

# What is your Professional Code of Ethics, and do you have the Moral Courage to uphold it?

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# Ethics on Wall Street

- The Securities Exchange Act of 1934 states that securities in transactions are affected with the national interest, and must be conducted so as to protect interstate commerce and *to insure the maintenance of fair and honest markets* in such transactions. These general mandates require that market participants operate with *the highest ethical standards and integrity* and comply with all laws and rules intended to achieve these goals.
- “The Commission’s mission starts with an uncompromising commitment to *the highest ethical standards...*”

*SEC General Counsel David Becker, 08/05/10*

*“These capitalists generally act harmoniously and in concert, to fleece the people”  
Lincoln*

# Ethics on Wall Street

- The *foundational rule in FINRA's rather large rule book is an ethical one*: that brokerage firms must conduct their business in accordance with "*high standards of commercial honor and just and equitable principles of trade.*"

*Mary Shapiro, CEO, FINRA 10/14/08*

- What's most important of all is for market participants—from senior executives to individual investors—to *possess a commitment to ethics, integrity, and professional responsibility.*

*Rick Ketchum, CEO, FINRA, 10/2/09*

# Ethics on Wall Street?

- The financial services industry is at a crossroads - we are faced with a little-before seen crisis in the global economy and several instances of publicized lapses in professional ethics.

*“Enhancing Professional Conduct in the Financial Services Industry” FINRA*

- “Wall Street’s moral lapses call into question the moral justification for capitalism.”

*Joseph Grundfest SEC Commissioner, 1987*

- “Wall Street needs to re-establish trust, honesty...

*John Mack, October 13, 2010*

# Ethics on Wall Street?

In Gallup's 2009 polling just 19% said the honesty and ethical standards of bankers were high; 12% felt that way about business executives, and 9% about stockbrokers. Stockbrokers were tied with members of Congress. Both ranked only slightly above HMO managers (8%) and car salesmen (6%), who took last place in the poll.

*Forbes 4/5/10 Karlyn Bowman*

There are many professions in which one can find examples of hollow values, but nowhere is it more evident than on Wall Street...

*Jon Huntsman, Winners Never Cheat*

*I believe that banking institutions are more dangerous to our liberties than standing armies. Thomas Jefferson*



*Laws control the lesser man. Right conduct controls the greater one. ~Chinese Proverb*

# What is a Professional?

The driving force of any profession includes not only the special knowledge, skills and standards that it demands, but the duty to serve responsibly, selflessly and wisely, and to establish an inherently ethical relationship between professionals and society.

*JOHN C. BOGLE 4/21/09*

*“If I know he’s a salesman, I will evaluate his recommendations differently,...  
When he is an adviser, I don’t question him, I assume he is a better expert than I am.”*

*Tamar Frankel, Boston University*

# Are you a Professional?

- Expert and specialized knowledge
- High quality work
- The professional owes a higher duty to a client
- Often the professional is required to put the interest of the client ahead of his own interests.
- A high standard of professional ethics

*You have to perform at a consistently higher level than others.  
That's the mark of a true professional. Joe Paterno*

# AIF & AIFA Code of Ethics

- *Act with honesty and integrity* and avoid conflicts of interest, real or perceived.
- Ensure the timely and *understandable disclosure* of relevant information is accurate, complete, and objective.
- Proactively promote and be a steward of ethical behavior...

*Where is there dignity unless there is honesty?*  
*Cicero*

# CFP Code of Ethics

- **Principle 1 - Integrity**
  - *Integrity demands honesty and candor....*
  - Certificants are placed in positions of trust...
  - Integrity cannot co-exist with deceit or subordination of one's principles.
- **Principle 4 – Fairness**
  - Fairness requires impartiality, *intellectual honesty* and disclosure of material conflicts of interest.
  - *Fairness is treating others in the same fashion that you would want to be treated.*

# ASPPA Code of Professional Conduct

- **Professional Integrity**
  - Shall perform services with *honesty, integrity*, skill and care.
- **Disclosure**
  - Shall make full & timely disclosure...of all sources of compensation or other material consideration that the member or the member's firm may receive...
- **Conflicts of Interest**
  - *If the member is aware of any significant conflict between the interests of a principal and the interests of another party, the member should advise the principal of the conflict...*

# Fundamental Principles of Professional Investment Ethics

- **Ethical Understanding** – Because investments are complicated, *you have an obligation not to knowingly engage in an investment transaction either you or others do not sufficiently understand. This includes knowing the underlying source of returns or fees charged.*
- **Trust & Fairness** – Because you are dealing with others' money either directly or indirectly, *you have an obligation not to abuse the trust* that others have either explicitly or implicitly placed in you to treat them fairly.

