



NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

BROKER-DEALER FEE SURVEY

A survey of fee disclosure and transfer fees.

By the NASAA Broker-Dealer Investment Products and Services Project Group:

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Executive Summary

The Investment Products and Services Project Group of NASAA's Broker-Dealer Section is tasked in part with preparing reports identifying products, markets, and practices that pose risks to investors or markets. The following individuals are current or former members of the Investment Products and Services Project Group who contributed to this report: Carol Anne Foehl (Massachusetts); Courtney Bowling (Texas); William Carrigan (Vermont); Anna Dennis (Kentucky); Deborah Fabritz (Wisconsin); Amita Mehra (Missouri); Marc Minor (New York); and Stephen Stroup (Minnesota).

In 2010 and 2011 the Connecticut Banking Department's Securities and Business Investments Division levied fines against several broker-dealers for what were characterized on customer statements as "miscellaneous" charges and postage handling charges. These charges concealed markups or profits for the broker-dealer.¹ FINRA also took action in 2011 against five broker-dealers, overlapping with Connecticut's actions, for excessive postage and handling charges.²

The Connecticut scenario prompted NASAA's Broker-Dealer Investment Products and Services Project Group ("Project Group") to conduct a survey on fee disclosures and types of fees charged by broker-dealers. In the spring of 2012, the Project Group members each surveyed 5 to 9 broker-dealers (small, large, full service, and retail) within their region.

The survey consisted of a number of questions requesting information including: (1) disclosure of fees to broker-dealer customers; (2) disclosure of additional fees or increase in fees to broker-dealer customers; (3) whether the broker-dealer has a separate internal listing of fees; (4) policies and procedures relating to closing accounts and fees charged to closed accounts; and (5) how the firm defines low balance and inactive accounts. For purposes of this report, the Project Group narrowed its focus to the following two issues: fee disclosures and transfer fees.

Key Findings

As a result of the survey, the Project Group discovered a wide disparity among firms in the way fees were disclosed. While broker-dealers may comply with the technical requirements governing fee disclosures, their disclosures lose effectiveness when hidden in small print, imbedded in lengthy account opening documents, or varied in terminology that does not define the service provided. Broker-dealer customers would benefit from greater consistency and transparency in the disclosure of fees.

¹ See *In the Matter of Woodstock Financial Group, Inc.*, Consent Order CO-2009-7751-S; *In the Matter of JHS Capital Advisors, Inc., f/k/a Pointe Capital, Inc.*, Consent Order CO-10-7780-S; *In the Matter of Salomon Whitney LLC*, Consent Order RCF-10-7792-S; and *In the Matter of Newbridge Securities Corporation*, Consent Order RCF-11-7794-S.

² See FINRA AWC No. 2009015974701 Re: Pointe Capital, Inc. (n/k/a JHS Capital Advisors, Inc.), FINRA AWC No. 2009016304801 Re: John Thomas Financial, FINRA AWC No. 2009016292001 Re: A&F Financial Securities, Inc., FINRA AWC No. 2009016348801 Re: First Midwest Securities, Inc., FINRA AWC No. 2010022181901 Re: Salomon Whitney LLC. FINRA's Letter of Acceptance, Waiver and Consents available at: <http://www.finra.org/Newsroom/NewsReleases/2011/P124283>.

The Project Group also discovered questionable practices regarding broker-dealer fee charges and markups. For purposes of this preliminary report, the Project Group focused its attention on the markups observed with one fee, outgoing transfer fees charged to customers. In its first review of fees, the Project Group noted one broker-dealer firm charging customers \$500 to receive their securities in certificate form. The broker-dealer's clearing firm only charged the broker-dealer \$60 for the certificate. According to the fee schedule with the clearing firm, the broker-dealer was able to add a customized markup to the certificate fee. This finding prompted the Project Group to contact a clearing firm for a number of the broker-dealers in the survey pool to discern the difference between what the broker-dealer is charged by the clearing firm for various services and the fees that the broker-dealer ultimately charges its customers.

