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BY ELECTRONIC FILING [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Mr. Jonathan G. Katz, Secretary  
Securities and Exchange Commission  
450 Fifth St NW  
Washington DC 20549-0609

RE: File Number S7-25-99 Certain Broker-Dealers Deemed Not To Be Investment Advisers

Dear Mr. Katz,

I appreciate the opportunity to comment on the proposal. I bring a unique and broad perspective on this topic. The Consortium is a consulting firm serving both Broker-Dealers (“BDs”) and Registered Investment Advisers (“RIAs”), including dual registrants. My financial services clients run the gamut from commission-only, fee-only, and commission or fee. I entered my financial services career as a stockbroker in 1978 for a wirehouse. Turning from sales to compliance in 1983, I became a Compliance Officer first for a BD, and then for an RIA. I founded The Consortium in 1989; where I continue to work with firms on compliance, practice management, and marketing.

I have no bias as to compensation. In some cases a commission-only account is in the best interest of clients; in other cases fees (or some combination thereof) may better serve the client.

I am in support of a regulatory regime that provides full disclosure to clients (in plain English) for investor protection, and regulations that are not too onerous to comply with. The challenge is how to implement such rules and regulations on the industry.

I am in support of a division of BDs and RIAs based on services and relationship. In the past, compensation has been one bright line test. Brokerage being transactional and based on commissions at the time of trading. Advisory being offered for a fee based on hourly, flat, or a percentage. Advisory, having its basis in advice, is not based upon a transaction. It could be argued that discretion is of an advisory nature, but the mode of compensation was a good indicator of whether the client was receiving brokerage or advisory services.

While there is pressure on the SEC to withdraw the proposed rule, and I would also support withdrawal of the rule, it seems to me that the SEC is intent upon moving ahead with the proposed rule, albeit in some modified state. Therefore it is my belief that my most constructive efforts will be to address the specific SEC requests for comments and how to make the proposal work. You will find however, that some of my comments bring me back around to withdrawal of the rule. Overall, I do not find that drawing the line at discretion rather than at the fee issue to add clarity for investors. Because I have attempted to address the majority of your comment points, this letter goes into some length.

### **Is the repropose rule necessary to preserve the scope of the Advisers Act?**

No, the repropose rule is not necessary. It is my belief that the rule can be withdrawn and we can rely on the form of compensation as one bright line test of what is “solely incidental.” (The “holding out” provision would be another bright line test.) Yes, this means that many firms will be subjected to multiple regulatory regimes. If we use discretionary services as the bright line test, it will not solve that problem. Many BD firms will still need to register as RIA firms because of discretion.

### **What investor protections are lost or gained? Comment on fee-based and commission-based.**

I am a proponent of full (plain English) disclosure. Unfortunately regulations often heap disclosure documents on top of the client. Too much disclosure is effectively no disclosure at all. We have experienced piece-meal disclosure documents that bury the client more on the brokerage side. (E.g., customer identification procedures under anti-money laundering laws, privacy notice, investment objectives definitions, business continuity scenarios, lengthy and highlighted arbitration clauses, mutual fund breakpoints that may be duplicative of prospectus language, variable annuity disclosure, and potentially point of sale disclosure also duplicative of the prospectus.) While some of these disclosures are applicable to RIAs, and in fact RIAs have a number of other disclosures to make, for the most part, RIAs are able to provide this within the Form ADV. We need disclosure; we just need to be mindful of how we do it. And whatever disclosure is adopted, it must be meaningful.

A fee-based compensation does not in itself better align the interests of BDs and Registered Reps (“RRs”) with their clients. Commissions can be more cost efficient for infrequent trading. And while fees can be more costly at times, it is with the anticipation that it comes packaged with value-added services.

The trend over the last many years has been towards fees. The Press endorsed it and the public embraced it. The Tully Report even put a stamp of approval on fees over commissions. It has been an easy sell for BDs and RIAs to offer the fee-based accounts. What is interesting is that it makes more economic sense for the BDs and RIAs to keep a steady stream of income flowing in each year rather than rely on occasional sales transaction compensation. It has given an incentive for reverse churning and offering the same old services without the value-added factor. It has given flight to stockbrokers to become fee-only RIAs. Firms can actually make more money for doing less; yet the investing public has a false sense they are always paying less because the annual fee looks a lot smaller than the one-time up-front commission. (Also bear in mind that the annual fee is charged on the whole portfolio; not just on the portion that is being transacted.) It seems the majority of the marketing today is wrongly focused on “fees.” *Marketing* financial services should not be about how the firm is paid – it should be about the service. However, *compliance* should be about disclosing fees and conflicts.

