February 28, 2000

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

Dear Chairman Levitt:

Since CFA submitted its comments on the proposed rule regarding the broker-dealer exclusion from the Investment Adviser Act, we have had a chance to review some of the other comment letters submitted. Despite the fact that widely diverging opinions were expressed on the merits of the rule proposal, we believe there is a way to produce a final rule that could satisfy the key concerns of brokers, investment advisers and financial planners, and investors.

Although different parties want different things out of the rule proposal, their objectives are not necessarily incompatible. Brokers want an assurance that they can adopt fee-based compensation without automatically being regulated as investment advisers. Investment advisers and financial planners want to know that they will not be subject to unfair competition from brokers who market themselves as advisers without having to meet the higher standard of conduct that implies. And investors want a clear standard that ensures that all those who hold themselves out as offering investment advice are subject, among other things, to a fiduciary duty to place clients' interests ahead of their own and to disclose any and all conflicts of interest.

One reason we believe it should be possible to reconcile these concerns is that there seems to be broad consensus on two issues that are central to the rule proposal:

1) that the nature of services rendered should be the primary factor that determines when a broker will also be regulated as an investment adviser; and

2) that brokers should be free to offer fee-based services without automatically triggering regulation as investment advisers.

Using these principles as a starting point, we offer the following suggestions on how to adapt the rule proposal to meet the key objectives outlined above.

I. Allowing fee-based compensation without undermining the special compensation test for the broker-dealer exclusion.

As we discussed in our comment letter, we do not believe that receipt of non-commission compensation for brokerage services should automatically trigger regulation as an investment adviser. Where the rule proposal goes wrong, in our view, is in equating fee-based compensation

for brokerage services with special compensation for advice. Once that step has been taken, the Commission can only exclude fee-compensated brokers from the investment adviser definition if it compromises the special compensation test for the exclusion.

The comments of the Securities Industry Association offer a helpful starting point for resolving this issue. The SIA suggests that references to "special compensation" in the rule proposal be changed to "compensation other than brokerage commissions." By removing the language that equates fee-based compensation with special compensation for advice, the Commission can maintain the integrity of the special compensation test for the exclusion while clarifying that brokers will not be regulated as investment advisers solely because they adopt non-traditional compensation arrangements.

At the same time, the Commission can and should reiterate the position it has taken in previous interpretations of the statute, that, in determining whether a broker has received special compensation for investment advice, "the essential distinction ... is ... between compensation for advice itself and compensation for services of another character to which advice is merely incidental." In keeping with this interpretation, brokers would be free to adopt fee-based compensation arrangements for traditional brokerage services, of which investment advice is an incidental component, without being regulated as investment advisers. On the other hand, brokers who offer more than incidental advice or who charge fees that they specifically identify as fees for advice would be precluded from relying on the exclusion.

II. Defining the differences between brokerage services and investment advice.

For such an approach to work, the Commission must define what it means for a broker to offer investment advice that is "solely incidental to the conduct of his business as a broker or dealer." Having acknowledged that the nature of services offered should be the primary factor that distinguishes a broker from an investment adviser, however, the Commission has unfortunately provided almost no guidance on this central issue. This is particularly troubling in light of the dramatic changes that have swept the securities industry over the last several decades, blurring the lines between investment advisers and brokers. With changes in compensation structures further confusing these distinctions, the Commission can no longer ignore its responsibilities in this area.

Instead of clarifying what it means for a broker to offer incidental investment advice, the rule proposal seems to take it on faith that the advisory services being offered by full-service brokers today qualify for the exclusion. We believe the issue requires greater attention before such a sweeping conclusion can be drawn. We therefore urge the Commission to undertake a study that examines the nature of investment advice being offered by full-service brokers. Based on the results, the Commission should issue clear guidelines on what constitutes "incidental" investment advice by brokers and what crosses the line into full-fledged investment advice.

As it undertakes that study, the Commission should keep the following questions at the center of its deliberations:

- Do full-service brokers limit themselves to advice that is "merely incidental to

brokerage transactions?"

- What is the primary service being marketed by full-service brokers -- advice or transactions?

- Are investors able to distinguish between the incidental advice offered by brokers and that offered by investment advisers and financial planners?

- What services offered by brokers can be adequately regulated under a sales standard?

- What services offered by brokers should be subject to the heightened fiduciary duty that applies to investment advice?

We believe such a study will lead the Commission to conclude that many full-service brokers today offer investment advice that goes far beyond the incidental advice Congress intended to exclude from regulation under the advisers act. If the Commission concludes, however, that full-service brokers today are limiting themselves to incidental advice, it has another question to explore: are brokers accurately portraying the services they offer to customers? Put another way, if brokers offer investment advice that is "merely incidental to brokerage transactions," should they be allowed to market themselves as if the primary service they offer is advice?

It is this issue which is central to investment advisers' and financial planners' concerns about unfair competition and to investors' concerns about a lack of regulatory uniformity. The Commission can address those concerns by limiting the ability of brokers to rely on the exclusion when they offer extensive investment advice and by reining in advertising that exaggerates the degree of advice offered. Brokers will then have a choice, either to offer the advice-driven services they seem to believe clients want and register as investment advisers or refrain from offering such services and retain their exclusion from the advisers act. We do not expect brokers to relish making such a choice, since they are currently being given the best of both worlds. However, we do believe this is a fair and reasonable approach that is consistent with the law and that promotes investor interests.

We hope these comments are helpful to you as you consider this rule proposal. Please feel free to contact me directly (at 719-543-9468) if you have additional questions of if I can be of any assistance.

Sincerely,

Barbara L. N. Roper
Director of Investor Protection