*Investment Ethics, Sarah Peck*

# Trust & Fairness

- “A broker has a fiduciary duty to the client where the broker knows, or should have known, *that trust has been placed* in that broker.”

*Gouger v. Bear Stearns, 823F. Supp. 282, 288 (E.D. Pa. 1993)*

- *Trust and confidence* are the glue that holds the markets together. They're more important than money and more valuable than any commodity.

*Mary Shapiro, CEO, FINRA 10/14/08*

# What is Fairness?

## Informed Voluntary Consent

- Both buyer & seller understand what they are giving up and what they are receiving in return.
- Neither buyer nor seller is compelled to enter into the exchange as a result of coercion, severely restricted alternatives, or other constraints on their ability to choose.
- Both buyer and seller are able at the time of the exchange to make rational judgments about its costs & benefits.

*A Modal Evaluation of Sales Practices, David M. Holley*

# 401k Industry Ethical Issues

- Fees, Expenses & Compensation
- Pilfering & Paltering
- Disclosure & Transparency of Disclosure
- Fiduciary Warranties
- Moral Courage

*"It is difficult to get a man to understand something when his salary depends on his not understanding it."  
Upton Sinclair*

# Fees, Expenses & Compensation

“A fiduciary shall discharge his duties . . . for the *exclusive purpose* of:

- (i) providing benefits to participants and their beneficiaries; and
- (ii) defraying *reasonable expenses* of administering the plan...”

*ERISA §404(a)(1)(A)*

*Rather fail with honor than succeed by fraud.*  
*Sophocles*

# Fees, Expenses & Compensation

“assure that the *compensation* paid directly or indirectly by [a plan to a service provider] is reasonable, taking into account the services provided to the plan as well as any other *fees or compensation* received by [the service provider] in connection with the investment of plan assets. *The responsible plan fiduciaries therefore must obtain sufficient information regarding any fees or other compensation that [the service provider] receives with respect to the plans investments ....to make an informed decision whether the [service providers] compensation for services is no more than reasonable.*”

*DOL - Frost (97-15A) and Aetna (97-16A)*

# *Participants' & 401k Fees*

- There are over 72 million 401k participants in America invested in more than 483,000 plans which contain over \$3 trillion in assets.
- 71% Believed they paid no fees
- 81% Believed it was very important/somewhat important in making investment decisions

