



SEC Investor Advocate

The Derivative Project
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Presentation to:
SEC Commissioner Aguilar
SEC Commissioner Paredes
SEC Commissioner Walter



What is the New Paradigm?

- Financial Services, representing over 30% of the U.S. GDP, require:
 - limitations on SEC regulatory expenses, requiring minimal, yet highly targeted, cost-effective regulation
 - prudent investment of retirement dollars into sustainable economic development to rebuild fragile U.S. economy, through raising “bar” on fiduciary standard and educational training of SEC Investment Advisors
- Effective Dodd-Frank rule-making for the CFTC/SEC monitoring of major swap participants speculative activity including:
 - Strict definition of “commercial end-user” in Title VII of the Dodd-Frank Act.
 - Protection of integrity of hedge markets, such as convergence of cash and futures markets



Why the New Paradigm?

- Retail Investment dollars can no longer be squandered in useless fees, useless losses, and imprudent investment management, when financial services represent over 30% of GDP in a deflationary environment.
- The U.S. cannot afford trillions of dollars to babysit greed and unethical behavior:
 - 1 Investors will have online access to cutting edge, explicit tools to make prudent investment choices, from analysis of divergence of credit default spreads and S and P ratings to access to online markets such as TradeWeb



What Tools Does The Retail Investor Require?

Elizabeth Warren stated recently, “I come to Washington as a genuine believer in markets and a genuine believer that the purpose of regulating the retail consumer markets is to make that market work for buyers and sellers alike.. a level playing field where the best products at the best prices win.”

- The same statement holds true for retail investors: free markets are critical, where there is sufficient transparency that an investor is empowered to make informed choices.
- There is a level playing field when there is minimal, but effective rules enforcement.



What Tools Does The Retail Investor Require?

- Elimination of conflict of interest on investment advice, especially ERISA plans
- Clarification/real education on role of broker vs. investment advisor and a new standard for SEC Registered Advisor (education) and SEC enforced fiduciary role
- Elimination of FINRA SRO for Advice complaint process and mandatory arbitration
- Private right of action under Investment Advisors Act of 1940 and new SEC enforcement of SEC regulated investment advisors
- No small print contracts, but full disclosure and fee transparency



Why the Legal Remedies of IAA of 1940 for a retail Investor are a Non-Existent

Dodd Frank States:

“ the Commission shall seek to prosecute and sanction violators of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under this Act ***to same extent as the Commission prosecutes and sanctions violators of the standard of conduct applicable to an investment advisor under the Investment Advisers Act of 1940.***”

The SEC Advocate must clearly define:

- 1 how the SEC is currently enforcing violations of the Investment Advisers Act of 1940 and where the current prosecutions are failing the retail investor
- 2 what body in the SEC will be best suited to protect and enforce the fiduciary standard to preserve the integrity of capital markets, minimize fraud and offer greatest protection to retail investor



Why the Legal Remedies of IAA of 1940 for a retail Investor are a Non-Existent

FINRA Interim CEO, Stephen I. Luparello, testified before Congress in 2008:

- “FINRA is not authorized to enforce compliance with the Investment Advisors Act of 1940. Authority to enforce that Act is granted solely to the SEC and to the States.” Testimony by Mr. Luparello before the Senate Committee on Banking, Housing and Urban Affairs on January 27, 2008.
- Yet, retail investors are forced through mandatory arbitration for IAA of 1940 claims before FINRA arbitration panels:
 - 1 That cannot enforce or award damages for IAA of 1940 breaches
 - 2 That are “industry” arbitrators, that are stockbrokers, not trained in “fiduciary” duty breaches.