The data that the Project Group received from the clearing firm suggest that broker-dealers in the survey pool reap a significant windfall by charging high markups for services delivered to their customers. In the certificate example cited above, the broker-dealer charged its customers a \$440 markup, more than six times the certificate cost to the broker-dealer. In the outgoing transfer fee context, markups were routinely in the 100% to 280% range. Pursuant to NASD Conduct Rule 2430,³ the fees imposed by broker-dealers on customer accounts must be reasonable for the services performed. Fees that are not reasonably related to services, or that are excessive, may constitute violations of state laws and FINRA rules.

Recommendation

As a result of the foregoing findings, the Project Group recommends NASAA work with the industry and FINRA in the adoption of model fee disclosures that will provide investors with greater consistency and transparency as envisioned in FINRA Rule 2010 and work with these same parties to holistically review broker-dealer markups to ensure investors are not charged unreasonable fees in violation of NASD Conduct Rule 2430. As the first order of business, the Project Group specifically suggests that NASAA establish a task force to work with industry in standardizing the language, placement, and structure of fee disclosures similar to the approach taken in the banking industry.

As part of this recommendation, the Project Group would also suggest that NASAA supplement these efforts by undertaking or facilitating state-led investor education campaigns to help investors find and understand the fees they are being charged. It may also be necessary in certain cases for individual states to follow-up with specific broker-dealers regarding questionable markups.

³ NASD Conduct Rule 2430. Charges for Services Performed: Charges, if any, for services performed, including miscellaneous services such as collection of moneys due for principal, dividends, or interest; exchange or transfer of securities; appraisals, safe-keeping or custody of securities, and other services, shall be reasonable and not unfairly discriminatory between customers.

FEE STUDY RESULTS AND DISCUSSION

PART I: FEE DISCLOSURE

In analyzing the fee disclosures, the Project Group reviewed information provided by all of the surveyed broker-dealers to compare methods used to initially disclose fees to customers. The Project Group compared timing, placement, format, and the length of the fee disclosures. Fees were typically disclosed at the time a customer account was opened and were often continuously disclosed on the broker-dealer's website.

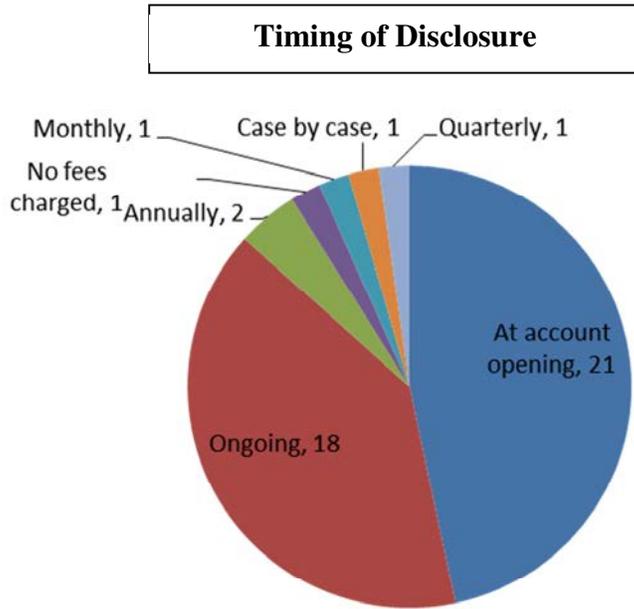
The location of the initial fee disclosures varied; the surveyed broker-dealers provided the fee disclosures on or with account statements, in separate booklets or mailings, on their websites, or in new account agreements. Most of the surveyed broker-dealers presented the fees in a chart format; however, some used a narrative format. The fee disclosures were typically one-to-two pages in length, but in some cases the disclosures were five-to-seven pages.

The Project Group also reviewed the information provided by the surveyed broker-dealers to compare methods used to disclose fee *changes* to customers. The Project Group compared when fee changes were disclosed, where fee changes were disclosed, the format in which fee changes were disclosed, and the length of the fee change disclosures. Most of the surveyed broker-dealers indicated that fee changes are disclosed to customers at least 30 days in advance. The location of the fee change disclosures varied; the surveyed broker-dealers provided fee changes on or with account statements, in separate mailings, or on their websites.

