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The Power of PFAC: Bridging Education to Practice

Introduction:

- Annuities Secrets
- Municipal Bonds Secrets
- Mutual Funds & UIT's Secrets
- Financial Advisor Standards
- Tools

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Annuity Secrets

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Expenses


Netty Income

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Annuity Industry

- Annuity Industry Statistics
 - \$2.7 Trillion in Assets Under Management
 - \$1.9 Trillion in AUM of Variable Annuities
 - Fixed Annuities
 - Structured Settlements
 - Low interest rates


Annuity Information obtained from Insured Retirement Institute

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Annuity Issues

- Lack of Transparency
 - Every Annuity is Unique
 - No Standards to Compare Products
- Difficult to Understand
 - Warren Buffet *“Never Invest In a Business You Cannot Understand”*
- Limited Liquidity
 - 7 Year Lock Up
 - Disability Waiver or Doctor Note
 - Senior Insurance Bill of Rights (SIBOR)
 - 30 day Free Look Provision


Annuity Information obtained from Insured Retirement Institute

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Annuity Issues

- Large Commission to Selling Broker
 - Questionable Switches/Swaps (1035 Exchange)
- High Surrender Charges
 - 4%-9% surrender charge
- High Fees to Owner of Policy
 - M&E, Riders, Mutual Funds, Surrender Charge

Annuity Information obtained from Insured Retirement Institute




Annuity Fees

Jackson National Perspective L Variable Annuity


- 1.60% Mortality/Expense Risk Charge
- 0.70% Guaranteed Death Benefit (Rider)
- 0.95% Guaranteed Withdrawal Benefit (Rider)
- 1.00% Mutual Fund Expense Ratio
- 1.44% Mutual Fund Trading Costs*
- 5.69% Annual Fee**

2.00% Upfront Fee to Selling Agent**
6.50% Surrender Charge if sold early**

Annuity Information obtained from Jackson National Life Insurance Company




Municipal Bonds Secrets



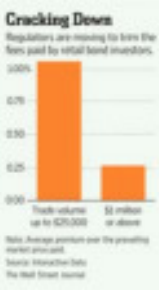
Municipal Bond Industry

- **Municipal Bond Industry Statistics**
 - \$3.7 Trillion in Assets
 - Over 1 million Muni bonds outstanding
 - Almost 44,000 Issuers
 - Retail Investors own 75% of Municipal securities
 - 1,800 Bond dealers
 - 1-5 top dealers account for 54% of all trades
 - 6-10 to dealers account for 21% of all trades

Municipal Bond Information obtained from SEC "Report on the Municipal Securities Market" on July 31 2012

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Municipal Bond Pricing




Trade Volume	Average Percent Over Prevailing Market Interest Rate
Trade volume up to \$25,000	~0.02 (2.00%)
\$2 million or above	~0.0131 (1.31%)

- Investors Paid \$10.6BN in Markups Across \$2.5TRN Worth of Municipal Bonds Since 2005
- More than half of markups were excessive
- Investors paid 2.00% in 2011
- Investors paid 1.31% in 2014


Municipal Bond Information obtained from Wall Street Journal article "Regulators Want Data on Bond-Trade Fees"

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Mutual Fund Secrets

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Mutual Fund Industry



Panel 1: "I'M STARTING A MUTUAL FUND FOR INVESTORS WHO AREN'T SMART ENOUGH TO KNOW THEIR ALTERNATIVES."

Panel 2: "IT MUST BE A HUGE MARKET. OTHERWISE MOST PEOPLE WOULD INVEST IN INDEX FUNDS."


Panel 3: "WHAT'S AN INDEX FUND?" "QUICK, QUICK! YOU'RE MAKING ME WAG TOO HARD!"



Mutual Fund Industry

- **Mutual Fund Industry Statistics**
 - \$30 Trillion in Worldwide MF Assets
 - 1 million seconds = 13 days
 - 1 billion seconds = 31 years
 - 1 trillion seconds = 31,688 years
 - \$15 Trillion in US MF Assets
 - 7,707 Different Mutual funds in US
 - 23,353 different shares classes
 - 264.9 Million Accounts
 - 5,008 Listed US Stocks


Mutual Fund Information obtained from Investment Company Institute 2014 Investment Company Fact Book
Stock Information obtained from World Federation of Exchange Members Number of Listed Companies



Mutual Fund Visible Costs

- **Visible Costs**
 - Loads
 - Front Load (A Shares)
 - Back Load (B Shares)
 - Level Load (C Shares)
 - Taxes
 - Expense Ratios (Average 1.19%)
 - Management Fees
 - 12b-1 Expenses
 - Administrative Fees
 - Operating Costs
 - All other Fees


Mutual Fund Information obtained from Investment Company Institute 2014 Investment Company Fact Book
Stock Information obtained from World Federation of Exchange Members Number of Listed Companies



