

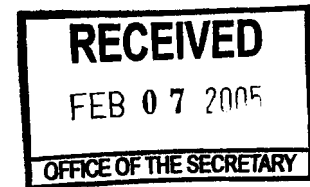
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Consumer Federation of America

February 7, 2005

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



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

Dear Secretary Katz:

I am writing on behalf of Consumer Federation of America¹ in response to the request for comment on the Commission's reading of the legislative history with regard to the broker-dealer exception from the Investment Advisers Act. CFA has also contributed to a group letter on the broader rule re-proposal and concept release, other aspects of which we support.² However, because we consider the interpretation of the "solely incidental to" standard to be so essential to development of an appropriate policy on regulation of financial professionals, and because we consider the Commission's presentation of the legislative history to be not just misguided but misleading, we felt a separate letter on this issue was needed.

I. Introduction

For years, we and other investor advocates have urged the Commission to define what it means for a broker-dealer to give advice that is more than "solely incidental to" its business as a broker. Only by defining the "solely incidental to" standard of the Investment Advisers Act can

¹ The Consumer Federation of America (CFA) is a nonprofit association of 300 consumer groups, representing more than 50 million Americans. It was established in 1968 to advance the consumer interest through research, education, and advocacy.

² Letter from Mercer Bullard, Fund Democracy, Barbara Roper, Consumer Federation of America, Sally Greenberg, Consumers Union, and Ken McEldowney, Consumer Action to Jonathan G. Katz, February 7, 2005.

the Commission create the meaningful functional distinction between brokers and investment advisers that Congress intended and that the Commission itself professes to prefer. We therefore enthusiastically received the Commission announcement in December that it would be issuing a concept release clarifying this standard.

Unfortunately, rather than clarifying the standard, the Commission has in essence interpreted it out of existence. In its place, it has proposed an “in connection with and reasonably related to” standard that would allow brokers virtually unlimited freedom to offer advisory services outside the protection of the Advisers Act. In proposing this anti-investor standard, the Commission has misrepresented much of the legislative record it cites as supporting its position and ignored the vast majority of the legislative record, which directly contradicts its interpretation.

The following analysis, based on a more complete and honest reading of the legislative record, will show that the only logical conclusion, based on both the statutory language and the legislative history, is that Congress intended to provide only a narrow exception for brokers engaged exclusively in typical brokerage activities, such as recommending to customers that they purchase or sell securities and expressing opinions on the merits of various investments. It will also show that, contrary to the claims of the Commission, Congress did not intend to permit brokers to offer a more extensive array of the advisory services outside the protections of the Advisers Act simply because they were offered as part of a package of brokerage services. Nor did it intend to permit brokers to hold themselves out to the public as advisers.

II. The Reason for the Exception

The Commission declares that Congress’s intent in crafting the Advisers Act exception for broker-dealers was “not to except broker-dealers whose advice to customers is minor or insignificant, but rather to avoid additional and duplicative regulation of broker-dealers.”³ The Commission cites only two sources in the legislative record for this interpretation, one of which actually refutes the Commission’s interpretation. It ignores a large body of the legislative record that contradicts its position. When read in its entirety, the legislative record clearly shows: that Congress was aware of and concerned about abuses associated with brokers offering investment advice; that its concern about these abuses was one motive behind the legislation; and that Congress consciously rejected the approach of providing brokers with a blanket exception and instead chose to provide only a narrow exception for brokers engaged exclusively in certain typical brokerage activities.

