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To: EBSA, E-ORI - EBSA

Subject: COMMENTS ON PROPOSED LEGISLATION RE INVESTMENT ADVICE

5/5/2010 We believe that the proposed regulation >>> should not <<<< be enacted, because it is likely to undermine a number of the "best practices" that currently benefit the 401(k) and related retirement plan markets, to a significant degree. Also, the proposed regulation unduly favors "computer models" that, while they may represent the potential for innovation in the industry, are far from proven. We also are concerned that this proposed legislation is merely another spear thrown by the Obama Administration at the thousands of decent and well-trained people who work in America's financial services industry, essentially cloaked in administrative jargon and bureaucratese, but pointedly intended to terminate the employment of experienced retirement plan personnel on "Wall Street" – and therefore we would, to the extent we can, say "No" to the proposal – and note that this particular section of America's financial marketplace, is really not calling for additional regulation at this time.

A few words on the "computer models" which under this legislation will be escorted in to America's retirement plan industry as some kind of all-knowing oracles of financial advice. Let the record show, there are no "computer models" which have risen to industry-standard levels, much less risen to a point where they supplant the need for experienced and qualified retirement plan personnel to be on the scene, on hand to take questions and talk with plan participants. Moreover, we can only assume that the goal is to escort in the types of "computer models" which are gaining in popularity – such as "Financial Engines" and the like. While these models are interesting – they pass off their conclusions as fact and that is not right. They (mis)portray asset allocation as a programmatic process that can be matched to a date in time, and produce conclusive answers regarding investment choices. This misportrayal is clearly misleading – and dangerous. It is dangerous to the plan participants because it will be passed off as "industry standard", which it is not today, and may not ever be. It is also dangerous to the markets as a whole because it will slant the entire apparatus of America's retirement plan industry toward passive index investing, which has good validity as an adjunct or satellite for plan investment strategy in mega-market categories such as the S & P 500, but unproven validity in basically all the other categories. The promoters of passive index investing have in some respects done a service to America, in the sense of educating people about their product and about benchmarking; but in other respects they have done a disservice to America by their constant and self-serving disparagement of active investing, which prices the market. It is a quantitative fact that the more people who utilize passive strategies, the less likely they are to work. It is also a quantitative fact that if enough people do it, it won't work. So before the Federal Government of the United States of America passes laws pressuring hundreds of millions of people into passive strategies, what happens if the law is "successful" and pushes the markets to the point where everyone is being passive, so the markets no longer price correctly. And, this will be on the nickel of the retirement plan investors. And for what? To let the SEIU cartel punch "Wall Street" in the nose? Note, as we use the term "Wall Street" it spans the entire country.

Also, the proposed legislation is very dangerous and improper in its suggestion that a retirement plan rep is wrong to use the menu of his or her firm's products for recommendations to the plan

participants. If his or her firm does not have a proper investment menu – that is a problem, but that is not what the proposed legislation is talking about. The proposed legislation would create a scenario wherein a plan vendor / professional, who perhaps allowed in some ultra-low cost investment choices to satisfy some very financially articulate and financially well-educated plan participants – wherein the professional could then not recommend the proper menu (albeit ever so slightly more costly) to the mass of plan participants, because in theory there is something cheaper they could buy. That does not help the plan participants. There are investment products out there that are costed down to almost zero, in some cases down to zero – yet they are very dangerous to people who do not understand them. This is not to excuse overpriced investment selections, by no means. Yet the proposed legislation effectively prohibits a basic plan professional from presenting a basic asset allocation suggestion using using basic products from leading firms – and that’s not good. The gist of it is, under the proposal, everything has to be costed down to zero, or near-zero, and then turned over to a computer. Not a good idea.

Bear in mind – where America is today regarding its housing finance markets, and the role computers played in that. It was after the implementation of “automated underwriting” that FNMA and FHLMC really went sour. And, this proposed legislation essentially mimics that. Why? Just so that a few thousand “Wall Street” reps who specialize in retirement plans lose their livelihoods? (At the expense of plan quality across the nation.) Automated underwriting turned out to be an unmitigated disaster for FNMA, for FHLMC, and for the United States of America. Let’s not have the same thing happen to the 401(k) industry. If the esteemed “computer models” have errors, who will correct them? And will they be corrected in time? In situations where quantitative finance is being implemented, our experience is that the people associated with it are extremely resistant to responding to reports of errors. Oftentimes, just looking the other way. For example, when I was engaged to review a text for the GARP FRM license program, the text contained an error. In presenting the formula for collateral coverage, they presented loan-to-value instead, which is essentially a numerator/denominator transposition error. We presented this to the publisher, and they did not even answer. (I’ll attach the page as a PDF file so you can see.) This is a representative risk of quantitative finance. And, people don’t like correcting them. There are numerous other similar situations that could be named as militating against quantitative finance applications. Quantitative finance is a fascinating area, but is it properly a very small subsection of the world of investments, and should not be passed off to America’s retirement plan participants as a standard for mainstream investment advice, because it isn’t. It’s not even close. It is an area of finance where errors are very prone to be missed, and that is not good. There are also very serious dangers in regard to the United States government pressuring the nation’s plan participants to all head toward passive investing – at some point, and it may not be far off, with enough investors going passive, the markets won’t price right.

The real answer is encouraging more professional involvement with retirement plans, not less; and encouraging more financial education and literacy, and providing good solid services to America’s retirement plan participants. This proposed legislation should be discarded.

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SUPPORTING AND GROWING AMERICA'S INTERESTS IN THE GLOBAL CAPITAL MARKETS

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$$8. \quad \text{Asset turnover ratio} = \frac{\text{Annual sales revenue}}{\text{Total assets}}$$

$$9. \quad \text{Dividend yield} = \frac{\text{Annual cash dividend}}{\text{Price per share}}$$

Note: ROE = ROA \times asset-to-debt ratio.

E. Securities analysis

$$1. \quad \text{EPS} = \frac{\text{Net income available for common stockholder}}{\text{Total number of outstanding common stock shares}}$$

$$2. \quad \text{Earnings yield} = \text{EPS/P}$$

$$3. \quad \text{Price-to-earnings ratio} = \text{P/EPS}$$

Note: Market cap = Price of equity \times total number of shares outstanding

F. Ratios for evaluating the expenses of a business

$$1. \quad \text{Cost of sales} = \frac{\text{Cost of goods sold}}{\text{Net sales}}$$

$$2. \quad \text{Overhead ratio (burden ratio)} = \frac{\text{Sales, general, and administrative expenses}}{\text{Net sales}}$$

$$3. \quad \text{Sales per employee} = \frac{\text{Net sales}}{\text{Average number of full-time equivalent employees}}$$

$$4. \quad \text{Gross profit per employee} = \frac{\text{Gross profit}}{\text{Average number of full-time equivalent employees}}$$

$$5. \quad \text{Direct employee expense} = \frac{\text{Total salary and bonus expense}}{\text{Average number of full-time equivalent employees}}$$

G. Ratios for evaluating the sufficiency of a firm's cash flow

$$\text{Cash flow adequacy} = \frac{\text{Cash from operating activities}}{\text{Long-term debt paid} + \text{fixed assets purchased} + \text{dividends paid}}$$

H. Ratios for evaluating collateral

$$\text{Collateral coverage} = \frac{\text{Loan balance}}{\text{Appraised or approximated value of collateral}}$$

This is LTV.

Note: If the borrower has more than one loan outstanding, and the loans are owed to the same bank, the balances on all such loans may be combined in the denominator, and the total value of all of the collateral may be combined in the numerator. However, such combinations should never be made if the loans are not explicitly cross-collateralized.