The Project Group attempted to categorize fees to determine the ease with which a customer could compare fees among broker-dealers. The Project Group attempted to classify fees by the type of service provided or the reason for the fee. While it was difficult and cumbersome to classify and compare the fees due to the different terminology used by the surveyed broker-dealers and the lack of consistent fee descriptions or definitions, the Project Group was able to gather some valuable information from this data.

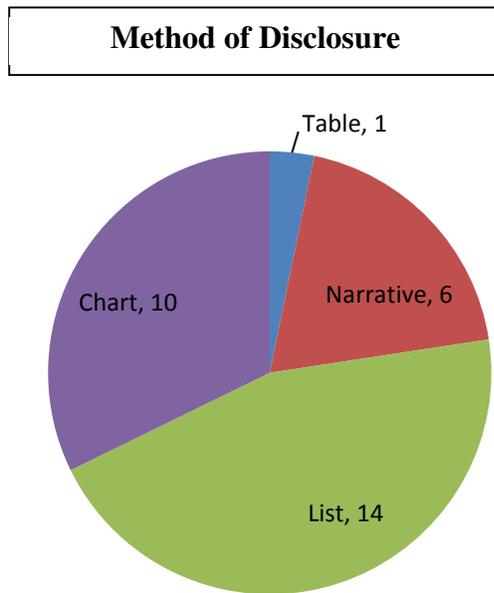
With regard to the timing of the fee disclosures, the data indicates that most surveyed firms provide disclosure at the time of account opening with many then providing ongoing disclosure. Importantly, after the account opening, it appears that firms exercise some discretion in determining when fees or fee changes will be subsequently disclosed to the clients. Very rarely are fee disclosures provided on a set schedule, or annually for that matter. (Fig. 1)

Figure 1



The survey revealed that most broker-dealers disclosed fees on a table, chart or list. A listing of fees was utilized by most reporting broker-dealers, followed by disclosures in chart form. A sizeable percentage of the firms utilized a narrative to generally inform investors that fees would be imposed for certain services, but did not typically include specifics like the applicable dollar amount or formula. (Fig. 2)

Figure 2



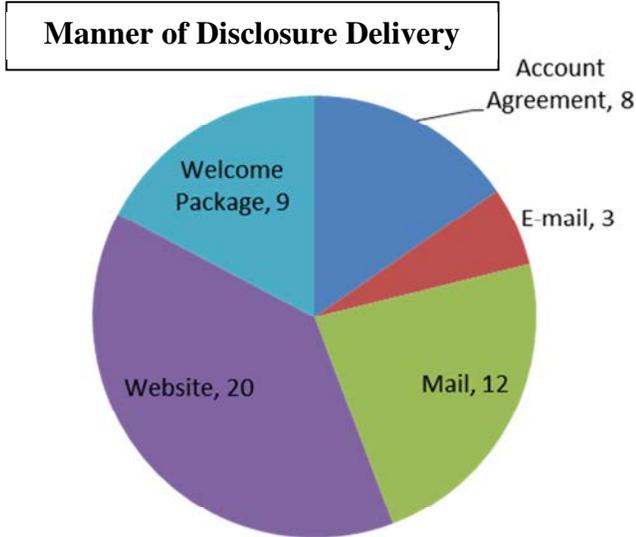
Next, the Project Group reviewed written account information to locate where a client might be able to find fee information in the wide range of documents provided to customers. The Project Group found that disclosures pertaining to fees ranged between a paragraph and seven pages in length. The actual fee disclosure verbiage itself was sometimes buried within a document having an overall length of between one and 45 pages in length. (Fig. 3)