*401(k) Participants' Awareness and Understanding of Fees, AARP, 2011*

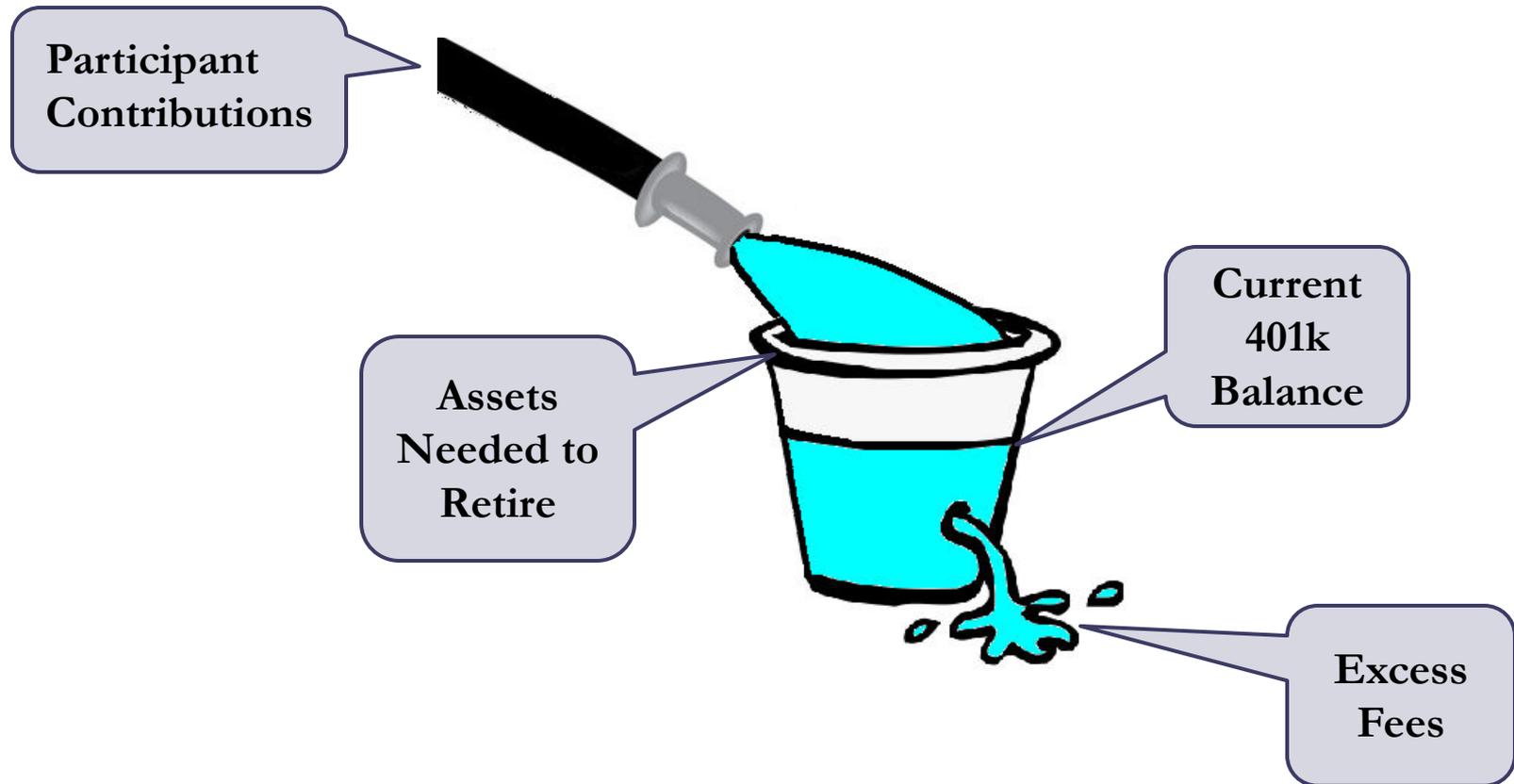
“...several billion dollars of revenue-sharing fees are being hidden annually from plan sponsors and plan participants...”

*Jay Sanders, The CPA Journal, NYSSCPA, 2005*

*“There is an undisputable fact of investing: Gross returns of a given investment, minus the costs of financial intermediation, equal the net returns actually delivered to investors.”*

*Jack Bogle, Vanguard*

# Why does it matter to the participant?



1% in excess fees over the average American's working lifetime, reduces their nest egg at retirement by 28%.

# Why does this matter to the Plan Sponsor?

- A fiduciary is *personally liable* for any losses the plan incurs by reason of its breach. A fiduciary who has breached its duty is liable to restore to the plan any profits the fiduciary made through its use of plan assets and for any other equitable or remedial relief deemed appropriate by the court, including removal of the fiduciary.

*ERISA § 409*

- The DOL has taken the position that fiduciaries have a duty to know and evaluate indirect payments. In performing that evaluation, fiduciaries need to consider whether the total amounts received, directly and indirectly, by their service providers are reasonable. Further, fiduciaries must evaluate whether the payments cause potential conflicts of interest and, if so, whether the plan and participants are protected from those conflicts... *The failure to evaluate those issues is a fiduciary breach.*

*Revenue Sharing: What Is It, Fred Reish*

**Is Your Company's 401(k) Plan Operated by  
any of these Insurance Companies?**

**TRANSAMERICA  
LINCOLN FINANCIAL GROUP  
HARTFORD FINANCIAL GROUP  
NATIONWIDE  
AXA, OR  
JOHN HANCOCK**

If So, You May Have Legal Claims Against, Transamerica, Lincoln Financial Group, hartford financial Group, Nationwide, AXA or JohnHancock.