One source cited by the Commission in support of its position is an exchange between Rep. William P. Cole, Jr. of Maryland and an investment counselor testifying before the

³ SEC Release Nos. 34-50980; IA-2340 (hereinafter Release), at page 16.

committee about the reasons behind the bill's exception for lawyers.⁴ In the course of that exchange, Rep. Cole offers an interpretation of the reason behind the "solely incidental to" exception that is similar to the Commission's:

"Well, in the hearings in the Senate, several of the Senators raised considerable objection to the possibility of the bill reaching law firms, for instance, their own firms, where they resided, and I gather from reading the testimony and discussion on the bill, that the only reason that these law firms are not under the bill is that they are pretty well regulated at home."⁵

By citing just this one source, however, the Commission has created a distorted picture of the discussion regarding this issue. A very different picture emerges when one also considers other related testimony. For example, testimony by the SEC Chief Counsel indicates that the basis for the lawyer's exemption was not just that they were already regulated, but also that they had "a high fiduciary duty"⁶ to their clients, something that could not be said of broker-dealers. Additional testimony ignored by the Commission explained the narrow scope of the lawyer's exception.⁷

The other source cited by the Commission is a memorandum prepared by the Illinois Legislative Council and entered into the hearing record on S. 3580.⁸ The Illinois memorandum analyzes the pros and cons of various approaches to regulating investment advisers as the basis for possible future legislation in that state. The portion of the document cited by the Commission notes that, among the handful of states that had already adopted laws regulating investment advisers, some had chosen to provide exemptions for certain groups, including brokers. It goes on to state that one reason appeared to be that "such persons and firms are already subject to governmental regulation of one type or another."⁹ Again, this statement is only one part of the

⁴ The Advisers Act: Hearings on H.R. 10065 Before a Subcommittee of the House Committee on Interstate and Foreign Commerce, 76th Congress, at 88 (1940).

⁵ House hearing, at p. 88.

⁶ Testimony of SEC Chief Counsel David Schenker at p. 49 of the Senate hearing record.

⁷ Testimony of Harvard Law School Professor E. Merrick Dodd, Jr. at p. 765 of the Senate hearing record and described in more detail below at p. 10.

⁸ Memorandum entitled "Statutory Regulation of Investment Counselors – by Research Department, Illinois Legislative Council," appearing in Investment Trusts and Investment Companies: Hearings Before a Subcommittee of the Committee on Banking and Currency on S. 3580, United States Senate, 76th Congress, at 996-1016 (1940).

⁹ Illinois report at p. 1007 of the Senate hearing record.

discussion.

The Illinois report goes on to state that “the investment advice furnished by these excepted groups would seem to be merely incidental to some other function being performed by them.”¹⁰ In other words, the reason behind the exemptions was not simply to avoid duplicative regulation, as the Commission suggests, but also that the individuals and firms excepted were not viewed as being engaged in rendering investment advice on more than an incidental basis. Furthermore, the memorandum notes, in deciding what approach to take on the issue of exceptions, legislators would need to decide “whether to exempt only those who incidentally and occasionally give advice as to investments or whether to exempt as a general rule all who regularly furnish investment advice if they also belong to one of the groups in relation to which some other form of governmental regulation exists.”¹¹ While the existing state laws cited in the Illinois report provided a blanket exemption for brokers,¹² Congress opted instead to provide exemptions in the federal law “only to those who incidentally and occasionally give advice as to investments.” Thus, taken as a whole, the Illinois report refutes rather than supports the Commission’s conclusions about congressional intent to avoid duplicative regulation of brokers.

In reaching its faulty conclusion about the reason for the exception, the Commission has not only misrepresented the Illinois report, it has ignored the fact that the original Senate bill (S. 3580) did not provide *any* exception for brokers, although it did already include the solely incidental exception for lawyers and other professionals.¹³ The Commission even ignores a statement by the Senate bill’s chief sponsor, Senate Robert F. Wagner of New York, that a significant reason, in his mind, for insisting on legislation rather than deferring to self-regulation, was the need to regulate the advisory activities of brokers. Responding to a representative of the Investment Counsel Association of America (ICAA), who had been arguing in favor of self-regulation, Sen. Wagner made the following comment:

“Let me say that if I thought you could get all the brokers in, I – as one member of the committee – would be quite satisfied by your regulation under your own association’s rules. However, how are you going to get in the others, who may not want to live up to your high standards?”¹⁴

This quote helps to better illustrate just what Congress was trying to achieve by regulating

¹⁰ Illinois report at p. 1007 of the Senate hearing record.

