

MDP ASSOCIATES LLC

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Reversal of the “Merrill Lynch” Rule--what it is and how it may affect your investments:

Before getting into specifics, it is important to understand the difference between a broker and an investment advisor. (I am an advisor, not a broker.) A broker is an intermediary between buyers and sellers whose function is to execute purchases and sales of stocks, bonds, mutual funds, options, other financial instruments, or property. As such a broker does *not* have a “fiduciary” responsibility to act in the clients’ financial interests. In contrast an advisor acts on behalf of clients and does have fiduciary responsibility. One important distinction is that an advisor will usually have discretionary authority over client accounts. That means permission to place orders and take other actions without first getting approval from clients. Brokers often do not have such authorization, so they must get client approval, usually through a phone call, before placing orders in client accounts. However, some brokers also act as advisors, which can lead to confusion.

Brokers and advisors are regulated by the SEC and states in different ways. In general, the standards and requirements are stricter for advisors because they have fiduciary responsibility. Brokers typically are paid through commissions on transactions. Advisors may be paid that way if they are also brokers, but most such as me choose to be paid as a percentage of the assets under management.

Some brokerage firms have arrangements where client accounts are charged an annual fee based on the size of the account, which is similar to how I charge clients. If the individual broker, usually called an account representative, has discretionary authorization over the account, in effect that person is acting as an investment advisor. At Merrill Lynch’s request, the SEC ruled that the individual representatives who were licensed as brokerage agents did not also have to be registered and licensed as investment advisors. With this ruling, persons acting as investment advisors were not subject to the more stringent requirements and regulations applicable to a registered investment advisor (RIA) compared to those for broker’s representatives.

The ruling raised objections from the RIA community and financial planners on the grounds that it was an end run around RIA regulations. The problem is that those with discretionary authority were not being held to fiduciary responsibility standards. A recent ruling by a federal court said the Merrill Lynch rule was improper for these reasons. The SEC could have appealed the decision but decided to accept the ruling, which revokes the rule.

How it may affect your investments: If you have an account with a brokerage firm for which you are charged a fee based on the account assets and the broker has discretionary authorization over the account, this arrangement may no longer be valid. If your account representative is also an RIA, then no changes are needed since he or she is subject to the stricter regulation. An article in the May 17 *Wall Street Journal* discusses the alternatives, how you interact with the firm, and possible increased investment costs.

An important factor is how much attention you want to pay to the day-to-day management of your investment accounts. An advisor with discretionary authorization can provide the convenience of taking care of all the buy and sell decisions and placing the appropriate orders in your accounts. I provide that service for clients. If your account that I manage is with Fidelity, and most of my client accounts are, then I can manage accounts with virtually any type of investment. While I focus on mutual funds offered by Fidelity and some other companies, your Fidelity accounts can also own stocks, exchange traded funds, bonds, options, and many “alternative investments”. While not rock bottom, Fidelity’s commissions for most transactions are quite reasonable and much less than those charged by brokers such as Merrill Lynch.

I started as an investment advisor trading sector funds and have gradually expanded the types of investments and strategies that I employ. I am continuing to do so and now can offer active management for a broad range of investments including precious metals and real-estate funds. I recently attended the annual conference of the National Association of Active Investment Managers (NAAIM). This one had an unusually large number of speakers discussing innovative investment ideas and techniques. I never accept what others promote without doing my own research and analysis. Usually the ideas need some modification to make them suitable for my purposes. I am looking at some from the conference. I will implement those that I feel are worthy in a personal account to get some hands-on experience before offering them to clients. Several times that experience has revealed that the method while looking good “on paper” (actually in a spreadsheet) would not be suitable in the real world of client accounts.

If you are interested in discussing additional types of investments in your accounts or talking about my management of your accounts or your financial concerns, please get in touch with me.

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