CERTIFIED FINANCIAL PLANNER
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6 February 2005

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

RE: S7-25-99

Dear Mr. Katz:

As recently re-proposed in *Certain Broker-Dealers Deemed Not to Be Investment Advisers,* the Commission's rule addressing the application of the Investment Advisers Act of 1940 (the "'40 Act") to broker dealers engaged in certain advisory activities is almost certain to generate hundreds, if not thousands, of comment letters. Nearly all will be from parties with financial interests at stake. This letter is one of the few sent on behalf of the investing public.

The Commission's release struggles to mesh laws and legislative history created generations ago with current public policy goals. The result is tortured and, if the Commission proceeds to adoption with the current re-proposal, the public interest would be sacrificed. Although an optimal result probably would require a comprehensive re-consideration and updating of 65-70 year-old statutes, the pending rule as re-proposed can be improved in furtherance of the Commission's overarching investor-protection mandate.

CFP Board

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[1]The Mission of Certified Financial Planner Board of Standards, Inc. (CFP Board) is to help people benefit from competent, professional and ethical financial planning. To further this mission, CFP Board works to: (1) create awareness of the importance of financial planning and the value of the financial planning process, (2) help underserved populations have access to competent and ethical financial planning, and (3) create and enforce uniform standards of competency, practice and ethics of financial planners through rigorous, validated and professionally administered education, examination, experience and ethics requirements.

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standards more rigorously or is more zealous informing the public of the results of its processes. CFP Board believes that protecting average citizens' financial health is critical to our country's well being and political stability.

An "incidental" exception that swallows an entire statute

To further one important public policy, the proposed rule would harm another, to the ultimate detriment of investors. The Commission's desire to permit fee-only brokerage accounts (to reduce the churning believed to be encouraged by commission-based accounts), prompted it to propose a rule to remove a legal disincentive to fee-only accounts. The first proposed rule, issued in 1999, re-interpreted and, in our view, improperly re-wrote legislative history to encourage creation of these accounts.

The original proposal, as now expanded and re-proposed, allows fee-only brokerage accounts to escape the jurisdiction (and therefore the protections) of the law governing the provision of investment advice—the '40 Act. While the re-proposed rule thus promotes fee-only accounts, it does so by denying investors using these accounts the protections of the '40 Act.

Investment advisers are per-se fiduciaries under '40 Act;
Brokers are not per-se fiduciaries under '34 Act

The '40 Act holds service providers to a stricter standard than the standard generally applied to brokers under the Securities Exchange Act of 1934 (the "'34 Act"), notwithstanding the various safeguards cited in the Commission's release. The critical and fundamental difference between the broker-dealer and investment-adviser regulatory schemes is the per-se fiduciary status of the registered investment adviser. A registered broker dealer ordinarily is not deemed a fiduciary—however heavily it otherwise might be regulated by the Commission, the NASD and the states.

A broker's suitability obligations simply do not equate to the statutorily imposed fiduciary obligations that run between a registered investment adviser and his or her clients. Put another way, it is the burden of the injured investor to persuade a fact-finder that, under a particular set of facts and circumstances, an individual broker-dealer might be deemed to have owed that investor a fiduciary duty. An advisory client, in contrast, need only allege a breach of the registered adviser's statutory fiduciary duty and force that adviser to demonstrate that the relationship of trust and confidence was not, in fact, breached.

Proposed rule allows brokers to give investment advice without becoming '40 Act fiduciaries

The reduction in the level of protection provided to brokers' clients who use fee-only accounts that include an advisory element was troubling enough under the originally proposed rule. It has become significantly more troubling under the re-proposed rule. This is because the Commission, in the latest formulation of the proposal, has blown open the only limitation contained in the original proposal—the "solely incidental" limitation.

“Incidental” redefined to mean unlimited

The original rulemaking allowed brokers’ investment advice that would otherwise be subject to the ‘40 Act to escape the act’s investor protections if the investment advice was “solely incidental” to brokerage work.

