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U.S. Securities and Exchange Commission

Via Electronic Submission

Re. **File No. S7-25-99**

Proposed Rule: Certain Broker-Dealers Deemed Not To Be Investment Advisers

Comments submitted on File No. S7-25-99 (7FEB05)

By Charles D. Meyer, MBA, CFP, Fee-Only Registered Investment Adviser

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SUMMARY

In the interest of creating a level playing field among the universe of advisers, and of creating a unique consumer directory, I challenge regulatory bodies to help the consumer make informed choices based on objective, relevant, and consistent information. Expand the query capability and sort functions of the Form ADV database that already exists and promote it as a tool that the advice-seeking public can use to narrow their search for appropriate (and legally registered) advisers. Unlock the information contained in the ADV-IARD database and turn it into an Investment Adviser Directory that individual investors can use to screen for and select appropriate advisers.

General Comments on the Proposed Rule/Proposal to Create an Investment Adviser Directory

The bureaucracies currently charged with securities regulation *could* provide consumers with a powerful investor protection/education tool - and most of it is already in place! It shouldn't be difficult to develop "the last mile" of this tool which, if made available and promoted, would finally give the small investor (indeed all investors) the upper hand in terms of being an informed consumer when choosing an adviser that best meets their circumstance. I suspect it could drastically reduce securities fraud and abuse as well.

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I propose that the regulatory authorities unlock the information contained in the ADV-IARD database and turn it into an Investment Adviser Directory that individual investors can use to screen for and select appropriate advisers. Perhaps some of the \$55 million earmarked for the SEC's Investor-Education Plan could fund this directory *and promote it*.

Currently, there is much debate about how to provide consumer protection that is effective, efficient, and within the bounds of budgetary prudence. There are many proposals and new statutes aimed at "financial consumer protection" - coupled with (or additions to) the old Acts of '33, '34, and '40 – not to mention Sarbanes-Oxley, Eliot Spitzer's crusades, and the SEC's Regulation NMS and Merrill Lynch Rule controversies.

Self regulation has been the law of the land for many decades. Notwithstanding the fact that the concept is literally a system where the fox guards the henhouse, it seems to be an accepted premise that it is the only game in town. NASD, NYSE, and hundreds of other so-called industry self regulatory organizations (SROs) are charged with providing the first line of defense against the unfair and illegal practices of their "members."

All an investor needs to do is look at the fine print in the financial section of the major newspapers (when SROs report violations of their rules and the sanctions on members who have taken advantage of the consumer) to know that this regulatory boat is springing more and more leaks and getting lower in the water by the day. I have always found it curious that nearly all sanctions imposed on these broker dealers and their agents along with fines varying with the severity of the crime allow the perpetrator to "neither admit nor deny" being guilty! Imagine if the police – *the real police* – arrested bank robbers caught red-handed robbing banks and the courts allowed them to "plead" that they neither admitted or denied that they had robbed the bank, and the court allowed them to pay a fine (out of the proceeds of the robbed bank no less) and agree not to do it again!

At the end of the day, I wonder how much of the results of all the rearranging of regulatory chairs will actually help the consumer (especially the small investor who can least afford to afford mistakes) with her quest to see appropriate returns on her hard-earned money without the fear of losing it all to unethical practices and unsuitable products.

As I was preparing to file my annual ADV registration update, it occurred to me that the SEC and state securities agencies are overlooking a potentially valuable consumer education/investor protection tool in their adviser database.

The SEC has an extremely capable systems department. It publishes on its Website a large body of regulatory information and commission activity, including the electronic version of public comments on proposed Rules. The NASD also seems to have an efficient procedure for handling electronic Form ADV registrations and updates.

Perhaps now that the various state and federal bodies entrusted with securities regulation have standardized filing requirements – and made filings electronic – they might want to consider offering the data as a useful tool for consumers to use when seeking the *best fit* for an adviser. **This also might arm**

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the consumer with the means to avoid the *wrong fit*. This tool I propose could literally make this Proposed Rule moot.

