May 31, 2000

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

Re: Release Nos. 34-42009; IA-1845; File No. S7-25-99; Certain Broker-Dealers Deemed Not To Be Investment Advisers

Dear Mr. Katz:

The Consumer Federation of America[1], the Certified Financial Planner Board of Standards[2], the Investment Counsel Association of America[3], and the National Association of Personal Financial Advisors[4] submit the following group letter to supplement the comment letters our organizations submitted earlier on the proposed rule regarding the broker-dealer exclusion from the Investment Advisers Act. Although our organizations approach the issue from very different perspectives, we agree on a number of the key points related to the rule. We are writing to reiterate and reinforce those points and urge that they be incorporated into a rewrite of the rule proposal. Our failure to discuss here other issues mentioned in individual organizations' comment letters does not indicate any diminished concern regarding those issues.

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[1] The Consumer Federation of America (CFA) is a non-profit association of more than 260 pro-consumer organizations which in turn represent more than 50 million individual consumers. CFA was founded in 1968 to advance the consumer interest through advocacy and education.

[2] Founded in 1985, the Certified Financial Planner Board of Standards, Inc. (CFP Board) is a non-profit professional regulatory organization whose mission it is to benefit the public by fostering professional standards in personal financial planning. The CFP Board owns the marks CFP and Certified Financial Planner and the CFP design mark and licenses individuals who meet its certification standards to use them. The CFP Board also serves as an educational resource to federal and state lawmakers and regulators on personal financial planning issues.

[3] The Investment Counsel Association of America (ICAA) is a not-for-profit trade association that exclusively represents the interests of federally registered investment advisory firms. Founded in 1937, the ICAA today consists of more than 250 firms that collectively manage in excess of $2 trillion for a wide variety of individual and institutional clients. For more information, please see www.icaa.org.

[4] The National Association of Personal Financial Advisors was founded in 1983 based on the principal that third party payments for client services created conflicts of interest. NAPFA has taken a strong supportive role in advocating consumers' rights to obtain unbiased assistance in making important financial decisions. The 650 member professional organization adheres to strict membership criteria including a peer review process, a fiduciary oath, principles of full disclosure and continuing education standards. NAPFA is headquartered in Buffalo Grove, IL.

Instead, our purpose in this letter is to point out the broad consensus for changes to the current rule proposal in the following three areas.

1. The Commission must clarify what constitutes "solely incidental" investment advice by a broker-dealer.

In the 60 years since the Investment Advisers Act was adopted, the Commission has provided little meaningful guidance on what it means for a broker to provide investment advice that is "solely incidental to the conduct of his business as a broker or dealer." At the time the law was written, it may have been reasonable to assume that the differences between broker-dealers and investment advisers were so obvious to the average investor that they needed no further legal clarification. Since then, however, dramatic changes have swept the financial services industry, blurring those once clear distinctions. Recent changes in brokerage compensation structures -- despite the benefits they may offer in reducing potential conflicts of interest -- serve to confuse the picture further. An average investor today would be hard-pressed to distinguish a broker-dealer from an investment adviser based, at least, on how they present themselves and describe their services to clients.

In light of these developments, our organizations believe strongly that the Commission can no longer afford to ignore its responsibilities in this area. It must clarify what advisory activities by broker-dealers will be considered solely incidental to sales transactions and what activities will be subject to regulation under the Advisers Act. Further, the Commission must continue to update those guidelines as the full service brokerage industry evolves and changes. We recognize that this will not be a simple task, but it is an important one. First and foremost, it will determine whether the advisory clients of broker-dealers receive the legal protections appropriate to that relationship. Second, it will provide a clear basis for distinguishing between the services offered by brokers and investment advisers that can then be relied on with confidence by compliance departments and, as an added benefit, can be used in educating investors about the differences between these two types of financial professionals.

2. All discretionary accounts should be treated as advisory accounts, regardless of the method of compensation.

In perhaps its most glaring inconsistency, the rule proposal would treat fee-compensated discretionary accounts as advisory accounts while continuing to treat commission-compensated discretionary accounts as brokerage accounts. Our organizations believe strongly that these two types of accounts should be treated alike. A broker-dealer with discretionary authority is entrusted with responsibility for selecting the securities to buy and sell on behalf of an account without first obtaining the investor's consent. By definition, then, the investment advice offered through a discretionary account cannot be considered "solely incidental" to the execution services. The fact that the broker receives no special compensation for advice becomes irrelevant when the advice is more than solely incidental. Indeed, in a recent speech, Paul F. Roye, Director of the SEC's Division of Investment Management, agreed that this "anomaly" in the rule proposal "does not make sense to me ..."[5]

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[5] *2000 and Beyond: SEC Priorities for the Investment Adviser Profession*, Remarks by Paul F. Roye,

3. Broker-dealers who claim the exclusion should be precluded from marketing their services as advisory services.

It seems self-evident that brokers who claim an exclusion from the Advisers Act based on the notion that any advice they offer is solely incidental to sales transactions should not be able to turn around and advertise those same services as primarily advisory in nature. Our organizations believe strongly, therefore, that the rule should be amended to preclude brokers who claim the exclusion from marketing their accounts as advisory accounts or based on the advisory services provided.

We also recognize that such distinctions will not always be simple and that broker-dealers can be expected to test the boundary, that is, to come as close as they can to portraying the accounts as advisory accounts without actually crossing the line. To help combat any confusion that may arise as a result, our organizations believe mandatory disclosures in advertisements must be prominent and must make a clearer, stronger statement than that suggested in the rule proposal. Thus, we applaud Mr. Roye's suggestion that the Commission is "considering more specific disclosure requirements for the final rule."[6] A simple statement that the account is a brokerage account will not be meaningful to the average investor. The disclosure must make clear that any investment advice provided through the account is merely secondary to sales transactions. The SEC and others will need to reinforce this message with an educational campaign designed to alert investors to the differences between brokers and investment advisers.

It is worth noting that all three of these points are also raised by the North American Securities Administrators Association in its comments on the rule proposal. Specifically, NASAA's comment letter includes the following relevant statements:

- "NASAA recommends that the Commission set out factors for determining when advice is 'solely incidental.'"

- "Discretionary authority allows a broker-dealer to execute trades without first obtaining the client's consent. Under such circumstances, the broker is performing the essential functions of an adviser and should be treated as such. NASAA believes 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."

- "Several states' laws provide that if a person holds out in any manner as providing advisory services or otherwise suggests through marketing that advisory accounts are available then such persons are treated as investment advisers. This approach creates a level playing field for offering advisory services between broker-dealers and investment advisers and narrows the confusion factor for investors ... We would recommend that the

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Director, Division of Investment Management, SEC, Before the Investment Counsel Association of America (April 6, 2000).

[6] *Id.*

Commission consider revising the proposed language of 202(a)(11)1(a)(3) 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."

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In short, while there may be other areas where we disagree over details, there is a strong consensus among investor representatives, the investment adviser and financial planning communities, and state securities regulators that these three areas should, at a minimum, be addressed. We urge you to take these concerns into account as you review and revise the rule proposal.

Again, we appreciate your attention to our concerns. Please feel free to contact any or all of us individually if you have questions or if we can be of additional assistance.

Respectfully,

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