

# WHAT YOU NEED TO KNOW ABOUT FINANCIAL ADVICE

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## INVESTOR CONFUSION EXISTS OVER FEE-BASED ADVICE OFFERINGS

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**In the financial world today**, there are basically two types of advice available to investors: that given by stockbrokers, and that given by Registered Investment Advisors (RIAs). Unfortunately, most investors don't know the difference between these two kinds of advice.

**In fact, most aren't even aware a difference exists.**

**In a recent survey:**

- 54% of investors believed both stockbrokers and independent RIAs have a responsibility to act in their best interests.\*
- 74% of investors did not understand the different obligations required of RIAs and stockbrokers. Unlike stockbrokers, RIAs

have an obligation to act in an investor's best interests in all aspects of the financial relationship.\*

- 79% said they would rather work with an investment advisor if they knew advisors provided greater investor protection than stockbrokers.\*

The truth is, there's considerable confusion in the investment community regarding financial advice and the people who dispense it. The following questions and answers aim to sort out some of the confusion, and to help you find advice you can trust.

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## WHY DOES THIS CONFUSION EXIST?

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Historically, brokerage firms could offer investment advice only if that advice was "solely incidental" to their brokerage business, and only if they did not receive "special compensation" for the investment advice. The SEC interpreted these provisions narrowly until 1999, when it issued a proposal allowing brokerage firms to offer fee-based accounts without registering as investment advisors. The SEC also issued a controversial "no-action" position, allowing brokerages to take advantage of the proposal even before it was finalized.

In 2004, the Financial Planning Association sued the SEC for allowing the "no-action" position to continue without taking final action after hundreds of comments were submitted in opposition to the proposal. The SEC then reopened the comment process, and on April 6, 2005, it announced it was adopting a final rule generally similar to its 1999 proposal.

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## WHERE DOES TD AMERITRADE STAND ON THIS ISSUE?

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At TD AMERITRADE, we firmly believe investors are entitled to one clear set of regulations, no matter who they turn to for their financial advice. And we're not the only ones. A recent poll\* revealed that 84% of investors want Congress to set uniform

standards of protection for both stockbrokers and investment advisors. We stand firmly on the side of the investor to promote a set of regulations that is fair for advisors, brokers and, most importantly, investors like you.

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## THE NEW SEC RULE AND WHAT IT MEANS

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**As of July 22, 2005, any brokerage firm that offers fee-based accounts must prominently disclose the following:**

- Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits and our salespersons' compensation may vary by product and over time.
- Brokerage firms must include this disclosure in their brokerage account applications, and in advertisements and sales materials for fee-based accounts.

- Brokerage firms must make available someone who can explain to potential customers the differences between brokerage accounts and investment advisory accounts.

**As of January 31, 2006:**

- Brokerage firms may *not* offer discretionary accounts, except in accounts regulated as investment advisory accounts.
- Brokerage firms may *not* offer "financial planning" services, except in accounts regulated as investment advisory accounts.

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## HOW ARE INVESTMENT ADVISORS DIFFERENT FROM STOCKBROKERS?

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Some of these key differences follow:

- Investment advisors have a fiduciary duty to act in the best interests of their clients at all times. Brokerage firms generally are not fiduciaries to their customers and therefore may not make decisions that are solely in their customers' best interests.
- Investment advisors provide their clients with a Form ADV that describes exactly how the investment advisor does business and obtains the client's consent to any conflicts of interest that might exist with the investment advisor's business. Brokerage firms are not required to provide customers with any comparable type of disclosure.
- Investment advisors cannot trade with their clients as principal except in extremely limited circumstances. Brokerage firms often earn significant profits by trading as principal with their customers.
- Investment advisors charge clients a fee negotiated in advance and cannot earn any other profits from their clients without the clients' prior consent. Most investment advisors are paid an asset-based fee, so their interests are aligned with their clients. Brokerage firms' revenues may increase even if the customers' assets shrink.
- Investment advisors manage money in the best interests of their clients. They do not engage in business activities like investment banking or underwriting, which brokerage firms do. These other businesses may cause a brokerage firm's interest or attention to focus on other areas of the firm outside of their retail brokerage business and customers.

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## WHAT ARE THE ADVANTAGES OF WORKING WITH AN INDEPENDENT REGISTERED INVESTMENT ADVISOR OVER A STOCKBROKER?†

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RIAs are held to a higher standard than stockbrokers when it comes to putting investors' interests first and doing the right thing for their clients' investments. Independent RIAs have a fiduciary duty to their clients, which means they must:

- **Act in the best interest of their client**
- Identify and monitor illiquid securities
- Employ fair market valuation procedures where appropriate
- Observe procedures regarding the allocation of investment opportunities, including new issues and the aggregation of orders
- Have policies regarding affiliated broker-dealers and maintenance of brokerage accounts

- Disclose all conflicts of interest
- Have policies on use of brokerage commissions for research
- Have policies regarding directed brokerage, including step-out trades and payment for order flow
- Abide by a code of ethics

**Stockbrokers are held to suitability obligations on the part of their broker-dealer when making recommendations:**

- Reasonable Basis Suitability — the broker-dealer must believe that the recommended security is suitable for any investor
- Customer-Specific Suitability — the broker-dealer must believe that its recommendation is suitable for that particular investor

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