Integrity: Is It Really That Rare?

Back in ancient times, when I was in college, I was invited to join the national honor business fraternity, Alpha Kappa Psi, as we were being inducted, we were individually invited up to receive our pins and the "secret word." A couple of fraternity brothers and I, from our social fraternity (could have been a model or the inspiration for "Animal House's" Delta Tau Chi) sort of snickered at the thought of a secret word from such a staid, pin striped aggregation of old businessmen. However, as each hand was shook and pin offered, we received the word: integrity! As one looks at today's business world and based upon my experience, the financial services industry, one can only wonder if anyone ever knew or even remembers this word and its meaning.

Integrity (def): 1. Uprightness of character, probity, honesty. 2. Unimpaired state, soundness.... (See synonyms under Fidelity, Justice, Virtue, Worth). Does this sound like the state of today's business world with its "golden parachutes" and huge compensation packages paid to incompetents or bailouts and overwhelming greed as is on display in the financial services and banking industries? Free market capitalism faces its biggest threat, not from the know nothings of the occupy movement or the Castro's or Hugo Chavez's of the world, but from it's own internal rot, which we see illustrated on an ongoing and seemingly never ending basis. I'm reminded of Lenin's famous observation and quote about the end of capitalism: "...when the time comes to hang the capitalists, they will sell us the rope!" Anything goes -- for a price!

Most are probably now completely familiar with the debacle that was and led up to the 2008 meltdown. You want to talk about integrity, how about bankers and mortgage brokers laughingly putting together packages of what were known euphemistically as "liar loans!" Imagine the cheek: they all knew what they were doing and even applied this name to it and continued to do it! Why? Aside from the obvious greed, there is and was an astounding lack of integrity -- it was just plain dishonest but there was so much to be made doing it that integrity went out the window!

Investing? A few months back I resurrected an old story by a financial writer for one of the more popular financial magazines where he "confessed" that even though they (the staff writers) knew that it didn't work and that at night, they were all investing using index funds, by day they were writing about the best mutual funds to buy for that year or the best stocks to own. I wrote, in the introduction to our book about my last day on Wall Street where the senior VP threatened me if I didn't trade my customers' accounts. His rationalization, even

though it was a horrible time to be investing was: "your clients have to understand: they have to support you in the 'bad' times so you can be there for them when things are 'good!'" My response is fairly obvious since this was my "last day!"

Somehow, the old saw about how the more things change, the more they remain the same. Back in the 40's, there was a book based upon an old Wall Street story about a yacht broker showing all the boats in the NY yacht club and showing off by telling a potential buyer which belonged to which Wall Street tycoon. The rejoinder from the prospect was: "but where are the customer's boats?" Unfortunately, sad but true and still true today!

Two recent and possibly egregious examples come to mind (in some respects, referencing my year end Commentary and the brief article below this one): MF Global, the missing billions of customers and the Corzine speculations and another example recently featured in the NY times, relating to our old friend (investor nemesis might be a better appellation), Citicorp. Ah, dear old Citicorp. Seems like its every decade with them!

In the Citicorp case, a couple of wealthy investors, who were looking for a "safe alternative" to staid old municipal bonds, filed suit against Citi in arbitration and surprisingly, since it was an arbitration case, were awarded over $54 million. More surprising, some $17 million of the award was for punitive damages - something rarely seen in an arbitration case. Since Citi appealed, the arbitration documents were unsealed which has shone a bright light on some of the inner workings and processes of the brokerage world (keep in mind that Citi is hardly alone as an offender and this is hardly the only case of paying for the broker's yachts).

Internal memos produced in the arbitration described the products invested in as "...ideal for customers seeking alternatives to fixed income investments" (typically lower risk). One document produced discussed how their aim was to target those clients who wished for an alternative to traditional fixed income products but without "materially altering their risk characteristics." But, oh those Emails which will catch up with you every time. Internal Emails were much clearer about the actual risks involved. When the head of Wealth Management at Citi asked about the actual risk profiles of these products, she received an answer: "Alternatives are always in 3-5," came the reply. A rating of 5 was usually reserved for potentially volatile products that <u>clients could lose their entire investment, or more</u>.

Evidence was produced that showed that Citi's internal guidelines were far different than what was in the Private Placement Memorandum. One manager was queried about this and replied "yep" regarding the difference between what was discussed internally and that, which was foisted upon the public. "yeah, so we focus on what's in the docs, rather than, you know..." was one executive's response, his voice trailing off.

Emails from angry brokers were among the documents filed with the court. Citi had offered, as a solution, to buy the products back - but at a steep discount. One wrote: "I'm sure a great deal of time and energy went into (the product) but my clients and I don't see it as a solution (the offer). From our simplistic perspective, the products were defective, management inept, risk controls nonexistent and the effect was ruinous. If one drives their car into another, they are responsible; they have no option but to take responsibility for their actions."