These potential claims are related to fees and charges taken from retirement assets by Transamerica, Lincoln Financial Group, Hartford Financial Group, Nationwide AXA, or John Hancock.

For a free consultation to learn more about your potential claims contact Robert L. Lakind, Esq. at (609)276-0400 or [rlakind@szaferman.com](mailto:rlakind@szaferman.com)

**KNOW YOUR RIGHTS! WE CAN HELP!**

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*Newark Star-Ledger  
August 2010*



# Two Ethical Issues

Failure or refusal to fully disclose fees, expenses, revenue sharing, and other hidden costs is causing hundreds of thousands of 401(k) and similar plans to operate outside the realm of fiduciary prudence, *unknowingly engage in prohibited transactions*, and *unnecessarily erode the future benefits belonging to participants* and beneficiaries.

*Matthew D. Hutcheson, Congressional Expert,  
Ethical Principles and Legal Obligations, July 2007*

# West Point Honor Code

- A Cadet will not lie, cheat, steal, or tolerate those that do.
- Cadets violate the Honor Code by lying if they deliberately deceive another by stating an untruth or by any direct form of communication to include *the telling of a partial truth and the vague or ambiguous use of information or language with the intent to deceive or mislead.*
- At West Point, this form of lying is called “quibbling”.
- Ethically speaking its called “paltering.”

*A half truth is a whole lie. ~Yiddish Proverb*

# Deceptive Behaviors

## CAIN Analysis

Context	Action	Intention	Example	
<b>Entertainment</b>	Truth not necessary	False or misleading info	Misdirection, intrigue	Movies, novels, magic acts, poker
<b>Etiquette</b>	Truth preferred, but not necessary	Incomplete information	Kindness or respect	"Does this make me look fat?" Tact.
<b>Mistake</b>	Truth expected	Factually incorrect info	Tell the truth	Misremembers
<b>Lying</b>	Truth expected	Factually incorrect info	Mislead, deceive	Lies; steroids in sports
<b>Paltering</b>	Truth expected	Factually correct but incomplete or out of context	Mislead, deceive	Innuendo; Partial truths "lies of omission"

*Lying and Paltering, Bennett Blum, MD*

# Pilfering & Paltering

- **Pilfer** - to steal repeatedly, especially in small amounts so to go unnoticed
- **Palter** - to intentionally deceive or mislead without making a false statement in order to advantage one's self and /or disadvantage another

*The least initial deviation from the truth is multiplied later a thousand-fold. ~Aristotle*

# Types of Paltering

- **Equivocation:** making an indirect, **ambiguous**, or contradictory statement. To use one word but for multiple meaning, or two words with the same meaning.

*ABC Firm receives payments of **up to** 0.15% on new asset purchases made by the plan. These payments **may be** referred to as “revenue sharing” **under some circumstances**. The payments are made by the XYZ Company to ABC Firm. Your Financial Advisor does not receive any part of these payments. Amounts payable by XYZ Company to ABC Firm do not result in an additional **direct charge** to your Plan or to the products, **except to the extent** XYZ Company applies an asset charge or other charge and pays compensation to ABC Firm from its general revenues.*

# Types of Paltering

- **Concealment: omitting** information that is material to the context, or hiding material information

*Fiduciaries are required to know all expenses that are being paid by the plan, directly or indirectly, and to determine if they are reasonable (that is, whether the expense is competitive in the marketplace and whether the plan and its participants receive value commensurate with the cost). In addition, **the advisor** should be able to explain the structure of the compensation he or she **individually receives** from each investment. Fiduciaries are not required to choose the least expensive services; rather, they should ensure that they are getting good value for the plan's money.*

# Concealment

## Needle in a Haystack QUIZ

- How many pages of documentation must a plan sponsor review in order to read all of the available information regarding fees, compensation & potential conflicts of interest?

