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NORTHERN ILLINOIS UNIVERSITY

"Conflicts of Interest Concerning Brokerage Remuneration and the Current Lack of Proper Disclosure to Investors"

A Thesis Submitted to the

University Honors Program

In Partial Fulfillment of the

Requirements of the Baccalaureate Degree

With University Honors

Department of

Accountancy

By

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DeKalb, Illinois

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ABSTRACT:

Within the brokerage industry, hidden potential conflicts of interest between brokerage firms and investors exist concerning brokerage remuneration. Usually unknown to the investor, the brokerage agent has incentives, other than the standard commission, to sell a certain fund family. The purpose of this project will be to examine the different types of hidden conflicts of interest most prominent in the brokerage industry. The paper will examine basic conflicts of interest inherent to the industry and more fully discuss the problems related to conflicts that are hidden to investors. Recent rules and requirements passed by regulators of the industry will by evaluated and the their effectiveness discussed. The paper will recommend actions and policies that would help to resolve the controversy.

Recent news articles, statements, and company announcements were reviewed and analyzed. It was found that current regulations were not strict enough to properly protect investors' interests. Current rules must be clearer concerning shelf-space payments and brokerage firms must make more disclosure to investors concerning possible conflicts of interest.

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"Conflicts of Interest Concerning Brokerage Remuneration and the Current Lack of Proper Disclosure to Investors"

There are inherent conflicts of interest in any professional service: it may not be in a lawyer's best interest to resolve a case quickly if he/she is paid an hourly rate; a doctor is paid more for an operation that may not be entirely necessary; etc (Stoneman, 1996). The same potential conflicts of interest exist within the brokerage industry. The truth is that brokerage firms are in the business to sell, not to manage clients' money. Brokerage firms receive a commission when a client buys or sells a security, regardless of whether or not the security performs well. Very often, in the brokerage industry, there are conflicts of interest that are not even known to the client.

The purpose of this paper will be to more closely examine the different hidden conflicts of interest that are present within the brokerage industry and review the steps that are and should be taken to expose the conflicts to the investing public.

A review of what a conflict of interest entails will be discussed before moving more specifically to the inherent conflicts of interest in the brokerage industry. An analysis of how conflicts of interest exist within the brokerage industry, unbeknownst to investors, will be then be covered. Specific examples of hidden conflicts will be reviewed here as well. Detailed examples of brokerage firms and fund companies at the root of the problem will be examined. Current steps and proposals made by the

Securities and Exchange Commission (SEC or Commission) and other agencies on this matter will be analyzed and evaluated. New propositions to resolve this controversy will also be suggested.

CONFLICTS OF INTEREST

Any time something is done for different reasons, there is a potential conflict of interest. Law professor, John Coffee Jr., of Columbia University, says that "Essentially, the law says that there are times when you…should not accept other kinds of interests or payments that could give you a reason to act contrary to the best interests of your employer or the person to whom you owe a duty" (Mendels, 2001). Potential conflicts of interest do not always become real but should be acknowledged. Tracy Pride Stoneman, an attorney at law, advises that, "The number one guideline in choosing any professional help is first to determine what the potential conflicts of interest are and second, to try to eliminate or control those conflicts" (Stoneman, 1996).

In the brokerage industry, there are several, well-known conflicts of interest present. The fact that a broker receives a commission charged to his/her client is a given, but a client cannot know for sure whether the stock that the broker recommended was in his/her own best interests or the broker's. Like a hospital or a legal firm, a brokerage firm is in the business to sell. A doctor makes the hospital more money when surgery is performed than when it is avoided and a lawyer makes his/her firm more profits when more hours are spent on a case that could have been resolved quicker. A broker will generate more profits for him/herself and the firm when a client buys the product that is

best for the firm. This is not to say that what is best for the client is mutually exclusive from what is best for the firm, but, often enough, the interests of the firm take weight over those of the client. A broker is paid his/her commission whether the stock he/she recommended performs well or not.