Thus, the Role of the SEC Investor Advocate is Bi-Partisan

The first role of the SEC Investor Advocate is communicating with Congress on a bi-partisan basis these crucial points:

- Retail investors need immediate access to legal remedies when their savings have been harmed due to breaches of the Investment Advisors Act of 1940.
- Continued investment of retail investor funds in useless financial services fee income and imprudent investments will stall a U.S. economic recovery
- A vision for rebuilding the U.S. economy through retail investments, in a cohesive, inspirational fashion, will go further than squandering taxpayer dollars on systemic risk management and useless fee income that enriches the bottom line of financial services firms



What are the Key Requirements for the SEC Investor Advocate?

- An experienced international/ commercial banker, trained in credit analysis and over five years derivatives experience
- Experience as a SEC registered investment advisor, who has completed Series 7 and Series 4.
- A retail investor who has experienced a FINRA arbitration and understands limitations of an SRO
- A retail investor who trades on a regular basis for their own account, both equities, bonds and knowledge of alternative investments



Key Requirements for SEC Investor Advocate

- ✓ One cannot be an advocate without deep appreciation of the cause. Robert Kennedy fought admirably and effectively for civil rights, but it was only a Martin Luther King, who had lived the reason for the need for these rights, that could communicate to others and to bring about the change.



Key Requirements for SEC Investor Advocate

- Why a Practitioner?
 - ✓ The financial crisis of 2008 has proven “text book knowledge” is not enough in today’s financial markets. It is only through hands-on, day to day experience, that the risks and pitfalls of the potential “big picture” that may cause another collapse can be seen
 - ✓ The role of credit analysis going forward, the role of derivatives and the role of SEC registered investment advisors are all in flux. Without understanding the day to day roles of each of these entities, one cannot effectively advocate for the requisite changes.
 - ✓ The SEC Advocate must be free from conflict of interest and have had no financial services employment during the last five years or following five years.



Key Requirements for SEC Investor Advocate

- Caution of academic relationships for the SEC Investor Advocate:
 - ✓ The 2008 financial crisis has shown academics are in an ivory tower when it comes to financial services. To keep up with the intricacies of derivatives, for example, you must have had first hand experience in their application, which is why from major universities to central banks, they have called on us trained in derivatives to educate them, not the academic world.
 - ✓ The 2008 financial crisis has shown a serious conflict of interest between leading U.S. academic institutions' testimony to Congress, in exchange for significant payments.



Key Requirements for SEC Investor Advocate

- ✓ Change of this magnitude can only be made with fresh ideas and untainted allegiances to Congress or to Wall Street.
- ✓ The SEC Investor Advocate will very much need strong legal counsel which is permitted to be arranged on a contract or staff basis.
- ✓ SEC Advocate will be a practitioner with such diverse experience, they can bring a vision for significant change for the role of the retail investor in rebuilding the foundation of the U.S. economy, through access to cutting edge product knowledge and online market tools
- ✓ The SEC Advocate will assist the retail investor to become a partner in the capital markets, a level playing field.



Where can the SEC Investor Advocate Make Crucial Changes, While Simultaneously Limiting Regulation

- The New Paradigm calls for a new type of Registered Investment Advisor
- Transparency and an informed investor will reduce regulatory costs and minimize fraud and investor complaints on a long-term basis
- ✓ SEC Training requirements would be completely revamped and experience levels to become a SEC Registered Investment Advisor would dramatically change, combined with the new fiduciary standards.
- ✓ Hands on experience in commercial lending, credit analysis, and derivatives would assist in the unhealthy dependence on credit rating agencies and potential fraud detection.
- ✓ Hedging, options and management of bond and equity portfolios in times of economic crisis would be de rigueur training. \$2 trillion dollars of losses in American's retirement accounts in 2008 financial crisis were preventable.



Vision for SEC Investor Advocate

- Unifying Congress around vision to rebuild our GDP through:
 - ✓ Significant new training and stature for SEC registered Investment Advisor that serves to inspire and mobilize American's savings into productive investments and efficient allocation of scarce capital resources following the Crisis of 2008
 - ✓ Limitations on excessive, non-productive financial services fee income
 - ✓ Brokers are brokers and not in the "investment advice" field, without receiving the new SEC mandated curriculum for SEC Registered Investment Advisors and requisite fiduciary standard.