Today there seems to be consensus that conflicts of interest exist when those *giving advice* about which products to buy are the same people earning a living by *selling* those same products. These conflicts have never been deemed illegal (nor should they be) but they are *supposed* to be disclosed to the consumer *prior* to any transaction/engagement.

Another consensus is that conflict of interest might be avoided if advice were offered by those who charge *only a fee for their advice*, and who are not involved in the *sales* of financial products.

It is also widely reported that the cost of hiring competent, so-called *fee-only* financial advice is prohibitively expensive for all but the wealthy. Even among financial advisers, there is the notion that it is impossible to make a living advising the small investor.

In the 67 pages of Release S7-25-99 (Proposed Rule), there is not one mention of the distinctions offered by the three prominent advisory delivery methods: commission-based, fee and commission-based, and fee-only. This, despite the efforts of so many in the industry to position themselves *away from* product-oriented selling of financial services.

Disclosure is one of the primary consumer protection tools promoted by the securities industry and its regulators. An educated and informed consumer is better prepared to recognize fraud, mismanagement, incompetence, and abusive practices than a naïve or uninformed one. Indeed, most Websites of consumer, trade, and regulatory organizations dedicate considerable space to educating the public on how to choose advisers wisely. Who can deny, however, that this free public education is likely to have at least some bias toward the author's self-interest? Why then, shouldn't the information gathered about investment advisory firms by governmental agencies be made available in a form that could be used effectively by the consumer to FIND and CHOOSE an appropriate adviser?

At present, the SEC, state governments, and the NASD use a system that gathers data from electronically filed ADV forms of all legally registered investment advisers. The electronic document contains 24 pages of information in a standardized format, covering the background, business format, and procedures of every registrant. The data is used by regulators to monitor registrants (who are also required to offer this information to their prospective clients). I believe it's a safe bet that few consumers are aware of the Form ADV, know that advisers have an obligation to offer to deliver it, or consider what use it might be to them if they received one. Since this document serves more to bind advisers to the legal recourse of their regulators than to inform the public in plain language, it is doubtful that the consumer knows what to do with an ADV Form if and when presented with one.

The present format of information available to the public is **ONLY** the native form of the 24 page document known as Form ADV Part 1. In addition, an ADV Form can only be accessed via the SEC Website using one of the following search criteria:

Firm Name
Firm IARD/CRD Number
Firm SEC Number

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and allows search “options” of 25, 50, 75, or 100 records per page. “Records” refer to an individual investment advisory firm.

In other words, unless a consumer knows the name of a firm to look up in the first place, it is nearly impossible to “search” for a firm by any meaningful criteria. A consumer is not likely to be seeking the help of a firm by IARD, CRD, or SEC number. In fact, the entire database is organized around the presumption that searches will be conducted on a specific adviser, NOT with the intent of using the database to screen for advisers. The presumption appears to be that the public will only need to use the database when they are already aware of the firm’s or individual’s name. Actually, I doubt if the purpose of this tool was ever meant to be as a *proactive tool* to facilitate initiation of an adviser relationship. In fact, it would appear that its use is thought to be more of a *reactive/punitive* one (to screen for reported regulatory scheme violations).

The search engine made available to consumers is virtually useless as a means of screening registered advisers in the hope of finding a suitable one! To be fair to regulators, this database was not designed to help consumers find advisers, rather it was designed to help regulators keep track of advisers (at least legally registered ones). **My point is that, now that regulators have designed an electronic database, and compelled advisers to provide detailed and uniform information about themselves, why shouldn’t this fertile body of public information be made available to consumers in such a form that it *could* be useful to them as well?**

