Consumer Federation of America

July 2, 2008

Nancy M. Morris
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File No. S7-10-00

Dear Ms. Morris:

I am writing on behalf of the Consumer Federation of America[1] to express our strong support for the Commission's proposed revisions to Form ADV and our equally strong opposition to suggestions put forward by various securities industry representatives to weaken that proposal. CFA has long supported the Commission's efforts to make the ADV Form more user-friendly as a disclosure document. We believe the proposed revisions to Form ADV accomplish that, by making it easier for investors to obtain information about key issues they should consider when choosing an investment professional and to understand that information.

As we noted in our June 22, 2000 comment letter on the proposed ADV rewrite, CFA believes investors stand to benefit in particular from the addition of a brochure supplement providing information on the individuals actually providing the investment advice, the higher standards for reporting conflicts of interest, the clarification that a broad range of disciplinary events must be disclosed, and the presentation of that information in the form of a plain English narrative brochure.[2] Having recently read many of the comments submitted regarding this proposal, we were disappointed to see that a number of the aspects of the proposal that are central to its investor benefits are under attack by members of the securities industry. Rather than simply reiterating our support for the proposal, this letter is intended to refute these anti-investor proposals.

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[1] Consumer Federation of America (CFA) is a non-profit association of approximately 300 national, state, and local pro-consumer organizations. CFA was founded in 1968 to advance the consumer interest the research, advocacy, and education.

[2] Letter from Barbara L. N. Roper, Director of Investor Protection, Consumer Federation of America to Jonathan G. Katz, Secretary, Securities and Exchange Commission regarding Proposed Rule – Electronic Filing by Investment Advisers and Proposed Amendments to Form ADV (File No. S7-10-00), June 22, 2000.

1) DO NOT eliminate the brochure supplement.

Several industry commenters suggested eliminating the brochure supplement, which provides information on the individual or individuals who will provide investment advice to the investor. In doing so, they argued that the information contained in the supplement offers little value to investors and is available elsewhere and that preparing the supplements will impose a significant burden on the industry. None of these arguments holds water.

Merrill Lynch suggests, for example, that the brochure supplement provides limited useful information for investors. As far as we can see, Merrill Lynch offers no evidence to support its claim. We respectfully disagree. While some investors may choose their financial professional based on the reputation and qualification of firm principles, we believe many more are likely to be interested in the background, qualifications, and disciplinary record of the individual or individuals who will actually be servicing their account and providing them with investment advice. This is most true in a large firm, such as Merrill Lynch, where many layers will separate the firm principles from the employees actually providing the investment advice. By providing this more relevant information, the proposal to create a brochure supplement closes what has long been a gaping hole in investment adviser disclosure.

In its letter, Sifma makes much of the fact that, at least for those investment advisers who are dually registered as broker-dealer representatives, much of the information proposed to be included in the brochure supplement is already available through Finra's Broker Check system. The fact that an enterprising investor who takes the initiative and knows where to look can find this information does not begin to offer the same investor benefits as providing that information in a plain English brochure at the outset of the engagement. Arguably, those investors who are least sophisticated and therefore most likely to need this information are the very ones who are least likely to seek it out, absent an affirmative delivery obligation. This notion, which we will discuss in greater detail below, that access to information is equivalent to delivery of that information has no place in the retail investor context.

Sifma, Merrill, and others also base their opposition on the significant financial burden they claim this requirement will impose. While we acknowledge that there are likely to be significant start-up costs associated with adopting this proposal, we believe the benefits of providing investors with information directly relevant to their account greatly outweighs the costs. Contrary to the arguments of industry, we believe its greater personal relevance to investors will make the brochure supplement among the most widely read of the disclosure documents they receive, particularly if they receive it in a timely fashion. Moreover, the industry arguments appear to contradict themselves. If brokerage firms are already required to compile and update much of this information when they fill out Form U-4, and if the information is available through Finra's Broker Check, then the costs of formatting that same information in a plain English brochure ought to be minimal, at least once the initial brochure format is developed. In developing their cost estimates, the brokers appear to be either exaggerating or "double-billing" – i.e., attributing costs to the brochure that they already incur to comply with other regulatory obligations.

2) DO NOT shift the burden for obtaining disciplinary information onto investors.