¹¹ Ibid.

¹² Ibid, at p. 996-998.

¹³ See S. 3580's definition of investment adviser at p. 27 of the Senate hearing record.

¹⁴ Senate hearing, at p. 739.

investment advisers. As this and other similar testimony suggests, their concern was not primarily with the legitimate Investment Counsel – who provided continuous, ongoing, and professional advisory services to their clients and viewed themselves as fiduciaries with an obligation to avoid conflicts of interest – although the legislation certainly affected them. Their concern was with other elements who had attached themselves to this profession without meeting appropriate professional standards. James N. White of Scudder, Stevens & Clark summed it up this way: “The discussion yesterday seemed to indicate two classes of undesirables: First, the “fringe” as typified by the tipsters; and second, the firms which fall within any reasonable definition of investment counsel and yet have not high standards.”¹⁵

Brokers were clearly identified in the hearing record as one of the groups that was a subject of concern. ICAA President Dwight Rose noted, for example, that their association’s survey of the field had found that: “Some of these organizations using the descriptive title of investment counsel were in reality dealers or brokers offering to give advice free in anticipation of sales and brokerage commission on transactions executed upon such free advice.”¹⁶ It is shortly after this comment that Sen. Wagner made his statement regarding the need to regulate brokers.

The Commission acknowledges that Congress knew of the abuses that might arise when brokerage services are combined with advisory services. It cites, among other things, the above quote from Mr. Rose, as well as a portion of the Illinois memorandum.¹⁷ A later section of the Illinois report is even more explicit in its warnings than the section cited by the Commission:

“The criticisms of counselors also acting as brokers or dealers are founded upon possible encouragement of practices bordering on fraud. The major danger is that a counselor connected with a brokerage house will unduly urge frequent buying and selling of securities, even when the wisest procedure might be for the client to retain existing investments.”¹⁸

Instead of acknowledging this further evidence of its incorrect interpretation of the legislative history, however, the Commission would have us believe that Congress was aware of problems associated with investment advice provided by brokers, including those who did not charge a separate fee for the advice, but chose to ignore them, and that it instead focused its attention on regulating legitimate Investment Counselors, where there had been no similar suggestions of

¹⁵ James N. White, Scudder, Stevens & Clark at p. 761 of the Senate hearing record.

¹⁶ Dwight Rose, President, ICAA at p. 736 of the Senate hearing record.

¹⁷ Release at p. 20, including footnote 51.

¹⁸ Illinois memorandum at p. 1014 of the Senate hearing record.

abuse.¹⁹ In addition to being in direct conflict with the legislative history, including the statement by bill sponsor Sen. Wagner, this simply makes no sense.

Ultimately, we believe there is a grain of truth in the Commission's view that Congress adopted the exception to avoid duplicative regulation. But the duplicative regulation being avoided was not regulation of broker-dealers, as the Commission suggests, but of brokerage activities.²⁰ In other words, Congress recognized that it is impossible to act as a broker without recommending the purchase or sale of securities and expressing opinions on the merits of various investment opportunities, all of which fit within the Act's definition of investment advice. Having already adopted a regulatory regime to cover brokers engaged in such activities, Congress saw no need to also regulate these same activities under the Advisers Act. So, to the degree that brokers limited themselves to these sorts of typical brokerage activities – activities that were “solely incidental to” their function as brokers – they were excepted from the Act, if they did not charge “special compensation” for that advice. Brokers who provided investment advice that went beyond those inherent to the sales function would not be excepted, regardless of whether they charged “special compensation.”

III. The Scope of the Exception

The Commission, on the other hand, argues that Congress intended to regulate under the Advisers Act only those brokers who provided investment advice through a special advisory department and for which customers contracted separately and paid a fee.²¹ In support of this view, the Release cites one reference in the testimony to the bill's coverage of such advisory activities and one early Commission interpretation of the bill, IA Release No. 2, that mentions the existence of such departments. Neither of the sources cited actually supports the Commission position. In fact, IA Release No. 2 indicates that the Commission in 1940 clearly

¹⁹ Release at p. 20 to 21, including footnote 51.