Let’s take an example: I am interested in finding an adviser and I’ve read many articles telling me that I need help to invest my money properly and warning me that finding the right assistance will be difficult. I’m worried about all the headlines about stock market bubbles, mutual fund scandals, and company bankruptcies. I’m also mesmerized by the letters after people’s names and the flashy advertising in effect saying “trust us, we can help you.” I’ve come to the conclusion that what I need is an investment adviser, the kind that works for ME as a paid adviser, not someone who works as an agent for a broker hawking products – in other words – I want a *fiduciary* relationship with someone who knows how to manage money for my benefit. I’m, in effect, looking for a *financial doctor* NOT a *financial pharmacist* (at least not yet). I know there may be over-the-counter generic help (in the form of mutual funds, stock brokers, and TV gurus for example) but I think my pain requires more potent medicine that will probably need a prescription. Is there a financial doctor in my area who can help diagnose my symptoms and help my ailment? AND will I be able to afford this doctor’s help?

What I would like to have is the local directory of registered investment advisers who can help me with my problem, and who charge a fee that I can afford. If I could only find such a directory, I would like to look into their background to see if there are any that seem like they might be worth calling to arrange for an initial consultation. If such a directory were available, I think I have enough common sense to do homework on my own so that, when I finally pick up the phone to make an appointment, I’ll be in the right ballpark. The trouble I’m having is that all of my research tells me that there is no such directory available, and even if there was, my case is too small for any of those in the directory to be willing to help.

The irony is that the information that I would like to see published in the directory is contained in a place called the NASD-IARD Form ADV database. The only trouble is, it can’t be accessed by the

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public in directory form, at least not with the current search engine made available at its front end. There is not even a means by which two or more ADV forms can be compared side by side unless they are both printed.

What an opportunity lost for true consumer education, choice, and protection in the marketplace!

Imagine if I could go to the NASD-IARD Website and ask for the name of every registered investment adviser within a three digit zip code that managed money for accounts averaging \$100,000 or less, had no minimum account size, had been in business for ten years or more, and whose principals had at least 6 years of post-high school education. Wouldn't that be a useful search criteria for a small investor to consider? But according to most media reports, even if this search could be made, a database of registered investment advisers would return no records (since no fee-only advisers exist who meet these criteria). I know this to be a false assumption.

Consumers can currently make choices of advisers based solely on yellow pages, billboards, print, radio, "uncle Harry," or TV commercials. As it stands now, they are bombarded by titles, "credentials," tag lines, and smiling faces. They are hawked by calls at dinnertime and offered free dinners at fancy restaurants. Product sales organizations are scheming for new ways to "cross-sell" and optimize their fixed-cost sales-driven overhead – this in the face of continued cut throat competitive pressures ushered in by the Internet, electronic trading, and other modern systems. The main universe of "potential" advisers available to most people is through paid advertising delivery schemes and the high overhead that goes with them. Why should we be surprised that consumers are sold unsuitable products and that product salespeople want to masquerade as advisers?

The Merrill Lynch Rule (and its curious staying power) is itself probably an excellent example of what is wrong with current regulatory thinking. Insurance and securities sales organizations have been re-naming themselves for years in their attempts to lure new customers. "*Estate planning*" has long been an industry term used to sell whole life insurance; "financial planning" is a more recent term coined to sell life insurance, securities, and other products. A large industry has evolved to offer various "designations" to "certify" and "standardize" processes that - in the end - boil down to the same old insurance and securities products being sold. The elimination of fixed commissions, the advent of defined contribution plans, the aging of baby boomers, spread of personal computers, and the evolving/converging of the Internet over the past twenty-five years have caused a *revolution* in the financial marketplace. Barriers between product sponsors have been eliminated while transaction costs have plummeted, squeezing margins. Yet what I see with the Proposed Rule is a brokerage industry clinging to a 1970s model and regulatory structure clinging to a 1940s model.

The data is there and the technology is there, why not provide the public with a 21st century model for investor information, education, and protection?