In a variety of cases in previous years the Commission interpreted “solely incidental” to mean limited in *amount*. For example, a professional who primarily engaged in other work—such as a lawyer doing legal work—could provide investment advice and not be subject to the ’40 Act if the work amounted to less than ten or fifteen percent of the professional’s business. In addition to being constrained by amount, the earlier ruling constrained the meaning of “solely incidental” by *description.* In other words a professional could not give investment advice and escape the ‘40 Act even if the advice was limited in amount if the professional held him- or herself out as primarily providing investment advice. These were two significant constraints; they are also constraints that are consistent with what average people understand words like “solely incidental” to mean.

The Commission’s new release, however, departs dramatically from both its own precedent and the commonly understood meaning of the word “incidental.” In the new release “solely incidental” is defined to have no limitation in amount whatsoever. Under this new rule a broker can spend 99% of his or her time engaging in the services otherwise covered by the ‘40 Act and escape coverage as long as he or she engages in *any* brokerage service. This odd result is possible because the Commission has redefined “solely incidental” to mean “in connection with or reasonably related to the brokerage services provided in the account.” There is, in other words, nothing in this definition limiting the amount of investment advice that can escape ‘40 Act regulation as long as brokers engage in some brokerage activity on the side. And, as is discussed below, with one surprising exception, the Commission also abandons the “holding out” supplemental limitation on “solely incidental.”

The Commission attempts to rely on the legislative history of the ‘40 Act to justify this remarkable re-definition of “incidental.” Congress of that era could not have envisioned the dramatic restructuring of fee arrangements and brokerage services—not to mention the securities markets themselves—that has occurred over the course of the ensuing decades.

The Commission observes that Congress was aware in 1940 that brokers did some advising along with their brokerage services yet sought to exempt such advice, a fact the Commission uses to justify ballooning the ‘34 Act to nearly erase the existence of the ‘40 Act for anyone offering a combination of brokerage and advisory services. There is no indication in the history that Congress thought brokers engaged in more advice than brokerage or that anyone with a broker’s license should get a free pass to engage in as much investment advice as they pleased—the term “solely incidental” was not mere surplusage then, nor should it be treated as such now in the rulemaking context.

This total redefinition of “solely incidental” would have the very effect the Commission professes to disfavor—it “would have the effect of negating any limitation inherent in the ‘solely incidental to’ standard.” Such a result is particularly troubling because the Commission is well aware that brokerage houses are engaged in large-scale campaigns to portray themselves to the public as full-service advisers indistinguishable from investment advisers.

The public would be better served if the Commission defined "solely incidental" to be both consistent with what the words mean to most people and consistent with the Commission's own past interpretations of this very language.

We respectfully submit that re-drawing the regulatory line between brokers and investment advisers in terms of the discretionary or non-discretionary character of investor accounts is not enough to assure that brokerage customers receive the protections to which they are entitled under the '40 Act. Congress in 1940 did not envision the eventual deregulation of brokerage commissions in 1975, much less the decimalization of the securities markets, the advent of online (and off-market) trading, and other developments that have culminated in the sharply reduced profit margins derived from the provision of traditional brokerage services—negotiation and/or execution of a securities transaction for customers, and various custodial services—thus encouraging brokerage firms to market heavily their customized investment advisory services in an effort to distinguish themselves from one another.

Whatever level and type of "incidental" advisory services Congress may have contemplated brokers being free to provide in 1940 in no way resemble today's full-service brokerage that is marketed so heavily to the investing public on the basis of advisory services. The Commission's concerns in this regard are well founded.

In sum, investors who choose to maintain non-discretionary accounts with, and are offered investment advice by their brokers therefore should no longer be denied the critical protections derived from the '40 Act's fiduciary duty of trust and confidence owed by registered investment advisers to their clients.

