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Public Hearing on Definition of Fiduciary
EBSA's Office of Regulations and Interpretations,
Attn: Public Hearing on Definition of Fiduciary
Room N-5655
U.S. Department of Labor
200 Constitution Ave. NW
Washington, DC, 20210

RE: U.S. DEPARTMENT OF LABOR
EMPLOYEE BENEFITS SECURITY ADMINISTRATION
DEFINITION OF FIDUCIARY INVESTMENT ADVICE

Gentlemen,

I have reviewed all the comments on both days of the testimony, positions by the financial planning community, Schapiro's comments on the necessity of consumer education and just about everything else in regards to knowledge and competency for 'broker's, planners, arbitrators, attorneys et al for over two decades. There are lots of pros and cons regarding who should do what, are commissions the devil incarnate, are fee advisers absolved of ethical conflicts (not even close) but nary a word on whether the advisers identified can act under suitability rules never mind fiduciary. No they can't.

Brokers?

Neither the DOL nor the industry understands the problem. In fact, the DOL panelists are validating deceit of the industry in their own testimony. And the bulk of testimony from participants could be an attempt to validate an egregious deception to the DOL, consumers and just about everyone else.

What is it? You are all using the term '**broker**' in the two days of testimony. That is almost a complete lack of understanding of what goes on in the real world. Here is a sample:

"Independent broker/dealers and their **representatives** are especially well suited to provide middle-class

Americans with the investment products and services necessary to achieve their retirement security and other financial objectives and goals.

When I call my **broker** and say, "Bernie" "what should I buy?"

But if I ask my **broker** to send me his firm's research on Cisco, and that research contains a buy rating and a price target available to all the firm's clients, that advice is not individualized and arguably should not carry with it fiduciary responsibility, at least when it's provided to plan fiduciaries.

If all **brokers** who provide market color or investment information are deemed to be fiduciaries regardless of the intentions of the parties, the vast majority of commission-based accounts may move towards fee-based asset arrangements.

The Department's proposals would deem a **broker** a fiduciary merely because it is complying with industry rules intended to set standards for **brokers** who are not **investment advisers**."

The DOL's expanded definition of fiduciary is expected to limit **brokers'** ability to recommend their firms' proprietary investment products to employers, and to prohibit them from collecting commissions from product sponsors.

Brokers can continue working with plan clients as recordkeepers without accepting the fiduciary standard of care, but some plan sponsors might want to bring in third-party plan advisors to help them make fund selections."

End

The point is that there are **no** retail brokers left in the U.S. They have been called various monikers for decades. First it was 'vice president' or 'senior vice president' depending on the amount of commissions generated. In the late 90s the titles expanded to include 'financial planners, advisers, consultants, wealth manager' and more all with the clear intent to show that the individual agent has an extended ability to apply far greater competency than just acting as a sales person.

Go into Wells Fargo, BofA, Chase, Merrill etc. all across America and one is inundated galore with supposed professionalism with all the signs pointing to 'financial whatever's'. But not a single card with the term broker or registered representative. You have to live in a tomb to miss this clear marketing attempt to sway the naive consumer to utilize one of a firm's unknowledgeable reps (lack of fundamentals).

In testimony last year in an arbitration I stated that if you are want to be called a financial 'whatever' you must be held accountable to that level of competency. The defense attorney asked if the use was illegal. It is not. But it absolutely is a breach of a fiduciary duty, suitability et al to attempt to state you are something other than what you are. To sway consumers with marketing may be OK with a Bud Light commercial, but the allowance in marketing for lifetime assets to 'brokers' who have had nothing more than a one week course in securities is patently absurd.

I repeat- there have not been any retail brokers for over a decade. It is a travesty to the public to allow this. Fix this now. It is an absolute breach.

Knowledge

This is *the key* to suitability and fiduciary ability. I find the inherent lack of knowledge in the industry to be absolutely abhorrent. And no one steps up and wonders why so much goes wrong. This is noted about the rule from 1975- “The advisor must (1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property and do so (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan.” OK- how???

Thirty five years ago there may have been some assumption about the knowledge and ability of a securities licensee. Not any more. Not even close. Specifically, “the adviser must render advice....” How? A series 7 is so sophomoric in its knowledge base since at least the mid/late 1980s, they are so far behind the times that they may never catch up.

There are two points to this- the first will invalidate most ‘brokers’ and broker/dealers from offering fiduciary advice to customers. (I am excluding appraisers and more that are outside my expertise and involvement.) I am directing my commentary to those that deal directly with the various plans covered by the DOL- for that matter, any organization or rule including ERISA, SEC, FINRA, state governmental entities and so on. And that is that a broker or registered representative, by definition those with a series 6, 7, 24, 63, etc., have never been taught the fundamentals of investing. It is disingenuous for any governmental organization to suggest competency (real life knowledge) in working with retirement plans, ERISA standards, providing education, etc. unless you know what the background of the agent is. I will repeat this statement again- the fundamentals of investing have never been taught to a broker, are not now, and may never will be unless and until the governmental entities have a clue to what a professional adviser must know. After all, if one does not know diversification by the numbers, under what scenario can any instruction, advice, education be passed on to the public? It is not just diversification that is missing in instruction for licensing- asset allocation, standard deviation, correlation, risk of loss, budgeting, efficient market theory, capital asset pricing, Sharpe ratio and on and on. No training in the use of a financial calculator. Why would anyone use an adviser who does not know how money works (though they try to indicate they have a computer at work. Not even close.).

