



*BISA Regulatory & Compliance Conference
June 10, 2004*

Morgan Lewis
C O U N S E L O R S A T L A W

Impact of Multiple Types of Fees and Services

Sharon D. Taylor
Group V.P. &
Chief Compliance Officer
SouthTrust Securities, Inc.

Steven W. Stone
Partner
Morgan, Lewis & Bockius LLP

Patricia A. Gomez
Senior Vice President, Director of Regulatory Affairs
Wells Fargo Investments, LLC

Richard D. Starr
Director of Government Affairs
BISA

Overview



- Increased Scrutiny of Fee and Compensation Arrangements
- Mutual Funds
- Variable Products
- Differential Compensation
- Fee Based Brokerage Arrangements
- Wrap Fee Arrangements
- Bank Sweep Arrangements
- Referral Fees
- Other Fees

Increased Scrutiny

- Regulators are Taking a “Follow the Money” Approach to Fees and Compensation
- Focal Points
 - Conflicts
 - Disclosure & Transparency
 - Reasonability
 - Suitability
 - Supervision
- Issues are Most Acute at Point of Sale

Mutual Funds



- B Share Issues
 - 529 Plan issues
- Breakpoint Issues
 - NTMs 02-85 & 03-47
- NAV Transfer Issues
 - NASD Investor Alert
- Revenue Sharing and Shelf Space Payments
 - Proposed amendments to Rule 2830 (NTM 03-54)
 - Proposed SEC Rules
- Special Cash Compensation Restrictions
 - Enforcement Cases coming
- Brokerage for Fund Sales
 - Proposed SEC Bar
 - Enforcement Cases
 - Morgan Stanley
 - More coming
- Cash and Non-Cash Compensation Issues
- Sales contests

Variable Products



- NASD Concerns
 - Ads that fail to disclose charges and fees
- NASD Proposed Risk Disclosure Document
 - Surrender charges and IRS penalties
 - Sales charges
 - Fees (including mortality and administrative fees, investment advisory fees and charges for riders or special features)
- Recent NASD Enforcement Actions
- Layering of Fees

Differential Compensation



- Initial Regulatory Focus Limited
 - Proprietary Funds (1995 Tully Report)
 - Preferred or “Partner” Funds
- Focus on Disclosure and Suitability
 - Proposed amendments to Rule 2830 (NTM 03-54)
- SEC Now Taking More Aggressive Enforcement Stances
- Emerging Issues
 - Differential compensation for different products and services
 - Differential compensation for referrals versus fund sales
 - “President’s Clubs”

Fee Based Brokerage



- **NASD NTM 03-68:**
 - “Members must have reasonable grounds for believing that a fee-based program is appropriate for a customer given the services provided, cost, and customer preferences”
 - “It generally is inconsistent with just and equitable principles to place a customer in an fee-based account that reasonably can be expected to result in a greater cost than an alternative offered by the member that provides the same services & benefits”
- **According to the NASD, members must**
 - Have reasonable grounds before opening a fee-based account to believe the account is appropriate
 - Disclose all material components of a fee-based program (e.g., fee schedule, services provided, and that the program may cost more than paying for services separately)
- **Absent “inducement by the member,” no suitability liability will arise where**
 - A member discloses that a potentially lower cost account is available
 - The member has documented and can demonstrate the customer opted chose a fee-based account for reasons other than cost

Fee Based Brokerage



- **Periodic Reviews & Reporting**

- Members should periodically review fee-based accounts to determine if they remain appropriate
- Members should consider whether changes have occurred in key assumptions about appropriateness of fee based arrangement
- Members also may “wish” (but are not required) to create reports that compare the asset-based fees to those that would have been generated in the same account on a commission basis
- “A retrospective finding that a customer would have been charged less in a commission-based account is not conclusive that the account is inappropriate for that customer. However, such a finding should cause the member to give careful scrutiny to those issues.”

Wrap Fee Arrangements



- Reasonable grounds to believe wrap fee arrangement is appropriate
- Disclosure that obtaining services separately may be less costly

Bank Sweep Arrangements



- More Bank Affiliated Brokers Moving to Use of Bank Account Sweeps
- Array of Issues
 - Disclosure of differences
 - Insurance scheme
 - Yield
 - Regulatory scheme affecting use of assets
 - Negative consent issues
 - Eligible accounts

Referral Fees

- GLBA – Recent SEC Rulemaking
- Non-Securities Aspects
 - Insurance products
 - RESPA

Other Fees

- Administrative charges
- Inactivity fees
- "Segment" or Management Reporting



*BISA Regulatory & Compliance Conference
June 10, 2004*

Morgan Lewis
C O U N S E L O R S A T L A W

Impact of Multiple Types of Fees and Services

Sharon D. Taylor
Group V.P. &
Chief Compliance Officer
SouthTrust Securities, Inc.

Steven W. Stone
Partner
Morgan, Lewis & Bockius LLP

Patricia A. Gomez
Senior Vice President, Director of Regulatory Affairs
Wells Fargo Investments, LLC

Richard D. Starr
Director of Government Affairs
BISA