The article in the paper concluded: "Come to think of it, that's kind a good metaphor for the entire credit meltdown. Except for the taking responsibility part, that is."

Source: New York Times Financial Section, January 15, 2012. Author: Gretchen Morgenson.

The lesson here is whether you are the average Joe or Mary investor or even if you are a supposedly "sophisticated" investor, integrity or it's lack are still critical components of the equation. Ultimately, you have to consider yourself prey and, as such, do everything in your power to protect yourself. This is why totally relying upon or "trusting" one individual just isn't sufficient. You have to literally invest the time to acquire sufficient knowledge to understand what you are doing and why you are doing it. This is one of the only ways of protecting yourself, your loved ones and your financial future!

Integrity and its lack. The more things change, the more they stay the same!

Be sure to peruse and file away the article provided below, *Awkward Questions You Must Ask Your Financial Advisor*, for future reference when considering dealing with anyone in the financial services industry!

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As a follow up to my year end commentary regarding just how much was your money and/or account at risk, I came across an interesting article that all should file away for future reference when dealing with someone in the financial services industry (stock broker, financial planner, wealth manager, insurance / annuity salesperson, et al). I believe that I have answered these questions publicly on more than one occasion. However, if anyone missed any of those responses, feel free to pose any and all to me again!

Awkward Questions You Must Ask Your Financial Adviser

By Rachel Koning Beals

Put brokers, financial planners, and asset managers on the spot

Ask investment professionals questions that creep into uncomfortable territory and you'll be glad you did. Go ahead and say it: "How do I know you won't steal my money or defraud me?" How quickly and sincerely do they answer such a question?

In the wake of well-publicized frauds by Bernie Madoff and Allen Stanford, investors have expressed alarm and distrust, but many still take little action at the outset to make sure they're working with a professional they not only trust with their life savings, but that they genuinely like.

The Madoff case involved high net-worth and even famous clients who largely relied on word-of-mouth recommendations without running their own checks. That's a tough lesson that translates to all investors no matter the size of their nest egg. Of course, the tragedy of fraud is that sometimes even the most

respectable of financial professionals can fall from grace and fail their loyal clients. Investors are also relying on regulators to do their jobs.

Claiming ignorance is not an excuse for skipping your homework. "It's the information age, but you'd be surprised at how little average investors use even basic Internet searches to pre-screen investment professionals," says Randy Shain, author of Hedge Fund Due Diligence and founder of BackTrack Reports, a New York-based firm that specializes in investigating the backgrounds of hedge funds, private equity investors, and financial services professionals.

Many of the early screening questions investors should be asking financial professionals, and themselves, fall under the "common sense" category. Yet that doesn't guarantee that investors are doing the asking.

1. Ask the manager to explain his or her strategy. If the explanation sounds too complicated or the manager can't explain it in layman's terms, be wary.

2. Get to know the manager and his or her personality before you commit.

3. Ask for a resume and even consider calling former employers to ensure accuracy. (Yes, you are allowed to do this.)

4. Ask whether the professional tends to work with people your age and at your income level.

5. Ask whether there have been regulatory inquiries into the individual or the firm, noting that if they fudge the truth, you will be able to check. This can be a good measure of honesty very early in the process.

6. Ask if the firm will cover fraudulent or even unethical actions by an individual it employs.

And the biggie, which you should ask yourself: Do these returns or other benefits sound too good to be true? Investors get caught up in marketing materials that show track records. But they may not ask the tougher questions of a manager or advisor: What's the negative scenario? What's the chance the worst will happen?

Knowing the experience level of your financial professional is important. During the boom real estate and credit years earlier this decade, some professionals were chasing new licenses with haste, combining a mortgage business with insurance and general financial planning. On top of that, some professionals operating under the broad umbrella of "financial services" even snagged a real estate license and were showing and selling homes. Some professionals can handle it, but others spread themselves too thin.

"The reality is there's not such a huge barrier to entry to financial services," says Shain. The barrier then lies with you and your decision to let a particular professional handle your money.

Three agencies are a good starting point for screening: the Financial Industry Regulatory Authority (FINRA), the Securities and Exchange Commission (SEC), and the National Futures Association (NFA).

To check the background of a broker, use FINRA's BrokerCheck or call (800) 289-9999. For an investment adviser, use the SEC's Investment Adviser Public Disclosure website.

You may also opt to call your state securities regulator. Contact the North American Securities Administrators Association at 202-737-0900.

To check out investments, ask first: Is this investment registered with the SEC or with my state securities regulator? Use the SEC's EDGAR database of company filings or call your state securities regulator.

Also check out NFA's Background Affiliation Status Information Center , or BASIC.

Source: www.jewishworldreview.com.