October 26, 1999

Arthur Levitt
Chairman
Securities and Exchange Commission
450 5th Street, N.W.
Washington, D.C. 20549

Dear Chairman Levitt:

Nobody needs to tell you that the nation's securities markets today are undergoing their most dramatic changes in decades, or that those changes have potentially enormous consequences for the growing legion of average, unsophisticated Americans who have come to rely on the markets to save for retirement, a child's college education, or a first home. You are to be congratulated for your efforts to ensure that the interests of these investors are not forgotten as the industry responds to new challenges and opportunities.

It is in that capacity that I am writing to you today -- as a guardian of investors in a rapidly changing financial marketplace. On a number of the central issues of the day -- demutualization of the major markets, the advent of after-hours trading for retail investors, and the need to protect against market fragmentation, for example -- you have already staked out strong pro-investor positions.

In particular, we share your concern that having for-profit markets serve as self-regulators creates potentially harmful conflicts of interest. If our markets are to be preserved as the premier markets of the world, these conflicts must be addressed as privatization moves forward. With Congress all but silent on the dangers of for-profit self-regulation, your leadership in raising this issue has been crucial. We stand ready to help in any way that we can to devise workable solutions that ensure that a vigorous, well funded regulatory structure operating in the public interest is not sacrificed in the pursuit of new, more flexible market structures.

Another transformation that has received somewhat less attention is the changing role of the full-service broker. But this is also an area where, in our view, regulation should be reexamined to ensure that it adequately addresses the realities of today's marketplace.

As you know, traditional full-service brokerage firms are suddenly faced with very real competition from on-line firms for the business of self-directed investors. These changes come on top of two decades in which full-service firms have faced growing competition for advice-seeking customers from the financial planning industry, whose claim to offer comprehensive, objective financial counsel has been an attractive selling point with the public. As a result, full service firms are being pulled in two very different directions. On the one hand, they must seek to satisfy self-directed investors, who want to complete their transactions quickly and conveniently at the lowest possible price. Advice-seeking investors, on the other hand, increasingly want services that aren't muddied by the conflicts of commission-based compensation.

In short, market forces seem increasingly to be driving a wedge between the two major functions traditionally offered to clients in combination by full-service brokers -- advice and product sales. Although it poses serious challenges for the industry, this division has the potential to benefit investors in the long run. The combination of advice and commission-based compensation has always been a troubling one, creating as it does a serious, largely undisclosed conflict of interest that can serve to bias the registered representative's recommendations. For investors to benefit, however, the increasingly advice-based services offered by full-service brokers must be held to the professional standards that this relationship implies -- a fiduciary duty to place clients' interests ahead of their own and an accompanying responsibility to fully disclose any and all conflicts of interest.

With this in mind, I was concerned by a report earlier this year that the Commission is considering a rule proposal that would treat fee-based wrap accounts as brokerage accounts, rather than subjecting them to the disclosure requirements of the Investment Advisers Act. I do not know whether these reports are true. If they are, I encourage you to rethink this proposal. While I certainly understand, and share, the desire to encourage the brokerage industry to move further toward less conflict-inducing compensation methods, exempting the industry from the professional standards to which others offering competing services must adhere seems to me to be too high a price to pay. It would set an unfortunate precedent, both for lowering the already modest standards that apply to advisory services generally and for providing the brokerage industry with additional special exemptions from advisory standards, even as they move increasingly into the advisory business.

With your focus on industry compensation practices, you have played a leading role in initiating the debate over appropriate professional standards for an advice-driven brokerage industry. After all, the brokerage industry will find it difficult, if not impossible, to evolve into a more professional advisory profession if it retains compensation practices, such as sales contests, that smack of the used car lot. The North American Securities Administrators Association has also entered the debate, with its up-coming round-table on the appropriateness of the current suitability standard for on-line investors. It seems to me, however, that they have asked only half of the question. The other half -- whether the suitability standard is an adequate standard for an advice-driven broker-client relationship -- is at least as important.

What is missing, it seems to me, is a broader vision of how broker-dealer regulation can help to advance the investor interest as the market for brokerage services evolves. If you share our interest, CFA would be pleased to work with you and your staff to help develop such a vision.

No one can predict with any confidence what our securities markets will look like ten, or even five, years from now. Investors are fortunate to have you at the helm of the SEC during this period of unprecedented change and turmoil. Please let me know if there is anything CFA can do to assist you. Meanwhile, if you or a member of your staff would like to discuss these issues further, please feel free to call me at 719-543-9468.

Sincerely,

Barbara L. N. Roper
Director of Investor Protection