²⁰ This is also the construction used by one of the sources quoted in footnote 43 of the Release. Thomas P. Lemke, Investment Advisers Act Issues for Broker-Dealers, Securities & Commodities Regulation at 214 (Dec. 9, 1987) (“While most broker-dealers initially will come within the definition of an investment adviser, it is clear that Congress did not intend brokerage *activities* to be regulated under the 1940 Act [citing S. Rep. No. 76-1775]. Rather, such *activities* were intended to be regulated under the 1934 Act without the additional and often duplicative requirements under the 1940 Act.” (Emphasis added.)

²¹ Release, page 16-17. (“The exception also differentiated between advice provided by broker-dealers to customers as part of a package of traditional brokerage services for which customers paid fixed commissions – which was not covered by the Advisers Act, and advice provided through broker-dealer's special advisory department for which customers separately contracted and paid a fee – which was covered by the Act.”)

believed it was possible that investment advice offered by a broker outside a separate advisory department might not meet the “solely incidental to” standard.

The hearing record cited by the Commission is an excerpt from Senate testimony on S. 3580 by Douglas T. Johnston, vice president of the ICAA. In that testimony, Mr. Johnson states that the bill’s definition of investment adviser would include “certain investment banking and brokerage houses which maintain investment advisory departments and make charges for services rendered.”²² However, as the Commission surely realized when it cited that testimony, S. 3580 did not provide *any* exception for broker-dealers. Absent such an exception, Mr. Johnston’s reference to the existence of special investment advisory departments can hardly be taken to indicate that these are the only type of broker-dealer advisory activities the legislation was intended to cover.

When read in its entirety, without the ellipses of the SEC’s citation, the quote makes clear the real point Mr. Johnston was trying to make – that the Act’s definition of investment adviser covered a wide range of advisory activities, many of which bore little resemblance to the professional services provided by Investment Counsel.²³ In short, far from supporting the notion that Congress intended to regulate only a very narrow range of advisory conduct under the Act, Mr. Johnston’s testimony and other testimony like it elsewhere in the hearing record clearly indicates that Congress knowingly and intentionally adopted an expansive definition of investment adviser that would cover a great many different types of investment advice offered by a great many different types of advisers.²⁴

²² Senate hearing at p. 711, as quoted in footnote 44 of the Release.

²³ Douglas T. Johnston, Vice President of ICAA, at p. 711 of the Senate hearing record: “The definition of ‘investment adviser’ as given in the bill, *in spite of certain exclusions, is quite broad and covers a number of services which are entirely different in their scope and in their methods of operation. For example, as we read the definition, among others, it would include those companies which publish manuals of securities such as Moody’s, Poor’s, and so forth; it would include those companies issuing weekly investment letters such as Babson’s United Business Service, Standard Statistics, and so forth; it would include those tipsters who through newspaper advertisements offer to send for a nominal price, a list of stocks that are sure to go up; it would include certain investment banking and brokerage houses which maintain investment advisory departments and make charges for services rendered; and finally it would include those firms which operate on a professional basis and which have come to be recognized as investment counsel.*” (Italicized text was omitted from the SEC citation.)

²⁴ David Schenker, Chief Counsel, Securities and Exchange Committee at p. 47 of the Senate hearing record: “The proposed bill also contains a short title relating to investment advisers, which encompasses that broad category ranging from people who are engaged in the profession of furnishing disinterested, impartial advice to a certain economic stratum of our population to the other extreme, individuals engaged in running tipster organizations, or sending

In addition, the Release cites an early Commission interpretation of the statute, IA Release No. 2. In the part cited by the Commission, IA Release No. 2 refers to the “well known” fact that “many brokers and dealers have investment advisory departments which furnish investment advice for compensation in the same manner as does an investment adviser who operates solely in an advisory group.”²⁵ However, the statement quoted simply supports the document’s preceding assertion, that a broker is not “excluded from the purview of the Act merely because he is also engaged in effecting market transactions in securities.”