Figure 3

Length of Actual Fee Disclosure Language Compared to Overall Document Length					
Firm	Disclosure Length	Doc. Length	Firm	Disclosure Length	Doc. Length
1	1 page	16 pages	19	7 pages	7 pages
2	2 pages	31 pages	20	3 pages	3 pages
3	1 paragraph	1 page	21	2 pages	2 pages
4	5 pages	5 pages	22	1 page	1 page
5	1 page	16 pages	23	4 pages	4 pages
6	2 pages	15 pages	24	2 pages	2 pages
7	1 page	1 page	25	2 pages	2 pages
8	2 pages	2 pages	26	4 pages	4 pages
9	1 page	1 page	27	1 page	1 page
10	1-2 pages	2 pages	28	2 pages	45 pages
11	2 pages	17 pages	29	5 pages	5 pages
12	1 page	1 page	30	1 paragraph	1 page
13	1 page	1 page	31	1 page	1 page
14	4 pages	8 pages	32	2 pages	2 pages
15	2 pages	2 pages	33	2 pages	2 pages
16	2 pages	2 pages	34	1 page	1 page
17	1 page	1 page	35	2 pages	2 pages
18	2 pages	2 pages			

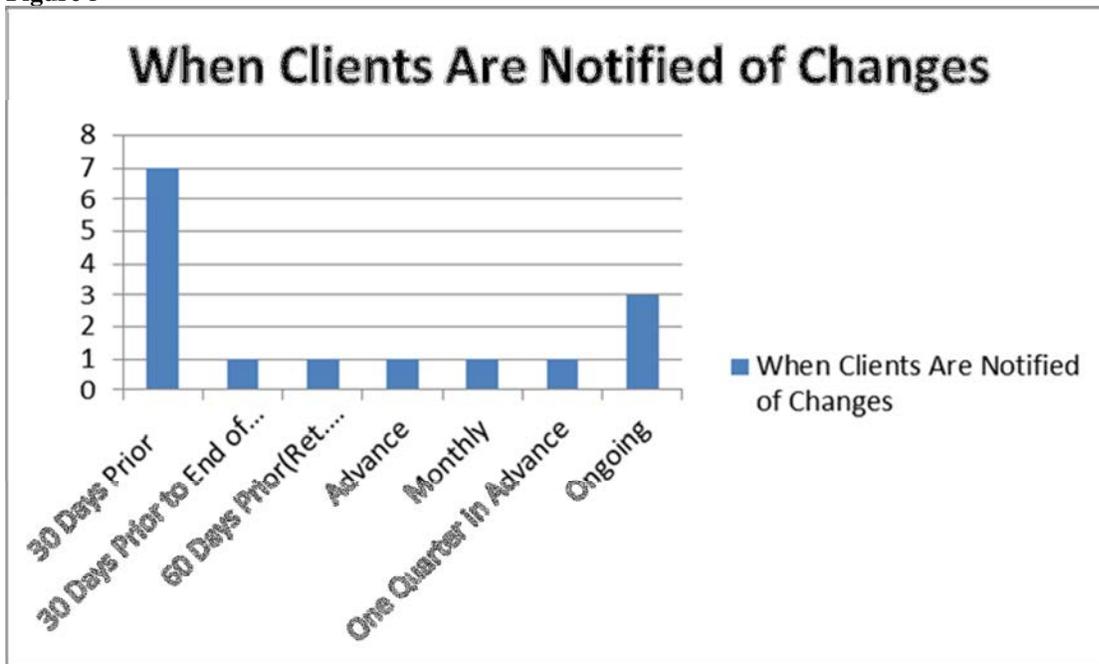
The Project Group also analyzed the method of delivery for fee disclosures amongst the surveyed firms. The mechanism used most to disclose fees was the internet, typically the broker-dealer's website. The second most common delivery of fee disclosure was via postal mail. The third most utilized method was to include the fee information in a welcome package, part of the overall marketing material provided to clients at the opening of the account. Last, and little used for fee disclosures, were email and the actual account opening agreement. (Fig. 4)

Figure 4



The Project Group also analyzed fee changes, to better understand when customers were notified of changes to the fee schedule and how those changes were communicated. Not all firms provided the requested data, but generally, clients of the responding firms were notified of changes in fees 30 days prior to the implementation of the fee change. Some of the reporting broker-dealers were less specific as to when the fee changes were disclosed, indicating that they would notify clients on an “ongoing” basis or within the quarter in which the fee change took place. (Fig 5)

Figure 5**



** Reported times include: 30 days prior to change; 30 days prior to end of quarter; 60 days prior to change (retirement accounts); monthly; one quarter in advance, and ongoing.