Conclusion – SEC Investor Advocate

Bi-partisan support to build for tomorrow:

- A vision to minimize capital market regulations, through retail investor education and a new paradigm SEC registered Investment Advisor with a strong fiduciary training and standard
- Transparency in fees, contracts and the role of a salesmen vs. role of a highly trained fiduciary investment advisor
- An educated, empowered retail investor who has tools and transparency to make informed choices for his or her future, reducing fraud and regulatory costs
- Strong SEC enforcement division with on-going cost-benefit analysis of regulations and enforcement tools to ensure an ongoing level playing field for the retail investor



Appendix

- Statement by Elizabeth Warren:, Interim Head, CFPB ““I come to Washington as a genuine believer in markets and a genuine believer that the purpose of regulating the consumer markets is to make that market work for buyers and sellers alike.. a level playing field where the best products at the best prices win. When it works, the market is an ally to consumers. And, when it works, the market rewards those first who offer the best value to their customers.” ...“When I talk about functioning markets, I’m not using the word “market” as coded language for a return to the Wild West where Firms use deception to pick off every consumer they can get in their sights.. A free market is one where consumers have the ability to make well- informed choices, where the choices are visible and the terms are clear, and where there are cops on the beat to make sure that everyone plays by the same rules.” -Elizabeth Warren



Appendix

Dodd Frank and Enforcement of IAA - 1940

1. The SEC does not currently enforce breaches of IAA of 1940 against a small retail investor, who has even lost \$100,000 in retirement savings due to clear breaches, such as not informing client of past regulatory fines and material conflicts of interest.
2. The SEC registered advisor is usually dually-registered as a broker, forcing the retail investor into mandatory arbitration by FINRA. The Investment Advisor's legal counsel tells the arbitration panel Congress has not given FINRA authority to enforce the IAA of 1940 and you have no legal right to award damages under IAA of 1940 to the retail investor, only the SEC can do that.
3. Thus, the retail investor is forced through months of arbitration, cannot be given damages, despite acknowledgment by the Panel of clear violations of IAA of 1940.
4. The retail investor then cannot go to the court system because "the courts will not overturn a FINRA panel", even if the reason was the Panel saw a violation, but did not have the authority to award damages.
5. The SEC Office of Investor Advocacy does nothing to resolve this lack of enforcement of IAA of 1940 and refuses to address the issue for future retail investors in a comparable situation.



Appendix: Why the SEC Advocate Must Be A Practitioner and Retail Trader/Investor

John Taft Chair of SIFMA:

- In a recent speech to the association, Taft pledged that the organization would “provide fact-based, content-rich analysis [and] expertise required to create rules that will help the financial services industry do what we do best ... help facilitate and foster economic growth ... something our country desperately needs right now.”
- But as head of the industry group representing brokers and asset managers, he will be pushing for “balance on reform measures that will help ensure the United States avoids future financial crises, while allowing financial institutions to effectively do their part in supporting America’s economic recovery and job creation.”
- “Frankly, our biggest fear is that regulators will be overwhelmed by the assignment. Not because there aren’t good, smart people working there, but there simply aren’t enough of them,” he said. “But this phase of reform shouldn’t just be about meeting rulemaking deadlines. It’s about getting it right. We need to get it right.”



Appendix: Why The SEC Advocate Must Be A Practitioner

- Taft elaborated in an interview:
- “Regulatory reform had to happen,” he said, pointing out that current rules and laws, “some written at the beginning of the last century,” are not up to the task of regulating complex financial instruments and high-speed, computer-driven trading technologies across global markets.
- One aspect of Dodd-Frank that Taft is most familiar with — rewriting the “the fiduciary standard of care” for all investment advisers — is of particular concern. Under Dodd-Frank, the SEC has to write “nothing short of a complete overview of the personal investment advice industry” in five months. Without help from the industry itself, the SEC will not be able to “address all the issues. I don’t care who you are.”



