ADDING VALUE

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2011 will be the "Year of Regulation."
There are:
- *New Disclosures*
- *New Brochures*
- *High Costs*
- *Questionable Success*

FINANCIAL REGULATION

On July 21, 2010, the SEC voted unanimously to adopt amendments to Form ADV Part II and related rules. (The Form ADV Part II is the document that advisors must file with the SEC and deliver to prospective clients before any relationship between the parties can commence.) Under the new amendments, investment advisors must replace the current Form ADV Part II, commonly called the "check-the-box and Schedule F approach", with a narrative brochure, now called Form ADV Part 2A. In addition, advisors must provide clients with brochure supplements that "introduce" particular individuals who will be providing advisory services, Form ADV Part 2B. To ensure that these Form ADV changes not only disclose more meaningful information, but do so with more clarity, both the narrative brochure and supplements must be written in "plain English," rather than the ambiguous and confusing language often used today. Finally, the newly adopted rules require advisors to file their brochures electronically, making the documents publicly available on the SEC's Investment Adviser Public Disclosure website ("IAPD").

Because the financial services industry has been inundated lately with complicated regulations, revisions to existing regulations, and regulations in reaction to the major financial meltdowns that have occurred during the last 10 years, we thought it was worthwhile to devote this issue of Adding Value to making sense of all the paperwork we are required to provide to you and whether, in our opinion, it is effective and preventative of future financial problems.

PART 2A: THE BROCHURE

SEC-registered investment advisors are now required to provide prospective and existing clients with a narrative brochure, which must be written in plain English. While it seems to be coincidental with the Great Crash of 2008, former SEC Chairman Levitt has been a big proponent of this legislation for a long time. In theory, it makes perfect sense. *Investors need to read and understand disclosure documents to benefit fully from the protections offered by federal securities laws.* Warren Buffett has even added his two cents when he states: "…Chairman Levitt's whole drive to encourage "plain English" in disclosure documents, is good news for me. For more than 40 years, I've studied the documents that public companies file. Too often, I've been unable to decipher just what is being said or, worse yet, had to conclude that nothing was being said."

ADDING VALUE is mailed quarterly to our clients and friends. The intent of this publication is to share some of our more interesting views and research with our clients.

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The prime requirement of the new brochure is to focus on the advisor's business and its actual and potential conflicts of interest. The brochure has 18 sections that must be discussed including investment strategies and methods of analysis utilized; fees and compensation; additional business activities engaged in by the advisor and/or its management persons; brokerage practices; solicitation activities; proxy voting; Code of Ethics and personal trading by related persons of the firm; custody of client assets, among other items. Throughout the brochure, the adviser must identify any conflicts (or potential conflicts) of interest and describe how the firm and its related persons will address such conflicts.

Therefore, it seems to us that to fully comply with the intent of the law, before one drafts the brochure, a conflict of interest inventory should be conducted. Here is what we think are some of the biggest pitfalls or conflicts in the industry today:

- **An investment advisor that also has custody of the assets: Just say NO**! In our business we use Charles Schwab & Co., Inc. as an independent, third-party custodian. Schwab serves as a check and balance for the collection and disbursement of all cash flows into and out of your accounts. Schwab is your watchdog. Simply put, if the statements provided by Wright Associates do not match precisely with the statements provided by Schwab, there is either a mistake or a problem. If the clients of Madoff had insisted on a separate, independent custodian, most would not have lost their money. There may be a slight cost for this protection but, to us, it is worth every penny.

  Periodically, the industry goes through the process of defining "custody." In some instances, an advisor is deemed to have custody if they are permitted to disburse money from client accounts for fee payments and/or if they accept a check to be deposited in their client's account, but written in the name of the advisory firm. Presently, there is an exclusion of fee disbursement from the custody rule. Over 88% of Wright Associates clients have fees deducted directly by us from their accounts; most clients consider this as the most efficient way of doing business. You will note that we never accept a check written to Wright Associates (except for fees); all clients are advised to write checks for deposit to Charles Schwab & Co., Inc., with reference to their account number. This allows us to avoid some serious regulatory oversight, which somehow Madoff was able to escape.
- **Fees and compensation.** Our **ONLY** method of compensation is the fee that you pay to our firm. We don't accept kick backs, bribes, gifts, sales commissions, or free samples. We don't pay to play. There may be even other ways to finagle more compensation that we just don't spend time trying to understand. We don't have any other source of compensation. Period.