*(Lets assume there is just one mutual fund in the plan!)*

- a) 127
- b) 539
- c) 827

# Concealment

- **Prospectus** – 72 pgs
    - 9 pages
  - **SAI**– 285 pgs
    - 17 pages
  - **Annual Report** – 44 pgs
    - 6 pages
  - **Semi-Annual Report** – 36 pgs
    - 8 pages
  - **Group Annuity Contract** – 33 pgs
    - 5 pages
  - **Plan Level Documents** – 58 pgs
    - 9 pages
  - **Adm Service Agreement** – 11 pgs
    - 2 pages
- 539 pages! 56 references to fees, compensation, and potential conflicts of interest**

*It doesn't require many words to speak the truth - Chief Joseph*

# Paltering & Federal Trade Commission Act

- The FTC defines deception as: **be a representation, omission or practice that is likely to mislead the consumer.**
- Under Section 5, the Commission has determined that a representation, omission, or practice is deceptive if: (1) it is likely to mislead consumers acting reasonably under the circumstances; and (2) it is material, that is, likely to affect consumers' conduct or decisions with respect to the product at issue.
- The FTC said that “disclosures that are required to prevent deception or to provide consumers material information about a transaction must **be presented clearly and conspicuously.**”

# Paltering in Plain Sight

But ethical misconduct doesn't need to reach criminal levels in order to harm investors. What we often see is a culture of neglect or rationalization, where the pursuit of profit obscures a sense of any moral obligation to the investor.

*Mary Shapiro, CEO, FINRA 10/14/08*

*It is not necessary that whilst I live I live happily; but it is necessary that so long as I live I should live honorably. Immanuel Kant*

# Paltering in Plain Sight

## Retail vs. Wholesale

	A	R-1	R-2	R-3	R-4	R-5	R-6
Management fees	0.43%	0.43%	0.43%	0.43%	0.43%	0.43%	0.43%
Distribution and/or service (12b-1) fees	0.24	1.00	0.75	0.50	0.25	none	none
Other expenses (Sub-TA Fees)	0.18	0.21	0.48	0.22	0.18	0.13	0.09
Total annual fund operating expenses	0.85	1.64	1.66	1.15	0.86	0.56	0.52

*Integrity has no need of rules. Albert Camus*

# The Epitome of Paltering

- Group annuity contracts are often more complex than plan sponsors realize, *riddled with hidden charges* and lock-up periods... Marketing materials touted low-cost to employers, but left out all of the charges their workers would be subjected to.

*Forbes, Retirement Plans From Hell*

- “While we acknowledge and agree that situations in which the sale of a variable annuity within a qualified plan are limited, and that the suitability of all such sales should be closely scrutinized...”

*Jude A. Curtis, Senior Vice President & Chief  
Compliance Officer, John Hancock, Aug 9, 2003*

# The Epitome of Paltering

	1 mo.	3 mos.	YTD	1 yr.	3 yrs.	5 yrs.	10 yrs.	Since* Inception	Expense Ratio
Vanguard Target Retirement 2030 Ret Opt	-0.54	10.59	7.58	9.53	-3.67	N/A	N/A	1.90	0.94

Performance shown is average annual total separate account investment choice returns (except 1 month, last quarter, and year-to-date) for the period indicated, net of the total operating expenses of the separate account or underlying investment as listed on the individual investment fact sheets. Performance returns reflect reinvestment of dividends and capital gains distributions. *Application of the contract asset charge and any discontinuance charges or service fees deducted from the account would reduce this return.*