As long as an investor is aware of these potential conflicts of interest, he/she can take steps to eliminate, or at least reduce them. One must ask questions of the broker, like, "How do you make money?" or, "Who pays you?" Stoneman recommends that an investor remain a client to a broker as opposed to a customer, "If you remain a customer, merely a person whom the broker calls when he has his next hot idea, the conflict remains high" (Stoneman, 1996). To be a more aware client, one must build a relationship with his/her broker. To reduce conflicts of interest, a client should make the broker aware of his/her interests, goals, and financial needs through in depth conversations. This process will help to diminish some of the more apparent conflicts of interest. But, all too frequently, many of the conflicts of interest within the brokerage industry are hidden from the client.

HIDDEN CONFLICTS

Aside from the commission that a broker receives when his/her client buys or sells an investment, the broker can be remunerated in other ways. Most of the time, the client is not even aware of the many other ways in which brokers are paid. Unless the client reads the prospectus in detail, he/she may never know of the other forms of

commission, which can be exorbitant. These hidden incentives pose a material conflict of interest to the client.

Some stockbrokers, in addition to selling their firm's securities, sell from their own portfolios. This practice gives a stockbroker an incentive to make a profit, on top of their commission incentive (Stoneman, 1996). Although this practice is not illegal, a client might think otherwise about making the investment if aware of the stockbroker's motive for pushing the security. Closely linked to the broker's profit incentive in selling from his/her own portfolio is the accelerated payout that some brokers receive from their firm during their first year or month. Sometimes, as a bonus for coming to that firm, a new broker will receive a higher commission rate for a specific period of time. After a certain time the commission percentage drops (Stoneman, 1996). The client may never know that he/she is paying a higher commission than normal but it is in the broker's best interest to sell higher volume and "push product" before his/her commission percentage goes down (Stoneman, 1996). Even if the client is aware of the broker's high commission rate, the client may not be aware that the rate is only temporary. The conflict of interest is obvious and, if the client was aware of it, it seems likely that the client would be more hesitant to place larger orders with a broker who might only be rushing to get as much business as possible at a higher commission rate before it drops.

Common in many sales businesses is the sales contest. The person that sells the most or a certain amount wins a prize or gets a bonus. This is a firm's way of increasing its sales force's incentive to sell. These sales contests are perfectly legal but the naïve investor would probably make different investment choices knowing that his/her broker

might only be recommending a certain stock so that he/she might win a vacation (Stoneman, 1996).

One of the most popular hidden conflicts of interest in the brokerage industry is what is known as "paying for shelf space". Paying for shelf space occurs when a fund company pays a brokerage firm a fee to preferably present its product on a recommended or favored list to its clients (Pender, 2004). There are two ways, traditionally, that fund companies can pay for shelf space. For one, the fund company could make a one time, up-front cash payment to the brokerage firm, this is known as revenue sharing. The other way is for the fund company to send the fund's trading business to the brokerage firm, known as directed brokerage (Pender, 2004).

Revenue-sharing agreements involve money that mutual fund companies pay to brokerage firms, in excess of the usual sales commissions, for promoting their funds. For the extra, up-front payments, brokerage firms place the fund companies' funds, or products, on a list of preferred or recommended stocks that brokers use in selling to clients. This is a conflict of interest because it may not be in the best interests of the investor to buy these funds that the brokerage firms are pushing. Most clients will never even be aware of the potential conflict if they do not do detailed research into the statements of additional information concerning their investment. Brokerage firms and fund companies will contest that "because fund companies make revenue-sharing payments out of their own coffers, as opposed to fund assets, they, not fund shareholders, are technically the ones paying for preferential treatment" (Jacobson, 2005).

