SHELF SPACE SHENANIGANS
MARCH 2007

I would like to draw attention to question #22 in our article Help Wanted***..."Is any of your compensation based on selling product? Explain?"***

In 2004, the Securities and Exchange Commission put foreword a rule change that would help satisfy its mission to *"protect investors and maintain fair, orderly and efficient markets,"* and was dubbed the *"Point of Sale"* rule. This would force broker-dealers to disclose to all investors whether they operate shelf space programs, which give preferential treatment to mutual fund companies in return for a fee. *Investment News* reported on February 26th, 2007 that in January 2004 plans were in place that would require all broker-dealers to provide their customers with information regarding the costs and conflicts of interest that arise from the distribution of mutual fund shares; Section 529 college savings plan interests and variable insurance products. In addition, the SEC went as far as to conduct investor interviews to test and refine point of sale disclosure forms.

We have reported several egregious examples of this conduct. Waddell & Reed according to the NASD engaged in an *"aggressive campaign"* to switch its customers from one annuity company to another. The reason for the switch, according to the NASD, had nothing to do with what was right for the client but rather due to the fact that Waddell lost its shelf space agreement with United Investors Life Insurance and therefore would no longer receive trailer fees. Subsequently, Waddell forced its sales force to sell the United contracts and purchase Nationwide, which whom they struck an agreement. This switch generated $37 million in commissions for Waddell and cost customers $10 million in surrender fees.

There is also the case of William Dornan vs. Morgan Stanley which we reported on back in January of 2005 in the article Swiper! No Swapping! During the discovery phase of a lawsuit that Dornan filed against Morgan Stanley, he learned that since 1990 variable annuity underwriters and Morgan Stanley maintained "secret contingent fee sharing arrangements" in which a portion of commission revenue was paid to the brokerage as an incentive to sell the product. Morgan Stanley has also limited its variable annuity sales to underwriters who participated in fee-sharing deals.

In the March 2005 follow up piece Return of the Swiper, we reported on Edward Jones receiving $82.4 million in payments from seven different mutual fund companies. Edward Jones had a lopsided fee structure that in many cases gave the firm greater compensation for hawking poorly performing funds over stellar performers. Regulators alleged that Edward Jones was pushing the majority of their clients into these preferred funds over better performers. Some of the most ill-performing fund families offered Edward Jones the most lucrative of incentives.

We at Markowski Investments believe that investors should be made aware of all fee sharing agreements on all financial products. Investors need to know if their advisor or broker is receiving any special compensation for choosing one product over another. The elimination of conflicts of interest is a goal that is too often paid lip service with no action to follow up. Currently the best way investors can protect themselves is too ask the right questions. Unfortunately much too often many advisors are much too loose with the truth and versed in the language of indistinct. One of the missions of the Securities and Exchange Commission is that ***"all investors whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it and so long they hold it."*** Shelf space/revenue sharing agreements in my opinion would definitely fall under the long shadow of that statement and should be dealt with in plain English and disclosed to all investors. Until then...ask the right questions.