Mutual Fund Examples

- **PIMCO Total Return Fund**
 - Largest Fund in the World
 - \$270 BN Fund
 - 09/26/2014 Bill Gross Departs PIMCO for Janus
 - \$27.5BN pulled from PIMCO in December
- **Columbia Large Growth Quantitative Fund**
 - Kiplinger’s Top 10 Large Company Stock Fund
 - \$700 Million Fund


Mutual Fund Information obtained from Morningstar
Columbia Large Growth Fund obtained from Kiplinger’s Top-Performing Mutual Funds By Category (Large Company Stocks Funds – 1 Year)
<http://www.kiplinger.com/top/oversting/1041-5001-top-performing-mutual-funds/index.php>



Mutual Fund Comparison

PIMCO Total Return Bond Fund					Columbia Large Growth Quant Fund				
Ticker	Share Class	Load	Exp Ratio	T/O	Ticker	Share Class	Load	Exp Ratio	T/O
PTTAX	A	3.75%	0.85%	227%	RDLAX	A	5.75%	1.26%	105%
PTTAX	B	3.50%	1.60%	227%	CGQBX	B	5.00%	2.01%	105%
PTTCX	C	1.00%	1.60%	227%	RDLCX	C	1.00%	2.02%	105%

Mutual Fund Information obtained from Morningstar (www.morningstar.com)



Mutual Fund Invisible Costs

- **Shedding Light on “Invisible” Costs: Trading Costs and Mutual Fund Performance**
 - The Average Mutual Fund Trading Costs is 1.44%
 - The Average Expense Ratio is 1.19%
 - Average Expense Ratio (1.19%) + Average Mutual Fund Trading Cost (1.44%) + Advisor Fee (1.00%) = Total “All In” Cost
 - **1.19% + 1.44% + 1.00% = 3.63% ALL IN FEE + Taxes**
 - Mutual Funds are Required to Pay Capital Gains to Investors


Information obtained from “Shedding Light on ‘Invisible’ Costs: Trading Costs and Mutual Fund Performance” by Roger Edelen, Richard Evans and Gregory Kadlec.



Quoted Fee vs. All In Fees

1.00% ≠ 3.63%


Information obtained from “Shedding Light on ‘Invisible’ Costs: Trading Costs and Mutual Fund Performance” by Roger Edelen, Richard Evans and Gregory Kadlec.



Beware of Financial Products

- Be aware of the advisor who only quote their front end fee. Ask for **“ALL IN”** Fee quote.
- What products does the advisor use?
- How much turnover is in the portfolio?
- Do they charge any additional commissions or fees?
- Do they invest in structured products, private placements or alternative investments?
- Turnover => Taxes => Higher Accounting Costs

Information obtained from "Shedding Light on 'Invisible' Costs: Trading Costs and Mutual Fund Performance" by Roger Edelen, Richard Evans and Gregory Kadlec.



Possible Tax Deduction

- **California Society of CPAs (CalCPA)**
 - You may be able to deduct certain expenses
 - Expenses must be ordinary and necessary and related to production of taxable income
 - The investment related expenses, along with your other misc itemized deductions, must exceed 2% of AGI to be deductible
 - Investment advice – you may be able to deduct payment to a broker or an investment manager for portfolio management

Information obtained from Cal CPA (<http://www.calcpa.org/content/consumers/ask/06deductibles.aspx>)



Financial Advisor Standards



Financial Advisor Standard


Financial Advisor Standards

Suitability Standard:

- Advisors make suitable (reasonable) recommendations
- Advisors regulated by FINRA
- Not required to put client's interest first
- Not obligated to disclose conflicts of interest

Fiduciary Standard:


- Required to put client's best interest first
- Avoid conflicts of interest
- Binds Advisor + Firm as a Fiduciary to client



Investment Platform

Investment Platform

- Traditional / Transactional Broker
 - Beware of Commissions and Suitability Standard
 - Beware of non-compliance UPIA & PC §2574 Investing
- Mutual Fund / Mutual Fund Supermarket / UIT's (high internal fees – not managed)
 - Beware of Non-Transparent Costs of Mutual Funds
 - Not PC §2574 Compliant
- Separately Managed Account (SMAs)
 - Beware of high frequency transactions
 - Beware of high costs for court accountings (hidden fees)
 - May unintentionally violate PC §2574 (Foreign Ordinary shares)
- Delegation / Discretionary Accounts
 - Fiduciary Standard



Delegation & Liability

Probate Code 16052:



(a) A trustee may delegate investment and management functions as prudent under the circumstances. The trustee shall exercise prudence in the following:

- (1) Selecting an agent.
- (2) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust.
- (3) Periodically reviewing the agent's overall performance and compliance with the terms of the delegation.

(b) In performing a delegated function, an agent has a duty to exercise reasonable care to comply with the terms of the delegation.