Appendix: Why the SEC Advocate Must Be A Practitioner

“The Office of Investor Education and Advocacy posts information to warn people about scams, compiles complaints, and provides help for people seeking to recover funds. The Office of the Investor Advocate will be a very different office, said Senator Akaka. The Investor Advocate is precisely the kind of external check, with independent reporting lines and independently determined compensation, that cannot be provided within the current structure of the SEC. It is not that the SEC does not advocate on behalf of investors, noted Senator Akaka, it is that it does not have a structure by which any meaningful self-evaluation can be conducted. This would be an entirely new function, he added, and the Investor Advocate would help to ensure that the interests of retail investors are built into rulemaking proposals from the outset and that agency priorities reflect the issues confronting investors.” ---Senator Alaska



Appendix: Why The SEC Advocate Must Have A Vision For Significant Change

More than two months after the Dodd-Frank Act was enacted, Jeremy J. Siegel, a professor at the University of Pennsylvania's Wharton School, said the following:

“The vast majority of regulations required by the law are yet to be written. If they become burdensome, they will make our financial sector less competitive. If not, they can contribute to growth and stability. The devil of this law is not only in the details, but also in the regulators who enforce them.”



Appendix: Investment Advisors Act of 1940 and Dodd Frank

- (1) SECURITIES EXCHANGE ACT OF 1934.—Section 15 of Exchange Act of 1934, as amended by subsection (g)(1), is further amended by adding at the end the following new subsection: “(m) HARMONIZATION OF ENFORCEMENT.—The enforcement authority of the Commission with respect to violations of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer shall include—“(1) the enforcement authority of the Commission with respect to such violations provided under this Act; and“(2) the enforcement authority of the Commission with respect to violations of the standard of conduct applicable to an investment adviser under the Investment Advisors Act of 1940, including the authority to impose sanctions for such violations, and the Commission shall seek to prosecute and sanction violators of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under this Act to same extent as the Commission prosecutes and sanctions violators of the standard of conduct applicable to an investment adviser under the Investment Advisors Act of 1940.”.



Appendix: Fiduciary Standard

- The SEC is required to carry out other changes on behalf of small investors, under the Dodd-Frank law. The law “is a broad sword in some areas and a scalpel in others,” Schock said. One of the most controversial is a study examining whether ordinary investors understand the different legal obligations that investment advisors and stockbrokers now have to their clients. While investment advisors are required to register with the SEC and has a fiduciary responsibility to help clients choose the best investment products for their needs, brokers are often salesman for a particular product, unbeknownst to investors, and are not obligated to act in the best financial interests of their clients.
- A survey released last month, conducted by the Consumer Federation of America and other groups: showed that Americans usually don't know the difference between brokers and investment advisors. The SEC must report to Congress in January with recommendations on whether the fiduciary obligation should be expanded to other investment professionals – an issue that brokers' groups are fighting. Another “scalpel” provision involves binding arbitration that many small investors are now required to accept when they hire an advisor. The SEC is going to take a closer look at the contracts that investors sign with investment advisors.

most of which require any complaints to be mediated by an arbitrator and prohibit the client from filing a lawsuit. The SEC is now empowered to make rules limiting binding arbitration clauses. The agency also has the power to improve or amend the often daunting financial disclosures investors receive. Silvers said the Dodd-Frank law is stronger than most realize for individual investors. If the law's goals are achieved, resulting in a more transparent system that is less prone to boom and bust cycles, a small investor relying on the market to retire or save would see a huge benefit. “The potential of Dodd-Frank is to create a system that is less vulnerable to bubbles,” Silvers said. “A marketplace full of tricks and traps and opaque forces is a market the individual investor is not likely to do well in.” But Silvers said how effective the act is for investors will ultimately be up to how the SEC establishes rules to carry out the law. “Are those rules robust and is the authority used widely?” he asked.