



Institutional Brokerage Services for Advisors
Member FINRA/SIPC/Reg'd MSRB

9845 Erma Road, Suite 312
San Diego, CA 92131
Phone (858) 530-1031
(800) 380-7370
Fax (858) 530-1820

February 2, 2009

Dear Advisor,

The Madoff scandal has caused investors to be wary with their investment relationships, and rightfully so. To help you address client concerns, we have outlined a number of important considerations regarding how we protect client assets and how our firms are different from Madoff & Company. We have also included a recent article from ABC News and an informative overview regarding our clearing arrangement which can be presented to clients.

How your firm is different from Madoff & Company.

1. As an independent RIA you are regulated by the SEC or by the state regulators where you do business. Madoff however apparently operated as an unregulated hedge fund for most of the time, so there was no similar regulatory oversight—at least not until 2006, when he became a registered investment advisor. You submit to periodic inspections by the SEC or by your state authorities. After becoming an RIA, Madoff apparently never did undergo a full SEC audit.
2. You are not affiliated with your custodian or with the brokerage firm that holds your clients' investments and handles your trades, which was apparently not true of the Madoff business. Madoff operated both a brokerage firm and an advisory firm.
3. As an independent advisor, you do not have the ability to hold your client's assets on your books, nor do you have full power of attorney as per client authorization. You only have the ability to effect trades in client accounts, charge advisory fees, and request checks payable to the client to be sent to their address of record. Madoff apparently had the ability to convert assets or transfer ownership of assets from one account to another and from one firm to another, so he had unimpeded control. We require the authority of the owner of the assets to accomplish these things.
4. Shareholders Service Group is an SEC registered broker/dealer, not an investment advisor. We are regulated by the Financial Industry Regulatory Authority (FINRA, www.FINRA.org), and we are a registrant of the Municipal Securities Rulemaking Board (MSRB, www.msrb.org). These regulators are different than the ones that regulate your advisor business, which affords additional layers of regulatory oversight and protection for you and your clients. FINRA reviews our business independently of any review of your business by the SEC or your state. We report daily and monthly on a number of trading and asset metrics and we undergo periodic inspections. Our last examinations were in 2007 and again in January 2009.
5. By regulation, we calculate our net capital monthly, or daily if there's any question, and we must notify FINRA and the SEC if it comes within 120% of our minimum required capital. Hedge funds have no similar requirement. They can lose all their clients' money. We file a full statement of financial condition quarterly with the SEC and FINRA.
6. We are a clearing correspondent of Pershing LLC, where all of our client accounts are held in custody. Pershing is owned by Bank of NY Mellon which is the oldest bank in the country and the largest asset custodian in the world with over \$20 trillion in assets. Because of our clearing arrangement, there are 3 layers of independent control, 3 layers of independent regulatory oversight, and 3 sets of financial reporting. Each firm must have its own capital and must remain

solvent. If something bad happens to BNY Mellon, each account is insured, and we can move our client accounts to another clearing firm, if necessary. If something goes wrong at our firm, Pershing can step in and move the client accounts to another firm without disruption.

7. The regulation described in items 4 and 5 above also apply to Pershing, our clearing agent, which is also an independent broker/dealer. Pershing's Statement of Financial Condition is sent to clients annually, and it is available online at www.pershing.com.
8. Clients receive a full statement of positions, balances and account activity monthly or at least quarterly from a source that is not affiliated with you or with Shareholders Service Group. Hedge funds do not have the same requirement.
9. As a member of the Securities Investors Protection Corporation (SIPC), our client accounts are covered by insurance protection up to \$500,000 including \$100,000 for claims of cash. In addition to the SIPC account coverage, we have excess coverage from Lloyd's of London to protect your clients' assets up to an overall aggregate level of \$1 billion for assets in custody, including up to \$1.9 million in cash awaiting reinvestment per client account. This provides the highest level of protection available in the industry today. For more information about Lloyd's of London visit www.lloyds.com.
10. We undergo a full financial audit annually of all our accounts and financial operations by an independent certified auditor. Our auditor is Breard and Associates in California, an independent public accounting firm registered with the Public Company Accounting Oversight Board (PCAOB). Our audited financial statements are filed with the SEC, FINRA, and with state regulators where required.
11. Many of the large firms that have recently experienced problems had or have very complicated portfolios. Their balance sheets can look fine one day, but as we have seen, they can be bankrupt the next. In the case of some of the big wirehouse firms, it seems that no one really knew what all the risks were. It's still not clear if they are out of the woods yet. They run complicated businesses, acting as both custodians and investment bankers. By contrast, the simplicity of our business limits risk. We don't have any debt. We do not have any position trading accounts or proprietary inventory in any illiquid investments nor do we make markets. Our business risks are limited to our capacity as a custodian and basic trading functions. In short we don't have any investments that could "blow up" and jeopardize our advisors or their clients.
12. We do not operate a "financial supermarket" or wirehouse brokerage company, where one division can bring unforeseen risk to the whole firm. As a result of our size, we can be more responsive and flexible, and it actually affords clients additional protections and benefits. We don't have a retail division or investment banking, which add different sets of risks and interests that may create internal competition for capital, time and other resources. Nor do we have outside shareholders pressing for new and increasing sources of revenue. Our company is employee-owned. Our ownership structure and our size are also of benefit when it comes to service. We are focused on serving advisors only. If our advisors are happy, we are happy.

Please feel free to contact me if you have any questions or if you wish to discuss this further.

Sincerely,

Peter Mangan
President & CEO