Directed brokerage agreements are basically a potential conflict of interest between a fund's advisor and its shareholders. In this practice, fund companies "direct"

brokerage transactions to reward brokerage firms that also sell the companies' funds. Recently made illegal by the SEC, "the potential conflict involving this practice has led to concern about the use of shareholder assets by fund managers" (Questions & Answers About ICI Actions, 2003). Unlike revenue-sharing agreements, which are paid for the fund companies' own assets finance directed brokerage financed with shareholders' assets. Mutual funds use brokerage firms for two reasons: brokerage firms sell mutual funds and also execute the trades of securities in the fund's portfolio. Fund companies are obligated to seek out the best value for their trades yet, in some instances, "direct" trades to brokerage firms in consideration of the firm's sale of fund shares to investors (Questions & Answers About ICI Actions, 2003). This practice was generally contained by loose and often unclear regulations. The SEC has only recently recognized the potential conflicts associated with this arrangement and has made the practice of directed brokerage illegal. The SEC said, "the practice posed a potential conflict because the practice could put the interests of the mutual fund manager ahead of the fund's shareholders" (Leitch, 2004). In the past months, many firms had been fined for failing to conform to prior existing standards for directed brokerage agreements but no admission of guilt on behalf of the fund companies was ever volunteered. Rarely were any steps taken by the companies to really address the problem either. For the practice of directed brokerage agreements to cease posing potential conflicts of interest, the laws concerning the practice must continue to be enforced and steps must be taken for proper disclosure.

CURRENT EXAMPLES

The most widespread of the hidden conflicts of interest in the brokerage industry is the practice of paying for shelf space. The first aforementioned method of paying for shelf-space, revenue sharing, poses a greater conflict than fund companies and brokerage firms would have investors believe. In a statement posted by Merrill Lynch on its Web site, they say that they "do not purchase placements on any preferred lists or any special positioning or coverage of certain funds" (Jacobson, 2005). Yet, Merrill Lynch says, "Funds that do not enter into arrangements with Merrill Lynch are generally not offered to clients" (Jacobson, 2005). Basically, Merrill Lynch is saying that they do not offer special treatment to certain funds because all of the funds they push on clients receive the same special treatment. The companies that pay extra for Merrill Lynch to push their product will be sold and others' funds that do not pay need not bother. Merrill Lynch and other companies practicing revenue sharing in this manner would not lose related legal cases due to the legalese. The potential conflicts of interest concerning revenue sharing agreements are made all the more problematic because of the fact that those are generally hidden conflicts.

After settling allegations with the Securities and Exchange Commission (SEC or Commission), the government body responsible for regulating the stock market, the firm did not stop accepting revenue sharing payments. In fact, they simply provided some details on its Web site about how much money it receives from the firms it does business with (See Appendix A) (Jacobson, 2005). For example, the Goldman Sachs fund family paid Edward Jones $13.98 per $10,000 of fund assets invested with the firm in 2004. The

Hartford fund family paid over $20 per $10,000 of assets invested with the firm compared to the American funds that paid only $3.36 per $10,000 of assets with the firm (Preferred Mutual Fund Families, 2005). This disclosure may seem like a step in the right direction towards better disclosure to investors but it only reinforces the truth that the brokerage firms have a conflict of interest. Edward Jones receives more money from the Hartford fund family than the American funds and has more incentive to push Hartford over the American funds. Simply disclosing the conflict, in this case, does not do enough to help the situation; a major problem still exists.

The Securities and Exchange Commission views the directed brokerage method of paying for shelf space as more of a problem because the directed brokerage commissions are paid with shareholders' assets (Pender, 2004). Recently, the SEC announced settlements with the companies that distribute Pimco stock funds. The Commission highlighted a potential conflict of interest and, without admitting responsibility, the Pimco bodies consented to pay a total of $20.6 million in state and federal fines. The numerous fines relate to charges that the entities failed to properly disclose to their clients that they paid brokerage firms to promote the sale of its funds (Pender, 2004). Though the companies that manage Pimco stock funds were charged with not properly disclosing hidden conflicts of interest to investors, they never admitted fault and have not done much to stop the conflicts.