Far from offering support for the Commission’s position, an earlier statement in IA Release No. 2 actually undercuts that position. In the letter from SEC General Counsel Chester T. Lane that makes up the bulk of the Release, Mr. Lane lays the groundwork for the discussion of compensation issues by first establishing the solely incidental nature of any advice offered in the examples.²⁶ The letter from the SEC General Counsel states, “I shall assume *for the purposes of this letter* that, in every situation outlined above, the transaction is ‘solely incidental to the conduct of ... business as a broker or dealer.’” (Emphasis added.) Since none of the examples cited in IA Release No. 2 involve advice offered through a separate advisory department and paid for by a fee, this document actually supports an interpretation directly contradicting that put forward by the Commission in its current Release – that the Commission in 1940 assumed that certain investment advice offered as part of a traditional package of brokerage services might nonetheless fail to satisfy the “solely incidental to” requirement of the Act.

Unfortunately, since it is devoted exclusively to issues related to “special compensation,” IA Release No. 2 does not offer any further clarification of what sort of investment advice by a broker-dealer would not be excepted under the “solely incidental to” standard.

IV. The Meaning of Solely Incidental

Based on its wholly unfounded conclusion that Congress intended to provide a broad exception for any investment advice a broker might offer as part of a “package” of brokerage services, the Commission has developed an interpretation of the term “solely incidental to” that

through the mails stock market letters.” Charles M. O’Hearn, Vice President and Director of Clarke, Sinsabaugh & Co., Investment Counsel at p. 716 of the Senate hearing record: “When investment advisers were included under this proposed legislation, many persons and firms were included who, in our opinion, are more notable for the differences between them than for their likenesses.” Dwight Rose, President, ICAA at p. 736 of the Senate hearing record: “Besides those which may be described as exclusively investment counsel firms, a great variety of persons is engaged in investment advisory activities.”

²⁵ Advisers Act Release No. 2, as quoted in footnote 44 of the Release.

²⁶ IA Release No. 2, at p. 3.

ignores the simple meaning of the statutory language and is directly contradicted by the legislative record. Specifically, the Commission states:

“In general, we understand investment advice to be ‘solely incidental to’ the conduct of a broker-dealer’s business within the meaning of section 202(a)(11)(C) when the advisory services rendered to an account are in connection with and reasonably related to the brokerage services provided to that account.”²⁷

The idea that “solely incidental to” could be construed as meaning “in connection with and reasonably related to” would be laughable, if it didn’t result in such atrocious public policy.

In backing up its claim, the Commission suggests that the phrase “solely incidental” has been improperly interpreted to mean “minor,” “insignificant,” and “periodic.” Such an interpretation is hardly surprising. When you follow the online dictionary link the Commission provides in footnote 100 of the Release, the first definitions for incidental that come up are:

- occurring or likely to occur as an unpredictable or minor accompaniment;²⁸
- of a minor, casual, or subordinate nature;²⁹ and
- subordinate or secondary in importance or position.³⁰

The problem with relying on such definitions, according to the Commission, is that commenters have focused too much on the word “incidental” and not enough on how the word is used in the context of the entire section. The language does not mean that the advice is incidental – i.e., minor – according to the Commission, but rather that it is “incidental to” a broker-dealer’s business – i.e., “following as a consequence of” that business.³¹

Even if you accept the Commission’s selection of the one definition of “incidental to” that doesn’t include any reference to the minor or secondary aspect of the term, it still doesn’t support the Commission’s definition of “solely incidental to” as “in connection with and reasonably related to.” Rather, if you paraphrase the “solely incidental to” requirement using the

²⁷ Rule Release at p. 43.

²⁸ *The American Heritage® Dictionary of the English Language, Fourth Edition*, © 2000 by Houghton Mifflin Company at www.dictionary.com.

²⁹ *Ibid.*

³⁰ *Merriam-Webster Dictionary of Law*, © 1996, Merriam-Webster, Inc.