  However, in our business, we do use mutual funds to implement our strategies, brokers to buy and sell the mutual funds, and custodians to hold the assets for the client's benefit. Each of these other firms also charge fees. We do everything in our power to make this added expense as low as possible including, among other things, buying institutional registered funds, avoiding funds that charge 12(b)-1 fees (if possible), using the cost effective services of Schwab Institutional, using swaps rather than individual buys and sales, and most importantly, keeping our turnover low. By the way, some of our funds do have one additional fee that we are in favor of—redemption fees. These fees discourage day traders which is a good thing.

- **Disciplinary Information.** Advisers are now required to disclose all facts about any legal and/or disciplinary events that are material to a client's evaluation of the integrity of the advisor or its management. All disciplinary events that occurred within the previous 10-year period are deemed to be material and must be disclosed in the brochure. This seems like a sensible requirement. As you can imagine, there is nothing that we have done or will do in the future that will result in disciplinary judgment. We go one step further, we make efforts to recognize the organizational structure of the mutual fund that we are investing in and the leadership of that company—we don't want to do business with people who bend the rules or don't have enough experience to understand problems that can occur. We only want to do business with people whose ethics are of the highest caliber. We are alert to problems in every investment that we make as stewards of your capital and ours. So far we have avoided investments in technology companies bought at the top of the market, firms who participated in the day trading scandals, money market fund meltdowns, and Madoff-like investment schemes. To the extent that it is humanly possible, we hope to avoid all situations that involve permanent loss of capital to our clients.
- **Voting Client Securities.** Usually proxy statements fall in two categories: routine business and updates to compensation structures, takeover proposals, mergers and acquisitions, etc. We usually vote with management for the routine business and critically read proposals for increased compensation. You can request our voting records at any time.
- **Code of Ethics.** We state in our Form ADV Part 2A that we invest our client's assets in the same manner and with the same diligence as is done with our own investments. We practice our trade with scrupulous honesty, discipline, and integrity. Amidst the market turmoil and the Great Recession of 2008 and the decline in long-only equity allocations in the last few years, our client base has remained stable. The stability that our clients give to our business and their long-term time horizon have allowed us to be patient and successful in delivering respectable performance to you, net of all fees. Many of our clients have been with us for at least 10 years and some go back even longer to 1993. Every day we come to work to learn more, to read more, to work for your benefit—that is our "Plain English" code of ethics. We try to stay ahead of the latest "new, new" thing so that we can preserve and grow your capital over the long-term. We encourage every client to let us know ways to serve you better.
- **Financial Information.** We operate our business on a cash basis, and we have no leverage. We do ask for quarterly fees in advance and take discretionary authority over the accounts. Our management contract is fairly simple. We promise to serve you to the best of our ability, but if somehow we cannot meet your expectations, you are welcome to terminate the relationship. We don't require a minimum holding period; all relationships can be terminated immediately with any pre-paid fees refunded.

These expanded answers cover 6 of the 18 topics required under the new regulations. Included in this mailing are the revised Form ADV Part 2A and Part 2B. We encourage all clients to read these documents in their entirety.

IMPORTANT COMPLIANCE DATES

The dates that must be adhered to in this new regulation are as follows:

- July 21, 2010-SEC Commissioners approve new Form ADV Part 2 (A & B).
- October 12, 2010- Effective Date of Rule.
- January 1, 2011- Advisers registering for the first time must use the new Form ADV.
- March 31, 2011- Form ADV Part 2 must be submitted in PDF format to the SEC for existing advisers with a December 31, 2010 fiscal year end.
- May 31, 2011-SEC registered Advisers must provide Form ADV Part 2A to all current clients.
- April 30, 2012- Advisers must provide an annual summary of material changes that includes an offer to provide a copy of the current brochure. Any disciplinary event requires interim delivery. This requirement continues annually until revoked.