The Securities and Exchange Commission sued the company that distributes Pimco stock, PA Distributors, and two additional firms that manage Pimco stock funds for not appropriately disclosing to investors the directed brokerage agreements with nine other brokerage firms, which were not named (Edward Jones Pays, 2004). At the time,

the directed brokerage agreements that these companies had were legal. The California attorney general sued PA Distributors for not disclosing the directed brokerage agreements or the revenue sharing agreements. PA Distributors provided some information to investors about the agreements but Attorney General Bill Lockyer said, "that was not sufficiently detailed or appropriate disclosure" (Pender, 2004). PA Distributors settled to pay a $5 million fine that will go into the California State general fund and $4 million to cover the state's legal fees. PA Distributors also agreed that it would "provide much better disclosure about its shelf-space payments in its prospectus or statement of additional information" (Pender, 2004). Still, better disclosure to investors does not go far enough.

Even though the law is unclear concerning the proper procedure for disclosing these conflicts of interest, the law requires adequate disclosure to investors. Other companies that provide disclosure to investors of potential conflicts of interest give just enough disclosure for the law to view it as adequate. Buried within the prospectus is the disclosure of the potential conflicts of interest and only when read in detail will an investor be aware of the potential problems. Even when given a prospectus before, or in some cases after, investors have purchased mutual funds, few investors bother to ever read it in the detail required to decipher the legalese (Pender, 2004). The level of disclosure that the law considers adequate can hardly provide investors with enough information to understand that there even is a potential conflict of interest. Even with the disclosure that these firms provide, the conflicts still remain hidden.

Like the Pimco entities that settled charges in September of last year, brokerage firm Edward D. Jones & Co. recently settled allegations of improper mutual fund

marketing without admitting or denying responsibility (Edward Jones Pays, 2004). Edward Jones agreed to pay $75 million in fines and take corrective measures to settle with regulators. The Edward Jones settlement came after a string of similar settlements with other fund companies. MFS Investment Management settled with the Commission earlier that year in March for $50 million for keeping its trustees and investors in the dark concerning the details of agreements with distributors to sell MFS funds (Edward Jones Pays, 2004). In November, a month prior to the Edward Jones settlement, Morgan Stanley agreed to pay $50 million in settlement of charges that it did not inform investors of the compensation it received for selling specific fund shares (Edward Jones Pays, 2004). Nowhere among these settlements do the companies take responsibility for the allegations against them.

One of the terms of Edward Jones's settlement was that it had to disclose on its public Web site the information regarding its revenue sharing payments (See Appendix A) and hire an independent consultant to review its new disclosures (Edward Jones Pays, 2004). This action is at least a little clearer than PA Distributors' promise to provide "better disclosure" of shelf-space agreements. Some believe that this, still, does not go far enough to address the problem. The "corrective measures" that Edward Jones plans to take to conform with SEC requirements and the $75 million settlement is "inadequate", says California's Attorney General Bill Lockyer (Edward Jones Pays, 2004). Companies are paying for their failure to communicate the potential conflicts of interest to investors but are not doing enough to correct the problems. Even with disclosures like Edward Jones's Web statement regarding its "Preferred Mutual Fund Family Revenue Sharing Agreement", investors will still be ignorant of the potential conflicts of interest if they do

not perform their own detailed research into their investment firm (Edward Jones Pays, 2004).

Currently, regulators are cracking down on these hidden conflicts of interest. Mostly, however, as we have seen, regulators are simply making allegations and charging fines. Some corrective measures have been taken to help the current situation, but only in a very minimal way. The steps that have been taken to actually remedy the situation and feasible actions towards resolution will be discussed next.

