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# Consumer Federation of America

November 4, 2004



William H. Donaldson  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

S7-25-99

Dear Chairman Donaldson:

I am writing to bring to your attention the results of a recent survey that we believe have important implications both for the pending rule proposal addressing fee-based brokerage accounts and for the broader question of how the investment advisory activities of brokers should be regulated.<sup>1</sup> The survey confirms a view that we have held intuitively for many years: that the SEC's current approach to regulating the investment advisory activities of brokers has resulted in widespread confusion among investors and has failed to provide the level of protection investors believe is appropriate.

We urge you to take these findings into account as you make important decisions in the coming weeks about the applicability of the Investment Advisers Act to the activities of broker-dealers. Specifically, we urge you to define, once and for all, the functional differences between brokerage services and advisory services, and to do so in a way that ensures that all those who provide investment advice are subject to the fiduciary duty and disclosure obligations provided by the Investment Advisers Act.

The brokerage firms have pinned their view that further regulation of their advisory activities is unnecessary on two key arguments: 1) that investors understand the differences between brokers and investment advisers; and 2) that brokers are already adequately regulated. The survey clearly refutes the first point. It also shows that investors do not share the view that brokers' advisory activities deserve some special exemption from the rules that govern all other

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<sup>1</sup> The survey was commissioned by CFA and the Zero Alpha Group, a national network of eight independent investment adviser firms, and was conducted by Opinion Research Corporation International. Results are based on telephone interviews in October with 1,044 investors. The margin of error at a 95 percent confidence level is plus or minus three percentage points. Complete results of the survey, including the actual questionnaire, are available at [www.zeroalphagroup.com](http://www.zeroalphagroup.com).

investment advice just because brokers are already regulated as salespeople.

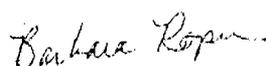
The survey documents widespread confusion among investors about the nature of services provided by brokers. Nearly three-quarters (73 percent) of the investors surveyed did not understand the very basic point that the primary service brokers offer is to buy and sell stocks, bonds, mutual funds, and other investment products on behalf of their clients. Of those, 28 percent thought financial advice was the primary service offered by brokers, 25 percent thought advice and transaction assistance were equally important services offered by brokers, and 20 percent couldn't even venture a guess.

This confusion is the entirely predictable result of SEC policies over the last two decades that have allowed brokers virtually unlimited freedom to remake themselves in the image of advisers without requiring them to comply with the investor protection rules that govern advisers. To be specific, the SEC has allowed brokers to offer financial planning and other related services that are clearly advisory in nature, it has allowed them to call their sales reps by titles, such as financial consultant or financial advisor, designed to imply that their primary service is to give advice, and it has allowed them advertise their services based on the advice offered – all without requiring them to comply with the Investment Advisers Act. Under the circumstances, it would be nothing short of astonishing if investors did understand that brokers are salespeople.

The result of these policy decisions has been to make the nature of the firm providing the service, rather than the nature of services provided, the key factor that determines the applicability of the Advisers Act. As the survey makes clear, however, this is an approach that American investors overwhelmingly oppose. More than nine in ten investors surveyed (91 percent) believe that, if a stockbroker and financial planner offer the same kind of investment advice services, they both should have to follow the same investor protection rules. Nearly as many (86 percent) believe that stockbrokers should have to disclose any financial incentives they receive from investment product sponsors to promote the sale of that product. In other words, believing that brokers are advisers, investors also naturally believe brokers should have to provide the same kind of disclosure of conflicts of interest that advisers are expected to provide.

In light of these findings, it is unacceptable in our view for the Commission to continue simply to reiterate a “solely incidental” standard governing applicability of the Advisers Act that it has neither defined nor enforced. Instead, we urge the Commission during its consideration of the pending rule proposal to define solely incidental advice and to do so in a way that draws a clear line between brokerage services and advisory services. That is the only way to provide the kind of functional distinction that the law calls for, that the public expects, and that the rule proposal promises, but fails to deliver.

Respectfully submitted,



Barbara Roper  
Director of Investor Protection

cc: Commissioner Paul Atkins  
Commissioner Roel Campos  
Commissioner Cynthia Glassman  
Commissioner Harvey Goldschmid  
Paul Roye, Director, Division of Investment Management