice is no longer solely incidental to the brokerage service. Rather, by charging a fee, the investor is likely to view the investment advice as the primary service

### ***Interpretation on Non-Incidental Services***

The Committee recommends the Commission issue an interpretation to address the application of the “solely incidental to” requirement of the Advisers Act. Regardless of the Commission’s final determination to adopt or withdraw this Rule, we believe certain activities of broker-dealers should not be considered incidental to their business as a broker-dealer. The interpretation should define the following activities as no longer incidental to brokerage services, regardless of the broker-dealer’s method of compensation: (1) holding out to the public as an investment adviser, financial planner, financial consultant, or other similar terms, (2) providing financial planning services, and (3) sponsoring wrap fee programs.

The Commission established precedence for this interpretation in its Investment Advisers Act Release No. IA 1092, October 8, 1987. The Commission staff has viewed the availability of the lawyer’s and accountant’s exception as turning on whether the lawyer or accountant has held himself out as providing financial planning, pension consulting, or other financial advisory services. The Committee believes a similar application of IA 1092 is appropriate to broker-dealers.

### **All Discretionary Accounts are Advisory Accounts**

The Committee agrees with the Commission’s position that all discretionary accounts be treated as advisory accounts. However, we do not believe discretionary authority is an

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<sup>1</sup> Section 3(a)(4)(A), Securities Exchange Act of 1934.

<sup>2</sup> Section 3(a)(5)(A), Securities Exchange Act of 1934.

acceptable bright line test in determining the advisory status of accounts. The Committee believes many non-discretionary accounts rise to the level of a fiduciary relationship based on the facts and circumstances of the broker-dealers' relationship with the client. We believe it is the relationship with the client, not merely the discretionary nature of the account, which is the impetus for regulation under the Advisers Act.

For example, the broker-dealers' relationship with the client may be ongoing and continuous and the client may place reliance on the advice of the broker-dealer in meeting his or her retirement or other personal financial goals. Although the client retains the ultimate authority to initiate transactions, the reliance on the advice of the broker-dealer could be equivalent to discretionary influence. This relationship is arguably a fiduciary one best served by an advisory account. The Committee cannot envision a bright line test to clearly identify when such nondiscretionary accounts rise to a fiduciary level as the determination must be based on the facts and circumstances of the client's relationship with the broker-dealer.

Further, an individual client may have both discretionary and nondiscretionary accounts with the same broker-dealer. We strongly believe that once a fiduciary relationship with a client has been established by the broker-dealer or a related entity, all accounts with that client should be managed as advisory accounts.

### **The Broker-Dealer Prominently Discloses to Its Customers that Their Accounts are Brokerage Accounts and Not Advisory Accounts**

The proposed Rule would require all advertisements for the accounts and all agreements and contracts governing the operation of the accounts contain a prominent statement that the accounts are brokerage accounts and not advisory accounts. In addition, the disclosure would be required to explain that, as a consequence, the customer's rights and the firm's duties and obligations to the customer, including the scope of the firm's fiduciary obligations, may differ. Finally, broker-dealers would need to identify an appropriate person at the firm with whom the customer can discuss the differences.

The revised disclosure requirement is an improvement from the version proposed in the original rule. However, we do not believe the complex differences between investment advice provided through a brokerage account and an advisory account can be adequately described in a simple disclosure. Further, naming a person at the broker-dealer's own firm as the individual responsible for meeting with clients to discuss the differences between accounts presents an inherent conflict of interest. The Committee agrees that disclosures are an important component to assist prospective clients in making informed decisions but the proposed disclosure is inadequate to meet that objective.

### **Conclusion**

The PFP Executive Committee commends the Commission's efforts to further enhance the proposed Rule. The Committee was optimistic an acceptable rule could be developed by the Commission based on the substantial comment submissions. After careful consideration and lengthy discussions, the PFP Executive Committee could not conclude that the re-proposed Rule, even with substantial modification, will meet an acceptable level of clarity to further protect the interests of investors. Therefore, we recommend the Commission withdraw the re-proposed Rule in its entirety, thus requiring all fee-based brokerage services to be managed as advisory accounts subject to the Advisers Act.

Sincerely,

Joel H. Framson, CPA/PFS, CFP®  
Chair, Personal Financial Planning Executive Committee  
American Institute of Certified Public Accountants