If principal trading prohibitions are the real problem, address them directly rather than allowing wholesale avoidance of '40 Act protections

We recognize that dual investment adviser and broker-dealer registration might create practical problems for broker-dealers—perhaps foremost among which is the prohibition of principal trading. However, as the Commission suggests, these problems can be addressed by carving out broker-dealers with dual '34 and '40 Act registrations from the application of specific prohibitions that could harm the brokerage business without advancing investor interests.

Restricting 'holding out" limitation to financial planners is unworkable and promotes wrong result

Although the Commission, in its proposal, creates a gigantic exception to the '40 Act, allowing brokers to engage in nearly unlimited investment advice without being subject to the Act's protections, it does create one limitation to this big loophole—a strikingly ironic limitation. Brokers who hold themselves out as "financial planners," unlike their colleagues who perform the same functions but use other labels for their advisory services, cannot take advantage of this loophole.

Brokers call themselves all sorts of other names that imply they are giving comprehensive client-centered advice, not just "financial planners." So selecting out financial planners does not in any way deter brokers who wish to convey to the public the idea that they are providing comprehensive investment advice or planning. So this constraint, limited as it is to "financial planners" is readily evaded, and is thus, at best,

useless, if the goal is to help the public understand what services they are and are not getting and the standards to which their services providers will be held.

This is a troubling limitation for another reason. Individuals cannot call themselves CERTIFIED FINANCIAL PLANNERS™ unless they meet strict educational and experience requirements, pass a rigorous two-day exam and subject themselves to ongoing, high-level regulation by CFP Board. Many financial planners are registered as investment advisers subject to the '40 Act and are proud to be so registered. In contrast, individuals or firms that call themselves most of the other terms used to imply they offer comprehensive advice that puts the client's interests first are not regulated by CFP Board and, in most cases, not held to a fiduciary standard, although they are generally subject to other regulatory requirements of the Commission, the NASD and various state laws.

It does not therefore seem to promote good public policy to draw a regulatory distinction that disfavors financial-service professionals who voluntarily submit to rigorous educational, experience, exam and ethics requirements compared to others offering the same services but who have not obtained CFP® certification. This is particularly the case because this exception the Commission creates is so easy to evade by use of substitute terms than can easily confuse the public.

Disclosure

The current proposed rule adds some disclosure requirements not contained in the original proposal. These were added largely because it is widely understood in financial policy circles that many—or most—investors do not understand the difference between a broker governed by the '34 Act and an investment adviser governed by the '40 Act. Because many investors do not understand the differences between these service providers, they do not understand the different legal standards to which each is generally held.

The public doesn't understand the differences between brokers and investment advisers

This point was made vividly in a study just released and reported in the February 2, 2005, edition of *The Wall Street Journal.* The study surveyed wealthy investors—presumably a generally more sophisticated group than average investors. These investors were asked about their levels of satisfaction and trust with their investment "advisers." The key point of the study for purposes of this rulemaking is this: *brokers* were included, along with investment advisers and financial planners, in the group considered to be "advisers" to these clients. Thus, neither the surveying company nor the surveyed investors seemed to understand the difference between the investment advising standards applied to brokers and those applied to investment advisers. If *this* group does not understand the difference, it is easy to imagine how much greater this misunderstanding is among investors generally.

A broker saying "I'm a broker, not an investment adviser" doesn't clear investors' confusion

To remedy this situation the Commission would need to require brokers to explain what a broker is. Instead the Commission simply proposes that brokers explain that they are brokers, not investment advisers. This does not address the problem, particularly because brokers can confuse matters more by describing themselves with additional terms with advice-giving connotations.

Individuals who go to brokers almost always know they are going to a broker; they simply don't realize they don't understand what that means—and doesn't mean. So having a broker say "I'm a broker" adds nothing to the individual's understanding, and may be undercut by the broker's added descriptions of services that sound, or are, advisory.