(c) Except as otherwise provided in Section 16401, a trustee who complies with the requirements of subdivision (a) is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.



(d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this state, an agent submits to the jurisdiction of the courts of this state.

Uniform Prudent Investor Act
(CA PC §§ 16002(a), 16003, 16045-16054)

Uniform Prudent Investor Act



- “ A trustee shall invest and manage trust assets as a prudent investor would, by considering the purposes, terms, distribution requirements, and other circumstances of the trust. ”
- Provides for “safe harbor” for Trustees.
- Risk can be legally viewed in totality for the portfolio, rather than on each invested security.
- Allows for prudent diversification of the client’s investment assets.
- Focus is on the **PROCESS** of how investments are determined and implemented.
- Periodic review of portfolio risk, returns and relative performance is necessary to maintain “safe harbor.”

Uniform Prudent Investor Act
(CA PC §§ 16002(a), 16003, 16045-16054)

Trustee Duties Under UPIA


- A duty to make trust assets productive.
- A duty to select risk and return objectives reasonably suited to the particular trust.
- A duty to diversify.
- A duty to evaluate investments in the context of the portfolio as a whole.
- A duty to avoid unreasonable or inappropriate costs.
- A duty to consider tax consequences.

California Probate Code Section §2574

(a) Subject to subdivision (b), the guardian or conservator, **WITHOUT AUTHORIZATION OF THE COURT**, may invest funds of the estate pursuant to this section in:


- (1) Direct obligations of the United States, or of the State of California, maturing not later than **FIVE YEARS** from the date of making the investment.
- (2) United States Treasury bonds redeemable at par value on the death of the holder for payment of federal estate taxes, regardless of maturity date.
- (3) **Securities listed on an established stock or bond exchange in the United States which are purchased on such exchange.**
- (4) Eligible securities for the investment of surplus state moneys as provided for in Section 16430 of the Government Code.
- (5) An interest in a money market mutual fund registered under the Investment Company Act of 1940 (15 U.S.C. Sec. 80a-1, et seq.) or an investment vehicle authorized for the collective investment of trust funds pursuant to Section 9.18 of Part 9 of Title 12 of the Code of Federal Regulations,



California Probate Code Section §2574

(5), cont.
 the portfolios of which are limited to United States government obligations maturing not later than five years from the date of investment and to repurchase agreements fully collateralized by United States government obligations.


(6) Units of a common trust fund described in Section 1564 of the Financial Code. The common trust fund shall have as its objective investment primarily in short-term fixed income obligations and shall be permitted to value investments at cost pursuant to regulations of the appropriate regulatory authority.



CA PC §2574 PROHIBITED INVESTMENTS

California Probate Code §2574 Does **NOT** Allow Purchase of:

- **Traditional Mutual Funds or Unit Investment Trusts.**
- U.S. Treasury or CA State bonds greater than 5 years in maturity.
- Corporate Bonds of any type or maturity.
- OTC stocks.
- **Annuities or Insurance Contracts.**
- Non-public REITS or Limited Partnerships.
- Gold or Silver Bullion or Coins, Stamps or Collectibles.
- Trust Deeds, Viatical Settlements, Oil & Gas Partnerships.
- Alternative Investments, Hedge Funds, Strategic Return Notes.
- And many other "risky" investments.



CA RULE of COURT 7.903

- Rule 7.903. Trusts funded by court order

(2)"Continuing jurisdiction of the court" under (b) means and refers to the court's continuing subject matter jurisdiction over trust proceedings...

(3)"Court supervision under the Probate Code" under (b) means and refers to the court's authority to require prior court approval or subsequent confirmation of the actions of the trustee as for the actions of a guardian or conservator of the estate...

(4) Prohibit investments by the trustee other than those permitted under Probate Code Section 2574

(8)Require compensation of the trustee, the members of any advisory committee, or the attorney for the trustee, to be in just and reasonable amounts that must be fixed and allowed by the court. The instrument may provide for periodic payments of compensation on account...



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Resources & Tools




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Resources & Tools

- How to hire a Competent Financial Advisor Worksheet
- Questions for Hiring a Financial Advisor Worksheet




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Resources and Tools

- **Investment Advisor Background Check**
www.finra.org/Investors/ToolsCalculators/BrokerCheck
- **Municipal Bond Pricing Websites**
www.investingbonds.com
www.municipalbonds.com
www.bondview.com
www.emma.msrb.org
- **Mutual Fund Cost Calculators**
www.personalfund.com
www.finra.org/fundalyzer
www.morningstar.com

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Summary:

- Make sure to understand the products your clients own and how to advocate for them
- Make sure to know the Standard and the Account Type of your Investment Advisor
- Make sure to ask questions before you take on a new financial advisor even if they came with the client

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THANK YOU, THANK YOU & THANK YOU

— Reminders

- Submit your evaluation

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