There is nothing on ‘suitability’ in licensing since it effectively appears as a word only. *No real life application of product.* Of course one can say- and the industry does- that 20 or 30 years of experience is more than adequate time to address additional sophistication in the needed areas of investing. And one would therefore choose a witch doctor with 50 years of experience over that of a relatively new physician with a full medical degree and residency overseen by other professionals. A compliance officer or supervisor with none of the underlying fundamentals as a basis for a suitability determination is also a pretty useless decisionmaker save for the most mundane of issues (whatever those may be).

As for the attorneys at any of the firms- there is nothing in the education that offers the fundamentals of investing. Any subsequent position has to be based on a very limited opinion rather than the fundamentals of investing. Never meant one who understood the true meaning of diversification. Or an arbitrator. Admittedly there must be some- just never met any.

In fact, I doubt anyone that anyone at the DOL has bothered to learn diversification since my attempt in 1995 to suggest updated education to the fundamentals. No one knew what I was talking about. (*How many stocks must you have in a portfolio in order to insulate it due to unsystematic risk? If you do not know that, then you

cannot get to risk. If you cannot get to risk, you cannot get to suitability.) Sure diversification is *mentioned* in the series 7 classroom material but that is the extent (generally don't put all your eggs in one basket. And that means??? If it cannot be defined with numbers, it is pretty useless.) The bottom line is that the sale of most individual securities is a breach of suitability- and obviously fiduciary responsibility- because there are not enough stocks in the portfolio to keep risk 'acceptable'. As a result of that gross ineptness across all levels of industry knowledge, we had Enron, Worldcom, Adelphia and devastation on thousands upon thousands of retirees that should not have happened. Some basic education- none of which has stayed up with the times over the last 35 years- could have tempered much of the financial ruin and saved many a retiree.

Risk

Here is the second major problem. Whenever a portfolio is designed, where are the numbers for risk? Is there anything taught on risk of loss in a portfolio? No. So how is risk designed for the consumer? It starts with a complete hack job with client questionnaires. The *consumer* is required to indicate what their risk is. The consumer is going to the adviser to ask what they should do, not vice versa. The difficulty is that there are NO definitive standards for risk. What is conservative, moderate, aggressive, speculative? The answers would be totally variant for both consumers and advisers. And universally just as useless. There *must* be consistency in an explanation of risk.

That statement begs the issue- isn't risk known by standard deviation (SD)? No. How about volatility? No. Yet so many offerings to American consumers tend to include something about standard deviation as risk since so many 'brokers/advisors' use Morningstar reports. But there is nary a reader of these reports that has a clue to the annual standard deviation of the numbers mentioned therein (trick question which I doubt any reader will recognize. Hence the problem.)

It is true that SD goes down over time and that is what is presented- as though the *risk* goes down. It is a breach of duty to ever allow SD to be used even with some caveat or exculpatory disclaimer in the 'small print'. Why? It is the fact that the risk of LOSS goes up the longer you hold equities. How much you can lose is the key to deciding what one will do.

And where is risk of loss? Nowhere to be found. This lack of fiduciary focus is the reason we got into the mess in 2000 and further in 2008. An inability to teach what is necessary to consumers. If there had been some simple coursework identifying real life risk, a great number of Americans could have avoided the bulk of losses they have sustained. But the risk of loss is not generated in any of the computerized software by any firm dealing under DOL standards. Or ERISA. One cannot offer education regarding risk and reward without the necessity and ability to at least show the exposure to risk for effectively any allocation. It can be done. It must be done. If not, the Dodd Frank requirements are useless. (Most allocations will have at least a 50% possible loss over time- though that can be in as short as one year.) Every equities investor (401k in particular) needs a fiduciary to address that statistic (which can *only* be done by a personal financial calculator at present. Firms do not want to include it because it would open up difficult dialogue with the advisor and inherently reduce sales).

Further, any fiduciary viewing the economics before 2000 and 2008 should have identified the overriding economic risks. But where was the knowledge? Where was the real life element of the inverted yield curve. (It is a 100% indicator of a recession.) Unemployment. Real Estate. Dollar. Asia. Even if certain issues are touched upon, there are none of the potential implications in licensing preparation. In any case, what can one expect from a one week licensing course that does not include the fundamentals.

And while I am on the subject, where is correlation? No adviser, no software program can do an allocation without addressing the very difficult movement of one investment to another. A fiduciary must be able to do it. But it is not in the series 7, series 24, or any others, CFPs included. How can you even have suitability applied? You cannot. And one can sure not be a fiduciary. Since the subject is not addressed anywhere in any rule, I have to assume that the DOL, SEC, FINRA and more are clueless to what is necessary for fiduciary responsibility.

