

DON P. MATHESON & CO.

Investment Advisors Act of 1940 - Section 206

Sep 1, 1976

TOTAL NUMBER OF LETTERS: 2

SEC-REPLY-1:

Our Ref. No. 76-IA-247

Don P. Matheson and Company

File No. 801-1588-3

**RESPONSE OF THE BRANCH OF INVESTMENT ADVISER REGULATION
DIVISION OF INVESTMENT MANAGEMENT**

This responds to your letter of December 1, 1975 concerning the fee arrangement employed by Don P. Matheson & Co. ("Matheson"). We regret the delay in our reply, which resulted from the press of other work as well as the need to seek additional clarification of the somewhat novel arrangements you have described.

Based on your letter and your telephone conversation with a member of our staff on May 6, 1976, we understand the facts to be as follows:

Don P. Matheson & Co. is a dually registered investment adviser/broker-dealer furnishing advisory services to clients on both a discretionary and non-discretionary basis. Apparently, Matheson also acts as broker with respect to recommended transactions for its advisory clients.

Matheson's fee for its advisory service is determined, at the election of the client, either on a "per transaction" basis or on a flat annual basis calculated as a percentage of the total current market valuation of the portfolio under management. The per transaction advisory fee is, in effect, a double commission charge.

After reviewing the disclosures you propose to make to clients pursuant to revised paragraphs 6(a) (i) and 6(b) in the advisory agreement, there appear to be a number of disclosure problems under the antifraud provisions of the Investment Advisors act of 1940 ("Act").

The per transaction fee appears to involve a conflict of interest, since Matheson is compensated only when it recommends a particular transaction. Under these circumstances, Matheson may have an incentive to recommend transactions with a frequency which may not be consistent with a client's best interests. Consequently, we believe it is necessary to fully and completely inform clients of this conflict.

Revised paragraph 6(a) (i) states that "[with] the advent of fully negotiated commission rates on May 1, 1975, there is no established rate structure to which all firms adhere. It is our intention to select the rate structure of one such member firm upon which our charges will be based. Upon request, you will be given the name of that firm and a full disclosure of the fee structure being applied." A client should be able to assess the fees he will be charged at the time he enters into an advisory agreement. Accordingly, we believe that Matheson should furnish at least a statement of the fee structure prior to entering into any investment advisory agreement with clients.

You have indicated in a telephone conversation with a member of our staff on May 6, 1976 that the brokerage commission fee schedule presently employed by Matheson is the same as that of one particular broker-dealer, regardless of the securities exchange or market in which such transaction occurs or the actual cost of executing the transaction. This would appear to conflict with the first two sentences of revised paragraph 6(a) (i) of the "Letter of Agreement," which indicate that the per transaction advisory fee will be based on the brokerage commissions charged to individual customers by a member firm of the securities exchange upon which such issues are normally traded and that for issues not traded on a national securities exchange, the advisory fee will be determined as if the security were listed on the New York Stock Exchange and traded through such member firm.

In view of the fact that your advisory clients appear to be executing recommended transactions through your firm, it is our view that, under the antifraud provisions of the Act, you should inform your investment advisory clients of their ability to seek executions of transactions recommended by your firm through other broker-dealer firms. In addition, your clients should be advised that, as a result of your fee structure, brokerage customers will not benefit from any savings in execution costs which you may bring about through favorable negotiation of commission rates, bunching of orders, selection of a particular exchange or other market for a given transaction, or otherwise. Also, to the extent that the brokerage commission rates utilized by the broker-dealer you have selected as the standard for your own commissions reflect the provision of services (such as research) in addition to mere execution, your brokerage customers would be paying commissions which are partially based on services they may not be receiving.

We suggest that you communicate with our Division of Market Regulation in order to determine whether your method of charging brokerage commissions is appropriate from the standpoint of your responsibilities under the Securities Exchange Act of 1934. In any event, we believe that, pursuant to the antifraud provisions of the Investment Advisers Act, full disclosure of the matters discussed in the preceding paragraph should be given in meaningful terms to all advisory clients, particularly those whose advisory fee is determined by your brokerage commission rate structure.

Please let us know how you intend to resolve the disclosure problems discussed above.

Seymour Spolter, Special Counsel
Branch of Investment Adviser Regulation

AUG 2 1976

INQUIRY-1:

**Matheson & co.
1501 LAKE DRIVE, S.E.
GRAND RAPIDS, MICHIGAN 49506
PHONE 459-6175**

December 1, 1975

**Mr. Seymour Spolter
Special Counsel
Branch of Investment Advisor Regulation
Division of Investment Management Regulation
Securities and Exchange Commission
Washington, D.C. 20549**

Sir:

This will acknowledge receipt of your form reply to my letter of November 17, 1975 addressed to Mr. Alan Rosenblat. I have noted that the letter has been referred to Mr. Stanley Brand and the Reference No. 75-1057CC assigned to it. The enclosed release dealing with the procedure to be followed in requests for interpretative letters was also appreciated.