The means by which fee change information is distributed to clients is more diverse. Some broker-dealers created mailings separate from account statements to notify clients of fee changes while other broker-dealers would simply include a notice in the client’s monthly or quarterly account statements. Many broker-dealers rely on electronic forms of communication to alert clients to fee changes whether by email, posting the information on their website, or some combination of the two. (Fig. 6)

Figure 6

HOW/WHERE CLIENTS ARE NOTIFIED

An insert with account statements
Separate mailing
Statements or separate mailing
Clearing firm account statements
Mail, E-mail, Website
Letter with statements or separate mailing
Paper or electronic communication
Website
On account statements
Message on statement
E-mail
Revised account agreements, mailings, and/or account statement messages
Quarterly client disclosure booklet mailed or emailed
Mailed with quarterly account statements
electronic messages with statements

From an investor perspective, there is no uniformity in fee or fee change disclosure. The Project Group observed significant differences in the methods, terminology, specificity, length, and placement of fee disclosures. Below the Project Group outlines its recommendations to improve uniformity in fee disclosure including a recommendation on the use of a model fee disclosure template.

Recommendation – Simplified or Model Fee Disclosure

In July 2013, FINRA issued Regulatory Notice 13-23 to provide guidance regarding the disclosure of fees in communications concerning brokerage and individual retirement accounts. Noticeably, FINRA commented in Regulatory Notice 13-23 that it was concerned “that some broker-dealers’ communications that discuss fees may not be fair and balanced, and could be misleading.”⁴ Especially concerned with claims of “no fee” accounts, FINRA suggested a fair and balanced approach, with a link to a comprehensive fee schedule to avoid customer surprise.

⁴ Financial Industry Regulatory Authority (FINRA), *Brokerage and Individual Retirement Account Fees*, Regulatory Notice 13-23, at 2, (July 2013), available at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p304670.pdf>.

Last year, in response to complaints about fees and the tendency of banks to bury them in complex documents, the banking industry began moving toward the use of a model for simplified fee disclosures summarized in a short format. Numerous banks have adopted the disclosure form referred to as “Pew’s model disclosure” after its creation by Pew Charitable Trusts.⁵

Following the banking industry example and concurring with FINRA’s expressed concerns, the Project Group recommends greater uniformity in the provision of fee disclosures by broker-dealers to their customers. Uniformity would be appropriate with respect to the timing and placement of the disclosures, as well as their presentation and to some extent, content. The development of a model fee disclosure would address the following issues:

Timing

Fee disclosures may appear in account opening documents or they may be the subject of annual disclosure updates. Greater consistency in the timing of fee disclosures to customers would reduce the occasions on which complaints are received by firms and regulators in which customers complain about their surprise at being assessed a particular fee. For instance, if firms were required to disclose fees in a separate document associated with an account opening and then reminded customers on a consistent basis (*e.g.* annually) of the availability of fee disclosures on the firms’ websites, customers and firms would both benefit from an increased transparency of fee disclosures.

Placement and Notification

The placement of fee disclosures in documents and on websites varies significantly among broker-dealers. In one case, the fee disclosures began on page 18 of a 24-page customer account agreement, reducing the likelihood that customers will ever see the list of fees applicable to their accounts.

Fee lists and charts are often difficult to locate on broker-dealer websites. They may be imbedded in the legal disclosures that are linked from a phrase such as “legal notice” or “important disclosures” appearing in small print at the bottom of the website page. To provide investors with a greater level of transparency, fee disclosures should appear and be located in a prominent place on the broker-dealer’s website.

Significant variations exist with respect to how customers are notified of fee changes – they may be in account statements, separate mailings, or websites. The expected location of updated information should not be so widely varied to discourage customer review.

Format

⁵ The Pew report is available at: http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/SafeChecking_PolicyRecommendation_Factsheet1.pdf (last visited March 31, 2014).

Currently, broker-dealers use various lists, charts, and summaries to explain fees to customers, making it difficult to make apple-to-apple comparisons of fees between firms. Ideally, broker-dealers would adopt a more standardized form or chart for use throughout the industry for fee disclosures. These standardized documents would identify the categories of fees such that customers can locate a fee such as a wire transfer fee. This approach would minimize the variations in the categorization of fees that exists today. For example, the Project Group observed that one broker-dealer listed a wire transfer fee under “cash management service fees” and another broker-dealer listed the same fee under “other fees.”