There is an old saying: "if it looks like a duck, quacks like a duck, and walks like a duck, it's a duck." If the brokerage industry selling financial products wants to call its sales agents "financial consultants," "financial planners," "bank officers," "real estate agents," "accountants," "lawyers," "college planners," "loan officers," "financial advisers," "financial gurus," or "financial cumquats," then it only seems logical that it is holding these agents out as people offering to help the consumer with her money. How

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this financial cumquat is compensated (or whether discretion or possession is involved) is irrelevant to the fact that advice about how to invest money is being offered.

The issue in the Proposed Rule that the status of discretion should affect whether or not advice is being offered, triggering a need to register, is curious. While discretion certainly elevates the *potential* for harm to the consumer, it hardly seems pivotal as a determinant of whether advice is being dispensed. My investment advisory format is based on advice for a fee, and I have *never* had a need to take even limited power of attorney over my clients' funds.

I suspect that the SEC and various state regulatory bodies are just as worried about having to register everyone holding themselves out as financial cumquats as the financial cumquats are at having to register. It is obvious that the Merrill Lynch Rule is going to be adopted by the SEC. I can see modifications made in this most recent Proposal that throw a bone at some of the obvious issues regarding "level playing fields" and "bright lights."

There is an irony in the Proposed Rule with regards to my proposed ADV Database. Registered Representatives and other sales agents (and their supervisor/product organizations) don't want to have to register as Investment Advisers (and the SEC does not want to have to register them). What a sweet arrangement this would be to those of us who DO have to register – as well as the consumer - IF the regulators were to make an ADV Database available to the public! With an ADV Database available for all consumers to query, all the advertising dollars in the world could not make a financial cumquat look like an Investment Adviser. The Merrill Lynch Rule would become moot. If you're in the ADV Database, you're an Investment Adviser and legally registered to help people with how to invest their money. If you're not in the ADV Database, you're NOT an Investment Adviser and you are not legally registered to help people with how to invest their money. If the public was made aware of this distinction, consumers would be able to make a clear and informed choice.

Another irony concerns the SEC's Investor-Education Plan created as part of a landmark settlement (with 10 investment banks accused of providing misleading research to investors). The banks agreed to pay \$1.4 billion to settle charges, with eight firms contributing \$55 million for a federal investor-education program. This program was established nearly a year ago and has yet to meet its mandate nor has it provided quarterly financial reports to the U.S. District Court overseeing the global settlement. According to an SEC spokesperson, the program "is in the process of obtaining its tax-exempt status from the [IRS] so that it can fund worthy and cost-effective investor-education projects that will help equip Americans with the knowledge and skills necessary to make informed investment decisions." Indeed. My proposal for an ADV Database would be a giant leap toward a true investor education plan and would cost a fraction of this \$55 million, since most of the system is already in place.

The information required of advisers on their Form ADV is currently held hostage by a system that presumes that the investing public is too stupid to make informed decisions on its own. Even though the existing regulatory structure springs holes every day, it won't admit that the ship is sinking. The ultimate irony is that regulators have information the public needs to make informed decisions about choosing advisers, and it doesn't seem to want to provide it in meaningful form. Perhaps it doesn't believe the public is interested in or capable of using it in order to justify the cost of making it available. It just may be that no one has given this much thought.

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I suspect that if the consumer is made aware of a powerful tool such as the one I propose, not only will investor protection be better served, but in all likelihood more advisers would consider offering business formats that better meet the public's needs. I suspect that there would no longer be the need to split hairs over the issue of when offering advice is incidental to selling products. It would be clear...to the consumer anyway.

Additional thoughts on this subject can be found in my earlier comments to investment adviser Proposed Rules: S7-03-03, S72599, and S7-04-04 or by following the links below:

<http://www.sec.gov/rules/proposed/s70303/cdmeyer041803.htm>

www.sec.gov/rules/proposed/s72599/cdmeyer1603.htm

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Thank you.

Sincerely,

Charles D. Meyer

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