We submitted our new brochure to the SEC on February 28, 2011. Enclosed with this newsletter are all the current regulatory documents (both from the latest round of regulation and from previous regulation, such as Sarbanes-Oxley) that must be provided to you annually in some form. These include:

- Form ADV Part 2A (Brochure)
- Privacy Policy
- Code of Ethics
- Proxy Voting Policy
- We have also included the Form ADV Part 2B (Brochure Supplement) which is technically only required to be submitted to clients of state-registered advisors.

If you want to view the brochure and brochure supplement directly on the Internet, you may visit the SEC's website at www.adviserinfo.sec.gov. The searchable IARD/CRD number for Wright Associates is 121300.

IA SWITCH

Buried in Section 410 of the approximately 2,400 pages of the Dodd-Frank Wall Street Reform and Consumer Protection Act is a clause that increases the asset threshold above which Registered Investment Advisors ("RIAs") must register with the SEC from $25 million to $100 million. Consequently, after the SEC completes its rule making process, then current SEC-registered advisers whose assets fall below $100 million (presumably as of a date that is to be determined) will be required to switch their registration from federal to each applicable state in which they do business. These rules create an extremely difficult problem for certain advisers whose assets under management are at this arbitrary, but fixed, dividing line. Under the current rules and regulations, the RIA is required to switch back and forth from state to SEC registration depending on a date that has not yet been determined. In fact, six phone calls to the SEC, the PA State Security Commission, and Barney Frank's office left us no closer to an answer to that mysterious date than before we started the phone calls. As you can see in the brochure, we ended the year with assets under management ("AUM") of $102,000,000 on December 31, but on December 21, our AUM totaled $99,500,000. It sure would be helpful if the government in drafting legislation would be held to the same plain

English standard that we are required to present to our clients and to them. The compromise at the moment is that being on this uncomfortable cusp could result in being subjected to both state and SEC audits. We will keep all clients posted on this situation as it becomes known to us. In the interim, we expect no changes to the management of your account.

By-the-way, the SEC website states that the form will require 10.6 hours of "estimated average burden hours per response" to implement all these changes in 2011. Note to SEC: You are not even close to the actual time commitment. It also fails to quantify the very real cash costs of all the middlemen who have proliferated to create the infrastructure necessary to comply with all these regulations which is also a very real burden on small businesses. As the SEC itself states: "The SEC may not tolerate firms that have made the required disclosures but made the information unclear or difficult to understand." Perhaps, we should remind them to do unto others as they would do unto themselves.

CONGRESSIONAL ACCOUNTABILITY

One of the most important political stories of 2011 will be regulation. The basic problem seems to be that Congress delegates far too much power to regulators, passing ambiguous laws that convert agencies into quasi-legislative bodies that aren't politically accountable. Most politicians seem to be supporting the status quo because they can take credit for popular goals by pontificating in front of microphones on Capitol Hill and then blaming the bureaucracy for the costs and problems they create. We seem to be using regulation and tweaks to existing status quo which result in multi-thousand page documents (full of special interest exclusions), instead of developing new public policy that addresses a world that is now globalized and more complex. The weight of this added bureaucracy in our everyday lives is becoming unmanageable. The consequences of some of this poor, long-term public policy planning in the financial area is readily apparent in our tax laws, our employee benefit statutes, and in our banking regulations. For instance, because of regulations, defined benefit plans are now virtually non-existent. (What company today would voluntarily start a Defined Benefit ("DB") plan in accordance with a compendium of code and law that is a virtually unreadable set of complex congressional provisions over 3,000 pages long?) Instead, defined contribution plans ("401(k) plans") hold almost $2 trillion of assets for 80% of the 78 million people in the U.S.'s private workforce. From our experience these 401(k) plans which default employees into self-directed plans and allow them 24/7, 365-day per year switching are not helping amateur investors reach their retirement goals.

In conclusion, as a federally-registered investment advisor (at least for now!), we comply and produce documents in accordance with the latest reactionary legislation that results from another financial calamity that demands political grand standing. We add to our daily workload while trying to preserve and build capital for our clients over the long-term in an independent, fiducially responsible manner. At some point, we have to demand that our government also has some accountability.

Sincerely,

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