STEPS TAKEN TO ADDRESS THE PROBLEM AND POSSIBLE MEASURES FOR RESOLUTION

Regulators of the securities industry have not been totally idle while these hidden potential conflicts of interest remain widespread in the business. Early last year the Securities and Exchange Commission proposed new rules to require disclosure to investors of the ways in which brokerage firms make money selling mutual funds (Labaton, 2004). Basically, what Edward Jones was forced to do a few months earlier, publicly revealing how much it is paid when it sells certain funds, is now required for all brokerage firms. Now, certain arrangements between fund companies and brokerage houses can be legal as long as it is fully disclosed to investors. The SEC says that, "the problem in too many cases is that investors in the mutual funds have been kept in the dark about such payments and the fact that their brokers have a financial interest in promoting a particular fund" (Labaton, 2004). The new requirements do not go far enough to state what full disclosure actually entails. Companies like to bury the

disclosure in the prospectus, or statement of additional information, and call that "full disclosure". Most investors lack the ability to fully interpret the legal jargon that prospectuses are printed in and few will ever take the time to pour over the details of a these statements.

Concerning shelf-space payments, the Securities and Exchange Commission recently announced, on August 18, 2004, "Under the amendments adopted today to rule 12b-1 of the *Investment Company Act*, investment companies will be prohibited from paying for the distribution of their shares with brokerage commissions" (SIA: Directed Brokerage Ban, 2004). This new rule will stop the mutual funds from using the directed brokerage method of buying shelf space to compensate brokerage firms. This rule will not bar the fund companies from transactions to broker-dealers that "distribute fund shares where funds have policies and procedures designed to insure that the transactions are consistent with best execution obligations, and not tied to the level of fund sales" (SIA: Directed Brokerage Ban, 2004). While this is a step in the right direction to properly address the conflict of interest issues, problems still arise.

The amendments to rule 12b-1 prohibit fund companies from directing business to brokerage firms unless policies are in place to insure best execution trades for investors. This does not eliminate the threat of a potential conflict of interest. The policies in place that are supposed to insure best executions are tied to the level of fund sales, not the funds themselves. In the Edward Jones example (refer to Appendix A), this rule would not guard against the brokerage firm pushing Hartford funds (annual asset fees based on $20.90 per $10,000) over American Funds (annual asset fees based on $3.36 per $10,000) (Preferred Mutual Fund Families, 2005). To dodge this new rule, all a brokerage firm

needs to do is push a more expensive fund to avoid best execution policies tied to fund levels.

The Commission's efforts cannot seem to strangle the brokerage industry with too tight a grip, but it cannot have too loose a hold either. A line down the middle of the road should be drawn where there is enough regulation to protect investors without being too laissez-faire. The amendments to rule 12b-1 are not powerful enough to fully outlaw directed brokerage. A company like Merrill Lynch can still get away with directed brokerage if they have "policies and procedures" designed to promote best execution. However Merrill Lynch executes their trades, they win. Merrill Lynch only offers funds to its investors when fund companies pay them fees to promote them. Rule 12b-1 only requires policies of best execution tied to the level of fund sales, not the funds themselves. Merrill Lynch and Edward Jones will not be fazed by the new amendments to the rule because they are not strict enough to adequately protect investors.

To better address the problems in the brokerage industry regarding hidden conflicts of interest, regulators should be more specific as to what "full disclosure" actually means. Any rule passed has yet to say that a broker-dealer is required to inform his/her client of the potential conflict of interest. Currently, a broker-dealer need only hide the details of a possible conflict in paperwork. Without being too strict, but still managing to better protect investors, the Commission should be more rigorous and definite about its disclosure requirements. The SEC could require that all investors, before the time of sale, acknowledge that they have been informed by their brokerage firm of a potential conflict of interest. A rule like this will not diminish the potential

conflicts but will at least put the conflict on the forefront and the problems will cease to be hidden from investors.