### **Should differences in the nature of services provided be relevant to adopting the rule?**

Yes. BDs who provide advice that is incidental to brokerage activities should have an exemption from registration as an RIA. The issue at hand is, “What is incidental?” The three-prong test set out in SEC Release IA 1092 seemed to work. Of course BDs always met the first test of advice or analysis concerning securities. “In the business” or the “holding out” issue was (and still should be) critical. The third “compensation” element could be met by any economic benefit, whether in the form of fees or commissions. The BD exclusion in the Advisers Act allowed for advisory services that were “solely incidental” and for no special compensation.

Differentiating the special compensation as fee-based versus commissions was a very easy test to understand, and therefore is a good standard to keep. If the RR received a fee to prepare a financial plan, it was special compensation. If a percentage of the assets under management is received to monitor and report on activity, then it was special compensation.

The compensation method in conjunction with advertising or holding out as providing financial planning or asset management services, should continue to be effective in determining who is a BD and who is an RIA. It is a common-sense approach that investors can comprehend, without the need for another disclosure document being tossed at them.

### **Competitive Implications**

The grass is always greener on the other side. It is argued by some that it is easier to be an RIA because they are only subjected to vague SEC regulations and not the minutia details of the self-regulatory organization (“SRO”) rules. RIAs are often confused as to what the regulators want (until it’s too late), simply because they don’t have more detailed rules to live by. RIAs have fewer layers of regulators looking over their shoulders, hence subject to fewer audits. RIAs are fiduciaries and have a full disclosure document (Form ADV Part II) to provide to clients. It is true that the BD and RIA industry are blending, and some of these differences “are not fair.” Some of the fairness issues should be resolved, but some may not.

If we keep the “holding out” criteria as a viable test, then BDs should be restricted in the way they advertise advisory services. You cannot compete for business on the basis of something that is considered incidental. If a BD wants to compete for advisory services, then the BD should also be registered as an RIA.

What is grotesquely unfair, especially as the services of firms merge together, is that RIAs cannot use testimonials in advertising, yet their BD brethren can. Investors need to know that RIAs have satisfied customers and need to rely on experiences of other customers. If the advertisement is false and misleading, then that is another issue.

## **Regulatory Approach**

It would seem to be counterproductive to not exclude BDs from the Advisers Act, but simply exempt them from registration. You giveth and taketh away.

However, principal trading is problematic. A BD exemption from this rule may be in order. It has hindered the way dual registered firms are allowed to do business. It also has a rippling effect to RRs that are separately registered as RIAs.

## **Investment Discretion**

I disagree that the compensation criteria has ceased to be a viable bright line. However, if we have to pick a new bright line, then discretion is something that you can attempt to get your hands around. This however would defeat the purpose of carving out a niche for BDs. Just as many (or more) BDs would be subjected to RIA requirements because of discretion.

I'm still concerned that a non-discretionary fee-based account would be confusing to the investing public – keeping the lines blurred between BD and RIA services. While the customer disclosure would attempt to fill that gap, we all know that disclosures are not always clear. Case in point is all the privacy notices that “value my privacy” regardless if the company shares my information or not. Privacy notices are meaningless – albeit the credit card companies are the biggest abusers – not BDs and RIAs. A disclosure that says, “this is a fee-based brokerage account and not a fee-based advisory account” does not say much at all.

## **Customer Disclosure**

Disclosure is always the tough issue. What's too long for an advertisement? What's too short (or too long) so that it is meaningless in any document? Is putting the prominent disclosure in advertisements and “all” governing forms overkill? Do we put one more piece of paper (that won't be read) in front of an investor when opening a brokerage account? Do we bury the legend in another document to avoid more paperwork? Do we consolidate the information but make it prominent – as so many other disclosures are supposed to be prominent; thereby making one document go on page after page because of so many different highlighted clauses? I know you are asking the questions, and I am throwing them right back at you.

Stating that an account “is a brokerage account” is just as meaningless as stating that an account “is not an advisory account.” It still does not disclose the differences. To make the statement “as a consequence rights and duties may differ” is still vague and simply takes up valuable paper space for no real purpose. To identify “an appropriate person” to talk to is fruitless. Most investors will not take the time to call, and continue to be in the dark. Even if we are able to accomplish putting the investor in touch with a compliance person (not a salesperson), verbal disclosures are not consistent in the way delivered and lack documentation of exactly what was disclosed.

Given the complexity of the concepts involved, the best alternative is to keep the bright line tests that were in place – holding out and special [fee] compensation.