A more standardized format would decrease the ability of firms to mask unusual markups. Uniform terminology will facilitate greater customer understanding of fees charged from one firm to the next for a similar service.

Fee Amounts

While varying business costs and levels of client service are likely a barrier to uniform account maintenance fees across the industry, firms should seek to establish fees that are fair and that have a reasonable connection to the actual cost of the service generating the fee. Outgoing transfer fees may be a good example where broker -dealers can and should do more to reasonably limit the percentage markup charged to investors.

PART II: TRANSFER FEES/ACAT FEES-BACKGROUND AND FINDINGS

In reviewing Automated Customer Account Transfer (“ACAT”) fees, the Project Group compared the ACAT fee amounts supplied by the surveyed broker-dealers to determine the range of fees charged to customers for transferring accounts via ACAT. For the purposes of the Project Group’s survey, the ACAT is defined as a service offering of National Securities Clearing Corporation (“NSCC”) that automates and standardizes procedures for the transfer of assets in a customer account from one brokerage firm and/or bank to another.⁶

The Project Group found that ACAT fees ranged from \$0 to \$175 for 31 of the 34 surveyed broker-dealers as follows. (Fig. 7)

⁶ See http://www.dtcc.com/products/cs/equities_clearance/acats.php; <http://www.dtcc.com/about/subs/nscc.php>.