³¹ Rule Release at p. 44.

Commission's definition, it would except broker-dealers from the Advisers Act only insofar as they limit themselves to giving nothing more than (solely) the investment advice that follows as a consequence of (incidental to) their primary business of effecting transactions in securities on behalf of customers.

This rephrasing of the statutory language, and the narrower definition of "solely incidental to" it supports, is consistent with the cogent explanation of "solely incidental to" offered by Professor E. Merrick Dodd, Jr., of Harvard Law School in his Senate testimony. Professor Dodd was commenting on the bill's exception for lawyers, since the bill at that time did not include any similar exception for brokers. However, his analysis is equally appropriate to both circumstances, since the broker-dealer exception later added to the bill also hinged on an interpretation of "solely incidental."

"Moreover, it is not accurate to state, as Mr. Loomis stated, that lawyers are exempt from that provision of the bill. They are only exempt insofar as they give advice about investments incidental to conducting their ordinary professional duties as lawyers. What that means it seems to me is obvious. If I, as a lawyer, have a client who is accustomed to come to me for legal advice, and in that connection I have become thoroughly familiar with the financial affairs of that client, who is very likely to be a woman or other person not perhaps very cognizant of investments, and if he or she asks me a question about whether a certain investment he or she proposes is a good risk the bill allows me to answer the question to the best of my ability, without saying: I cannot give you any advice about that because I am not a registered counsel.

"But that does not mean that because I am a lawyer I can hold myself out as giving good investment advice to all comers. I am not exempt from the provisions of the bill because I am a lawyer, but only exempt in the narrow field where I can give investment advice as incidental to my ordinary duties to my regular legal clients."³²

Clearly, Professor Dodd would not have accepted the Commission's current practice of allowing brokers to offer extensive advisory services and to hold themselves out to the public as advisers even as they rely on the "solely incidental to" exception. Perhaps that explains the Commission's decision to ignore the one portion of the legislative record that comments directly on the meaning of the term it is attempting to define.

The other problem with the Commission's interpretation of the "solely incidental to" requirement – aside from the fact that it is contradicted by both the clear meaning of the statutory language and by the legislative record – is that, rather than bringing clarity to this issue, it

³² Professor E. Merrick Dodd, Jr., Harvard Law School, at p. 765 of the Senate hearing record.

interprets the standard out of existence. It is difficult to imagine a financial advisory service that could not be offered in connection with a brokerage service and that could not be construed as being reasonably related to that service.

This interpretation is particularly troubling when you realize that at least for some at the Commission, a “traditional package of brokerage services” does not mean the kind of services brokers have always offered, but rather any services they may come to offer. This viewpoint is evident in the language in footnote 113 of the Release. Having provided a reasonable explanation for why financial planning should be considered an advisory service, and not anything Congress in 1940 could have conceived as part of a traditional package of brokerage services, the Commission adds the following caveat: “On the other hand, the brokerage business has evolved significantly since 1940, and it may be appropriate to consider financial planning to be part of the traditional package of services broadly understood.”³³ Such reasoning this is exactly the sort of reasoning that helped to erase any semblance of a functional distinction between brokers and advisers.

V. Conclusion

Brokers today have become indistinguishable from the financial professionals who are regulated under the Advisers Act. They use the same titles. They claim to offer the same services. And they market their services as if they were primarily advisory in nature. This is the direct result of the Commission’s past application of its “in connection with and reasonably related to” standard for the broker-dealer exception. Far from providing the kind of functional distinction Congress sought to create and the Commission professes to favor, this approach determines applicability of the Advisers Act based not on the nature of services offered but on the nature of the firm offering the services. That simply makes no sense.