To address the shelf-space payments, stricter rules are also needed to help resolve the potential conflicts of interest. Directed brokerage, regardless of the policies and procedures in place to help promote best execution practices, should be illegal. As shown before, even with best execution policies, firms like Edward Jones and Merrill Lynch can still have a conflict of interest with their clients. The current rules regarding directed brokerage and best execution requirements are tied to the level of fund sales. New rules tied to the fees paid by fund companies to brokerage firms should be put in place. Fund companies should not be allowed to use shareholders' assets to make payments to brokerage houses, like Edward Jones and Merrill Lynch, which only offer funds that have paid for shelf space. The rule should be, flat-out, that it would be illegal to use shareholders' assets to make payments to brokerage house for directing a company's business; all forms of directed brokerage need to be illegal in order to better protect the investor.

As for the other form of paying for shelf space: revenue sharing agreements, fund companies and brokerage house will insist that because fund companies make the payments from their own pockets, no one is hurt. This is not true. A potential conflict of interest still exists between the brokerage firm and the investor. Just because the fund company makes payments from its own assets and not the investors', it does not mean that the brokerage firm is any less pressured to push those preferred funds. In cases of revenue sharing, regulators should require more blatant forms of disclosure to clients about the potential conflicts.

To better protect and inform the investor, the Securities and Exchange Commission could make a rule requiring that brokerage firms state outright to investors in every instance of transaction, whether they are influenced by a revenue-sharing agreement with the fund company. A written agreement should be read and agreed to by the investor before the sale. This rule would not lessen the potential conflict of interest, but by making it better known to the investor, the investor could make a more informed decision about the fund that he/she was buying.

CONCLUSIONS

"A customer has the right to know what the incentives are when the selling broker recommends a particular fund family" (Labaton, 2004). The issues surrounding potential conflicts of interest have been discussed. The current examples of hidden conflicts of interest have been highlighted. Shelf-space agreements, both revenue-sharing agreements and directed brokerage agreements, have been evaluated for potential conflicts of interest between brokerage firms and investors. While revenue-sharing agreements do not require payments from shareholders' assets, they still pose a threat to investors. Even though directed brokerage agreements have been deemed illegal by the Securities and Exchange Commission, fund companies and brokerage firms can still find ways to sidestep the rules. Stricter rules must be put in place by regulators. Without tightening its grasp so much to choke the industry, the SEC must put in place better rules to protect investors. Shelf space agreements, in the form of revenue sharing, should still be legal when the proper disclosure is made. For proper disclosure, a brokerage firm

must be required to communicate to the client frankly that a potential for a conflict of interest exists and seek acknowledgement from the client before making any sale. This way, regulators will not too tightly control the industry and the investing public will be better informed and protected.

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Mutual Funds

Mutual Funds

About Mutual Funds

Preferred Mutual Fund Families, Including Information About Revenue Sharing

Mutual Fund Glossary

Preferred Mutual Fund Families, Including Information About Revenue Sharing

With thousands of mutual funds in the marketplace today, you may be overwhelmed by the task of selecting an appropriate fund. Edward Jones believes that you are better served if the firm focuses on a select group of mutual fund families that offer a broad spectrum of mutual funds. Out of the many mutual fund families we offer, Edward Jones has designated seven fund companies as "preferred families."

Presently, Edward Jones' preferred fund families are:

- American Funds
- Federated Investors
- Goldman Sachs Group
- Hartford Mutual Funds
- Lord Abbett Funds
- Putnam Investments
- Van Kampen Investments

What does it mean to be a preferred family?

Edward Jones exclusively promotes preferred fund families on this Web site and in other mutual fund and 529 plan marketing materials. The preferred fund families have greater access to our investment representatives to provide training, marketing support and educational presentations. Consequently, while our investment representatives may sell, and our customers are free to select funds from many mutual fund families, as discussed below, there are financial incentives associated with the sale of preferred funds. Virtually all of Edward Jones' transactions relating to mutual funds involve preferred family funds.