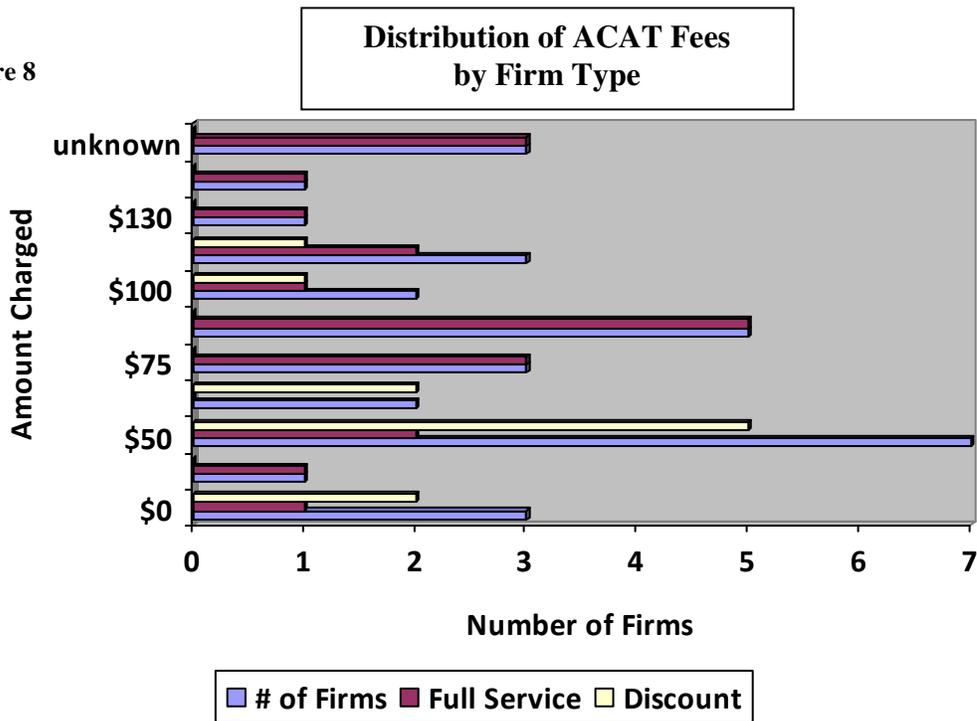
Figure 7

Fee Amount	# of Firms	# of Full Service / Discount Firms	# of Large / Mid-Small Sized Firms
\$0	3	1 Full Service / 2 Discount	2 Large / 1 Mid-Small
\$35	1	1 Full Service / 0 Discount	0 Large / 1 Mid-Small
\$50	7	2 Full Service / 5 Discount	4 Large / 3 Mid-Small
\$60	2	0 Full Service / 2 Discount	1 Large / 1 Mid-Small
\$75	3	3 Full Service / 0 Discount	0 Large / 3 Mid-Small
\$95	5	5 Full Service / 0 Discount	5 Large / 0 Mid-Small
\$100	2	1 Full Service / 1 Discount	0 Large / 2 Mid-Small
\$125	3	2 Full Service / 1 Discount	0 Large / 3 Mid-Small
\$130	1	1 Full Service / 0 Discount	1 Large / 0 Mid-Small
\$175	1	1 Full Service / 0 Discount	0 Large / 1 Mid-Small
Unknown	3	3 Full Service / 0 Discount	2 Large / 1 Mid-Small
TOTALS	31	20 Full Service / 11 Discount	15 Large / 16 Mid-Small

As illustrated in the following chart, the Project Group found that 13% of firms charge below \$50, 23% of firms charge \$50, 32% of firms charge more than \$50, but less than \$100, and 23% of firms charge \$100 or more in fees per account for a customer to transfer their account via ACAT.

The results for *full service* firms reflect that 10% of these responsive surveyed firms charge less than \$50, 10% charge \$50, 65% charge more than \$50; and 15% unknown. The results for *discount firms* reflect that 18% charge less than \$50, 45% charge \$50, and 36% charge more than \$50. (Fig. 8)

Figure 8



In comparing the ACAT fee amounts charged to customers by the surveyed broker-dealers to the cost charged by the clearing firm to the broker-dealer to transfer a portfolio via ACAT, the Project Group discovered the ACAT fees charged by the majority of the surveyed broker-dealers would include a large, undisclosed markup.

Outgoing Transfers and Other Transfer Charges

The Project Group analyzed data from a large clearing firm that provides clearing services to nine of the surveyed broker-dealers. While the clearing firm charged \$25 to facilitate an account transfer, the broker-dealers charged customers between \$50 and \$100 to facilitate the transfer. The corresponding percentage markup to the clearing firm charge ranged from 100% to 280%. (Fig. 9)

The transfer fees were listed under “Customer Re-Billable Fees” within the broker-dealer/clearing firm contract. Specifically the contract states: “with the exception of Mutual Fund and Systematic Reinvestment (SRS) Exchanges, each of the *below fees may be billed directly to the client with a customized markup*. Broker is responsible for client notification of fees.” (emphasis added).

Figure 9

**Outgoing Transfer Fee
Breakdown**

Broker-Dealer	Outgoing Account Transfers-Clearing Firm Charge to the Broker-Dealer	Outgoing Account Transfers-Broker-Dealer Charge to Customers	% Markup
National Full Service Broker-Dealer	\$15	fee imposed by transfer agent	not available
Regional Full Service Broker-Dealer	\$25	\$95	280%
Regional Full Service Broker-Dealer	\$25	\$50	100%
Regional Full Service Broker-Dealer	\$25	\$75	200%
National Full Service Broker-Dealer	\$25	\$95	280%
National Full Service Broker-Dealer	\$25	\$50	100%
Regional Full Service Broker-Dealer	\$25	\$50	100%

Recommendation-Accounting

The broker-dealer’s wholesale cost paid to the clearing firm, compared to the transfer fees paid by the broker-dealer’s customers, revealed a large undisclosed markup. Broker-dealers, in charging fees, are under an obligation to adhere to the reasonableness requirement of NASD Conduct Rule 2430. The Project Group suggests, as another area for analysis by the Fee Task Force, an accounting of the costs for the broker-dealer facilitating an outgoing transfer and an evaluation of whether the markups to the internal costs are reasonable.

CONCLUSION

The Project Group has identified several concerns in this report regarding the fee practices of the surveyed broker-dealers. As a result, the Project Group suggests that: (1) the investing public needs to be alerted to these issues through investor education; (2) NASAA should work with FINRA and the broker-dealer industry to develop a model fee disclosure that is simple to read, easily accessible, and can be used effectively by investors to understand fees and to conduct fee comparisons; and (3) states should undertake further review of the issues discussed in this report.