In a similar vein, Sifma and others have urged the Commission to eliminate the requirement that advisers disclose disciplinary information as part of Form ADV. Again, the argument rests on the notion that the availability of the information elsewhere eliminates the need to affirmatively disclose it. The existence of a disciplinary record, particularly a record of abusive sales practices, is highly relevant information that reasonable investors are likely to want when selecting and working with a financial professional. Arming investors with this information is one of the best tools we have to put investors on their guard so that they can protect their own interests. Forcing investors to take the initiative to seek this information out on their own, however, would significantly dilute this benefit. It would guarantee that far fewer investors would actually view this information and take it into account when selecting a financial professional. In addition, advisory firms that are required to disclose disciplinary information, and to constantly update that information, may be quicker to dismiss those practitioners with a tendency to explore the boundaries of what is ethically acceptable. For all these reasons, we believe the requirements to include disciplinary information in the brochure supplement and to require that information to be regulatory updated are absolutely essential and must not be eliminated.

3) DO NOT exempt non-discretionary fee-based accounts from the disclosure requirements.

Absent the complete elimination of the brochure supplement requirement, Sifma urges the Commission to exempt non-discretionary advisory accounts. This would, of course, have the effect of exempting the fee-based accounts the courts recently determined were appropriately regulated as advisory accounts, though its reach would be much further. Sifma offers no justification for exempting one class of advisory accounts from one of the central investor protections contained in the Advisers Act. We strongly oppose any such exemption, which would flout the recent court decision, create a dangerous precedent, and leave vulnerable investors without important protections.

Our previous research suggests a strong tendency of investors to rely heavily on the recommendations they receive from financial professionals and to do little or no additional research of those recommendations, even outside discretionary accounts.[3] Given that tendency, the decision of whom to rely on for investment recommendations is often the most important investment decision most investors will ever make. Unfortunately, it has long been a decision for which we fail to provide useful, timely and understandable disclosures. The proposed revisions to Form ADV begin to redress that disclosure failure. The exemption proposed by Sifma would undo much of the benefit. Moreover, at a time when the recently completed RAND Study tells us investors do not understand the differences between various types of financial professionals and investment services, Sifma's proposed approach would not just perpetuate, but expand a discredited regulatory approach in which services that are indistinguishable to the average investor are subject to different regulatory standards and requirements. Under no

[3] Roper, Barbara and Brobeck, Stephen, *Mutual Fund Purchase Practices: An Analysis of Survey Results*, Consumer Federation of America, June 12, 2006, pg. 2.

circumstances should the Commission increase regulatory inconsistency by applying different disclosure standards to different types of advisory accounts.

4) DO NOT eliminate the requirement that brochures be updated to reflect material events.

Some have urged the Commission to eliminate the requirement to update the brochure to reflect material changes and to provide investors with a summary of those changes. One argument made is that the definition of what constitutes a "material" change is unclear. It is ironic that the same industry representatives that argue for a more principles-based approach to regulation oppose that approach whenever they encounter it. The current standard for materiality, which requires firms to make professional judgments, is as good an example of principles-based regulation as you will find in U.S. securities laws. An appropriate approach to interpreting the standard is clearly articulated in the letter of the Investment Advisers Association and is based on what information a reasonable investor would want to have.[4]

We also believe the requirement to provide a summary of those changes will greatly assist investors who have engaged an investment adviser to focus on the issues that are most likely to be of interest to them. It is not enough, as some have suggested, for the summary simply to identify the sections of the brochure that contain changes. Rather, the summary must provide a brief description of the nature of those changes if it is to serve as a useful guide to investors. We urge the Commission to make this clear when it adopts the final amendments.

On the other hand, we are open to alternatives to the annual delivery requirement. Specifically, we believe an approach that provided investors with a summary of material changes and the option to obtain the complete brochure might provide an acceptable approach. For this to work, the summary of material changes would have to provide enough information for investors to determine whether they need to see the updated brochure. Properly structured, such an approach could improve on the existing system, in which investors are simply notified of their right to obtain an updated brochure, and minimize some of the on-going costs of these proposed amendments without significantly sacrificing investor protections.

5) DO NOT rely on an access equals delivery model for dissemination of the disclosures.

In several cases, commenters have suggested that the fact that investors have access to information should substitute for actual delivery of that information. We believe such an approach has no place in the retail investor context. Furthermore, the analogy that several of these commenters draw to the mutual fund profile is not relevant. In that case, there is a disclosure document, the profile, which is being affirmatively delivered to investors, while the prospectus is made available on-line or in writing upon request. That would not be the case here, if the Commission were to take the ill-advised recommendation to allow posting on the IARD to substitute for actual delivery of the brochure. Moreover, as we noted above, many investors rely

[4] The Morgan Stanley letter, on the other hand, gets this issue backwards. The question isn't whether a brokerage firm of its size would consider a $2,500 SRO fine material. The question is whether an investor would do so. So, the issue of materiality does not vary with the size of firm.

heavily, if not exclusively, on the recommendations they receive from financial professionals. That makes their decision about whom to rely on for recommendations, and the disclosures they receive to help them make that decision, of paramount importance. The Commission should be looking for ways to increase the likelihood that investors will access and use this information, not adopt an approach that would reduce that likelihood.