If you own a preferred fund, or if you are interested in our preferred fund families, we want you to be aware of our revenue sharing arrangements. Edward Jones receives payments known as revenue sharing from the preferred fund families. While the receipt of revenue sharing is among the factors that determine whether a fund is treated as "preferred," such payments are not the only factor considered in deciding which fund families are designated as preferred. Edward Jones' investment representatives and equity owners benefit financially from the receipt of revenue sharing payments from the advisers and distributors of the preferred fund families. The firm does not receive revenue-sharing payments from any non-preferred mutual fund families.

These revenue sharing payments are in addition to standard sales loads, annual service fees (referred to as Rule 12b-1 fees), expense reimbursements, sub-transfer agent fees for maintaining customer account information and providing other administrative services for the mutual funds (shareholder accounting and networking fees), and any reimbursement for education, marketing support and training-related expenses. For more information about fees, please see About Mutual Funds.

Revenue sharing, as received by Edward Jones, involves a payment from a mutual fund company's investment adviser or the company that distributes a mutual fund company's shares. Revenue sharing is calculated in different ways by the different preferred funds. For instance, some fund distributors or advisers pay Edward Jones a fee based on the value of assets under management. This is called an asset-based fee. This generally means that each year you maintain your holdings in a preferred mutual fund, Edward Jones is paid by the fund company adviser or distributor. For example, if you made a $10,000 preferred mutual fund purchase and held it for a year, and its value remained the same, Edward Jones would be paid by the adviser or distributor .075% or 7.5 basis points. That would translate to a $7.50 payment from the preferred fund's distributor or adviser to Edward Jones for the $10,000 investment in your account. For every subsequent year you held that $10,000 preferred mutual fund investment in your Edward Jones account, the fund's distributor or adviser would make a $7.50 payment to Edward Jones, assuming no change in the value of your $10,000 investment. Asset-based payments will increase or decrease from year to year with changes in the value of fund assets held by Edward Jones' clients. Again, this payment is not an additional charge to you by the mutual fund company or Edward Jones, but comes from the fund company investment adviser or distributor.

Other distributors or advisers may pay Edward Jones a fee for each share of the fund that Edward Jones sells. This is referred to as a sales-based fee and is based on the dollar value of your purchase. For example, a preferred mutual fund distributor or adviser may pay Edward Jones .125% or 12.5 basis points for each dollar of shares purchased by you. Therefore, if you purchase $10,000 of that preferred mutual fund, its adviser or distributor would pay Edward Jones $12.50 for that transaction. This payment is not an additional charge to you by the mutual fund company or Edward Jones, but comes from the fund company investment adviser or distributor.

There are, as noted above, other formulas and types of revenue sharing. The chart below summarizes Edward Jones' revenue sharing arrangements by identifying the preferred fund family, the name of the entity that actually pays the revenue sharing to Edward Jones, the amount of revenue sharing that Edward Jones receives from each of the preferred families based on $10,000 of assets purchased ("Sales Fees") or held by a client ("Annual Asset Fees"), and the total amount of revenue sharing in dollars that Edward Jones earned from each preferred fund family adviser or distributor from January through November 2004.

Preferred Mutual Fund Families Revenue Sharing Summary

Description	American Funds[4]	Federated[5]	Goldman Sachs	Hartford[6]	Lord Abbett	Putnam	Van Kampen
Annual Asset Fees[1] (Based on $10,000 of fund assets	$3.27	$10.00	$14.18	$20.69	$10.00	$7.50	$9.45

owned)							
Sales Fees[2] (Per $10,000 of fund assets purchased)	$0	$0	$0	$12.11	$0	$12.50	$21.97
Total Earned January - December 2004[3]	$29.2 million	$1.4 million	$4.1 million	$18.1 million	$11.5 million	$10.6 million	$14.3million
Paid by	American Funds Distributors, Inc.	Federated Investment Management Co.;	Goldman Sachs Asset Management, L.P. and/or	Hartford Investment Financial Services,	Lord Abbett Distributor LLC	Putnam Retail Management Limited	Van Kampen Funds, Inc.