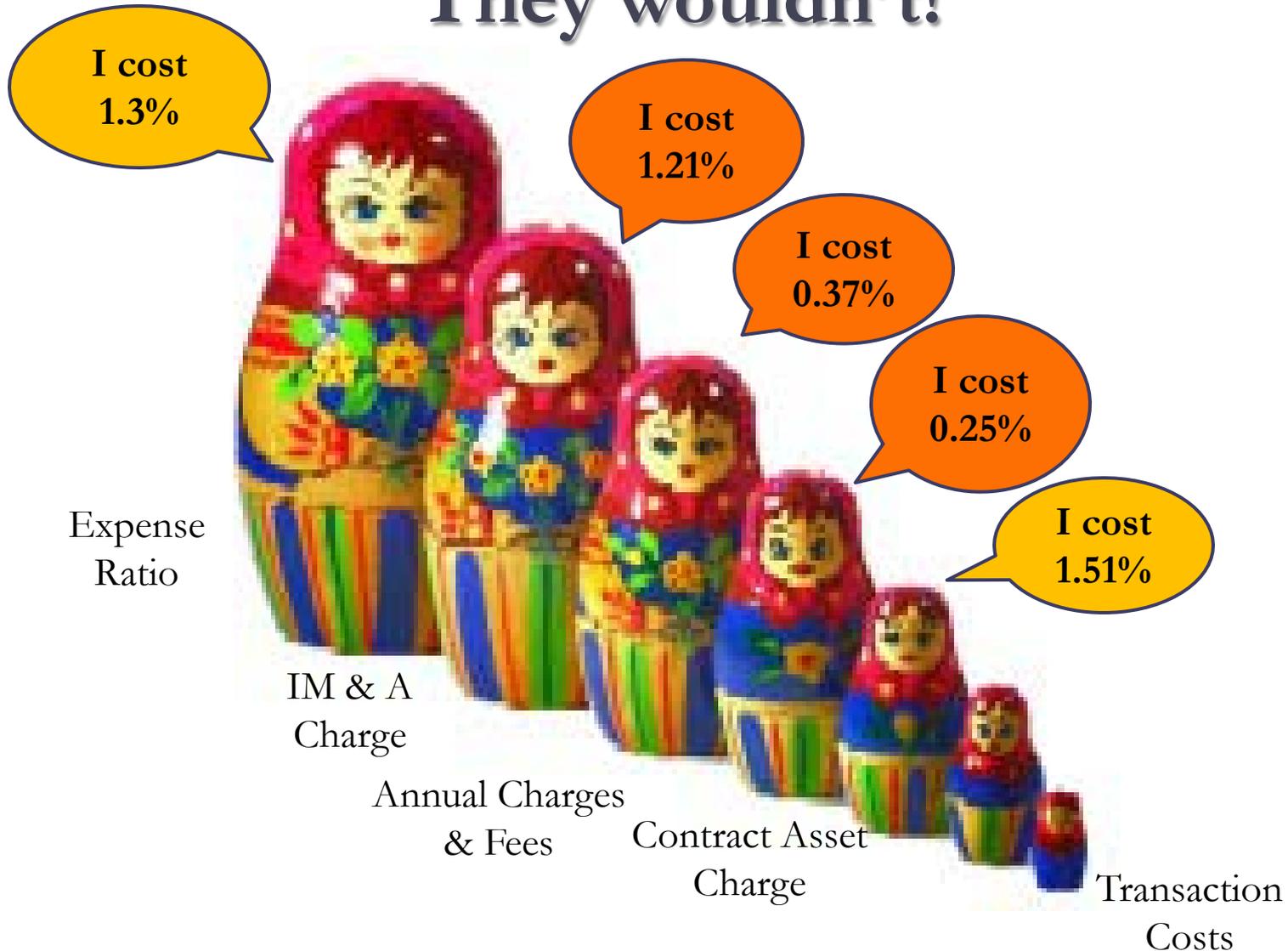
*Group Annuity 401k Participant Website*

Why would anyone knowingly pay  
3% to 5% in 401k fees?