We also reject the suggestion made by at least one commenter that negative consent and consent through the course of business should satisfy consent obligations for electronic delivery. While the day will certainly come when electronic delivery will be the norm for the vast majority of investors, that day has not yet arrived. There are still significant numbers of investors who do not wish to receive disclosure documents in this manner. CFA's survey on mutual fund purchase practices, for example, asked about respondents' willingness to use the Internet for various purchase-related purposes. Only half (49 percent) were willing to use the Internet to receive periodic reports and disclosure documents, including just six in ten investors 44 and younger.[5] Among older investors the percentages were much lower. This suggests that we still have a ways to go before we can force an Internet-based approach to disclosure.[6]

6) DO require disclosure of disclose arbitration awards or damages in civil proceedings.

Right now, the Commission does not propose to require disclosure of arbitration awards or damages in civil proceedings. Not surprisingly, this decision is supported by many in industry, who have a clear interest in minimizing the information investors receive about disciplinary events. One argument made is that arbitration awards should not be included because there is no finding of facts or conclusions of law in arbitration. It is cynical indeed for the very firms that force investors to adjudicate their disputes through an industry-run arbitration system to then cite the shortcomings of that system as the reason arbitration awards should not be included among the disciplinary events disclosed to investors. We strongly disagree. Investors deserve the most complete information available from which to build a picture of an advisers' integrity. That includes arbitration and civil damages awards, at least as they pertain either to firm practices that are relevant to their account or to the individuals who provide advice to their account. For that reason, we concur with the North American Securities Administrators Association that this information should be included in the brochure.

7) DO consider developing a short-form disclosure document to supplement the revised ADV Form.

Several commenters have suggested that the proposed amendments to Form ADV will result in a brochure that is too long to win wide acceptance among investors. They tend to base this view on the findings of the RAND Study, which found that investors don't read lengthy disclosure documents. While we believe it is premature to conclude that this will be the case, we fear this criticism may have some validity. We reject the suggestion, however, that the proper

[5] Roper, Brobeck.

[6] The first step in that process should be developing a better understanding of the reasons behind investors' reluctance to rely on the Internet for these purposes.

course is therefore to delay implementation of the amendments until they can be incorporated within the Commission's overall response to the RAND Study. This proposal has already been delayed for far too long. It would be a grave disservice to investors to prolong that delay based on an uncertain timeline for responding to the findings of the RAND Study.

Instead, we would encourage the Commission to proceed with this rule-making, but to also consider developing a short-form disclosure document as a supplement to Form ADV. Such a document should answer at least the following the questions: What services do you offer? How will I be charged? How will you be compensated? What conflicts of interest are present in your business model? And what is your disciplinary record? If an abbreviated disclosure document of this type were developed, then it would be possible to consider a disclosure approach that resembles that now proposed for mutual funds, where investors are provided with the abbreviated document and given the option of receiving the longer disclosure document.

Furthermore, in considering its response to the RAND Study, we would urge the Commission to consider whether all financial professionals should be required to provide this type of tiered disclosure. Given the blurring of lines that has occurred between the different types of financial professionals, and investors' well documented confusion about these differences, we believe these disclosure obligations should be universal for all financial professionals subject to the Commission's jurisdiction who work with retail clients. This would expand on the benefits offered by the current proposal to amend Form ADV by ensuring that investors get plain English information about key issues relevant to selecting a professional for all types of professionals who offer investment recommendations, not just investment advisers.

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CFA has long advocated improved disclosure to assist investors in making the most important investment decision most will ever make – the decision about whom to rely on for investment recommendations. We have given our strong support to the proposed revisions to Form ADV because we believe it furthers that goal by making key information more accessible, more relevant to the individual investor, and more understandable. We are pleased that the Commission finally appears ready to adopt these proposed revisions after years of delay. If the proposal is to retain its promised investor benefits, however, it is essential that the Commission reject the many anti-investor changes being pushed by certain industry representatives. Thank you for your attention to our concerns.

Respectfully submitted,

Barbara Roper
Director of Investor Protection

cc: Andrew J. Donohue, Director, Division of Investment Management
Robert E. Plaze, Associate Director, Division of Investment Management