

May 6, 2003

The Honorable William Donaldson
Chairman
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Dear Chairman Donaldson:

The Consumer Federation of America,¹ Fund Democracy,² the Investment Counsel Association of America,³ the Financial Planning Association,⁴ Certified Financial Planner Board of Standards, Inc.,⁵ and the National Association of Personal Financial Advisors⁶ are writing to urge the Commission to give renewed consideration to a long-pending rule proposal that would inappropriately expand the broker-dealer exemption from the Investment Advisers Act. The Advisers Act excepts from the definition of “investment adviser” a broker or dealer “whose performance of advisory services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor.” In 1999, the Commission proposed that a broker-dealer would not be deemed an investment adviser based solely on its receipt of special compensation (such as fees based on managed assets) if it does not exercise investment discretion over the accounts from which it receives special compensation, any advice provided with respect to those accounts is solely incidental to brokerage services provided, and it employs

¹ The Consumer Federation of America (CFA) is a nonprofit association of approximately 300 pro-consumer organizations. It was founded in 1968 to advance the consumer interest through advocacy and education.

² Fund Democracy is a nonprofit membership organization that acts as an advocate and information resource for mutual fund shareholders.

³ The Investment Counsel Association of America is a not-for-profit association that represents the interests of investment advisory firms. Founded in 1937, the ICAA’s membership today consists of about 300 SEC-registered companies that collectively manage in excess of \$3 trillion for a wide variety of individual and institutional clients. See www.icaa.org for more information.

⁴ The Financial Planning Association is the largest organization in the United States representing financial planners and affiliated firms, with approximately 29,000 members. Most FPA members are affiliated with investment adviser firms registered with either the SEC or state securities administrators, or both.

⁵ Founded in 1985, Certified Financial Planning Board of Standards, Inc. (CFP Board) is a nonprofit professional regulatory organization that fosters professional standards in personal financial planning so that the public values, has access to, and benefits from competent and ethical financial planning. CFP Board currently authorizes more than 41,500 individuals to use its marks CFP® and Certified Financial Planner™ in the United States.

⁶ NAPFA is the largest membership organization of independent, Fee-only, comprehensive financial advisors in the United States.

a disclaimer in advertising.

Although we approach this issue from very different perspectives, our organizations are united in our views: (1) that there are serious problems with the rule as proposed, and (2) that it is inappropriate for the Commission to continue to rely on the no action position it took, pending final adoption, when it issued the rule proposal more than three years ago.⁷ We urge you to take up this issue without further delay.

Most of our organizations have submitted extensive and detailed comments to the Commission (copies of which are included in this packet) in response to the proposed rule. If you review those comments, you will see that, while we may disagree over various details, we agree on far more.

Most importantly, our organizations agree that, if the Commission wishes to rely on nature of services rendered rather than method of compensation as the key means of distinguishing between brokers and advisers, it must clarify what constitutes "solely incidental" investment advice by a broker-dealer. The recent blurring of lines between brokers and advisers, accelerated but certainly not initiated by the move toward fee-based broker compensation, has made action in this area imperative.

Emboldened by Commission inaction, brokerage firms aggressively advertise their services based on the advice offered and constantly seek to extend the reach of the solely incidental exemption, even to such clearly advisory services as financial planning. One result is that financial professionals who are indistinguishable to investors based on the titles they adopt, the way they market themselves, and the services they claim to offer are subject to very different regulatory regimes. Another result is that consumers are left in the dark about conflicts of interest that can exist, even with fee-based accounts, when those accounts are offered by a broker. Clearly, neither result is in investors' best interests.

The proposed rule combines this error of omission – failing to provide guidance on what constitutes solely incidental advice – with several errors of commission. These include its inconsistent treatment of discretionary accounts, its failure to rein in misleading advertising practices, and its weak advertising disclosure requirements. In revising the rule, we therefore urge you, at a minimum:

- to define what constitutes “solely incidental” advice by a broker and to do so in a way that is consistent with Congress’ clear intent to limit the advice brokers can offer without triggering the protections of the Advisers Act;
- to require that all discretionary accounts be treated as advisory accounts, regardless of the method of compensation;

⁷ “Until the Commission takes final action on the proposed rule, the Division of Investment Management will not recommend, based on the form of compensation received, that the Commission take any action against a broker-dealer for failure to treat any account over which the broker-dealer does not exercise investment discretion as subject to the Act.” Proposal at 4.

- to prohibit brokers who claim the "solely incidental" exemption from marketing their services as advisory services; and
- to require prominent disclosure of all material facts regarding any advice offered through the account, including but not limited to, the solely incidental nature of such advice.

Investor advocates and representatives of the investment adviser and financial planning communities are not alone in raising these concerns. These same issues were addressed by the state securities regulators in the North American Securities Administrators Association's comment letter on the proposed rule. Specifically, NASAA's comment letter recommends that the Commission "set out factors for determining when advice is 'solely incidental,'" asserts NASAA's view that "all discretionary accounts of broker-dealers, regardless of how compensation is paid, should be treated as advisory accounts and subject the broker to the requirements of the Advisers Act," and suggests that the Commission amend the proposed rule "to specifically preclude a broker-dealer from suggesting that the account is anything other than a brokerage account or that advisory services are also available."

We certainly understand that the Commission has had a full agenda of pressing matters to address in the past year and a half and that issues such as this were, of necessity, pushed to the back burner during that time. However, the Commission's no-action position on this issue cannot be allowed to stand indefinitely. We believe the time has come for the Commission to act. We look forward to working with you to achieve a final rule that ensures investors relying on financial professionals who offer investment advice will receive the vital protections Congress intended, regardless of whether the advice comes from a traditional money manager, a financial planner, or a broker.

We would greatly appreciate the opportunity to meet with you to discuss these issues in more detail. Meanwhile, thank you for your attention to our concerns.

Respectfully submitted,

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