<u>Regulation for Rupert</u>

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For at least a year, there has been an ongoing debate regarding financial reform. It seems that everyone has been heard from except “Rupert” - the actual consumer. Rupert is one of the few laymen who are considered “financially literate”, but we still have to ascribe even more financial knowledge to him in order to make our points. “Rupert”, of course, exists only in my imagination and his thoughts are only my opinion, but try to forget this.

Rupert is 50 years old, has a few children and one is still in college. His real wages have not grown in 20 years but, in that time, health care has gone up at twice the rate of inflation and the cost of education has gone up at 7% per year. He pays for this out of his property taxes, college loans, and out-of-pocket. He has $93,000 saved for retirement in a 401k plan. He will not be able to increase his retirement savings until his last child is out of college a few years from now. This is about the time that his employer will want him gone.

In the last two years, like the rest of what was once a “middle class”, he has lost about 50% of his net worth primarily due to the 30% drop in the value of his home (90% of the equity) and a 35% drop in the value of his 401k. He read somewhere that the market went down 50% in the decade following the Crash of 1929. However, due to *deflation*, a dollar invested in 1929 had $.61 in buying power ten years later. His 401k is invested in the S&P index. However, due to the drop in the market, coupled with *inflation*, a dollar invested ten years ago only has the buying power of about $.60 today. Rupert notes that we seem to have had a “Greater Depression” without even knowing it.

Rupert thinks he should get a better deal from now until retirement. He knows that his investments over the past 20 years have not even beaten the inflation rate. He reads that financial institutions, which he supplies with the capital they use, have done much better. When they *did* get into trouble, his taxes got them right back on track. Overall, their profits greatly exceeded the rate of inflation and their top executives seem to make more millions than there are hairs on Rupert’s head. (Rupert has a beautiful head of hair.) He also has noted that the compensation for government workers and teachers has greatly outpaced inflation and neither group have any concerns about retirement. He knows that he pays for their salaries, health care, and pensions.

So, what would Rupert like to see as far as financial regulation? What would help him get a fair shake? What would restore his faith in financial institutions? In my opinion, he would like to see that which follows.

Rupert's broker, who calls himself a "Financial Adviser", is always trying to sell him something. He knows that the brokerage makes a lot of money by trading securities and there is a lot of interaction between their proprietary portfolio and those of clients like him. He knows that there are a dozen ways that his brokerage can get unwanted securities into his investments. He sees a huge potential for abuse but he sees no way that anyone could actually prove that abuse occurs, if indeed it does.

Rupert thinks it would be a good idea if retail brokerage was divested from firms that trade securities themselves.

Rupert meets with his "Financial Adviser" and expresses his appreciation that he is not just a "stockbroker". He has heard nothing good about them! Seeing the silly look on his "Financial Adviser's" face, he asks some questions and discovers that, in his case, his "Financial Adviser" is actually nothing more than a "stockbroker" and is licensed and regulated as such. In his defense, his "stockbroker" tells him that the "Wealth Adviser" and "Vice President of Investments" sitting nearby are nothing but stockbrokers as well. Rupert feels "betrayed". He thought his "Financial Adviser" was required to act in Rupert's best interests and now he has a "stockbroker" who is merely a securities salesman for his firm.

Rupert thinks it would be a good idea if these titles were regulated so consumers would know where the loyalties lie in the people they deal with. He thinks the title "Financial Adviser" should be replaced with "Caveat Emptor", and the titles "Wealth Manager" and "Vice President of Investments" should be replaced with "Who's Kidding Who?"

Rupert remembers that his insurance agent calls himself a "Financial Planner", and decides to find out just what that means. Sure enough, he finds out that that title means nothing more than "insurance salesman". His tax preparer, another "Financial Planner", is an accountant. Rupert realizes that pretty much anyone can call themselves a "Financial Planner" if they feel it helps them sell products. After all, life insurance and annuities from a "Financial Planner" are much more attractive to a lot of folks than life insurance and annuities from an "insurance salesman".

Rupert thinks it would be a good idea if the term "Financial Planner" was banned from usage until it actually means something.

Rupert's broker is always quoting his firm's research when trying to sell him something. Rupert knows that his brokerage is involved in "investment banking". He remembers the scandals some years ago involving dishonest research arising from a desire to please profitable investment banking clients. He knows that he has no means of determining if the research quoted to him by his broker is honest or not. Who could tell?

Rupert thinks it would be a good idea if retail brokerage was divested from firms that have investment banking clients.

Rupert recalls the many scandals on Wall Street that involved practices that his broker was unaware of. He assumes that if such were occurring today, his broker would be similarly unaware.

