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April 13, 1995

REPORT OF THE COMMITTEE ON COMPENSATION PRACTICES

April 13, 1995 TO: SEC RULES COMMITTEE No. 56-95 RE: REPORT OF THE COMMITTEE ON COMPENSATION PRACTICES ____ The Committee on Compensation Practices, chaired by Daniel P. Tully of Merrill Lynch & Co., Inc., recently issued a report on compensation practices in the brokerage industry. SEC Chairman Arthur Levitt requested the formation of the Committee in May 1994 as part of a program to address concerns about actual and potential conflicts of interest in the retail brokerage business. A copy of the report is attached. The CommitteeGs mandate was three-fold: (1) to review industry compensation practices for registered representatives (brokers) and branch managers; (2) to identify actual and perceived conflicts of interest for both brokers and managers; and (3) to identify the "best practices" used in the industry to eliminate, reduce, or mitigate these conflicts. In preparing the report, the Committee solicited input from industry, consumer groups, brokerage firms, and individuals. Several practices that create the potential for conflicts of interest are identified in the report, including the use by brokerage firms of transaction-driven compensation, sales contests, differentiated compensation by product or source of product, undisclosed bonuses, and higher commission payouts paid to transferring brokers. The report also underscores the idea that "full disclosure of . . . compensation practices . . . can reduce the potential for conflict and abuse." The report further identifies those "best practices" (i.e., activities that are most effective in serving the interests of all parties to a retail sale or service transaction) presently being used by firms in the brokerage industry. These practices include, among others, paying identical commissions to brokers for proprietary and non-proprietary products within a product category; paying a portion of compensation based on client assets in an account, regardless of transaction activity; prohibiting sales contests; deferring a portion of brokersG compensation or using stock options or stock purchase plans as part of compensation; and eliminating up-front bonuses paid to brokers. Finally, the report describes the roles that both senior management of brokerage firms and investors can play in mitigating conflicts. Alexander C. Gavis Assistant Counsel Attachment