Given the fact that the SEC may move ahead and adopt the rule, I have proffered disclosure language. Disclosure should also include affirmative statements of what is provided, not just a list of don'ts.

BDs should include the abbreviated brokerage account language in advertisements (print, radio, and television) for any fee-based services as follows:

The account is a brokerage account and the firm does not offer investment advisory services. As a consequence, the customer's rights and the firm's duties to the customer may differ.

BDs should include the standard brokerage account language in all sales literature and in **one of** the account opening documents (agreement, new account form, application, etc.) for any fee-based services as follows:

The account is a brokerage account and the firm does not offer investment advisory services. The firm does review your suitability, investment objectives, and risk tolerance in making our recommendation. The firm is a member of NASD, SIPC. We are not registered under the Investment Advisers Act of 1940 and therefore do not act as a fiduciary on your behalf. We do not have discretionary authority over your account. Investment advice offered is incidental to brokerage services provided.

Despite my best attempts, I am not completely satisfied with the disclosure fix. I come back to the bright line tests of holding out and special [fee] compensation. It is more straightforward. It is an easier concept to understand without adding awkward disclosure.

### **Discretionary Asset Management**

Is there a clear distinction to say all discretionary accounts are advisory; but non-discretionary accounts could be brokerage or advisory? No bright line test there.

Would investors have any better understanding of the differences in BDs and RIAs if discretionary commissioned accounts are brokerage; while discretionary fee accounts are advisory; and non-discretionary fee accounts could be brokerage or advisory? Discretionary does not seem to provide a bright line test, because an overlap remains on the non-discretionary side.

Yes, discretion has a supervisory or managerial characteristic. But RIAs also provide non-discretionary managed accounts. RRs should be allowed to at least exercise limited discretion. And there could be arguments why a BD should continue to be allowed full discretion over commissioned accounts, without it appearing as an advisory account. And the distinctions stay blurry.

The fee basis and hold out provision seems to be much more clear-cut in making distinctions between BDs and RIAs.

## **Scope of Exception**

I support that a BD registered under the Advisers Act would be able to distinguish its brokerage customers from its advisory clients. I agree that a RR who provides investment advice independent of his BD could not rely on the exception.

## **Holding Out**

I believe that the three-prong test set out in IA Release 1092 continues to give clear guidance. All three prongs must be met for registration to occur; escaping one prong relieves the requirement to register. Yes, BDs give advice on securities. Yes, BDs get compensated; albeit no special [advisory or fee] compensation. Generally the critical factor for BDs is the “in the business” or “holding out” prong.

It is important for investor clarity that BDs offer brokerage services and do not hold out as providing advisory services. Therefore BDs that are not also RIAs should be restricted from marketing “managed” or “supervised” accounts, or “financial planning” services. RRs should be restricted from using terms such as “financial consultant,” “financial advisor,” “financial planner,” and similar titles.

## **Financial Planning Services**

I concur that most BDs that offer financial planning services for a separate fee treat these as advisory services.

I agree that full-service BDs must consider “some” aspects of financial planning when determining suitability. A free “simple” financial plan focusing on certain segments relating to investments, retirement, and insurance needs is incidental. This may include asset allocation charts, analysis of income needs at various stages in life, and even touch on tax issues. It would be clear that any such analysis would be focused on a product solution (investments and insurance) offered by the brokerage firm. These simple financial plans could be generated on computers utilizing simple financial planning software and produce reports and graphics.

The financial plan should not be “comprehensive” and would not include “complex” issues (estate, tax, retirement, and other areas) that may need other than just a product solution.

There should be no separate fee for the simple financial plan. It would be offered at no cost or obligation. Compensation would be derived only if the client implemented investments and at the same basis as any client who did not receive the simple financial plan.

There would be no marketing campaign that the BD provides financial planning or approaches investments from a financial planning aspect. Minimal mention could be made in marketing brochures such as “Consult your stockbroker about the availability of a free simple financial plan. This does not take the place of a comprehensive financial plan that would be offered through an investment advisory firm.”

### **Wrap Fee Sponsorship**

When a BD is a “sponsor” of a wrap fee program, this is not incidental to brokerage activity. A wrap fee account is of a managed or supervised nature.

### **Regulatory Regime**

During the December 22, 2004 webcast, I heard that there was consideration of a special study to bring BDs and RIAs under one regulatory regime. Whether you draw the line at fees versus commission, or at discretion, the reality is that most firms today do/will come under a dual regulatory regime. There are some firms however that stay clearly on one side or the other. Can we be better served with only one set of rules, or is the division necessary? I welcome the opportunity to participate in that study and offer further insights.

Sincerely,

Nancy Lininger