

# Investment Advisers Craft Fee Rebate Programs

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Recently-publicized fee rebate programs may signal a coming trend, as investment advisers seek to market strong cultures of client service and responsiveness. For example, in August, the Securities and Exchange Commission (SEC) staff issued a no-action letter for a program under which a TD Ameritrade-affiliated adviser automatically rebates advisory fees to clients that invest pursuant to model portfolios that experience two consecutive calendar quarters of negative performance. This follows Charles Schwab's announcement last December of a program that permits clients who are for any reason "not happy" with the advisory services provided to request refunds of the most recent quarter's advisory fees. Because advisory fee rebates can make the adviser's compensation to some extent contingent upon an account obtaining a certain performance level, TD Ameritrade sought SEC guidance because its program might be construed to violate the Investment Advisers Act's general prohibition on adviser compensation that is based on capital gains or capital appreciation in a client's account. This prohibition reflects Congress' concern that such compensation schemes could encourage advisers to take undue risks and speculate with client assets on a "heads I win/tails you lose" basis. However, this type of conflict is largely absent under the circumstances of both the TD Ameritrade and Schwab programs. For instance, the TD Ameritrade adviser will hire an independent adviser to make the investment decisions for the model portfolios, from which the TD Ameritrade adviser will have only limited discretion to deviate (such as for tax-related considerations and client restrictions). Under the Schwab program, dissatisfied clients may obtain fee rebates regardless of account performance. Therefore, any relationship between the adviser's compensation and any capital gains or capital appreciation is attenuated, at best.

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