This letter will deal with another matter which was raised during a recent examination of my investment advisory operation by a representative of the Chicago regional office. After several preliminary exchanges of correspondence and conference phone discussions, Mr. Edwin I. Harmelin, attorney with that office, requested that I correspond direct with you concerning my proposed solution.

Enclosed is a copy of the Letter of Agreement form which is currently employed by us to set forth our relationship with investment advisory customers. I call your specific attention to Paragraph 6 of such

Letter of Agreement which is the subject of the Chicago office's concern.

This Paragraph offers the customer an alternative of selecting a flat rate annual fee based upon the total current market valuation of the portfolio (the customary basis upon which investment advisory fees are levied), or a "per transaction" charge which is, in effect, a double commission charge since, as stated, it is to be an equal amount, in addition, to the normal stock exchange brokerage commission for common and preferred stocks and a stated figure for bond transactions. The Chicago office stated their concern as follows:

"With regard to the latter alternative of computing fees on a transaction basis, it would appear that under certain circumstances (i.e., accounts with aggressive objectives or where market conditions necessitate repeated purchases and/or sales) it could result not only in the charges being substantially higher than those computed under the firm's other fee alternative, but, in addition, could also result in your fees being greater than those charged by other advisers for similar services."

As further background, I should like to point out that this method of compensation has been offered and widely agreed to by our customers for over 17 years. I was advised that the examiner made some limited test of total charges incurred by our accounts and did not find any instances where "per transaction" charges totaled amounts which, in his opinion, were excessive. This "counseling fee" is separately set forth on our purchase and sale confirmations (copy enclosed) so that the customer is, at all times, aware of the fact that this extra charge is being collected.

The Chicago office's concern continues:

"It should also be noted that if the yearly advisory fee paid by any particular client on a transaction basis was substantially greater than the client would have paid other advisers for similar services, it would be difficult for us to conclude that such a client in possession of all material facts, would continue to agree to such a fee arrangement."

In my reply, excerpted below, I acknowledge that certain types of accounts could potentially create the sort of circumstance that concerns Chicago. However, in practice, it is unlikely since I do not accept trading accounts, as such, and few other investment advisers handle what I consider to be small accounts (\$25,000 and under).

"I am fully aware of the possibility that in a given year, the "per transaction" fee basis could potentially result in my company receiving greater income from an investment advisory account than would be generated by our usual fee basis. This could result from (a) an active trading account, (b) the initial investment of a complete portfolio from funds previously held in savings, or (c) a small account. It has been my practice to carefully point out this situation to each new client. One of the problems I see in your position as set forth in your letter is the inference that you would view the income generated on an annual basis. There is no way, for example, that the normal activity in one of our accounts would, over a period of time, generate more fees for us on a "per transaction" basis that would be charged as a specified percentage of the total portfolio. However, in any given single year, that circumstance would possibly arise."

Set forth below are some typical accounts, showing portfolio valuations as of December 31, 1974 and the total amounts of investment counseling compensation collected from them for the year of 1974. This data is taken from Federal income tax returns for the clients listed:

Client	Portfolio Value	Counseling Fees
Winona A. Cayvan	\$ 127,820	\$ 357
Kenneth H. Gelders	70,156	280
Carl W. Geske	439,899	1,226

Client	Portfolio Value	Counseling Fees
Harmon D. Ingwersen	56,522	478
Anthony B. Parker	42,517	- (*)

(*) Minimum \$50.00 charge billed in 1975 for 1974.

During the course of my discussions with Mr. Harmelin and his associates, I raised another point which I felt should be set forth in any revision of the compensation Paragraph 6 of the Letter of Agreement. With the advent of fully negotiated commission rates, no single member firm of an exchange necessarily charges the same brokerage fees as any other member. I propose, then, to revise Paragraph 6 (a) (i) as follows:

(i) In the case of common stocks, preferred stocks, warrants, rights, and/or options an amount shall be charged for investment advisory services which is based on based on non-discounted rates charged to individual customers by a member firm of the securities exchange upon which such issues are normally traded. For issues not traded on a national securities exchange, the amount to be charged will be determined as if the security were listed on the New York Stock Exchange and traded through such member firm. With the advent of fully negotiated commission rates on May 1, 1975, there is not established rate structure to which all firms adhere. It is our intention to select the rate structure of one such member firm upon which our charges will be based. Upon request, you will be given the name of that firm and a full disclosure of the fee structure being applied.

In addition, after Paragraph 6 (b), there will be inserted the following caution:

In selecting the alternative fee schedules set forth in (a) and (b) above, you are cautioned to bear in mind that, under certain circumstances such as unduly heavy trading activity or the initial investment of savings in a complete securities portfolio, the "per transaction" charges levied in (a) could exceed the amount otherwise chargeable under (b) for any given single year. Over an extended period of time, it is our firm conviction that alternative (a) will result in the lowest overall cost to you for such investment advisory services.

May I suggest that you advise me if you have any objections to the suggested revisions and additions to the Letter of Agreement to comply with the concerns of the Chicago office. Kindly send them a copy of your reply since I am supplying them with a copy of this letter at their request.

Thank you,

Don P. Matheson