It has also been demonstrably harmful to investors. The mutual fund scandals provide ample evidence of abusive sales practices that pervade the broker-dealer community. Evidence of similar abuses has emerged in the area of 529 plans, variable annuities, and elsewhere. The Commission and the NASD Regulation are to be congratulated for their role in bringing many of these problems to light and for their efforts to crack down on the most egregious practices. Such efforts are inevitably piecemeal, however, and the problem is more fundamental. Investors are being encouraged to rely on their brokers as trusted professional advisers, but the brokers are not consistently acting as trusted advisers in their dealings with customers. We believe our narrower interpretation of the “solely incidental to” requirement would benefit investors by providing clear guidelines for distinguishing between advisers and salespeople, by providing better disclosure of conflicts of interest for all those holding themselves out as advisers, and by providing a mechanism for holding all advisers accountable for acting in the clients’ best interests, regardless

³³ Release at p. 50.

of the context in which they offer their advice.³⁴

Despite its total misreading of the “solely incidental to” requirement, the Commission offers a number of very positive suggestions for addressing these issues in this Release. Specifically, we support regulating all discretionary accounts as advisory accounts, regardless of the method of compensation. We also agree that financial planning is an advisory service. In both these cases, advice is the primary service being sold. And we strongly urge the Commission to stop allowing brokers who are not advisers to hold themselves out to the public as financial advisers, financial consultants, financial planners, etc. To allow them to do so is not just confusing to the public, it is misleading both about the nature of the services being offered and about the nature of the relationship. No amount of disclosure can counteract this effect. One strength of our alternative interpretation of “solely incidental to” is that – in sharp contrast to the Commission’s interpretation – it actually supports the policies the Commission has proposed for consideration in this Release.

Despite its beneficial suggestions, the Commission cautions elsewhere in the Release against this narrower approach to “solely incidental to” out of a concern that “it would eventually result in the extension of the Advisers Act to most brokerage relationships.”³⁵ The Commission implies that Congress in 1940 could have had no such intent. But Congress did not intend in 1940 that fixed commissions would be deregulated. And it did not intend that full-service brokers would come to face competition on two sides – from discount brokers offering cheaper execution and from financial planners offering comprehensive financial advice. Congress did not intend that brokers would respond by adopting a more advice-driven business model. Congress did not intend these things, but it did provide for them – by limiting the broker-dealer exception to brokers engaged exclusively in traditional brokerage activities.

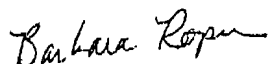
It is not the Commission’s job to preserve the broker’s regulatory status when the broker’s business model has changed so dramatically. It is the Commission’s job to ensure that investors are adequately protected. By that standard, the Commission’s past policy has failed abysmally. It does not provide investors with any ability to distinguish between financial professionals subject to two very different standards of conduct. It does not provide adequate disclosure of conflicts of interest by brokers offering advice. And it does not make clear that every broker offering investment advice should be considered a fiduciary with an obligation to place the customer’s interests ahead of the broker’s own.

³⁴ Under our standard, brokers would be free to recommend securities for their customers to buy or sell and to offer their views on the merits of various investments without triggering regulation under the Investment Advisers Act. They would also be free to answer questions from their existing customers that might entail giving more extensive advice. To the degree that brokers chose to offer more advisory services generally and to hold themselves out to the public as advisers, those services and accounts would be subject to adviser regulation.

³⁵ Release at p. 19.

The Commission now has an opportunity to rescue that failed policy, and several good suggestions in this Release for doing so. However, it would be a grave error and great disservice to investors to let stand the unfounded, illogical, anti-investor interpretation of “solely incidental to” presented in this Release. Instead, we urge the Commission to adopt an interpretation that supports a meaningful functional distinction between brokers and advisers. We believe the alternative interpretation we have provided in this comment letter meets that criteria. It has the added benefits of being consistent – as the Commission interpretation is not – with the statutory language, with the legislative history, and with simple common sense.

Respectfully submitted,



Barbara Roper
Director of Investor Protection

cc: Chairman William H. Donaldson
Commissioner Paul S. Atkins
Commissioner Roel Campos
Commissioner Cynthia A. Glassman
Commissioner Harvey Goldschmid
Paul F. Roye, Director, Division of Investment Management
Annette L. Nazareth, Director, Division of Market Regulation