Rupert thinks it would be a good idea if brokerages were required to disclose all conflicts of interest to their brokers so that they might, in turn, disclose them to their clients.

Rupert recalls that many abuses stem from "proprietary products" that bind a client to the brokerage and are susceptible to high costs, trading revenue, soft dollars, security dumping, reciprocity agreements, etc.

Rupert thinks it would be a good idea if retail brokerages would not be able to sell their own products (or products in which they have a financial interest) to their clients.

Rupert notes that the securities industry is "self-regulated". Rupert asks himself how that is working out for him and recalls almost nothing but "unsavory deals" for as long as he can remember. He suspects that what is discovered is only the tip of the iceberg. He knows that the "meat industry" was once "self-regulated" and remembers why it no longer is. He knows that the meat packers objected, but "enough was enough already!"

Rupert thinks it would be a good idea if the securities business offered the same amount of consumer protection as the "used car" business.

Rupert knows that the widespread use of the "prospectus" was once for the protection of the "buyer". He notes that now the seller uses the prospectus as "armor plate" to protect himself, while the consumer knows only one thing about the prospectus – that he doesn't understand it. As currently written, the prospectus offers no protection for any consumer other than an attorney, but it allows the seller to bury any number of unfortunate facts in the fine print. Rupert wonders if "fine print" and "hard to read" are somehow connected…….

Rupert thinks that the prospectus can be written in any language known or unknown to man as long as anything to the advantage of the seller is in bold English on the front page that the buyer signs off on and anything else is not enforceable.

Rupert recently bought a ladder that had ten warning labels on it, including an admonishment to "refrain from standing on the top rung while over an alligator pit and swatting a hornets nest". He has never seen a financial product with warnings on the contract such as "beware the effects of inflation", "deposit only guaranteed if you die", "money not invested in an actual fund", etc. He wonders why ladders are more regulated than annuities.

Rupert thinks it would be a good idea if financial institutions "dropped the act" regarding the financial acumen of the public, particularly since polls consistently show that few have any financial acumen at all.

Rupert recently bought a car seat for his grandson which was immediately recalled due to some defect. Rupert tried to remember when the last time was that a financial product was recalled. Oh, yes, it was *never.* Rupert had an insurance agent try to talk him into what was called a "Bonus Annuity" that offered a 6% bonus up front that the agent said would offset the surrender charge that Rupert would have to pay if he exchanged annuities. After the insurance industry gorged on this deception for years, regulators started warning consumers that the "bonus" was actually a "loan" that the buyer would repay with interest through additional expenses. Rupert thinks that the number of owners who actually knew this was "zero".

Rupert thinks that it would be a good idea if such products would have to be recalled by the manufacturer who would "fix" the product or refund people's money. Manufacturers could buy "recall insurance" and pay premiums according to the riskiness of getting caught.

Rupert knows that many insurance companies manufacture products that are "abuse friendly". These are products that pay high commissions, have a sales "gimmick", and appeal to the gullible, the recently frightened, and the elderly. Above all, they are products that they do not sell through their own salesmen. They then "wash their hands" of culpability.

Rupert thinks that it would be a good idea if products not sold directly by the manufacturing firm would require prior approval by a regulating agency before being sold to the public.

Rupert knows that there are many products, such as "index annuities", that can be very different. Some might be very good for the buyer and pay the seller a 7% commission. Some might be very bad for the buyer and pay the seller an 18% commission.

Rupert thinks it would be a good idea if all insurance products prominently stated the sales commission in writing on the contract. Clients should know what is being taken out of their return. Consumers don't have to be financially literate to know that a product that pays the salesman an 18% commission isn't going to be very good for them. Rupert wonders why such products are even allowed. Is it a restriction on consumer choices to ban unsafe child car seats?

Rupert likes solid products like a well-constructed hammer. He doesn't like hammers that have a lightening bolt on a balsa wood handle and an "easy-off, clear glass hammerhead. He wonders why financial products seem to be manufactured with sales in mind instead of performance. However, he knows that when the public doesn't know anything about hammers, they will go for the "easy to sell" and get their brains knocked out.

Rupert thinks it would be a good idea to protect the "financially illiterate" just as the "hammer illiterate", and the "used car illiterate", and the "oven illiterate", and the "lead paint illiterate" are protected.

Thomas Jefferson once said, in reference to slavery, “We have picked up a wolf by the ears, and now we can neither hold him nor let him go”. In Rupert’s opinion, financial institutions are in the same predicament. Their businesses are built upon a disproportionate split of investment return between themselves and their clients. The clients get very little even though they provide 100% of the capital and take 100% of the risk Shall we continue to rely upon the Wall Street “honor system”? Can’t something be done with financial regulation for the sake of Rupert? *He needs our help.*