To be helpful the broker needs to explain not just that he/she is a broker and not an investment adviser, but that this means he/she is held to a different legal standard under which he/she may advise the customer to buy a stock, even if the broker knows that it is not the best choice for the customer, as long as the stock is a "suitable" selection.

The public should be directed to a neutral third party for additional information

The Commission is at its most disappointing when it proposes that a broker advise a customer that if the customer has any questions, he/she can ask a fellow broker. The same obvious incentive the first broker would have not to give a disinterested explanation would be shared by his or her broker colleagues. This idea is not up to the Commission's usual standards.

It would be preferable for the Commission to require brokers to inform customers that, if they want additional information, they seek it from a neutral third party before opening or modifying their account arrangements to include the type of advisory services now being touted by many broker-dealer firms, whether that neutral source be the Commission's own website or those of public-service entities that provide financial information and sell nothing to investors.

Or be given a short, clear written disclosure separate from other documents

Alternatively, we recommend that the Commission require broker-dealers to provide standard disclosure dictated specifically by Commission rule that would highlight the absence of any fiduciary duty running from the broker-dealer to its customer except under particular facts and circumstances based on a course of dealing between the parties. Most investors would prefer knowing that, along with generally having no recourse to the courts under most brokerage customer arrangements, they are owed no duty of trust and confidence by their broker. The broker should be required to disclose just what suitability means and doesn't mean, and when the broker will and will not "be held to a fiduciary standard with its customer, akin to that of an adviser and a client." [Release at note 103]. In other words, if a broker-dealer wants to provide advisory services within the limits of the "solely incidental to" standard, it should be required to disclose the differences between a brokerage and an advisory account.

We suggest the following formulation for inclusion in all broker-dealer promotional materials [television, print, website, etc.] as well as standard account-opening documents: "The account is a non-discretionary

brokerage account, not an advisory account, and our firm is [or I am] not licensed to offer investment advisory services—that is to recommend that you buy or sell a particular security or package of securities. Although we are [I am] subject to regulation by the NASD and the SEC as a registered broker-dealer, we are [I am] not registered with the SEC as an investment adviser under the Investment Adviser's Act of 1940 and therefore can only offer very limited investment advice incidental to [my] our primary business as a broker-dealer. This means that, while we [I] do have to make certain suitability determinations with respect to your investment decisions, you are primarily responsible for those decisions because you are opening a non-discretionary account, and we [I] therefore do not owe you a fiduciary duty of trust and confidence simply because we [I] might provide investment advice that is only incidental to the brokerage services for which you are contracting."

Conclusion

CFP Board thanks the Commission for re-proposing this rule and thus permitting additional public comment on the important issues it contains. CFP Board recognizes that the Commission must address large numbers of complex issues that compete for its time; CFP Board appreciates the Commission elevating the issues in this rulemaking by re-proposing the rule.

CFP Board also wishes to emphasize that the overwhelming majority of financial service providers, whether they are brokers governed by the '34 Act, investment advisers governed by the '40 Act or otherwise, are honorable professionals providing valuable services. CFP Board also believes that financial professionals and their clients and customers should be allowed to enter into a wide variety of private contractual arrangements—CFP Board does not suggest by any comments in this letter that one type of relationship or form of compensation is inherently more virtuous than another. CFP Board merely wishes to emphasize that the Commission should use its rulemaking powers to protect investors who misunderstand the terms of their relationship with their financial advisers, to deter professionals from furthering these misunderstandings, and to set uniform standards that bear a logical relationship to the underlying services.

CFP Board also recognizes that the Commission is limited in its options by statutes passed in an era very different from the current one. As Commissioners have commented in various open forums, the best way to eliminate the difficulties reflected in the proposed rule is to revisit these statutes with an eye to conforming them to modern financial markets and modern investors' needs. CFP Board would be honored to assist in this undertaking should it be initiated.

Sincerely,

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