I cost 1.3%

# They wouldn't!



*"Pay no attention to the man behind the curtain" Wizard of Oz*

# Paltering & Pilfering?

1.30%	Total Expense Ratio
1.21%	Investment Management & Admin Charge
0.37%	Annual Charges & Fees
0.25%	Contract Asset Charge
<u>1.51%</u>	<u>Transaction Costs</u>
4.64%	Actual Cost

*Honesty pays, but it doesn't seem to pay enough to suit some people.  
Frank McKinney "Kin" Hubbard*

# A Note of “Transaction Costs”

- Broker-dealer costs for securities transactions within a mutual fund are not reportable under the new fee disclosure rule; however:
- In order to be Rule 404(c) compliant: The participants or beneficiary is provided...the following information, which shall be based on the latest information available to the plan: (i) A description of the annual operating expenses of each designated investment alternative (e.g., investment management fees, administrative fees, **transaction costs**) which reduce the rate of return to participants and beneficiaries... *ERISA 404c-1 (2)*

*I am not bound to win, but I am bound to be true. I am not bound to succeed, but I am bound to live by the light that I have. I must stand with anybody that stands right, and stand with him while he is right, and part with him when he goes wrong.” Lincoln*

# Paltering with Mouse Print Fiduciary Warranties

- *“This unprecedented program offers plan sponsors and fiduciaries greater confidence, security and peace of mind by providing specific assurance for their fund selection. We’re so confident, we promise to restore any losses to the plan and pay litigation costs related to the suitability of our investment process and Fund lineup for 401(k) plans.”*
- *“We recognize that fund selection and monitoring is an important part of the due diligence process for plan fiduciaries, and we are confident that our investment selection and monitoring process meets the highest standards. We are willing to put our name behind the Funds selected from our investment lineup and promise that our Funds....”*
- *“...we are committed to helping you meet the highest fiduciary standards in the investment selection and monitoring process and commit to restore losses and pay litigation costs in the event that legal action is brought against qualifying plans. Now that’s security for your plan!”*

# Paltering with Mouse Print Fiduciary Warranties

“...since past performance is not a guarantee of future results, we cannot warrant or guarantee either that any investment option will yield any specific return, or even that it will yield a positive return. *Nor does our Fiduciary Standards Warranty extend to claims that any expenses paid directly or indirectly by the Plan are reasonable.*”

*“This witch’s brew of hidden fees, conflicts of interest and complexity in application is at odds with investors’ best interests.”* Christopher Cox, Chairman, SEC

# Moral Courage

- Ethics is all about how we meet the challenge of doing the right thing when the act will cost more than we want to pay.

*Michael Josephson*

- Courage is not the understanding of what is right or wrong. Rather, it is the strength to choose the right course.

*Jon Huntsman, Winners Never Cheat*

- Encourage us in our endeavor to live above the common level of life. Make us to choose the harder right instead of the easier wrong, and never be content with a half-truth when the whole can be won.

*West Point Cadet Prayer*

# Moral Courage

- 401k Plan Sponsors have a fiduciary duty to discover all fees being paid from plan assets; all compensation being paid to any interested party; and to evaluate those fees and compensation relative to the services being provided.
- Failure to fulfill this duty puts the plan sponsor in personal jeopardy, and threatens the retirement income security of plan participants.
- As a AIF/AIFA or CFP Designee, or as a member of ASPPA, what is your ethical obligation if you are providing a service to a Plan Sponsor who is unaware of the fees and/or compensation within their 401k plan?

*“Moral courage is a more rare commodity than bravery in battle or great intelligence.”* RFK

# Moral Courage

- Act with honesty and integrity
- *Proactively* promote and be a steward of ethical behavior...
- Integrity demands honesty and candor....
- Integrity cannot co-exist with deceit
- Intellectual honesty
- Fairness is treating others in the same fashion that you would want to be treated. *If the member is aware of any significant conflict between the interests of a principal and the interests of another party, the member should advise the principal of the conflict...*

# The Three Wise Monkeys



*You will never do anything in this world without courage.  
It is the greatest quality of the mind next to honor. Aristotle*

So, I guess the point you want to walk away with, and I don't know if its leadership or responsibility, but when you take on a job...it wouldn't have to be a big job... *you have a responsibility to do what you think is right*, and stand up sometimes when the odds are against you and people are pushing you. I think that there are enough stories you can read about in the paper where if people would have done that, they wouldn't be in the pickle they are in now. So I guess if you leave here and the thing to think about is, *stand up for what you believe in, do what you think is right*, be prepared to suffer the consequences. *But don't be pushed around when you know in your heart of hearts that it's the wrong thing to do.*

*John Mack, "Leadership in Crisis" Oct 2009*