



## Consumer Federation of America

December 13, 2001

Harvey L. Pitt  
Chairman  
Securities and Exchange Commission  
450 Fifth St., N.W.  
Washington, D.C. 20549

Dear Chairman Pitt:

I am writing to you to seek your intervention on an issue before the Commission that I believe desperately needs a fresh viewpoint. The issue in question is the proposed rule on the broker-dealer exclusion from the advisers act. This is an issue of the highest priority for CFA, as it affects the most vulnerable of investors -- those who must rely on financial professionals for advice but who have little sophistication in judging the financial professionals who compete for their business.

Unfortunately, in developing its proposed rule, the Commission has been so focused on encouraging brokers to adopt fee-based forms of compensation (a goal we support) that it has failed to take into consideration the broader investor protection implications of its policy. The real issue is whether financial professionals who are indistinguishable to the average investor -- by virtue of the fact that they call themselves by the same titles and market themselves as providing the same services -- should continue to be regulated under very different standards. Clearly, that is not in investors' interests.

That said, we agree with the basic philosophy underlying the proposed rule, that method of compensation should not be, and was never intended to be, the primary factor determining whether a broker is also subject to regulation as an investment adviser. The primary test should be whether that broker provides advice that is more than merely secondary to product sales. If they do -- and just about all of the full-service brokerage firms advertise that they do -- then they are investment advisers, regardless of how they are compensated. Compensation only comes into play when the broker provides only advice that is solely incidental to product sales but nonetheless charges special compensation for that advice.

The problem is that the Commission has, to date, avoided the difficult job of defining what constitutes advice that is solely incidental, or merely secondary, to product sales. Instead, the commission has taken what up until now was the relatively easy way out, by using method of compensation as a convenient proxy in determining the application of the advisers act. The growth of fee-based compensation has forced a reevaluation, not because fee-based

compensation is by definition special compensation for advice, but because its growing use has forced the agency to come up with a new method for drawing a line between those financial professionals who are engaged strictly in securities sales and those who offer broader advisory services.

This reevaluation is long overdue. It should, for example, have been prompted when Shearson Lehman advertised itself in 1991 with a call to investors to "[t]hink of your Shearson Lehman Financial Consultant more as an advisor than a stockbroker." Or when then Merrill Lynch Chairman William A. Schreyer offered the following explanation to *Leaders* magazine for why the firm had decided to drop the title of "stock broker" in favor of a new title, "financial consultant":

"The fact is that [the new title] reflects what they do. Back in the old days stock brokers sold stocks and bonds, and perhaps commodities. Today, we offer financial planning and profiling, packaged products, such as mutual funds, tax-advantaged retirement accounts, insurance, trust services, "wrap" fee accounts run by professional money managers, cash flow management and business valuation services for small business owners and self-employed professionals -- and this is just a small sample. So financial consultant more accurately reflects what we actually do for clients. It reflects a shift from a sales approach that is built around products to sell to a marketing approach built around profiling client needs."

While not all of the changes outlined by Schreyer reflect a transformation from salesperson to adviser, some clearly do. That transformation has only become more apparent over the last decade, as full-service brokerage firms have chosen to compete for retail clients by recasting themselves as financial advisers. Clearly, the firms have concluded that advice, not product sales, is what retail clients most want. While some of these changes have been beneficial, investors have not received the full potential benefits because brokers have been allowed to make the move toward increasingly advice-based services without also triggering the heightened fiduciary duty and disclosure requirements that go along with that role. And, with the issue finally coming to a head, the Commission has proposed a rule that ducks that central issue entirely.

Frankly, the proposed rule doesn't do a particularly good job on the question of compensation either. The question of what constitutes special compensation doesn't need a broad new rule because of the growth of fee-based compensation. Regardless of whether compensation comes in the form of commissions or fees, the question should be the same: is a portion of that compensation specifically identifiable as special compensation for advice. So, the fact that Prudential charges fees for its Prudential Advisor accounts should not automatically lead to the accounts' regulation under the advisers act. The fact that Prudential advertises that "you pay a fee for advice" should.

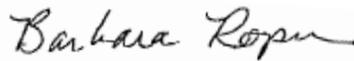
The point is that brokers haven't adopted fee-based compensation out of an altruistic desire to reduce conflicts of interest. Brokers have adopted fee-based compensation because it helps them to compete for clients who are looking primarily for advisory services. And they have promoted the accounts with that in mind. After all, the fee-based program at Prudential

isn't called "Prudential Broker," and the same ad that touts the fee for advice also states that "it's advice, not execution, that's at the heart of our relationships."

The question before you, then, is whether the Commission is going to perpetuate a system in which salespeople are free to promote themselves to clients as advisers without having to meet the fiduciary duty and disclosure requirements that accompany that role. So far, the Commission's proposals in this area have missed that central point. I hope that, by bringing a fresh viewpoint, you can get this issue back on the right track.

In case my somewhat long-winded letter has not already over-taxed your interest in this matter, I am enclosing a copy of CFA's initial comment letter on the proposed rule as well as a follow up letter we sent to Chairman Levitt. Let me know if I can be of assistance as you further develop your position on this issue.

Sincerely,

A handwritten signature in cursive script that reads "Barbara Roper". The signature is written in black ink on a light-colored background.

Director of Investor Protection  
Consumer Federation of America