COMMENT LETTER

January 18, 2000

Comment Letter on SEC Proposal to Exclude Certain Broker-Dealers from the Advisers Act, January 2000

January 14, 2000

Jonathan G. Katz, Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0690

Re: Release No. IA-1845; File No. S7-25-99

Dear Mr. Katz:

The Investment Company Institute[1] appreciates the opportunity to comment on the Securities and Exchange Commission's proposed Rule 202(a)(11)-1 under the Investment Advisers Act of 1940 (the "Advisers Act").[2] The rule would exclude a broker-dealer providing investment advice from regulation under the Advisers Act so long as: (i) the advice is provided on a non-discretionary basis; (ii) the advice is solely incidental to its brokerage services; and (iii) the broker-dealer discloses to its customers that its accounts are brokerage accounts. As discussed more fully below, the Institute supports the proposed rule.

As the Release recognizes, broker-dealers have taken steps to re-price their services. Many of these revised compensation arrangements may benefit customers by better aligning their interests with those of the broker-dealer. This is why they were included as one of the recommendations of the "Report of the Committee on Compensation Practices."[3]

The introduction of these new compensation arrangements, however, raises the issue of whether the form of compensation paid by a customer remains an appropriate criterion on which to base the regulation of the related services under the Advisers Act. Because, as we understand, the services are fundamentally similar to those provided under traditional brokerage programs and because requiring registration of these programs under the Advisers Act could act as a disincentive to implementing this recommendation in the Tully Report, we support the Commission's proposal. Furthermore, to use the form of compensation as the basis for distinguishing between those broker-dealers that must register under the Advisers Act and those that do not is somewhat arbitrary.

While we recognize that the line that would be drawn under the Commission's proposal is still somewhat arbitrary, we believe it is a preferable alternative to subjecting all broker-dealers to regulation under the Advisers Act solely because they re-price their traditional brokerage programs. This is true even though, for example, advisers without discretionary authority that are not broker-dealers would continue to be required to register under the Advisers Act, notwithstanding the fact that they are providing very similar services to those broker-dealers that would not be subject to registration under the Advisers Act under the Commission's proposal. Moreover, broker-dealers with discretionary authority would continue to have their status under the Advisers Act turn on the form of compensation they receive.

Nevertheless, we believe the approach taken in the Commission's proposal is a sound one because it appropriately recognizes market realities; would not subject to regulation under the Advisers Act those persons that engage in activities that are generally considered to be a component of traditional brokerage services; and would preserve the sanctity of the Advisers Act by excluding from the proposed exclusion broker-dealers that exercise discretionary authority for special compensation or render advice that is not solely incidental to their brokerage business.

While the Institute supports the Commission's current proposal and recommends its adoption, in view of the changes taking place in the industry, we believe it would be appropriate for the Commission to study some of the broader issues that are raised by this proposal, such as whether the exercise of discretionary authority should trigger regulation under the Advisers Act and the meaning of the terms "solely incidental" and "special compensation" as used in Section 202(a)(11)(C) of the Advisers Act.

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The Institute appreciates the opportunity to submit these comments on the Commission's proposed rule. If you have any questions concerning them or would like any additional information, please contact the undersigned by phone at 202-325-5825.

Sincerely,

Tamara K. Reed
Associate Counsel

cc:Paul F. Roye, Director
Robert E. Plaze, Associate Director
Cynthia M. Fornelli, Attorney Fellow
J. David Fielder, Senior Counsel, Task Force on Adviser Regulation
Division of Investment Management

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,004 open-end investment companies ("mutual funds"), 494 closed-end investment companies, and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.404 trillion, accounting for approximately 95% of total industry assets, and over 78.7 million individual shareholders. The Institute also represents the interests of advisers. Many of the Institute's investment adviser members render investment advice to both investment companies and other

clients. In addition, the Institute's membership includes 417 associate members which render investment management services exclusively to non-investment company clients. A substantial portion of the total assets managed by registered investment advisers are managed by these Institute members and associate members.

2 See Advisers Release No. 1845 (November 4, 1999)(the"Release").

3 This report, which is also known as the "Tully Report," was prepared by a committee formed in 1994 at the request of SEC Chairman Arthur Levitt and issued April 10, 1995. According to the Report, "In many cases the best advice a [registered representative ("RR")] can give a client at a point in time is to 'do nothing,' or to keep assets in the safety of a money market account. The RR's reward for this advice is zero compensation. Some firms' practice of basing a portion of RR compensation on client assets in an account is seen as one way to reduce the temptation for income-seeking RR's to create inappropriate trading activity in an account. Fee-based accounts may also be particularly appropriate for investors who prefer a consistent and explicit monthly or annual charge for services rendered, and whose level of trading activity is moderate." Tully Report at pp. 12-13. (Emphasis in original.)