Returns

Testimony noted representations to consumers about returns- and of course the education under 401ks et al include various groupings of performance coupled with some pretty Powerpoint graphs. Almost universally they are based on past history that starts in 1900 or maybe 1925, or 1960 or ????? If one backtests (also not taught) enough, it is possible to make certain scenarios appear better or worse. No matter, past results are an emotional and professional crutch for advisors unwilling to spend time in the present and look to the future. One does not really have to read or think- just let the computer dump out an allocation that is the same for just about anyone and then sit back with a buy and hold and reap the money from fee advisement. Just where has the broker/advisor added value?

Doing nothing can work- if one is lucky. It also is the reason we are in the financial devastation we are now in. Yes, there might be some sophomoric commentary about risk- returns are not guaranteed, etc. Not good enough when risk of loss can be calculated for each consumer's allocation. It can be taught- but again, one needs a personal financial calculator. And the use of a financial calculator is not required by a broker. Nor attorneys dealing in any securities matters. Nor compliance officers. Nor supervisors with a series 24, nor arbitrators. How is anyone going to be a fiduciary to a plan without knowing how money works? They cannot.

Registered Investment Advisers

Next is the competency of Registered Investment Advisers per se. While the SEC regs demand a fiduciary duty to consumers, where is the knowledge to justify it? There are a few CFAs, PhDs, MBAs in the mix but the bulk of the RIAs came from the brokerage industry and used the series 7 as the background for the RIA (like myself in 1984). Hence the comment- the fundamentals are not there either. And recognize that there are NO continuing education requirements. So why is it not apparent that the lack of knowledge was one of the key reasons for the failure of so many allocations in 2000 and 2008?

Annuities

There have been comments about the inclusion of annuities in the education and inclusion in 401ks. Where will this education come from? Certainly not from RIAs. There is nothing that covers indexed annuities, step ups or guaranteed income streams. Anyone doing this is going to have to have a insurance license and/or a mandatory fee insurance license from the 30+ states that require one. Otherwise how can they present the appropriate knowledge, experience or competency?

Life Insurance

No education of retirement can be done without covering the policies that are already in existence. For the purposes of this short paper, I will exclude the issues about the necessity of having insurance when one is younger. It is the fact that many retirees already have insurance purchased decades ago. Perhaps there is an idle

comment about the decision of whether one needs to keep old insurance that may no longer is needed or too expensive and that would be it. So just surrender the policy. And that would be wrong. Unneeded policies for the old or sick become an asset that can be sold for greater than the existing cash surrender value. A fiduciary has to know what a life settlement is and how they work. This asset could greatly assist many retirees.

Long Term Care

No retirement education can exist without addressing the need to cover for the eventuality of assisted living and nursing home care. It is expensive and while not being an absolute statistic, it must be formally addressed in the retirement budget. An RIA has no background in annuities, life insurance, life settlements or long term care. A fiduciary explaining retirement is responsible for all of these sections and more.

Summary

I have read most blogs, articles, reports, presentations, etc., on fiduciary duty for decades and nary a one has ever mentioned competency via knowledge. FINRA doesn't want to rock the boat; the SEC is... well the SEC and guided by a commissioner who refused to include the fundamentals of investing when at FINRA; state governmental entities - like the others- are underfunded and not all that competent either. All have been swayed, cajoled and marketed to maintain the status quo over the past 35 years. It is financially beneficial for the industry. Knowledge would certainly slow sales. When I went to the NASD in the mid 90s with a proposal to instruct arbitrators, I was told that the industry would never allow it since it would slow sales (true). In the mid 2000s with another 'suggestion' to increase education overall, I was met with Schapiro's office that FINRA was a procedural entity, not a substantiative one. The writing was on the wall- the industry pretty much controls what happens.

The exponential surge of technology from the mid 1990s has changed every facet of our lives. Increased volatility is now the norm, as is 24 hour trading, derivatives, lack of pensions, longer lives, instantaneous transfer of information (not necessarily knowledge), Alzheimers, terrorism and more. Old school financial education- actually the lack thereof - has left consumers and advisers living on past history as their guide to the future. It is obvious that the old homilies and inviolate theories that became dogma were and are not suited to this new world order. We need forward thinking fiduciaries who understand the past but are duty bound to do the heavy lifting to move into an entirely different economic arena. Thirty five year old licensing material with no true focus towards risk has left the entire nation in a financial mess. 'Brokers' do not exist and the advisors acting in almost any capacity- and certainly as a fiduciary- must increase their grasp and understanding of real life product application. The series 7 and 24 have never provided the fundamentals of investing.

You can hear all the testimony you want about the formal inclusion of fiduciary standards. But the key is mandatory education with absolute coverage of the fundamentals of investing and insurance/annuities.

Dodd Frank has provided an opportunity to scale up an industry far different from a marketing system with very little substance. Fiduciary duty is where the adviser has the requisite skills to provide knowledge. Maybe 35 years ago but not for the last 15- 20 years.

Fix this.

Very Truly,

Errol F. Moody Jr

* How many stocks- for the uninitiated, it is up to 350. If you are trying to establish a formal allocation out of stock, good luck in analyzing that many and the corresponding correlations (impossible for both consumers and advisers.)